

Auditor's Report – Effect of Going Concern and Fraud Proposals

Objective:

The objective of the IAASB discussion in September 2024 is to holistically consider the impact on the auditor's report as a result of the changes proposed to enhance transparency to intended users of financial statements about going concern and fraud.

Section I – Introduction

Background

1. The IAASB's projects on [Going Concern](#) and [Fraud](#) are currently considering proposals that include changes to the auditor's report to enhance transparency to users about going concern and fraud.
2. The proposals for each project have already been informed by respondents' feedback,¹ and there has also been effective coordination among the respective project task forces to understand respondents' views relating to enhancing transparency in the auditor's report for going concern and fraud.
3. The table below summarizes the key changes proposed to the auditor's report under each project:

<i>Key Changes to the Auditor's Report</i>	
<i>For Going Concern</i>	<ul style="list-style-type: none"> ▶ For all entities, providing explicit statements about the auditor's conclusions for going concern on the appropriateness of management's use of the going concern basis of accounting and whether a material uncertainty has been identified. ▶ For listed entities, enhanced reporting: <ul style="list-style-type: none"> ○ When significant judgments were made by management in concluding that there is no material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern ("close call" situations). ○ Improved description of the auditor's response in the Material Uncertainty Related to Going Concern section.
<i>For Fraud</i>	<ul style="list-style-type: none"> ▶ For all entities, providing a statement that the auditor communicates with those charged with governance identified fraud or suspected fraud and other matters related to fraud that are, in the auditor's judgment, relevant to the responsibilities of those charges with governance.

¹ See the Exposure Draft (ED-570): [Proposed ISA 570 \(Revised 202X\), Going Concern](#) and ED-240 [Proposed ISA 240 \(Revised\): The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements](#).

Key Changes to the Auditor's Report

- ▶ For listed entities, enhanced reporting to:
 - Emphasize in the auditor's responsibilities section that key audit matters include matters related to fraud.
 - Communicate key audit matters related to fraud in the auditor's report. The key audit matters related to fraud are included in the key audit matter section and have an appropriate subheading that clearly describes that the matter relates to fraud.

Materials Presented

4. To support the Board's deliberation, IAASB Staff have prepared an illustrative auditor's report (see **Section II** below) that reflects the cumulative changes proposed to the auditor's report as a result of the proposals for going concern and fraud, including their impact on the auditor's report.
5. The illustration has been developed based on the following sources:
 - ISA 700 (Revised),² Appendix: Illustration 1: An auditor's report on financial statements of a listed entity prepared in accordance with a fair presentation framework. This illustration was supplemented to reflect changes to approved standards, including:
 - ISA 600 (Revised);³ and
 - The narrow scope amendments to ISA 700 (Revised) and ISA 260 (Revised),⁴ as a result of the revisions to the IESBA Code⁵ that require a firm to publicly disclose when a firm has applied the independence requirements for Public Interest Entities (PIEs) approved as part of Track 1 of the Listed Entity and PIE project.
 - Draft of proposed ISA 570 (Revised 202X), *Going Concern*, Appendix: Illustration 2, presented in **Agenda Item 3-B** for discussion by the Board in September 2024. The circumstances depicted in this illustration include an auditor's report of a listed entity where the auditor concluded, based on the audit evidence obtained, that a material uncertainty does not exist and management has disclosed information about significant judgments made in concluding that no material uncertainty exists (i.e., a "close call" situation).⁶
 - ED-240 for the changes to the 'Auditor's Responsibilities for the Audit of the Financial Statements' section.

² ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

³ ISA 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

⁴ ISA 260 (Revised), *Communication with Those Charged with Governance*

⁵ International Ethics Standards Board for Accountants' International Code of Ethics for Professional Accountants (including International Independence Standards)

⁶ The wording used to describe how the auditor evaluated management's assessment of the entity's ability to continue as a going concern was sourced from a publicly available auditor's report and amended as necessary for purposes of the proposed illustration.

- For changes to the Key Audit Matters section draft of proposed ISA 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, presented in **Agenda Item 8-A** and **Agenda Item 5** of the [December 2022 IAASB meeting](#).
6. Certain text in the illustration has been *grayed out*. This is because the Board is not being asked to provide their observations on the wording used in the illustrative reports. In providing its feedback, the Board is asked to focus their observations on matters related to *coherence* and *understandability* of the overall auditor's report considering the effects of the combined changes for going concern and fraud.

Section II – Illustrative Auditor's Report

Illustration – Auditor's Report on Financial Statements of a Listed Entity Prepared in Accordance with a Fair Presentation Framework

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- **Audit of a complete set of financial statements of a listed entity using a fair presentation framework. The audit is not a group audit (i.e., ISA 600 (Revised) does not apply).**
- **The financial statements are prepared by management of the entity in accordance with IFRSs (a general purpose framework).**
- **The terms of the audit engagement reflect the description of management's responsibility for the financial statements in ISA 210.⁷**
- **The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.**
- **The relevant ethical requirements that apply to the audit comprise the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA Code), together with the ethical requirements relating to the audit in the jurisdiction, and the auditor refers to both. The IESBA Code and the ethical requirements relating to the audit in the jurisdiction include independence requirements that are applicable to audits of financial statements of public interest entities. They also require the auditor to publicly disclose that the independence requirements applicable to audits of financial statements of public interest entities were applied.**
- **Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist in accordance with ISA 570 (Revised 202X).**
- **Management has disclosed information about significant judgments made in concluding that there is no material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and the disclosures are adequate in view of the applicable financial reporting framework.**
- **Key audit matters have been communicated in accordance with ISA 701.⁸**
- **The auditor has obtained all of the other information prior to the date of the auditor's report and has not yet identified a material misstatement of the other information.**
- **Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.**
- **In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law.**

⁷ ISA 210, *Agreeing the Terms of Audit Engagements*

⁸ ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

Report on the Audit of the Financial Statements⁹

Opinion

We have audited the financial statements of ABC Company (the Company), which comprise the statement of financial position as at December 31, 20X1, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including material accounting policy information.

In our opinion, the accompanying financial statements present fairly, in all material respects, (or *give a true and fair view of*) the financial position of the Company as at December 31, 20X1, and (of) its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards) (IESBA Code)*, as applicable to audits of financial statements of public interest entities, together with the ethical requirements that are relevant to audits of the financial statements of public interest entities in [jurisdiction]. We have also fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Going Concern

No Material Uncertainty Related to Going Concern

In the context of our audit of the financial statements as a whole, and in forming our opinion thereon, we have concluded that management's use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

We draw attention to Note X in the financial statements, which describes the uncertainties faced by the Company, the significant judgments made by management in assessing the entity's ability to continue as a going concern and the range of mitigating actions that have been deployed to address the effects on the Company's business activities.

In undertaking their assessment of going concern for the Company, management reviewed the forecast future performance and anticipated cash flows. In doing so they considered the financing available to the Company and associated debt covenants, including the covenant relaxation that the Company has obtained in relation to its financing facility, and cost saving actions that the Company have taken, including certain

⁹ The sub-title "Report on the Audit of the Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

Government support schemes. Management have also determined appropriate sensitivities to these forecasts and considered the results in forming their conclusion.

In responding to the identified events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, we completed the following audit procedures:

- Obtained an understanding of relevant controls relating to the assessment of going concern models, including the review of the data and significant assumptions used in those models;
- Obtained management's board approved three-year cash flow forecasts and covenant compliance forecasts, including the sensitivity analyses;
- Assessed the appropriateness of forecast assumptions by:
 - Reading analyst reports, industry data and other external information and comparing these with management's estimates to determine if they provided corroborative or contradictory evidence in relation to management's assumptions;
 - Comparing forecast sales with recent historical financial information to consider accuracy of forecasting;
 - Enquiring of management regarding the mitigating actions to reduce costs and manage cash flows and challenging the quantum of those actions with reference to supporting evidence and assessing whether the mitigating actions were within the Company's control;
 - Testing the underlying data generated to prepare the forecast scenarios and determined whether there was adequate support for the significant assumptions underlying the forecast;
 - Reviewing correspondence confirming Government support;
 - Reviewing correspondence relating to the availability of the Company's financing arrangements, including the covenant relaxation obtained by the Company in relation to its financing facility;
 - Understanding and challenging the level of further mitigations available to the Company beyond those included within the forecast; and
 - Considering the results of the sensitivity analyses performed; and
- Evaluated the Company's disclosures on going concern against the requirements of IAS 1.

Based on the audit evidence obtained, we have not identified a material uncertainty related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern.

Our conclusions are based on the audit evidence obtained up to the date of our auditor's report and are not a guarantee as to the Company's ability to continue as a going concern.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a

separate opinion on these matters. In addition to the matter described in the *Going Concern* section, we have determined the matters described below to be the key audit matters to be communicated in our report.

Fraud Risk: Revenue Recognition (Refer to note XX of the financial statements)

As part of our risk assessment and based on a presumption that there are risks of fraud in revenue recognition, we evaluated which types of revenue transactions and assertions give rise to the risk of fraud in revenue recognition. The Company enters into contracts that are considered complex from a revenue recognition perspective. We focused on those contracts which include a fixed price element. The nature of those contracts require management to estimate the cost to complete, that impacts the revenue recognized.

Estimates are inherently uncertain and might be subject to management bias. There might be incentives for management to use estimates in order to satisfy stakeholders, reach key performance indicators (KPIs) outlined in compensation plans and/or to meet debt covenants.

Where relevant to our audit, we assessed the design of the internal control measures related to revenue recognition and in the processes for generating and processing journal entries related to the revenue. We used a primarily substantive testing-based approach with respect to the cost to complete. The audit procedures included obtaining evidence to support applied hourly rates, challenging the number of expected hours to complete the project and reconciling changes in budgets to supporting evidence such as contract modifications. We also discussed the progress of the projects with the respective project managers and management of the operating companies. When performing these audit procedures, we remained alert to the inherent risk of management bias.

Project Revenue Recognition and Valuation of Contract Assets (Refer to notes XY and YY of the financial statements)

Management applies judgement to determine the cost to complete for contracts, which is the basis for revenue recognition and contract asset valuation, as well as for assessing provisions for onerous contracts. In addition, the valuation of contract assets requires significant management judgement in determining recoverability, especially in the XYZ region, considering the above average ageing and the magnitude of the contract assets.

We assessed the nature of the Company's revenue contracts. We performed substantive audit procedures on individually significant projects as well as high-risk projects. In addition, we took a sample over the remaining population to ensure sufficient coverage over all projects. These substantive procedures focused on the key assumptions applied by the Company to determine the cost to complete. The procedures included obtaining evidence to support applied hourly rates, challenging the number of expected hours to complete the project and reconciling changes in budgets to supporting evidence such as contract modifications. We also discussed the progress of the projects with the respective project managers and management of the operating companies. In these audit procedures, we were alert to management bias.

With regards to the above average ageing, magnitude of the contract assets in the XYZ region, and the announced decision to reduce the Company's footprint in the XYZ region, specific attention has been given to the collection of trade receivables and valuation of several contracts with significant contract assets. We have discussed management's position papers for these projects with the responsible project managers, the contract solutions team and the regional CFO and CEO. We have obtained supporting documentation, which included support for contract modifications, correspondence with the client and minutes confirming the status of negotiations with the client. We assessed the adequacy of the disclosures relating to revenue recognition, in accordance with the requirements of IFRS15.

Valuation of Goodwill and Intangible Assets (Refer to note ZZ of the financial statements)

We focused on this area given the magnitude of the goodwill balance and because the executive board's assessment of the 'value in use' of the Company's eight Cash Generating Units (CGUs) is subject to significant estimation uncertainty. This involves significant judgement about the future revenue growth, operating earnings before interest tax and amortization (EBITA) margin, working capital developments and the discount rates applied to discount cash flow forecasts.

We especially focused our audit efforts on those CGUs that had limited headroom, specifically the AA CGU. Our audit procedures mainly included, an assessment of assumptions applied in the model, testing of the inputs to the model, assessing the disclosure note on goodwill, testing mathematical accuracy of the model and a reconciliation of the model to the five-year forecasts and long-term strategic plans that were approved by senior management. Our valuation experts supported us in the evaluation of the model in accordance with IAS 36, evaluation of the discount rate as well as other assumptions and methodologies used.

We have challenged the assumptions applied by management. This was done by, amongst others, testing the expected margin increase, by comparing the margin and revenue growth to the historic performance of the Company, assessing the expected revenue growth by reviewing available market data for the industry outlook and development of the book-to-bill ratio. Discussions were held with local management of AA CGU, emphasizing the measures taken within the organization to reduce costs and improve margins. Further, we gained an understanding of local management strategic plans to improve the CGU's performance in the future and the inclusion thereof in the forecast used for impairment testing. We also have analyzed the sensitivity of the 'value in use' to changes in the respective assumptions. We assessed the adequacy of the disclosures relating to goodwill in accordance with the requirements of IAS 36.

Fraud Risk: Risk of Management Override of Controls

The risks of fraud and management's ability to override the system of internal control are present in every entity. We therefore paid attention to the risk of management override of controls, including identifying fraud risks based on an analysis of potential interests of management such as the incentive by management to meet certain targets. Considering this analysis, we paid specific attention to the estimate of the cost to complete on revenue contracts.

We evaluated the design of the internal control environment that reduces the risk of a breach of internal controls. Also, we paid specific attention to user access management in the IT system and performed compensating procedures when necessary. We selected journal entries based on risk criteria and performed audit procedures to validate these entries. We also performed specific audit procedures regarding important estimates made by management, including the cost to complete revenue contracts for clients. In our assessment of estimates, we remained alert to the inherent risk of bias from management with regards to estimates.

Other Information [or another title if appropriate such as “Information Other than the Financial Statements and Auditor’s Report Thereon”]

Management¹⁰ is responsible for the other information. The other information comprises the [information included in the X report,¹¹ but does not include the financial statements and our auditor’s report thereon.]

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements¹²

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRSs,¹³ and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company’s ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company’s financial reporting process.

Auditor’s Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor’s report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

¹⁰ Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction

¹¹ A more specific description of the other information, such as “the management report and chairman’s statement,” may be used to identify the other information.

¹² Throughout these illustrative auditor’s reports, the terms management and those charged with governance may need to be replaced by another term that is appropriate in the context of the legal framework in the particular jurisdiction.

¹³ Where management’s responsibility is to prepare financial statements that give a true and fair view, this may read: “Management is responsible for the preparation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards, and for such ...”

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.¹⁴
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any:

- Significant deficiencies in internal control that we identify during our audit,
- Identified fraud or suspected fraud; and
- Other matters related to fraud that are, in our auditor's judgment, relevant to the responsibilities of those charged with governance.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, actions taken to eliminate threats or safeguards applied.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters, which includes matters related to fraud. We describe these key audit matters, including matters related to fraud in our auditor's report unless law or regulation precludes public disclosure about

¹⁴ This sentence would be modified, as appropriate, in circumstances when the auditor also has a responsibility to issue an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements.

the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities prescribed by local law, regulation or national auditing standards. The matters addressed by other law, regulation or national auditing standards (referred to as "other reporting responsibilities") shall be addressed within this section unless the other reporting responsibilities address the same topics as those presented under the reporting responsibilities required by the ISAs as part of the Report on the Audit of the Financial Statements section. The reporting of other reporting responsibilities that address the same topics as those required by the ISAs may be combined (i.e., included in the Report on the Audit of the Financial Statements section under the appropriate subheadings) provided that the wording in the auditor's report clearly differentiates the other reporting responsibilities from the reporting that is required by the ISAs where such a difference exists.]

The engagement partner on the audit resulting in this independent auditor's report is [name].

[Signature in the name of the audit firm, the personal name of the auditor, or both, as appropriate for the particular jurisdiction]

[Auditor Address]

[Date]

Matter for IAASB Consideration:

1. The Board is asked whether they agree that the illustrative auditor's report appropriately reflects the proposed changes for enhanced transparency in the auditor's report as discussed as part of **Agenda Items 3 and 8** and whether there are any matters related to *coherence* and *understandability* that should be further considered?