AASB
Auditing and Assurance Standards Board

Fraud and Going Concern: What's Your Role?

We are committed to providing transcriptions in order to promote the accessibility of webinars that we offer. To that end, we endeavor to provide a transcription that accurately reflects the information conveyed. Please note, however, that there may be instances where we are unable to accurately capture what was said by the speakers. If you have any questions or concerns about the transcription provided, please contact us.

BACKROUND

KAREN DEGIOBBI: So by way of background, on September 15, the International Auditing and Assurance Standards Board released a discussion paper on this topic. The purpose of their paper was to get input from stakeholders on these topics as it relates to the role of the auditor in an audit of financial statements, and whether the IAASB standards remain fit for purpose.

The deadline for comments for this discussion paper was February 1, 2021. And the Canadian Auditing and Assurance Standards Board issued their response after considering the feedback received from their consultations and outreach.

Our outreach we conducted was two part. Part one focused on having targeted consultations with individual stakeholder groups in isolation. Such as practitioners, management, audit committees, regulators, and users, to get their detailed feedback on these issues. We held close to 15 targeted outreach sessions ranging from individual interviews with members of the user community, through to small group sessions with practitioners, regulators, and those charged with governance.

The second piece of our outreach plan was a larger multi-stakeholder outreach that we hosted in November. The preparation for this session was leveraging the individual stakeholder input that we received through our part one conversations with stakeholders on these key issues.

We used the multi-stakeholder format to ensure that we were getting a more holistic perspective rather than the views of any one group in isolation. And as I mentioned earlier, the input from the outreach was used by the AASB in informing their views and responding to that discussion paper.

THE EXPECTATION GAP

So that was a quick summary of the background. Let's get into the discussion areas and get an opportunity to hear your views. The concept of the expectation gap is one that has been discussed at length over years.

The IAASB broke down that gap into three components. The knowledge gap, being the difference between what the public thinks the auditors do and what auditors actually do. The performance gap,

being a lack of application of the standards and regulations by practitioners. And finally, the evolution gap, which is what they perceive to be left over once you carve out the other two gaps. And this is really where the profession may need to evolve.

We asked our stakeholders, which of these sub-components, in their view, was the main cause or driver of the expectation gap. The views we heard were varied. Generally speaking, most were of the view that the knowledge gap was an underlying driver of the expectation gap. They acknowledged that there is a lack of understanding by financial statement users of the roles and responsibilities of each party within the financial reporting ecosystem, including the auditor.

As it related to fraud, in addition to the knowledge gap, some stakeholders felt the performance gap was also a main driver. These stakeholders had the view that there are instances in which the auditor is not fulfilling the audit standard requirements. Or that the audit standards around fraud were not robust.

It was interesting to note, however, that this was the view of all stakeholder groups other than the practitioners. And for the evolution gap, the majority of stakeholders felt that evolution in the auditor's responsibilities was needed in response to the ever-changing tools and techniques used by fraudsters.

As it related to going concern, outside of the knowledge gap, stakeholders felt there was less need for the auditor's role to evolve than there was in the case of fraud. They emphasized that it's important not to ignore the role of other parties, particularly management, who holds responsibility for completing the going concern assessment.

Overall, when we take a step back and reflect on the views that were shared, while the views may have varied, there was one underlying theme from all of the discussions. It was really the few things that the stakeholders could all agree on, which was that in order for the expectation gap to be narrowed, collective action is needed from all parties in the financial reporting ecosystem and it can't just be the auditor.

FRAUD

BIRENDER GILL: So in the IAASB's discussion paper, they provide or discuss some possible enhancements that could help to address the expectation gap as it relates to fraud. And so we'll talk about five of those enhancements. The first one being increased use of forensic specialist or other specialists in the audit.

So the suggestion here is that requiring the use of forensic specialist in the audit more broadly will help to strengthen the audit procedures that are conducted in respect to fraud. And so in our outreach, stakeholders supported this option but in part. Practitioners agree that involving forensic specialist will enhance or could enhance the audit procedures. But especially since they do struggle sometimes in order to address fraud risks of what procedures may be appropriate.

However, practitioners cautioned that involving forensic specialists in every audit may not be appropriate. They like the flexibility that's provided in the extant standard where this decision is left to the practitioners professional judgment, and rather than being mandated. And they feel that that continues to be appropriate.

They also raised scalability concerns with this option. Since there are a limited number of forensic specialists available, that getting them involved could become an issue. And then the cost. It can be a high cost to involve these specialists. And especially on smaller engagements that it may be difficult to rationalize this additional cost.

Also practitioners felt that if forensic specialists are involved, that this may actually increase the expectation gap. They believe that users may believe that a forensic audit was conducted when it's not. Regulators were the only stakeholder group that supported involving forensic specialists more. They believe that there's a number of specialists that are involved in the audit currently, and so this is an added area where expertise should be utilized.

Another enhancement discussed in the paper is additional focus on non-material fraud. So currently, the fraud standard ISA 240, requires the auditor to evaluate each identified misstatement for whether it's indicative of fraud.

So questions have been raised as to whether the auditor needs to do more in relation to or identifying non-material frauds. And here in our outreach, stakeholders did not support this option. They reinforced that preventing, detecting, and investigating fraud really is the responsibility of the entity. The extant requirement for the auditor to evaluate all misstatements for any indication of fraud continues to be appropriate. Stakeholders also recognize that it would be inappropriate to expect the auditor to conduct audit procedures to identify non-material fraud, since this does not align with the objective of the audit.

The third enhancement discussed in the paper is increasing the auditor's responsibilities with respect to third-party fraud. So the definition of fraud in ISA 240, includes intentional acts that may be conducted by third parties. But the discussion paper asks whether the auditor should be required to conduct additional audit procedures in order to identify third-party frauds.

So stakeholders once again did not support the exploring this option further. Practitioners believe that the requirements of the extant standard adequately consider risks of third-party fraud as part of the risk assessment and the fraud assessment process. Those charged with governance were the only stakeholder group that supported exploring this further. They believe that there is an increased risk of third-party fraud, especially due to the business environment right now due to COVID and the increased use of technology. So therefore, additional focus by the auditor on this risk area should be required.

The fourth enhancement was enhancing quality control requirements. So right now specific quality control reviewer procedures related to fraud are not explicitly required. But in some jurisdictions like Japan, they have implemented additional quality control reviewer procedures related to fraud.

And so here in our outreach we heard the-- stakeholders felt that additional research is needed, and really to understand whether this option would result in the desired changes in behaviour. Practitioners were cautious to add another checklist type of procedure. And so evidence is really needed to demonstrate that there would be a positive impact on the auditor's ability to identify or address fraud risks in the audit.

Practitioners recognize that enhancements in this area would be or could be easier to implement because the process exists right now rather than trying to create a new process. Regulators were also supportive

of this option since the framework already exists and the procedures could be targeted based on the fraud risk profile of the entity.

And lastly, the enhancement of whether the auditor should have a suspicious mindset when conducting the audit. The discussion paper recognizes that merely asking the auditor to be more skeptical will not drive the behavioural change that's needed. And so hence should the auditor really be having more of a suspicious mindset when they're conducting the audit.

For this enhancement, we really heard no support. Stakeholders struggled to understand what is meant by suspicious mindset and what that would entail. There was concerns that having this suspicious mindset would mean a greater burden of proof in trying to collect audit evidence or lead to onerous information demands for entities. And really the suspicious mindset could lead to an adversarial relationship between auditors and clients and would not be conducive to a healthy relationship.

Stakeholders supported the concept of professional skepticism but they understand that practitioners sometimes struggle with how to apply this. So they felt that greater guidance or educating auditors on how to implement professional skepticism better would be better warranted.

During our outreach, we also heard feedback about ISA 240. And there are some concerns raised regarding several of the sections or requirements within the standard. The first one really being the rebuttable presumption related to fraud risks over revenue.

Practitioners questioned whether this presumption continues to be appropriate. Some practitioners believe that undue time is spent on this when it's not always relevant to the nature of the business or given the nature of the entity. And on the other hand, regulators were concerned that auditors are rebutting this presumption too often. That in 25% of audits, it is rebutted. And they felt that this was a little high.

The second one was the unpredictability of audit procedures. So regulators expressed concerns that auditors tend to perform the same audit procedures year over year. And that loses its unpredictability. On the other hand, practitioners were concerned that if the standard provided a list of procedures, that would negate you know the unpredictability of the procedures. So there really does need to be a fine balance.

Third was around the nature and extent of journal entry testing. So feedback from stakeholders suggested that some auditors don't understand the purpose of journal entry testing and how it fits into the overall approach for identifying and addressing fraud risks. So stakeholders also believe that the standard could be updated to recognize the use of audit analytics and how that fits into journal entry testing.

And lastly, the appendices that are in ISA 240, stakeholders felt that they could be updated to better reflect current business practices.

GOING CONCERN

CHI HO NG: So on the discussion paper, it provided discussion of three areas for further discussions with respect to going concern, the first one being the time period for going concern really deals with whether the International Auditing and Assurance Standards Board should work with the International Accounting

Standards Board, and other accounting standards setters to determine whether the going concern assessment should be extended beyond a normal practice of 12 months.

The second area of exploration was other concepts of resiliency. So taking a more holistic view of a entity's ability to adapt to adverse circumstances as opposed to a mere pure determination of whether it could survive.

And the third area was just really looking at the term material uncertainty relating to going concern. What does the term mean.

And so with the first one, extending the time period for going concern assessments, the discussion paper sort of talks about how most accounting frameworks require a going concern assessment based on the business cycle. And 12 months is a period that's most frequently used because it's often tied to things like funding cycles or reporting cycles like I guess Laurentian University funding, normally done on a 12-month basis.

So it sort of asks the question as to whether the Auditing and Assurance Standards Board should work with the accounting standard setters to explore whether to extend the time period for assessing going concern. And the thinking is that management still has to go first. The accounting standards would require management to perform an assessment over a longer period of time and the auditor would then evaluate this longer management assessment.

And what we have heard for this one, is that there's very little support for further exploring this area. Key reason being that it's hard enough to assess going concern for the next 12 months. Extending the time period would make most assessments extremely unreliable. I mean if we look back 12 months ago today, I would say virtually all going concern assessment done 12 months ago really would not have reflected what actually happened in the course of this 12 months.

The second item on the other concepts of resiliency, the discussion paper itself looked into other jurisdictions around the world that has some studies of initiatives on looking at a company's resiliency. So for example in the UK, in addition to just the normal short term going concern assessment, certain listed entities are also required to disclose longer term resiliency. So things such as a result of stress testing the company under various scenarios et cetera.

And what we have heard from stakeholders on this second aspect was there is definite interest in further exploration of resiliency concepts. And we've also heard that the public sector already has some guidance on looking at let's say an entity's flexibility, sustainability, and vulnerability. But having said that, there is still also a lot of hesitancy in terms of stakeholders voicing actual support for any of the enhancements. Really stakeholders just want to know more about how would such resiliency concepts look like. What exactly would management be required to assess, and how would auditors audit such assessments. So this is-- I would say some early stage aspiration. But this is probably a definite area that I think would be of interest to many stakeholders, including regulators and such.

The last area in the discussion paper, material uncertainty going concern, many stakeholders have identified problems with applying the existing accounting standard dealing with material uncertainty. So it really includes given the same set of circumstances that cast doubt on a company's ability to continue as

going concern, different people reach different conclusions as to when material uncertainty on going concern is triggered.

And this inconsistent interpretation obviously has quite significant ramifications on disclosures in the financial statements as well as in the auditors' reports. And I think this concern is really consistent with the comments that we've heard just now about crying wolf. When do we cry wolf? Is it too early, is it too late?

And there was actually some good suggestions from stakeholders that included-- so perhaps supplementing this material uncertainty on going concern disclosures with other disclosures. So sort of more of a disclosure of a spectrum of going concern risk that the entity is facing. So there was some suggestions of maybe perhaps how to address this.

The last item I want to talk about is something that's outside of the discussion paper. But there were other suggestions that we heard from stakeholders on how auditors could enhance the ability to identify and assess going concern risk under the current accounting as well as auditing standards. And I think Candice probably mentioned something about there are often indicators before things really go wrong.

And so some of the suggestions on how to maybe better identify such indicators include more in-depth understanding of the entity and its environment. So for example, maybe having more specific elected procedures at the risk assessment stage that includes specific going concern risk considerations. More robust discussions with management those structure of governance. So rather than just simply asking are you aware of any going concern risk, maybe questions such as what keeps you up at night may prompt more thoughtful discussions. And lastly, another suggestion was perhaps quality control system at the firm level could be enhanced. So maybe having policies and procedures to monitor news for potential going concern risk that may impact the firm's client portfolio. So these are some of the suggestions that we have heard.

CONCLUSION

KAREN DEGIOBBI: This conversation is not over, it's just the beginning. We are at the information gathering stage of the project. So happy to hear your views.