U.S. GOVERNMENT ACCOUNTABILITY OFFICE

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February 1, 2021

Ms. Beverley Bahlmann
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International Auditing and Assurance Standards Board
529 Fifth Avenue
New York, NY 10017

GAO's Response to the IAASB's 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*

Dear Ms. Bahlmann:

This letter provides GAO's comments on the International Auditing and Assurance Standards Board's (IAASB) 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*. GAO promulgates generally accepted government auditing standards (GAGAS).[1] GAGAS provides standards for performing high-quality audits of government organizations, programs, activities, and functions and of government assistance received by contractors, nonprofit organizations, and other nongovernment organizations with competence, integrity, objectivity, and independence.

We support the IAASB's efforts to gather perspectives from stakeholders on fraud and going concern in financial statement audits and on whether auditing standards related to fraud and going concern remain appropriate in the current environment. In relation to fraud, we generally believe that the current financial statement audit requirements are sufficient if auditors effectively implement them. However, we also believe that implementation could be improved if the IAASB provides additional guidance or tools to assist auditors in identifying risks of material misstatement caused by fraud or error. In relation to going concern, we note that going concern as contemplated in the commercial sense is not applicable to government financial reporting. We suggest that the IAASB consider whether different guidance is needed for government auditors.

The IAASB asked for responses to a number of questions related to the discussion paper. Our responses to the questions follow in the enclosure to this letter.

[1]GAO, *Government Auditing Standards: 2018 Revision*, GAO-18-568G (Washington, D.C.: July 2018).

Thank you for the opportunity to comment. If you have questions about this letter or wish to discuss any of our responses, please feel free to contact me at (202) 512-3133 or dalkinj@gao.gov.

Sincerely yours,

James R. Dalkin
Director
Financial Management and Assurance

Enclosure

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Responses to Questions on the International Auditing and Assurance Standards Board's (IAASB) Discussion Paper

1. **In regard to the expectation gap:**
   (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?**

   We generally believe that the expectation gap exists because financial statement users may not understand financial statement auditing standard requirements and related scope of financial audits. As noted in the discussion paper, auditing standards require auditors to obtain reasonable assurance rather than absolute assurance. Also, audits focus on material misstatements rather than all misstatements. In our view, financial statement users' misunderstanding of auditing standards is the main cause of the expectation gap relating to fraud and going concern.

   (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?**

   In our view, it will be challenging to revise both auditing standards and the auditor's report in a meaningful way to help financial statement users understand auditing standards requirements, thereby closing the expectation gap related to fraud and going concern.

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

   We generally believe that the current requirements with regard to fraud are sufficient if auditors effectively implement them. However, we also believe that implementation could be improved if the IAASB provided additional guidance or tools to assist auditors in identifying risks of material misstatement caused by fraud or error. This could include further guidance on considering external factors, high-level analytical procedures, and procedures related to evaluating the control environment component of internal control.

   We believe that auditors could benefit from tools to assist them with sufficiently identifying risks of material misstatement. If auditors do not sufficiently identify risks of material misstatement, they will not design and implement responses to effectively address them and perform audit procedures that may identify fraud.

   For example, to identify risks of material misstatement, auditors may need to focus more on the environment in which an entity operates, including industry and other regulatory factors. The current conditions of the audited entity's industry may help auditors more sufficiently identify such risks. If other entities in the same industry are facing financial challenges and the audited entity is showing strong financial returns, auditors should consider this when identifying risks. This may include considering why the entity is demonstrating strong financial returns and whether errors in financial reporting or fraudulent financial reporting could be driving the unexpected reported financial results. We also believe that auditors may need tools to help them ensure that unusual and unexpected relationships are identified through high-level analytical procedures and factored into their risk assessment.

The IAASB could consider adding guidance that the engagement team's discussion of the susceptibility of the financial statements to material misstatement due to fraud include a consideration of external factors. Such consideration could include the entity's current industry conditions, a comparison of its financial condition with other entities in the industry, and whether any inconsistencies or other conflicting information the audit team has encountered may indicate a risk of fraud.

The IAASB could also consider whether audits would benefit from enhanced guidance related to the control environment component related to fraud. Such guidance for evaluating the control environment as it relates to fraud could assist auditors in understanding the audited entity's corporate culture and whether the culture would permit fraud. This enhanced guidance coupled with tools to help auditors sufficiently identify risks could help address the challenges related to auditors' identifying material misstatements due to fraud.

(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 ISAs or outside the scope of an audit (e.g., a different engagement)? Please explain your answer.

In our view, the current requirements for financial statement audits in relation to fraud are sufficient if auditors effectively implement them. We note that the International Standards for Auditing (ISA) already require further audit procedures to obtain more persuasive audit evidence when auditors determine that an increased risk of material misstatement exists.[2] As noted in our response to the previous question, tools to assist auditors in more sufficiently identifying risks could help auditors appropriately assess and respond to such risks with further audit procedures and in their related assessment of evidence.

(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?

We do not believe that the IAASB should enhance auditor considerations around fraud to include a "suspicious mindset." We find the description of professional skepticism in the paper, *Enhancing Auditor Professional Skepticism*, to be compelling.[3] We agree with

[2]*International Standard on Auditing (ISA) 330, The Auditor's Responses to Assessed Risks*, para. 7(b).

[3]Professors Steven M. Glover and Douglas F. Prawitt, Brigham Young University, *Enhancing Auditor Professional Skepticism* (November 2013).

the paper that it is helpful to think of professional skepticism on a continuum related to the risk of material misstatement and other factors. We suggest that the IAASB consider adding guidance that a neutral mindset may be appropriate in certain low-risk circumstances but presumptive or complete doubt may be warranted in other higher-risk circumstances. For this perspective to be useful, auditors need to sufficiently and accurately identify and assess risk. This further highlights the importance of providing auditors with the tools for more sufficiently identifying risks, as discussed in our response to question 2(a).

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

In our view, it will be challenging to revise the auditor's report in a meaningful way that would help close the expectation gap related to fraud in auditing financial statements.

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

If the IAASB adds or enhances requirements with regard to going concern, we suggest that it consider whether different guidance is needed for government auditors. Going concern as discussed in the IAASB's discussion paper is generally not relevant for government auditors and government entities. For example, for federal government entities the Federal Accounting Standards Advisory Board (FASAB) considered the nature of the federal government and determined that going concern as contemplated in the commercial sense is not applicable to federal government financial reporting.[4] Rather, for the consolidated financial report of the U.S. government, FASAB requires fiscal sustainability reporting.[5] Also, the International Public Sector Accounting Standards Board issued a Recommended Practice Guideline to provide guidance on reporting on the long-term sustainability of a public sector entity's finances.[6] If the IAASB were to consider additional requirements related to going concern, it may be beneficial to examine the need for government auditors to perform audit procedures related to identifying any fiscal sustainability challenges for government entities and potentially disclosing them in their auditor's report.

(b) Is there a need for enhanced procedures only for certain entities or in specific circumstances? If yes:

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[4]Federal Accounting Standards Advisory Board (FASAB), *Statement of Federal Financial Accounting Standards (SSFAS) 39, Subsequent Events: Codification of Accounting and Financial Reporting Standards Contained in the AICPA Statements on Auditing Standards*, para. A5 (August 2010).

[5]FASAB, *SFFAS 36, Comprehensive Long-Term Projections for the U.S. Government* (September 2009).

[6]International Public Sector Accounting Standards Board, *Recommended Practice Guideline 1*, *Reporting on the Long-term Sustainability of an Entity's Finances* (July 2013).

(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.

As noted in our response to question 3(a), we suggest that the IAASB consider whether different guidance related to going concern is needed for government auditors.

(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, it will be challenging to revise the auditor’s report in a meaningful way to increase transparency about auditors’ work in relation to going concern in an audit of financial statements.

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 do not have any additional matters that should be considered beyond those covered above.