February 1, 2021

Mr. Willie Botha
Technical Director
International Auditing and Assurance Standards Board
529 Fifth Avenue
New York, New York 10017

Re: Discussion Paper, 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 Statement Audit

Dear Mr. Willie Botha:

The Center for Audit Quality (CAQ) is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors; convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention; and advocates policies and standards that promote public company auditors' objectivity, effectiveness, and responsiveness to dynamic market conditions. Based in Washington, DC, the CAQ is affiliated with the American Institute of CPAs (AICPA). This letter represents the observations of the CAQ but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

The CAQ appreciates the opportunity to share our views and provide input on the questions included in the International Auditing and Assurance Standards Board's (IAASB or the Board) Discussion Paper, *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 Statement Audit* (the Discussion Paper). The CAQ is supportive of the IAASB's efforts to gather perspectives from its stakeholders about the role of the auditor in relation to fraud and going concern in an audit of financial statements, and to obtain input on matters about whether the IAASB standards related to fraud and going concern remain fit-for-purpose in the current environment.

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Our views herein are provided from the perspective of the existing United States public company auditing regulatory and legal environment, where the Sarbanes-Oxley Act (SOX) and its cascading impact has helped to highlight the shared responsibility of fraud deterrence and detection among those charged with governance, management, and internal and external auditors. The Securities and Exchange Commission's (SEC) guidance for management related to management's report on internal controls,[1] together with the 2013 Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control - Integrated Framework, provide management and boards of directors a means to identify and analyze risks, and to develop and manage appropriate responses to risks within acceptable levels and with a greater focus on anti-fraud measures.

In addition, enhancements by the Financial Accounting Standards Board to establish a disclosure framework, together with incremental requirements that govern SEC filings, has served to provide transparency about a company's ability to continue as a going concern and related risks (e.g., liquidity, financing and other risks that could adversely affect a company).

These actions, together with United States public company auditing standards have, in our view, had a positive impact on providing useful information from the company's perspective and providing a robust foundation for auditor involvement. These actions have served the public interest well. As such, we encourage the Board to not only seek feedback on the auditing standards but to work collaboratively with others in the financial reporting ecosystem to seek holistic solutions where possible. As the primary responsibility for fraud deterrence and detection rests with management and those charged with governance, we believe that any potential solution should align with, and consider the efforts by, the International Accounting Standards Board (IASB) and International Ethics Standards Board for Accountants (IESBA), among others.

We also encourage the Board to seek feedback from the International Organization of Securities Commissions (IOSCO) and the International Forum of Independent Audit Regulators, as these groups may be able to assist with the development of comprehensive solutions. We recognize the challenges of developing a global approach that is principles-based, capable of being implemented in a scalable manner and that is compatible with a variety of other jurisdictional regulatory systems. Accordingly, we do not believe that the IAASB should seek to incorporate all changes being considered in specific jurisdictions into the International Standards on Auditing (ISA).

In addition to seeking feedback from regulators and accounting standard setters, we encourage the Board to carefully consider whether making changes to the ISAs is the most appropriate response to the challenges outlined in the Discussion Paper with respect to fraud and going

[1] https://www.sec.gov/rules/interp/2007/33-8810.pdf

concern. We believe the Board has a menu of options when it comes to affecting change in these areas. Implementation guidance, non-authoritative support materials, and staff audit practice alerts supporting sufficiently principles-based standards likely can achieve many of the objectives laid out in the Discussion Paper.

As it relates to questions raised in the Discussion Paper, the following observations are for the Board's consideration:[2]

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?*

Of the three components outlined in the Discussion Paper, we believe that the "Knowledge Gap", or the difference between what the public thinks auditors do and what auditors actually do with respect to fraud and going concern, is the component that is most often responsible for the expectation gap. Despite a handful of recent corporate failures across the globe, it is important for the public to understand that the IAASB's current auditing standard, ISA 240, *The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements* (ISA 240), requires the auditor to provide reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. As outlined in ISA 240, the primary responsibility for the prevention and detection of fraud rests with management and those charged with governance. Properly designing and executing an audit in accordance with auditing standards to obtain reasonable, not absolute, assurance does not mitigate all risks of material misstatement. Risk remains, in part, because attempts by management to conceal a potential fraud can be difficult to detect, particularly in situations where fraud is accompanied by collusion, as outlined in ISA 240. However, as described in our response to Question 2(a), we believe a better understanding of actual or perceived performance gaps also is important.

With respect to going concern, we believe that in addition to the "Knowledge Gap", the "Evolution Gap" also contributes to the expectation gap. Considering the related accounting and auditing standards together with the modernization of business and user needs could address the "Evolution Gap". We discuss this in more detail in our response to question 3(a).

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?*

Continued, targeted regulator and/or standard setter education of the public with respect to the responsibilities of management and those charged with governance under International Financial Reporting Standards (IFRS) and the auditor's responsibilities under the standards set by the IAASB may assist with narrowing the "Knowledge Gap" with respect to both fraud and going concern. For example, in response to COVID-19, both the IOSCO and the SEC issued

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[2] We have not responded to all questions included in the Discussion Paper.

statements that reminded the public that management has a responsibility to assess an entity's ability to continue as a going concern and that such responsibility is not solely the responsibility of the auditor.

Further, we believe that all other participants in the financial reporting ecosystem, including internal and external auditors, audit committees, and management, should continue to educate the public and users of the financial statements as to their particular role and responsibilities when it comes to deterring and detecting fraud. Education also could come in the form of additional guidance related to what is expected from each participant in the financial reporting ecosystem, which may help further narrow the "Knowledge Gap". For example, in the United States, the COSO 2013 *Internal Control-Integrated Framework* outlines 17 principles to consider for effective internal control over financial reporting, one of which specifically relates to management's fraud risk assessment. Such clarity as to what is expected of management could help users of the financial statements understand how the responsibilities of management, auditors and others interrelate.

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?*

In considering recent corporate failures, we recommend that the IAASB seek to understand through discussion with regulators and others whether these issues were due in part to an auditor failing to perform under the auditing standards, or a perception thereof, or whether the auditor's responsibilities under the current standards are viewed as being unclear. Fraud may be perpetrated in different ways and fraud schemes and the methods of perpetrating them continue to evolve with technological advances. The Board could consider formally evaluating the auditing standards and related guidance in light of these technological developments. Such evaluation could provide insight as to whether supplemental guidance would be helpful to facilitate auditors applying the current auditing standards through a modern lens that considers the latest technologies used to perpetrate fraud.

We believe current auditing requirements, including recent changes to auditing and ethical standards (e.g., the IESBA's revised International Code of Ethics for Professional Accountants [the Code] to promote the role and mindset of professional accountants), strike the appropriate balance between investor expectations of performance and costs to complete a financial statement audit. With respect to listed entities, we would recommend that the Board consider the differences in the broader financial reporting system in the United States and international jurisdictions and assess whether any potential new or revised requirements in the ISAs would achieve the objectives in the Discussion Paper without complementary systemic changes. As described earlier in our letter, SOX was enacted in 2002 in response to significant corporate frauds and has had profound effects on financial reporting in the United States. SOX enhanced requirements for all participants in the financial reporting system including management, those charged with governance and the auditor. Among other changes, we would highlight sections 301, 302, 404(a) and 404(b) as key sections that helped to shape the financial reporting landscape in the United States. Additional regulatory actions, such as the establishment of the

SEC's Whistleblower Program, have placed greater attention on fraud detection to complement actions by auditors.

We believe the recent improvements to ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement*, could assist auditors in performing a more robust consideration of management's tone at the top, risk assessment process, and inherent risk factors, such as susceptibility to misstatement due to management bias and other fraud risk factors. The revised standard provides additional application guidance that more clearly describes the objective of the requirements (i.e., 'what' needs to be done) and considers the auditor's use of technology (automated tools and techniques) which may be used to enhance risk assessment. Similarly, structured application guidance related to potential fraud risk identification, both internal to the entity and from external sources (including but not limited to cybersecurity-related risks at third party service organizations) may achieve the objectives of narrowing both the Performance and Evolution Gaps. For example, an increased focus on understanding the processes and internal controls management and those charged with governance have established to address allegations of fraud raised by employees or other parties (e.g., whistleblower or ethics hotlines) can inform the auditor's risk assessment. This also may help the auditor to form a view as to whether non-material fraud (i.e., fraud that does not result in a material misstatement of the financial statements) may be indicative of a bigger issue, without necessarily expanding the auditor's responsibilities to design and perform specific procedures with regard to misstatements that are not material. In our view, expanding the scope of the audit to require procedures designed to detect non-material fraud could be costly without commensurate benefit and could serve to widen the expectation gap.

The IAASB also could consider whether the issuance of periodic staff audit practice alerts that highlight common fraud schemes and other potential fraud risk factors at entities could better illustrate how professional skepticism is applied in considering risks of material misstatement due to fraud and developing an appropriate response to those risks.

We recommend that the Board consider whether the requirements outlined in ISA 240 paragraphs 40-42, and the related application guidance achieve their intended objectives; specifically, whether the existing auditor communication requirements sufficiently promote two-way communication between the auditor and those charged with governance. In our view, the communication requirements, as currently written, lack specificity with respect to the significant judgments in the auditor's fraud risk assessment and could better address the specific planned responses and results of procedures related to fraud risks. We believe it is important that those charged with governance fully understand the auditor's risk assessment with respect to fraud and the judgments made. Correspondingly, more detailed requirements also could help encourage those charged with governance to communicate to the auditor how they oversee management's risk assessment process and their own views of fraud risk within an entity. This would assist the auditor with considering whether there has been robust dialogue with those charged with governance related to the fraud risks within an organization and whether such risks have been appropriately addressed in the audit.

In our view, the effectiveness of any possible actions by the IAASB, including changes to the requirements in ISA 240, will need to be considered against the different components of the expectation gap explained in the Discussion Paper.

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

As ISA 240 is sufficiently principles-based, we do not believe that there is a need for enhanced auditor requirements only for certain entities or in specific circumstances, but additional application material or other implementation guidance may be helpful to support a more consistent execution of the requirements as noted in our response to Question 2(a). Having principles-based standards allows for innovation and flexibility in how auditors comply with auditing standards. Auditors are increasingly leveraging new technologies and techniques to detect potential fraud. As an example, even though not required by the auditing standards, technology can now be used to analyze entire populations of data with thousands, sometimes millions of individual transactions. Such use of technology can allow the auditor to identify and focus on those transactions that exhibit unique or unexpected characteristics, including those that are potentially indicative of fraud. While this is mentioned in ISA 315 (Revised), implementation guidance that emphasizes how auditors may consider the results of applying such technologies and how the auditor's approach to assessing fraud risks may be adapted could be helpful.

Separately, the Discussion Paper highlights illustrative examples of potential changes that could be made to the ISAs with respect to forensic specialists. Any changes that the Board considers should remain sufficiently principles-based to allow the financial statement auditor flexibility given that the facts and circumstances can vary significantly from audit to audit. For example, we believe that the judgment as to whether a forensic specialist should be involved in certain aspects of the financial statement audit (e.g., fraud inquiries or risk assessment) should be left to the financial statement audit team, as they are best positioned to understand the unique risks associated with each financial statement audit. We acknowledge that in certain circumstances, when the financial statement auditor determines it is appropriate, involving a forensic specialist in aspects of a financial statement audit can increase audit quality; however, a broad requirement to include forensic specialists in all financial statement audits would be costly, time consuming, and in most cases, we do not believe that it would contribute to increased audit quality. Further, we are concerned that a broad requirement for forensic specialist involvement in a financial statement audit may increase the expectation gap. A forensic specialist's involvement in a financial statement audit would not be the same as a separate forensic engagement given that the scope of forensic engagements often is narrowly focused on specific allegations.

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?*

We have concerns with the suggestions that auditors be required to use a “suspicious mindset” in planning and performing an audit. We believe that such a requirement could jeopardize the auditor’s ability to have effective two-way dialogue with management and those charged with governance and ultimately inhibit the auditor’s ability to complete a high-quality financial statement audit. For example, robust fraud inquiries with management and those charged with governance are a critical step in the audit process. Approaching such discussions with a “suspicious mindset” could significantly diminish the effectiveness of such inquiries, with the interviewee becoming defensive and unwilling to share important information. In addition, requiring a “suspicious mindset” could result in a significant increase in audit effort that would not correspond to an increase in audit quality. A potential requirement for a suspicious mindset only in certain situations, such as higher-risk circumstances, also could create confusion in practice as to when it is appropriate for an auditor to use one mindset versus another.

A clear understanding of the behaviors and outcomes that are sought seems more pertinent than the phrase or term to be applied. Actions that change behaviors are likely to have a more meaningful impact to achieve the desired outcomes than adding a new term.

For these reasons, we remain supportive of the existing requirements in ISA 240 related to maintaining professional skepticism throughout the audit and other requirements in the ISAs for auditors to revise their risk assessments when necessary and to obtain more persuasive evidence the higher the assessed risk of material misstatement. We also recommend that the IAASB continue to monitor the implementation of IESBA’s recent revisions to the Code that require the professional accountant to have an “inquiring mind.” The IAASB also could consider whether the audit evidence project recently approved by the Board represents an opportunity to further enhance the focus on professional skepticism in the auditor’s evaluation of sufficient appropriate evidence.

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.)?*

There are likely different options that could be considered in enhancing transparency about the auditor's work in relation to fraud in an audit of financial statements. As outlined above, we believe that transparency and robust two-way communication between the auditor and those charged with governance with respect to the auditor’s work in relation to fraud remains a critical step in the audit process. Separately, as mentioned in our response to Question 1(b), continued education of the public with respect to the roles and responsibilities of the participants in the financial reporting ecosystem when it comes to deterring and detecting fraud also could provide transparency as it relates to the auditor’s work in relation to fraud.

With respect to the auditor’s report, key audit matters already provide transparency into the matters that were communicated to those charged with governance and that required significant auditor attention in performing the financial statement audit, which may involve matters related to fraud risks. We believe that if the Board were to consider expanding the auditor's communications in the auditor's report, it would be important to weigh the benefits and risks of such an approach carefully. We are not supportive of an incremental requirement for the auditor to report the specific audit procedures being performed to respond to fraud risks as it may result in unintended consequences such as disclosing information to the public that did not require disclosure in the financial statements by management. In addition, fraudsters may take the information in the auditor's report and adapt their activities to better avoid detection. Finally, apart from the requirements identified in paragraphs 28-33 of ISA 240, a significant portion of audit procedures performed are intended to respond to the risks of material misstatement, regardless of whether due to fraud or error. The delineation between which audit procedures were performed in response to a fraud risk versus a risk of error may be difficult to identify in many circumstances.

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?*

We believe that the primary responsibility for assessing going concern rests with management as outlined in International Accounting Standard 1, *Presentation of Financial Statements*. The performance of audit procedures over a company's ability to continue as a going concern is inherently linked to management's evaluation and reporting requirements set forth in relevant financial reporting frameworks, where applicable. ISA 570 (Revised) is focused on the auditor's evaluation of the appropriateness of management's assessment of the entity's ability to continue as a going concern and the related disclosures. As such, we believe that having a robust set of requirements for management in the relevant financial reporting framework related to their evaluation of the entity's ability to continue as a going concern and disclosure of the significant judgments in making that evaluation is essential. For example, we believe that the lack of specificity in the IFRS accounting framework as to the period management considers in its going concern assessment and the lack of transparency of the liquidity and risk factors that impact an entity's ability to meet its obligations in the future are both factors that contribute to the expectation gap.

Certain regulatory regimes also require disclosures that complement management's going concern assessment, such as disclosures relating to risk factors, liquidity risk, financing plans, and forecasts. In the United States, SEC Regulation S-K requires additional transparency relating to risk factors associated with an entity's operations and results. Management's discussion and analysis of financial condition and results of operations also is required to include an assessment of the entity's liquidity. While unaudited, we believe these disclosures provide investors with meaningful information on which to assess an entity's forward-looking prospects.

We suggest the Board seek feedback from the IASB and consider whether any potential revisions to the international accounting standards are necessary to enhance the IFRS financial reporting framework with respect to 1) clarifying management's responsibilities with respect to its going concern assessment, and 2) enhancing management's reporting of their evaluation and conclusions related to material uncertainty about the entity's ability to continue as a going concern prior to assessing whether the auditor's requirements should be enhanced or expanded. In the absence of revisions to the international accounting standards to provide more clarity as to the going concern assessment period, the Board could consider whether there are changes to ISA 570 (Revised) that could assist with narrowing the expectation gap. For example, ISA 570 (Revised) could be revised to include a requirement for the auditor to assess the reasonableness of the period utilized by management in their going concern assessment.

If enhancements to financial reporting are pursued by the IASB and others, a more fulsome dialogue could follow in relation to how the auditor's responsibilities may need to change. Discussion topics could include whether the extent of additional audit procedures required would need to change if management presents additional disclosures or assertions outside of the financial statements about an entity's solvency or viability, including whether these would be the subject of a separate assurance engagement.

Q.3(c)ii. *Do you believe more transparency is needed 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 more transparency by management with respect to the basis of accounting used to prepare the financial statements as well as its going concern assessment would be useful. Insight into how management made its evaluation, including details such as the risk factors considered and the period for which management is considering their assessment, could benefit users by increasing transparency with respect to the significant judgments made relating to going concern, and where applicable, any events or conditions that have been identified that may cast doubt on the entity's ability to continue as a going concern and the basis for management's conclusion that a material uncertainty does not exist. We acknowledge that changes to disclosure requirements would mean revisions to the accounting standards by the IASB, and that such changes could not be directly implemented by the Board; however, we believe they could enhance transparency around management's responsibilities, resulting in greater understanding around the auditor's work.

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We appreciate the opportunity to comment on the Discussion Paper. As the IAASB gathers feedback from other interested parties, we would be pleased to discuss our comments or answer any questions regarding the views expressed in this letter. Please address questions to Catherine Ide (cide@thecaq.org).

Sincerely,

Catherine Ide
Vice President, Professional Practice
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