

1 February 2021

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Dear Willie,

IAASB Discussion Paper: Fraud and Going Concern in an Audit of Financial Statements

Thank you for the opportunity to comment on this Discussion Paper (DP). We submit the feedback from the New Zealand Auditing and Assurance Standards Board (NZAuASB).

The External Reporting Board (XRB) is a Crown Entity responsible for developing and issuing accounting and auditing and assurance standards in New Zealand. The XRB's outcome goal is to contribute to the creation of dynamic and trusted markets through the establishment of an accounting and assurance framework that engenders confidence in New Zealand financial reporting, assists entities to compete internationally and enhances entities' accountability to stakeholders. The NZAuASB has been delegated responsibility by the XRB for developing and issuing auditing and assurance standards.

The NZAuASB commends the IAASB's initiative to explore ways to narrow the expectation gap on these two important topics in its role as the standard setter while also highlighting the role of all participants in the financial reporting ecosystem. The NZAuASB strongly agrees that all participants in the financial reporting ecosystem have an important role to play to narrow the expectation gap and build trust in reporting. We consider that matters related to both fraud and going concern are a responsibility of the whole of the financial reporting ecosystem and that changes to the auditing standards cannot address the expectation gap on their own. The NZAuASB is supportive of the IAASB's DP to inform a public debate with all participants in the reporting ecosystem, to clarify the respective roles and responsibilities of all participants relating to fraud and going concern. We support the IAASB exploring what is realistically expected from auditors in the public interest, together with the associated costs of those expectations, to enable a robust cost-benefit analysis to inform any proposed changes to the auditing standards in a targeted cost-effective manner.

The New Zealand context

In New Zealand, there has been a co-ordinated effort between the New Zealand Accounting Standards Board (NZASB) and the NZAuASB to consider matters related to going concern. In February of 2020, the two boards held a joint meeting to explore going concern matters specifically. Further prompted by the COVID-19 pandemic and growing calls for additional reporting around going concern matters, the NZASB added specific going concern disclosure reporting requirements in New Zealand where an entity's going concern assessment has involved the application of significant judgement and/or the consideration of material uncertainties about the outcomes of future events or conditions, effective for accounting periods ending on or after 30 September 2020. This co-operative approach has informed the response to this consultation paper.

In addition, the NZAuASB considered going concern matters in detail in its project to revise the standard on interim reviews, especially exploring matters related to enhancing communication of responsibilities on

going concern matters in the auditor's report. The learnings from this project also helped to inform the response to this consultation paper.

Outreach

In formulating this response, the NZAuASB hosted a virtual roundtable event, seeking feedback from assurance practitioners, preparers, regulators, professional bodies, academics and investors. The NZAuASB considered the Discussion Paper at recent board meetings. The focus of these discussions was not targeted at less complex entities, in light of the IAASB's separate project for less complex entities. However, any specific matters raised for smaller practices are included in our detailed responses.

Overarching comments


The NZAuASB strongly agrees that the IAASB cannot address the expectation gap on its own and is therefore very supportive of this initiative, with its focus on promoting ongoing co-operation between all participants in the financial reporting ecosystem. The entire ecosystem has an important role to play if the expectation gap is to be reduced for both fraud and going concern matters.

With respect to the auditing standards, the NZAuASB is supportive of an initiative to explore how the fraud standard can be enhanced, albeit in a limited sense, to clarify and enhance auditor responsibility after due consideration of a cost benefit analysis and the impact on audit fees.

In respect of going concern, the NZAuASB recommends that the public interest would be best served by the auditing and accounting standard setters working collaboratively. Enhancing the reporting requirements should be a priority together with ongoing education across the ecosystem of the respective responsibilities. The NZAuASB recommends that the IAASB focus on collaboration with reporting standard setters rather than on the auditing standards in the first instance, because the NZAuASB considers there are limitations on how the auditing standards can be enhanced while the disclosure requirements are not explicit.

Should you have any queries concerning our submission please contact either myself at the address details provided below or Sylvia van Dyk (sylvia.vandyk@xrb.govt.nz).

Yours sincerely,



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Chairman

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Submission of the New Zealand Auditing and Assurance Standards Board

IAASB Discussion Paper: Fraud and Going Concern in an Audit of Financial Statements

1a) In regard to the expectation gap what do you think is the main cause of the expectation gap relating to fraud and going concern in an audit of financial statements?

Response:

The NZAuASB considers the analysis of the various causes of the expectation gap to be helpful and that the knowledge gap, performance gap, evolution gap and hindsight gap are all causes of the expectation gap. However, the Board considers the main causes of the expectation gap relating to fraud and going concern differ.

Fraud

At our roundtable event, most participants, from all stakeholder groups, noted the knowledge gap is a key contributor to the expectation gap. Concepts such as reasonable assurance, materiality, risk-based auditing etc can be very difficult to explain. Understanding the ambiguity in these concepts and the implications of such ambiguity for audit engagements require in-depth technical knowledge of auditing. This contributes to the knowledge gap of what the public expects from auditors. This knowledge gap is difficult to reduce, and cannot be addressed by amending the role and responsibilities of the auditor alone. Some of the participants, primarily academics, further believed that auditors cannot clearly explain what their role is in detecting fraud, and this may also contribute to the knowledge gap.

Another factor that may contribute to the knowledge gap is that some of the public expectations of auditors in relation to fraud are made in a vacuum of a cost-benefit analysis. Without knowing the cost of meeting these expectations, and who is expected to meet them, it is difficult to talk about the expectation gap in a realistic sense. A cost-benefit analysis is needed to enable meaningful discussions about user expectation.

The roundtable participants, from all stakeholder groups, also agreed that there is an evolution gap in relation to prevention and detection of fraud. There may be a place for evolution about what is meant to be reported on, as the economic environment changes. However, it is not solely the responsibility of external auditors. It is vital that all those within the financial reporting ecosystem do their part to meet evolving expectations.

Management and those charged with governance, who hold the primary responsibility for preventing and detecting fraud, have a particularly significant role to play. It would be impractical for auditors to meet these expectations without specific disclosures and statements regarding management's responsibilities for implementing systems that are adequate to prevent and detect fraud. Of equal importance is those charged with governance'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.

At our roundtable event, participants' views were that there is also a performance gap in case of financial reporting fraud perpetrated by senior members of management. ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, clearly stipulates that such instances of fraud should be a key focus for auditors. Instances of major financial reporting frauds must be duly studied, and the lessons learned shared between both auditing standard setters and audit practitioners.

Views were mixed about whether the expectation gap relating to auditor's identification of instances of misappropriation of assets can be attributed to the knowledge gap or performance gap.

It was also noted that audit procedures may not be targeted at detecting fraud. Auditors rarely come across instances of fraud perpetrated by employees in their auditing careers and external audit procedures rarely find actual instances of fraud. This makes training auditors to be good at detecting fraud difficult. Furthermore, most instances of fraud perpetrated by employees are discovered by an entity's system of internal controls (e.g., Internal auditors), not by external auditors and their audit procedures. This is to be expected as detecting small scale frauds requires in depth knowledge of and continuous involvement in the day-to-day activities of the entity. External auditors seldom have such knowledge or involvement in the day-to-day activities of the entity. It may be unreasonable to expect auditors to be more successful at identifying actual instances of misappropriation of assets by employees (other than senior management) than an entity's internal controls.

The auditing standards recognise that management of an entity may conclude that it is not cost effective to implement certain controls (e.g., management accepts the higher risk associated with a lack of segregation of duties)¹. The auditing standards require auditors to mitigate this increased risk of fraud by adjusting their risk assessment. However, it is unclear if it is reasonable to expect auditors to be able to compensate for the inadequate controls with cost-effective audit procedures. Clear communication of such strategic choices and the associated risks by management to those charged with governance, and where appropriate, to users is required if the expectation gap relating to these types of fraud is to be meaningfully narrowed.

Going concern

At our roundtable event, 57% of participants identified the knowledge gap as the main cause of the expectation gap relating to going concern. 10% of participants consider that the performance gap was the main cause, 13% considered the evolution gap the main cause. 20% of participants considered that the knowledge gap, the performance gap and the evolution gap apply equally.

While users of the audit report may want and therefore expect that the auditor is providing a level of confidence in the future viability of the business, auditors are focussed on obtaining evidence related to management's assessment of the use of the going concern basis of accounting. Users' expectations need to be tempered by the limitations on what the auditor can realistically do. (i.e., auditor's are not responsible to provide assurance on the future viability of an entity beyond a reasonable period, especially in light of the scope of an audit and what is currently required to be reported by the preparer under the financial reporting framework).

The NZAuASB considers that there are significant inherent limitations to the level of confidence and assurance that auditors can contribute to reducing users' expectations on matters related to going concern, given that going concern assessments are necessarily forward looking (i.e., involve crystal ball gazing).

Going concern expectations are called into question when an entity collapses or investors lose money. There are various reasons that result in an entity collapsing, including black swan external events or internally generated collapses as a result of poor management and/or weak controls indicative of an incorrect business model or overly aggressive or optimistic risk appetite. In addition, investors also need to understand that in a business cycle there are going to be ups and downs. Auditors are not

¹ Paragraphs A32 and A33 of ISA 240,

responsible for poor management decisions, however, do have a role to play in challenging management on overly optimistic assumptions, in circumstances where management is unwilling to acknowledge, or be transparent, when an entity may be in difficulty. Additional disclosure requirements for preparers are necessary, which may lead to enhanced auditor responsibilities, to address this expectation gap. A co-ordinated reporting ecosystem response is needed.

Developments in extended external reporting (EER), especially EER with a focus on strategy and risk reporting have a longer timeframe perspective and may provide more contextual information about the ongoing viability of a business. Users are increasingly interested in this type of reporting. The evolution in reporting may enable assurance to evolve to better meet users' needs. Reporting requirements of this nature continue to evolve, and in many instances are not mandatory, or do not fall within the scope of the audit. As the EER reporting requirements continue to evolve and entities mature in the controls and reporting process, assurance may be voluntarily sought or required. A cost/benefit analysis will also be necessary to ensure that the benefits of such assurance outweigh the costs.

1b) In regard to the expectation gap 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?

Response:

The NZAuASB strongly agrees with the IAASB's observation that these issues need to be addressed as a whole of financial reporting ecosystem issue in the public interest. The role of the auditor is only part of the solution. The NZAuASB is of the view that without changes related most specifically to the responsibilities of management and those charged with governance in the areas of reporting, risk management and internal controls, any change to the auditor's responsibilities will have little impact.

Fraud

The 'evolution expectation gap' related to fraud will not be narrowed by standard-setting alone—it will require efforts from all participants in the financial reporting ecosystem.

Management and those charged with governance play a key role in preventing fraud by fostering an appropriate corporate culture and implementing effective internal controls. Adopting appropriate strategies for preventing fraud is likely to be far more effective than trying to identify instances of perpetrated fraud.

In New Zealand, about 60% of all instances of identified fraud in 2020 with values greater than NZD 100,000 are attributed to weak internal control.² Of particular importance is the risk of management override of controls. Indeed, with very few exceptions, most of the major fraud cases in the past 50 years that had catastrophic results for the victim organisations were perpetrated by senior members of management circumventing or overriding seemingly sound systems of internal control.³ Those charged with governance's responsibility to implement and oversee adequate and appropriate procedures to mitigate the risk of management override of controls is of crucial significance.

In order to meet evolving expectations in relation to fraud, it is important that there are appropriate reporting requirements and two-way communication between those charged with governance and the auditor on the effectiveness of internal control relating to the prevention and identification of fraud. This

² [Fraud Barometer](#), KMPG NZ, September 2020.

³ Management Override of Controls: The Achilles' Heel of Fraud Prevention, American Institute of Certified Public Accountants, 2016.

is clearly beyond the IAASB standard setting mandate and would require collaboration between all participants in the financial reporting ecosystem.

Better training of auditors can help to narrow the performance gap. Limited on the job learning opportunities mean that there must be a stronger focus on formal training on fraud. It may be beneficial to train auditors in forensic accounting skills and fraud awareness. Sharing knowledge between audit firms can help to improve professional knowledge to better identify, assess and respond to risks of fraud in the financial statements. While this is mostly outside of the scope of the IAASB's standard setting work, it is important for the IAASB to work closely with the International Panel on Accounting Education (IPAE) to address this issue which would help to narrow the performance gap.

It is also important to learn from practice. In New Zealand all public sector entities are required to report all instances of identified fraud to their auditor, regardless of the perceived materiality of the incident. The Office of Auditor-General analyses these cases and uses it to better train public sector auditors in being fraud aware.

Going concern

The NZAuASB encourages the IAASB to continue to explore a collaborative approach with accounting standard setters and regulators to develop a more holistic solution for addressing the expectation gap by management, those charged with governance, the regulator and the auditor related to going concern. The going concern basis of accounting is likely to be too narrow a construct to meet users' needs, and it is possible that the expectation gap will widen in the short term. The XRB, as an organisation, considers that broader reporting, in a more holistic way, is the first step to narrowing the expectation gap, but it will take time to get there.

Limits on what the reporting entity is disclosing places significant restrictions on how an audit can evolve to better meet user needs. The entity has the primary responsibility for assessing its ability to continue as a going concern and for assessing the appropriateness of the use of the going concern basis of accounting. In the first instance, the financial reporting requirements should require more explicit information about going concern.

Those charged with governance and management need a better understanding of their obligations, more requirements and guidance about how to undertake a robust assessment of their entities ability to continue in the foreseeable future, and about what disclosures are appropriate and when, so as to keep users well informed.

Practitioners comment that in many instances, the preparer is not aware of their obligations and responsibilities to assess the appropriateness of the ongoing use of the going concern basis of preparation, especially in smaller entities. The auditor is therefore in a position where they are educating the preparer on their responsibilities in the first instance. In this sense, we understand that practitioners consider that there is a performance gap by directors and management that needs to be addressed as a priority.

As part of the XRB's response to the COVID-19 pandemic, we developed guidance to educate the entire financial reporting ecosystem on the respective responsibilities of management, those charged with governance and auditors related to going concern. An unexpected benefit of the COVID pandemic, is the close focus on going concern matters, requiring in depth discussions between auditor, management and those charged with governance and an increasing awareness of the respective responsibilities while reiterating the need for auditor independence. Preparers are disclosing more than they have in the past, in the COVID environment. It will be important to capture the benefits of this response in the longer term so that these disclosures are made more routinely. Ongoing education

across the reporting ecosystem of these respective responsibilities through various economic cycles will be useful.

The NZASB has also developed additional reporting requirements relating to going concern for preparers and New Zealand stakeholders commented that even more is needed. We recognise that this is mostly outside of the scope of the IAASB's standard setting work.

More requirements or guidance for the preparer (and users) as to what "going concern" means, what is a material uncertainty, what is a close call, how to make this assessment and what to disclose is seen as the matter requiring the most urgent attention. More specifically, the NZAuASB considers that it is in the public interest to clarify what is, and what is not, meant by "going concern" and how matters related to liquidity, solvency and information about an entity's resilience fit with the concept of the going concern basis of accounting for all stakeholders. The IAASB has an important role to play in ensuring that changes for preparers align with the auditor's responsibilities or amending or clarifying the auditor's responsibilities in conjunction with changes for preparers, while remaining independent from the accounting standards board.

While there may be enhancements that could be made to the auditing standards, the NZAuASB does not consider that changes to the auditing standards are the priority. Rather we encourage the IAASB to work with the accounting standard setters and others to enhance the reporting requirements to clarify the concept of going concern across all of the standards in the public interest.

2a) Should the auditor have enhanced or more requirements with regard to fraud in an audit of financial statements? If yes, in what areas?

Response:

At our roundtable event, 28% of participants agreed that the auditors should have enhanced or more requirements with regards to fraud in an audit of financial statements, 14% thought that the requirements are appropriate and 52% believed that a separate engagement would be a more appropriate response (7% of participants had no opinions).

The overall view was that auditing standards related to fraud may not require an overhaul, as underlying principles are appropriate, but that the public interest may instead require certain relevant standards, in particular ISA 240, to be updated, clarified and enhanced. Currently there is some confusion about what is expected from auditors in ISA 240. For example, ISA 240 includes as an example of misappropriation of assets: an employee who colludes with a competitor by disclosing technological data in return for payment⁴. It is unclear how an auditor is expected to identify this type of fraud. It is likely that only forensic investigation procedures (such as surveillance of the employee's activities) are capable of identifying such instances of fraud.

Also, some of the specific requirements in ISA 240 may require updating. For example, our outreach activities and discussion with auditors and auditor oversight bodies indicates that auditors have not identified any instances of fraudulent financial reporting identified by journal testing in regulated audits over the past few years. This indicates a need to reassess the effectiveness and relevance of required journal testing in light of practical experience. The focus on journal testing may be detracting from other high-risk areas.

Participants in our outreach also strongly supported training auditors in forensic skill and fraud awareness as well as providing further guidance in ISA 240 on when to involve forensic specialists.

⁴ Para A5, ISA 240.

Some of the participants noted that forensic specialists are often only involved when there is a suspected instance of fraud. However, forensic specialists could be involved in the risk assessment stage of an audit to enhance auditors' identification and assessment of fraud risks and in designing and implementing appropriate responses to address the identified risks. This could be especially relevant for engagements with a high risk of fraudulent financial reporting (e.g. issuers with complex structures operating in industries with complicated financial reporting practices and opportunity for management to commit financial reporting fraud). Accordingly, the NZAuASB recommends including additional application guidance in ISA 240 to elaborate how involving forensic specialists may enhance the fraud risk assessment and corresponding response.

The NZAuASB also cautions against the auditing standards requiring further involvement of forensic specialists in an audit engagement. Any requirement to involve forensic specialists would be especially challenging for smaller practices to implement. The scope of a forensic engagement is very different to an audit. A forensic engagement is used when fraud is suspected, i.e., is a much deeper dive into a particular area. It is not appropriate for the auditor to always perform such work as this is not in the scope of an audit. That deeper dive requires a different skill set for what the auditor is engaged to do. Another significant difference is that in a forensic engagement those charged with governance share responsibility for the investigative work.

With technological advances there may be a greater capacity for the auditor to detect fraud through data analytics and other analytical tools. The NZAuASB encourages the IAASB to consider how auditors can better employ emerging technologies to enhance auditor performance regarding fraud. This would presumably be done as part of the IAASB's [technology](#) 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 panacea and that technology would have been unlikely to have helped auditors to detect the Carillion and Wire Card frauds. Appropriate risk identification and in-depth knowledge of the entity, its industry and the environment it operates in are required to identify fraud-indicating red flags.

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

If yes:

- (i) For what types of entities or in what circumstances?**
- (ii) What enhancements are needed?**
- (iii) Should these changes be made within the ISAs or outside the scope of an audit (e.g., a different engagement)? Please explain your answer**

Response:

The NZAuASB is of the view that the auditing standards related to fraud may not require an overhaul, as underlying principles are appropriate, but that ISA 240 could be updated, clarified and enhanced. This may include clarification of the use of forensic experts, recognition of the increasing use of and advances in technology, and reconsideration of certain requirements in light of practical experience (e.g., journal testing as highlighted in response to question 2a above).

Notwithstanding the above, the majority of participants in our roundtable believed that narrowing the expectation gap in respect to fraud would require changes to the responsibilities of all participants in the financial reporting ecosystem. They favoured a separate engagement outside the scope of an audit. The NZAuASB is also of the view that a separate assurance engagement is likely to better serve the public interest. Such an engagement would require a clear scope as well as a clear specification of

the responsibilities of management and those charged with governance. Auditors can then be engaged to provide an independent view on whether those responsibilities have been met. This would be similar to engagements to evaluate effectiveness of internal controls as required by the Sarbanes-Oxley Act of 2002 (the Sarbanes-Oxley Act) in the USA. Although concerns were also raised that in New Zealand, implementing such engagements may be cost prohibitive. This may only be viable for large public interest entities.

2c) Would requiring a “suspicious mindset” contribute to enhanced fraud identification when planning and performing the audit? Why or why not?

(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

Response:

At our roundtable event, 72% of participants did not agree that requiring a “suspicious mindset” would contribute to enhanced fraud identification, while 28% of participants agreed with such a move. Those opposing believed that professional scepticism is adequate and appropriate to describe the quality auditors must possess to be able to respond competently to risks of fraud.

Some participants noted that adopting a presumptive doubt approach may logically require authentication of records and documents (one has to assume records are not authentic until otherwise proven). It was also noted that introducing such a concept may have a detrimental impact on the relationship between auditors and management and may reduce the level of management cooperation with the audit.

However, other participants supported requiring a suspicion mindset, specifically in relation to management risk of override of controls. Requiring a suspicious mindset may prompt auditor to more vigorously respond to such significant risks thus reducing the likelihood of them being unable to identify material financial reporting frauds.

2d) 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.)?

Response:

At our roundtable event, some participants called for greater transparency from auditors in relation to significant deficiencies in an entity’s internal controls identified during the audit. Views were expressed that it may be appropriate for auditors to report significant internal control deficiencies as a key audit matter (KAM) in the auditor’s report.

Others called for additional information to be disclosed by management, e.g., management’s assessment of risk of fraud. Such additional information, where relevant, could prompt commentary from the auditor in their report.

Requiring disclosure of materiality judgements in the audit report was another suggestion.

Opposing views were that audit reports are already too long and too difficult for users to understand. Concerns were also raised about the implications for auditor liability in requiring additional material in the report, although the NZAuASB recognises this is a jurisdictionally specific issue.

There was consensus however that if there is more to be said in the auditor report it has to be bespoke and tailored to the audited entity and not involve the use of boilerplate statements with little specificity to the entity.

3a) Should the auditor have enhanced or more requirements with regard to going concern in an audit of financial statements? If yes, in what areas?

Response:

At our roundtable event, 50% of participants agreed that the preparers' requirements should be enhanced as a priority, 39% agreed that both the preparer and auditor's requirements should be enhanced as a priority, 11% thought that the requirements are appropriate and 0% agreed that the audit requirements should be enhanced as a priority.

The NZAuASB considers that there are limitations on enhancing or adding more requirements for the auditor to narrow the expectation gap while reporting requirements for preparers remain relatively light. The NZAuASB strongly agrees that the primary responsibility for assessing the appropriateness of the use of the going concern basis of accounting lies with management and those charged with governance. The NZAuASB notes that, in contrast to the detailed auditing standard on the auditor's responsibilities related to going concern, IAS 1 contains only two paragraphs about the disclosure obligations of the preparer.

The expectation gap with respect to going concern has thus existed for many years. The IAASB tried to address this as part of the auditor reporting project but even then, identified the need for stronger collaboration with the accounting standard setters.

Practitioners have commented that in many instances, the auditor is taking on the role of educator to the preparer about their responsibilities. This tends to drive the preparer to develop their thinking around providing evidence for the auditor, rather than matters they are primarily responsible for.

There are limitations on how good the audit can get, given these inherent limitations, and the NZAuASB is strongly supportive of a focus on management disclosures as a priority in addressing the public interest issues identified in the paper.

The NZAuASB is particularly interested in the Brydon report recommendations in the UK relating to resilience reporting to connect the dots with the director's responsibilities. The NZAuASB considers that in terms of addressing the evolution gap, users want both information and reassurance about the resilience of an entity, which is often confused with going concern. The whole ecosystem has a role to play in exploring the extent to which information about resilience can and should be reported and assured. A cost/benefit analysis is required to ensure that any demands for information and reassurance about an entity's resilience can realistically be met. The NZAuASB has also observed comments that there appear to be fewer issues relating to going concern in jurisdictions where there is a strong emphasis on director's responsibilities.

The NZAuASB considers that the public interest would be best served if the auditing and accounting standard setters work closely together to consider the spectrum of circumstances relating to going concern reporting from: very low risk; through increasing uncertainty up to the close call stage; where a material uncertainty exists and where it is no longer considered to be appropriate to use the going concern basis of preparation.

We encourage the accounting and auditing standard setters to agree definitions for key cross over points on this spectrum and agree the triggers for disclosure at each of these stages and then

reassess the auditor's responsibilities at each stage, depending on the applicable disclosure requirements. This work needs to happen in tandem, and therefore on balance the NZAuASB recommends that the focus be on a collaborative effort, not the ISAs in isolation. It is not appropriate to address this issue through the auditing standards without changes to the financial reporting requirements.

The current COVID-19 reporting environment is providing a rich "training" ground for both preparers and practitioners, and an unexpected benefit is that the pandemic is raising awareness by the preparer as to what their responsibilities are and promoting more transparency about going concern assumptions.

Time frame

At our roundtable event 60% of participants do not consider that the time frame for the assessment should be extended beyond 12 months. 30% thought maybe or sometimes.

ISA 570 (Revised) *Going Concern* paragraph 13 requires the auditor to consider the same time frame as that used by management to make its assessment, as required by the applicable financial reporting framework, but not less than twelve months from the date of the financial statements. IAS 1⁵ refers to a period which is at least, but not limited to, twelve months from the end of the reporting period. Our roundtable participants stressed that the assessment is linked to the reporting cycle (and interim reporting plays into this too) and the need for consistency with the financial reporting requirements. Auditor liability concerns, limitations on the value of extending the time period given the increasing uncertainty the longer the time period where highlighted, and questions raised as to how the benefits of extending the time period would outweigh the costs.

In New Zealand, the NZAuASB has extended the relevant period for consideration by the auditor in ISA (NZ) 570 (Revised) to a period of at least twelve months from the date of the auditor's report. Historically, the New Zealand auditing standards have referred to the period of 12 months from the date of the auditor's report. Therefore, this is established best practice in New Zealand. Given the recent focus on going concern matters, the NZAuASB considers that audit quality may be significantly enhanced where the auditor's assessment covers a minimum of twelve months from the date of the current auditor's report. This would mean that the auditor has considered the appropriateness of the use of the going concern basis of accounting up until the date that the audit is formally completed for the next period. We note that there has not been alignment in New Zealand between the accounting standards and the auditing standards in this regard. Participants in our roundtable event, did not identify any unintended consequences arising from this difference.

The NZAuASB does not consider the time period should be extended beyond 12 months from the date of the auditor's report but would support consideration of whether the application material should have less of a focus on 12 months given there are circumstances where this may vary.

Interim reviews

The NZAuASB is of the view that the IAASB's interim review standard would benefit from revision, especially to clarify what the auditor's responsibilities are related to going concern at the interim stage. This is important for jurisdictions where listed entities have a requirement for an interim review. The need for an interim review is also relevant to the appropriateness of the "12 month" period in the auditing standards. If an entity's basis of preparation is being reconsidered by both management and the auditor every 6 months, this provides a more frequent flow of information to the user and provides

⁵ IAS 1, *Presentation of Financial Statements*, paragraph 26.

a more timely update. The time frame for going concern considerations at the interim review stage also needs to be clarified, noting that the auditor will be required to conclude on the appropriateness of the use of the going concern basis of accounting at the annual reporting stage.

Flowchart

The NZAuASB has included a flowchart in the appendix to ISA (NZ) 570 (Revised), the flowchart is included in the appendix to this response. Practitioners have found the flowchart to be a useful visual guide to reporting on going concern issues and we recommend that such a flowchart be added to ISA 570.

3b) 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?

Response:

The NZAuASB is not supportive of distinguishing requirements within the auditing standards based on the type of entity. We consider such an approach would run the risk of widening the expectation gap even further.

(ii) What enhancements are needed?

Response:

The NZAuASB does not support enhancing audit procedures in the auditing standard as the priority. As described in response to question 3a, none of the stakeholders at our roundtable event considered that enhancing the audit requirements in isolation was a priority. The NZAuASB recommends enhancing the audit requirements in tandem with enhancements to the financial reporting standards.

(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

Response:

The NZAuASB is particularly interested in the Brydon report recommendations in the UK relating to resilience reporting. The NZAuASB considers that the expectation gap relating to going concern is fundamentally about users seeking more transparency over, and information about, business viability. The lack of a common understanding, of all players in the financial reporting ecosystem, of the term “going concern” and how it works together with concepts such as liquidity, solvency and resilience is therefore at the heart of the expectation gap. More information about business risk and strategy, some of which might already be reported in the directors’ report or included in management commentary, is key information to the user. But this is not required by the financial reporting requirements and is therefore not within the scope of the audit. If entities were required to report more information in the first instance, this would help to reduce the expectation gap where users respond to a negative event by asking the auditor “why did you not tell us there was a problem”. The auditor can only report uncertainties that are disclosed by the entity.

Assurance over extended external reporting might play an important role in future, as reporting over EER and then EER assurance engagements continue to evolve.

3c) Do you believe more transparency is needed

(i) About the auditor’s work in relation to going concern in an audit of financial statements? If yes, what additional information is needed and how should this

- information be communicated (e.g. in communications with those charged with governance, in the auditor's report, etc.)?**
- (ii) About going concern, outside of the auditor's work relating to going concern? If yes, what further information should be provided, where should this information be provided, and what action is required to put this into effect?**

Response:

At our roundtable event, participants were evenly split as to whether or not additional transparency is needed in the auditor's report (34% thought yes, 31% thought no and 34% agreed sometimes).

As part of the NZAuASB's outreach related to the auditor reporting post implementation review project, the Board heard from users of the auditor's reports that auditors communicate well on matters related to going concern. As a result of the COVID-19 pandemic, in New Zealand we have seen an increase in the number of KAMs related to going concern, in "close call" situations. As part of this broader outreach, we have also heard from users that lengthy audit reports that include standardised wording are not useful, i.e., few users read the parts of the audit report that focus on management's and/or the auditor's responsibilities that include generic standardised text. In fact, some investors we spoke to, do not read the auditor's report at all, other than to glance at who the auditor was. They take some confidence in the fact that an audit was conducted but do not overly rely on the contents of the audit report.

Based on this feedback, the NZAuASB considers that adding additional reporting requirements into the auditor's report that is overly standardised is unlikely to have an impact on narrowing the expectation gap.

The NZAuASB explored ways to enhance the auditor's interim review report in detail as part of its domestic project to revise NZ SRE 2410. As part of this project, we sought views from all participants in the financial reporting ecosystem. While the project was focussed on interim review reports, a number of key themes emerging about communication of matters related to going concern are equally applicable to audits. These key themes include:

- A caution against a lengthy section on going concern in all instances. Such an approach was likely to unbalance the report, overly focussing on going concern matters and possibly even exacerbating the expectation gap, given that there is already a misconception of a guarantee.
- Preparers were especially concerned that such an approach may result in a self-fulfilling prophecy, making users nervous about going concern even in circumstances where going concern risks was low. If the IAASB were to develop further reporting requirements on going concern matters, it is important that such an approach not leave the user hanging, i.e., must conclude on the matter if you are highlighting the matter to the user.
- A counter argument is that the auditor is not concluding on the ability of the entity to continue as a going concern, and should avoid a focus or wording that may imply as much
- Listing procedures performed is not overly useful as users are most interested in whether the auditor found anything. The auditor is already required to report a material uncertainty related to going concern or a KAM in the close call situations.

Auditors consider that the reporting requirements relating to going concern have become overly complex as a result of the introduction of KAMs as well as a separate section for a material uncertainty related to going concern (MURGC) or emphasis of matter (EOM) paragraphs. If the auditor is reporting a MURGC, by nature it is a KAM, and therefore practitioners are of the view that it is appropriate to report the same details as are reported for a KAM, by including detail on the procedures undertaken i.e., how the MURGC was addressed by the auditor.

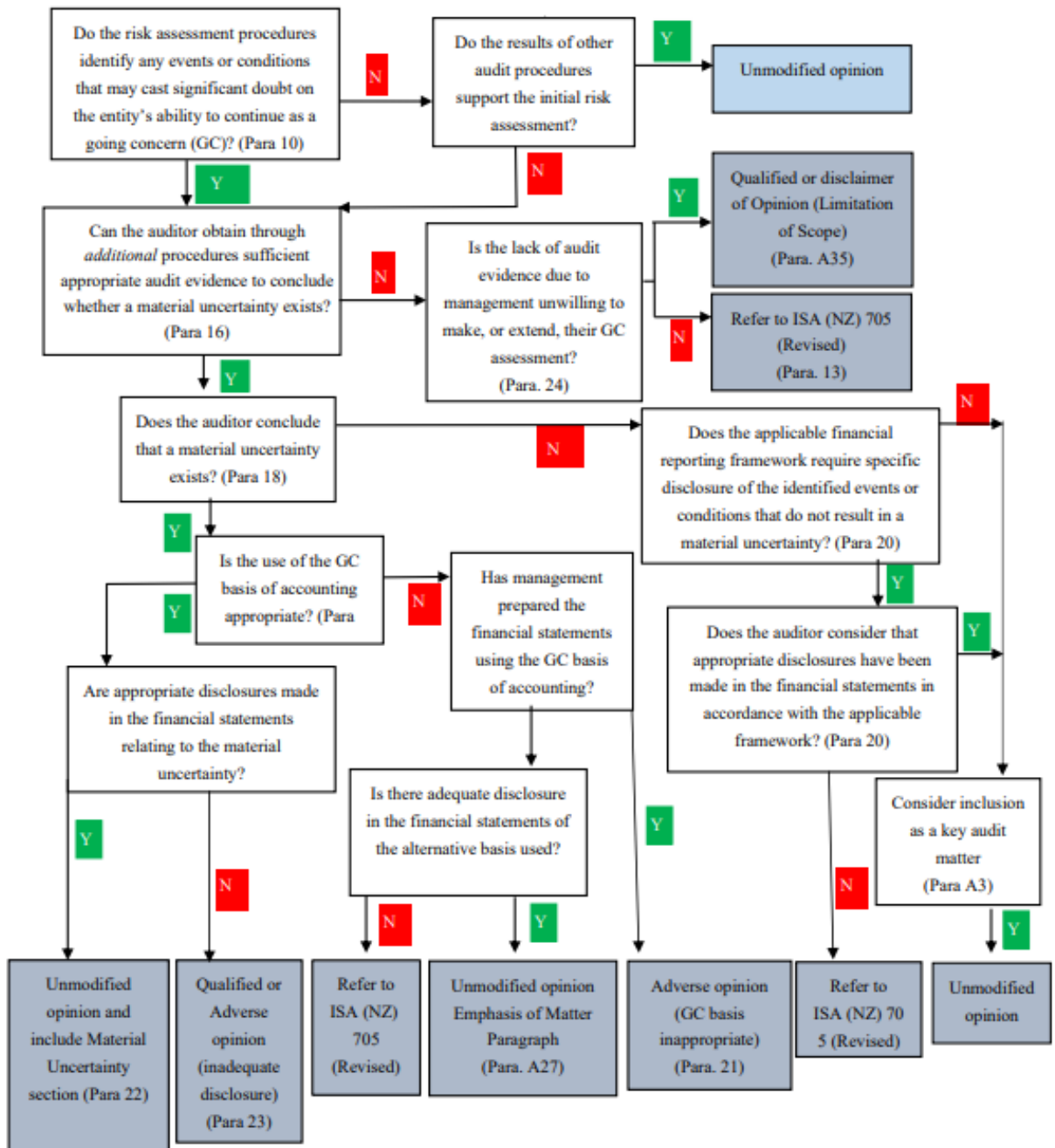
On balance, the NZAuASB does not consider that adding more transparency about the auditor's work related to going concern into the auditor's report will assist in reducing the expectation gap. A different way to communicate with users may be more effective than using different technical headings that many users may not necessarily understand. Education included in the auditor's report has historically been the way in which standard setters have tried to narrow the expectation gap. However, this approach has had very little effect. We have heard from users that they generally do not read the auditor's report in detail, especially any boilerplate, standardized text about the auditor's responsibilities or that they regard the auditor's report as too technical to be clearly understood.

The NZAuASB does however see merit in promoting awareness and transparency about what the auditor's role is, together with what the responsibilities of management and those charged with governance are, related to assessing the appropriateness of the use of the going concern basis of accounting.

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?

The NZAuASB 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 during the annual general meetings. Broader engagement outside of the auditor's report may be a more effective way to promote a better understanding of what an audit is (provide an opportunity for auditors to "educate" users as to what it is they do) and for users to provide more information to auditors about how they wish the audit to evolve to start to narrow the evolution gap, bearing in mind trade-offs around cost and benefit and the impact on audit fees.

Linking Going Concern Considerations and Types of Audit Opinions



Note: Audit opinions in this diagram must comply, as appropriate, with: ISA (NZ) 700 (Revised) *Forming an Opinion and Reporting on Financial Statements*, ISA (NZ) 705 (Revised) *Modifications to the Opinion in the Independent Auditor's Report* and ISA (NZ) 706 (Revised) *Emphasis of Matter Paragraphs and Other Mater Paragraphs in the Independent Auditor's Report*.