

January 28, 2021

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

Submitted electronically at: IAASB [Submit Comment](#) link

**Re: Discussion Paper – *Fraud and Going Concern in an Audit of Financial Statements***

The New York State Society of Certified Public Accountants (NYSSCPA), representing more than 22,000 CPAs in public practice, industry, government and education, welcomes the opportunity to comment on the above-captioned Discussion Paper.

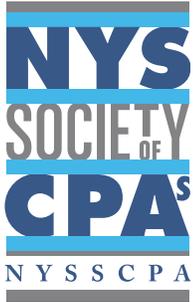
The NYSSCPA's Auditing Standards Committee deliberated the Discussion Paper and prepared the attached comments. If you would like additional discussion with us, please contact Bonnie S. Mann Falk, Chair of the Auditing Standards Committee, at (516) 984-7225, or Ernest J. Markezin, NYSSCPA staff, at (212) 719-8303.

Sincerely,

A handwritten signature in black ink that reads 'Edward L. Arcara'. The signature is written in a cursive style and is positioned over a faint, light blue watermark of the NYSSCPA logo.

Edward L. Arcara  
President

Attachment



**NEW YORK STATE SOCIETY OF  
CERTIFIED PUBLIC ACCOUNTANTS**

**COMMENTS ON**

**DISCUSSION PAPER – *FRAUD AND GOING CONCERN IN AN AUDIT OF FINANCIAL  
STATEMENTS***

**January 28, 2021**

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Ernest J. Markezin

## **New York State Society of Certified Public Accountants**

### **Comments on**

#### **Discussion Paper – *Fraud and Going Concern in an Audit of Financial Statements***

We welcome the opportunity to respond to the International Auditing and Assurance Standards Board’s (IAASB or the Board) invitation to comment on its Discussion Paper – *Fraud and Going Concern in an Audit of Financial Statements*.

#### **General Comments**

We believe the Discussion Paper raises appropriate questions and provides excellent background material for fraud and going concern which are both significant and subjective audit issues. The Discussion Paper covers both issues in a single document, but when the projects are ultimately included in the IAASB’s working agenda we suggest that fraud and going concern be kept separate in the standards. They have underlying commonality including high risk, subjectivity, and reporting significance. However, detection of fraud is based on historical information (or the absence of such information) while going concern evaluation relates principally to estimates and uncertainty in prospective information. During the pandemic we are currently experiencing, the link between the issues of fraud and going concern is deeper, since there is potentially an increased motivation to commit fraud in order to avoid doubt about an entity’s ability to continue as a going concern; however, we view this heightened risk to be temporary.

#### **Questions for Respondents**

We offer our responses to the Questions for Respondents (reprinted in bold italics) below.

##### ***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?***

The material extracted from an Association of Chartered Certified Accountants (ACCA) publication and included in the Discussion Paper on page 11 succinctly identifies the components of the expectation gap, currently identified as relating to fraud and going concern, as the knowledge gap, performance gap, and evolution gap. Each component significantly contributes to the expectation gap, with each component being interdependent of the other. With that said, the core of the issue lies in the public’s perception of the audit, the auditors, and the auditing standards. This perception is skewed by the idea that all audits are performed in the same prescribed manner, following the same “rule book.” The public may not fully understand the goal of the audit and the meaning of “reasonable assurance,” and the gap widens as advances in technology enable

more transactions to be looked at and more procedures to be performed. This technological expansion is (perhaps mistakenly) perceived to increase the auditor's ability to identify fraud and going concern issues.

***(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?***

There are several areas that we would characterize as current weaknesses in the International Financial Accounting Framework (IFRS) and the International Auditing Standards (ISAs) for which some remedies have been made by certain national regulators in Canada and Japan, as discussed in the Discussion Paper. Since the professional standards have a large degree of conformity, these changes, that were deemed necessary to improve audit quality even though they created differences at the time of their issuance, can be easily adapted into the international versions.

As the Discussion Paper mentions, other national standard setters, namely those in Canada, the UK, Japan and Australia, launched initiatives and made revisions to their own standards and regulations to address fraud and going concern in the last several years. The IAASB and the IASB should look at these projects as part of any contemplated future revisions. In looking at the reports and standards issued in these countries more closely, we wish to emphasize the importance of the duty to prevent and detect fraud remaining with directors and management, while the auditor's duty remains to be to assess the effectiveness of controls and perform certain procedures should suspected fraud come to the auditor's attention. Additional guidance on fraud-related procedures and quality control considerations when a suspicion of material misstatement due to fraud exists may increase audit quality and help narrow the expectation gap and further distinguish between the roles and responsibilities of an auditor and a forensic specialist. Similarly, the assessment of going concern must remain with management, while the auditor's duty is to evaluate management's assessment, remedial plans and related disclosures and report as necessary. The key for the auditor is to be able to audit management's going concern assertion/evaluation and disclosures and determine their impact on the auditor's report, if any, ranging from no mention of it or including an emphasis-of-matter paragraph, to including it as a key audit matter.

Another example of a significant improvement occurred in the US when the FASB issued ASU 2014-15, Presentation of Financial Statements – Going Concern (Subtopic 2015-40): *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*.

The main provisions of the ASU clarify that responsibility for the going concern evaluation remains squarely into the hands of management who must make a focused, structured evaluation of the events or conditions that in the aggregate raise substantial doubt about the entity's ability to continue as a going concern (over a stipulated period). Management must also evaluate any mitigating factors, its remediation plans, and disclosure of such information. Equally significant is that the FASB set the standard for related disclosures thus providing auditors with a benchmark against which they may assess the adequacy of such disclosures. This approach is more focused and utilitarian.

The Auditing Standards Board of the AICPA provided guidance in AU-C Section 570 clarifying the auditor's role to evaluate management's plans to mitigate a going concern issue(s), and whether the specific plans are probable of mitigating the conditions and events that raised the substantial doubt. While these efforts made progress in enhancing the standards related to going concern, further clarification might further lessen the expectation gap. For example, a definition of "substantial doubt" which incorporates "probable" is included in ASU 2014-15. An improvement that could have a positive impact on the expectation gap would be to define the term "probable" quantitatively within the standards, like an academic citing a threshold of 50-70%<sup>1</sup> chance of occurrence, while Deloitte and others suggest 70%<sup>2</sup>. While we believe elucidation would be effective, it needs to be accompanied by follow up monitoring, including analyzing going concern status and reaching out to stakeholders, carried out by the standard setting bodies. This monitoring would allow regulators to conclude regarding the effectiveness of established standards and identify next steps as necessary.

The Discussion Paper identifies several high-profile financial frauds. The paper would have been more instructive if the text outlined the circumstances that allowed the frauds to go undetected for extended periods. Within many international auditing networks, if there is a significant audit failure within the network, the affected firm may change its methodology and procedures if their regulators require that, and the network generally integrates a discussion of the failure into its training programs. Regulators of public interest entities generally require prompt notification.

We are encouraged by the outreach of the various national standard setters, the IAASB, and the large international networks of firms. Many have programs that include podcasts, educational initiatives, and implantation guides to support broader understanding of the issues and a consequential reduction in the expectation gap. These outreach efforts need to continue.

***2. This paper sets out the auditor's current requirements in relation to fraud and going concern in an audit of financial statements, and some of the issues and challenges that have been raised in 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?***

When a significant fraud occurs, financial statement users and the investor community will ultimately raise the question, often seen in the press, "where were the auditors?" This is especially true when the fraud occurs over an extended period of time and is undetected during such period. Public perception of how the auditor's responsibility for fraud is understood is complicated by the countries the client does business in, the nature of the business environment in those countries, the extent and effectiveness of government and

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<sup>1</sup> ASU 2014-15 paragraphs BC17 cited Bortiz, 1991.

<sup>2</sup> [A Road Map to Accounting for Contingencies and Loss Recoveries, Deloitte, 2019, page 21.](#)

other regulation, the purpose of the audit and the level of risk of material misstatement at the entity level.

We believe a final standard would be most useful if it were to provide auditors with guidance that might enable discovery of fraudulent activity that has no material effect in any one audit period but is material only when its effect is aggregated over several periods. Otherwise, we do not see a compelling reason to prescribe enhanced or extended procedures for all entities to address fraud risks. We think the upgrades to be made in ISA 315 will likely provide better focus and evaluation of risk. Many firms' methodologies ask their auditors to designate inherent and control risks with fraud risk characteristics, based on characteristics of the entity being audited. Other firms isolate their fraud risk evaluations at the account/assertion level as a separate exercise. Properly applied, both approaches can be effective.

We believe that artificial intelligence tools now being utilized by many internal and external auditors can be a valuable addition to the auditor's toolbox. Fundamental changes to auditing standards prompted by this initiative, if any, should be deferred until the effectiveness of these tools can be evaluated.

***(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 ISA's or outside the scope of an audit (e.g., a different engagement) Please explain your answer.***

We cannot answer this question definitively since changes in the accounting and auditing standards can have a wide range impact on risks of fraud and going concern depending on how rapid these changes are, and the industries affected (or the specific entities ability to respond). There are of course industries that are inherently risky by their very nature without the ability to foresee changes. As a result of rapid changes in technology, there may be many more incidences of entities with going concern issues and related fraud risks. For example, ten years ago, technology unexpectedly changed the risk profile of the oil and gas industries significantly as fracking became a material factor in production. Another example is how technology rapidly changed the for-hire car industry in the US.

A third example is commercial banking. In the US, this industry's risk profile has changed significantly. Prior to the repeal of the Glass Steagall Act, the investment portfolios of commercial banks generally constituted about one-third of their balance sheets. The portfolios were comprised of securities with little or no credit risk (e.g., government securities). After the law changed, more risk was introduced into portfolios as the accounting requirements moved to address fair value reporting. Fraud risk increased incrementally. To address these risks, firms increased the use of valuation specialists (both within their firms, and others such as third-party pricing specialists). They also provided special training and higher levels of review and supervision during the major engagement phases. The financial crises provided special challenges. During this period the accounting

and auditing standard setters helped audit professionals to manage their fraud risk, but those efforts were not completely successful, and they keep evolving within the industry even today.

We think the most appropriate response to this type of fraud risk should be in the form of encouragement that better guidance be provided at the firm level. Therefore, additional prescribed procedures (or enhancements thereof) in the standards would not be necessary, even in higher risk situations and within higher risk industries, as auditors would be expected to expand their audit procedures as deemed necessary in the circumstances. Additionally, audit firms' acceptance and retention policies are an added element of protection against fraud risk.

Any changes or enhancements to procedures should be done in the ISA's and outside the scope of the audit in the guidance related to different types of engagements, *i.e.*, audits versus non-audits such as forensic investigations. Any clarifications to the responsibilities of the auditor versus another specialist would work toward narrowing the expectation gap.

***(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.***

No. We believe that professional skepticism as defined in the auditing literature is sufficiently helpful to address fraud identification in planning and performing the audit. Audit regulators and standard setters in the major free markets have embedded specific mention of the term professional skepticism in their standards and regulation. Many have embarked on outreach projects explaining what professional standards mean in this context, and how firms and individual need to respond to these requirements. We believe that the concept requires auditors to evaluate any information that is contrary to management's assertions, including information that is illogical, and those issues need to be documented along with what response was taken.

In addition, the wording "suspicious mindset" has a more negative connotation, insinuating an inherent bias to believe that someone has likely done something wrong, illegal, or dishonest rather than the more neutral and objective term currently in use and well understood, "professional skepticism." We recommend retaining the term, "professional skepticism," as is currently in use.

***(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 communication with those charged with governance, in the auditor's report, etc.)?***

No. Communication requirements are adequate. Auditors have flexible options and, in most circumstances, can provide increased disclosure to users and others based on ethical requirements, when it is deemed necessary.

**3. This paper sets out the auditor's current requirements in regard to going concern in an audit of financial statements and some of the issues and challenges that have been raised about to this, 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?**

We think the extant ISA 570 requirements to going concern are adequate and the upgrades made in ISA 315 will provide better focus and evaluation of risk. Additional prescribed (enhanced) procedures for engagements with going concern issues are not necessary as firms can and will expand their audit procedures as deemed necessary based on existing standards.

**(b) Is there a need for enhanced procedures only for certain entities or in specific circumstances? Is 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 our response to question 2(b), we cannot answer this question definitively because changes in the accounting and auditing standards can have extensive and diverse impacts on going concern issues and fraud risks depending on how rapid these changes are made, and the specific entities or industries most likely affected or their ability to respond.

Subject to our other recommendations contained elsewhere in this letter, we believe the scope of auditing procedures currently proscribed in ISAs 315 and 570 are generally sufficient for application in financial statement audits intended to result in an opinion as to the absence of material misstatements when viewed in the context of the financial statements taken as a whole. More robust fraud procedures should be prescribed only in a standard intended to be applied in a different type of engagement such as a forensic investigation, the objective of which is to identify and evaluate fraud that may not rise to the level of material in an financial statement context.

**(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?**

In our view, the communication requirements to going concern are adequate. Auditors have flexible options and, in most circumstances, can provide increased transparency to

users in the independent auditor's report, through key audit matters, as well as communications to those charged with governance, as applicable.

***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 have no other matters related to going concern issues to discuss in addition to our responses, above.

As to fraud, the requirements to communicate to audit committees or others charged with governance, include internal control deficiencies, which may include the absence of controls such as separation of duties, increasing the risk of fraud even when other controls are in place and are tested as effective. The requirements provide for rapid communication when fraud is suspected even when a determinative conclusion has not been made. Audit firms in such circumstances often ask audit committees to endorse extending audit procedures and/or a forensic audit engagement. Although these communications are important, we believe they are highly sensitive. We, therefore, also believe that the current communications guidance should be improved to align various expectations related to the audit of the auditor, with the expectations of those charged with governance, management, and other users of the communications and the financial statements. For example, since fraud is a legal determination, we believe this fact be included in disclaimer language to be required by the standards in such communication. In addition, outreach projects, implementation guidance, and in-firm training could prove beneficial. Most of all, any changes implemented by the IAASB should be followed by monitoring efforts to assess the effectiveness of the changes.