

# UNIQUE ASPECTS OF FRAUD AND GOING CONCERN IN AUDITS OF LESS COMPLEX ENTITIES

*IAASB-Facilitated Roundtable Discussion*



**OCTOBER 7, 2020**

**7:00 AM EDT – 9:30 AM EDT**

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## INTRODUCTION

The role of the auditor in relation to fraud and going concern in an audit of financial statements continues to receive heightened public attention, particularly following recent high-profile corporate failures around the globe in recent years. Corporate failures are not unique to large, global groups of companies. Less complex entities (LCEs) also fail and, when they do, have serious consequences to their owners, employees, and a range of other impacted parties. Due to the public interest in these topics, the IAASB has commenced information-gathering efforts to help determine the direction of possible new projects in the areas of fraud and going concern.

In addition, in terms of the IAASB's focus on LCEs more broadly, we are also in the process of progressing our work on audits of LCEs. There are two streams to this: (1) the development of a separate standard for audits of LCEs, and (2) further consideration about what can be done within the International Standards on Auditing (ISAs) with regard to complexity, understandability, scalability and proportionality. Challenges and concerns relating to fraud and going concern in audits of LCEs have been highlighted to the IAASB, and further consideration of these aspects will also form part of the work in these two streams.

### ***Purpose of the Roundtable***

This roundtable seeks stakeholder perspectives on the following topics:

1. If, and how, the nature of fraud perpetrated in LCEs is different from more complex entities, including identifying risk factors that may be unique to LCEs in the context of an audit of financial statements;
2. What factors or characteristics are unique to less complex entities in considering an entity's ability to continue as a going concern;
3. Which requirements in ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, and ISA 570, *Going Concern*, are particularly challenging to apply for LCEs and why; and
4. How audit procedures performed to meet the requirements of ISA 240 and/or ISA 570 in audits of LCEs may be executed differently from audits of more complex entities.

*Registration is required to attend and participate in the discussions. Once you have registered, you will receive a personalized link to join the roundtable and you will be prompted to add the Zoom meeting reminder with the link to your calendar.*

*This roundtable discussion will be live streamed to the [IAASB YouTube Channel](#). The full session will also be recorded and published on the IAASB website on a future date.*

# FRAUD AND GOING CONCERN IN LESS COMPLEX ENTITIES

Smaller entities make a critical contribution to the world economy, and quantitatively the majority of audits globally are audits of smaller entities. The ongoing challenges relating to the complexity, understandability and difficulties in applying the ISAs faced by those auditing smaller (or less complex) entities<sup>1</sup> is an area that is of particular importance to the Board.

To inform the IAASB's future work, the IAASB is seeking a thorough understanding about the challenges faced by auditors of LCEs, including the underlying causes of those challenges, in the many jurisdictions impacted by our activities. This roundtable, which specifically focuses on the areas of fraud and going concern, will allow us to hear from stakeholders and gather information to determine what is most appropriate and what will be most effective in our future actions.

## Fraud

According to the Association of Certified Fraud Examiners (ACFE) 2020 [Report to the Nations](#), a study on the costs and effects of occupational fraud, CFE estimate that organizations lose 5% of revenue to fraud each year. Small businesses (those with fewer than 100 employees) had the highest median loss due to fraud of USD 150,000. The report goes on to say that certain fraud risks were more likely in small businesses than in large organizations, such as billing fraud, payroll fraud and check or payment tampering. Also, whether due to resource limitations, a lack of awareness, or a tendency to place too much trust in their employees, small businesses implement anti-fraud controls at a much lower rate than their larger counterparts. While not all small businesses are LCEs (and some larger entities may be LCEs), this research indicates that certain LCEs may be particularly vulnerable to fraud.

The IAASB is interested in stakeholder perspectives on the unique aspects of fraud in audits of LCEs and the challenges for auditors in applying current auditing standards related to this topic.

## Comments Raised to Date

Stakeholders have already raised some concerns related to fraud procedures in audits of LCEs through other standard-setting

## WHAT IS A LESS COMPLEX ENTITY (LCE)?

The IAASB has not yet determined a description of an LCE as part of its separate project workstreams on audits of LCEs. We have looked at our current definition of a "smaller entity," which sets out many of the qualitative characteristics that could be attributable to an LCE, such as:

- Concentration of ownership and management in a small number of individuals

*One of more of the following:*

- Straightforward or uncomplicated transactions
- Simple record-keeping
- Few lines of business and few products within business lines
- Few internal controls
- Few levels of management with responsibility for a broad range of controls
- Few personnel, many having a wide range of duties

*These qualitative characteristics are not exhaustive, they are not exclusive to smaller entities, and smaller entities do not necessarily display all of these characteristics.*

<sup>1</sup> As part of its work on audits of LCEs, the IAASB will further consider how to describe an LCE and determine how this forms part of the applicability of the new separate standard.

projects or feedback forums. The IAASB analyzed comments received so far. Based on this analysis, we have already identified some themes, including:

- The **rebuttal of presumed risk of fraud in revenue recognition** is not well understood and therefore applied inconsistently in practice.
- Many firms **rebut the risk of management override of controls inappropriately**.
- The **extent of work required for journal entry testing** for LCEs is unclear.
- **Language in the standard is complex** which makes it difficult to apply for LCEs.

## Going Concern

The size of an entity may affect its ability to withstand adverse conditions. Smaller, less complex entities may be able to respond quickly to exploit opportunities but may lack reserves to sustain operations.<sup>2</sup> LCEs have unique aspects to consider in regard to their ability to continue as a going concern. As such, the IAASB is interested in obtaining stakeholder views on what these unique aspects are, and what challenges the auditors face in carrying out the required procedures related to going concern.



### Comments Raised to Date

Based on feedback already received to date through other feedback forums and IAASB projects, the IAASB identified some themes related to the challenges of performing going concern procedures in audits of LCEs, including:

- The **lack of formal forecasts** and lack of management capacity or capability to perform the assessment makes it difficult for auditors to fulfill their responsibilities in accordance with the standard.
- That the assessment of going concern in LCEs may be difficult if their **survival depends on the owners** – on their funds and willingness to continue to invest, and the evidence to support those assertions.
- The **need for additional guidance** for unique factors that auditors of LCEs should consider in relation to the entity's ability to continue as a going concern.

## IAASB Information-Gathering Activities

The IAASB is undertaking a range of information-gathering activities, of which this roundtable is just one aspect, to inform the nature and extent of any future IAASB actions in relation to these topics.

### IAASB Roundtable Discussions

This roundtable is the final in a series of three virtual roundtable discussions featuring participants from various professional and geographic backgrounds to help inform any future IAASB actions on various topics, as described below:



<sup>2</sup> ISA 570, *Going Concern*, paragraph A5

#	Roundtable	Date/Time
1	Fraud in the Digital Age: Impact of Technology Advancements on Fraud Perpetration and Detection	Was held on September 2, 2020 7:00AM – 10:00AM EDT
2	Narrowing the Gap: <ul style="list-style-type: none"> <li>Exploring the “Expectation Gap” Related to Fraud and Going Concern in Audits of Financial Statements</li> <li>Feeding Back on the IAASB’s Auditor Reporting Standards</li> </ul>	September 28, 2020 7:00AM – 10:00AM EDT
3	<b>Unique Aspects of Fraud and Going Concern in Audits of Less Complex Entities</b>	<b>October 7, 2020 7:00AM – 10:00AM EDT</b>

### *Other IAASB Activities Related to Fraud and Going Concern in Audits of Financial Statements*

In addition to the roundtables described above, we are also undertaking other targeted research and outreach activities to further inform any decisions about future standard-setting or other efforts by the IAASB related to fraud and going concern in an audit of financial statements. As each activity progresses, we will undertake further research and outreach, as necessary. Below are the planned activities underway:

- Review of academic research, external publications and outcomes of jurisdiction-level reviews.
- Discussions with national standard setters, particularly in jurisdictions where relevant standard-setting efforts have taken place or are underway.
- A Discussion Paper targeted to solicit feedback on the “expectation gap” with regards to fraud and going concern in an audit of financial statements.

Participants are also encouraged to respond to the [Discussion Paper, Fraud and Going Concern in an Audit of Financial Statements: Exploring the Differences Between Public Perceptions About the Role of the Auditor and the Auditor’s Responsibilities in a Financial Statement Audit](#), which is currently open for consultation. The deadline for comments is January 12, 2021.

### *Roundtable Discussion Questions (on next page)*

*The questions set out on the next page will be discussed during the roundtable (all discussions will take place with the full group – there will be no individual breakout groups). Participants are not expected to answer all questions. Participants will be asked to “raise their hand” using the Zoom functionality if they wish to contribute a response.*

# DISCUSSION QUESTIONS FOR ROUNDTABLE



## Unique Aspects of Fraud in LCEs

1. Is the nature of fraud perpetrated in LCEs different from frauds in more complex entities (in the context of an audit of financial statements)?
  - Are there fraud risk factors that are unique or more prevalent in LCEs as compared to more complex entities?

## Fraud Procedures in Audits of LCEs

2. In our work to date, the following challenges have been highlighted to us with regard to audits of LCEs:
  - The **rebuttal of presumed risk of fraud in revenue recognition**.
  - **The risk of management override is often inappropriately rebutted**.
  - The **extent of work required for journal entry testing** for LCEs is unclear.
  - **Language in the standard** (ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*) **is complex**, which makes it difficult to apply for LCEs.
  - (a) Are these challenges unique to LCEs and why are they challenging in audits of LCEs?
  - (b) In which specific areas of the standard is the language complex to apply in audits of LCEs?
  - (c) Are there other areas of ISA 240 that are challenging to apply? Why?
3. Users of financial statements for LCEs are often different as compared to users of financial statements of more complex entities. What do you think the users of financial statements of LCE's would view as necessary procedures for auditors when considering fraud in an audit of an LCE?

## Unique Aspects Related to Going Concern in Audits of LCEs

4. Are there characteristics that are unique when auditing going concern assessments for LCEs as compared to more complex entities?

## Going Concern Procedures in Audits of LCEs

5. In our work to date, the following challenges have been highlighted to us with regard to audits of LCEs ?
  - The **lack of formal forecasts** and lack of management capacity or capability to perform the assessment makes it difficult for auditors to fulfill their responsibilities in accordance with the standard.
  - The assessment of going concern in LCEs may be difficult if their **survival depends on the owners** – on their funds and willingness to continue to invest – and the evidence needed to support the assumptions in management's assessment of going concern.
  - The **need for additional guidance** for unique factors that auditors of LCEs should consider in relation to the entity's ability to continue as a going concern.
  - (a) In what areas is additional guidance needed that would be unique to the auditor's procedures in an audit of an LCE?
  - (b) Are there other requirements in ISA 570, *Going Concern*, that are particularly challenging to apply for audits of LCEs? Why?
6. Users of financial statements for LCEs are often different as compared to users of financial statements of more complex entities. What do you think the users of financial statements of LCE's would view as necessary procedures for auditors when considering management's assessment of going concern in an audit of an LCE?

## Practical Application of ISA 570 and ISA 240

7. In practice, for audits of LCEs, are audit procedures related to going concern and fraud carried out differently to the procedures for audits of more complex entities? If yes, what are the differences?

## ROUNDTABLE AGENDA

### UNIQUE ASPECTS OF FRAUD AND GOING CONCERN IN AUDITS OF LESS COMPLEX ENTITIES

*IAASB-Facilitated Roundtable Discussion:*

**October 7, 2020, 7:00AM EDT – 9:30AM EDT**

**Roundtable Moderator: Kai Morten Hagen (IAASB Member and Chair of the LCE Working Group)**

*Note: The full session will be live streamed to the [IAASB YouTube Channel](#).*

<b>7:00AM – 7:15AM</b> <b>(15 minutes)</b>	<b>IAASB Introduction</b> Introductory remarks by Tom Seidenstein (IAASB Chair) and Kai Morten Hagen (IAASB Member and Roundtable Moderator)
<b>7:15AM – 8:15AM</b> <b>(60 minutes)</b>	<b>Open Roundtable Discussion</b> <ul style="list-style-type: none"> <li>• Unique aspects of fraud in LCEs</li> <li>• Fraud procedures in audits of LCEs</li> </ul>
<b>8:15AM – 8:30AM</b> <b>(15 minutes)</b>	<b>Break</b>
<b>8:30AM – 9:25AM</b> <b>(55 minutes)</b>	<b>Open Roundtable Discussion</b> <ul style="list-style-type: none"> <li>• Unique aspects related to going concern in LCEs</li> <li>• Going concern procedures in audits of LCEs</li> <li>• Differences in practical application of the requirements</li> </ul>
<b>9:25AM – 9:30AM</b> <b>(5 minutes)</b>	<b>Closing Remarks</b> Closing remarks by Tom Seidenstein (IAASB Chair)



## APPENDIX B:

# PARTICIPANTS

**Moderator:** Kai Morten Hagen, *IAASB Member and Chair of IAASB LCE Working Group*

#	Participant Name	Country	Details
1	Andrew Brathwraite	Barbados	AFP Consulting Inc.
2	Atul Gupta	India	President, Institute of Chartered Accountants of India (ICAI)
3	Brendan Murtagh	Ireland	Partner, Nexia Smith & Williamson, and former IAASB member
4	Ee Wen Kuah	Singapore	Senior Manager, Ernst & Young Singapore
5	Gill Spaul	United Kingdom	European Technical Director, Moore Global Network Limited
6	Gordon Cummings	Canada	Principal, D+H Group LLP and former member of the Canadian Auditing Standards Board
7	Guy Cox	Belgium	Partner, HLB Belgium
8	Hilde Blomme	Belgium	Deputy Chief Executive, Accountancy Europe
9	Jenny Reed	United Kingdom	Global Audit Methodology Manager at Baker Tilly International
10	Mike Santay	United States	Audit Partner, Grant Thornton and Former Chair of AICPA Auditing Standards Board
11	Monica Foerster	Brazil	Chair of IFAC SMP Advisory Group, and Partner, Confidor
12	Nilesh Vikamsey	India	Partner, Khimji Kunverji & Co LLP and former President of ICAI
13	Noémi Robert	Belgium	Director, Accountancy Europe
14	Twaha Kaawaase	Uganda	Partner, Seijaaka, Kaawaase & Co. Certified Public Accountants
15	Sarah Coulson	Canada	Industry Strategist at Caseware International Inc.
16	Juane Schreuder	South Africa	Quality Control Manager, Moore Cape Town
17	Jeanne Viljoen	South Africa	SAICA Project Director, Practices and Ethics
#	Official Observer Name	Country	Details
1	PIOB Observer	Global	PIOB Observer
2	IESBA Observer	Global	IESBA Observer
#	IAASB Members and Staff; IAASB Observers	Country	Details
1	Tom Seidenstein	United States	IAASB Chair
2	Kai Morten Hagen	Norway	IAASB Member and Roundtable Moderator
3	Fiona Campbell	Australia	IAASB Deputy Chair
4	Josephine Jackson	United Kingdom	IAASB Member
5	Eric Turner	Canada	IAASB Member
6	Isabelle Tracq-sengeissen	France	IAASB Member
7	Roger Simnett	Australia	IAASB Member
8	Robert Dohrer	United States	IAASB Member
9	Sue Almond	United Kingdom	IAASB Member



10	Sara Ashton	United States	IAASB Technical Advisor
11	Antonis Diolas	United Kingdom	IAASB Technical Advisor
12	Susan Jones	United States	IAASB Technical Advisor
13	Willie Botha	Global	IAASB Technical Director
14	Beverley Bahlmann	Global	IAASB Deputy Director
15	Kalina Shukarova Savovska	Global	IAASB Principal
16	Angela Donnelly	Global	IAASB Staff Fellow