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International Organization of Securities Commissions
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Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue, 14th Floor
New York, NY 10017 U.S.A.

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Subject Line: IAASB's 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 Sir:

The International Organization of Securities Commissions' Committee on Issuer Accounting, Audit and Disclosure (Committee 1) appreciates the opportunity to comment on the International Auditing and Assurance Standards Board's (the 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 Paper). As an international organization of securities regulators representing the public interest, IOSCO is committed to enhancing the integrity of international markets through the promotion of high quality accounting, auditing and professional standards, and other pronouncements and statements.

Members of Committee 1 seek to further IOSCO's mission through thoughtful consideration of accounting, disclosure and auditing concerns, and pursuit of improved global financial reporting. Unless otherwise noted, the comments we have provided herein reflect a general consensus among the members of Committee 1 and are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

Calle Oquendo 12
28006 Madrid
ESPAÑA
Tel.: + 34 91 417.55.49 Fax: + 34 91 555.93.68
mail@oicv.iosco.org - www.iosco.org

Overall Comments

General

High quality financial reporting provides information to assist investors in decision making. Consistent performance of high quality audits promotes investor confidence in financial reporting and the integrity of capital markets because it provides investors with independently verified information. In our view, fraudulent financial reporting and failure to report going concern uncertainties continue to be at the forefront of the public interest in audited financial statements, particularly in light of recent corporate failures and the going concern uncertainties arising from the current economic environment resulting from the COVID-19 pandemic.

While ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, states that the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management, the role of the auditor is to obtain reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. Therefore, there is a rightful public expectation that auditors are responsible to detect and report on fraud that is material to the financial statements. Additionally, ISA 570, *Going Concern,* requires auditors to conclude on the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements and to conclude on whether a material uncertainty exists about the entity's ability to continue as a going concern. Accordingly, a lack of going concern disclosures and undetected material misstatements, whether due to fraud or error, can undermine the trust stakeholders place in the financial reporting ecosystem.

Additionally, as highlighted in the Paper on pages 9 and 10, "multiple initiatives have been launched around the globe to explore, among other things, the topics of fraud and going concern". As a result, certain jurisdictions have implemented incremental requirements beyond relevant extant standards. Therefore, we support the IAASB's efforts to explore the challenges, issues and appropriate responses related to auditor's responsibility for the detection of fraud and evaluation of and reporting on going concern, including whether incremental procedures to be performed by auditors are warranted to mitigate the risk that

Calle Oquendo 12
28006 Madrid
ESPAÑA
Tel.: + 34 91 417.55.49 Fax: + 34 91 555.93.68
mail@oicv.iosco.org - www.iosco.org

material misstatements go undetected, and whether incremental transparency is necessary with stakeholders (e.g., Audit Committees, regulators).

Because the topics of fraud and going concern are different (and likely have different root causes and expectation gap elements), we first provide observations with respect to the auditor's responsibility for the detection of fraud. After which, we provide observations with respect to going concern uncertainties.

Auditor's Responsibility for the Detection of Fraud

IAASB's strategy and work plan

To further the IAASB's efforts on the auditor's responsibility for the detection of fraud, we encourage the IAASB to consider fraud as well as professional skepticism as evergreen agenda items, given the historical occurrences of fraud and ever-changing environment in which companies and auditors operate. The way frauds are perpetrated likely will continuously evolve and increase in complexity due to the pace of change in technological advances and sophistication of schemes. Therefore, an auditor's attitude of professional skepticism will also need to evolve, as it will be critical to the auditor's ability to recognize and respond to circumstances that may exist that can result in the financial statements being materially misstated, whether caused by fraud or error. We believe ongoing attention to these topics would be prudent from a strategic and public interest perspective.

The need for root cause analyses

We believe that there are, broadly, two potential issues at play with respect to the auditor's detection of fraudulent financial reporting. First is the potential that some auditors have failed to conduct audits in accordance with the existing requirements of professional standards – though the standards are clear (we refer to this as failures in performance). Second is the potential that there should be incremental requirements (or clarifications) in the professional standards to mitigate the risk that material misstatements, whether due to fraud or error, go undetected when auditors are providing reasonable assurance on the financial statements. We believe it is important to distinguish these two because we are concerned about standard-setting responses to failures in performance rather than in response to the need for enhancements or clarifications of extant standards.

Calle Oquendo 12
28006 Madrid
ESPAÑA
Tel.: + 34 91 417.55.49 Fax: + 34 91 555.93.68
mail@oicv.iosco.org - www.iosco.org

As such, during the information-gathering phase, we recommend that the IAASB engage in a multi-stakeholder approach to perform root-cause analyses into auditor's role in fraudulent financial reporting that will lend insight as to whether there is a need for the existing auditing standards to be revised in order to remain fit-for-purpose. Looking back at recent occurrences of fraud (several of which are identified in the Paper), it appears that there may be both a failure of performance by auditors to comply with the standards in some situations and, there also may be a need to improve the standards to more clearly specify and perhaps increase the auditor's responsibility for the detection of fraud in the financial statements. We also encourage the IAASB to explore how the future framework for identifying and evaluating findings at audit firms in accordance with ISQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Service Engagements,* can help inform any of the IAASB's efforts in the future related to the auditor's responsibility for detection of fraud.

Expectation gap with respect to the auditor's responsibility for the detection of fraud

While we support the IAASB's efforts, the Paper appropriately highlighted the important role of each stakeholder group in the financial reporting ecosystem in improving external reporting. A collaborative, multi-stakeholder solution is necessary to address the challenges and achieve the desired progress to narrow (with the goal to minimize as much as possible) the expectation gap. For example, each stakeholder group could consider educational communications to their target audiences as one effective step to narrow the expectation gap. In addition to a multi-stakeholder educational effort, we believe that the perspectives gathered from various stakeholder groups as part of the feedback to the Paper can inform the IAASB about possible further standard setting responses to narrow the expectation gap which the IAASB can begin while a more holistic multi-stakeholder solution is developed.

Acknowledging our role as securities regulators around the world, we welcome the initiation of dialogue by the IAASB through the Paper, and we look forward to further engagement with all relevant stakeholders to work towards a collaborative, multi-stakeholder approach.

What are causes of the expectation gap?

We appreciate the discussion on the audit expectation gap included in the Paper on page 11, "which described three components of the expectation gap: the "knowledge gap", the "performance gap", and the "evolution gap".

Calle Oquendo 12
28006 Madrid
ESPAÑA
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In our view, there is an overlap between the knowledge and evolution gaps, in terms of financial statement users' expectation of auditors. This relates to not only what auditors' current responsibilities *are* today based upon the existing standards, but what the users expect they *should* be. We believe the IAASB should consider as part of its information gathering activities what, if any, expectations that users have of auditors beyond the core responsibilities to provide reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error, when it pertains to undetected fraud.

The last component of the expectation gap outlined in the Paper is the performance gap, where we believe a critical activity for the IAASB during the information gathering phase is to analyze the root causes of recent events, in order to determine the cause(s) of the performance gap.

What can be done to narrow the expectation gap – education, collaboration and coordination

In addition to potential standard-setting discussed above, we encourage the IAASB to consider whether other approaches such as robust investor education may assist in enhancing investors' understanding of the current role and responsibilities of the auditor with respect to fraud.

One of the core building blocks to continue to make progress on narrowing the expectation gap, in our view, is that each stakeholder group not only contributes to the educational effort, but also commits to a collaborative and coordinated approach. With that being said, we applaud the IAASB's recent stakeholder outreach (e.g., three roundtables on fraud and going concern in September and October 2020 with various stakeholder groups) to help inform the degree to which an expectation gap exists today.

We welcome the IAASB's engagement to identify what education and/or incremental collaboration and coordination amongst the various stakeholders in the financial reporting ecosystem is needed to achieve the common goal of narrowing the expectation gap.

Auditor's Requirements in Relation to Fraud

General

Calle Oquendo 12
28006 Madrid
ESPAÑA
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The Paper notes on page 6 that "each of the questions set out on these pages should be considered in the context of the benefits that will be provided in the public interest, weighed against the cost to various stakeholders of implementing the suggested actions (as additional actions will likely involve increased resources)." While we agree that cost/benefit analysis is inherent in any standard setting effort, we believe that the cost/benefit analysis for fraud is multidimensional in nature and therefore, should be thought of perhaps in a different way than compared to cost/benefit analysis on other standard-setting initiatives. In particular, while fraudulent financial reporting may not occur frequently, the cost of audit failures can be catastrophic when they occur because of the magnitude and consequence across the financial reporting ecosystem. Therefore, we encourage the IAASB to thoughtfully consider "the benefits" which should include the avoidance of the significant negative impact from a single fraud (and the exponential impact dependent on magnitude) on the overall investor confidence in the quality of financial reporting and the resultant consequences to the capital markets.

Enhanced auditor requirements – Professional Skepticism version 2.0

In addition to our earlier comments about the need for root cause analyses, we refer the IAASB to our comment letter dated July 4, 2019, *Proposed Future Strategy for 2020-2023 and Work Plan for 2020-2021* for suggested priorities on ISA 240, *The Auditor's Responsibilities relating to Fraud in an Audit of Financial Statements* and ISA 505, *External Confirmations* for key areas to be addressed as it pertains to the auditor's responsibility for the detection of fraud. These suggested priorities are included below for reference:

ISA 240, *The Auditor's Responsibilities relating to Fraud in an Audit of Financial Statements*	There should be clear requirements and guidance in ISA 240 and throughout the ISAs regarding the exercise of professional skepticism by auditors.
ISA 505, *External confirmations*	There should be guidance for auditors on how to assess the reliability of external confirmations received having regard to the possibility of fraud. There also should be more complete requirements on how auditors should respond where there is no reply to a confirmation request.

Calle Oquendo 12
28006 Madrid
ESPAÑA
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To supplement our suggestions above taken from our previous comment letter, we encourage the IAASB to consider whether ISA 505, *External confirmations,* needs to be strengthen (either through standard-setting or application guidance) to adapt to the complexities and technological advances that exist in today's global business environment (e.g. paper vs. electronic confirmation) and whether further guidance for auditors in evaluating evidence received from external sources is needed.

The Paper on page 6 asks respondents whether "requiring a 'suspicious mindset' [would] contribute to enhanced fraud identification when planning and performing the audit? Why or why not?" as well as "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?" In our view, there may be unintended consequences when introducing new terminology (especially if similar in nature to professional skepticism which is universally accepted), which could widen the expectation gap or create confusion for auditors of when and how to apply a suspicious mindset versus professional skepticism during the course of an audit. Rather, we believe that professional skepticism should be emphasized and enhanced to "raise the bar" in how it is applied in practice (to evolve Professional Skepticism to an enhanced version 2.0).

Therefore, we encourage the IAASB to consider how they can work with other stakeholders in the financial reporting system to collectively reinforce the need for, and enhance, professional skepticism throughout an audit, including an increased willingness to challenge management. The auditor's attitude, especially by those in charge of the audit, should be emphasized in the standard as it is important to set the tone at the top for their teams and that attitude should become more heightened as risks are identified during the planning and performance of an audit. An example of where others are contributing to the financial reporting system in this public interest area is the IESBA's Role and Mindset of a Professional Accountant project. From a public interest perspective, it is an auditor's responsibility to promote confidence and integrity of capital markets through the performance of high quality audits. Therefore, auditors having a mindset with an enhanced level of vigilance for both the risk of fraud and potential signs of fraud is imperative to audit quality and ultimately investor protection. This can also be true in connection with evaluating audit evidence received from management, where professional skepticism and a thoughtful risk-based evaluation (e.g., nature and significance of the account and related evidence obtained) is necessary. We believe that this can be achieved through, for example, application material that includes "triggering events" where an auditor's skepticism should be elevated and

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28006 Madrid
ESPAÑA
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therefore the nature, timing, and extent of audit procedures are tailored in response to the risk identified.

Finally, we believe that there should be a heightened focus on professional skepticism in light of the changes in how audits and interactions with management are performed in the current "virtual" environment and to the extent that some of these virtual operating cadences become a permanent part of the audit.

Use of forensic specialists

The Paper on page 18 introduces a question about requiring the use of forensic specialists or other relevant specialists in some aspects of a financial statement audit. We support investigating the benefits that targeted utilization of forensic specialists, particularly in the risk assessment and fraud risk brainstorming phases of a financial statement audit, may bring, and whether forensic specialist involvement in other phases of a financial statement audit depending on the entity's risk profile is appropriate (including in the planning of audit procedures or using forensic specialists in an unpredictable or surprise manner). In light of our comment regarding the cost/benefit analysis above, the benefits of engaging forensic specialists in the risk assessment and fraud risk brainstorming phases of an audit could be one avenue to introduce a forensic mindset to an engagement team at a critical juncture of an audit. Additionally, the interaction among audit engagement team members with forensic specialists can add educational value to less experienced team members to enhance their skillset which can result in improvement in audit execution and ultimately audit quality.

Auditor's Requirements in Relation to Going Concern

General

Many of our comments made throughout this letter (e.g., root cause analyses, multi-stakeholder engagement and education, enhanced professional skepticism version 2.0) also apply to going concern, as the IAASB considers if enhanced performance or reporting requirements are necessary in relation to going concern.

We support the continued efforts of the IAASB's Auditor Reporting Implementation project which can also be a mechanism to, not only inform and educate users but, solicit feedback as to the effectiveness of the current reporting model. Auditor reporting requirements as it

Calle Oquendo 12
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ESPAÑA
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relates to going concern is an important public interest matter, and the challenging economic environment resulting from the COVID-19 pandemic only serves to further emphasize the importance of revisiting the topic of the auditor's responsibility with respect to an entity's ability to continue as a going concern.

We observed that at one stage of the Auditor Reporting project there was a proposed requirement that auditors be required to provide in their audit reports explicit statements addressing whether a material uncertainty that may cast significant doubt on the entity's ability to continue as a going concern had been identified, and the appropriateness of management's use of the going concern basis of accounting. As part of the ongoing implementation review and in light of current market conditions, the IAASB should consider whether requiring those explicit statements by the auditors would be in the public interest and meet the need of investors for further transparency as to whether there are material uncertainties regarding an entity's ability to continue as a going concern, and the appropriateness of the entity's financial reporting framework.

In addition to transparency within auditor reports, questions for the IAASB to consider with regard to the going concern assessment include: Should the time horizon over which the going concern assessment is made be lengthened, either in all cases or if certain conditions exist (e.g., significant debt facilities coming due in the medium term)? To what degree should the audit requirements align with the accounting and disclosure requirements?

To further strengthen public confidence and contribute to overall financial stability, we also encourage the Board's continued engagement with accounting standard setters (e.g., IASB) to ensure that a holistic approach is taken in relation to going concern that meets the expectations of all stakeholders in the financial reporting ecosystem. This will also be important in the interest of collaboration in order to answer the questions posed in the previous paragraph.

Concurrent with the IAASB's Auditor Reporting project that concluded in 2015, we note that ISA 570 was revised. We question whether these revisions were sufficient to address the interactions between standards on auditing and the relevant financial reporting framework requirements (e.g. IFRS).

The connection between ISA 570.20 and IFRS resides in a July 2014 IFRS Interpretations Committee Agenda Decision (the AD) which concludes that the requirement to disclose

Calle Oquendo 12
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ESPAÑA
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mail@oicv.iosco.org - www.iosco.org

significant judgments made by management (IAS 1.122) applies to going concern situations where there are mitigating factors which led to management's conclusion that there is no material uncertainty relating to the entity's ability to continue as a going concern. The interaction between these assurance requirements and IFRS reporting requirements has been documented in publications of the IAASB (Auditor Reporting on Going Concern, January 2015).

Based on our experience, we observe instances where the disclosures about these judgments are not provided. We further note that disclosures about the auditor evaluation of management's disclosures (as required by Paragraph 20, A24 and A25 of ISA 570) are also not commonly found in auditor reports. It is our view that the authority of the expectation contained in the AD, as well as the lack of a clear and strong connection to paragraph 20 of ISA 570, are the primary reasons for the lack of high-quality financial reporting in "close calls" situations. Given the substantial economic challenges in the current environment, we are concerned that preparers and auditors may not focus to an appropriate degree on these important disclosures and audit reporting requirements.

We request the IAASB to consider additional requirements in this area, and work with the IASB to a greater extent, to achieve a stronger connection between ISA 570 and IFRS that might be similar to what exists between ISA 570 and U.S. GAAP (Presentation of Financial Statements—Going Concern (Subtopic 205-40)).

Finally, we support investigating the benefits of potentially requiring auditors to perform additional procedures when risk assessment procedures around going concern warrant, such as use of predictive models (e.g., Altman Z Score Model). This may be another avenue where technology (and more specifically data analytics) can assist auditors in relation to auditing the going concern assertion and improve audit quality.

Thank you for the opportunity to comment on the Paper. If you have any questions or would like to further discuss these matters, please contact Michael Porth at ph. + 49[0]228 4108-4013 (email: michael.porth@bafin.de) or myself. In case of any written correspondence, please mark a copy to me.

Calle Oquendo 12
28006 Madrid
ESPAÑA
Tel.: + 34 91 417.55.49 Fax: + 34 91 555.93.68
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OICV-IOSCO
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Organisation internationale des commissions de valeurs
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Sincerely,

Makoto Sonoda
Chair, Committee on Issuer Accounting, Audit and Disclosure
International Organization of Securities Commissions

Calle Oquendo 12
28006 Madrid
ESPAÑA
Tel.: + 34 91 417.55.49 Fax: + 34 91 555.93.68
mail@oicv.iosco.org - www.iosco.org