



**Australian Government**  
**Auditing and Assurance Standards Board**

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Wednesday, 23 December 2020

Mr Willie Botha  
Technical Director  
International Auditing and Assurance Standards Board  
International Federation of Accountants  
529 5th Avenue, 6th Floor  
New York, New York 10017 USA

Dear Willie,

**AUASB Submission on the IAASB's Fraud and Going Concern in an Audit of Financial Statements Discussion Paper**

The Australian Auditing and Assurance Standards Board (AUASB) is pleased to have the opportunity to comment on the IAASB's Fraud and Going Concern in an Audit of Financial Statements Discussion Paper (the Discussion Paper).

In formulating its response, the AUASB has sought input from its constituents by hosting virtual roundtable meetings with stakeholders representing assurance providers from the private and public sector, academics, regulators and the professional accounting bodies across Australia. We also attended forums held by other parties on the Discussion Paper, and the AUASB members considered the Discussion Paper at recent board meetings.

The AUASB commends the IAASB in seeking feedback from a broad range of stakeholders for these two important topic areas. The AUASB is supportive of all parties in the financial reporting ecosystem working together to ensure that there is confidence in financial reporting by the capital markets and considering initiatives to address the expectation gap in relation to fraud and going concern. We fully support the IAASB identifying and analysing the root causes that drive these expectation gaps so that any proposed changes to the Financial Reporting or Assurance frameworks are targeted, cost effective and practical.

There have been concerns expressed recently in Australia about audit quality, which led to an Australian parliamentary inquiry into the Regulation of Auditing in Australia (the inquiry). Fraud and going concern were raised at the inquiry as specific areas requiring further consideration, and the final report of the inquiry has recommended that a review of the sufficiency and effectiveness of reporting requirements in relation to the prevention and detection of fraud and management's assessment of going concern is undertaken. Consistent with AUASB's strategic directive to adopt standards issued by the IAASB, we are coordinating our efforts to respond to the IAASB's Discussion Paper with our responses to the inquiry.

*Fraud*

The AUASB and its stakeholders agree with the IAASB's view that significant matters related to fraud are a whole of financial reporting ecosystem responsibility, and that changing auditors' responsibilities relating to fraud is only part of the answer. Stakeholders provided feedback to the AUASB that, without addressing other factors (such as the responsibilities of management and those charged with governance (TCWG) in the areas of financial reporting, corporate risk management and internal controls) changes to auditors' responsibilities on their own will have little impact in addressing the expectation gap.

Overall the consistent view from the AUASB and its stakeholders was that ISA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of a Financial Report* is fit for purpose and does not require a fundamental overhaul. It was acknowledged however that the standard could be modernised to address some of the issues raised relating to the performance gap (e.g. closer links to ISA 540 *Auditing Accounting Estimates and Related Disclosures*) and the evolution gap (e.g. technological advancements on the audit approach and users expectations). This is outlined in more detail in Attachment 1 of our response.

It was strongly acknowledged by our stakeholders that one way to address the performance gap relating to fraud would be to improve the education and professional training requirements auditors undertake. Educators (i.e. Universities and Professional Accounting Bodies) play a significant role in ensuring that our next generation of auditors are appropriately trained in the application of fraud risk assessment, forensic skills and applying a sceptical mindset. This is the case at both the undergraduate level and as part of the ongoing training and development auditors undertake in these areas once they join the profession. The AUASB received feedback that auditors' skills in fraud detection could be enhanced throughout each stage of their formative and continuing professional development. Our stakeholders communicated that the performance gap could be reduced by identifying better ways to share knowledge and experience from more senior team members with students and less experienced staff about how to appropriately respond to fraud throughout the audit process. This coupled with a greater degree of supervision and involvement by senior team members throughout the audit engagement in this area would assist in reducing the performance gap.

Finally, the AUASB's outreach and consultation on this topic identified that management and TCWG also need to be better skilled in preventing and detecting fraud, and that it can't just be left to auditors to address the issue. This is particularly the case for Boards and Audit Committees, who oversee management's responsibility to prevent and detect fraud from occurring. Many of our stakeholders fed back that there should be a greater focus on regulating the internal control requirements relating to fraud at an entity, which then auditors could address as part of an extended audit scope if external assurance on this is desired.

#### *Going Concern*

The AUASB acknowledges that an expectation gap in relation to going concern exists, and the IAASB need to carefully identify the root-causes to ensure that any proposed amendments to auditing standards and / or other requirements address this. Care should be taken to ensure that any additional measures are effective in reducing the expectation gap but that these do not result in an unacceptable increase in audit effort. Like our comments on fraud above, the expectation gap relating to going concern cannot be addressed by auditors alone. The IAASB is strongly encouraged to work with all parties in the financial reporting ecosystem to determine how to reduce the expectation gap in relation to going concern.

The AUASB consider that the first priority which will assist in reducing the expectation gap in relation to going concern is to address the reporting requirements relating to going concern in the Accounting Standards. Management and TCWG have primary responsibility for going concern assessments and informing users about the risks of the entity. Ensuring the entity's reporting requirements are sufficiently robust and understood will assist greatly with addressing the expectation gap in relation to going concern and align the perceptions of users when it comes to work preparers and auditors do in response to going concern considerations.

COVID-19 has put a "spotlight" on going concern and the difficulties in making forward looking assessments and gathering audit evidence in an environment of such high uncertainty as to the future. This has also highlighted the importance of robust going concern assessments and disclosures about uncertainties and key assumptions that management and TCWG have made in forming their conclusions to allow users to understand the uncertainty which exists. We would urge the IAASB to engage with the IASB, and other relevant stakeholders, on how the reporting and auditing requirements relating to going concern can be better aligned.

The AUASB's detailed responses to the specific questions asked in the Discussion Paper accompany this letter as Attachment 1 for Fraud and Attachment 2 for Going Concern.

Should you have any queries regarding this submission, please do not hesitate to contact Matthew Zappulla at [mzappulla@auasb.gov.au](mailto:mzappulla@auasb.gov.au).

Yours sincerely,

A handwritten signature in black ink, appearing to read "R. Simnett". The signature is written in a cursive style with a large initial "R" and a stylized "S".

Professor Roger Simnett AO  
Chair

## Attachment 1 - Fraud

### 1. In regard to the expectation gap:

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

##### *Knowledge Gap*

Contention persists around the expectation gap between what users of financial statements expect an auditor to provide and what auditors are required to provide under statutory obligations when it comes to the auditor's role in preventing and detecting fraud. In part the knowledge gap exists because users of the financial statements (e.g. investors) believe that auditors should be able to detect all material fraud. That is, they do not have enough understanding of the complexities (i.e. intentional behaviours, collusion) that usually exist when a sophisticated fraud is perpetrated, and therefore the difficulties encountered by auditors in detecting fraud. The IAASB could work with the international investor community to further educate both institutional and retail investors in this area.

Most stakeholders agreed that the knowledge gap contributes significantly to the expectation gap, but it is not the only factor to consider. Other auditing and assurance concepts relating to fraud, such as the different levels of assurance (i.e. reasonable and limited), materiality, risk-based auditing, and sampling can be very difficult for users to comprehend. Understanding these concepts and the implications of them for audit engagements requires in-depth technical knowledge of auditing. This contributes to the knowledge gap of what the public expects from auditors. The knowledge gap is always going to be challenging to address, however through improved communication of these concepts in the audit report (for example, using Key Audit Matters (KAMs)) and other communication strategies there are other ways this could be addressed by the IAASB.

Another factor that may contribute to the knowledge gap is that some of the public's expectations of auditors in relation to fraud are developed without any consideration of a cost-benefit analysis. Without determining the true cost of meeting any increased expectations, and who is expected to address them, it is difficult to talk about the expectation gap in a practical sense. To enable meaningful discussions about practically addressing user expectations, a proper cost-benefit analysis is required for any additional measures to address the fraud knowledge gap.

##### *Performance Gap*

The view of the AUASB and its stakeholders is that the current fraud standard, ISA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of a Financial Report*, remains fit for purpose and does not require a fundamental overhaul. Enhancing the requirements of this standard is one possible course of action the IAASB could take to address the drivers of the performance gap, but our consultations on this topic did not see it as the only approach. Feedback we received indicated the responsibility to address issues associated with the performance gap spreads across multiple parties in the financial reporting eco-system.

In particular, a key part of addressing the fraud performance gap lies with management and those charged with governance (TCWG) and their role to implement and manage relevant governance, culture, risk management and internal control requirements that fulfil their obligations to prevent and detect fraud. The AUASB's outreach noted that any changes to the auditor's responsibilities to respond to fraud risk needed to be aligned to commensurate responsibilities for management and TCWG. This could also be supported through further reporting by TCWG on fraud in their attestation requirements, such as the Directors' Declaration which accompanies an entity's financial report and is audited as part of the financial statements in Australia, or similar Director responsibility statements used in other jurisdictions.

Stakeholders agreed that corporate culture has a significant impact on the likelihood of fraudulent financial reporting. Further consideration on governance and integrity around internal controls and the

impact on culture and behaviour, as lines of defence in the prevention and detection of fraud should be given high priority. Of equal importance is TCWG's responsibility for creating and maintaining a corporate culture and identity conducive to integrity, as well as implementing and overseeing adequate controls to mitigate the risk of management override.

### *Evolution Gap*

The AUASB and its stakeholders noted that the expectations of users and entities relating to fraud may have changed due to the increased use of specialist technological tools and techniques (e.g. data analytics and other data mining tools). Considering how the use of technology is now more likely to be included in a firm's audit methodology and the way firms use technology on an audit has evolved, then this is an area which could be better reflected through a modernisation of ISA 240.

However, our outreach noted that the adoption of specialist technological tools and techniques by auditors when it comes to addressing fraud prevention and detection is not as widespread as many may believe, as the investment in infrastructure and training to effectively apply technology on audits is still significant. Accordingly, any suggestion that the better adoption of technology is the sole solution to address the evolution gap is misplaced.

### ***(b) In your view, what could be done, by the IAASB and / or others (please specify), to narrow the expectation gap related to fraud in an audit of financial statements?***

The AUASB encourages the IAASB to explore ways in which the auditor can better engage with the users of the audit report, both in terms of exploring the scope of the audit and through other forms of communications e.g. annual report. Broader engagement outside of the auditor's report may be a more effective way to promote a better understanding of what an audit is and provide an opportunity for auditors to "educate" users as to what it is they do. This would also provide more information to auditors about how users consider the audit may evolve to start to narrow the evolution gap, bearing in mind trade-offs around cost and benefit. This could be achieved through an IAASB staff paper about the role of those parties that comprise the whole of financial reporting ecosystem. The focus would include the role of TCWG and management, reporting requirements, what an audit is and is not, auditors' responsibilities, common terminology e.g. materiality and the gaps that have been identified through the research phase of this project, and how the IAASB and other parties may look to address these gaps for the users of the financial statements.

Our stakeholders felt there could be an opportunity to simplify language in the auditing standards, as well as the use of more practical examples. The AUASB note however that the use of examples for principles-based standards should not be over simplified. These examples may be best placed in the Appendices to the standard or guidance. Some of the language and requirements are complicated, which allows auditors to hide behind complexity at times.

It was strongly acknowledged by our stakeholders that one way to address the performance gap relating to fraud would be to improve the education and professional training requirements auditors undertake. Educators (i.e. Universities and Professional Accounting Bodies) play a significant role in ensuring that our next generation of auditors are appropriately trained in the application of fraud risk assessment, forensic skills and applying a sceptical mindset. This is the case at both the undergraduate level and as part of the ongoing training and development auditors undertake in these areas once they join the profession. The AUASB received feedback that auditors' skills in fraud detection could be enhanced throughout each stage of their formative and continuing professional development. Our stakeholders communicated that the performance gap could be reduced by identifying better ways to share knowledge and experience from more senior team members with students and less experienced staff about how to appropriately respond to fraud throughout the audit process. This coupled with a greater degree of supervision and involvement by senior team members throughout the audit engagement in this area would assist in reducing the performance gap.

## 2. *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?***

Overall the AUASB and its stakeholders believe that the current version of ISA 240 remains adequate and fit for purpose and does not require a fundamental overhaul. The IAASB as part of its root cause analysis (through targeted research) of the drivers of the expectation gap can further evidence this position. It is the AUASB's view that the current requirements of ISA 240 are sufficient, and that the instances of material fraud which draw attention to the audit profession are a very small proportion of the total number of financial statement audits conducted internationally each year.

The issues our stakeholders identified are more about perceptions others have about the performance and evolution gap, and whether auditors are adequately trained in identifying material fraud.

Some areas highlighted for possible consideration by the IAASB for enhancement in ISA 240 include:

- closer links to ISA 540 *Auditing Accounting Estimates and Related Disclosures* and management bias for complex accounting estimates;
- improvements on the requirements around gaining an understanding on where fraud could occur (practical case studies) – identifying fraud risk factors and not just in the area of revenue recognition and/or journal entries;
- more guidance on how “unpredictable audit procedures” address fraud risk; and
- what is required of the auditor when fraud is detected and the impact on the planned audit approach which includes links to ISA 250 *Consideration of Laws and Regulations in an Audit of a Financial Report* and ISA 260 *Communication With Those Charged With Governance*.

With technological advances there may be a greater capacity to detect fraud through data analytics and other analytical tools. The AUASB encourages the IAASB to consider how auditors can better employ emerging technologies to enhance auditor performance regarding fraud as part of the IAASB's Technology working group project. Feedback from our stakeholders is that the IAASB's initiative to provide non-authoritative guidance on how auditors may use technology in harmony with auditing standards can be particularly helpful in this area. However, it was also noted that technology is not a universal remedy for this issue - an important human element also comes into play. There is an opportunity for all involved - management and boards, auditors and regulators - to focus more on corporate culture and behaviours to support fraud detection. Appropriate risk identification and in-depth knowledge of the entity, its industry and the environment it operates in are required to observe fraud-indicating red flags and feed into a fraud risk assessment process, and it is unrealistic to expect the auditor alone can be responsible for all of these aspects.

Consistent views were also expressed by stakeholders in the area of the evolution of the financial statement audit alongside the expectations of the general public and entities on the use of technological advances e.g. data analytics and other data mining tools to enhance the audit and add more value. At the same time, auditors still face challenges when it comes to acquiring and analysing the relevant data from companies, either due to systems infrastructure, formatting issues, or data privacy rules. If the use of technology is now more deeply embedded in audit methodology and the way firms conduct an audit has evolved, then this may be an area which could be better reflected through a modernisation of ISA 240.

### ***(b) Is there a need for enhanced procedures only for certain entities or in specific circumstances? If yes, in what areas?***

The AUASB is of the view that if the IAASB decide to enhance fraud procedures under ISA 240, these would need to apply to all entities in all circumstances and not just listed or public interest entities. It would not assist in closing the expectation gap if different levels of audit requirements were applied to different entities based on different characteristics, In fact this approach is likely to have the opposite

effect and increase the knowledge gap around understanding the level of assurance a financial statement audit provides to the users.

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

See comment at 2(b).

**(ii) What enhancements are needed?**

See 2(a) above.

**(iii) Should these changes be made within the ISAs or outside the scope of an audit (e.g., a different engagement)? Please explain your answer.**

No comments. Refer 2(a) for suggested changes within ISA 240.

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

On the whole, the AUASB and its stakeholders did not agree that requiring a “suspicious mindset” would contribute to enhanced fraud identification when planning and performing the audit. Stakeholders agreed that the profession should try to determine how to better apply professional scepticism and encourage sceptical behaviour in the right circumstances.

Stakeholders perceived there to be a cultural aspect to audit team members being able to understand and implement the difference between suspicious mindset and professional scepticism. It is difficult to adopt a sceptical mindset – it is a behaviour that comes with experience and application in challenging, not just corroborating the evidence (i.e. it is natural to seek confirming rather than disconfirming evidence; anchoring on client numbers). Hindsight bias is always present in evaluating auditor performance after the fact. There may be a need for involvement from the more senior audit team members in performing work around fraud coupled with effective supervision and review.

Adopting a suspicious mindset may have a detrimental impact on the auditor’s relationship with management, which could in turn impact audit efficiency and effectiveness.

**(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?**

The concept of “suspicious mindset” being introduced to contribute to enhanced fraud identification was not strongly supported by the AUASB or its stakeholders, as they felt that professional scepticism was sufficient in the audit of the financial statements and more widely understood and defined concept in the auditing standards. It was also noted that professional scepticism is still in the process of being properly embedded throughout all areas of the financial statement audit through the recent changes to ISAs and relevant application material and guidance.

**(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.)?**

The AUASB and its stakeholders have mixed views about increasing transparency in relation to fraud with TCWG and/or in the audit report. It was strongly agreed by stakeholders that if the auditor were required to disclose more in the audit report about the audit procedures undertaken in relation to fraud that this would be coupled with more transparency around the responsibilities of management and TCWG in relation to the prevention and detection of fraud. This may be achieved in Australia through the director’s declaration or the equivalent Director responsibility statements used in other jurisdictions.

Some stakeholders called for greater transparency from auditors in relation to identified significant controls' deficiencies and weaknesses. Views were expressed that it may be appropriate for auditors to report significant internal control deficiencies as a KAM in the audit report.

Others called for additional information to be disclosed by management, e.g. management assessment of risk of fraud. Such additional information, where relevant, could prompt commentary from auditors in their report. Requiring disclosure of materiality judgements in the auditor report was another suggestion. However, there were also opposing views were that auditor reports are already too long and too difficult to understand. Concerns were also raised about the possible increase in auditor liability if including more in their audit report.

There was consensus however that if there is more to be said in the auditors' report it has to be bespoke and tailored to the audited entity and not 'boiler plate' statements with little specificity to the entity.

**3. *Are there any other matters the IAASB should consider as it progresses its work on fraud in an audit of financial statements?***

No further matters for IAASB consideration that have not been discussed elsewhere in the submission.

**Other perspectives raised in the Fraud section of the Discussion Paper**

***The IAASB is interested in perspectives about the impact of corporate culture on fraudulent financial reporting and what, if any, additional audit procedures for the auditor should be considered by the IAASB in this regard.***

Overall the AUASB and its stakeholders agreed that corporate culture has a significant impact on the likelihood of fraudulent reporting and further consideration on the governance and integrity of internal controls that impact an organisation's culture and behaviour, as lines of defence in the prevention and detection of fraud, should be given high priority. Of equal importance is TCWG's responsibility for creating and maintaining a corporate culture and identity conducive to integrity, as well as implementing and overseeing adequate controls to mitigate the risk of management override of controls.

The links between fraud and the way senior executives are incentivised in the short term and how this may encourage more risk-taking behaviours which may not be in the longer term interests of the entity and its shareholders, continues to be an area of focus and priority for regulators and Boards internationally. Users of the financial statements (particularly shareholders) require further education and understanding on the three sides of the fraud triangle - opportunity, pressure and rationalisation and that 'incentive' for management to undertake fraud has been increasing over time based in part on the shareholders desire to have a growing proportion of their remuneration tied to shareholder returns. In this scenario well intentioned alignment of interests can lead to adverse consequences. Noting in Australia that the remuneration report of a listed entity is audited annually and is voted upon by shareholders for approval at the Annual General Meeting, there may still be scope to enhance the ability to detect fraud and focus on this complex area by the auditor when considering identification of material audit risk factors.

***The IAASB is interested in perspectives about requiring the use of forensic specialists or other relevant specialists in a financial statement audit, and, if considered appropriate, in what circumstances the use of specialists should be required.***

Overall there was not strong support by the AUASB for forensic specialists to be required to be used under ISA 240. The main reason being the cost vs benefit to the entity. It was generally agreed that the decision to use specialists, forensic or otherwise should still be a decision for the engagement partner based on the circumstances of the engagement.

Stakeholders agreed that bringing fraud specialists in as part of the engagement team fraud discussion to assist with identifying risk assessment and understanding the entity and the possible fraud schemes



that could be perpetrated may be useful. However most agreed that upskilling auditors in forensic techniques is a better option and the engagement of forensic experts should only be considered necessary when issues of fraud are identified.

***As the world is changing and non-material frauds are becoming more prevalent, the IAASB would like to explore whether more needs to be done in relation to non-material frauds identified. As such, the IAASB is interested in perspectives about the perceived responsibilities of the auditor regarding non-material fraud in a financial statement audit (i.e., a broader focus on fraud) and what additional procedures, if any, may be appropriate. The IAASB is also interested in perspectives about whether additional audit procedures should be required when a non-material fraud is identified, and if so, what types of procedures.***

The AUASB do not consider additional procedures relating to the auditor's responsibilities to identify and address non-material fraud are necessary. Some of our stakeholders considered there could be better guidance for auditors on how to deal with the cumulative impact of non-material fraud across multiple years (i.e. the impact in each year might not be material, while the cumulative total could be material), and the need to consider non-material fraud when evaluating internal controls at an entity that may be systematic, but there was no call to extend the auditor's existing responsibilities to include more relating to non-material fraud in ISA 240 or other auditing standards.

***The IAASB is interested in perspectives on whether enough emphasis is placed on the auditor's responsibilities around fraud related to third parties. We are also interested in feedback about the auditor's role in relation to third party fraud that does not result in a material misstatement of the financial statements but may have a severely negative impact on the entity (e.g., cybercrime attacks).***

The AUASB consider fraud related to third parties an emerging issue that requires further attention. Even though third-party fraud (e.g. cybercrime) engagements are generally undertaken as a separate engagement from the financial statement audit, the point of convergence and impact on the financial statement audit and fraud risk assessment cannot be underestimated. The potential impact to an entity from cybercrime and the risk of fines/penalties, impact on business operations and cash flows and therefore asset values mean this should be assessed as part of the audit as part of the entity's risk assessment and internal controls evaluation under ISA 315.

Stakeholders generally agreed that this is a significant and growing area that many auditors would not be appropriately equipped to understand the risks. An auditor may be aware of cybersecurity fraud risks at a high level however may not necessarily know when to engage an expert or even adequately identify and rate the risks. We would support activities which consider further how the assessment of fraud controls at an entity is impacted by third party fraud related issues like cyber controls by both the entity and the financial statement auditor.

***The IAASB is interested in perspectives on whether additional engagement quality control review procedures specifically focused on the engagement team's responsibilities relating to fraud should be considered for audits of financial statements of listed entities, and those other engagements, if any, for which the firm has determined an engagement quality control review is required.***

Overall the AUASB do not support additional engagement quality control review procedures for EQR's in relation to fraud, as it was felt that the recently revised ISQM 2 *Engagement Quality Reviews* standard has adequate procedures and guidance in this area.

#### **Other matters relevant to Fraud**

***The IAASB is interested in perspectives about whether more is needed related to professional scepticism when undertaking procedures with regard to fraud and what additional procedures, if any, may be appropriate.***

Stakeholders noted that requirements around application of professional scepticism, in particular when determining the nature and extent of audit evidence required appear to be increasing. The AUASB notes this point but considers the existing requirements in ISA 240 relating to professional scepticism are appropriate. We would however acknowledge and support the measures the IAASB are intending to undertake on this topic in connection with the revision of ISA 500 *Audit Evidence*.

***The IAASB is interested in perspectives about whether more information is needed in the auditor's report regarding fraud, and if so, further details about the transparency needed.***

- See comments at Question 2(d).

***In addition, the IAASB is interested in perspectives about whether more transparency is needed with regard to communications with those charged with governance.***

Whilst the primary responsibility for responding to fraud risks rests with the entity, the audit profession needs to consider how it can undertake measures designed to address the audit expectation gap. It was consistently acknowledged throughout our outreach on this topic that extending the auditor's responsibilities alone will not be effective. The AUASB would support measures that increase an entity's transparency about their governance processes and internal controls related to fraud prevention and detection. This could be either under separate reporting obligations, as part of the existing audit framework or potentially as a separate assurance engagement independent of the current financial reporting assurance process.

Also, the AUASB and stakeholders agreed that if enhancements were made relating reporting to TCWG in ISA 240, these need to be appropriately linked to requirements in ISA 250 and ISA 260 so that efficiency, effectiveness and consistency is maintained across the requirements in the suite of ISAs.

## Attachment 2 - Going Concern

### 1. *In regard to the expectation gap:*

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

The AUASB acknowledges that an expectation gap in relation to going concern exists, and the IAASB needs to carefully identify the root causes to ensure that any proposed amendments to auditing standards and / or other legislation address these, are effective in reducing concern and do not simply increase audit effort. The expectation gap cannot be addressed by auditors alone. The IAASB is encouraged to work with all parties in the financial reporting ecosystem to determine how to reduce the expectation gap in relation to going concern.

A driver of the debate in relation to going concern appears to be media reporting of high profile international corporate failures where there is a perception the market was not fully informed of the factors that ultimately resulted in the entity failing. Many of these appear to be the result of irregularities in accounting and fraud resulting in unreported financial losses, disguising the true financial position and risks of the entity. An efficient market presumption is that a portion of entities will fail, and any solutions contemplated by the IAASB regarding going concern should be mindful of this fundamental market presumption. Various mechanisms within the ecosystem should provide for the market to be informed on a timely basis of going concern risks, such as through timely disclosures in the financial statements or other corporate reporting, to avoid being surprised by a failure.

COVID-19 has put a “spotlight” on going concern and the difficulties in making forward looking assessments and gathering audit evidence in an environment of such high uncertainty as to the future. This has also highlighted the importance of robust management assessments of going concern risk and disclosures about uncertainties and key assumptions that management and TCWG have made in forming their conclusions to allow users to understand the risks and uncertainty which exists.

#### *Knowledge gap*

We consider the expectation gap to contain a knowledge gap due to users not fully understanding management, TCWG and auditor’s differing responsibilities for maintaining the entity as a going concern, a once a year going concern assessment and reporting thereof, and for ensuring there are fulsome and timely disclosures of key judgements and risks. Users also may not understand what a going concern assessment is, and the auditor’s responsibility to conclude on the appropriateness of management’s use of the going concern basis of accounting does not provide a guarantee that the entity will continue to exist until the next audit report is issued. Going concern assessments are forward looking which involves judgement about inherently uncertain future outcomes of events or conditions. Users’ expectations may not be realistic, however the AUASB consider that more could be done to explain the current responsibilities and provide definitional transparency.

The IAASB is encouraged to further engage with users to understand if further reporting on responsibilities would be beneficial. If the IAASB considers that further reporting on relevant responsibilities may be beneficial, we expect the reporting by the auditor to be aligned with proportionate reporting by management / TCWG. It is difficult to communicate complex matters such as going concern and audit concepts succinctly so the IAASB is encouraged to carefully evaluate whether any increased reporting will inadvertently increase the expectation gap. Some of our stakeholders also expressed a view that further reporting on going concern matters for all audits when there is no going concern issue, may not be beneficial as users won’t see this reporting as an “alert”.

The current reporting requirements for going concern issues in the auditor’s report is complex and users may not understand and interpret the difference between a MURGC and a KAM, or their importance to their decision making. By way of example, the information required to be communicated in the audit

report if going concern is a KAM is greater than if a MURGC. We have feedback from academic studies that the greater the volume of words in the audit report can be interpreted as the issue having greater importance, however in the case of MURGCs versus KAM this is not proportionate to the relative severity of the issue. The auditing standards note a MURGC is by its nature a KAM. With the background above, in our view this connection confuses the purpose of each, clouds the distinction needed for readers of severity and importance to their decision making, and the resultant volume of communication in the auditor's report should reasonably expected therefore to be consistent, which it is not. The AUASB remains supportive of retaining the separate distinction of MURGC paragraphs as this gives this appropriate prominence in the auditor's report. However, the IAASB should consider if the required reporting of a MURGC should be disconnected from KAMs as a concept and contemplate more balanced qualitative information to be communicated regarding the key factors and the procedures in the audit report. The IAASB can use this feedback to also reflect on the volume of words and communicative expectations for modification to the audit report, in comparison to KAMs as well.

### *Performance gap*

The AUASB considers that there is a performance gap, not only for auditors, but also for preparers of financial statements which needs to be addressed through greater education and enhanced Accounting Standard requirements. Whilst acknowledging that auditors could do more to improve how going concern related audit issues are addressed, the AUASB received feedback that the main issue driving the performance gap is the inconsistency in how management / TCWG fulfil their responsibilities when making going concern assessments, and ensuring fulsome disclosure of significant judgements and assumptions to keep users informed on matters relevant to going concern. The Accounting Standards need to be enhanced using a multi-layered approach, covering definitional issues, measurement expectations for a going concern assessment, and more explicit disclosure requirements of key matters relevant to the going concern assessment and whether a MURGC exists.

The Accounting and Auditing Standards should be better aligned. Management / TCWG also need more detailed requirements and / or guidance on how to make going concern assessments including how to identify whether there is a material uncertainty, how to determine if an entity is not a going concern, and a framework for reporting when the going concern basis is not appropriate.

Enhanced reporting by entities on going concern matters will also assist with addressing the knowledge gap as users will be more informed on issues arising, risk factors relevant to going concern, and key judgements made by management / TCWG on which their conclusions were made. By way of compare and contrast, the accounting standards have very few paragraphs relating to the fundamental concept of going concern, and hundreds of paragraphs/pages related to other individualised accounting issues. Given the focus of users on going concern, the importance of the concept to the operation of the capital markets and economic investment, this misalignment needs to be addressed. Refer to question 1b) for more detail.

The AUASB has received feedback and have observed that there are some inconsistencies in how auditors comply with ISA 570 including the reporting requirements which should be addressed. Refer to question 3a) for further detail. However, in our view these are not contributing greatly to the expectation gap in relation to going concern.

### *Evolution gap*

The AUASB agrees that user expectations have evolved and is supportive of further consideration by all parties in the financial reporting ecosystem as to whether the current reporting requirements in the Accounting Standards and other corporate reporting requirements in relation to going concern are fit for purpose, or whether further reporting would be beneficial.

In relation to the time period for going concern assessments, in Australia we have already extended this to approximately 12 months from the date of the auditor's current report to the expected date of the next auditor's report, which is greater than the time period in ISA 570. The AUASB do not support further

extending the time period for going concern assessments beyond our localised position due to the inherent difficulty in obtaining sufficient appropriate audit evidence that provides reasonable assurance on management's assessment and plans over a longer time period. Additionally, extending the relevant period that the auditor needs to assess going concern would also risk increasing the knowledge gap associated with users' understanding of the auditor's responsibilities in this area. And the longer the relevant period after the date of the auditor's report, the higher the likelihood other factors that alter an entity's going concern assessment may occur, such as unanticipated changes in economic conditions or market activity.

The AUASB considers that reporting by entities on other concepts of resilience and longer-term viability should be explored further. Now is an appropriate time to consider if reporting by entities on longer term viability would be of more value than the current going concern assessments alone. Then there should be a careful consideration as to the auditor's responsibility to provide a level of assurance or read and consider (other information) on this type of reporting.

***(b) In your view, what could be done, by the IAASB and / or others (please specify), to narrow the expectation gap related going concern in an audit of financial statements?***

All parties in the financial reporting ecosystem have a responsibility and role to play in high quality financial reporting of which going concern assessments and disclosures are critically important. The IAASB is encouraged to engage with parties in the financial reporting ecosystem to identify the root cause of and address any concerns holistically.

Management and TCWG are responsible for managing the entity in their day-to-day decisions to ensure the entity remains a going concern, annual going concern assessments supporting the preparation basis of their annual financial statements, and the related disclosures to inform users of their circumstances. We have received feedback that the responsibilities for going concern assessments and disclosure requirements in the financial statements are not consistently understood and / or applied by management and TCWG. There is variability and inconsistency in the robustness of these assessments and the quality of relevant financial statement disclosures.

As detailed in our response to question 1(a) the IAASB is encouraged to engage with the IASB in relation to more granular requirements in the Accounting Standards for management and TCWG given the fundamental criticality of this subject matter. This should include:

- Reconsider the definition of going concern and whether it remains fit for purpose.
- Provide guidance on qualitative and quantitative factors to consider when interpreting the going concern definition. The existing 3 limb definition "intention to liquidate, intention to cease trading, or no realistic alternative but to do so" remains open to significant interpretational differences and in the absence of guidance or tests to meet these limbs, inconsistency prevails. Modern markets have a range of entity status, from the advent of 'start-ups', to exploration, to operational, to run-off, to closure, to dormant. The existing definition of going concern provides little to no context to this range and the variability of criteria applicable when assessing an appropriate basis of preparation, such that users understand the risks.
- Minimum requirements on how to perform robust going concern assessments and quality of sources of information underlying these. We consider liquidity to be a key feature of assessments and the expansion of these concepts to be useful for preparers. The critical importance of quantifiable measurement criteria has the opportunity to move going concern disclosures to beyond the preparer's desired story or attestations about their business, to true insights on the business model and its risks. Similar to other Accounting Standards, this allows a clear pathway for preparers to aim for, ie compliance with the standard, by meeting those measurement/minimum requirements, and auditors to assess against. If the Accounting Standards have not then been followed, the auditor has a basis for communicating the non-

compliance, in a similar manner to, for instance non-compliance with other financial statement account items.

- Explicit financial statement disclosure requirements for all scenarios on the spectrum of risk i.e.:
  - where there is a very limited risk in relation to going concern;
  - there are indicators of a going concern risk however a MURGC does not exist;
  - a MURGC exists and the key events which resulted in this conclusion; and
  - the going concern basis of preparation is not appropriate.

The nature of financial statement disclosures to be considered should extend to recent experience of indicators of stress, calculated from the last financial year results, to risks impacting the going concern forecast period. Readers could benefit from more granular indicators to draw a picture of the business model, risks and dependencies, such as days outstanding creditor payments, loss of key customers etc, as they impact recent results and forecast amounts. Key indicators such as these are used by our stock exchange to assess the spectrum of risks.

- The standards to include adequate and consistent definitions for a MURGC and the inability to continue as a going concern, and guidance to support more consistent application of these concepts.

We also consider that it is important that the IASB provide guidance on an alternate basis of preparation when the going concern basis of accounting is not appropriate.

We encourage further engagement with user groups to ensure their views are understood and addressed where practicable and realistic. This should include understanding whether reporting on other concepts of resilience and longer-term viability would decrease the knowledge gap. The IAASB is also encouraged to engage with TCWG about the type of reporting on longer term business strategy, going concern and viability that they believe they can meaningfully provide given the inherent difficulties in predicting the future.

The IAASB also need to engage with regulators as to their observations on what has gone wrong and how auditor's procedures may need to be enhanced.

### ***3. 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?***

The AUASB consider that the priority is to address the reporting requirements in the Accounting Standards. Management and TCWG have primary responsibility for going concern assessments and informing users about the risks of the entity. Ensuring the entity's reporting requirements are sufficiently robust and understood will assist greatly with addressing the expectation gap in relation to going concern.

We are aware that the UK FRC have recently enhanced their equivalent ISA 570 to include more requirements for the auditor in areas such as risk assessment, evaluating management's assessment, considering management basis, and reporting. The AUASB does not believe that ISA 570 needs urgent enhanced or more requirements in the absence of addressing the opportunity to provide clarity to preparers, via the Accounting Standards. Symmetry in definitions, interpretations, and tests in the auditing standards can be achieved thereafter. In the meantime, we are supportive of the IAASB considering if minor amendments to address internal inconsistencies or amplify guidance may result in more consistent application by auditors.

The AUASB has received feedback that enhanced guidance for auditors on how to apply ISA 570 would be beneficial, as follows:

- Clarify the obligation of auditors, and the level of assessment – current terminology in the objective of ISA 570 is to assess basis of preparation, elsewhere language references assessing management’s assessment of going concern. Is the terminology in the ISA “assess ability to continue as a going concern<sup>1</sup>” the same or different to “conclude on the appropriateness of management’s use of the going concern basis of accounting<sup>2</sup>”? As detailed in your Discussion Paper, there are different views about whether the auditor’s responsibilities include reporting on the entity’s going concern status. It is important that this is clarified for auditors and users.
- How to conduct risk assessment procedures, using ISA 315 revisions as an opportunity to reorient ISA 570 to the new risk assessment approach. This could also be an opportunity to re-think the terminology ‘that may cast significant doubt over going concern’ as this is another concept in ISA 570 that appears to be used with alternate nuances in the Accounting Standards, is likely designed to be a risk assessment gateway, but is not well understood or applied consistently. We recommend exploring whether going concern risks be a more aligned concept. This may also have utility when referencing the assessment for a MURGC, or in the longer term in collaboration with the Accounting Standards setters, whether this style of terminology and risk scale may be a modernised replacement for the MURGC concept.
- More guidance on how to evaluate management’s assessment of the entity’s ability to continue as a going concern. We note that the ISA (UK) 570 includes more prescription on how to perform this assessment which would be helpful for auditors as guidance.
- More guidance to assist auditors on how to assess the factors that exist and to interpret evidence when concluding on whether a MURGC exists or that the going concern basis of accounting is not appropriate.

The AUASB staff have conducted research on auditor reporting during the COVID-19 pandemic including how going concern matters have been reported. [Refer to the AUASB Research Report 5 COVID-19 Snapshot of Auditor Reporting in Australia](#). When conducting this research, we observed some instances where going concern reporting has not been in accordance with the Auditing Standards, possibly driven from the unnecessary complexity in the Auditing Standards. This is consistent with feedback we have received that the auditor reporting requirements are complex and should be evaluated to consider if they could be simplified. The 2016 new layers of reporting, including modifications, MURGCs, EOMs, Other Matter Paragraph (OMP) and Other Information (OI) etc have caused confusion in users and auditors. The post-implementation review of these standards by the IAASB is timely to connect these issues.

We have also received feedback from auditors that further guidance in evaluating what type of modified opinion to provide in what circumstances would be beneficial. The considerable disruption to the Australian economy during the COVID-19 pandemic highlighted practical challenges for auditors when there is considerable uncertainty as to the future and how to assess if the auditor has sufficient evidence to conclude that the use of the going concern basis of accounting is appropriate, versus that there is sufficient evidence that the entity cannot support a going concern basis of preparation. There is little guidance on how an auditor interprets the evidence they do have, where there is market uncertainty, to form a view, versus the desire for more persuasive evidence, where there is market uncertainty, and how this impacts the obligation to gather sufficient appropriate evidence. This determination is critical as it could be the difference between a disclaimer of opinion or an adverse opinion. Currently in the absence of guidance this assessment is prone to varying interpretations and further guidance is required to support auditors in making these judgements and to result in consistent interpretation.

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<sup>1</sup> ISA 570 paragraph 12

<sup>2</sup> ISA 570 paragraph 17

The AUASB also encourage the IAASB to consider if and how data analytic and other tools may assist such as those that predict financial stress/bankruptcy.

**(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?**

The AUASB believe that responsibilities and procedures in relation to going concern should be consistent for audits of all entities. The going concern basis of accounting is a fundamental concept in the preparation of the financial statements and this does not differ or become more or less important depending on the type of entity.

**(ii) What enhancements are needed?**

Refer 3b.

**(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.**

Refer 3b.

**(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.)?**

Overall, we received mixed views from stakeholders about whether increasing transparency in relation to going concern in the auditor's report would assist in reducing the expectation gap. As detailed in question 1, the AUASB do consider that there is a knowledge gap which could be addressed by further transparency about the auditor's work in the auditor's report. However, we encourage the IAASB to further engage with users as to whether more reporting about the auditor's work in relation to going concern would be beneficial. More reporting could be about the auditor's responsibility in relation to going concern and how they have fulfilled this for all audits, and / or more reporting if going concern is a KAM or a MURGC. However, if the auditor is required to disclose more in the audit report about the auditor's responsibility or audit procedures undertaken in relation to going concern this should be fully aligned with the reporting of management's and TCWG's responsibility so as to not further increase the expectation gap. We note the competing issues that more transparency leads to more words, with the risk this reduces understandability or readability of the auditor's report.

Also as detailed in question 1 the AUASB have received feedback that reporting on going concern matters if going concern is a KAM verses MURGC, needs to be reconsidered.

The AUASB considers the current communications to TCWG are sufficient.

**(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?**

The AUASB considers more transparency in the financial statements about an entity's going concern assessment is critically important and it is the most urgent matter to be addressed. The AUASB considers that if the Accounting Standards are not enhanced, increased transparency by the auditor will not address the going concern expectation gap.



As detailed in our response to question 1(a) and 1(b), the IAASB is strongly encouraged to further engage with the IASB in relation to more granular requirements in the Accounting Standards for management and TCWG given the fundamental criticality of this subject matter.

We also consider that the IAASB should encourage the IASB to provide guidance on an alternate basis of preparation when the going concern basis of accounting is not appropriate.

**4. *Are there any other matters the IAASB should consider as it progresses its work on going concern in an audit of financial statements?***

The AUASB and NZAuASB have recently re-issued our equivalents of ISRE 2410 with the objective of aligning the auditor's review report to the year end auditor's report. As part of this, our intention was to include a description of the auditor's responsibility in relation to going concern in the auditor's review report, however we found it very difficult to articulate this in a concise manner without further exacerbating the expectation gap that exists on the scope of a limited review engagement. Through this we realised that there are differing views as to the auditor's current responsibility in ISRE 2410, and questions as to whether the current standard is fit for purpose.

We strongly encourage that the IAASB update ISRE 2410 to clarify the auditor's responsibility for going concern in the performance of an interim review. With the changes in 2016 to ISA 570 to explicitly perform reasonable assurance procedures to enable an explicit conclusion on the appropriateness of the use of the going concern basis of accounting, an unanswered question is the expectation of users then on the role of limited assurance. This is also relevant when considering the time frame of the assessment performed as part of the annual audit. However, this needs to be carefully balanced with the overall auditor's responsibilities and objective of a limited review engagement.

In Australia we have included a flowchart *Linking Going Concern Considerations and Types of Audit Opinions* as an appendix to ASA 570. We have received considerable positive feedback from auditors that this is extremely beneficial in navigating the complex reporting requirements in ASA 570. We recommend that the IAASB include an equivalent flowchart as an appendix to ISA 570.

**Other perspectives raised in the Going Concern section of the Discussion Paper**

***The IAASB is interested in perspectives on whether entities should be required to assess their ability to continue as a going concern for longer than twelve months, and therefore whether auditors should be required to consider this longer time period in their assessment, beyond the current required period. If stakeholders believe a longer timeframe should be required, alignment will need to be retained between the requirements under the applicable financial reporting framework and the auditing standards in order for auditors to be able to adequately perform their procedures.***

In Australia we have already extended the time period for the auditor's assessment beyond ISA 570 to at least approximately 12 months from the date of the auditor's report to the expected date of the next auditor's report. Auditors are also required to request management and TCWG to extend their assessments to align with the auditors. The AUASB do not support further extending the time period for going concern assessments beyond our localised position due to the inherent difficulty in obtaining sufficient appropriate audit evidence on management's assessment and plans over a longer time period. If there is a need to provide more information to users on longer term risks to the viability of an entity this may be better achieved through careful consideration as to longer term reporting such as Resilience or Viability Statement. We recommend the IAASB consider extending the ISA 570 time period to our localised Australia position, of at least approximately 12 months from the date of the auditor's report to the expected date of the next auditor's report.

***The IAASB is interested in perspectives about whether changes are needed with regard to going concern and other concepts of resilience (within the purview of the IAASB's remit).***

There is acknowledgement that the public expectation in relation to going concern has evolved and the AUASB is supportive of consideration as to whether more reporting by entities on other concepts of resilience and longer-term viability would be beneficial to users. The IAASB is encouraged to further engage with users and TCWG about the type of reporting that would meet user needs, balanced with what TCWG believe they can meaningfully provide given the inherent difficulties in predicting the future.

This reporting could either be in the financial statements which would require the IAASB to include in their standards, or outside the financial statements and legislated through another mechanism. Then consideration as to the auditor's responsibility and to the level of assurance provided or read and consider for inconsistencies (ie. Other information).

***The IAASB is interested in perspectives on what more is needed to narrow the knowledge gap with regard to the meaning of material uncertainty related to going concern, to enable more consistent interpretation of the concept.***

The AUASB consider that there needs to be a consistent and aligned definition and guidance in the Accounting and Auditing Standards in relation to a MURGC to assist with consistent interpretation by management, TCWG and auditors. The IAASB should also receive feedback from users as to whether the current reporting requirements are effective in communicating going concern matters. In particular whether users understand what a MURGC is, and how this conclusion is different between a MURGC and a KAM. Refer to question 3a where we recommend the IAASB consider how ISA 570 can be enhanced and aligned with ISA 315 and to re-think the terminology used including MURGC.

***In addition, the IAASB is interested in perspectives about whether the concept of, and requirements related to, a material uncertainty in the auditing standards is sufficiently aligned with the requirements in the international accounting standards.***

The Accounting and Auditing standards are not currently aligned and this needs to be addressed. Disclosure requirements should be mandated by Accounting standards and the Auditing standards should require the auditor to conclude if the financial statements have been prepared, in all material respects, in accordance with the financial reporting framework. Refer to question 1b for further details.

#### **Other matters relevant to Going Concern**

***The IAASB is interested in perspectives about whether more is needed related to professional scepticism when undertaking procedures with regard to going concern and what additional procedures, if any, may be appropriate.***

The AUASB agrees with the IAASB that merely asking auditors to be "more sceptical" is not effective in driving behavioural change. Overall the AUASB do not consider that there needs to be additional procedures around professional scepticism and going concern in ISA 570.