ACCURATE AND RELIABLE

INSIGHT PAPER · AUDIT & ASSURANCE

Fraud and Going Concern

A multi-stakeholder approach. What the public expects of audit, what auditors actually do, and the three gaps in between.

IN THIS PAPER

PUBLISHED BY
EDRAK Global

SUBJECT
Audit expectations, fraud and going concern

PREPARED FOR
Boards, audit committees and audit teams

ENQUIRIES
info@edrakglobal.com
edrakglobal.com

01 — THE RECORD

Lessons from the past

A number of corporate failures and scandals across the globe have sparked debate between regulators, public policy makers, investors, auditors, and others.

Those debates involve questioning the responsibilities of different participants in the financial reporting ecosystem. Five cases in particular shaped the conversation:

2015

JAPAN

Toshiba Corporation

Overstated operating profits by more than $1.2 billion in a scandal that began in 2008 and spanned 7 years.

2017

SOUTH AFRICA

Steinhoff International Holdings NV

A fraud investigation uncovered billions of dollars of fictitious and irregular transactions.

2018

UNITED KINGDOM

Carillion

The company's collapse left £2 billion owed to its suppliers and £2.6 billion in pension liabilities.

2019

CHINA

Luckin Coffee

Fraudulently inflated sales by 2.1 billion yuan (over $300 million), which resulted in the company being delisted from the US Nasdaq exchange.

2020

GERMANY

Wirecard

Filed for insolvency after admitting that approximately $2.6 billion of assets on the company's balance sheet likely did not exist.

02 — THE MANDATE

Why focus on fraud and going concern?

- The public sees audit as part of the solution for preventing corporate failure
- The public demands more responsibilities for auditors in identifying and reporting fraud
- The public believes audit should evolve in a way that prevents corporate failure
- Collaboration is needed between all stakeholders of the profession

The debate is not only about what auditors find, but about what the public believes they are looking for.

> **The knowledge gap is the difference between what the public thinks auditors do and what auditors actually do.**

03 — THE GAPS

Three gaps to close

The debate between the profession, its regulators and the public can be described in terms of three distinct gaps. They are set out overleaf.

1

Knowledge gap

The difference between what the public thinks auditors do and what auditors actually do. This recognises that the public can sometimes misunderstand audit: for example, a belief that auditors are responsible for preventing corporate failure.

2

Performance gap

The difference between what auditors actually do and what auditors are supposed to do, given the requirements of auditing standards or regulations. Audit firms have systems and processes that seek to ensure quality in their engagements. Audit regulators inspect files of completed engagements to evaluate whether quality is being achieved.

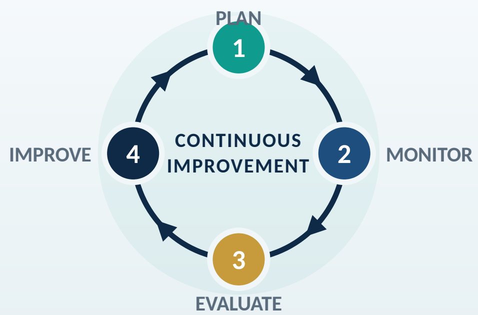
3

Evolution gap

The difference between what auditors are supposed to do if they actually follow the requirements of auditing standards and regulation, and what the public wants auditors to do. It indicates the areas of the audit where there may be a need for evolution, taking into consideration general public demand, technological advances and how the overall audit process could add more value in the public interest.

Addressing the knowledge and performance gaps is an important first step in determining what needs to evolve in audit. This will help to avoid overregulation and inappropriate developments in auditing standards, when the real problems could be lack of knowledge or poor performance.

Source: ACCA



Closing the gaps is a collaborative task rather than an audit-only one.

04 — FRAUD

Heightened risk, heightened response

> **At a time when entities are under increased pressure, and internal controls may not be operating as planned, the auditor should also consider whether their assessment of risks of material misstatement due to fraud or irregularity needs to be heightened as a result, and additional audit procedures need to be carried out.**

FRC 2020a

"When controls change or don't operate effectively, the auditor needs to look at the nature, timing and extent of their audit work and how they deal with these changes" (Niesche 2020). This could also be linked with additional fraud-related risks.

Possible revisions to ISA 240

The auditor's responsibility for detecting material fraud. Some regulator representatives raised concerns about the introduction of ISA 240 and particularly **paragraph 5**, which notes the inherent limitations of an audit. This paragraph states that while the audit may be properly planned and performed, some material misstatements may not be detected.

THE REGULATORS' CONCERN

Responsibility is underplayed

The regulators argued that this underplays the responsibility that auditors have in detecting material fraud, as it states that fraud may go undetected.

THE COUNTER-ARGUMENT

Limitations must stay clear

Some participants pointed to the need to be very clear on the limitations of reasonable assurance engagements in order to avoid widening the expectations gap.

Source: ACCA global publication

05 — THE ECOSYSTEM

Roles in the financial reporting ecosystem

E

Entity and its management (preparers)

Prepare the financial statements in accordance with the applicable financial reporting framework. Also responsible for internal control related to financial statements.

B

Boards and audit committees

Those charged with governance are responsible for overseeing the strategic direction and obligations related to accountability, including the entity's financial reporting.

These are two of the roles in the ecosystem. The full picture also takes in auditors, regulators, standard setters, investors and the wider public — each with a distinct part in preventing, detecting and reporting fraud.

Reviewing your fraud risk approach?

To learn more about the roles in the financial reporting ecosystem and to know the ways to discover fraud, please contact us.

info@edrakglobal.com

EDRAK Global · Accurate and Reliable · edrakglobal.com