



Basel Committee on Banking Supervision

BANK FOR INTERNATIONAL SETTLEMENTS

Chairman

Via email: TomSeidenstein@IAASB.org

Mr Thomas Seidenstein
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IAASB discussion paper: Fraud and going concern in an audit of financial statements

Dear Mr Seidenstein

The Basel Committee on Banking Supervision welcomes the opportunity to comment on the IAASB's discussion paper on fraud and going concern. The Committee has a strong interest in promoting high-quality auditing and ethical standards for auditors and is supportive of the work of the IAASB in setting such standards.

Overall comments

The Committee encourages the IAASB to continue its work in this important area. Questions around the audit requirements and work undertaken in relation to fraud and going concern are important to the Committee. In addition to being relevant to banks, they affect the entities to which banks lend or which they have as financial counterparties. Failures of companies and their auditors to identify fraud and going concern matters have the propensity to undermine confidence in financial reporting generally, and they seem to be perennial. Therefore, the Committee supports further work in this area, which is consistent with the IAASB's public interest objectives, to develop enforceable standards under which it is clear what is required of auditors and where users of financial statements are clear what auditors have done, thereby narrowing the expectations gap.

The Committee agrees that there are parties other than the IAASB that play an important role in contributing to high-quality financial reporting. The Committee encourages the IAASB to continue its dialogue with accounting standard setters and others that may be able to enhance requirements for preparers of financial statements and those charged with governance, including the disclosures they need to make, on both fraud and going concern.

Fraud

The Committee understands that there may be gaps between what the users expect from the auditor and the financial statement audit. As noted in the discussion paper, this could include a misunderstanding of the role of auditors (knowledge gap), unclear or inconsistently applied requirements (performance gap) or the need for enhancements to add more value (evolution gap).

In order to narrow these gaps, the Committee suggests a review of current audit standards to identify the source of the expectations gaps. For example, the basic requirement of an audit “to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error” (ISA 200 para 11) may be weakened by ISA 240 on fraud (para 6) which states that “the potential effects of inherent limitations [on the auditor’s ability to detect material misstatements] are particularly significant in the case of misstatement resulting from fraud” without clearly stating that the auditor’s responsibilities are not affected by these limitations. An additional area of focus to mitigate the expectations gap could be for the IAASB to consider whether the requirements in auditing standards result in auditors providing the same level of assurance in relation to both material fraud and error. The primary responsibility for the prevention and detection of fraud rests with both those charged with governance and management of the entity, though that does not lessen the auditor’s responsibilities.

The Committee believes that the IAASB’s proposed reviews of research and audit quality reviews by audit regulators, especially in cases where a material fraud has not been identified by the auditor, should help the IAASB to identify sources of the problem and possible solutions.

The Committee agrees with the IAASB that several related standards may be affected and should be considered (eg laws and regulations). The Committee also encourages the IAASB to approach the subject with an open mind: for example, building solutions based on the audit being “not forensic in nature” and noting that many audit firms do not have access to forensic specialists (page 18) may limit the IAASB’s chances of achieving the right outcomes. The IAASB will, of course, need to be proportionate in any final proposals, and forensic expertise is unlikely to be necessary on all audits. The Committee also believes that serving the public interest through a transparent and high-quality assurance product where professional scepticism is applied in its delivery should be prioritised over concerns about “the audit relationship” (page 27).

The Committee believes that most of the questions that should concern the IAASB are about how to ensure that existing standards are clear and enforceable and that requirements are coherent across different standards. However, we agree that it would be helpful for the IAASB to consider whether increasing the responsibility of the auditors is warranted regarding fraud that is not related, or immaterial, to the financial statements, or fraud that seems unrelated but could potentially have a material impact when discovered (eg fraudulent product quality certification). This could include the third-party fraud mentioned in the discussion paper. Even if the IAASB determines that auditor requirements and responsibilities are sufficient under the current standards, it would be helpful to be definitive and clear on this.

Going concern

The Committee believes that information about management's assessment of risks and vulnerabilities to an entity's existence, fully described by management and properly challenged, assessed and reported upon by auditors, would be beneficial to users of financial statements.

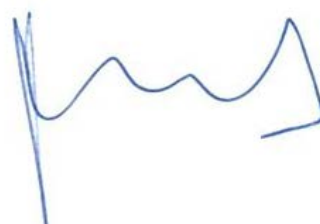
The Committee believes that more information is needed about an entity when its going concern status is in the "no material uncertainty" stage so that there is less of a cliff edge once it is determined that there is a material uncertainty related to going concern. In addition, more understanding is needed about the different going concern stages and the thresholds between them.

Many banks are subject to stress testing requirements. While the Committee is not suggesting that it would be appropriate to introduce requirements for "stress testing" for all entities, we note that the discipline of examining different scenarios and their potential effect on an entity may be useful to management and auditors and, when disclosed, to users in considering going concern and viability. This is a topic the IAASB may wish to consider further.

The Committee agrees with the areas set out in the discussion paper for investigation (ie the time period for going concern assessments, the relationship between going concern and other concepts of resilience, identification and disclosures of material uncertainty, and increased transparency in the auditor's report).

We hope you find our comments constructive and helpful. If you have any questions regarding these comments, please contact Joanne Marsden at the Basel Committee Secretariat (+41 76 350 8541).

Yours sincerely

A handwritten signature in blue ink, consisting of a series of connected loops and a final downward stroke.

Pablo Hernández de Cos