economistas
Consejo General
REA auditores

Discussion Paper

FRAUD AND GOING CONCERN IN AN AUDIT OF FINANCIAL STATEMENTS

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?

We understand that the main cause of the expectations gap is due to the difference between what the general public thinks that the auditors do and what the auditors actually do, which implies that the users of the audit report can misinterpreting the role of auditors or confusing their professional activity. And we believe that this is due, fundamentally, to the lack of knowledge of a good part of the users of the audit reports of what is the objective of the audit of accounts of financial statements and the requirements of the technical auditing standards (NIA).

Although the DP mentions three components of the "Audit expectation gap", according to an ACCA publication of May 2019, we consider that the expectation gap, in general terms, is the difference between what users expect from the auditor of audit accounts of financial statements, and the reality of what an audit is defined in its regulations.

(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?

In our opinion, the problem that gives rise to the expectations gap is due, as we indicated in the answer to question a) above, to the lack of knowledge on the part of the users of what an audit of accounts consists of and the technical auditing standards (ISAs). For this reason, we think that a good measure would be to increase the actions aimed at its disclosure and better understanding of the object of an audit. To begin with, we consider that economic and auditing training should be established from the earliest levels of university education (perhaps even earlier). This is a very topical debate in Spain that is being promoted in different economic and academic forums.

Increase the publication of articles in the press and specialized magazines, as well as other informative documents, information sessions, etc. on financial information and verification procedures would help to encourage healthy concern in society about this matter that would help to understand what the role of the auditor is and how they should interpret audited 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?

No.

We consider that the International Standard ISA 240 (of 2013), in Spain NIA-ES 240, which deals with the responsibilities of the auditor with respect to fraud in the audit of financial statements, contains sufficient requirements to meet the auditor's objectives when respect; this is:

(a) identify and assess the risks of material misstatement of the financial statements due to fraud;
(b) obtain sufficient and appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, by designing and implementing appropriate responses; Y
(c) respond appropriately to fraud or signs of fraud identified during the audit.

This standard develops the way to apply ISA 315 and ISA 330 in relation to the risks of material misstatement due to fraud.

It should be taken into account that, as established in ISA 240 itself in relation to the auditor's responsibilities with respect to fraud, "The auditor who performs an audit in accordance with the ISAs is responsible for obtaining reasonable assurance that the Financial statements taken as a whole are free from material misstatement due to fraud or error. Due to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements in the financial statements may not be detected, even if the audit has been properly planned and executed in accordance with the ISAs.

The standard itself recognizes that the inherent limitations are especially important and significant in the case of misstatements due to fraud. The risk of not detecting material misstatements due to fraud is greater than the risk of not detecting them as fraud can involve sophisticated and carefully organized plans for their concealment. The auditor's ability to detect fraud depends on factors such as the expertise of the perpetrator, the frequency and extent of the manipulation, the degree of collusion, the relative size of the individual amounts manipulated, and the hierarchical rank of the fraud. Therefore, while the auditor may be able to identify the existence of potential opportunities to commit fraud, it may be difficult for him to determine whether misstatements in areas where judgment is necessary, such as accounting estimates, are due to fraud or error.

In this sense, the standard refers to the need for the auditor to maintain an attitude of professional skepticism throughout the audit, taking into account the possibility of management circumventing controls and recognizing the fact that audit procedures that are effective for error detection may not be effective for fraud detection.

If yes, in what areas?

Although we do not consider additional or “improved” requirements necessary, we would like to mention some aspects that are mentioned in the publication of the Canadian Public Accountability Board and that could be considered in a possible guide to action in this regard:

Fraud risk management program
A company's susceptibility to fraud, whether due to fraudulent financial reporting or misappropriation of assets, is significantly affected by the robustness of its fraud risk management program. The program includes a company's fraud risk governance policies, fraud risk assessments, and fraud detection and prevention controls. An effective fraud risk management program creates a strong fraud deterrent effect. In more than half of the audits we inspected, auditors evaluated aspects of the company's fraud risk management program to inform their fraud risk assessments. The procedures included evaluations of:

- Code of conduct communications and related approvals by employees,
- the processes in place to investigate fraud and take corrective action, and
- the quality of supervision exercised by the audit committees over the program.

These procedures help auditors gain an understanding of the strengths and weaknesses of a company's fraud risk management and where opportunities exist for bypassing internal controls and for fraud to occur.

Assessment of the Whistleblower Line

In a global study on fraud, the effectiveness of an evaluation of the effectiveness of the whistleblower line was evidenced. The audit procedures included:

- Assessment of the implications of whether the whistleblower hotline is run by the company or outsourced to a third party.
- Assessment of the hotline escalation process, including whether complaints / suggestions are dealt with in a timely and appropriate manner.
- Mock complaints from whistleblowers. Some auditors submitted anonymous complaints through the hotline to confirm their understanding of how complaints are received, escalated and resolved.

Assessing the effectiveness of whistleblower hotlines also helps the auditor to understand the tone at the top of the company, including the importance placed on ethical conduct.

(b) Is there a need for enhanced procedures only for certain entities or in specific circumstances?[1]

Not necessarily.

However, in some specific cases the intervention of specialists may be required.

We must bear in mind that, as the complexity of the business environment continues to increase, so has the variety of specialists hired by statutory auditors to participate in their audits. These specialists are key members of the audit team that needs to be expanded due to the expertise they bring in highly specialized areas of auditing. The perspectives of specialists during the planning phase of the audit are relevant to the audit team due to the involvement of each specialist in complex areas of the audit, including critical accounting estimates with high degrees of subjectivity that are particularly susceptible to fraud. .

Furthermore, it must be borne in mind that with the digitization and automation of financial information systems, fraud is becoming more and more sophisticated. This suggests that the specialized skills of fraud and forensic specialists (fraud specialists) can be beneficial in helping account auditors identify areas in which sophisticated fraud could be committed against a company. Account auditors should consider when it is appropriate to hire fraud specialists prior to a triggering event. Considerations may include the complexity of the company's business model and operations, whether the company has operations in emerging markets, the complexity of the company's regulatory environment, and idiosyncratic fraud risks associated with the company or industry. But ultimately, this would be one more procedure depending on the particular circumstances of each entity.

(i) For what types of entities or in what circumstances? N/A

[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

(ii) What enhancements are needed? N/A

(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. N/A the procedures are already contemplated in general terms in the current ISA 240.

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

Yes, this is already provided for in international regulations. Specifically, the ISA 240 standard already includes specific requirements in this regard.

It should be taken into account that, in general, accounting scandals increase after the stock market crashes and the deterioration in economic activity, probably due to the fact that when the economy is doing well, business results are better and companies tend to apply more prudent accounting criteria and, on the contrary, when the economy deteriorates, business results tend to be more negative and there are companies that try to reduce them with more aggressive accounting criteria (activation of expenses, reduction of amortizations and provisions, for example).

If the economy continues to deteriorate, managers with lower ethical principles may be tempted to commit accounting fraud that, in many cases, ends up coming to light as the economy deepens its deterioration. Ultimately, as the economy worsens, motivation to commit fraud may increase, especially in companies where managers are under more pressure to meet certain revenue and profit targets.

In these situations, the auditor's skepticism obviously contributes to identifying fraud. And you should apply that skepticism from the planning phase and throughout the audit work.

(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?

No. We consider that the requirements of Standard 240 and the application guide in relation to professional skepticism include the necessary considerations that should be applied, in general, in all audits (In accordance with ISA 200, the auditor will maintain an attitude professional skepticism throughout the audit, recognizing that, despite prior experience with the honesty and integrity of the entity's management and those charged with governance, it is possible that there is a material misstatement due to fraud); although it seems clear that the audit of those entities with deficient internal control and those whose sector is being most affected by the current crisis should be intensified.

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

(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.)?

No.

One of the most relevant points in the communication of the account auditor with management and those charged with corporate governance is the concern and measures adopted by management in relation to fraud, and this is established in Standard 240 as well as in ISA 260 Communication with those responsible for the government of the entity, which establishes as one of the aspects related to planning that may be appropriate to discuss with those responsible for the governance of the entity "The attitude, awareness and actions of those responsible for the government of the entity in relation to: (a) the entity's internal control and its importance to it, including how those charged with governance oversee the effectiveness of internal control, and (b) the detection or possibility of fraud."

For its part, the audit report already includes, in Spain, in the section "Auditor's responsibilities in relation to the audit of the annual accounts", his responsibility and the audit procedures, in general terms, in relation to fraud.

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:

(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?

No.

The requirements of the 570 (R) standard seem appropriate to us. Current standards, as discussed above, require the auditor to apply professional skepticism in their work and ISA 570 has been applied in Spain since 2013.

(b) Is there a need for enhanced procedures only for certain entities or in specific circumstances?1

No.

Management has the most relevant information to evaluate the future performance and viability of the company and takes the first step to evaluate the going concern. It is important that the administrators or management of the entity prepare a comprehensive evaluation, which the auditor can review. The document to be prepared by management (or administrators) should be similar in depth and nature to their assessments in relation to asset impairment, for example, providing information and analysis that facilitate the independent assessment of the auditor. Auditors need to gain a good understanding of the processes that management oversees. A thorough and thoughtful evaluation by management is an important precondition for high-quality audit work in this area. These procedures are already contemplated in ISA 570 (R).

If yes:

(i) For what types of entities or in what

circumstances? N/A

(ii) What enhancements are needed? N/A

(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. N/A

(c) Do you believe more transparency is needed:

(i) About the auditor's work in relation to going concern in an audit of financial statements? If yes, what additional information is needed and how should this information be communicated (e.g., in communications with those charged with governance, in the auditor's report, etc.)?

The current regulations already require their communication, both in relation to the communications that must be maintained throughout the work with those charged with corporate governance, and in the audit report, where appropriate. It would be advisable for the entity's management to provide the auditor with a document with an analysis and assessment of the entity's ability to apply the going concern principle (see answer to question 3b).

(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?

No.

The information is covered by the NIA 570 standard: if there is uncertainty about the application of the going concern principle, the auditor must include in his report a paragraph on "Uncertainty in the application of the going concern principle"; On the other hand, in accordance with the aforementioned standard, the auditor must issue an opinion with qualifications (if there is a lack of information on the uncertainty regarding the application of the Going Concern principle in the report) or unfavorable (for not being going concern principle applies). Additional information will be included, where appropriate, in these paragraphs.

On the other hand, in Spain there is a Resolution (of October 18, 2013), issued by the regulatory body for auditing accounts (ICAC), which includes specific rules for the formulation of annual accounts in the event that it does not result from I apply the going concern principle.

In addition, the section of the audit report relating to "Responsibilities of the auditor in the audit of the annual accounts" explains in this regard: "We conclude on whether the use, by the administrators, of the accounting principle of a going concern is adequate and, based on from the audit evidence obtained, we conclude on whether or not there is a material uncertainty related to events or conditions that may generate significant doubts about the Company's ability to continue as a going concern. If we conclude that there is a material uncertainty, we are required to draw attention in our audit report to the corresponding information disclosed in the annual accounts or, if such disclosures are not adequate, to express a modified opinion. Our conclusions are based on the audit evidence obtained up to the date of our audit report. However, future events or conditions may be the cause of the Company ceasing to be a going concern. "

Furthermore, in Spain, the regulations applicable to PIEs) require the auditor to inform the regulators (CNMV and ICAC) of the circumstances related to a Going Concern (in accordance with article 12.1 of RUE 537).

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?

We consider that, in those cases in which fraud is detected that entails the loss of confidence in the management or administrators with the risk involved in working in those circumstances, once the contract has been completed, it seems reasonable that there may be the possibility that the auditor considers it "just cause" and may request the audited entity to terminate the contract.

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