

FRAUD AND GOING CONCERN IN AN AUDIT OF FINANCIAL STATEMENTS:

**Exploring the Differences Between Public Perceptions
About the Role of the Auditor and the Auditor's
Responsibilities in a Financial Statement Audit**



**DISCUSSION PAPER
COMMENTS DUE: JANUARY 12, 2021**

IAASB

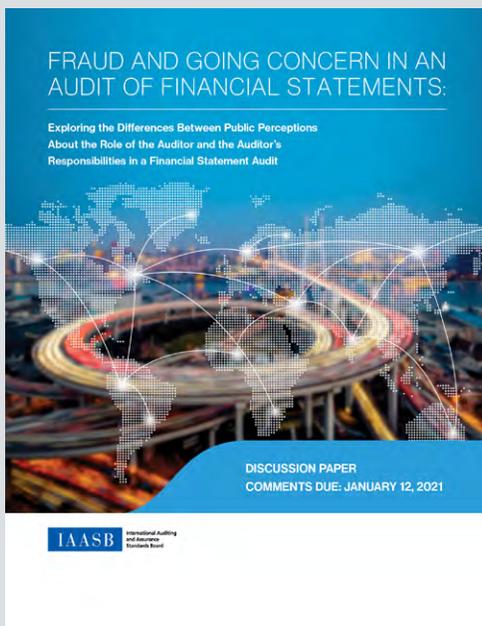
International Auditing
and Assurance
Standards Board

IAASBInternational Auditing
and Assurance
Standards Board

The International Auditing and Assurance Standards Board (IAASB) is a global independent standard-setting body that serves the public interest by setting high-quality international standards which are generally accepted worldwide.

The IAASB follows a rigorous process in developing its standards, involving multi-stakeholder input, including from the IAASB's Consultative Advisory Group, the International Federation of Accountants' (IFAC) relevant committees and professional accountancy organizations, regulatory and oversight bodies, firms, national standard setters (NSS), governmental agencies, investors, preparers and the general public.

For copyright, trademark, and permissions information, please see page 34.



REQUEST FOR INPUT

This Discussion Paper was developed by Staff of the International Auditing and Assurance Standards Board® (IAASB®).

Comments are requested by **January 12, 2021**.

Respondents are asked to submit their comments electronically through the IAASB website, using the "Submit a Comment" link. First-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the IAASB's website.

This publication may be downloaded from the IAASB website:
<http://www.iaasb.org>

CONTENTS

A WORD FROM THE IAASB CHAIR	4
INTRODUCTION	5
QUESTIONS FOR RESPONDENTS	6
I. BACKGROUND	8
II. FRAUD	16
III. GOING CONCERN	21
IV. OTHER MATTERS RELEVANT TO BOTH FRAUD AND GOING CONCERN	26
APPENDIX A	30
APPENDIX B	32

A WORD FROM THE IAASB CHAIR

Serving the public interest is core to the IAASB's mission. Our new initiatives to address issues and challenges related to fraud and going concern in audits of financial statements respond to the significant questions raised regarding the role of auditors in these areas. Many of the regulatory inquiries that have become commonplace in the aftermath of corporate collapses routinely highlight the importance of considering what more can be done by auditors on these two topics.

The debate is timely and vital to enhancing confidence in external reporting. The outbreak of the COVID-19 pandemic has heightened the focus on fraud and going concern. Many companies' control environments have been impacted and may not be what they were before. Furthermore, the nature of evidence that is obtained has significantly changed—all of which changes the risk profiles of many audits, particularly in relation to fraud. The uncertainty created by the pandemic will also challenge the auditor's ability to evaluate the going concern assessments of management.

Our work to identify the challenges, issues, and appropriate responses related to going concern and fraud will touch upon many aspects. One aspect common to both fraud and going concern that is continually highlighted relates to the expectation gap. We recognize that we cannot narrow the expectation gap alone, but we believe this Discussion Paper is the first structured step in better understanding how standards can meaningfully narrow that gap. Others too will need to consider what role they have in narrowing the gap so that there is a better functioning financial reporting ecosystem.

Companies, those charged with their governance, investors, regulators, and others have an important role in improving external reporting in relation to fraud and going concern. The respective responsibilities of the various stakeholders support and reinforce one another. Our specific focus is on the auditor's responsibilities and whether they should be expanded with regard to these topics in the context of an audit of financial statements. We will also consider whether such enhanced responsibilities are needed in all audits, or only in some circumstances. Our efforts will necessarily require us to work with others in the financial reporting ecosystem, because the effectiveness of any potential changes may depend partly on the actions of other stakeholders. We would like to understand the many perspectives on these matters so that we can make informed decisions about possible changes to the standards.

Although not specifically covered in this Discussion Paper, we are also mindful of the impact of technology on the way that frauds are committed. We have other targeted efforts on this aspect, as well as other specific areas that have been highlighted to us through various channels, which are described in Appendix A.

We remain committed to actively further exploring and progressing our thinking in relation to fraud and going concern in audits of financial statements. I wish to emphasize the importance of receiving input from all our stakeholders and look forward to your responses to the questions and issues laid out in this Discussion Paper.



IAASB Chair



INTRODUCTION

Purpose of this Discussion Paper

The purpose of this Discussion Paper is to gather perspectives from all our stakeholders about the role of the auditor in relation to fraud and going concern in an audit of financial statements, and to obtain input on matters about whether our standards related to fraud and going concern remain fit-for-purpose in the current environment.

The information collected will help us to make an informed decision(s) about possible further actions – we are open-minded as to how we could contribute to narrowing the expectation gap, bearing in mind our role as a standard-setter, the proportionality of any proposals and the objective of a financial statement audit.

We have set out certain matters for consideration that have been raised to us through feedback forums or research, but we are not committing to any specific actions at this stage—decisions will be made once we have an informed view about the issues that we need to address and have considered the most appropriate way to address them.

Although the primary focus of this Discussion Paper is on matters that are relevant to the IAASB's remit (i.e. audit standard-setting and related activities), we encourage all participants in the financial reporting ecosystem to evaluate the necessary changes each stakeholder needs to implement if we, collectively, are to be successful in narrowing the expectation gap.

Other IAASB Activities Related to our Projects on Fraud and Going Concern in an Audit of Financial Statements

This Discussion Paper specifically focuses on the expectation gap – but this is just one aspect of our planned activities on the topics of fraud and going concern in an audit of financial statements. As part of our information gathering efforts, we are also undertaking other targeted research and outreach activities to further inform any decisions about future standard-setting or other efforts by us. Appendix A sets out further detail on these other efforts to date.

Next Steps

The IAASB invites all interested stakeholders to respond to this Discussion Paper, including investors and other users of financial statements, those charged with governance of entities, preparers of financial statements, national standard setters, professional accountancy organizations, academics, regulators and audit oversight bodies, auditors and audit firms, and others where interested.

Questions are set out on pages 6 and 7.

“We acknowledge that with changing stakeholder expectations, the status quo is not sustainable and there is a need to urgently review and build a new consensus around the role of the auditor and the scope and expectations of an audit, otherwise such expectation gaps will continue to undermine the perceived value of an audit. With that said, however, the costs arising from any widening of scope and expectations of an audit needs to be balanced against the benefits to stakeholders.”

– Institute of Singapore Chartered Accountants (ISCA), June 2019 response to IAASB Strategy and Workplan

QUESTIONS FOR RESPONDENTS

Questions for respondents are detailed below. Respondents may choose to answer all, or only some, of the questions – all input is welcome. In addition, specific matters are detailed throughout this Discussion Paper where the IAASB is interested to obtain stakeholder perspectives (these have been highlighted as... “The IAASB is interested in perspectives...”). Respondents may wish to comment on those matters.

Proportionality: While we recognize it is not precisely measurable, each of the questions set out on these pages should be considered in the context of the benefits that will be provided in the public interest, weighed against the cost to various stakeholders of implementing the suggested actions (as additional actions will likely involve increased resources).

1. In regard to the expectation gap (**see Section I**):
 - (a) What do you think is the main cause of the expectation gap relating to fraud and going concern in an audit of financial statements?
 - (b) In your view, what could be done, by the IAASB and / or others (please specify), to narrow the expectation gap related to fraud and going concern in an audit of financial statements?

2. This paper sets out the auditor’s current requirements in relation to fraud in an audit of financial statements, and some of the issues and challenges that have been raised with respect to this (**see Sections II and IV**). In your view:
 - (a) Should the auditor have enhanced or more requirements with regard to fraud in an audit of financial statements? If yes, in what areas?
 - (b) Is there a need for enhanced procedures only for certain entities or in specific circumstances?¹ 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.
 - (c) Would requiring a “suspicious mindset” contribute to enhanced fraud identification when planning and performing the audit? Why or why not?²
 - (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?
 - (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.)?

¹ **Appendix B** illustrates possible alternative ways any proposed enhanced procedures may be built into the standards – i.e., for all audits or only in specific circumstances, or performed as part of the audit or as a separate engagement in addition to the audit. Respondents may wish to refer to Appendix B to better understand examples of some of the possible response options.

² See section titled Professional Skepticism in Section IV that introduces the notion of a “suspicious mindset” if the circumstances require it.

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

- | | |
|---|--|
| <p>(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?</p> <p>(b) Is there a need for enhanced procedures only for certain entities or in specific circumstances? If yes:</p> <p>(i) For what types of entities or in what circumstances?</p> <p>(ii) What enhancements are needed?</p> <p>(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.</p> | <p>(c) Do you believe more transparency is needed:</p> <p>(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.)?</p> <p>(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?</p> |
|---|--|
-

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?

I. BACKGROUND

THE INFLUENCE OF THE FINANCIAL REPORTING ECOSYSTEM

The ‘financial reporting ecosystem’ includes those involved in the preparation, approval, audit, analysis and use of financial reports. Each participant of this ecosystem plays a unique and essential role that contributes towards high-quality financial reporting.

Maintaining high-quality financial reporting requires all parts of the financial reporting ecosystem to interact and connect, either formally or informally, to influence the overall outcome, as well as how the ecosystem functions.

In recent years, amplified by high-profile corporate failures or significant accounting restatements that cause shocking news headlines around the globe, trust in the financial reporting ecosystem has been eroded. Corrective steps in all parts of the financial reporting ecosystem are needed to address this crisis of confidence in financial reporting.

This Discussion Paper is an important step of the IAASB’s efforts to play its part toward understanding the most important public interest issues that have been identified in relation to audits of financial statements and responding as needed.

Broadly, many commentators continue to challenge the auditor’s role in respect to fraud and going concern. Most notably is the emphasis on a continuing “expectation gap,” or in general terms, a difference between what users expect from the auditor and the financial statement audit, and the reality of what an audit is. Regardless of the inherent limitations of an audit, the expectation gap, which is intensified when companies collapse without warning signals, is one element that detracts from the public’s confidence and trust in the financial reporting system.

The IAASB is committed to exploring how we can contribute to narrowing the expectation gap, but we cannot solve this problem alone. Within this Discussion Paper we refer to others in the financial reporting ecosystem as relevant, but it will take efforts from all participants of the financial reporting ecosystem to bring about meaningful change and improve financial transparency.

Roles in the Financial Reporting Ecosystem:

Entity and its management (i.e. preparers)



Prepare the financial statements in accordance with the applicable financial reporting framework, also responsible for internal control related to financial statements

Boards and audit committees



Those charged with governance are responsible for overseeing the strategic direction and obligations related to accountability, including the entity’s financial reporting

External Auditors



Evaluate the company’s financial statements (and sometimes internal controls) in accordance with professional standards, report to users of the financial statements, and report certain matters to those charged with governance

Governments, regulators, professional bodies, and standard-setters



Establish and enforce legal and other obligations, regulatory requirements, and develop accounting and auditing standards

Investors, analysts, lenders, consumers, the public, and other stakeholders (i.e., financial statement users)



Make investment and business decisions based on the financial information available

THE CURRENT FINANCIAL LANDSCAPE

A number of corporate failures and scandals across the globe have sparked debate between regulators, public policy makers, investors, auditors, and others. While those debates involve questioning the responsibilities of different participants in the financial reporting ecosystem, they have also highlighted issues in relation to expectations of auditors, including the role and responsibility of the auditor regarding fraud and going concern in an audit of financial statements. Some examples, include:



Toshiba Corporation (2015), Japan

Overstated operating profits by more than \$1.2 billion in a scandal that began in 2008 and spanned 7 years.



Steinhoff International Holdings NV (2017), South Africa

A fraud investigation uncovered billions of dollars of fictitious/irregular transactions.



Carillion (2018), United Kingdom

The company's collapse left £2 billion owed to its suppliers and £2.6 billion in pension liabilities.



Luckin Coffee (2019), China

Fraudulently inflated sales by 2.1 billion yuan (over \$300 million), which resulted in the company being delisted from the US Nasdaq exchange.



Wirecard (2020), Germany

Filed for insolvency after admitting that approximately \$2.6 billion of assets on the company's balance sheet likely did not exist.

Multiple initiatives have been launched around the globe to explore, among other things, the topics of fraud and going concern. More pertinent high-profile initiatives where these topics have been highlighted include:

- In the United Kingdom (UK)—In December 2018, Sir John Kingman published the report and recommendations arising from his review of the Financial Reporting Council (FRC), "**Independent Review of the Financial Reporting Council**", which strongly recommended that independent work should be done to explore the issues arising from the "audit expectation gap" (described in the next section). Subsequently, in December 2019, a review into the quality and effectiveness of the audit in the UK was completed by Sir Donald Brydon, which included recommendations for improvements related to fraud and going concern (the "**Brydon Report**").
- In Australia—The *February 2020 Interim Report from the Parliamentary Joint Committee on Corporations and Financial Services regarding the Regulation of Auditing in Australia* recommended a formal review on the sufficiency and effectiveness of reporting requirements related to the prevention and identification of fraud and management's going concern assessment.

- In Canada—In 2019, in light of global corporate failures, the Canadian Public Accountability Board (CPAB) launched a *Fraud Thematic Review* to evaluate how auditors in Canada are complying with the audit standard relevant to fraud, and explore what actions can be taken by all relevant stakeholders to better prevent and detect corporate fraud. Also in 2019, the CPAB launched a *Going Concern Project* to enhance their understanding of how auditors approach their work to review management’s assessment of going concern risk and explore what else companies, audit committees, auditors and others can do to better inform relevant stakeholders when companies are faced with challenging financial conditions that may lead to unexpected business failures.



In addition, national standard setters in certain jurisdictions have completed projects on these topics in response to well-publicized corporate failures or fraud scandals, including:

- In Japan—The Business Accounting Council established a new standard in 2013 titled “*Standard to Address Risks of Fraud in an Audit*” to be applied to audits of publicly traded companies. This new standard clarifies fraud-related audit procedures, requires more cautious performance of audit procedures in certain circumstances, particularly when the auditor has determined that any suspicion of a material misstatement due to fraud exists, and establishes additional quality control considerations.

To date there has been no direct analysis of the effectiveness of the changes in Japan. However, the Certified Public Accountants and Auditing Oversight Board performs external inspections and their inspection findings include matters relating to the new standard. Therefore, there are some that have the view that the changes have clarified what needs to be done when a fraud is suspected and believe that the more robust procedures in these instances have contributed to higher-quality audits.

- In the UK—In September 2019, the FRC issued a *revised going concern standard* with strengthened audit requirements, particularly around the auditor’s evaluation of management’s assessment of going concern, professional skepticism, and more robust auditor reporting requirements.

THE AUDIT “EXPECTATION GAP”

The concept of an audit “expectation gap” has existed for decades and has been defined and described in several ways. The next two sections provide an overview of the purpose of a financial statement audit as it is currently understood in accordance with the auditing standards, and a description of the audit “expectation gap” for purposes of this Discussion Paper.



Purpose of a Financial Statement Audit

The purpose of a financial statement audit, as currently described in the auditing standards, is to enhance the degree of confidence of intended users in the financial statements. This is achieved through the expression of an auditor’s opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. As the basis for the auditor’s opinion, the auditing standards require the auditor to obtain **reasonable assurance** about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.³

“Reasonable assurance is not an absolute level of assurance, because there are inherent limitations of an audit which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor’s opinion being persuasive rather than conclusive.”

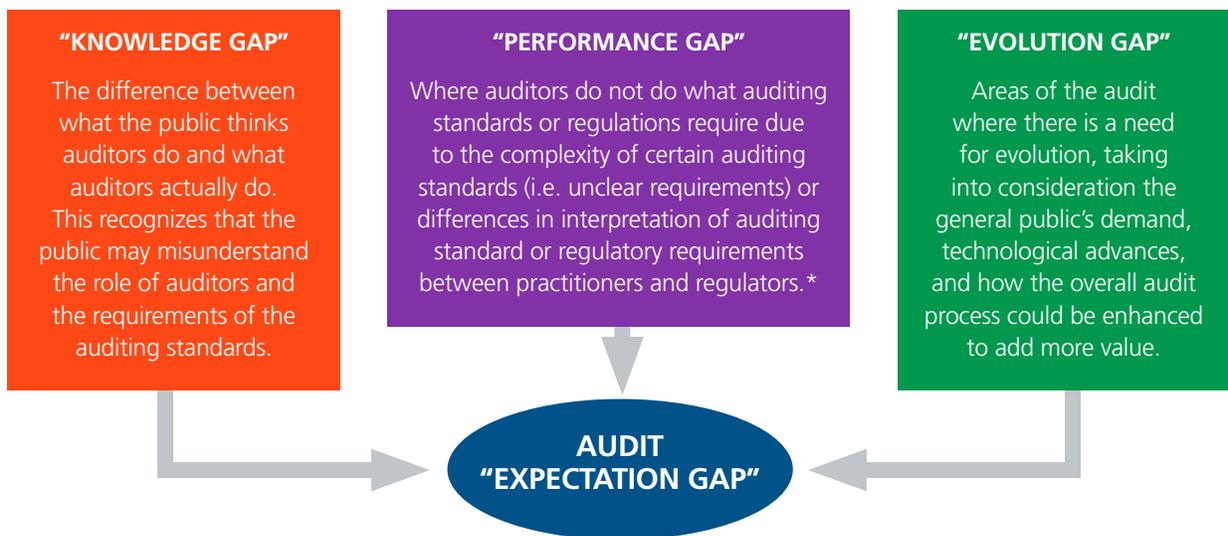
– International Standard on Auditing (ISA) 200, paragraph 5

Professional Judgment and Professional Skepticism

The auditing standards require that the auditor exercise professional judgment and maintain professional skepticism throughout the planning and performance of the audit.⁴ These concepts are particularly relevant to fraud and going concern in an audit of financial statements (see later section titled “Professional Skepticism” where this concept is further discussed).

The Audit “Expectation Gap” Described

As already mentioned, the expectation gap, in general terms, is the difference between what users expect from the auditor and the financial statement audit, and the reality of what an audit is. This is further broken down in a May 2019 publication by the Association of Chartered Certified Accountants (ACCA) titled “Closing the Expectation Gap in Audit,” which describes three components of the expectation gap: the “knowledge gap,” the “performance gap,” and the “evolution gap,” described in the diagram below.



*The ACCA document referenced above describes the performance gap as also including areas where there is clarity in requirements, but auditors fail to do what standards or regulations require, for example as a result of insufficient focus on audit quality. Others consider that, while important to the public interest, this is not part of the expectation gap because the requirements were clear - rather this is a breakdown in the auditor’s application of the requirements. For purposes of this Discussion Paper, matters related to the performance gap focus primarily on areas where auditors do not do what is required because the requirements are not clear or leave room for misinterpretation.

³ ISA 200, paragraphs 3 and 5

⁴ ISA 200, paragraph 7

Several other terms and elements of the expectation gap have been referenced in publicly available information. For example, an “interpretative gap” deals with the interpretation of what the existing auditing standards require and what they actually require auditors to do or to communicate to the user about the audit process or results. Stakeholders and market participants might have different interpretations about existing requirements and the assurance that is conveyed by the auditor’s report, and as a result, may expect more than is actually required. In addition, some academic reports refer to a “reasonableness gap” – that is, a gap between public expectations of auditors and what auditors are reasonably capable of delivering (and therefore what auditing standards can require given the inherent limitations of audits).

Another aspect of the expectation gap that has been referenced is the “hindsight gap.” Hindsight bias is said to exist when individuals overestimate the extent to which an outcome could have been anticipated prior to its occurrence. Therefore, there can be a gap between what stakeholders expect of auditors prior to a negative event as opposed to after that event occurs.

Furthermore, in some articles or periodicals, the “knowledge gap” described above is referred to as the “information gap.” “Delivery gap” is a term that has also been used to describe the “performance gap.”

Although these and other terms have been used to describe aspects of the expectation gap, this Discussion Paper



focuses on the three terms described in the diagram above that make up the audit expectation gap: the knowledge gap, the performance gap, and the evolution gap, as these descriptions better facilitate the exploration of areas that are most relevant to the IAASB’s work.

The table below outlines examples of matters contributing to each component of the audit expectation gap, gathered from various sources in our information gathering and research activities. The table distinguishes between those aspects that could possibly be addressed by standard setting (which are further explored later in this Discussion Paper), and those aspects that require further consideration about how to address, either by the IAASB and / or others (e.g. audit firms, regulators, investors, accounting standard setters, professional accountancy organizations, academia, etc.). In addition, **Appendix A** describes certain matters that were raised to the IAASB but fall outside of the IAASB’s remit or fall outside the scope of this Discussion Paper.

Examples of Components of the Expectation Gap	
Aspects that Could Possibly be Addressed by Standard-Setting, Including Support Materials	Aspects that Require Further Consideration
Knowledge Gap	
<ul style="list-style-type: none"> • The nature, extent and limitations of the auditor’s responsibilities in relation to fraud and going concern may be unclear in the auditor’s report. * • The description of a material uncertainty in both accounting and auditing standards with regards to an entity’s ability to continue as a going concern is inconsistently understood and applied. * 	<ul style="list-style-type: none"> • Some users of financial statements do not understand what an audit entails (i.e., the nature, extent, and limitations of the auditor’s procedures to obtain evidence to support an audit opinion). • Some may have unreasonable expectations of what auditors ought to do compared to what auditors are actually capable of doing due to the inherent limitations of an audit. • The public thinks the role of the auditor is to detect fraud, including non-material fraud. • Differences of view as to the meaning and implication of material uncertainties and the going concern concept.

Examples of Components of the Expectation Gap	
Aspects that Could Possibly be Addressed by Standard-Setting, Including Support Materials	Aspects that Require Further Consideration
Performance Gap	
<ul style="list-style-type: none"> • Aspects of some standards may not be clear such that there is inconsistent application or confusion as to how to apply them. * • There is insufficient guidance and support materials to assist with effective application. * 	<ul style="list-style-type: none"> • The auditor is pressured, either by management or by tight deadlines, resulting in lower-quality audit work. • Auditors may not be adequately trained. • The firm may not have clear policies and procedures with regards to audit quality or they are not applied appropriately. • The auditor is pressured to accept less transparent company disclosures and/or not to include going concern uncertainties in the auditor’s report because of fears that such disclosures/reporting will be a self-fulfilling prophecy.
Evolution Gap	
<ul style="list-style-type: none"> • Audits may not have evolved to meet changing expectations due to developments within the environment, for example: <ul style="list-style-type: none"> – Stakeholders seek more insight into a company’s future viability than is currently provided for in accounting and auditing standards. * – Environmental influences encourage more transparency from auditors which is not forthcoming because it is not required. * • The environment is evolving at a more rapid pace which may necessitate different, and more robust, procedures targeted at ongoing changes. ** • Users of financial statements are looking for enhanced procedures in relation to fraud and going concern that is not currently provided by the requirements of the auditing standards. * • In the current environment, the auditing standards may not be robust enough when a possible fraud is identified. * 	<ul style="list-style-type: none"> • Shareholders are seeking more information from entities’ auditors, however, there are insufficient opportunities for the auditor to formally engage with shareholders and the public. • The expectation of audit committees and those charged with governance has increased with evolving environmental influences, for example there is a greater emphasis on setting tone and monitoring culture. • There is a call for a broader and more holistic view of the auditor’s role beyond what the audit delivers, for example separate engagements on an aspect of the audit where stakeholders are looking for more.
<p>* Aspects addressed in this Discussion Paper</p> <p>** Topic will also be addressed through further activities in relation to technology</p>	
<p>Throughout this paper, we set out matters or research areas related to the expectation gap that have been communicated to the IAASB through other feedback forums and indicate (noted next to each matter presented) the primary component(s) of the audit expectation gap (as explained above).</p>	

KEY DEPENDENCIES ON OTHERS IN THE FINANCIAL REPORTING ECOSYSTEM

All parts of the financial reporting ecosystem are essential to help effectively narrow the expectation gap. In addition to auditors appropriately applying the International Standards on Auditing (ISAs), we have highlighted certain roles below that directly impact the effectiveness of any standard-setting the IAASB undertakes.



Management and Those Charged with Governance

Management

Management has a primary responsibility for the prevention and detection of fraud. Management is also responsible for assessing the entity's ability to continue as a going concern. Management's responsibilities with regard to these topics are described further in sections II, III, and IV of this Discussion Paper.

Those Charged with Governance

Those charged with governance are responsible for oversight and monitoring. In fulfilling this role, they should be satisfied that the entity has policies and procedures in place to prevent and identify fraud. Those charged with governance should also work with management to oversee the establishment of appropriate anti-fraud controls and take the necessary steps when fraud is detected.

Another part of the responsibilities of those charged with governance is the oversight over the financial reporting process, including the quality of the financial reporting and internal control related to the preparation of the financial statements. Robust requirements for those charged with governance with regard to their role will increase the effectiveness of the financial reporting system as they may also be in a position to influence the quality of the audit through, for example:

- Providing their views on financial reporting risks and areas of business that they believe warrant particular audit attention;

- Discussing with the auditor their views on the fraud risks and their understanding of management's controls to address those risks;
- Considering independence issues and assessing their resolution;
- Creating an environment in which management is not resistant to challenge by the auditor and is not overly defensive when discussing difficult or contentious issues, and
- Assessing how management was challenged by the auditor during the audit, particularly with regard to the assessment of fraud risk, management's estimates and assumptions (including with regard to going concern) and the choice of accounting policies.⁵

The Importance of Culture and Tone at the Top

A 2015 academic report titled "*Corporate Culture and the Occurrence of Financial Statement Fraud: A Review of Literature*" (Omar, Johari, Z. and Hasnan) explored the impact of corporate culture in the occurrence of financial statement fraud. It refers to culture as values that are shared by the people in a group and that tend to persist over time even when group membership changes. All entities have corporate cultures, and some have much stronger cultures than others. The report goes on to reference a study (Biggerstaff, Cicero, and Puckett 2014) that shows employees take their cues from top management, because the character of the CEO and other top officers is generally reflected in the character of the entire company.

⁵ Some of these examples are from the IAASB's *A Framework for Audit Quality: Key Elements that Create an Environment for Audit Quality*, paragraph 56

The importance of a culture of honesty and ethical behavior, reinforced by active oversight, as well as management and those charged with governance placing a strong emphasis on fraud prevention and fraud deterrence, is emphasized in the auditing standards. In addition, the auditing standards suggest that the audit engagement team may include in their discussions a consideration of factors that may indicate a culture that enables management or others to rationalize committing fraud. Culture is also highlighted in the examples of fraud risk factors included in an appendix to the auditing standards

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.

Accounting Standard Setters

The content of the financial statements and the preparation thereof is prescribed in the applicable financial reporting framework, which is the responsibility of the relevant accounting standard-setter. The IAASB's ISAs do not impose responsibilities on management or those charged with governance as they deal with the requirements for auditors when performing a financial statement audit and expressing an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework (as previously described).

The auditing standards are not able to impose additional content not provided by management in preparing the financial statements, unless the information relates to the audit, for example, a misstatement in relation to a disclosure(s) that is(are) required by the applicable financial reporting framework, in which case further



transparency may be possible, for example, through the auditor's report. Accordingly, where there is a call for greater responsibilities to be imposed on management or those charged with governance, or more information to be included in the financial statements in certain areas, this may require changes to the applicable financial reporting framework, which is in the remit of the relevant accounting standard-setter.

Regulators and Audit Oversight Bodies

The synergies between auditors, standard-setters and regulators and audit oversight bodies, is critical to the effective functioning of the financial reporting ecosystem.

Appropriate sharing of information and open communication assists all of these parties in undertaking their activities effectively. Some matters related to the expectation gap may also need to be addressed by regulators and audit oversight bodies as appropriate, as they are in the unique position to influence auditors, and management and those charged with governance through oversight, stakeholder engagement, inspections, and enforcement actions.

II. FRAUD

Fraud is described in the auditing standards as *“an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.”*



Responsibility for Fraud at the Entity

Primary responsibility for the prevention and detection of fraud rests with both those charged with governance and management of the entity.



The Auditor's Responsibilities with Regard to Fraud in an Audit of the Financial Statements

An auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error (i.e., designing and performing audit procedures to identify and respond to risks of material misstatement, including those arising from fraud)

The auditing standards prescribe specific procedures targeted at identifying and assessing risks of material misstatement, including procedures targeted at identifying risks of material misstatement arising from fraud, and procedures to respond to those risks. The auditing standards also require the auditor to evaluate the implications when a possible misstatement may be indicative of fraud.

Owing to the inherent limitations of an audit, there is always the unavoidable risk that some material misstatements of the financial statements may not be identified, even though the audit is properly planned and performed in accordance with the ISAs. This is because most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion is persuasive rather than conclusive. There is also the added risk of not identifying a material misstatement resulting from fraud⁶ because fraud schemes are often carefully planned and concealed.

Responsibility for Compliance with Laws and Regulations⁷

A matter that is often closely related to fraud is non-compliance with laws and regulations. It is the responsibility of management and those charged with governance to ensure that the entity's operations are conducted in accordance with the applicable laws and regulations, including compliance with the relevant laws and regulations that determine the reported amounts and disclosures in an entity's financial statements. The auditor is not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

The auditor's responsibilities in relation to laws and regulations when obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether due to fraud or error, are to consider the applicable legal and regulatory framework relevant to those laws and regulations that have a direct

⁶ The IAASB's recently completed revised standard on risk identification and assessment ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatements*, has introduced more robust procedures for identifying risks of material misstatement, including risks arising from fraud. Part of the enhancements has been to introduce inherent risk factors into the auditor's considerations, to assist with identifying and assessing where risks of misstatement could arise. These inherent risk factors include fraud risk factors.

⁷ ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, paragraphs 3-5

effect on financial reporting. The auditor is also required to perform specific procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements, and respond accordingly.

As the topic of fraud is often inter-related with non-compliance with laws and regulations, the information gathered through the questions in this Discussion Paper may also inform the need for possible future changes in the auditing standard related to consideration of laws and regulations in an audit of financial statements.

Understanding Perceptions and Views Related to the Auditor’s Responsibilities in the Current Environment

There are differing views about the role of the auditor in detecting fraud as part of the financial statement audit. Some believe the auditor’s responsibilities should be expanded to better detect fraud and undertake further actions in relation to fraud to meet the evolving expectations of the public today. Others have highlighted that a financial statement audit cannot ever be designed to identify all fraud due to the nature of an audit and the inherent limitations of the procedures required to gather audit evidence when forming an opinion (such as using the concepts of materiality and selecting items for testing).

It has also been suggested that auditors be required to evaluate and report on management’s processes and controls to prevent and detect fraud. If the auditor’s responsibilities are expanded to report as such, this will necessitate obligations on management to perform certain activities related to, and report on, the entity’s processes and controls to prevent and detect fraud.

Many public sector audits are carried out using the ISAs. Although the objectives are the same, it has been highlighted that the public sector auditor’s approach to fraud may be more robust, and further consideration of how public sector auditors approach their work in relation to fraud may also help inform the IAASB as it considers whether changes to its standards are needed.

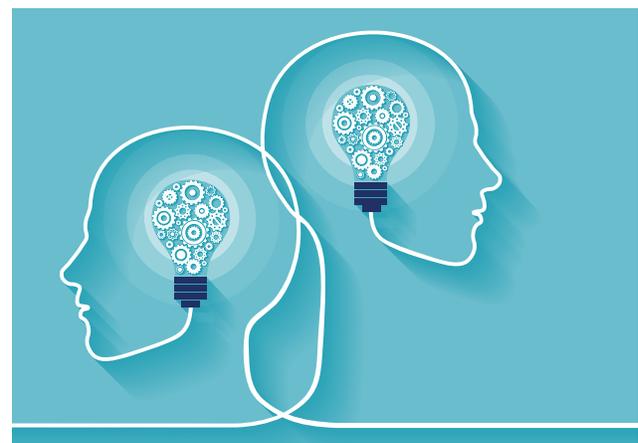
Discussion on Matters Related to the Expectation Gap and the Auditor’s Responsibilities⁸

In the following sections, we explore additional matters that have been highlighted to the IAASB, either by stakeholders through other feedback forums or through research performed. The IAASB is open to receiving feedback on these specific matters, or on any other related matters that respondents wish to comment on. We welcome any suggestions for possible actions that could help to narrow the audit expectation gap as it relates to fraud.

INCREASED USE OF FORENSIC SPECIALISTS OR OTHER RELEVANT SPECIALISTS

EVOLUTION GAP

A forensic audit (or investigation) is an investigation and evaluation of a firm’s or individual’s financial records to derive evidence that can be used in a court of law or legal proceeding with regard to corruption, asset misappropriation or financial statement fraud. These engagements are targeted in scope and undertaken by individuals who have been trained and certified in forensic techniques. Although some similar procedures to an audit of financial statements may be used (such as analytical procedures), they also make use of investigative techniques and advanced technologies to gather evidence for use in civil or criminal courts of law.



⁸ The topics of professional skepticism and auditor reporting are addressed later in this Discussion Paper as these aspects are relevant to both fraud and going concern.

The auditing standards do not specifically require the use of forensic specialists.⁹ However, the auditing standards do include that the auditor may respond to identified risks of material misstatement due to fraud by assigning additional individuals with specialized skills and knowledge, such as forensic and IT experts, to the engagement.¹⁰

It has been suggested that requiring the use of forensic specialists on an audit engagement more broadly may help narrow the evolution gap by strengthening the procedures of the auditor with respect to fraud (i.e., respond to those that believe that more should be done with regard to fraud in a financial statement audit, while recognizing that the use of a forensic specialist in a financial statement audit is not equivalent to a forensic audit (or investigation)).

Specifically, it has been noted that forensic specialists may be used during the engagement team discussion about possible areas of material misstatement arising from fraud, during inquiries with management and others, and when performing audit procedures to respond to certain risks of material misstatement. Forensic specialists or other relevant specialists may be able to provide increased insight into the fraud risks of the company.

It has been suggested that requiring the use of forensic specialists on an audit engagement more broadly may help narrow the evolution gap by strengthening the procedures of the auditor with respect to fraud (i.e., respond to those that believe that more should be done with regard to fraud in an audit of financial statements). However, it has also been cautioned that a financial statement audit is broader in scope and not forensic in nature, and the effectiveness of using forensic specialists or other relevant specialists

must be considered in the context of the objectives of each financial statement audit and the nature and circumstances of the specific engagement. In addition, many audit firms do not have access to these specialists in-house, and therefore this may present scalability issues.

It has also been suggested that training in both forensic accounting and fraud awareness could be enhanced as part of the formal qualification and continuous learning process for financial statement auditors. As noted in Appendix A, the IAASB views this as a relevant suggestion for other stakeholders to consider (e.g. International Federation of Accountants (IFAC) International Panel on Accountancy Education, audit firms, universities, certification boards, etc.).

In addition, some have suggested that the use of other relevant specialists to perform fraud procedures may help narrow the evolution gap. For example, data or information technology experts may be used to help perform procedures using advanced technologies (such as data mining or data analytics) to test full populations or identify populations subject to greater risk. However, similar to forensic specialists, proportionality and scalability are important considerations, particularly for audit firms who do not have access to these specialists in-house.

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.

ADDITIONAL FOCUS ON NON-MATERIAL FRAUD

EVOLUTION GAP

Financial statement audits are not designed to identify misstatements that are not material to the financial statements as a whole, including those due to fraud. The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error.¹¹



⁹ While the use of forensic specialists is not specifically required, the auditing standards do require the engagement partner to be satisfied that the engagement team and any auditor's experts, who are not part of the engagement team, collectively have the appropriate competence and capabilities to perform the audit engagement and issue an auditor's report that is appropriate in the circumstances.

¹⁰ ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraph A35

¹¹ ISA 200, paragraph A47

While the auditor is not required to design and perform specific procedures with regard to misstatements that are not material, any misstatement related to fraud that has been identified may be indicative of a bigger issue. For example, evidence that an employee is not acting with integrity may also reflect broader issues in the entity's corporate culture. Furthermore, frauds that are not material that recur over long periods of time may become material (quantitatively or qualitatively) in the future.

The auditing standards require the auditor to evaluate whether identified misstatements are indicative of fraud and assess the impact on other aspects of the audit, particularly management representations. If the auditor identifies a misstatement, whether material or not, and has reason to believe that it is, or may be, the result of fraud, and that management (in particular, senior management) is involved, the auditor must reevaluate their original assessments with regard to the risks of material

misstatement due to fraud and the impact on planned audit procedures in response to those risks. The auditor must also consider possible collusion involving employees, management or third parties when reconsidering the reliability of evidence previously obtained.¹²

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.

AUDITOR'S RESPONSIBILITIES WITH RESPECT TO THIRD-PARTY FRAUD

EVOLUTION GAP

Third-party fraud is often committed in collusion with employees at the company. As noted previously, the definition of fraud in the auditing standards includes fraud by third parties.¹³

Auditors are required to identify and assess risks of material misstatement due to fraud, design and implement appropriate responses to those risks, and take appropriate action regarding fraud, or suspected fraud, identified during the audit, including material fraud involving third parties. However, it has been highlighted that additional emphasis should be placed on procedures related to identifying third-party fraud.

In addition, it has been questioned whether audit procedures should be designed to detect fraud that is not directly related to risks of material misstatement (e.g., cyber-attacks resulting in theft of customer information) and are rather related to reputational or operational risk. This would expand the scope of the financial audit beyond what is currently required.



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).

¹² ISA 240, paragraphs 36–37

¹³ ISA 240, paragraph 11(a)

ENHANCED QUALITY CONTROL REQUIREMENTS

PERFORMANCE GAP

EVOLUTION GAP

International Standard on Quality Control (ISQC) 1¹⁴ requires that firms establish policies and procedures requiring, for certain engagements, an engagement quality control review that provides an objective evaluation of the significant judgments made by the engagement team and the conclusions reached in formulating the auditor's report or other engagement report. The engagement quality control review process is 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.^{15, 16}

Specific quality control review procedures related to fraud are not explicitly required. However, a material misstatement arising from fraud would likely be considered a significant matter or an area requiring significant judgment¹⁷ and therefore be addressed by the engagement quality control review.

As referenced earlier, in 2013 a new fraud standard was established in Japan (only applicable for audits of publicly traded companies) that introduced enhanced quality control review procedures related to fraud. For example, it explicitly requires that an engagement quality control review be conducted at appropriate stages during the audit, such as when significant judgments are made and conclusions reached to address the risks of fraud, in compliance with the policies and procedures of the audit firm. These enhanced procedures also explicitly require that when the auditor determines that a suspicion of material misstatement due to fraud exists, the auditor shall not express an opinion until the engagement quality control review procedures in regard to the auditor's response to that suspicion have been completed.



In addition, the new fraud standard requires firms to establish policies and procedures that explicitly address the risks of fraud in the elements of the quality control system (i.e., leadership responsibilities for quality within the firm, acceptance and continuance of client relationships and audit engagements, human resources, engagement performance, and monitoring)..

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.

¹⁴ ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

¹⁵ The IAASB's Quality Control Standards will be replaced imminently by its new standards on Quality Management. Proposed International Standard on Quality Management (ISQM) 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*, and ISQM 2, *Engagement Quality Reviews*, will contain similar requirements in relation to engagement quality reviews for certain engagements.

¹⁶ ISQC 1, paragraph 35

¹⁷ ISQC 1, paragraph 37

III. GOING CONCERN

Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern¹⁸ and will continue its operations for the foreseeable future.

Going Concern Assessment for the Entity



- Some financial reporting frameworks contain an explicit requirement for management to assess the entity's ability to continue as a going concern, as well as provide certain disclosures with regard to the entity's going concern in the financial statements.
- Detailed requirements regarding management's responsibility to assess the entity's ability to continue as a going concern may also be set out in law or regulation.
- There may also be no explicit requirement to make a specific assessment. However, where going concern is a fundamental principle in the preparation of the financial statements (i.e., assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business), management is still required to assess the entity's ability to continue as a going concern as it underlies the basis of preparation.

Responsibilities of the Auditor with Regard to the Entity's Going Concern



- To obtain sufficient appropriate audit evidence regarding, and concluding on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements.
- To conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern.
- To report in accordance with the ISAs.

The requirements for management's responsibilities with regard to going concern are generally set out in the applicable financial reporting framework. For example, International Accounting Standard (IAS) 1, *Presentation of Financial Statements*, requires management to make an assessment of the entity's ability to continue as a going concern when preparing the financial statements. IAS 1 further explains that the degree of consideration depends on the facts in each case, further noting that in some cases a detailed analysis may not be needed but in others "management may need to consider a wide range

of factors." When management is aware of material uncertainties related to events or conditions that may cast a significant doubt upon the entity's ability to continue as a going concern, those uncertainties are required to be disclosed.

Management has the most relevant information to assess the entity's future performance, and a robust and balanced assessment of the entity's ability to continue as a going concern by management, and disclosure of any uncertainties, provides the foundation for the auditor's procedures.

¹⁸ As described in IAS 1, an entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading or has no realistic alternative but to do so.

The auditing standards describe specific procedures to evaluate management's assessment of the entity's ability to continue as a going concern, and consideration of any related disclosures. These procedures are aimed at assisting the auditor to conclude on the entity's ability to continue as a going concern based on management's assessment, and to assess the adequacy of any disclosures necessary in terms of the applicable financial reporting framework. The auditing standards also set out the implications of the auditor's conclusions on the auditor's report.

"A thorough and thoughtful assessment by management is an important precondition to high-quality audit work in this area."

– Canadian Public Accountability Board (CPAB) Exchange (January 2020)

The auditor's procedures are largely focused on whether events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern, and whether these have been taken into account in management's assessment. The auditor is also required to remain alert throughout the audit for evidence that there may be a going concern issue.

Understanding Perceptions and Views Related to the Auditor's Responsibilities in the Current Environment

The potential effects of inherent limitations on the auditor's ability to identify material misstatements are greater for future events or conditions that may cause an entity to cease to continue as a going concern. The auditor cannot predict such future events or conditions. Accordingly, the absence of any reference to a material uncertainty about the entity's ability to continue as a going concern in an auditor's report cannot be viewed as a guarantee as to the entity's ability to continue as a going concern.

High-profile corporate failures have triggered public criticism of auditors and raised questions around how much they should be able to detect from their audit procedures in relation to the going concern of the entity, and what is communicated to users with regard to the entity's ability to continue as a going concern for the foreseeable future.

There are different views about the auditors' responsibilities for identifying and addressing issues related to an entity's ability to continue as a going concern, including reporting on the entity's going concern status. Some have recognized the difference in the responsibilities of management and auditors, particularly that the auditor is not required to opine on the entity's ability to continue as a going concern – rather, the auditor obtains sufficient appropriate audit evidence to be able to conclude on the appropriateness of management's assessment. For others there is a blurring of these responsibilities.

The assumption that an entity will be able to continue as a going concern is fundamental to the preparation of the financial statements. Given the number of high-profile corporate failures, some stakeholders are also looking for enhanced procedures for the auditor with regard to the entity's ability to continue as a going concern. For example, in the UK, changes to their equivalent of ISA 570 (Revised) include requiring auditors to obtain an enhanced understanding of the processes that oversee management's assessments.

"Arguably, the information stakeholders most want is reassurance about the resilience of a company."

– Sir Donald Brydon, Report of the Independent Review into the Quality and Effectiveness of Audit, December 2019

Discussion on Matters Related to the Expectation Gap and the Auditor’s Responsibilities¹⁹

In the following sections, we explore matters that have been highlighted to the IAASB, either by stakeholders through other feedback forums or through research performed. The IAASB is open to receiving feedback on these specific matters or on any other matters that respondents wish to comment on. We welcome any suggestions for possible actions that could help to narrow the audit expectation gap with regard to going concern.

TIME PERIOD FOR GOING CONCERN ASSESSMENTS

EVOLUTION GAP

Current Accounting Requirements	Current Audit Requirements ²⁰
<p>Requirements for management to assess the entity's ability to continue as a going concern are often specified by an applicable financial reporting framework, including the period which the assessment must cover. For example, International Accounting Standards (IAS) 1, <i>Presentation of Financial Statements</i>, describes that management must consider all information about the future which is at least twelve months from the end of the reporting period.²¹</p>	<ul style="list-style-type: none"> • In evaluating management's assessment of the entity's ability to continue as a going concern, the auditor shall cover the same period as that used by management to make its assessment as required by the applicable financial reporting framework or by law or regulation if it specifies a longer period. If management does not perform an assessment that covers a period of at least twelve months from the date of the financial statements, the auditor shall request management to extend their assessment. • The auditor shall inquire of management as to its knowledge of events or conditions beyond the period of management’s assessment that may cast significant doubt on the entity's ability to continue as a going concern.

While auditors are required to inquire of management, they are not explicitly required to perform any other audit procedures to identify events or conditions beyond the required period of assessment that may cast significant doubt on the entity's ability to continue as a going concern, although all evidence otherwise gathered throughout the audit must be considered. Some stakeholders have questioned whether the auditor’s assessment should be extended to cover a longer period, while others have highlighted that auditors are not able to predict events too far into the future, in particular if management has no such requirement.

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.

¹⁹ The topics of professional skepticism and auditor reporting are addressed later in this Discussion Paper as these aspects are relevant to both fraud and going concern.

²⁰ ISA 570 (Revised), *Going Concern*, paragraphs 13 and 15

²¹ IAS 1, paragraph 26

GOING CONCERN AND OTHER CONCEPTS OF RESILIENCE

KNOWLEDGE GAP

EVOLUTION GAP

Certain jurisdictions require management to report on other concepts of the company’s resilience. For example, in the UK, certain entities have a responsibility to report on the entity’s longer-term viability. The statement is published in an entity’s annual report and explains management’s assessment of the company’s prospects over a specified period, taking account of its current position and principal risks. This type of reporting is more concerned with future scenario planning and what risks could at some future point crystallize as threats to survival. Auditors are required to perform procedures on the statement prepared by management to identify whether there is a material inconsistency between the auditor’s knowledge they have acquired during the audit, including that obtained in their evaluation of management’s assessment of going concern. Auditors have a requirement to report in the auditor’s report whether there is anything material to add or draw attention to in respect of management’s statement.

In Australia, directors declare a statement of solvency, indicating the company can pay all debts as and when they become due and payable. The directors’ solvency statement is contained in the directors’ declaration on the financial report, and therefore auditors consider its compliance with the Corporations Act 2001 when forming a view on the financial report as a whole.

In contrast, in many financial reporting frameworks, management’s assessment of whether the going concern basis of accounting is appropriate is based on whether management intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. When assessing whether the going concern assumption is appropriate, management takes into account all available information about the future which is at least, but not limited to, twelve months from the end of the reporting

period. The auditor is required to conclude on the appropriateness of management’s use of the going concern basis of accounting.

Some have raised that these differing terms to describe an entity’s financial health leads to confusion around what each term means, and have questioned the differences between the various concepts and the need for these different concepts, and the auditor’s responsibilities related thereto.

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).

MATERIAL UNCERTAINTY RELATED TO GOING CONCERN

PERFORMANCE GAP

KNOWLEDGE GAP

Current Accounting Requirements	Current Audit Requirements ²²
<p>An applicable financial reporting framework may provide the requirements for management’s assessment of the entity’s ability to continue as a going concern, which may also reference material uncertainties where they arise. For example, IAS 1 requires that when management is aware of material uncertainties related to events or conditions that may cast significant doubt upon the entity’s ability to continue as a going concern, the entity shall disclose those uncertainties.²³</p>	<p>A material uncertainty exists when the magnitude of its potential impact and likelihood of occurrence is such that, in the auditor’s judgment, appropriate disclosure of the nature and implications of the uncertainty is necessary for:</p> <ul style="list-style-type: none"> • In the case of a fair presentation financial reporting framework, the fair presentation of the financial statements, or • In the case of a compliance framework, the financial statements not to be misleading.

²² ISA 570 (Revised), paragraph 18

²³ IAS 1, paragraph 25

In considering whether disclosures for a material uncertainty may be required, it has been highlighted that the term 'ability to continue as a going concern' is interpreted and applied inconsistently, and in some cases, not understood by users of the financial statements. When this term is inconsistently interpreted, it impacts when the disclosures are made within the financial statements. It has been highlighted that earlier disclosures are more useful when there are material uncertainties.

It has also been highlighted that under some financial reporting frameworks there is no clarity for what has to be disclosed, and therefore there are inconsistencies in the disclosures that are made when a material uncertainty exists.^{24,25} Disclosure requirements are set forth by the applicable financial reporting framework, and any changes for further clarification with regard to these matters would need to be made by the accounting standard setters. In 2012, the International Accounting Standards Board did consider these matters with regard to its standards, but, on balance, agreed to not make any changes. At the time, it was noted by the International Financial Reporting Interpretations Committee (IFRIC) that IAS 1 (paragraph 122) did require disclosure of management's judgments when applying the entity's accounting policies that have the most significant effect on the amounts recognized in the financial statements, and any judgments made in concluding on material uncertainties would come under this remit.



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.

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.

²⁴ ISA 570 (Revised), paragraphs 19–20

²⁵ For example, the New Zealand Accounting Standards Board has proposed additional disclosures in the financial statements relating to significant judgements and assumptions regarding the appropriateness of the going concern assumption, and additional disclosures where material uncertainties had been identified, and the Australian Accounting Standards Board has agreed to encourage changes at an international level on these matters.

IV. OTHER MATTERS RELEVANT TO BOTH FRAUD AND GOING CONCERN

PROFESSIONAL SKEPTICISM

PERFORMANCE GAP

EVOLUTION GAP

Current Requirements in the Auditing Standards:

The auditing standards require the auditor to plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated.

Professional skepticism includes being alert to, for example:²⁷

- Audit evidence that contradicts other audit evidence obtained.
- Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence.
- Conditions that may indicate possible fraud.

Professional Skepticism

An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.²⁶

- Circumstances that suggest the need for audit procedures in addition to those required by the auditing standards.

In addition, the following summarizes the professional skepticism requirements detailed in the auditing standards related to fraud and going concern:^{28, 29}

ISA 240, The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

- The auditor shall maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance.
- Unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine. If conditions identified during the audit causes the auditor to believe that a document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, the auditor shall investigate further.
- Where responses to inquiries of management or those charged with governance are inconsistent, the auditor shall investigate the inconsistencies.

ISA 570 (Revised), Going Concern

- The auditor shall remain alert throughout the audit for audit evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

²⁶ ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraph 13(l)

²⁷ ISA 200, paragraph A20

²⁸ ISA 240, paragraphs 12–14

²⁹ ISA 570 (Revised), paragraph 11

The IAASB has recognized that merely asking auditors to be ‘more skeptical’ will not drive the behavioral change needed. Recent revisions to certain auditing standards have introduced new requirements articulated in a way that fosters a skeptical mindset. It has been highlighted that similar enhancements should also be considered for any future project on fraud and going concern. Examples of such changes could include:

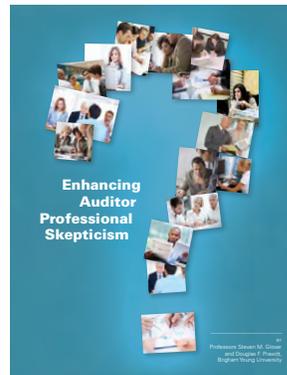
- Emphasis that audit procedures should not be biased towards obtaining corroborative evidence or towards excluding contradictory evidence.
- Enhancing the requirements to “stand-back” and evaluate all audit evidence obtained in forming conclusions.
- Use of stronger language in the standards (such as “challenge”, “question” and “reconsider”) to reinforce the importance of exercising professional skepticism.

As described earlier, in 2013, the Business Accounting Council in Japan established a new standard titled “Standard to Address Risks of Fraud in an Audit.” The new standard introduced an increased emphasis on professional skepticism, including a requirement that the auditor exercise increased professional skepticism in determining whether there is any suspicion of a material misstatement due to fraud and in performing the audit procedures to address such suspicion (which are more extensive than if no suspicion exists).



In the UK, the newly revised auditing standard related to going concern includes additional requirements designed to enhance the auditor’s application of professional skepticism. For example, auditors are required to evaluate whether judgements made by management in making its assessment of going concern are indicators of possible management bias.

The Brydon report recommends that auditors receive training in both forensic accounting and fraud awareness to apply a mindset of deep suspicion in relevant circumstances, rather than just skepticism. Instead of starting with a neutral mindset, auditors may need to approach the audit with a suspicious mindset if the circumstances require it. However, some have raised concerns that this may jeopardize the audit relationship. If management feels the auditor is deeply suspicious of them, that may damage their professional relationship with the auditor, and they may be less likely to cooperate as fully with auditor requests



A publication written by academic professors and commissioned by the Global Public Policy Committee titled “**Enhancing Auditor Professional Skepticism**” proposes that standards describe professional skepticism on a continuum, where a neutral mindset may be appropriate

in certain low-risk circumstances, but presumptive or complete doubt may be warranted in other higher-risk circumstances.

An academic report titled “Research on Auditor Professional Skepticism: Literature Synthesis and Opportunities for Future Research” (Hurt et. al) describes how research indicates unconscious bias may influence an auditor’s judgments or actions. The authors describe that several studies examine auditor’s tendency to focus on evidence that will confirm a client’s explanation of an account balance fluctuation, rather than looking for disconfirming evidence (resulting in a lack of skeptical judgment). The report goes on to describe one study (Fukukawa and Mock 2011) that indicates that although auditors do tend to confirm given assertions, they are less likely to confirm when assertions are stated negatively rather than positively. It proposes that standards can be developed to require auditors to view assertions in a negative rather than in a positive light.

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

MORE TRANSPARENCY RELEVANT TO FRAUD AND GOING CONCERN

PERFORMANCE GAP

EVOLUTION GAP

More Transparency in the Auditor's Report

There is no requirement currently to detail, in the auditor's report, specific procedures performed to address risks of material misstatement due to fraud or any views or conclusions on the appropriateness of management's use of the going concern basis of accounting. Auditors are required to determine and communicate key audit matters in the auditor's report for certain types of entities, but this may or may not involve matters related to the risks of fraud or going concern as this depends on what the auditor has determined are the matters of most significance in the audit of the financial statements of the current period.

It has been highlighted that, from an audit standard-setting perspective, the knowledge gap for users of the financial statements can only be addressed through more transparency in the auditor's report (i.e., the auditor provides more information within the auditor's report so that users better understand what the auditor did or the outcomes of certain procedures). For example, for statutory audits of public interest entities³⁰ in the European Union, in accordance with [Article 10 of the Audit Regulation](#), auditors are required to explain in the auditor's report to what extent the audit was considered capable of detecting irregularities, including fraud.



Going concern-specific considerations:

As part of the IAASB project on Auditor Reporting that was completed in early 2015, the auditing standards were revised to establish more specific auditor reporting related to going concern, and to present this within the auditor's report in specific circumstances. For example, if the use of the going concern basis of accounting is appropriate but a material uncertainty exists, and adequate disclosure about the material uncertainty is made in the financial statements, the auditor is required to express an unmodified opinion and include relevant information regarding the uncertainty in a separate section of the auditor's report under the heading "Material Uncertainty Related to Going Concern."³¹ The auditing standards also describe that if the auditor concludes no material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, the auditor may determine that one or more matters related to this conclusion are key audit matters. In that case, the description of the key audit matters in the auditor's report could include aspects of the identified events or conditions disclosed in the financial statements.³² However, as already noted, there are no other requirements for the auditor's

"Some participants suggested that companies should be required to report on the strength of their internal controls with respect to fraud, with auditors in turn providing assurance over those controls. They said this would provide investors and other stakeholders with more information about the potential risks of fraud within the business."

– The Future of Audit Report (July 2019), PwC

Suggestions have been made, that in order to narrow the expectation gap in relation to users of the auditor's report and their expectations for what has been done in an audit, the auditor's report should provide more detail with respect to going concern and fraud. Specifically, the auditor's report may be expanded to describe the specific procedures performed in these areas.

³⁰ See Article 2(13) of the [EU Directive](#) for a full definition of public interest entities.

³¹ ISA 570 (Revised), paragraph 22

³² SA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, paragraph A41

report to further detail what the auditor has done, or to provide a view of the auditor in relation to the entity's ability to continue as a going concern.

One potential solution to provide more transparency about the auditor's procedures with regard to going concern, could be to require auditors to explain how they evaluated management's assessment of the entity's ability to continue as a going concern and, where relevant, key observations arising with respect to that evaluation. This requirement



could apply even where the auditor concluded through their work on management's assessment that no material uncertainties exist. For example, in the UK, under their previously mentioned revised going concern standard, auditors are required to report their conclusions relating to going concern even when they conclude the use of going concern basis is appropriate and no material uncertainties exist.

In the absence of a requirement for management to always provide detailed disclosures regarding its assessment of the entity's ability to continue as a going concern (as management is in the best position to provide such information), the auditor would find it difficult to offer any detailed observations on such disclosures. The auditor would, in this case, be providing new information that is not disclosed by management in the financial statements. In addition, this calls into question whose responsibility it is to report on such matters, and it may not be appropriate for auditing standards to override the applicable financial reporting framework.

³³ ISA 240, paragraph 42-43

³⁴ ISA 570 (Revised), paragraph 25

More Transparency in Communications with Those Charged with Governance

The auditing standards require the following with regards to communication with those charged with governance:

- **FRAUD:** The auditor is required to communicate with those charged with governance on a timely basis if they identify or suspect fraud involving management, employees who have significant roles in internal control, or others where the fraud results in a material misstatement in the financial statements. If the auditor suspects fraud involving management, the auditor communicates these suspicions with those charged with governance and discusses with them the nature, timing, and extent of audit procedures necessary to complete the audit. The auditor also communicates with those charged with governance any other matters related to fraud that are, in the auditor's judgment, relevant to their responsibilities.³³
- **GOING CONCERN:** The auditor is required to communicate with those charged with governance events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern. Such communication includes whether the events or conditions constitute a material uncertainty, whether management's use of the going concern basis of accounting is appropriate in the preparation of the financial statements, the adequacy of related disclosures, and the implications for the auditor's report (where applicable).³⁴

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

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

APPENDIX A

OTHER IAASB ACTIVITIES RELATED TO FRAUD AND GOING CONCERN

We are also undertaking the following targeted research and outreach activities to further inform any decisions about future standard-setting or other efforts by the IAASB. As the projects progress, we will undertake further activities, as necessary.

- Analysis and assessment of comments submitted to the IAASB through other standard-setting projects and feedback forums that are relevant to these topics
- Review of academic research, external publications and the outcomes of reviews performed in various jurisdictions
- Discussions with national standard setters, particularly in jurisdictions where relevant standard-setting efforts have taken place, or are underway
- Facilitation of three global (virtual) roundtable discussions

Other Matters Raised to Date, which will be Considered by the IAASB in Further Information Gathering and Outreach Activities (*Not Included in the Scope of this Discussion Paper*)

FRAUD

- The use of technology in assessing fraud risks and identifying misstatements (material or not) due to fraud, as well as how technology is used to perpetrate fraud
- Scope of procedures required for less complex entities
- Consistent and correct application of the rebuttable presumption of significant risk of fraud in revenue recognition
- Consistent and correct application of the required audit responses to risks related to management override of controls, including journal entry testing
- Updates to the fraud risk factors included in the application material and integration of fraud risk in all aspects of the audit
- Better linkage between auditing standards
- Clarification of procedures required when fraud is identified

GOING CONCERN

- Communications with those charged with governance and with regulators/other supervisory bodies
- Scope of procedures required for less complex entities
- Better linkage between auditing standards and specific acknowledgment of using work performed in other areas of audit (e.g., risk assessment)

Other Matters Raised but Determined to Fall Outside the Remit of the IAASB

The matters below were raised to the IAASB through various feedback forums and determined not to fall within the remit of the IAASB. This is **not** an exhaustive list of all matters that should be considered by other participants in the financial reporting ecosystem.

Required Annual Assurance Meeting

Based on research and outreach performed to date, one suggestion is that a formal engagement mechanism should be established between auditors, company management, shareholders, and other stakeholders. This could be a required 'annual assurance meeting' led by the audit committee and attended by the auditor, who would be available to answer questions. Fraud and going concern could be mandatory items on the agenda. While certain principles of good governance are addressed in the auditing standards corporate meeting requirements are often determined by jurisdictional laws and corporate bylaws. Therefore, this is an area where the IAASB determined other stakeholders may be best suited to research and implement change, as determined necessary.

Required Forensic Training for Auditors

Certain sources have indicated that instituting forensic training requirements for financial statement auditors may help auditors adopt a more forensic mindset when performing audit procedures. Training requirements for audit and assurance professionals and course requirements and syllabus requirements for accounting students vary across jurisdictions and universities. Also, training requirements may be set by individual accounting firms for their employees. Therefore, this is an area where the IAASB determined other stakeholders should consider this recommendation.

APPENDIX B

ILLUSTRATIVE EXAMPLES OF HOW TO MAKE POSSIBLE CHANGES

The table below illustrates examples that the IAASB Staff has considered in regard to how possible changes, if determined to be appropriate, may be put into effect. However, this is not an exhaustive list of all possible alternatives and the examples presented are at a high level, since any alternative(s) considered would have to be further developed in terms of its(their) scope, impact and application. These illustrative examples serve to provide additional context for answering some of the questions in this Discussion Paper.

ALTERNATIVES SUMMARY (Possible solution could be one or a combination of alternatives)	DESCRIPTION	EXAMPLE
ALTERNATIVE A: Enhanced procedures apply to all entities as part of the audit	Enhancement of procedures more broadly are made directly to current auditing standards.	A specific requirement is added to the auditing standards to use forensic specialists for fraud inquiry procedures.
ALTERNATIVE B: Enhanced procedures apply conditionally as part of the audit depending on facts and circumstances <i>Three different illustrative examples are described in the columns to the right.</i>	<ol style="list-style-type: none"> (1) Enhancement of procedures in the auditing standards only for listed entities or entities of significant public interest.³⁵ (2) Enhancement of procedures in the auditing standards when the engagement team determines it appropriate based on a preliminary understanding of the facts and circumstances of the entity. (3) Enhancement of procedures in the auditing standards, but only for entities where certain specific triggers have been met (e.g., only in circumstances where there is a suspicion of fraud). 	<ol style="list-style-type: none"> (1) A requirement is added to the auditing standards to use forensic specialists for fraud inquiry procedures, but only for listed entities or entities of significant public interest. (2) A requirement is added to the auditing standards to use forensic specialists for fraud inquiry procedures when an engagement team determines it is necessary based on facts and circumstances. (3) A requirement is added to the auditing standards to use forensic specialists for fraud inquiry procedures only for entities where, for example, a suspicion of fraud has been identified.

³⁵ There is currently a project underway to establish convergence between the concepts underpinning the definition of a "Public Interest Entity" in the International Code of Ethics for Professional Accountants (including International Independence Standards), and the description of an "Entity of Significant Public Interest" in the IAASB standards. Further details can be found [here](#).

ALTERNATIVES SUMMARY (Possible solution could be one or a combination of alternatives)	DESCRIPTION	EXAMPLE
<p>ALTERNATIVE C:</p> <p>Enhanced procedures required conditionally outside the scope of the audit depending on facts and circumstances.</p> <p><i>Two different illustrative examples are described in the columns to the right.</i></p>	<p>(1) Enhancement of procedures are not made directly in the auditing standards. Rather, specific entities such as listed entities or entities of significant public interest are required to have an engagement performed that is in addition to the financial statement audit in relation to specified aspects of fraud or going concern (e.g., a review, agreed upon procedures etc.).</p> <p>(2) Expansion of auditor procedures are not made directly in the auditing standards. Rather, an engagement that is not part of the financial statement audit in relation to specified aspects of fraud (e.g., a review, agreed upon procedures etc.) is required for additional reliability when certain triggers have been met (e.g., there are suspicions of fraud).</p>	<p>(1) Forensic specialists are only required by listed entities or entities of significant public interest, not as part of the financial statement audit but rather as another engagement that is in addition to the audit (e.g., a review, agreed upon procedures etc.). This could be done through requirements introduced by a new subject-matter specific standard related to fraud for these circumstances.</p> <p>(2) The requirement to use forensic specialists is only required when there is a trigger, e.g., there is a suspicion of fraud, but not as part of the financial statement audit but rather as another engagement that is in addition to the audit (e.g., a review, agreed upon procedures etc.). This could be done through requirements introduced by a new subject-matter specific standard related to fraud for these circumstances.</p>

The structures and processes that support the operations of the IAASB are facilitated by the International Federation of Accountants® or IFAC®.

The IAASB and IFAC do not accept responsibility for loss caused to any person who acts or refrains from acting in reliance on the material in this publication, whether such loss is caused by negligence or otherwise.

Copyright © September 2020 by IFAC. All rights reserved.

The 'International Auditing and Assurance Standards Board', 'International Standards on Auditing', 'International Standards on Assurance Engagements', 'International Standards on Review Engagements', 'International Standards on Related Services', 'International Standards on Quality Control', 'International Auditing Practice Notes', 'IAASB', 'ISA', 'ISAE', 'ISRE', 'ISRS', 'ISQC', 'IAPN', and IAASB logo are trademarks of IFAC, or registered trademarks and service marks of IFAC in the US and other countries.

For copyright, trademark, and permissions information, please go to [permissions](#) or contact permissions@ifac.org.

IAASB

International Auditing
and Assurance
Standards Board



@IAASB_News



@International Auditing and Assurance Standards Board



@International Auditing & Assurance Standards Board

529 Fifth Avenue, New York, NY 10017
T +1 (212) 286-9344 F +1 (212) 286-9570
www.iaasb.org