1 February 2021

RESPONSE TO IFAC - IAASB CONSULTATION - ‘FRAUD AND GOING CONCERN IN AN AUDIT OF FINANCIAL STATEMENTS - EXPECTATION GAP’

The central premise of this consultation is incorrect because there is no ‘expectation gap’ under the law of many countries including the UK and other jurisdictions. In the UK, both the Judiciary and Parliament are clear on this.

Disappointingly, this IFAC-IAASB consultation spreads misinformation. We request that it is withdrawn by 21 February 2021, and we will also be asking accounting firms in the UK and the Financial Reporting Council to repudiate it.

The Business, Energy and Industrial Strategy Committee of the UK Parliament (‘The Parliamentary Committee’) determined that there was not an expectation gap under UK law. We are copying this to the UK Parliament and other parties.

The legal position is that fraud may cause a company (and a group of companies) not to be a going concern and the auditors can be responsible for it if they have missed it.

The Parliamentary Committee described the evidence of the largest accounting firms given to it as “blatant” and concluded that the problem was not the public’s expectation of auditors being wrong, the problem was a ‘delivery gap’ by the auditors, The Committee concluded:

“We were both surprised and disappointed to hear the view from audit firms that because fraud is difficult to detect, the public should not expect auditors to find it. The most blatant example came from Grant Thornton’s CEO, David Dunckley:

“We are not looking for fraud. We are not looking at the future. We are not giving a statement that the accounts are correct. We are saying they are reasonable. We are looking in the past and we are not set up to look for fraud.”

“We do not accept the attempts of auditors—particularly the Big Four and Grant Thornton—to underplay the role or scope of audit, nor to implicitly blame the public for failing to understand the purpose of audit. Rather, the firms should
focus on the poor quality of their audits, and on how they are falling short of what audits are for within the current framework."}

A High Court case settled in the middle of the hearing, Asset Co vs Grant Thornton, which involved a fraud. Not only was Grant Thornton held to be accountable for the illegal dividends, as a result of missing the fraud which led to the company not being a going concern (it had failed the capital maintenance requirements of the Companies Act) but Grant Thornton was also accountable for the misinvestment that this had caused the company to undertake.

We therefore had the “Alice in Wonderland” situation where:-

1) Grant Thornton admitted in court what the profession to Parliament, and this consultation, denies. Paragraph 2 of the Appeal Court decision states:-

“GT admitted that it had in important respects carried out the audits in breach of its duty of care and that it had failed in its duty to identify management fraud, particularly dishonest representations and evidence provided to it by senior management in the course of the audits.”

2) Grant Thornton told Parliament the opposite:-

“We are not looking for fraud. We are not looking at the future. We are not giving a statement that the accounts are correct. We are saying they are reasonable. We are looking in the past and we are not set up to look for fraud.

The consultation cites the position of the Certified Public Accountants of the USA. The USA itself has a framework of law and governance such that there may be different positions from US courts depending on the interaction of duties in state law and federal law. Indeed the legal responsibilities in the UK (and jurisdictions with similar law) exceed what most people would envisage given the consistent message from the auditors misleading people.

We needed to go no further than the introductory letter from the IAASB’s Chair, to see the strategy at play here.

The IFAC-IAASB is attempting to initiate a debate on the false premise that there is an expectation gap and that the auditor’s role needs to be expanded. Under the guise of offering an ‘upgrade’ the consultation is tilted towards a downgrade.

1 Para 25. https://publications.parliament.uk/pa/cm201719/cmselect/cmbeis/1718/171805.htm#_idTextAnchor018
2 Para 30 ibid
3 https://www.bailii.org/ew/cases/EWCA/Civ/2020/1151.html
4 https://www.bailii.org/ew/cases/EWCA/Civ/2020/1151.html

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Mr Seidenstein’s - the IFAC-IAASB Chair – introduction states [our underlines].

“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.

The suggestion too that parties other than auditors have a role is a buck pass. Mr Seidenstein’s introduction also states:-

“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.”

Problems with false assertions about an ‘expectations gap’ also flow through to the accounting standards regime, as some accounting treatments under IFRS are also inconsistent with the going concern position.

The overstatement of assets and understatement of liabilities permitted and required by the IFRS system, may in fact achieve similar outcomes to fraud and false accounting, by masking whether a company or group of companies is a going concern or not.

The situation is so serious that PIRC is minded to recommend that shareholders vote against any accounting firm that does not publicly repudiate the assertions in this document by 28 February 2021, as audits conducted on that basis would be in breach of duties and contract.

Yours sincerely

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cc: Mr Darren Jones MP, Business, Energy and Industrial Strategy Committee
    The Chair the Financial Reporting Council