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Thomas Seidenstein
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529 Fifth Avenue
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Our ref SRA/288

1 February 2021

Dear Mr Seidenstein

Re: IAASB Discussion Paper (DP), *Fraud And Going Concern In An Audit Of Financial Statements: Exploring the Differences Between Public Perceptions About the Role of the Auditor and the Auditor's Responsibilities in a Financial Statements Audit*

We appreciate the opportunity to comment on the above Discussion Paper (DP) issued by the IAASB. We have consulted with, and this letter represents the views of, the KPMG network.

We are supportive of the Board's overall objective in the DP to help ensure that the ISAs related to fraud and going concern, and indeed the concept of an audit itself, remain fit for purpose. We appreciate the Board's acknowledgement of the need to work with others in the financial reporting ecosystem as, to be effective, any changes to the role and responsibilities of auditors will likely require other stakeholders to make corresponding changes in respect of the roles and responsibilities of others in this ecosystem.

The DP is issued in the wake of a number of significant, high profile corporate collapses in recent years, which have inevitably, and rightly, given rise to questions, amongst other matters, about the role and responsibilities of the auditor in respect of the critical areas of fraud and going concern, with several stakeholders asking whether more could or should be done by auditors in relation to these areas.

In connection with this, the IAASB notes that there has long been an 'expectation gap' in respect of fraud and going concern and the focus of the DP is to explore the underlying reasons for this with the intention of identifying actions that may be taken by the IAASB, as well as other bodies, to try to address this gap. We note that the Independent Review into the Quality and Effectiveness of Audit conducted recently in the UK (the "Brydon Review") identified fraud and going concern as being the two areas that stakeholders want more information and clarity about, which we summarise as being whether the company is 'honestly' run and whether the company is 'resilient', i.e. whether it is likely to survive for a reasonable length of time – and we believe it likely

that stakeholders would call for certain key aspects of this information to be independently assured.

We also believe that exploration of these areas is particularly timely in the context of the COVID-19 pandemic, the effects of which may have significant implications for both fraud and going concern.

Accordingly, we support the Board's efforts to conduct a thorough exploration of the issues underlying the different aspects of the expectation gap in respect of the critical areas of fraud and going concern and potential solutions. We are committed to open and constructive dialogue so that audits continue to be fit for purpose and to evolve, as appropriate, to reflect changes in the business environment, including increasing globalisation and complexity, and resulting changes to stakeholder needs. We therefore support the IAASB in issuing the DP to frame the debate in this arena, as the IAASB is in a position to significantly influence and shape further discussions and play a key role in developing appropriate solutions.

We set out our overarching comments below.

The Purpose of Management's 'Going Concern' assessment

The purpose of management's 'Going concern' assessment may not be fully understood by users of financial statements, and this lack of understanding likely contributes to the expectation gap. In the context of a financial statement audit, management makes a 'going concern' assessment to determine the underlying basis of accounting used to prepare the financial statements. This includes determining whether it is appropriate to prepare the financial statements on a going concern basis or whether this would be inappropriate, and the financial statements should be prepared on a 'non-going concern' basis. Material uncertainties relating to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern are required to be disclosed but do not change the basis of accounting. Accordingly, the 'threshold' at which it is inappropriate to apply a going concern basis of accounting is high, i.e. an entity's financial statements are prepared on a going concern basis unless management either intends to liquidate the entity, or to cease operations, or has no realistic alternative but to do so (with 'realistic' also representing a high bar). However, this may not be clearly understood by all stakeholders more broadly, who may view the 'going concern' assessment not through the lens of being a fundamental assumption underlying an accounting basis of preparation of financial statements, but rather as whether the company itself is 'resilient/viable' in the longer-term.

This may lead to a fundamental misunderstanding of the role of the auditor (as well as of management/ those charged with governance), which we do not believe is capable of being addressed by making changes to the ISAs, or indeed to other standards, including financial reporting standards.

We believe that the current role and responsibilities of the auditor with respect to going concern continue to be appropriate to an audit of financial statements. However, we do believe that it is important to explore the corporate reporting model in respect of the

'evolution gap' to evaluate how to supplement the traditional focus on historical records of financial performance with forward-looking information, both financial and non-financial, to provide greater insight into how an enterprise creates value over the short, medium and longer term. We believe there is a role for the auditor (outside of the financial statement audit) related to this information as there is a clear market trend towards the need for wider assurance over elements other than the financial statements themselves, including corporate reporting of, and assurance over, ultimate business 'resilience' or 'viability'.

We highlight that we use 'assurance' in a broader sense and that, in our view, certain of the proposed solutions would not necessarily fall within the scope of the financial statement audit, (which, as a concept, we do not consider should be changed to address aspects other than the financial statements). For example, separate and specific engagements over an entity's system of internal control in relation to financial reporting (including in respect of fraud), in the form of an integrated audit with a separate auditor's report on this system of internal control or in the form of an assurance engagement over the system of internal control, or in respect of the preparation of viability/ resilience information, performed in accordance with the ISAE 3000 (Revised) suite of standards, may be the most appropriate solutions.

Prevention and Detection of Fraud

There are inherent limitations to the ability of an audit, that is nevertheless carefully planned and properly executed, to detect material fraud. This unavoidable risk is due, in part, to the fact that most audit evidence is persuasive rather than conclusive, in order to support reasonable assurance. Additionally, some frauds are highly sophisticated, carefully organised, may be perpetrated by senior management, and may involve collusion, making them particularly challenging to detect.

We believe there may be a fundamental lack of understanding by users of financial statements about the inherent limitations of an audit as described above, in particular, because these limitations interact with the fact that an audit is a risk-based, and not an absolute, assurance engagement, and is rooted in the concepts of materiality and reasonable assurance.

We believe there is also a lack of understanding as to what 'fraud' in an audit of financial statements actually means. There is also an interaction between the concept of fraud and that of breaches of laws and regulations, which have some degree of overlap (especially in the case of intentional violations) but with breaches of laws and regulations encompassing a significantly broader scope, including operational and reputational matters such as in respect of environmental or health and safety legislation. We believe users of financial statements may believe 'fraud' encompasses such matters beyond those that are directly connected to the financial statements themselves, however, as auditors, our focus is on risks of material misstatement of the financial statements due to fraud. Furthermore, ISA 250, *Consideration of Laws and Regulations*, which addresses such areas, also highlights inherent limitations of an audit in this area, particularly where the effects of such laws and regulations on the

financial statements are indirect. Therefore, there again remains a risk that not all such breaches that are material to the financial statements will be identified by an audit, and this risk increases significantly if the breach also involves an aspect of fraud in the form of intentional action or collusion by management.

We believe that, overall, the standards are clear regarding the role and responsibilities of the auditor with respect to the detection of material fraud and we do not consider that these should be changed more broadly, or the concept of an 'audit' changed fundamentally in this area. Management and those charged with governance are responsible for the control environment and policies and processes to prevent and detect fraud at an entity, including setting the right 'tone' regarding business conduct. However, we recommend considering certain enhancements to the current requirements set out in the ISAs, which we describe below under Changes to the ISAs.

We fully acknowledge the evolution gap in this area and, in that regard, we support greater consideration of how assurance engagements over an entity's processes and controls that are designed to prevent and detect fraud may address this gap. We believe that this solution would need to be focused on the internal control system holistically, as it relates to the preparation of the financial statements. Carving out anti-fraud processes and controls from other aspects of the internal control system would likely be challenging. Furthermore, in respect of anti-fraud processes and controls, we consider that such a solution would need to be directed to corporate reporting-related fraud, which needs to be clearly defined, as opposed to 'fraud' in the broader sense, including operational/ reputational matters, as we describe above. It is critical that a suitable framework, similar to the COSO Framework that is used in an audit of Internal Control Over Financial Reporting (ICOFR), against which to measure/evaluate an entity's processes and controls be developed, with emphasis on the appropriate involvement/ oversight of those charged with governance, and which ideally is globally recognised. Furthermore, for this solution to be effective, changes would also likely need to be made to laws/ regulations/ corporate governance requirements to place appropriate responsibilities directly on management/ those charged with governance rather than attempting to effect such changes indirectly via auditors. We believe an engagement of this nature should be either in the form of an integrated audit over the entity's system of internal control in relation to financial reporting (which would include anti-fraud processes and controls) with a separate auditor's report over internal control, or a separate assurance engagement, performed in accordance with the ISAE 3000 (Revised) suite of standards.

Changes to ISAs

We are supportive of exploring clarifications to the auditing standards, in particular, ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, and ISA 570 (Revised), *Going Concern*. However, we believe that at a conceptual level the ISAs, and the audit itself, remain fit for purpose.

We note that many of the potential solutions set out in the DP would give greater emphasis to requirements that are already embedded in the ISAs, such as involvement

of specialists (which would include forensic specialists and deployment of technology solutions, assisted by such specialists) when the engagement team considers appropriate; guidance regarding how to appropriately exercise professional scepticism, and challenging management appropriately regarding their assumptions and judgements.

Other potential solutions proposed, in our view, would constitute enhancements to existing ISA requirements, rather than representing fundamental changes to the ISAs. For example, in respect of fraud, introducing a 'standback' requirement to evaluate audit evidence obtained and how that affects our fraud risk assessment and the nature, timing and extent of our procedures to address fraud risks, and in respect of going concern, ISA 570 (Revised) may benefit from an enhancement that expresses the time-period for management's going concern assessment as covering at least, but not limited to, 12 months from the date of authorisation of the financial statements, rather than from the reporting date. However, this change would only be appropriate if it was aligned with the requirements of the relevant financial reporting framework. We also support the provision of training for auditors in forensic accounting and fraud awareness.

We believe such changes are commensurate with the nature and purpose of an audit of financial statements, as well as with the skill set of an audit professional, which naturally evolves over time. We suggest such enhancements to the ISAs apply to all audits, aligned to the risk-based approach that underpins audits, and not based on broad criteria e.g. size of an entity or whether an entity is listed, as such an approach may limit its effectiveness. For example, non-listed entities do not necessarily have a lower fraud risk profile than listed entities, and we highlight that going concern is a fundamental assumption underlying the basis of preparation of financial statements across all entities.

Audit is One Piece of the Puzzle

An audit is only one piece of the puzzle in the wider financial reporting ecosystem. Notwithstanding the fact that the auditor has a very important role to play in facilitating public trust in the capital markets, we consider that any changes made to the role and responsibilities of auditors in the ISAs, or the pursuit of separate engagements in the form of an integrated audit or assurance engagement in accordance with the ISAE 3000 (Revised) suite of standards, would need other stakeholders to make corresponding changes in respect of the roles and responsibilities of others in this ecosystem. Changes to roles and responsibilities would need to be substantially aligned and implementation would need to be appropriately sequenced to enable the ecosystem to operate effectively as a whole. We recognise that this would necessitate the introduction of legal/ regulatory/ corporate governance code requirements, which would take place on a jurisdiction by jurisdiction basis, with this evolution occurring at a different pace across different jurisdictions.

In respect of fraud, we highlight the "three lines of defence" approach described by the European Commission, comprising the pillars of corporate governance, the auditor, and

capital markets supervision, and we recommend that measures be taken to strengthen all three pillars concurrently in order to achieve optimal prevention and detection of corporate fraud.

Regarding going concern, we believe it is particularly important that where changes are made to the role and responsibilities of auditors, that these changes do not result in a misalignment with the role and responsibilities of management and those charged with governance, since they are ultimately responsible for establishing and maintaining a resilient business model and accordingly are best placed to make assessments in the area of going concern, and auditors to evaluate their assessment. We note that under the current framework, auditing standards are more prescriptive than financial reporting standards in some respects, and further increasing this asymmetry, by making changes to the auditing standards without corresponding changes to the financial reporting standards, may not be effective.

Therefore, in our view, any changes to certain requirements in the auditing standards, including information to be included in the auditor's report, may need to be predicated on corresponding and equivalent changes to financial reporting standards, e.g. IFRS Standards (in particular IAS 1), including changes to disclosure requirements. In addition, changes to certain requirements in the auditing standards, and the use of assurance engagements to report on an entity's internal control, would likely need related changes to legal/ regulatory/ corporate governance framework requirements in many jurisdictions.

Similarly, we highlight that new information about going concern and fraud matters should not be introduced via the auditor's report, which is focused instead on clarifying what the auditor has done to evaluate management's assessment, and may provide commentary about procedures, but rather should be included in the financial statements themselves or the annual report more broadly.

Exploration of Proposed Solutions

When considering the proposed solutions themselves, we highlight the importance of understanding in depth the underlying causes of corporate failures, to help ensure that all contributors to those failures can be clearly identified and that solutions implemented, across all roles/responsibilities in the corporate reporting ecosystem (including in respect of management/ those charged with governance and regulators, as well as auditors) properly address these issues.

An evaluation of the needs of investors and other stakeholders should be made, especially in respect of the more granular proposals noted. We believe that stakeholders have an important role to play in driving decisions about what additional information needs they may have; whether such information should be independently assured, and whether and how the role of the auditor (and others in the financial ecosystem) should evolve.

We believe that the potential solutions described in the DP are not mutually exclusive and therefore it is helpful to explore the merits of each both individually as well as when



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part of a suite of potential solutions, some of which may be implemented in the short term and others may be deployed over a longer term, in response to market demands.

Please contact Sheri Anderson at sranderson@kpmg.com if you wish to discuss any of the issues raised in this letter.

Yours sincerely

A handwritten signature in black ink that reads 'Larry Bradley' in a cursive script.

Larry Bradley
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Appendix – Specific Questions Posed by IAASB

1. In regard to the expectation gap

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

We agree with the IAASB that there has long been an 'expectation gap' in terms of a difference between what users of financial statements and the auditor's report thereon expect from auditors and the financial statement audit and what an audit actually is, in particular, in relation to the critical areas of fraud and going concern. We believe the analysis in the DP, which breaks the expectation gap down into the constituent parts of 'knowledge gap', 'performance gap' and 'evolution gap' is helpful in supporting further exploration of the underlying issues. We consider that all three of these aspects contribute to the expectation gap in respect of fraud and going concern.

Fraud

In respect of fraud, we suggest that the **knowledge gap** component is likely the main contributor to the expectation gap as the inherent limitations of an audit in this area are not well understood by the public in general.

ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, states that "the auditor's responsibilities are to obtain reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error" [ISA 240.5]. The standard further states that "owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the ISAs." [ISA 240.5]. This unavoidable risk is due, in part, to the fact that most audit evidence is persuasive rather than conclusive, in order to support reasonable assurance. Additionally, as stated in ISA 200.A53, "the potential effects of inherent limitations are particularly significant in the case of misstatement resulting from fraud." ISA 200.A53 highlights particular challenges when a fraud involves senior management, or collusion. ISA 240.6 highlights that fraud "may involve sophisticated and carefully organised schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. Such attempts at concealment may be even more difficult to detect when accompanied by collusion." We note that when serious frauds occur, they are often perpetrated by (senior) management, who have the ability to override control procedures designed to prevent similar frauds by other employees; directly or indirectly manipulate records/documents and make false representations.

ISA 240.6 also highlights that *“the auditor’s ability to detect a fraud depends on factors such as the skilfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved.”* Further, ISA 240 notes that *“it is difficult for the auditor to determine whether misstatements in judgement areas such as accounting estimates may be caused by fraud or error”*.

Accordingly, ISA 240 focuses on procedures to assist the auditor to identify and assess risks of material misstatement due to fraud, with specific identification procedures targeted at certain aspects. These are:

- the auditor understanding the entity and its environment;
- risk assessment procedures, including discussion amongst the engagement team, and considering specific fraud risk factors including whether there may be incentives/ pressures to commit fraud;
- making enquiries of management and others;
- understanding how those charged with governance exercise their oversight responsibilities; and
- identifying unusual relationships, and whether other information obtained by the auditor indicates risks of material misstatement due to fraud.

There are also targeted procedures required to respond to risks related to management override, including with respect to journal entries, accounting estimates and significant transactions that are outside the normal course of business or that otherwise appear to be unusual. The ISA emphasises the importance of exercising professional scepticism in this area throughout the audit, including in considering the implications for the audit when potential misstatements may be indicative of fraud.

We believe there is a fundamental lack of understanding by users of financial statements about the inherent limitations of an audit as described above, and the way in which ISA 240 and other ISAs are designed to address fraud, in particular, the fact that an audit is a risk-based, and not an absolute, assurance engagement, rooted in the concept of materiality.

We also highlight that there is a lack of clarity as to what ‘fraud’ in an audit of financial statements actually means. There is an interaction between the concept of fraud and that of breaches of laws and regulations, which have some degree of overlap, especially in the case of intentional violations, but with breaches of laws and regulations encompassing a significantly broader scope, including operational and reputational matters such as in respect of environmental or health and safety legislation. We believe users of financial statements may believe ‘fraud’ encompasses such breaches beyond those that are directly connected to the financial statements themselves. ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements* describes the inherent limitations of an audit in addressing breaches of laws and

regulations, principally when these do not have a direct effect on the financial statements. Although ISA 250 sets out required procedures, based primarily on inquiry of management and inspection of regulatory correspondence, to assist auditors in identifying actual or suspected breaches of laws and regulations in this area, there again remains a risk that not all such breaches will be identified by an audit and this risk increases significantly if the breach also involves an aspect of fraud.

We also acknowledge that there are aspects of the **performance gap**, and we suggest that the IAASB further consider certain enhancements to ISA 240 and other ISAs, that may address this. For example, we recommend consideration of:

- the introduction of a 'stand-back' requirement to ISA 240, to consider and evaluate all audit evidence in this area, and how this affects our fraud risk assessment and the nature, timing and extent of our procedures to address fraud risks, before forming an audit conclusion. This could be similar to other stand-back requirements such as that introduced in ISA 315 (Revised), together with additional material regarding specific areas which would benefit from the exercise of heightened professional scepticism, and include guidance on how to do this, such as material introduced in ISA 450 (Revised) and in proposed ISA 600 (Revised), *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*;
- potential enhancements to considerations as to when to involve forensic specialists. Please refer to our response to Question 1b) for further information;
- increased emphasis on evaluating the culture and tone at the top, clearly linked to the enhanced material in this area set out in ISA 315 (Revised), with related guidance as to how to do this and the implications for the audit if there are concerns in this area;
- expanding guidance with respect to responding to financial statement level fraud risks, such as:
 - obtaining more audit evidence from external sources, which may be appropriate if we are concerned about management override/ collusion within the entity, and which may assist the auditor with identifying assertion level fraud risks;
 - increased use of tests of details in the audit to respond to a risk of fraud that is more pervasive in nature, when the engagement team considers this to be appropriate;
 - involvement of specialists/ auditor's experts, when considered appropriate by the engagement team, focused on evaluation of subjective judgments across the financial statements to help identify/ address indicators of possible management bias that may be intentional and fraudulent (e.g. in relation to estimates).

We also note that there is an **evolution gap**, which we describe in more detail below under Evolution Gap – Fraud and Going Concern.

Going Concern

In respect of going concern, we note that the purpose of management's going concern assessment may not be fully understood by all stakeholders of an entity, i.e. there is a significant **knowledge gap**. In the context of a financial statement audit, management makes a 'going concern' assessment to determine the underlying basis of accounting used to prepare the financial statements. This includes determining whether it is appropriate to prepare the financial statements on a going concern basis, or whether this would be inappropriate, and the financial statements should be prepared on a 'non-going concern' basis. Material uncertainties relating to the events or conditions that may cast significant doubt on the entity's ability to continue as a going concern are required to be disclosed but do not change the basis of accounting. Accordingly, the 'threshold' at which such a going concern basis of accounting is inappropriate is high – i.e. an entity's financial statements are prepared on a going concern basis unless management either intends to liquidate the entity or to cease operations or has no realistic alternative but to do so. However, this may not be clearly understood by all stakeholders more broadly, who may view 'going concern' conceptually not through the lens of being a fundamental assumption underlying an accounting basis of preparation of financial statements but rather as whether the company as a whole is 'viable' or 'resilient' in the longer-term.

We also note that terms such as 'entity' (i.e. whether this refers to the legal entity or the underlying business), 'intends', 'liquidate', 'cease operations' and 'realistic' are not defined and therefore subject to differing interpretations, and, furthermore, there is a lack of clarity as to how these terms apply across the spectrum of business models that currently exist, e.g. start-ups, exploration entities with a limited lifespan, research and development entities, dormant entities etc.

We believe the current concept of going concern in relation to a basis of preparation of financial statements remains appropriate for financial statements and the audit thereon. We recommend the exploration of provision of more information regarding the longer-term viability of an entity, which we believe would be best placed within the annual report, outside the financial statements themselves, and we suggest that the IAASB explore the provision of separate assurance that is not part of the financial statement audit over such information. Please see our response to Question 3a) for further information.

We also consider there is a **performance gap** in respect of going concern, as there is a lack of clarity regarding certain ISA concepts and terminology, including the term 'going concern' itself, as well as regarding material uncertainty relating to going concern (MUGC). We also highlight that there is

potential misalignment between ISA 570 (Revised), *Going Concern* and financial reporting frameworks, including IFRS Standards. We set out further details regarding these areas and our recommendations as to how these issues may be addressed in our response to Question 3a).

We also consider there is an evolution gap, which we describe in more detail below.

Evolution Gap – Fraud and Going Concern

We recognise that there is a significant evolution gap in respect of both fraud and going concern. The UK Brydon Report identified these as being the two areas that stakeholders want more information and clarity about – which we summarise as being whether the company is ‘honestly’ run and whether the company is ‘resilient’, i.e. whether it is likely to survive for a reasonable length of time. We believe it likely that stakeholders would call for certain key aspects of this information to be independently assured. Please refer to our responses to questions 2a) and 3a) for further information and our recommendations to address this aspect of the expectation gap.

(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?

We consider that the DP sets out a thoughtful and thorough analysis of potential solutions to address the different aspects of the expectation gap in respect of the important areas of fraud and going concern.

We set out our views regarding potential solutions to address the expectation gap in detail in our responses to question 2 (in respect of fraud) and question 3 (in respect of going concern).

In general, we consider that the ISAs are fit for purpose in respect of addressing fraud and going concern, in the context of enabling auditors to fulfil their responsibilities in respect of each of these areas when performing an audit of financial statements. We set out our recommendations for solutions to clarify/enhance certain aspects of ISAs, however, we do not consider that these would constitute fundamental changes to the role and responsibilities of the auditor as currently envisaged.

Nevertheless, we also recognise the extent of the evolution gap in respect of both areas and we set out recommendations to address this in our responses to questions 2 and 3. We note in those responses that such solutions would, in our view, be most appropriately implemented by way of an integrated audit with separate reporting by the auditor over the entity’s system of internal control (including fraud), or in the form of specific, separate assurance engagements in these areas in accordance with the ISAE 3000 (Revised) suite of standards, rather than attempting to fundamentally change/ broaden the underlying scope

and purpose of the financial statement audit and the role and responsibilities of the auditor.

We also highlight that any changes to requirements in auditing standards regarding the role of the auditor and information to be included in the auditor's report may need to be predicated on corresponding and equivalent changes to financial reporting standards, e.g. IFRS Standards (in particular IAS 1), as well as legal/ regulatory/ corporate governance framework requirements, including in relation to disclosure requirements. Similarly, we highlight that new information about going concern and fraud matters should not be introduced via the auditor's report, which is focused instead on clarifying what the auditor has done to evaluate management's assessment and may provide commentary about procedures, when relevant. Instead, such information should be provided by the entity itself, e.g. in Other Information such as the front section of the annual report, as management is primarily responsible for these areas and is best placed to perform (initial) assessments and provide detailed information about these areas.

In addition, we also recommend that the IAASB explore the concept of 'fraud' in an audit of financial statements and provide further specificity as to how 'fraud' is defined in the financial statements, as well as the interaction between ISA 240 and ISA 250 in terms of fraud and breaches of laws and regulations.

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 we describe above, ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* sets the scene regarding the inherent limitations of an audit in respect of detecting material misstatements resulting from fraud, and sets out procedures to assist the auditor in identifying and assessing the risks of material misstatement due to fraud in designing procedures to detect such misstatements.

We consider that, in general, ISA 240 is fit for purpose in setting out the responsibilities of the auditor in respect of fraud when performing an audit of financial statements and in assisting the auditor to fulfil those responsibilities. Accordingly, we are supportive of the proposals set out in the DP that, in our view, would clarify or enhance certain existing requirements, as we consider these changes to be commensurate with the nature and purpose of an audit of financial statements, as well as with the skill set of the audit profession.

However, we would be concerned with proposals that we believe aim to change the role and responsibilities of the auditor more broadly, as well as the concept of an 'audit' more fundamentally. In this respect we highlight, as earlier, that management, under the oversight of those charged with governance of an entity, currently has, and in our view, should continue to have, primary responsibility for the prevention and detection of fraud in respect of an entity. This responsibility includes creating the right 'tone' regarding business conduct, as well as the establishment of an effective system of internal control.

We do not consider that the financial statement audit/ financial statement auditors should move into the forensic audit space, noting that a forensic audit is an entirely different engagement to an audit of financial statements, targeted at a very specific element of the entity in response to a particular fraud risk.

We set out our views on each of the solutions proposed in the DP in further detail below:

Requirements for auditors to receive training in forensic accounting and fraud awareness as part of the formal qualification and continuous learning process

We are supportive of initiatives to upskill auditors in this area, both at the start of, and then throughout, their professional careers, which we believe would be beneficial across all audit engagements. We recommend that training be closely aligned to core audit principles with a focus on identifying 'red flags' in respect of fraud risks; when it is most necessary, and how, to exercise professional scepticism in this area, and relevant considerations for determining when it would be appropriate to involve forensic specialists.

We also suggest that such training, in focusing on risk identification and exercise of professional scepticism, cover aspects of corporate culture and tone in relation to the elements of the 'fraud triangle' regarding pressure and rationalisation. To date, much of an auditor's focus has been directed towards the 'opportunity' aspect. However, broadening of training to also incorporate wider consideration of corporate culture and economic circumstances in relation to 'pressure', as well as human behavioural science to address 'rationalisation', including aspects of auditors' own behaviour such as conscious and unconscious bias, and cultural differences in business practices, given that audits are performed on an increasingly global basis, would also be of significant benefit.

We highlight, however, that care needs to be taken with this solution not to widen the expectation gap by creating the impression that in undergoing such training auditors would have a similar skillset to forensic specialists and would be effectively performing a 'forensic audit' as part of a financial statements audit.

Requirements for auditors to use other specialists e.g. data or information technology experts to perform data mining or data analytics techniques

We are supportive of the direction of travel of this proposal, highlighting that there have been significant developments in the area of data and analytics in recent years, enabling auditors to evaluate whole populations and mine and analyse large quantities of data, which can be a powerful tool. We note that recently revised ISAs, e.g. ISA 315 (Revised), pave the way for the use of such techniques as they evolve and auditors become more familiar with these.

However, we note that this approach is not a panacea in respect of detecting fraud and there are limitations to these techniques. We consider that it remains vital for auditors to continue to examine the data flow through an entity's systems; to understand the underlying rationale for transactions, as well as contractual terms. We also note there are challenges to use as a result of entities' systems of data infrastructure, as well as jurisdictional laws and regulation governing matters such as data privacy/ data sharing. Therefore, whilst we consider that technology-based solutions are very useful additions to the suite of tools and techniques that an auditor may use, when deployed in a thoughtful and targeted manner at the judgement of the engagement team, we do not consider that broad requirements should be introduced into ISAs in this area. For example, we do not recommend that such techniques are mandated for use on all audits, or on audits of listed entities, and neither should they be intended to replace current audit concepts and procedures.

We recognise that there are other IAASB work-streams in this area as well as other bodies which are actively exploring the use of such technology in an audit and we suggest that a coordinated approach be taken by such groups to arrive at a solution that is effective and capable of consistent global implementation.

In this regard, we recommend that the IAASB consider enhancing ISA 240 to expand requirements and guidance related to responding to financial statement level fraud risks, such as consideration of involvement of specialists to assist the auditor in evaluation of subjective judgements to help identify indicators of possible management bias that may be intentional and fraudulent (e.g. in relation to estimates).

Requirements for auditors to evaluate and report on the entity's processes and controls to prevent and detect fraud

We are supportive of this proposal, noting that, based on longstanding experience in this area in certain jurisdictions, such requirements are premised on the establishment of similar formal requirements regarding management's responsibilities to perform procedures and themselves report in this area, which introduces more rigour in itself.

In supporting this solution, we also highlight that it is closely aligned to the current concept of an audit and to auditors' professional skills and expertise.

We also believe that this solution is capable of development as a scalable solution and in this regard we recommend that any new requirements be established only for listed entities/PIEs, noting that such entities usually have a more formalised system of internal control that is capable of being subject to a specific assurance engagement.

However, as we note earlier, we would be concerned with changes to auditor's responsibilities in this area in the absence of equivalent changes to responsibilities of management/ those charged with governance, as such asymmetry would place responsibilities on an entity only indirectly using auditors as the mechanism to effect such changes. This would be challenging for auditors to achieve and such an imbalance of responsibilities may render it less effective as a solution if other parties are not considered to be properly accountable in this area.

Please refer to our response to Question 4, in which we note that for several of these solutions to be effected, bodies, including financial reporting standard setters, as well as regulators, will need to work together.

We also highlight that such an approach may widen the expectation gap or give rise to confusion to the users of the audit report, firstly, in the event that an auditor were to identify and report deficiencies in an entity's internal controls, whilst at the same time issuing a 'clean' audit opinion, because the auditor may be able to obtain sufficient appropriate audit evidence that the financial statements are not materially misstated even when a control deficiency is present. To help address this concern, we recommend that this be performed either as an integrated audit with separate reporting over the system of internal control in relation to financial reporting (including fraud) by the auditor, or as a separate assurance engagement performed in accordance with the ISAE 3000 (Revised) suite of standards. Secondly, as we highlight earlier, given the nature of frauds, which may be perpetrated by senior management, with the ability to override systems and controls, such systems, and assurance over them, will not necessarily prevent or detect fraud.

In terms of the scope of such an engagement, we have concerns if a fragmented approach is envisaged, targeted only at an entity's anti-fraud processes and controls. Instead we believe that this solution, if pursued, would best be focused on the internal control system holistically, although we note that this approach likely would result in significant incremental cost both in respect of entity compliance as well as auditor assurance, at least initially, with benefits such as reduced cost of capital being realised later. Accordingly, we recommend detailed outreach to stakeholder groups including investors to help ensure they understand the costs/ benefits of such an approach and are able to take an active part in determining whether this solution would meet their needs.

If this approach is pursued, it is critical that a suitable framework against which to evaluate an entity's processes and controls is developed, similar to the

COSO Framework that is used in an audit of Internal Control Over Financial Reporting (ICOFR), with emphasis on the appropriate involvement/oversight of those charged with governance as a critical and integral feature of the system of internal control. Other aspects of the framework should address business culture/ tone as well as matters such as whistle blower programs. Such a framework would need to be capable of reasonably consistent implementation on a global basis to ensure consistency and comparability of entities across jurisdictions.

We consider that the core principle applicable in other areas of corporate reporting that 'management goes first' should also be applied in this situation, i.e. management/ those charged with governance of an entity should be required by regulators to describe their approach to fraud identification and their response e.g. in the front section of the annual report, with auditors performing an integrated audit with separate reporting over internal control in relation to financial reporting, including in respect of fraud, or performing assurance in accordance with ISAE 3000 (Revised) over this information.

Requirements for auditors to involve forensic specialists on audit engagements more broadly

We consider that forensic specialist involvement can be of significant benefit on an audit engagement when performed in a targeted way that makes best use of forensic specialists' skill sets. ISA 240 currently envisages this, for example at paragraph A35, where it refers to "*assigning individuals with specialised skill and knowledge, such as forensic and IT experts*".

Accordingly, our recommendation is to consider enhancing the current standard at paragraph 30(a) and A35 to better emphasise the relevant considerations for determining the need for forensic specialist involvement, as well as involvement of other specialists e.g. valuation specialists, to assist the engagement team in robustly challenging management's assumptions with respect to estimates, or legal or tax specialists, to assist in robustly challenging management's assumptions and judgements in these areas. This would be aligned to the fact that an audit is a risk-based engagement, such that specialist involvement, if determined to be necessary, is to assist in responding to a particular risk already identified by the team and therefore their involvement is specifically targeted.

However, we believe this proposed solution is likely to be of more limited benefit if envisaged in the context of establishing a requirement for forensic specialist involvement across all audits or audits which meet high-level criteria such as size, as well as involvement in a generic and non-targeted manner such as during risk assessment procedures. Firstly, we note that engagement teams possess in-depth knowledge of clients and their industry sectors, which a specialist may not and therefore specialist contribution to audit quality may be limited unless it is appropriately focused, in accordance with their skill set.

We also note that even if the solution is applied based on broad criteria such as size, or whether or not an entity is listed, rather than being aligned to a risk-based approach, this may also limit its usefulness, e.g. we note that non-listed entities do not necessarily have a lower fraud risk profile than listed entities.

Furthermore, we would caution against a general requirement for involvement across all audits, when the role and responsibility of the forensic specialist is not clearly defined/ is not targeted, as this may instead create a perception that a 'forensic audit' is being performed or forensic auditor skillset is being deployed, which could possibly widen the expectation gap.

Focus on non-material fraud

The ISAs establish a number of requirements in this area, including requiring the auditor to evaluate whether identified misstatements are indicative of fraud and assess the impact on other aspects of the audit, particularly management representations. The Board questions whether these responsibilities should be expanded or enhanced, noting that non-material frauds are becoming more prevalent, and may be indicative of broader concerns regarding an entity, to require a wider focus by the auditor on fraud.

We do not believe the auditor's responsibilities need to be expanded, but we suggest that the IAASB consider enhancing the current material in the ISAs regarding the auditor's responsibilities when non-material fraud is identified (whether by the entity or the auditor) in terms of evaluating the implications on the audit as a whole. For example, greater emphasis could be given to understanding the actions taken by management in response to the identification of fraud, and evaluating the implications this understanding may have on risk assessment; the auditor's understanding of the entity's internal control; the reliability of audit evidence, and how we exercise professional scepticism.

We also suggest that the IAASB consider including enhanced guidance in respect of the term 'material' fraud, to highlight that consideration of materiality should involve qualitative as well as quantitative factors, with examples, linked to ISA 320.10, that this is factored in when determining materiality for the financial statements as a whole, and for particular classes of transactions, account balances or disclosures, i.e. there is no 'separate' materiality threshold in respect of fraud.

Third-party Fraud

The Board questions whether there should be additional emphasis placed on the auditor's procedures with respect to third-party fraud, which are currently triggered if auditors identify particular risks, e.g. around collusion opportunities between entity employees and parties external to the entity, as well as whether these responsibilities should be broadened beyond fraud that is directly related

to financial reporting to address matters such as cyber security risks that are related to operational or reputational risk.

We would be concerned with broadening auditors' responsibilities beyond the current remit and possibly widening the expectation gap, as a financial statement audit, by nature, is not directed towards identification of such frauds as it is focused on material misstatement of the financial statements rather than the entity's operational/ reputational matters.

Instead, we recommend the potential inclusion of enhancements to application material within ISA 240 in respect of professional scepticism, to highlight areas such as collusion opportunities/ risk factors (which may be more prevalent in certain industries or jurisdictions). This would be similar to enhancements made/proposed to other standards in recent years to raise awareness of the importance of professional scepticism and when, in particular, this may be necessary in performing an audit engagement.

Additional Quality Control Procedures

The Board questions whether enhancements to quality control requirements may be introduced, directed to fraud. For example, the Board suggests that the Engagement Quality Control Review could be enhanced to explicitly clarify that the EQC Reviewer considers significant judgements made and conclusions reached by the engagement team to address the risks of fraud.

We believe that the proposed revised ISQM standards are fit for purpose in this area, and these suggestions are already addressed by current quality control requirements. However, we would be supportive of enhancements to more explicitly clarify that 'significant matters' subject to EQC review would include significant matters in relation to 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?

As we note above, it is unlikely to be appropriate or effective to try to establish generic criteria for these potential solutions e.g. by size or whether or not an entity is listed, because risks are entity-specific, e.g. we note that non-listed entities do not necessarily have a lower fraud risk profile than listed entities. Instead, we support the proposals primarily directed to enhancements to ISA 240 and other ISAs, where relevant, in relation to all audit engagements, e.g. to better emphasise the relevant considerations for determining the need for forensic specialist involvement, or involvement of data and analytics experts, and how we exercise professional scepticism and considerations in this regard, which are aligned to the risk-based nature of an audit engagement.

Similarly, we believe that training solutions would be most effective if developed and made available to all auditors, as part of their qualification process and on an ongoing basis.

If solutions such as requirements for auditors to evaluate and report on an entity's system of internal control, or longer-term business resilience/ viability are explored further, we recommend that investors are involved in decision-making in this area and, given the significant cost involved, we believe such a solution would likely be more appropriate if restricted to listed entities/ PIEs. We also highlight that decisions in this area would generally fall within the remit of market regulators – please see our response to Question 4, noting that other bodies, including such regulators, would need to be involved in this dialogue.

(ii) What enhancements are needed?

Please refer to our responses above, which discuss in more detail our views on the various solutions proposed in the DP and our recommendations regarding the most appropriate avenues for the IAASB to pursue.

(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.

Please refer to our responses above. We recommend that enhancements to the ISAs be considered, in particular, to ISA 240, to clarify existing concepts, including to better emphasise the relevant considerations for determining the need for forensic specialist involvement, or involvement of data and analytics experts, and how we exercise professional scepticism and considerations in this regard, which are aligned to the risk-based nature of an audit engagement. We also set out recommendations in our response to Question 1a) regarding ISA 240 placing increased emphasis on evaluating the culture and tone at the top of the entity, as well as expanding guidance in responding to financial statement level fraud risks.

We also recommend exploring training solutions, working with other relevant bodies, including IAESB, National Standard Setters (NSS), and regulators to determine the appropriate scope of such training, noting that this should be responsive to the root causes of recent corporate failures.

If the IAASB, and other bodies, decide to pursue the solution of requirements for auditors to evaluate and report on the entity's processes and controls to prevent and detect fraud (or, as we recommend, on an entity's system of internal control more broadly, which may also include processes and controls in respect of provision of information regarding longer-term resilience/ viability of an entity), we note that a suitable framework establishing criteria for measurement/ assessment would need to be developed, similar to the COSO Framework that is used in an audit of Internal Control Over Financial Reporting (ICOFR), that would be capable of reasonably consistent application on a global basis.

Additionally, equivalent requirements for entities would likely need to be developed via financial reporting standards, laws and regulations, or corporate governance codes, rather than attempting to effect requirements indirectly through auditors.

Please refer to our response to Question 4, in which we note that for several of these solutions to be effected, bodies, including financial reporting standard setters, as well as regulators, will need to work together.

We consider that such an engagement should be performed as a separate engagement e.g. as an integrated audit with separate reporting by the auditor regarding internal control over financial reporting (including in respect of fraud) or as an assurance engagement in accordance with the ISAE 3000 (Revised) suite of standards, rather than as part of the audit of the financial statements..

We also believe that the core principle applicable in other areas of corporate reporting that 'management goes first' should also be applied in this situation, i.e. management/ those charged with governance of an entity should be required by regulators to describe their approach to fraud identification and their response e.g. in the front section of the annual report, with auditors providing assurance over this information.

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

We highlight that audits are risk-based assurance engagements and, accordingly, auditors exercise professional scepticism in a manner commensurate with their understanding of the entity and their identification and assessment of risk. As a result, an auditor is currently required to exercise professional scepticism appropriately and, when considered appropriate, will move towards a more suspicious frame of mind in a higher-risk engagement than in a low-risk engagement.

Accordingly, we do not believe there is a need to formally introduce a spectrum of professional scepticism as we believe the concept is already designed to be responsive to the circumstances.

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

We would not be supportive of such an approach. As we note above, we do not recommend that the IAASB make fundamental changes to the concept of professional scepticism as we believe that, as a mindset, this is already capable of, and required to be, adaptive to the entity’s circumstances and the risk environment.

In circumstances where presumptive doubt or complete doubt would be required, ISAs, as well as the IESBA *International Code of Ethics for Professional Accountants (including International Independence Standards)* (the "IESBA Code") currently address this by other mechanisms, including during client/engagement acceptance/ continuance procedures, as well as consideration of withdrawal from engagements. We believe that requiring a default mindset of "deep suspicion" would be contradictory to and may undermine the principles embedded in both the ISAs and the IESBA Code.

Instead, since professional scepticism is fundamentally a mindset/ behaviour and therefore it cannot be improved by simply requiring auditors to be 'more sceptical', we recommend exploration of additional enhancements to the ISAs that emphasise how to exercise professional scepticism in respect of fraud during the audit, including when this is most critical, as well as how to do this. For example, ISA 240 could introduce a 'stand back' requirement to consider all audit evidence obtained, similar to that included in ISA 315 (Revised), as well as guidance regarding auditor biases and how to address disconfirming audit evidence. This could be linked to the Examples of Circumstances that Indicate the Possibility of Fraud, set out in Appendix 3 of ISA 240. This requirement could emphasise the importance of discussion between members of the engagement team, similar to the Risk Assessment and Planning Discussion that is required by ISA 315 (Revised), as such matters may only be identified on a collective basis across the engagement team as a whole. We also suggest the inclusion of improved linkage to proposed ISA 600 (Revised), addressing frauds that arise at components and highlighting the importance of involvement of component auditors, given their greater knowledge of the component environment, including local language, prevailing business culture, risks, laws and regulations, ethical standards, corporate governance standards, and established business customs/ practices. This may be especially important when the component is in a jurisdiction that is considered to be "higher risk", because, for example, it involves a rapidly changing regulatory and business landscape, and is subject to heightened fraud risks.

We welcome the proposal to strengthen language used in the ISAs, e.g. to focus on '*challenging*' management, or '*reconsidering* evaluations/ assessments' when new information comes to light.

We are also supportive of the proposal to require auditors to evaluate whether judgements made by management in making its assessment of going concern are indicators of possible management bias, noting that this approach is required in the UK. The IAASB would need to provide guidance to support such assessments, including factors to consider.

We acknowledge the Board's commentary that, in order to avoid a bias for obtaining confirming evidence, the ISAs and financial reporting standards could be worded to place emphasis on negative rather than positive statements for management assertions, based on their research, which suggests that auditors

are less likely to seek confirming evidence for negative statements. We believe it would be helpful to explore this approach, noting that ISA 540 (Revised) requires the auditor to design and perform their further audit procedures in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory. Similar changes are proposed in other ISAs, e.g. proposed ISA 600 (Revised) and therefore the aims of this proposal would be aligned with other ISAs.

(d) Do you believe more transparency is needed about the auditor's work in relation to fraud in an audit of financial statements? If yes, what additional information is needed and how should this information be communicated (e.g. in communications with those charged with governance, in the auditor's report, etc.)?

We consider that communication about the auditor's work in relation to fraud is an important area about which to communicate clearly to both those charged with governance, as well as to users of the financial statements and the auditor's report thereon.

We believe that ISA 260 (Revised), *Communication With Those Charged With Governance* and ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management* sufficiently address communication in this area with those charged with governance. We believe such communication is a critical part of enabling those charged with governance to discharge their oversight responsibilities.

Although the inclusion of further information in the auditor's report regarding the auditor's responsibilities in this area, including the inherent limitations of an audit, may be helpful, we believe overall that this is likely to be of limited benefit to users of financial statements and may result in 'clutter' that could make the auditor's report unwieldy.

There is currently no requirement within the ISAs to describe specific procedures performed regarding risks of material misstatement due to fraud in the auditor's report, although such information may be included if it is determined by the auditor to be a key audit matter. We highlight, however, that a description of the extent to which an audit is capable of detecting fraud is now required to be communicated in all auditor's reports in the UK by UK ISA 700. We suggest that the IAASB explore the inclusion of enhanced material in the ISAs in this regard, including factors to consider in determining whether fraud, or fraud risk, may be a key audit matter. However, we note that it is important that any changes to the ISAs in this area do not encourage the inclusion of boilerplate material in this regard.

We also recommend that the IAASB monitor UK investor views regarding the provision of more information by the auditor as to the ability of the audit to detect fraud and other irregularities to help inform their considerations in this area.

3. This paper sets out the auditor's current requirements in relation to going concern in an audit of financial statements, and some of the issues and challenges that have been raised with respect to this (see Sections III and IV). In your view:

(a) Should the auditor have enhanced or more requirements with regard to going concern in an audit of financial statements? If yes, in what areas?

We do not consider that the fundamental responsibilities of auditors in terms of auditing 'going concern' in the context of being an assumption underlying the basis of preparation of the financial statements, or regarding their determination of the adequacy of disclosures in respect of 'going concern' should be changed. Please refer to our response to Question 1a) for more information.

However, we highlight that several aspects of ISA 570 (Revised) may give rise to inconsistency in interpretation/application in practice and therefore we recommend that the IAASB explore clarification of these areas, for ease and consistency of use. We set out our recommendations for exploration of potential clarifications below. In describing these, we emphasise that equivalent changes to both principles and terminology would need to be made to financial reporting standards, e.g. IFRS Standards (in particular, IAS 1), as well as legal/regulatory and corporate governance requirements directed at entities, so that these would be aligned and roles and responsibilities of different parties, including management and those charged with governance at entities, as well as regulators and others, would be appropriate and balanced across the financial reporting ecosystem.

We note that going concern requirements for auditors set out in the ISAs are currently more prescriptive than those for management/ those charged with governance, set out in financial reporting standards, and yet management/ those charged with governance are best placed to make assessments of going concern as a result of their detailed knowledge of the business, including future plans.

In relation to this, we further highlight that financial reporting standards (e.g. IFRS Standards) are limited in terms of the requirements/ guidance in respect of going concern. We recommend that the IAASB work with financial reporting standard setters, e.g. the IASB, and other bodies to explore this, including considering, in particular, enhancing disclosure requirements related to going concern to provide users with clear information, and to draw aspects of this together better in the financial statements to 'tell the story' for stakeholders in a more cohesive manner. Additionally, we recommend that regulatory bodies be encouraged to consider enhancing requirements regarding timely

communication to the market regarding going concern/ solvency issues as such enhancements would better address stakeholder information needs.

Recommendations for Enhancements to the ISAs Including Clarification of Going Concern Concepts

We set out below our observations regarding areas where there may be scope for differing implementation in practice of ISA 570 (Revised), in particular, in relation to a material uncertainty related to going concern (MUGC):

- The term 'going concern' is not defined, and there is also a lack of clarity regarding terminology used in describing the threshold for which the going concern basis is no longer appropriate (An entity's financial statements are prepared on a going concern basis unless management either intends to liquidate the entity or to cease operations or has no realistic alternative but to do). Terms such as 'entity' (i.e. whether this refers to the legal entity or the underlying business), 'intends', 'liquidate', 'or 'cease operations' are not defined, and there is a lack of clarity as to how these terms apply across the spectrum of business models that currently exist, e.g. start-ups, exploration entities with a limited lifespan, research and development entities, dormant entities etc., or whether 'realistic' means having exhausted all opportunities. Such definition could also clearly explain the fact that the threshold at which an entity would no longer be considered to be a going concern is deliberately high, commensurate with the fact that this is an assumption underlying a basis of preparation of financial statements;
- We believe there is scope for confusion around the concept of a MUGC itself, which may lead to inconsistency in practice, especially if financial reporting frameworks do not have a clear definition or do not specify what information should be disclosed;
- There is also scope for confusion resulting from the fact that a MUGC arises from events or conditions that may cast significant doubt (which is not a clearly defined term in itself) on the entity's ability to continue as a going concern, but elsewhere in the ISA (and in the auditor's report) significant doubt is described as resulting from a MUGC. This seems to be circular and does not help clarity;
- There may be a lack of consistent understanding of terms such as 'feasible'. We recognise that it is not usually possible to ascribe percentage probabilities to such outcomes and accordingly the determination of 'feasible' falls along a spectrum, however, we consider that it would be helpful for auditors if the ISA were to provide more guidance about factors to consider in determining where on this spectrum the matter may fall.

We recommend that the IAASB explore these concerns, with the aim of clearly defining the terminology used as well as providing greater clarification/ guidance regarding the measures, assumptions and judgements that are needed to address them. Such exploration could also focus on clarifying/simplifying the

steps to assess/evaluate going concern, and greater emphasis on disclosure requirements in financial reporting standards, including about matters that may cast significant doubt but do not give rise to a MUGC. Additionally, we recommend that clarification be explored regarding the extent to which mitigating factors may be considered, including significant assumptions and judgements about the feasibility of management's plans and the importance of assessing the extent to which such plans are within management's control. The IAASB would need to work with other standard setters, in particular, financial reporting standard setters, e.g. IASB, to help ensure that concepts and requirements are clear and are aligned between ISAs and financial reporting standards.

We also suggest that the IAASB explore clarification to terminology such as 'feasible' and how this may be impacted by significant economic uncertainty, such as that resulting from the COVID-19 pandemic. In exploring such changes, we note that we do not believe it would be in the public interest to enhance the standard such that there is an increase in MUGCs absent a change in economic conditions. Instead, we believe the emphasis should be on financial statement disclosures about key assumptions and judgements in making these determinations, and in the auditor's report regarding the procedures performed and conclusions reached, where relevant. Care would also need to be taken to ensure that additional information provided with the aim of transparency does not give rise to confusion for users as to the overall conclusion of management and the auditor (when the going concern basis of preparation is appropriate but there are significant events or conditions that may cast significant doubt), which we believe should remain as a binary conclusion about whether the going concern basis of preparation is appropriate or not.

In connection with this, it would be helpful for financial reporting standard setters to consider whether to require disclosure by entities that the financial statements are prepared on a going concern basis (when appropriate) unless management intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so.

Period of Assessment/ Evaluation of Going Concern

A key proposal in the DP is for the going concern evaluation to be extended to cover a longer period. Based on ISA requirements and their interaction with the requirements of financial reporting frameworks, e.g. IFRS Standards, the current period of assessment is 'at least, but not limited to, 12 months from the reporting date'. For some entities, there may be events or conditions that occur beyond such a timeframe that may cast significant doubt on the entity's ability to continue as a going concern, e.g. if the entity needs to undertake significant re-financing activities 18 months after the reporting date, the auditor would currently be required to consider available information about these events, as well as to make inquiries of management and remain alert to the existence of such events or conditions. Accordingly, our view is that it may be helpful to

explore certain clarifications regarding the auditor's evaluation of the appropriateness of the period for management's assessment.

We believe that consideration should be given to the length of the period of management's assessment being directly linked to the date of authorisation of the financial statements, rather than the reporting date, noting that this approach is already taken in certain jurisdictions, e.g. the US, the UK and Australia where, if management's assessment covers less than twelve months from the date of approval of the financial statements, the auditor requests management to extend its assessment to at least twelve months from that date. We consider that this may be more appropriate in terms of the underlying objectives of the requirement, as 'going concern' is a fundamental assumption underlying the basis of preparation of the financial statements and, accordingly, it is critical for this assumption to be appropriate at the time the financial statements are approved for issue, considering the information needs of users of the financial statements. This is also likely to be particularly important as the time between the date of authorisation and the reporting date increases.

We highlight that audit requirements are based on the fundamental premise that 'management goes first', i.e. management is best placed to make the assessment of going concern, based on their extensive knowledge of the specific circumstances of the entity, and the auditor evaluates this. We recommend, therefore, that financial reporting standards and other legal/regulatory/ corporate governance requirements retain this core principle.

Accordingly, in exploring any changes in this area, the IAASB would need to work closely with financial reporting standard-setters, including the IASB, as well as other bodies, e.g. regulators and national standard-setters.

In terms of the length of the period of assessment, we note that the further into the future the events/ conditions are expected to occur, the more uncertainty there is involved, and therefore it may be challenging to obtain sufficient appropriate audit evidence. Accordingly, if the length of the period were to be extended beyond 12 months from the date of authorisation of the financial statements, it would be more likely that a MUGC would be considered to exist, which we do not believe would be in the public interest.

We therefore recommend that the IAASB, together with financial reporting standard-setters and other bodies, consider this carefully, so that any solution achieves an appropriate balance in terms of a period that is sufficiently long that it is informative, however, not so long that uncertainty is introduced that is of such a degree that neither management nor the auditor is able to reach a conclusion or provide meaningful information. We consider that a period that is required to be 'at least, but not limited to, 12 months' remains fit for purpose in terms of achieving this balance, noting that this would align with the fact that most financial reporting cycles, and audits thereon, are on an annual basis, supplemented by updated information provided in respect of interim periods.

(See also our recommendations regarding longer-term resilience/ viability information below).

Furthermore, we recommend that the IAASB (and other international bodies) continue to express this period as being 'at least, but not limited to' and do not aim to establish an 'end-date'. Instead, the focus should clearly be on the need to evaluate *relevant* information, rather than on a specific time period. Management would be required to determine what information is relevant and then establish their period of assessment to include such information, i.e. standards should emphasise that the information about the future that may result in the identification of events or conditions that may cast significant doubt over the entity's ability to continue as a going concern determines the appropriate period rather than vice versa.

We believe that reference to a period of assessment that covers at least, but not limited to, 12 months from the date of authorisation of the financial statements would be a helpful indicative starting point for entities and auditors, who would also benefit from clearer guidance as to when it may be appropriate to extend the period of assessment beyond 12 months. We note that ISA 570.A14 states that '*since the degree of uncertainty associated with the outcome of an event or condition increases as the event or condition is further into the future, in considering events or conditions further into the future, the indications of going concern issues need to be significant before the auditor needs to consider taking further action*'. As such considerations likely require significant use of judgement, both management and auditors would benefit from further guidance including factors to consider in determining 'significance' to going concern. We believe this premise of relevant information and the appropriate period is embedded in the ISA currently, but it may benefit from clarification/ enhancement, with financial reporting standards, and laws/ regulations updated to align with this. The IAASB may also consider exploring whether to amend the ISAs to specifically require the auditor to evaluate the appropriateness of the period of management's assessment.

Separate Assurance Engagement Over Longer-Term Information

Going concern is a key area of the expectation gap and we fully acknowledge stakeholder calls for enhancements to the auditor's responsibilities in this area. As we describe earlier, a key component of the expectation gap in this area is the evolution gap, since financial statement audits have traditionally been premised on looking back at historical information, whilst many stakeholders are primarily focused on the viability/ resilience of the entity over the longer-term.

The ISA notes limitations of an audit in this area, including the fact that information becomes less reliable the further into the future to which it relates, as well as the fact that the auditor cannot make predictions about the future. Instead, it focuses on the performance of risk-based assessment and the identification of events or conditions that may cast doubt on the entity's ability to

continue as a going concern, with additional procedures required if such events or conditions are identified, noting that the concept is that of a basis of preparation of financial statements.

Accordingly, we suggest that the IAASB and other bodies explore the possibility of a 'combined approach', under which a formal going concern assessment be performed by management as described above, for a period that is at least but not limited to 12 months from the date of authorisation of the financial statements (i.e. beyond the existing requirement that requires a minimum 12 months from the reporting date), focused on information that is relevant to the going concern assessment, in the current context of going concern as a basis of preparation of financial statements. Auditors would evaluate this assessment as part of their financial statements audit.

Further information could also be provided by management, e.g. in the front section of the annual report, about potential events/ conditions and related risks beyond the period of management's assessment of going concern, looking at the longer-term, including business plans and risks more widely. Such information would not form part of the binary conclusion as to whether going concern basis of preparation is or is not appropriate (which would be restricted to the assessment made for the purposes of assessing going concern as the basis of preparation for the financial statements) but would provide important information to investors about the business model, key risks/ uncertainties and their implications for the resilience of that model in the longer-term.

Such information may address significant assumptions and judgements made by management, including funding assumptions and committed funding. Additionally, for more forward-looking information, 'reverse' stress-testing information could be provided, focusing on the likelihood of particular events/ conditions actually occurring. It is important that such information is entity-specific and avoids 'boilerplate' material in order to be decision-useful to investors. We suggest that the IAASB, together with other relevant bodies, explore the development a framework for such resilience/ viability measures, for reporting on by the entity and assurance by the auditor, drawing on the experience of the banking sector.

Such information would be 'Other Information' as defined in the ISAs and the auditor's responsibilities for such additional information, when performing an audit of financial statements, are set out in ISA 720, *The Auditor's Responsibilities Relating to Other Information*, i.e. to consider whether there are material inconsistencies with the financial statements/ the auditor's knowledge obtained in the audit.

However, recognising that there may be somewhat limited overlap between such information and that which is subject to audit, in particular, as such information relates to the longer-term, as well as the fact that investors are seeking assurance over such information, we recommend that the IAASB

explore this further. We recommend that assurance be provided over management's processes/ controls to develop the information, form assumptions and judgements, and the auditor could also provide commentary on those in a long-form report. This could be performed as a separate engagement, either as part of an integrated audit with separate reporting over an entity's system of internal control including in respect of this area, or as a separate assurance engagement performed in accordance with the ISAE 3000 (Revised) suite of standards. Such a separate assurance engagement may be optimal as it would allow greater flexibility as an entity's processes and controls in this area evolve, address information relating to a longer term, and as suitable criteria are developed, the pace of which may also vary across different jurisdictions. It would also enable assurance solutions to develop in line with stakeholder demand.

A framework for internal controls in this area, from the assessment through to inclusion of disclosures would need to be developed, capable of use on a globally consistent basis. This would support entities and auditors in assessing the design and implementation, and effectiveness of an entity's process over going concern, and compliance with the framework. IAASB would need to reach out to other bodies and work closely with them to effect such changes.

(b) Is there a need for enhanced procedures only for certain entities or in specific circumstances? If yes:

(i) For what types of entities or in what circumstances?

We consider that any changes to the ISAs (and financial reporting standards, where appropriate) as described above should be made in respect of all entities, as going concern is a fundamental assumption affecting the basis of preparation relevant to all entities.

In respect of assurance over longer-term viability/ resilience information, we suggest that the IAASB work with other bodies, including financial reporting standard setters, e.g. the IASB, as well as other standard-setters including sustainability standard setters, and legal/ regulatory bodies, and also to perform detailed outreach to investors and other stakeholders, to more closely explore criteria for performance of such engagements. For example, it may be determined that such engagements be required only for listed entities/ PIEs, given the heightened public interest in such entities, as well as the fact that they are more likely to perform such analyses with the appropriate rigour that would be a pre-condition for performance of an assurance engagement of this nature.

(ii) What enhancements are needed?

Please see our response to Question 3a) which sets out our recommendations both for enhancements to the ISAs, with equivalent changes made to financial reporting standards (e.g. IFRS Standards) as well as to legal/ regulatory frameworks, including corporate governance requirements and codes of conduct for entities, and for additional assurance engagements in respect of longer-term statements of viability/ business resilience.

(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.

Please see our response to Question 3a) which sets out our recommendations for enhancements to the ISAs, and financial reporting standards/ legal and regulatory requirement and corporate governance requirements/ codes of conduct to ensure that responsibilities are placed appropriately, in a balanced manner, across the financial reporting ecosystem as a whole.

We recommend that assurance over viability/ resilience information be performed as a separate engagement, either in the form of an integrated audit over an entity's system of internal control, including this area, with separate reporting over the system of internal control, or as a separate assurance engagement over management's process and controls to prepare this information, in accordance with the ISAE 3000 (Revised) suite of standards, with complementary changes to financial reporting/ sustainability standards.

(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.)?

One potential solution to address the knowledge element of the expectation gap relating to going concern would be to provide clearer information in the auditor's report regarding the responsibilities of both management/ those charged with governance and of the auditor in respect of going concern. This would include describing the specific nature and purpose of audit procedures in this area, including the inherent limitations of an audit.

Our view is that this is unlikely, at least on its own, to be helpful and furthermore, such additional information may result in the auditor's report becoming unwieldy and more difficult for users to navigate.

Another potential solution, which may be of greater benefit, is for financial reporting standard setters to introduce requirements into financial reporting standards for financial statements to state explicitly in the basis of preparation note why the going concern basis of preparation is used, i.e. that this is used unless management intends to liquidate the entity, or to cease operations, or has no realistic alternative but to do so, and disclosures regarding its assessment of the entity's ability to continue as a going concern, so that the auditor's report does not introduce new information about going concern, but rather provides commentary about how the auditor evaluated management's assessment. Such disclosures by management could include their significant assumptions and judgements regarding their going concern assessment, so that the users are able to assess the reasonableness of these assumptions. Auditors may provide commentary about such matters as a KAM, if they determine this to be appropriate.

(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?

As we state earlier, the Brydon Review identified going concern as one of the areas that stakeholders most want information and clarity about, i.e. whether an entity is likely to survive for a reasonable length of time, and that stakeholders would likely want certain aspects of this information to be independently assured.

We also highlight other recent initiatives and dialogue in respect of interconnected standard-setting for corporate reporting, with increasing recognition by many independent standard-setting bodies, regulators, preparers, practitioners and other stakeholders that reporting on historical financial information alone is not sufficient to provide a holistic view of a company's performance. There is increasing demand for a longer-term, future-oriented view across a wider range of aspects of a company's performance, including non-financial information elements, the impacts of these different aspects and their interdependency with financial reporting.

In connection with the above, there is increased stakeholder focus on the risks of climate change, environmental damage and societal issues, which have a close relationship with longer terms aspects of 'going concern' considerations, and such matters are likely to be in the spotlight more than ever as we emerge from the COVID-19 outbreak. As a result, we expect greater emphasis on reporting by companies that addresses their impacts and initiatives in relation to these overarching global concerns as a core feature impacting their market value.

We believe the IAASB has a key part to play in engaging in the dialogue to develop a global solution that best serves the public interest in this arena. In this context we welcome the DP.

We set out earlier our views on providing assurance over longer-term information provided by entities in respect of going concern.

In addressing calls for such information, we re-iterate that we consider that any solutions retain the core principle that 'management goes first' as we believe that entities themselves are best placed to provide such information to the market, with the auditor role being to evaluate such information and provide assurance.

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?

As we describe elsewhere in our response, we believe that certain changes to the role and responsibilities of auditors in respect of fraud and going concern need to be supported by complementary changes to requirements in respect of other key roles and responsibilities in the financial reporting ecosystem. Such changes need to be substantially aligned and need to be supported by clear frameworks for evaluation/ measurement of matters relating to fraud and going concern. We recognise that the introduction of legal/ regulatory/ corporate governance code requirements will take place on a jurisdiction by jurisdiction basis, with this evolution occurring at a different pace across different jurisdictions.

Therefore, we encourage the IAASB to reach out to and work closely with other bodies including financial reporting standard setters such as IASB, as well as national standard setters, bodies responsible for establishing legal and regulatory, and corporate governance, frameworks/requirements, on a global basis, in exploring this area and developing a suite of appropriate solutions. Such outreach and collaboration on a global basis will likely be challenging, but we consider it critical in order to drive the necessary improvements and improve public confidence in the global capital markets.

As part of engaging in the debate, we also suggest the IAASB discuss with other bodies the possibility of changes in the regulatory arena to encourage greater transparency by entities and also by auditors. These could involve, for example, the introduction of 'safe harbour' provisions for management/ those charged with governance of entities which establish appropriate systems of internal control in respect of fraud and going concern, and changes in the liability landscape regarding auditor reporting in relation to such matters.