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cpab exchange

2024 fraud thematic review

Auditors can play a critical role in combatting financial wrongdoing. While we have seen progress in auditors' approaches to identifying, assessing and responding to the risks of material misstatement related to fraud, we continue to identify inspection findings which require further attention, and where auditors can enhance their work in this area.

Introduction

In 2019, CPAB began its fraud thematic review, and has continued with each inspection cycle. CPAB's 2024 fraud thematic review identified progress in some areas of work auditors perform. However, we continue to identify findings in our inspections where risks related to fraud are not identified or sufficiently assessed by the auditor resulting in an audit response that does not sufficiently address the risk of material misstatement due to fraud. We also continue to observe a number of areas where the procedures could be enhanced.

About CPAB

The Canadian Public Accountability Board (CPAB) is Canada's independent, public company audit regulator. Charged with overseeing audits performed by registered public accounting firms, CPAB contributes to public confidence in the integrity of financial reporting and is committed to protecting Canada's investing public.

Fraud schemes continue to evolve. Auditors must continue to enhance their skills, processes and procedures for identifying and assessing fraud risk factors that may result in a material misstatement and designing and executing appropriate audit responses.

This publication highlights progress observed, areas where improvement is needed and provides case studies outlining key themes we observed during our 2024 inspection cycle.

Part 1 — The importance of a questioning mindset

Many auditors are moving in the right direction in terms of improving their identification and assessment of fraud risk factors and associated procedures. While most of the audit work that we inspect complies with the existing fraud standard (CAS 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*), to truly provide greater protection to the investing public a more questioning mindset is needed.

1. Professional skepticism is the heart of the audit. CPAB continues to observe instances where auditors have concluded on the appropriateness of the accounting and disclosures of transactions and management's explanations at face value without challenge.
2. As fraud schemes evolve, the auditor's fraud risk assessment must as well. This includes challenging assumptions and conclusions from previous years' risk assessments, considering different ways perpetrators of fraud may try to conceal wrongdoing, questioning inconsistencies between risks identified by management and the auditor, and diving deeper when management identifies a fraud risk that the auditor did not initially consider.

3. Auditors have an opportunity to identify control deficiencies, errors and potential issues during the course of an audit. The value and relevance of the audit is enhanced when auditors take the time to question when inconsistent facts are identified.

Part 2 — Fraud progress observed

CPAB's 2024 fraud thematic review was integrated into our regular inspections of all audit firms we inspect. It involved a deeper dive into the quality of work auditors performed to identify, assess and respond to fraud risks.

A key objective of this thematic review was to identify and share good practices and identify opportunities for auditors to improve.

In our ongoing discussions with firms, most are willing to enhance their procedures related to fraud and have noted their commitment to performing high quality audits. However, observations in audit files on actual work performed continue to demonstrate that only a small number of firms are taking steps to incorporate more robust procedures related to fraud.

The principal areas where we observed progress and areas we continue to have findings include:

Use of forensic specialists

In the files we inspected in 2024, we observed an increase in the number of auditors that engaged forensic specialists (2024: 11 per cent, 2021: six per cent and 2019: five per cent).

Where forensic specialists were involved, they primarily assisted the auditor with their fraud risk assessment procedures. For the remaining instances, they were involved in response to matters identified during the audit where the auditor recognized the need for additional expertise.

Several of the inspection findings related to the sufficiency of procedures to identify and assess fraud risk factors that were present. This indicates that the auditor may not have had sufficient and appropriate training, background or specialist resources to assist with fraud risk assessment and to design appropriate responsive procedures as part of the overall audit engagement. The engagement partner is required to ensure the members of the engagement team, collectively, have the appropriate competence and capabilities, including sufficient time, to perform the engagement. This determination needs to be done as part of planning, taking into consideration the nature and circumstances of the engagement, but also must be re-assessed to consider any changes that may arise during the engagement.

> We encourage audit teams to proactively reflect on their collective skill at all phases of the audit engagement and be open to the possibility that additional skillsets such as fraud expertise may be needed. For example, experienced auditors should be open to the possibility of new schemes not previously identified rather than relying on their existing knowledge of fraud.

We have also continued to observe that most auditors did not identify fraud risks beyond the two required in CAS 240 (revenue recognition and management override of controls), and did not appear to critically challenge where fraud could occur. Forensic skills and experience on an audit team will not only benefit the particular audit, they will also further develop the skillsets of all members of the audit team who can then bring their enhanced knowledge to other audit engagements.

Enhanced fraud risk assessment and identification

This topic encompasses several areas related to the entity's fraud risk management program, including an entity's whistleblower program, management's compensation and analysts' expectations.

In each of these areas we observed some progress compared to previous years. The majority of files inspected demonstrated an understanding of management compensation and analyst reports and expectations. While obtaining this information is an important first step, not all audit teams are taking the next step to evaluate how the information may translate into fraud risk factors evaluated as part of their fraud risk assessment.

While we have observed progress related to whistleblower programs, with an increased number of auditors making inquiries, the depth of procedures over whistleblower programs remains limited to inquiring whether the program exists.

As identified in previous thematic reviews, there is a wide range of procedures performed by auditors over whistleblower programs. The majority of teams obtained an understanding of the entities' whistleblower program and policies. Some audit teams went further and tested the design and implementation and operating effectiveness of the whistleblower program. Other audit teams inspected individual reports that came through the entity's whistleblower program, including considering the quantum and nature of items reported.

> We remind auditors that the most significant source of identification of financial wrongdoing is through whistleblowers.[1] The evaluation of an entity's whistleblower process, and what has been reported, provides a wealth of information. Auditors may find information related to management's tone at the top, the organization's culture, risks to the entity, how an organization responds to inappropriate activity, or weaknesses in the control environment.

Other areas of progress

We have observed increased participation of other specialists who support the audit team (i.e., tax, information technology, valuation, actuarial) in fraud planning sessions.

During the years where audits were executed under various in-person pandemic restrictions CPAB observed a significant increase in fraud inquires performed using email or audio only. We raised this as a point of concern with firms that more frequently used these approaches to conduct fraud inquiries.

CPAB has since observed the use of email and audio for fraud inquiries decrease significantly. Although CAS 240 does not stipulate the form of communication required, in-person, or at the minimum, video inquiries, yield the most effective outcomes and are aligned with the expectation of executing high-quality audits. Auditors must also remember that professional skepticism applies throughout the audit and responses to verbal inquiries often need further corroborative procedures. The ability to detect untruthfulness in a verbal inquiry setting is a skill that extends beyond most auditors' abilities, underlining the importance of applying professional skepticism, performing corroborative procedures, and being alert to contradictory evidence throughout the audit.

In addition to the above, a number of firms have implemented additional training sessions specifically related to fraud in order to enhance practitioners' knowledge bases.

Fraud risk assessments moving forward

During the most recent inspection cycle, we further evaluated the auditor's understanding of management's fraud risk assessment process and conclusions, and the auditor's response. We evaluated whether the auditor's fraud risk assessment considered areas such as:

[1] Association of Certified Fraud Examiners *Occupational Fraud 2024: A Report to the Nations* continues to demonstrate tips from a whistleblower is the common way fraud is identified.

- Related party transactions.
- Business risks, including those arising from industry or jurisdictions in which the entity operates.
- Consolidation process.
- Fraud or suspected fraud.
- Risks arising from the use of information technology.
- Internal control deficiencies including those related to information technology.
- Financial statement fraud.
- Misappropriation of assets.
- Corruption.
- Customer complaints.
- Whistleblower program.

The data revealed interesting areas for further evaluation. In particular, we identified a number of situations where management had identified fraud risks in areas where the auditor did not. In these cases there was insufficient evidence to demonstrate how the auditor reached the conclusion that the risk did not result in a risk of material misstatement due to fraud. This is particularly concerning as it raises the question of how an entity could view a situation as a fraud risk, while the auditor arrived at a different conclusion.

We also observed areas where neither management nor the audit team considered relevant factors within their risk assessments that clearly should have been evaluated. These factors fell primarily into the following categories: corruption, risks arising from information technology and the consolidation process.

Technology

Technology poses both a risk and an opportunity as it relates to fraud.

Technology is often exploited to perpetrate fraud. The emergence of new technologies and pace of change increases the number of risks audit teams need to consider. Given the increasing integration of information technology (IT) into the overall control structure of organizations, we expect to observe a higher instance of fraud risks related to information technology. One audit firm indicated to CPAB it plans to increase its oversight for audits of entities with a pervasive level of information technology in their business processes. In instances where no control testing is performed over general IT controls, audit teams will be required to reconsider the appropriateness of the design of the audit procedures and consider whether the related audit risks, including fraud risks, have been identified and addressed.

Technology can also be an extremely useful tool to help auditors execute their procedures. Certain firms have introduced software that can identify document alterations. We have also observed that firms continue to advance the deployment of data analyzing technology tools for risk assessment purposes to assess large volumes of data such as journal entries or all revenue transactions. This allows audit teams to move away from traditional sampling and instead perform procedures over entire populations of data.

Part 3 — Case studies on fraud risks and professional skepticism

A lack of professional skepticism continues to be a common theme identified in our inspection findings. This is particularly concerning in relation to fraud.

The effectiveness of procedures responsive to identified risks, in particular fraud risks, is directly dependent on the exercise of professional skepticism. In our experience, when auditors accept transactions and related management analysis or explanation as provided, there is an increased risk that the audit will fail to detect a potentially fraudulent situation.

The case studies below provide examples of situations observed in our inspections where professional skepticism and appropriate risk assessment procedures were not appropriately deployed to identify and assess fraud risk factors.

Case studies

The examples below are not intended to highlight all potential impacts or considerations and may not always lead to fraud. However, they demonstrate situations where the audit team would have benefitted from pausing and critically thinking about whether there was a potential fraud risk.

Situation	Fraud perspective
During an inventory count, the auditor identified differences in all the test counts performed. The differences were all in the same direction, with management's quantities higher than the auditor's count quantity. The auditor performed additional test counts and continued to find differences. However, the auditor failed to recognize that the differences were all directionally the same and did not perform procedures to understand the nature and cause of the differences identified.	From a fraud perspective, there is increased concern relating to the risk of the existence of an asset when management has recorded more inventory than an auditor counted. In this situation, professional skepticism should have driven the auditor to perform further procedures, including understanding the nature and cause of the error, the sufficiency of the sample to conclude on the overall population, and whether management's inventory count is reliable.
The auditor of a fintech entity auditing the cash balance sent a confirmation to the banking payment technology entity which reports the cash balance in the account. However, the banking payment technology entity outsourced the holding of cash to an independent Schedule 1 Bank. The auditor placed reliance on the confirmation for existence of the cash held by the open banking payment technology entity, even though this entity does not ultimately hold the cash.	In this instance, the auditor did not demonstrate that they understood who the actual custodian of the asset (the cash) was and did not appropriately design their confirmation procedures. There is a risk that the cash does not actually exist. If the procedures are not appropriately designed, an auditor may not detect this, because the confirming party does not actually hold the cash and is more of a flow through entity.
The entity had a deficiency in internal IT controls related to access rights of finance staff which permitted individuals to approve their own journal entries. Further, certain members of the finance team had inappropriate administrative access to each component's financial reporting system. The audit team did not consider this in their risk assessment and design of audit procedures over journal entries as no review was performed of the nature and type of entries recorded at the user level.	Many frauds have occurred through exploitation of weaknesses in the internal control environment, including weaknesses within IT environments through exploiting of user accesses. Using a skeptical mindset to think through how potential frauds could occur, auditors should design responses to known internal control weaknesses, and further, when weaknesses are identified during the audit, revise their audit approach to respond accordingly.

Situation	Fraud perspective
The entity uses a partner in the operations of the business. The entity's chief executive officer (CEO) also acts as the principal of the partnering organization, and it is a related party. The CEO, representing both entities, made amendments to the agreement between the two entities. However, given the position of the CEO in both entities, the individual was in a conflict of interest, which the auditor did not recognize as a risk or design audit procedures to respond to the risk.	Completeness and accuracy of related parties has been a theme identified in inspections. Conflict of interest is at the root of many fraud activities, as fraudsters often look to exploit different opportunities to perpetrate wrongdoing. Auditors need to evaluate situations where parties may be in a conflict of interest, and design and execute procedures to respond appropriately to the identified risk.
The entity acquired another entity during the year in exchange for consideration in the form of equity. The purchase price acquisition recognized the net assets acquired, including recognizing a brand intangible asset and goodwill. The auditor obtained management's valuation of the intangibles; however, no procedures were performed over the historical information, inputs, and assumptions used to determine the brand value. In addition, the auditor indicated management was not able to provide further support. Further, in the same fiscal year both the brand and goodwill were fully impaired.	Valuation of the brand was based on projected revenue which was supported by the historical revenue streams which created the value. If no information is available to support the historical revenue which projected revenue is based auditors should question how management, and those charged with governance, evaluated and arrived at their conclusions. Impairment in the year of acquisition, while possible, raises specific questions over what occurred from the point in time of the acquisition to the impairment date, and how this information was not known at the time of acquisition. Further, the auditors should ensure they understand the business rationale for the transaction, and why management entered into the arrangement and issued the equity as well as who ultimately benefitted from the arrangement.
The entity is comprised of 84 subsidiaries operating in different segments and business units, including four acquired in the current year. Individually the subsidiaries are not significant, however the aggregate is significant and material to the financial statements. The audit team used a substantive audit approach, and identified one component as a full scope entity, and 17 components as in scope for testing of revenue. The risk associated with out of scope entities was concluded to be remote based on an implicit assumption that the entity's control environment and consolidation processes were effective.	Auditors should employ a questioning mindset to think through different scenarios or approaches individuals may use to get something through the financial reporting process, including through an audit. In this situation, a material portion of the financial statement balances were not subject to any audit procedures and leads to risks and opportunities for fraud to occur. Other entities have experienced material fraud that exploited the complexity of large consolidations. The risk assessment process should have identified a fraud risk related to consolidation which would have led to the design of appropriate audit procedures.

Situation	Fraud perspective
The entity is in the construction industry, and revenues are recognized over time crossing over multiple reporting years. The company has been struggling financially, and obtaining financing was a constant concern for management. The audit team's fraud risk assessment for revenue linked the company's financial situation to management bias for presenting positive financial results, and identified revenue recognized over time as one avenue which may be susceptible to manipulation for appearance of better-than-actual financial results. However, the auditor's work was performed at a high level without the appropriate level of precision to respond to the risk. The accuracy and completeness of the initial budget, which was the base used to estimate revenue was not tested, and the procedures performed over subsequent estimates of costs to complete and project progress were inquiry-based only without corroborative procedures.	Revenue over time estimates are more complex in nature and provide an opportunity for manipulation of financial results. Completeness and accuracy of material, labour and other cost inputs included in those estimates may be exploited to drive desired financial results. In this situation the audit team identified appropriate fraud risks. However, the team lacked a sufficient understanding of management's process to develop estimates and the audit team's evaluation of the design and implementation of related controls was limited. This impacted their determination of which substantive procedures were appropriate to perform. Further, the corroboration of information management provides is critical to the exercise of professional skepticism and to respond to the identified risks.

The situations described above each demonstrate a lack of professional skepticism and questioning mindset even though the potential fraud risks in each of these situations are easily observable. If auditors are not identifying risks in these situations, we can expect it would be more challenging for an auditor to identify a material fraud where there is a more complex scheme or risk.

When auditors accept transactions and supporting documentation from management at face value, an implicit reliance on the integrity of management has overshadowed the auditor's role to exercise professional skepticism in executing the audit. Although the majority of individuals act in good faith, there will be a small percentage who do not, and it will be a challenge for auditors to identify these individuals or groups as those who commit financial wrongdoing are always looking for a weak spot to exploit.

These situations might have involved fraud, but further audit procedures would have been necessary to confirm it.

Conclusion: relevance, value and importance of an audit

Auditors have an opportunity to better protect investors and the public by identifying, in a timely manner, material matters which may lead to fraud. Auditors can alert those charged with governance who can take appropriate action before the financial statements are approved and released to the public.

Early detection is essential to reduce and limit the impact of fraud. Once financial wrongdoing occurs, regulatory investigations can take years, and in many cases the restitution, if there is any, may not be at the level of loss.

A questioning mindset and exercise of professional skepticism leads to quality audits and strengthen the confidence in the capital markets.

Additional CPAB resources

- CPAB responds to the IAASB's Exposure Draft on proposed revision to ISA 240 (June 2024).
- Canadian Public Accountability Board Symposium: The evolving fraud landscape publication (November 2023).
- CPAB Exchange: Fraud thematic review (May 2022).
- CPAB responds to the IAASB's discussion paper: Fraud and Going Concern in an Audit of Financial Statements (February 2021).
- An auditor's responsibilities related to fraud in an audit of financial statements (February 2020).

We want to hear from you

An objective of this publication is to serve as the foundation for ongoing discussions with audit firms, auditing standard setters and other regulators.

We would like to hear from you. Please send your comments or questions to thoughtleadership@cpab-ccrc.ca.

Learn more

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