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COVID-19 & Ethics | Staff Publication



# NAVIGATING THE HEIGHTENED RISKS OF FRAUD AND OTHER ILLICIT ACTIVITIES DURING THE COVID-19 PANDEMIC

Including Considerations for Auditing Financial Statements

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December 2020

# Navigating the Heightened Risks of Fraud and Other Illicit Activities During the COVID-19 Pandemic

## Including Considerations for Auditing Financial Statements

This staff publication highlights the heightened risks of fraud arising from the disruptive and uncertain COVID-19 environment and the implications for professional accountants in business, including accountants in government and professional accountants in public practice, including auditors.

This publication was developed by the Staff of the South African Independent Regulatory Board for Auditors (IRBA) under the auspices of a Working Group formed by the International Ethics Standards Board for Accountants (IESBA) and national ethics standard setters (NSS) from Australia, Canada, China, South Africa, the UK and the US.<sup>1</sup> In addition to the contributions from the Working Group, and IESBA Staff, the publication has also benefited from the input of the Staff of the International Auditing and Assurance Standards Board (IAASB).



This document complements the CPA Canada & IESBA joint Staff Publication, *COVID-19 and Evolving Risks for Money Laundering, Terrorist Financing and Cybercrime*.

The Working Group's charge is to develop implementation support resources to assist professional accountants in effectively applying the *International Code of Ethics for Professional Accountants (including International Independence Standards)* (the Code) when facing circumstances created by the COVID-19 pandemic.

This publication does not amend or override the Code or the International Standards on Auditing (ISAs), the texts of which alone are authoritative. Reading this publication is not a substitute for reading the Code or the ISAs. The implementation guidance is not meant to be exhaustive and reference to the Code or the ISAs, as appropriate, should always be made. This publication does not constitute an authoritative or official pronouncement of IRBA, the IESBA, the IAASB or the other NSS organizations that form part of the Working Group.

### TABLE OF CONTENTS

Page 3	<b>Introduction</b>
Page 3	<b>The Fraud Triangle</b>
Page 4	<b>How Can the International Standards Help?</b>
Page 6	<b>Auditing Financial Statements and the Increased Risk of Fraud</b>
Page 8	<b>What Now?</b>

1. The NSS are the Australian Accounting Professional & Ethical Standards Board, Chartered Professional Accountants of Canada, the Chinese Institute of Certified Public Accountants, the South African Independent Regulatory Board for Auditors, the UK Financial Reporting Council, and the American Institute of Certified Public Accountants.

## Introduction

Disruptions, breakdown in supply chains, job losses and financial distress are being experienced across the globe due to the COVID-19 pandemic. As a result, many entities and their stakeholders are experiencing financial, operational and personal difficulties.

Due to the pressures and significant uncertainty associated with the pandemic, entities are exploring avenues to remain as going concerns, keep operational stability, and drive sustainability and growth in the longer term. Those avenues might create opportunities for illegal and fraudulent activities.

The unprecedented environment created by the pandemic could provide new opportunities for fraud that remains undetected for a long period, causing more financial hardships for its victims. On the flip side, major crises can act like receding tides, exposing what has been hidden from view. This pandemic, therefore, may expose fraudulent activities that were previously concealed.

Supported by a robust Code, professional accountants can play an ethical leadership role in helping to minimize the incidence of fraud and to identify and respond to instances of fraud or suspected fraud in the public interest.

## The Fraud Triangle

The fraud triangle<sup>2</sup> is a frequently referenced model for explaining the factors that are present when fraud occurs. These factors are divided into (i) opportunities; (ii) incentives and pressures; and (iii) attitudes and rationalizations. The COVID-19 pandemic and the recent global developments have made many organizations more susceptible to all three factors.



**Opportunities** relate to circumstances that exist and which provide an opportunity for fraud to be perpetrated. The current environment has given rise to a number of such opportunities, including the following:

**Large amounts of funds being made available.** Governments, international financial institutions, development agencies, and others have announced large packages of financial assistance in the form of grants and other funding to address the health and economic impacts of the pandemic. The large sums involved present an attractive target to those looking to perpetrate fraud.

**Distracted management amidst time pressure.** The pandemic has brought about several unexpected variables that disaster recovery plans may not have taken into consideration. As management efforts turn to crisis management, mitigation of spread of infection and near-term sustainability of operations, this distraction and shift of focus from pre-pandemic operational priorities may result in opportunities for misappropriation. Additionally, there has been an increased need to accelerate decision-making to minimize the health and financial impacts of the pandemic. The resultant innovative ideas and agility have allowed for greater responsiveness to the demands of the crisis.

2. Click [here](#) to access additional information about the fraud triangle and general fraud resources developed by the Association of Certified Fraud Examiners.

for many entities. However, while a focus on timely and proactive decisions has been necessary, appropriate controls, policies and procedures, due diligence and oversight may be overlooked.

**Continuing effectiveness of internal controls.** The agility and flexibility of management have allowed many entities to pivot to alternative work methods, such as work-from-home, during the pandemic. This has allowed entities to remain open for business, with the agile and flexible work methods contributing to business sustainability over the prolonged lockdown periods. However, these methods, often involving use of technology to enable a virtual work environment, may create challenges to the effectiveness of the pre-existing internal control environment.

**Significant market opportunities.** The surge in demand for personal protective equipment (PPE) and therapeutics during the pandemic has given rise to significant opportunities for unethical players to exploit the market disruption, whether through the marketing of PPE that does not meet safety standards or through other means.

**Incentives and Pressures** *Fraud is more likely to occur when management and/or employees have an incentive or are under pressure, real or perceived, to “cross the line” and commit a fraudulent act.* The pandemic has adversely impacted entities and economies in a variety of ways. Many businesses are under

financial distress, facing severe cash flow shortages, and some have halted their operations as a result of lockdown or other pandemic-related measures. The desire of businesses to minimize financial losses and remain going concerns have given rise to both incentives and pressures to commit fraud. In addition, the surge in demand for PPE and therapeutics has also created incentives for entities to exploit such demand for quick, illicit financial gain.

**Attitudes and Rationalizations.** Attitudes and rationalizations provide the justifications for those involved in fraud to commit the fraudulent act. The pressures and business disruptions caused by COVID-19 are unprecedented. As such, management may be tempted to consider various methods to remain in business and avoid job cuts or future cash flow difficulties. This may be reasoned as a decision for the “greater good”. However, if these methods are fraudulent, rationalizing the decisions made may be a “slippery slope” leading management to behave unethically. *It should be clear that it is in the best interests of every entity, its partners, and employees to uphold the highest standards of ethical behavior during this time.*

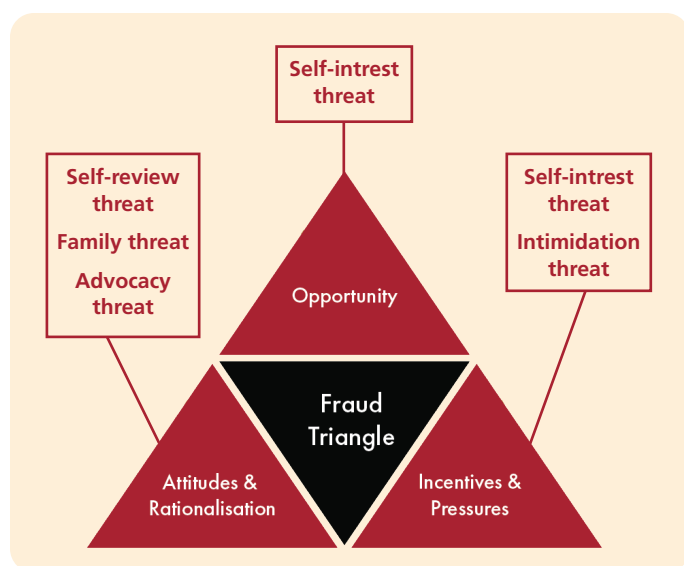
## How Can the International Standards Help?

**The May 2020 IESBA Staff Q&As publication, COVID-19: Ethics and Independence Considerations, includes a discussion of important considerations to bear in mind regarding compliance with the fundamental principles in the COVID-19 environment and in applying the Code's conceptual framework.**

The Code's fundamental principles are relevant to all accountants and the IAASB's International Standards are relevant to auditors in navigating opportunities, incentives and pressures, and attitudes and rationalizations that lead to fraudulent behaviors.

### Applying the Conceptual Framework

The Code's conceptual framework can help professional accountants navigate the heightened risks of fraud that are increasingly prevalent during the COVID-19 pandemic. Accountants should be watchful for any opportunities, incentives and pressures and changes in attitudes and rationalizations that could create or heighten one or more threats to compliance with the fundamental principles.



The evolving nature of the pandemic means that facts and circumstances are susceptible to sudden change. Under the conceptual framework, professional accountants are required to remain alert for new information and changes in facts and circumstances. Where that information or changes in facts and circumstances might impact whether a threat has been eliminated or reduced to an acceptable level (which may be common in the COVID-19 environment), the accountant shall re-evaluate and address that threat (see R120.9 to 120.9 A2).

The sudden changes arising from the pandemic might affect the reliability of information or amplify uncertainties, which might affect key judgments and conclusions that professional accountants make with respect to preparing, presenting, reviewing, and auditing financial information. It is important that accountants have an inquiring mind in undertaking their professional activities, particularly during these turbulent times. Among other matters, an inquiring mind helps in:

- Obtaining and understanding information relevant for making reliable judgments.
- Making informed decisions and challenging the views of others, as appropriate.
- Assessing the validity or integrity of information, including the source of the information and the appropriateness of its presentation.
- Exercising professional judgment that is informed by thoughtful consideration of all known and relevant available information.

As further discussed in the “Auditing Financial Statements and the Increased Risk of Fraud” section below, professional accountants performing audits, reviews and other assurance engagements are required to exercise professional skepticism, which includes a critical assessment of evidence.



### Australian authorities reveal alleged fraud of early access to superannuation

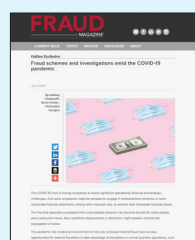
May, 2020

[Click image to read more](#)

### NOCLAR

Professional accountants need to be alert to the opportunities for fraud created by the current environment. The Code establishes a comprehensive framework to respond to non-compliance with laws and regulations (NOCLAR) or suspected NOCLAR (see Section 260 for accountants in business and Section 360 for accountants in public practice). Accountants have a responsibility to not only respond to, but also be alert for, NOCLAR or suspected NOCLAR. The COVID-19 pandemic creates increased opportunities for fraudulent activity, including:

- Fraudulent applications for government support
- Procurement and product fraud
- Benefit fraud, including fake claims
- Impersonation fraud
- Electronic fraud
- Insurance fraud
- Financial statement fraud



### Fraud schemes and investigations amid the COVID-19 pandemic

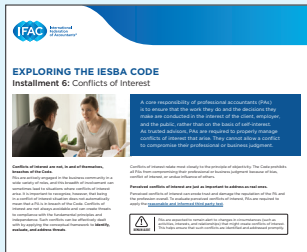
July 2020

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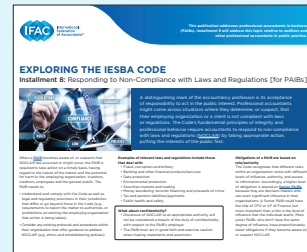
In times of crisis, incidences of fraud and dishonest behavior invariably increase. The health and economic crisis caused by the COVID-19 pandemic is no exception.

## Click on the images below to learn more by reading the relevant installments of the Exploring the IESBA Code publication series.



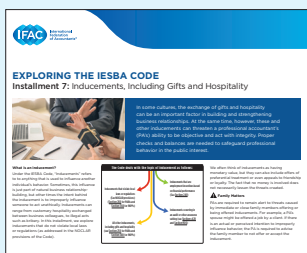
### Installment 6: Conflicts of Interest

[Click image to read more](#)



### Installment 8: Responding to Non-Compliance with Laws and Regulations [for PAIBs]

[Click image to read more](#)



### Installment 7: Inducements, Including Gifts and Hospitality

[Click image to read more](#)



### Installment 9: Responding to Non-Compliance with Laws and Regulations [for PAPPs]

[Click image to read more](#)

### Inducements, including Gifts and Hospitality

During turbulent times, it is not uncommon for employing organizations and firms to use inducements as a means of boosting morale or influencing the behavior of their direct reports and colleagues. Inducements might be permissible if they do not cause the recipient to act in an unethical manner. For some roles, however, employees may be more susceptible to bribery and corruption. Professional Accountants are prohibited from offering or accepting inducements with the intent to improperly influence the behavior of the recipient. Offering or accepting inducements where the intent is to improperly influence the behavior of the recipient will result in a breach of the fundamental principle of integrity. Accountants should also be aware of the relevant laws and regulations in their jurisdictions and comply with them.

### Pressure

Employing organizations, firms and individual professional accountants are experiencing significant pressures during the COVID-19 pandemic. In some cases, these pressures can potentially compromise the accountant's ability to comply with the fundamental principles of ethics. Accountants shall not allow

pressure to result in a breach to the fundamental principles and shall not exert pressure on others that would lead to a breach of the fundamental principles (see Section 270). Examples of COVID-19-related pressures include:

- Pressure to influence the preparation and presentation of information to present a false picture of the viability of business operations or valuation of assets and liabilities
- For auditors, pressure to accept management judgements which may not be reasonable or evidence-based
- Pressure related to the acceptance of inducements to behave unethically
- Pressure from intimidation by parties affected by the impact of the pandemic to achieve a desired outcome
- Pressure to turn a blind eye to unethical behavior
- Pressure to act without sufficient expertise or due care
- Pressure relating to putting personal/business interests ahead of the public interest



During the COVID-19 pandemic, professional accountants need to be especially mindful of the need to be adaptable and should always ensure that they have the right level of training, expertise, and experience in undertaking their professional activities.

## Auditing Financial Statements and the Increased Risk of Fraud

Auditing in the COVID-19 environment carries unique challenges in addition to the considerations for professional accountants set out above. The economic downturn has affected all entities in some way – for many there will be concerns about the viability of the entity and whether it can navigate the current circumstances. The combination of health and financial threats has made people more vulnerable and has created more opportunity for fraud, which in turn results in heightened risks of material misstatement of financial statements. Obtaining audit evidence may also be more challenging in the current COVID-19 environment as many businesses have moved to remote working, with a consequential impact on controls over financial reporting.

### Fraud Risks

The auditor considers fraud risk factors to help identify risks of material misstatement arising from fraud. In doing so, the auditor also considers the three 'sides' of the previously described fraud risk triangle from an audit perspective:

**Incentives / Pressures.** As financial situations have deteriorated, both for businesses and their employees, the incentive or pressure to commit fraud may have increased. Employees may feel pressured due to new constraints on their time, as more employees work from home and struggle to balance work with other responsibilities. This may be exacerbated by further reductions in workforces, adding further work responsibilities for already stretched employees. Financial difficulties may also add additional pressures. Management may feel pressured to modify or misstate the financial performance and financial position of the entity in order to achieve targets, avoid bankruptcy or foreclosure, sustain the customer base, raise debt or equity financing or qualify for government assistance.

**Audit focus area:**  
Journal entries

**Opportunity.** Breakdowns in internal control or adaptations to controls to accommodate a different working environment have presented more opportunity for fraudulent financial reporting or misappropriation of assets. For example:

**Audit focus area:**  
Internal controls and management override of controls

- Remote working has impacted internal control and may have left areas previously controlled exposed, as have other shifts in resources (such as job cuts with fewer employees to undertake the work).
- Supply chains have changed—different third parties and different exposures may result in heightened risks of fraud.
- Financial aid from governments and local authorities have given rise to new transaction flows and may result in new opportunities for fraud.

- Available audit evidence may be different to what the auditor has previously obtained including in terms of the nature, sources, access and use of information, and may not be as relevant or as reliable as what was previously used. This can create different challenges in relation to evaluating the relevance and reliability of information.
- Increased data security risks from working remotely may have allowed greater infiltration of technology-driven frauds from external parties, as well as increased internal risks from the move to remote working.
- A shift in focus by management and those charged with governance to address more immediate needs of the business such as financial and operational matters rather than focusing on compliance matters may have resulted in a weakened control environment.

**Rationalization.** As highlighted above, fraudulent activities could be rationalized in the current environment as helping the entity to survive, or for personal reasons (for example, rationalizing to oneself that they will pay the entity back once things return to normal), due to the downturn in the economy. Rationalization can manifest in different ways and at different levels of the entity—at the highest level involving management and those charged with governance, and at the operational level in relation to tasks and functions that may be particularly exposed, including where there may be collusion with third parties.



## Planning and Performing the Audit

In the COVID-19 environment, some fraud risk factors may have been magnified as explained above. Although risk identification and assessment may have been completed at the start of the audit, as the environment continues to change, auditors should continually be considering whether the identification and assessment of fraud risks remains the same throughout the audit, or whether further changes are needed. In response, changes may be required in relation to the design and performance of audit procedures for specific classes of transactions, account balances or disclosures.

Another important consideration relates to the information provided by the client, which may be in a different format than what has previously been used. Auditors may need to apply additional, or different, procedures to determine whether the information to be used as audit evidence is relevant and reliable, and to evaluate whether sufficient and appropriate audit evidence has been obtained.

*Audit focus area:*  
**Relevance and reliability of audit evidence obtained**

## Communication with Management and Those Charged with Governance

It is essential to understand the actions of management and those charged with governance with regard to what they have done to mitigate fraud risks. Regular and effective communication with management and those charged with governance is critical because events and changes are occurring at a rapid pace and may impact the audit.

*Audit focus area:*  
**Communications**

## Professional Skepticism

Professional skepticism is vital when planning and performing the audit, but particularly in the current circumstances – to have a questioning mind, to be alert to conditions that may be a possible indicator of risks arising from fraud or contradictory audit evidence, and to perform a critical assessment of the audit evidence that is obtained.

## NOCLAR

As already highlighted, the risk of NOCLAR is also heightened in the current environment. Entities may need to participate in various forms of economic stimulus funding, with regulations that are often unclear. There may be a heightened risk of inadvertent or intentional non-compliance because of the lack of clarity, as well as the short submission periods and the fact that accessing such funding (or making such applications) is new for many of those involved in the process.

## Auditing Accounting Estimates

There is a heightened risk of material misstatement, including due to fraud, when auditing accounting estimates (accounting estimates may often relate to revenue recognition, allowance for doubtful debts, impairment of assets, in particular intangible assets, financial instruments etc.). All accounting estimates have some degree of estimation uncertainty, which gives rise to subjectivity. The presence of subjectivity gives rise to the need for judgment by management, and therefore the susceptibility to unintentional or intentional management bias. Where there is intention to mislead, management bias is fraudulent in nature.

## The Auditor's Understanding of the System of Internal Control

The impact of the COVID-19 pandemic on the external and internal environment for all entities is widespread. As a result, there is an increased likelihood that the design and operation of internal controls related to financial reporting has been impacted as has the control environment (new reporting lines, different responsibilities, different focus).

Understanding the impact of the changes on all of the components of the entity's system of internal control is vital to the audit work to respond to possible risks of material misstatement arising from fraud. In considering whether changes are needed to the auditor's planned work, and especially if the auditor is relying on the operating effectiveness of controls, it is important to consider the impact of the pandemic on controls throughout the period under audit.



For example, as the pandemic started, and entities had to adjust quickly to working in a different (often remote) environment, the need to make changes and implement new controls, or supplement existing controls, may have put additional pressures on entities already struggling with the rapid changes. The operation of the entity's controls may have been suspended or delayed, and workaround processes may have been inadequate or insufficiently controlled at the time. Notwithstanding that at the start of the period the entity's controls may have been functioning, and many of the issues and challenges overcome by the end of the reporting period, it is essential that the time during which the significant changes took place are considered, in particular for fraud risk factors. Changes and disruptions during specific time periods may indicate higher risks of material misstatement due to fraud, which would impact the auditor's design and performance of further audit procedures.

## What Now?

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As a professional accountant you have many responsibilities, as mentioned above. While this realization may be intimidating, it can also be inspiring. This time of crisis is an opportunity for accountants to be looked at and admired as ethical leaders, and to demonstrate that they uphold the public interest. Accountants have a wide-ranging role in society and as a result, their skills and values can bring positive change through their work. The following are important reminders:

**Be alert:** The risks of fraudulent activities have increased significantly. Remain alert to threats to compliance with the fundamental principles. Professional accountants may be required to reconsider safeguards and the expectations of a reasonable and informed third-party.

**Be an advocate for the public interest:** Reminding others of these threats and helping them to identify these issues timely will assist in the longer-term viability and success of their employing organizations and clients. Add ethical considerations as a regular feature to written and verbal communications to continually amplify the messaging.

**Increase awareness:** Professional accountants are encouraged to promote these and other publications. This may help create awareness of ethics issues.

## Relevant Resources

### IESBA Guidance for Professional Accountants During the COVID-19 Pandemic

Joint Staff of CPA Canada & IESBA Publication, [COVID-19 and Evolving Risks for Money Laundering, Terrorist Financing and Cyberthreats](#)

Joint Staff of AICPA, IESBA and IAASB Publication, [Using Specialists in the COVID-19 Environment: Including Considerations for Involving Specialists in Audits of Financial Statements](#).

Joint Staff of APESB and IESBA Publication, [Applying the Code's Conceptual Framework in COVID-19 Circumstances: Scenarios in Taxation and Valuation Services](#)

Staff of IESBA [Questions and Answers: COVID-19: Ethics & Independence Considerations](#)

### IAASB Guidance for Auditors During the COVID-10 Pandemic

Staff Audit Practice Alerts:

[Review Engagements on Interim Financial Information in the Current Evolving Environment due to COVID-19](#)

[Auditing Accounting Estimates in the Current Evolving Environment due to COVID-19](#)

[Auditor Reporting in the Current Evolving Environment due to COVID-19](#)

[Subsequent Events in the Current Evolving Environment – Audit Considerations for the Impact of COVID-19](#)

[Going Concern Auditor Reporting in the Current Evolving Environment – Audit Considerations for the Impact of COVID-19](#)

[Highlighting Areas of Focus in an Evolving Audit Environment due to the Impact of COVID-19](#)

### International Federation of Accountants & its Network Partners

Exploring the IESBA Code publication series:

[Installment 7: Inducements](#)

[Installment 8: Responding to Non-Compliance with Laws and Regulations \[for PAIBs\]](#)

[Installment 9: Responding to Non-Compliance with Laws and Regulations \[for PAPPs\]](#)

[Installment 10: Pressure to Breach the Fundamental Principles](#)

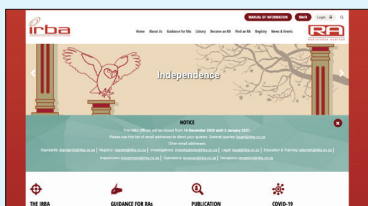
[Fighting Corruption Requires Accountants to Act: Here's How](#)

### CPA Canada

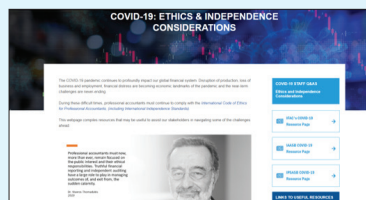
[COVID-19 fraud alert: Be on the lookout](#)

## COVID-19 Resource Webpages

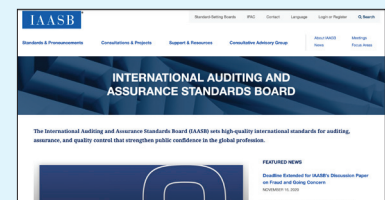
(Access COVID-19 Resources by clicking on the images below)



**IRBA**  
COVID-19 Resources for Auditors



**IESBA**  
COVID19: Ethics & Independence  
Consideration



**IAASB**  
Guidance for Auditors During  
the Coronavirus Pandemic

## About the IRBA

The Independent Regulatory Board for Auditors (IRBA) is the statutory body controlling that part of the accountancy profession involved with public accountancy in South Africa. Its strategic focus is to protect the financial interests of the public by ensuring that only suitably qualified individuals are admitted to the auditing profession and that registered auditors deliver services of the highest quality and adhere to the highest ethics standards.

## About the IESBA

The International Ethics Standards Board for Accountants (IESBA) is an independent global standard-setting board. The IESBA's mission is to serve the public interest by setting ethics standards, including auditor independence requirements, which seek to raise the bar for ethical conduct and practice for all professional accountants through a robust, globally operable *International Code of Ethics for Professional Accountants (including International Independence Standards)* (the Code).

## About IAASB

The International Auditing and Assurance Standards Board (IAASB) develops auditing and assurance standards and guidance for use by all professional accountants under a shared standard-setting process involving the Public Interest Oversight Board, which oversees the activities of the IAASB, and the IAASB Consultative Advisory Group, which provides public interest input into the development of the standards and guidance.

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