NASBA

National Association of State Boards of Accountancy

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International Auditing and Assurance Standards Board (IAASB)
529 Fifth Avenue
New York, NY 10017

Via website: www.iaasb.org

Re: Discussion Paper - "Fraud and Going Concern in an Audit of Financial Statements"

Dear IAASB Members and Staff:

The National Association of State Boards of Accountancy (NASBA) appreciates the opportunity to offer comments on the Discussion Paper: *Fraud and Going Concern in an Audit of Financial Statements.* NASBA's mission is to enhance the effectiveness and advance the common interests of Boards of Accountancy (State Boards) that regulate all Certified Public Accountants (CPAs) and their firms in the United States and its territories. Our comments on the discussion paper are made in consideration of the Boards' of Accountancy charge as regulators to protect the public interest.

In furtherance of that objective, NASBA offers the following comments on the questions as presented in the paper.

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?

(a) NASBA believes the expectation gap relating to fraud and going concern in a financial statement audit may be caused by a few factors: lack of understanding by the public as to what an audit is and what auditors do; inconsistent audit execution in these areas by some auditors due to lack of understanding and, in some cases, competence; and the inherent limitations of a financial statement audit.

(b) As the business environment is not static, we do not believe it is possible to completely eliminate the expectation gap in terms of the public's understanding; however, we believe the standard-setters and the profession can work towards narrowing the gap and suggest the following:

- Given their importance to financial statement audits, (1) fraud, (2) going concern, and (3) the resulting expectation gap should be "evergreen" topics on standard-setters' and regulators' agendas.
- Advance use of the latest technology in performing audits to increase audit quality in these areas.
- Clarify, and as further described below, enhance existing auditing standards to better communicate how auditors can more effectively fulfill the current requirements, which should lead to increased understanding and consistency in practice.
- Enhance training provided to auditors in these areas. Auditors must assess fraud and going concern issues in every financial statement audit, which requires certain critical skill sets.
- Consider the numerous studies and work of previous commissions that have examined the expectation gap.

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?

(a) Yes, NASBA believes the IAASB should consider enhancements to standards to promote better understanding of the current standards and greater consistency in their execution. NASBA believes that evaluations related to fraud should be risk-based. The recent update to ISA 540 was structured to provide guidance on risk assessment (ISA 315) and response (ISA 330) for issues specific to accounting estimates. Likewise, ISA 240, *The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements,* could address issues specific to fraud risk in the context of ISA 315 and 330. For example:

- Not necessarily presuming that revenue is an area of fraud risk but examining why and how in order to inform responsive procedures; and

- Determining how and in what instances journal entries present fraud risks so that testing can be responsive to those factors.

NASBA does not believe that forensic resources should be required in a financial statement audit unless material fraud is suspected. In such case, the auditing standards could suggest additional procedures, which may include adding forensic resources to the audit team.

(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.

NASBA believes that increased risk should determine the need for enhanced procedures. Fraud happens in organizations of all sizes and harms stakeholders in organizations both large and small. We believe auditors should perform a robust risk assessment when performing financial statement audits of organizations of every size. When risk surpasses a certain threshold, the auditor should apply enhanced procedures, such as we described in our response to Question 2(a).

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

NASBA does not believe that requiring a "suspicious mindset" would contribute to enhanced fraud detection when planning and performing an audit. Rather, we are concerned that the term's adversarial connotation could damage the auditor/client relationship, which requires full disclosure and candor regarding all aspects of the client's business.

We believe "professional skepticism" remains the appropriate frame of mind for financial statement auditors and support the profession's efforts to operationalize its application. We believe enhancing the guidance in ISA 240 when fraud is suspected would be helpful.

(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.)?

In terms of the auditor's communications with those charged with governance (TCWG), the IAASB should consider the Public Company Accounting Oversight Board's Auditing Standard 1301, *Communications with Audit Committees*, which requires auditors to discuss significant fraud risks with TCWG. The IAASB can consider a requirement that lower-level frauds be discussed with TCWG, or that the TCWG's views about fraud in the organization be obtained.

We are skeptical as to whether more disclosure in audit reports about the auditor's work related to fraud will be an effective way to narrow the expectation gap.

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?

The IAASB should consider enhancements to the current auditing standards for evaluating issues related to going concern, e.g., providing additional application material. Similar to our comments relating to addressing fraud, we believe that a risk-based assessment should drive the procedures performed and may require assistance from specialists.

We also believe that a lack of auditor competence in identifying "red flags" that indicate an organization may be failing, or analyzing management's forecasting and plans, are partly to blame for these challenges. Additional guidance is part of the solution. Seeking ways to better train auditors on addressing management's going concern assessment would also be beneficial.

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

Similar to fraud, NASBA believes that increased risk should determine the need for enhanced procedures related to management's going concern assessment. Going concern risks exist in organizations of all sizes and may result in serious consequences to stakeholders in organizations both large and small. Auditors should perform a robust risk assessment when performing financial statement audits of organizations of every size. When risk surpasses a certain threshold, the auditor should apply enhanced procedures, such as incorporating specialist help.

(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.)? (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?

NASBA recommends greater transparency with those charged with governance when the auditor has considered the risks and determined that a going concern disclosure in the auditor's report is *not* needed, but the decision was the result of a "close call" involving significant judgment.

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?

NASBA offers the following additional comments for the IAASB's consideration:

- Non-material frauds may be indicative of a corporate culture that considers them to be accepted behavior and, therefore, may indicate other frauds of greater consequence relevant to the audit exist. The role of the person committing the fraud and other qualitative factors should be considered.

- NASBA does not recommend expanding the scope of the financial statement audit beyond what is currently required to include audit procedures designed to detect fraud that is not directly related to risks of material misstatement (for example, to encompass reputational risks or possible cybercrime attacks). Our concern is that expanding the audit to include these procedures would widen the expectation gap. However, with the appropriate competence, we believe that an audit firm may perform such services as a separate engagement.

- Explore addressing fraud through best practices, for example, via a fraud clearance center. Several years ago, the U.S. Department of the Treasury's Advisory Committee on the Auditing Profession recommended creation of a national center that would (among other things) facilitate auditing firms' and other market participants' sharing of fraud prevention and detection experiences and practices. For additional details see https://www.treasury.gov/about/organizational-structure/offices/Documents/final-report.pdf.

- Consider whether regulatory bodies and other standard-setters should require training on fraud in the context of a financial statement audit as part of an auditor's continuing professional education (CPE). For example, the California Board of Accountancy requires its licensees performing attest services to complete four hours of CPE in fraud every two years. California Code of Regulations Title 16. Professional and Vocational Regulations Division 1. Board of Accountancy Regulations Article 12 Section 87 (f)

We appreciate the opportunity to comment on the discussion paper.

Very truly yours,

A. Carlos Barrera, CPA
NASBA Chair

Ken L. Bishop
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