

International Auditing and Assurance Standards Board
529 5th Avenue
New York, New York 10017

Driebergen, 29 January 2021

Dear Sir, Madam,

Kriton welcomes the opportunity to comment on the IAASB's Discussion Paper (DP) Fraud and going concern in an audit of financial statements. This response is mainly based on our own observations and experiences in the performance of our work as professionals and our ideas about opportunities for improvement. The response is not based on specific (scientific) research.

Kriton is a professional services organization that supports auditors, accountants and their firms with issues related to professional practice and quality assurance. Our services include advice, quality reviews, mentoring, training and providing learning and development programmes. The top 30 firms in the Netherlands are among our clients. Our professionals have all gained extensive experience in the practice of the Dutch firms, including Big 4 firms. Several of them are affiliated with the Dutch universities or universities of applied sciences that are allowed to provide the theoretical study and postgraduate programmes for the education of chartered accountants. Some professionals are members of the *Accountantskamer* (Dutch professional Disciplinary Court). Our disciplines include audit, accounting, forensic services, internal audit, IT audit, but also human and organizational behaviour and communication. This document sets out our (brief) response to the questions posed by the IAASB in the DP.

We are happy to explain our response in more detail.

Kind regards,


P. (Pieter) Mansvelder RA


drs. J.M.S. (Joeri) Frietman RA CFE

1 Expectation gap

1.1 Main cause of the expectation gap

In our opinion, the cause is a complex of factors, as was also mentioned in the discussion paper. None of these factors can be considered the main cause of the expectation gap.

1.1.1 Fraud

From within the audited entity, management, those charged with governance and the audit committee do not communicate sufficiently to users of the financial statements about how they identify fraud risks, which fraud risks they recognise and how they manage these risks (fraud risk management).

On the part of the auditor, a lack of knowledge, skills and the right attitude plays an important role. Scientific research shows that auditors:

- have too little knowledge of concepts of fraud and non-compliance;
- have difficulty applying theoretical knowledge about this in practice;
- are not really able to identify fraud risks specifically and concretely;
- cannot always determine an appropriate response to identified risks;
- do not (or cannot) perform the designed procedures adequately at all times and, therefore, they are unable to detect fraud properly.

What is worrying, is that auditors themselves think they have the necessary knowledge and skills. There is limited intrinsic motivation to improve the quality of the work in this area.

In addition, auditors do not sufficiently communicate to the users of the financial statements and the auditor's opinion what they must do, can do and have done when it comes to misstatements resulting from fraud. Users are unable to form a clear idea of what to actually expect from the auditor. They tend to interpret the scope of the audit too broadly. This is (possibly) also related to the definition of the term 'fraud' as used by the professional group and in professional regulations. That definition does not correspond to what is commonly understood by fraud in parlance. In 'society', the term fraud seems to be used for many aspects of financial and economic crime, which auditors do not always classify as fraud.

Lastly, the audit profession lacks an unambiguous (international) vision of necessary adjustments. Examples of good practices remain out of the picture for too long to be able to make a meaningful contribution to the 'learning audit profession'.

1.1.2 Going concern

In our opinion, the following factors play a role in the expectation gap around the use of the going-concern assumption:

- Wishful thinking by management (and where applicable, those charged with governance): signals of potential problems - which are sometimes obvious - are, consciously or not, ignored in the preparation of the financial statements. This may be related to pressure resulting, for example, from expectations raised by stakeholders, the remuneration structure, financing conditions or the feeling of having failed as an entrepreneur.
- A lack of objectivity, professional competence and/or professional scepticism on the part of the auditor: the interest of the client (painting a positive picture) consciously or unconsciously prevails

over the public interest (fair reporting), signals of any problems are overlooked during the audit or not evaluated critically enough and investigated further.

- Reluctance on the part of management (and the auditor) with regard to disclosure about a possible uncertainty about the continuity of the entity: this could be a self-fulfilling prophecy, because financiers, suppliers and customers, for example, are deterred.
- Unfamiliarity among users of financial statements and auditor's opinions with the actual meaning of using the going-concern assumption when preparing the financial statements: what period does it concern, how should the certainty or uncertainty about the going-concern assumption be interpreted and what is the scope of the reports by management and the auditor on this?

In a number of recent disciplinary rulings in the Netherlands about presumed audit failures in relation to the bankruptcies of audited entities, the factors mentioned in the first two bullets play a role to a greater or lesser extent.

1.2 Narrow the expectation gap

The following measures could help narrow the expectation gap.

1.2.1 Fraud

	What	Who
1.	Communicating about fraud risk management (for example in the directors' report or the in-control statement).	<ul style="list-style-type: none"> • Audited entity • National and international regulators (reporting)
2.	Clarifying the definition of fraud, as used in professional regulations.	<ul style="list-style-type: none"> • IAASB
3.	Expanding the scope of ISA 240 (proposal: financial and economic crime, including fraud, corruption, deliberate non-compliance with laws and regulations, money laundering and terrorist financing).	<ul style="list-style-type: none"> • IAASB
4.	Increasing the compulsory theoretical knowledge and facilitating an adequate interaction between theoretical training, practical training and continuous education. Areas of attention include: <ul style="list-style-type: none"> • Concepts and manifestations of financial-economic crime • Investigation methods and skills (such as interview techniques, CAAT) • Sociology and psychology (aspects of human behaviour) • Specialisation, where necessary (for example, based on risk profiles of audit clients, the role of the professional within the audit firm). 	<ul style="list-style-type: none"> • National institutions that determine the exit qualifications for theoretical study, including postgraduate programmes • Providers of theoretical study (universities (of applied sciences)) • National professional organizations/regulators
5.	Clarifying ISA 240 (see Appendix 1).	<ul style="list-style-type: none"> • IAASB • National professional organizations/regulators

6.	<p>Providing guidance and good practices regarding activities that might be appropriate in the given circumstances, taking into account the local and cultural context. Examples include subjects such as:</p> <ul style="list-style-type: none"> • Fraud risk analysis • Brainstorming and discussing fraud during the team meeting • Investigation methods and (technical) resources to be deployed. 	<ul style="list-style-type: none"> • National professional organizations
7.	<p>Removing shortcomings in laws and regulations. By way of illustration: in the Netherlands, there is a legal obligation to assess whether an audit client's recovery plan is adequate in the event of a suspicion of material fraud. However, criteria for determining adequacy are lacking.</p>	<ul style="list-style-type: none"> • National regulators

1.2.2 Going concern

The following measures could help narrow the expectation gap.

	What	Who
1.	<p>Communicating more clearly about the principles used for applying the going-concern assumption (in the explanatory notes to the financial statements).</p>	<ul style="list-style-type: none"> • Audited entity • National and international regulators (reporting)
2.	<p>Clarifying the scope of the term 'going-concern assumption', such as with regard to the period ('horizon') and the inherent uncertainty of forward-looking information.</p>	<ul style="list-style-type: none"> • National and international regulators (reporting) • IAASB
3.	<p>Increasing the theoretical knowledge and expertise of auditors with regard to the subject of 'going concern'. Areas of attention include:</p> <ul style="list-style-type: none"> • Going concern reporting concepts, including estimates, uncertainty and the importance of disclosures • Investigation methods and skills (such as interview techniques and financial analyses) • The distinction between uncertainty about future events and the inability to obtain sufficient appropriate audit evidence about the assumptions used • Sociology and psychology (aspects of human behaviour). 	<ul style="list-style-type: none"> • National institutions that determine the exit qualifications for theoretical study, including postgraduate programmes • Providers of theoretical study (universities (of applied sciences)) • National professional organizations/regulators
4.	<p>Clarifying ISA 570 (see Appendix 2).</p>	<ul style="list-style-type: none"> • IAASB • National professional organizations/regulators
5.	<p>Providing guidance and good practices regarding activities that might be appropriate in the given</p>	<ul style="list-style-type: none"> • National professional organizations

	<p>circumstances, taking into account the local and cultural context. Examples include subjects such as:</p> <ul style="list-style-type: none"> • Brainstorming and discussing going concern during the team meeting • Investigation and analysis methods and (technical) resources to be deployed. 	
6.	<p>Removing shortcomings in laws and regulations. By way of illustration: currently, the 'horizon' to be used in the regulations for applying the going-concern assumption is usually set at one year from the balance sheet date, while the common interpretation in practice is one year from the date of the preparation of the financial statements (or the date of the auditor's opinion).</p>	<ul style="list-style-type: none"> • National regulators

2 Enhanced or more requirements with regard to fraud in an audit

2.1 Areas for enhanced or more audit requirements

2.1.1 Immaterial fraud

Due to its scope, immaterial fraud is easier to conceal and therefore less easy to detect by auditors. Investigating whether immaterial misstatements may be the result of fraud can be very intensive, which can involve high costs. We believe that holding auditors responsible for detecting immaterial fraud is disproportionate.

What may be expected of the auditor is that for any suspicion of fraud, he establishes with a reasonable degree of certainty that there can be no material misstatement as a result of the fraud. We therefore propose the following requirements:

- The auditor examines whether management has sufficiently established the nature and extent of the fraud, including - as far as possible - the duration of the fraud.
- The auditor determines that management has investigated whether or not it concerns an isolated event.
- In accordance with ISA 260 and 265, the auditor communicates with management and those charged with governance regarding the identified immaterial fraud and related shortcomings in internal control, respectively.
- The auditor assesses whether the response of management and those charged with governance to the identified fraud has been appropriate within the legal and regulatory framework.

2.1.2 Fraud committed with or by third parties

The discovery of a material misstatement as a result of fraud committed in collusion with one or more third parties is, in principle, within the scope of an audit and the responsibility of the auditor. The collusion may cause the auditor to assume that the audit evidence obtained is convincing, when in fact it is incorrect. Therefore, the auditor may not detect such a misstatement even though the audit has been properly planned and performed. This is an inherent limitation of an audit. However, the auditor cannot use this starting point as a rationalisation for performing no or only a limited analysis - based on relevant fraud risk factors - of the risk of such a misstatement.

One example of a fraud committed by third parties is that the entity is a victim of business e-mail compromised fraud (also known as 'CEO fraud') or ransomware. The auditor is responsible for identifying and assessing risks from such fraud and for appropriately responding to them. These risks relate to the (possible) impact of such fraud, such as paying a ransom, a claim or a fine, but also, for example, reputation damage. A material misstatement may exist if such risks are incorrectly not taken into account in preparing the financial statements. So again, in his risk analysis, the auditor will have to pay due attention to (the possible consequences of) such risks and, where applicable, formulate an appropriate response.

In addition, the auditor's natural advisory role may entail that he may be expected to alert management to such risks. This certainly applies, but not only, to auditors from small and medium-sized companies. The question to what extent auditors may be held accountable for their duty of care if they do not point out such risks to management and/or those charged with governance is beyond the scope of this response.

2.2 Specific procedures for certain entities or in specific circumstances

At entities where management is also a shareholder, we regularly see that management wants more certainty with regard to improper appropriation of assets by employees (hereinafter referred to as employee fraud). They often apply low materiality limits for employee fraud and in many cases, they do not distinguish between theft and employee fraud. We believe that auditors can provide no to very limited assurance in this area. At most, management may ask the auditor to perform specific procedures. To this end, management must agree on a separate engagement with the auditor. We also note that the auditor must discover material misstatements resulting from such employee fraud (such as stock differences).

In our opinion, specific requirements should apply to the following situations:

- Organizations that receive public money (for example, support measures in the light of the Corona crisis).
- In the event of indications of fraud.
- In the event of a suspicion of fraud (both PIEs and non-PIEs).

For the first situation, new, specific Standards (for audits and other engagements) have recently been drawn up in the Netherlands. With regard to the second situation, it is necessary for the auditor to obtain more and/or different audit evidence to rebut the suspicion of fraud. In the third situation, it is desirable for management to report more extensively to users on the nature and extent of the suspected fraud and how it dealt with the fraud. The auditor examines the information provided by management and includes the outcome thereof in his opinion on the financial statements. Current laws and regulations, including the Standards, now offer too few specific tools for the second and third situation. Additional requirements, procedures or guidelines are therefore desirable.

2.3 Suspicious mindset

The 'neutral mindset' currently demanded offers too little guidance to identify fraud risks and to evaluate audit evidence critically enough. As stated in §1.2, we believe that the knowledge and skills of the auditor must be increased. This is necessary to be able to adequately identify and assess fraud risks. In the case of identified fraud risks, auditors should be more suspicious of the authenticity and reliability of audit evidence obtained. The audit evidence obtained must clearly show how the auditor has implemented the suspicious mindset. We are also in favour of tightening the requirements for

professional scepticism throughout the audit process, in accordance with revised ISA 315 and ISA 540. In addition, the introduction of the stand-back principle in ISA 240, as well as the inclusion of professional scepticism in relation to fraud risks as a mandatory point of attention in internal (engagement) quality assurance reviews, are in our opinion necessary. This applies to all audit engagements.

2.4 More transparency about the auditor's work

We support more comprehensive and concrete reporting by management and those charged with governance on (the process of) fraud risk management. This can be included in the directors' report or an in-control statement (to be further specified). The intention is that management and those charged with governance are accountable for how fraud risks are controlled by the entity. We emphasise that management should be cautious in mentioning specific measures that have been taken to prevent or detect fraud, because potential fraudsters can use this information to break through or circumvent the measures.

Subsequently, the auditor will have to report on his evaluation of the information included in the directors' report or in-control statement. We make some proposals for this in the paragraphs below. We will then post our comments on current developments in the Netherlands on this point.

2.4.1 No inaccuracies in the directors' report or in-control statement

The auditor examines whether the information contains (material) inaccuracies and reports on this. In addition, the auditor reports specifically on the adequate design and implementation of the relevant parts of the fraud risk management process.

In our view, the auditor is reluctant to report on the effectiveness of (specific) control measures. There is always a possibility that employees or management deliberately circumvent the control measures. In addition, potential fraudsters could use information about weaknesses in internal control.

In accordance with Article 10 of the European Regulation (EU) on specific requirements for statutory audits of financial statements of public interest entities, the auditor must explain in the auditor's opinion to what extent the audit is deemed to be able to detect irregularities, including fraud. We propose that this report be expanded with the aforementioned topics. We also propose that this reporting obligation also applies to statutory audits of non-PIEs. We expect that the benefits of such an obligation will outweigh the costs (such as awareness among management, transparency for and better decision-making by the users of the financial statements). The aspect of proportionality must be taken into account.

2.4.2 Suspected fraud

In the event of suspected fraud, the auditor refers in his report to the relevant passages in the directors' report and the financial statements. He also explains his activities under the key audit matters (in the case of a PIE) or in a mandatory explanatory paragraph (in the case of a non-PIE, as long as the key audit matters are not yet a mandatory part of the auditor's opinion). He also discusses his evaluation of the management's recovery plan.

2.4.3 Communication via the auditor's opinion in the Netherlands: an experiment

In the Netherlands, the proposal is being developed that auditors must include the activities and findings with regard to fraud risks in the auditor's opinion from the 2022 financial year. An experimental phase is expected for this. The objective of this is better communication and is in line with what we stated earlier in this response. In this context, we reiterate the possible downside of such communication, if overly detailed information about gaps in the risk management process is included. In addition, there is a risk that such an obligation will lead to the inclusion of boiler plate texts, with very limited value for the user of the financial statements and auditor's opinion. In our opinion, this detailed reporting is only necessary when there is a key audit matter, in specific cases of (suspected) fraud and when the directors' report contains incorrect statements about the fraud risk management process.

3 Going concern

3.1 Should the auditor have enhanced or more requirements with regard to going concern in an audit of financial statements?

In our view, the requirements regarding the going-concern assumption procedures should be clarified regarding:

- The horizon that the auditor should maintain in evaluating the information underlying management's application of the going-concern assumption. This concerns both the period for which forward-looking information must be taken into account (1 year or longer?) and the date on which that period starts (balance sheet date or date of the financial statements?).
- The requirements attached to the information on which management's application of the going-concern assumption is based: when is sufficient and appropriate audit evidence available, for example, with regard to management's plans?
- The requirements attached to a retrospective evaluation of, for example, the quality of information about cash flows, financial position, results, estimates and the explanatory notes thereto.

3.2 Is there a need for enhanced procedures only for certain entities or in specific circumstances?

We believe that ISA 570 can be adjusted on this point in line with the adjustments of, for example, ISA 315 and ISA 540 (applying scalability). No further distinction needs to be made according to types of entities or specific circumstances.

3.3 Do you believe more transparency is needed?

We support more comprehensive and concrete reporting by management and those charged with governance on principles used when applying the going-concern assumption. This can be included in the directors' report. The auditor must report on his evaluation of the information included in the directors' report. If there is (serious) uncertainty about continuity, this must be addressed (even now) in the explanatory notes to the financial statements. In our opinion, it is not sufficient for the auditor in that situation to refer to that explanation in an emphasis-of-matter paragraph in the auditor's opinion (whether or not in addition to his description of a key audit matter in the case of the audit of a PIE). He should detail his work in this regard in a separate section of the auditor's opinion, including his evaluation of management's plans.

4 Any other matters

We are in favour of an amendment to ISA 240, so that auditors internationally deal with (identifying) fraud risks and suspected fraud in the same consistent manner. In addition, as explained earlier in the response, we prefer that the concept of fraud be extended to 'financial-economic crime'. In various countries, the use of forensic expertise during audit engagements and the engagement quality review procedures is being discussed and experiments are being conducted.

In the Netherlands, the capacity of forensic expertise is limited and concentrated at a relatively limited number of (audit) firms. With mandatory use of forensic expertise, demand is likely to exceed supply many times over. Retraining auditors to become a forensic expert is not a feasible solution. The required investment in knowledge and experience ('flying hours') is too great.

We believe that audit firms - as part of the quality control system - should themselves determine what level of expertise is required for a particular set of circumstances (for example, simple, difficult, complex). Sometimes, the use of a forensic expert is desirable, but it is often sufficient for the audit firm to have persons with sufficient knowledge and experience to pay increased attention to fraud risk factors, fraud risks and indications of fraud during the audit. These persons are also able to initially take the lead if specific, forensic expertise is necessary. They are referred to as 'fraud experts' and we propose that the training, availability and deployment of fraud experts should be explicitly included in the quality control system.

APPENDIX 1

We propose the following amendments to ISA 240:

- Clarifying the definition of the term fraud (and, for example, the distinction between theft, embezzlement and fraud, as well as the reason why this distinction is important).
- Modifying the third criterion of the fraud definition: to obtain an advantage and/or harm another.
- Expanding the scope of ISA 240 to other aspects of financial-economic crime.
- Clarifying the relationship between fraud, materiality and the application of ISA 240
- Explaining more clearly what a requirement means or what the requirement is intended to cover.
- Clarifying the application and other explanatory material. They are now too superficial and open to multiple explanations.
- Clarifying what may be expected of the auditor, management, those charged with governance and others with regard to the roles and responsibilities when it comes to preventing, discovering and correcting material misstatements resulting from fraud or financial-economic crime.
- Recording the definition of a fraud signal.
- Implementing the principle of 'spectrum of inherent fraud risks', analogous to ISA 315 and ISA 540.
- Making the requirements for the fraud risk analysis more concrete. Examples include identifying fraud risks, regardless of materiality and any relevant internal control, subsequently assessing the inherent fraud risk and evaluating the significance.
- Clarify that a risk of (material) misstatement due to fraud is a significant risk because the auditor must pay particular attention to this risk on the premise that such misstatements are more difficult to detect because of intent and misrepresentation. In the current situation, many auditors assume that there is significant risk because it is 'mandatory' under ISA 240, without understanding the background to it.
- Making the requirements for identifying the internal control measures relevant to the audit more concrete, as regards risks of misstatement resulting from fraud.
- Where possible, introducing the principle of scalability with regard to the response to the identified risks, as is also the case with ISA 315 and ISA 540.
- With regard to the response to the risk of management override of controls, clarifying why the requirement for journal entry testing is included. In the current situation, many auditors fail to recognise that investigating 'conspicuous journal entries' contradicts the premise that fraud involves intent and deception. Furthermore, clarifying the requirements for the use of criteria for investigating journal entries, such as substantiation of the choice of the criteria and the reproducibility of the test work.
- Including a concrete step-by-step plan for the activities that follow the identification of a fraud risk factor, a fraud signal and suspicion of fraud, respectively.

APPENDIX 2

We propose the following amendments to ISA 570:

- Clarifying the difference between uncertainty about future events and not having sufficient appropriate audit evidence to support the going-concern assumption.
- Clarifying the effective date and duration of the period that the auditor must include in his evaluation of the forward-looking information to support the going-concern assumption.
- Implementing the principle of 'spectrum of inherent going-concern risks', analogous to ISA 315 and ISA 540.
- Where possible, introducing the principle of scalability with regard to the response to the identified risks, as is also the case with ISA 315 and ISA 540.
- Guidance in situations where there is no serious uncertainty about continuity, but - in the opinion of the auditor - the information for the users of the financial statements should include the underlying considerations (e.g. the outcome of the evaluation of the consequences of the Corona pandemic).
- Clarifying (consequences for the auditor's opinion in the case of) situations in which multiple material uncertainties exist that are significant to the financial statements as a whole. According to the application-oriented texts to Standard 570, 'the auditor may consider it appropriate in extremely rare instances to express a disclaimer of opinion rather than including an Emphasis of Matter paragraph. Standard 705 provides guidance on this issue.' This wording and reference leave a lot of room for interpretation.