

## Current Developments in ISA 240 Independent Auditor's Liabilities on Fraud: IAASB Project on Narrowing the Expectation Gap\*

Özkan SARISOY\*\*  
Çağla DEMİR PALİ\*\*\*

### ABSTRACT

Auditing standards that guide the auditing profession change and develop in line with the changes in the business world. In addition, various institutions conduct research and studies in this field. In 2020, the IAASB initiated a project to amend ISA 240, The Responsibilities Relating to Fraud in an Audit of Financial Statements. The reasons for the expectation gap regarding Fraud and going concerns and the possible solutions are investigated within this project's scope. In this study, the responses to the discussion paper published by the IAASB were examined. According to the results, the most important reasons for the expectation gap are that the public and the members of the financial reporting ecosystem, in general, do not have enough information about the audit, the auditors are not qualified enough, the audit is misevaluated, and parties in the ecosystem have unrealistic expectations. Among the most notable suggestions to narrow the gap are educating the members of the financial reporting ecosystem and the public, updating standards, preparing guides, and using technology/data analytics methods in auditing. In addition, the importance of clarifying key concepts such as materiality, reasonable assurance, auditing, Fraud, and professional skepticism is emphasized to narrow the expectation gap.

**Keywords:** IAASB, ISA240 Project, Fraud, Audit

**Jel Classification:** M41, M42

### ISA 240 Bağımsız Denetçinin Hileye İlişkin Sorumluluklarında Güncel Gelişmeler: IAASB Beklenti Farklarını Azaltma Projesi

#### ÖZET

Denetim çalışmalarına yön veren denetim standartları iş dünyasında meydana gelen değişimler doğrultusunda değişmekte ve gelişmektedir. Bu alanda çeşitli kurumlar araştırmalar ve çalışmalar yapmaktadır. IAASB, 2020 yılında ISA 240 Finansal Tabloların Bağımsız Denetiminde Bağımsız Denetçinin Hileye İlişkin Sorumlulukları standardında değişiklik yapmak için bir proje başlatmış ve bu proje kapsamında hile ve sürekliliğe ilişkin beklenti farklarının nedenleri ve olası çözümleri üzerine bir araştırma yapılmıştır. Bu araştırmada IAASB tarafından yayımlanan tartışma kağıdına gelen yanıtlar incelenmiştir. Sonuçlara göre beklenti farklarının en önemli nedenleri; kamunun ve genel olarak ekosistemdeki üyelerin denetim hakkında yeterli bilgiye sahip olmaması, denetçilerin yeterince kalifiye olmaması, denetimin yanlış değerlendirilmesi ve olağandışı beklentilerdir. Çözüm için sunulan önerilerden en dikkat çekenlerin başında finansal raporlama ekosistemindeki üyeler ve kamunun denetim hakkında bilgilendirilmesi, standartların güncellenmesi, rehberler hazırlanması ve teknoloji/veri analitiği yöntemlerinin denetimde kullanılması yer almaktadır. Beklenti farklarını azaltmak için önemlilik, makul güvence, denetim, hile ve mesleki şüphecilik gibi ana kavramların netliğe kavuşturulmasının önemi vurgulanmıştır.

**Anahtar Kelimeler:** IAASB, BDS240 Projesi, Hile, Denetim

**JEL Sınıflandırması:** M41, M42

\* Makale Gönderim Tarihi: 01.02.2023, Makale Kabul Tarihi: 10.04.2023, Makale Türü: Nitel Araştırma

\*\* Assist. Prof. Tekirdağ Namık Kemal University, osarisoy@nku.edu.tr, ORCID: 0000-0002-2226-0191.

\*\*\* Assist. Prof. Yeditepe University, cagla.demir@gmail.com, ORCID: 0000-0002-5859-7706.

## **1. INTRODUCTION**

The Nations Report prepared by the Association of Certified Fraud Examiners (ACFE) on 2110 cases states that businesses lose 5% of their approximately \$3.6 billion due to Fraud (ACFE 2022 Report to the Nations). Since Fraud harms companies, investors, and the economic system, the concept of a black hole is used to describe the term (Bozkurt 2009). Fraudulent financial reporting scandals that took place at the beginning of the current century had broad repercussions on the economic system, and regulatory agencies took the Fraud very seriously and made regulations on various issues.

Although the primary responsibility for detecting and preventing Fraud belongs to the management, various duties have been assigned to the independent auditors for detecting material misstatements due to error and Fraud within the scope of International Standards on Auditing (ISA). In the ACFE report, the role of independent auditing in detecting Fraud is stated as only 4% (ACFE 2022 Report to the Nations). On the other side, in the literature, many studies show that the public places more responsibility on the audit function and independent auditors than the standards. 'Expectation gap' is the concept used for the inconsistencies between demand, perception, and expectations for independent auditing. This concept has long been one of the issues sought to be resolved as a problem that risks the audit's success. Fraud is seen as one of the fundamental reasons for the expectation gap. In many studies, it has been determined that those who do not have reasonable knowledge in the field of auditing expect fraud-oriented audit work from the auditors.

The independent audit framework is an activity determined by standards and continues its activities within the framework. This framework is changed from time to time, considering the views of the auditing community. In this context, the International Auditing and Assurance Standards Board (IAASB) initiated a project to update ISA 240 Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements (ISA 240) and issued a call requesting the opinions of the auditing community. This study examined the opinion letters of the participants who responded to the call within the project's scope. Within the research's scope, the expectation gap due to Fraud was discussed, the studies in the literature on this subject were reviewed, and the fraud project of the IAASB was detailed. Then, the research methodology and research findings are explained. Finally, the results and evaluations are given in the last section.

## **2. EXPECTATION GAP DUE TO FRAUD**

Fraud is an activity in which the perpetrator harms the other party to gain a benefit and is contrary to legal regulations. Although Fraud contains the purpose of providing benefits to the perpetrator, there are also other sources of motivation. For example, findings indicate that acts such as abusing assets with a feeling of revenge can be taken because of mobbing or harassment from senior management (ACFE 2020 Reports to the Nations). Fraud can be expressed as a highly harmful term for businesses and the public. In addition to financial losses, Fraud causes significant non-financial losses, such as damage to reputation and public confidence (Putri et al., 2022: 566). Accounting and auditing scandals such as Enron and Worldcom that emerged at the beginning of the current century are still remembered and known even outside the audit community. These scandals in question caused significant changes in accounting and auditing activities. With the Industrial Revolution, businesses have reached

sizes a single person cannot manage. As a result, shareholders have moved away from management and left management to professionals. Shareholders, who were not involved in preparing financial data, are now the parties that want to ensure that they do not contain misstatements due to error and Fraud.

Although ISA 240 expects the independent auditor to focus on whether there is a material misstatement due to Fraud or error within the scope of independent auditing, the risk of not detecting the con due to its nature is higher than the risk of not detecting a material misstatement due to error because fraudulent acts are designed carefully. In addition, while actions that create opportunities for Fraud can be determined more easily by the auditor, it is more difficult to decide whether errors in critical areas, such as accounting estimates, are caused by error or Fraud (ISA240).

Although the auditor's approach to Fraud is limited in ISA240, the public's expectation differs. The auditor's primary responsibility within independent auditing is not fraud detection. Still, there is a perception in the public that he/she has a responsibility in this regard (Sikka et al., 1998: 319). This public perception regarding the auditor's role against Fraud is ancient (Chandler and Edwards, 1996: 12). From the past to the present, it is seen that the public misunderstood the auditors' responsibility and expected a fraud-based audit (McEnroe and Martens, 2001: 356). In this respect, due to users' misinformation about the nature and primary purpose of the audit, an expectation gap about Fraud arises (Dibia, 2015: 26). In the literature, it is stated that the public expects the auditors to provide complete assurance regarding the accuracy of the financial statements, the management's efficiency, the appropriateness of the financial policies, and the detection of all Fraud and irregularities (Ebimobowei, 2010: 130).

Similarly, Cohen et al. (2017) examined 40 fraud cases in the USA between 1992 and 2011 and stated that the performance gap could be reduced by strengthening the willingness and ability of the auditor to apply existing auditing standards regarding fraud detection. Also, improving the standards will help reduce the performance gap. In addition, it has been determined that the media tends to overemphasize unreasonable expectations in the news of Fraud and reinforce the view that the auditor should take more responsibility for revealing it.

Another study by Sule et al. (2019) revealed that most participants' perception of Fraud differs from ISA 240, and there is a high expectation for fraud prevention and detection. However, what is meant by the public should not be thought of only those who do not have sufficient knowledge about financial issues because it is seen in the literature that there are various segments, such as bankers, who have expectations that do not comply with the standards regarding Fraud (Salehi and Azary, 2008: 65).

The reasons for Fraud or the opportunities that allow Fraud are described in different ways, such as fraud triangle, fraud diamond (square), or fraud pentagon. In their study, Sahla and Ardianto (2022) revealed that the auditors do not fully accept the fraud pentagon as the trigger of Fraud. Suryandari and Gayatri (2022) stated that improvements in businesses, criminal and legal processes, and individual morality are needed to prevent Fraud.

It is crucial to consider Fraud as a hidden security risk. Therefore, strategies should be developed for early detection and adopted for prevention (Sánchez-Aguayo, 2022: 21).

### **3. IAASB'S PROJECT ON NARROWING THE EXPECTATION GAP**

With the first board discussion held by the IAASB in April 2020, a project has started to update the ISA 240, The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements standard. The aims of the project include clarifying the roles and responsibilities of auditors in the field of Fraud in financial statement audits, updating ISA 240, steps to be taken to respond most effectively to fraudulent material misstatements, increasing the importance of professional skepticism, increasing transparency about fraud-related procedures, and strengthen relations with those charged with governance (IAASB Fraud Projects).

On September 15, 2020, a discussion paper was published by the IAASB to get the stakeholders' opinions in the financial ecosystem about the expectation gap in the Fraud fields and "Going Concern" and to get their views on what improvements can be made by the IAASB (IAASB, Fraud, and Going Concern in an Audit of Financial Statements, 2020).

As members of the "financial reporting ecosystem" within the scope of the Discussion Paper, preparing (business management), approving (boards of directors, audit committees), auditing (independent auditors), analyzing (governments, regulators, professional bodies, and standard-setters) and using (Investors, analysts, consumers, lenders, the public and other stakeholders) have been defined. However, due to numerous large-scale scandals that have emerged in recent years, trust in the financial reporting ecosystem has been damaged, and it has become necessary to renew this trust. In order to make progress in this area, the ecosystem's members should be in mutual communication with each other and work together.

In this context, one of the critical problems is the "expectation gap." The expectation gap is the difference between the audit and what users expect from the auditor and the financial statement audit.

The expectation gap can be examined under three main headings.

- Knowledge gap: The difference between what the auditor does and what the public thinks the auditor is doing. The public does not have sufficient information about auditing standards and requirements.
- Performance gap: Auditors do not do what is expected of them due to the complexity of auditing standards (the language of the standards is not understood) or due to differences in interpretation (standard setters and practitioners perceive the requirements differently).
- Evolution gap: It is about the improvements to be made in the audit, taking into account the technological developments, the demands of the public, and what can be done to increase the added value of the audit.

The discussion paper has been prepared to make improvements in two areas, and the first area is Fraud. Fraud is "an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage." The primary responsibility for detecting and preventing Fraud belongs to the business management and those charged with governance. The auditors' responsibility is to provide reasonable assurance that the financial statements are free from material misstatement due to Fraud or error.

One of the current developments in Fraud is the involvement of forensic specialists or other relevant experts in the audit processes. Therefore, this field gains importance, especially regarding the evolution gap, and it is thought that the involvement of experts in various branches will contribute significantly to the audit work due to the changing business life and technological developments. In addition, the focus was on non-material Fraud with the evolution gap, and the participants' opinions were also requested on third-party Fraud. Finally, the issue of increasing quality control requirements is also included to increase the effectiveness of audit of Fraud.

The second issue that the discussion paper focuses on is going concern. According to going concern, one of the basic assumptions of the prepared financial statements is assumed that the businesses will continue their activities in the foreseeable future. In this area, the IAASB also aims to get opinions on how long the going concern assessment should cover (12 months is sufficient or whether a different period should be chosen), whether there is confusion about the concepts used to evaluate the financial health of companies, and whether the issue of material uncertainty needs to be clarified.

The IAASB held a roundtable meeting on September 28, 2020. The two primary purposes of the meeting are to discuss the differences in expectations of the stakeholders and to get the stakeholders' opinions about the new reporting standards of the IAASB. Subjects such as the parties' expectations on fraud and continuity issues in the financial statements, what the IAASB can do to reduce the differences in expectations, and whether there is a global demand to increase the transparency of the audit reports are emphasized.

Stakeholders in the financial ecosystem have been asked to evaluate the discussion paper and submit their comments by January 12, 2021, and it is aimed to publish the first draft in December 2023. It is planned that the comment process, which will then be reopened until May 2024, will end, and the project will be finalized with final approval in March 2025.

#### **4. RESEARCH**

Parties working on auditing and financial reporting standards have asked stakeholders' opinions on their projects. Some studies have examined interest groups' views and revealed different results in the literature. For example, Yen, Hirst, and Hopkins (2007) evaluated the comment letters submitted in response to the Financial Accounting Standards Board's (FASB) Comprehensive Income Reporting Exposure Draft. The research using content analysis results shows that many of the arguments in the letters are not theoretical or result-oriented and focus on the expected adverse effects for specific firms and industries. Tiron-Tudor and Müller (2009), on the other hand, carried out a quantitative and qualitative analysis of the comment letters of the International Accounting Standards Board (IASB) within the scope of the Exposure Draft on Joint Arrangements (ED 9). In a similar approach, Holder et al. (2013) examined the responses to the IASB's Draft of Disclosure on Proposed Amendments (ED) for IAS 37 and the FASB's FASB Notice No.5. In the research, 369 comment letters were read, and the results show that the opinions for both drafts were primarily negative. In their research, Simnett and Huggins (2014) analyzed 165 stakeholder responses to the IAASB's Invitation to Comment: Improving the Auditor's Report. In the research, the participants' opinions were evaluated according to various characteristics of the participants, such as audit and assurance firms, users, preparers, and regulators. It was revealed that the participants had different

opinions based on their interests. Cordoş and Fülöp (2015) examined stakeholders' views on ISA701 Key Audit Matters in their research. The research evaluated the answers to 47 letters sent only from Europe (138 feedbacks were gathered).

As can be seen, academic studies in the literature are handled in the context of evaluation of the comment letters. Therefore, this section presents the scope of the research methodology, the research topic, the research method, and the findings obtained.

#### **4.1. Methodology**

The independent audit activity has reached its present form through many changes from the past to the present. Due to the nature of being a social science, it is an activity with a dynamic structure, and continuous changes are possible. Because of that, IAASB carries out various projects by considering the parties' expectations concerning auditing expertise; as a result, changes occur like the audit. In this research, the discussion paper titled "Fraud and Going Concern in an Audit of Financial Statements: Exploring the Differences Between Public Perceptions About the Role of the Auditor and Auditor's Responsibilities in a Financial Statement Audit," which was presented to the public in September 2020 within the scope of the fraud project initiated by the IAASB in April 2020, is discussed by using content analysis method.

In the research, 85 letters sent by the respondents were read one by one. First, it was determined which sector the participants represented and which country they lived. Then, the answers, which amounted to 800 pages, to the questions about Fraud in the letters are categorized. There were also questions about going concerns in the call, but only those related to Fraud are included in the study's scope.

While some participants answered the questions individually, some made general evaluations for all or some of the questions, and some did not answer all the questions. For this reason, the answers were carefully read, and the issues related to the questions that the IAASB sought answers to were evaluated and categorized using keywords or statements. The results were varied. Thus, the findings obtained by reading the letters were examined repeatedly, and similar expressions were categorized again.

#### **4.2. Research Findings**

As mentioned before, first of all, data about the profiles of the participants were obtained by determining the institutions they were affiliated with and the countries they lived. Then, the answers to the questions asked in the discussion are examined. Finally, the countries where the participants operate are examined, and it was seen that the United States, United Kingdom, and South Africa were the countries with the highest number of participants. Also, 18 participants work in international organizations. The results are presented in Table 1.

**Table 1.** Participants by Country

Country	Number of Letters	Country	Number of Letters
International	18	Colombia	1
USA	10	Greece	1
United Kingdom	7	Hong Kong	1
South Africa	7	India	1
Canada	5	Ireland	1
Australia	3	Japan	1
Netherlands	3	Jordan	1
New Zealand	3	Mexico	1
Argentina	2	Russia	1
Belgium	2	Singapore	1
Botswana	2	Spain	1
European Union	2	Sweden	1
France	2	Switzerland	1
Germany	2	Turkey	1
Malaysia	2	Uganda	1
<b>Total</b>			<b>85</b>

The Union of Chambers of Certified Public Accountants Turkey answered the discussion paper as the representative of Turkey.

Participants are categorized by profession in Table 2. When the table is examined, it is seen that professional organizations give more than one-third of the answers. In some countries, since professional organizations have mixed structures as semi-public or public-private, a subcategory as a professional public institution is preferred. Based on that, if these two categories are combined, it can be stated that professional organizations give almost half of the answers.

**Table 2.** Participants by Profession

Profession	Number of Letters
Professional Organization	30
Audit Firm	18
Non-governmental organization	9
Professional Public Institution	9
Academician	4
International Professional Organization	4
Oversight Board	3
Regulators	2
Assurance Provider	1
Bank Oversight Body	1
Certified Public Accountant	1
Charity Organization	1
Independent Auditor	1
Internal Auditor	1

The other segments that participated the most were audit firms and non-governmental organizations. In addition, it is seen that four academicians gave their opinions. It is noticed that the users of the audit reports are not/very little represented in the answers. With this aspect, it can be stated that the answers reflect the perspectives of preparers of audit reports.

**Table 3.** Main Reasons for the Expectation Gap

Reasons	Count
Lack of knowledge of the public about auditing	44
Lack of knowledge-general	42
Incompetency of auditors	28
Unreasonable expectations	16
Misevaluation of audit	15
Other	14
Incompetency of the standards	6
Lack of knowledge of auditors	6
Inadequacy of audit reports	4
Nature of the audit	4
The negative reputation of the profession (auditing)	3
Failure to meet public expectations	3

When the reasons for the expectation gap stated in the letters are examined, it is seen that they focused on about 185 areas. As it is stated in Table 3, the common reason is the lack of knowledge. In addition, six participants specifically stated that the auditors had a lack of knowledge either. Therefore, it is concluded that there is a lack of knowledge on various issues, such as the nature of the audit, the auditor's responsibilities, and the management's responsibilities. However, some participants mentioned a lack of knowledge without specifying which subject they lacked; these answers are categorized as "Lack of knowledge-general." It is observed that the incompetency of the auditors is seen as another important reason for the expectation gap. Subsequently, unreasonable expectations and misevaluation or failure to evaluate the audit are among the issues reported as other significant reasons.

When the answer's justifications are examined, it is seen that the stated points are consistent with the expectation gap's components, but the organizations to which the participants are affiliated are one of the issues to be considered.

Reasons under the other category are different long-term business relationships between the auditors. For example, the auditee, communication difficulties of the auditors, the lack of global vision of the audit profession, the parties in the financial ecosystem not taking responsibility, the underlying causes of fraudulent audit failures, the diversity of businesses, lack of institutionalization, underestimation of reasonable assurance, the profession's inability to respond to developments promptly, international differences, deliberate actions of the management, ignorance of the management on their responsibilities and differences in perspective can be given.

**Table 4.** Five Common Reasons for Expectation Gaps by Organization

Reason	Audit Firm	Professional Public Institution	Professional Organization	Non-governmental Organization	International Professional Organization	Total
Lack of knowledge of the public about auditing	14	6	13	4	3	<b>40</b>
Lack of knowledge-general	11	5	14	6	4	<b>40</b>



Incompetency of auditors	8	1	12	-	-	21
Unreasonable expectations	-	-	-	2	-	2
Misevaluation of audit	-	-	-	-	3	3
Other	18	1	27	3	1	50
<b>Total</b>	<b>51</b>	<b>13</b>	<b>66</b>	<b>15</b>	<b>11</b>	<b>156</b>

When Table 4, which includes the five most reported reasons for the expectation gap by the organizations, is examined, it is seen that lack of knowledge (general and public) is the reason that is the most reported among all organizations. Audit firms reported 51 reasons for the expectation gap, while professional public institutions reported 13, professional organizations 66, non-governmental organizations 15, and international professional organizations 11. Unlike other organizations, it is also seen that international professional organizations see the misevaluation of audits as a reason for the expectation gap.

**Table 5.** What to Do to Eliminate Expectation Gap

What to do?	Count
Additional guidelines	42
Educating the public	27
Updating the standards	25
Educating the auditors	22
Using technology/business analytics	18
Defining the role of the auditor	17
Emphasizing the internal controls	16
Enhancing/defining the responsibilities of the management	15
More disclosures on the audit report	14
Improving/enhancing professional skepticism	11
Enhancing the communication and collaboration between management and auditors	10
Better presentation of the audit profession	10
Inclusion of forensic accountants	9
Definition of expectations	9
Enhancing the auditors' performance	8
Public release of fraud cases	8
Education-general	6
Considering the expectations in performing the audit work	5
Separating auditor and management responsibilities	5
Reporting by management	5
Defining the fraud types	5
Incentives for auditors	4
Having audit committee	4
Improving audit procedures	4
Monitoring	4
Better presentation of the standards	4
Emphasizing the importance of internal audit function	3
Regulating the corporate governance requirements	3
Educating the management	3
Using business analytics	2
Enhancing the role of auditors	2
Encouraging collaboration and consistency	2
Oversight	2
Defining the materiality	2
Designing and improving the scope of requirements for risk assessment and identification	2
Increasing transparency	2
International standards	2

Opinions and suggestions about eliminating the expectation gap are presented in Table 5. Narrowing the expectation gap by providing additional guidance, educating the public and auditors, and updating the standards are the most reported suggestions. However, whether additional guidance will be provided in the standards or as a separate document is not specified. Also, it is observed that no details have been given on the education suggestion about the method or scope. Therefore, some ambiguous suggestions cannot be analyzed thoroughly. Besides those stated in Table 5, all findings regarding narrowing the expectation gap are in Appendix 1.

**Table 6.** What to Do to Eliminate Expectation Gap by Organizations

What to do?	Audit Firm	International Professional Organization	Non-governmental Organization	Professional Organization	Professional Public Institution	Oversight Board	Total
Additional guidelines	12	2	4	15	5	3	41
Educating the auditors	6	2	-	-	-	-	8
Educating the public	6	-	2	9	6	-	23
Updating the standards	6	-	4	8	4	-	22
Using technology	6	-	-	-	-	-	6
More disclosures on an audit report	-	-	-	-	4	-	4
Enhancing the communication and collaboration between management and auditors	-	-	2	-	-	-	2
Emphasizing the internal control	-	-	2	-	-	2	4
Better presentation of the audit profession	-	2	-	-	-	-	2
Inclusion of forensic accountants	-	-	2	-	-	-	2
Enhancing the auditors' performance	-	-	-	-	-	2	2
Regulating the corporate governance requirements	-	-	-	-	-	2	2
Better presentation of the standards	-	2	-	-	-	-	2
Improving/enhancing professional skepticism	-	2	-	-	-	-	2
Other	71	13	16	93	27	16	236
<b>Total</b>	<b>107</b>	<b>23</b>	<b>32</b>	<b>125</b>	<b>46</b>	<b>25</b>	<b>358</b>

Table 6 explains the most common suggestions for what should be done about the expectation gap according to the organizations.\* As seen from the table, the suggestions for improvement in this field are mainly from audit firms. The general view of all participants is that additional guidance in this area is necessary. The recommendation for using technology mainly came from audit firms, and public education is considered necessary by audit firms, professional organizations, and professional public institutions. Various issues have been

\* A total of 107 answers were given by audit firms, 25 by oversight boards, 46 by professional public organizations, 125 by professional organizations, 32 by non-governmental organizations, and 23 by international professional organizations. Nevertheless, the evaluation is made on the reported more than once five most topics in Table 6. For example, auditors reported more than five topics, but the first five most reported issues are explained since the data consists of too many subcategories.

reported besides those indicated in this table, but the issues with low frequency within different categories are not indicated in the table.

**Table 7.** Who Should Act to Narrow the Expectation Gap

Who Should Act?	Count
IAASB	36
Regulators	9
Standard Setters	4
International Regulators	4
International Ethics Standards Board for Accountants (IESBA)	3
International Federation of Accountants (IFAC)	3
Auditors	1
Auditing Profession	1
The World Bank	1
Oversight Bodies	1
Organizations Supported by IAASB	1
International Money Fund	1
International Public Sector Accounting Standards (IPSASB)	1
Professional Organizations	1
Organization for Economic Co-operation and Development (OECD)	1
Professional Firms	1
Professional Boards	1
Capital Markets Boards	1
Transparency International	1
International Panel on Accountancy Education (IPAE)	1
Universities	1
Supporting Bodies	1

The answers about who should act to narrow the expectation gap are given in Table 7, which shows that the solution is mainly expected from the IAASB. Moreover, it seems consistent that the resolution is also expected from the IAASB, as the recommendations center around additional guidance. However, there is no specific explanation about who should make which development.

**Table 8.** Terms Need Clarification

Terms	Count
Materiality	10
Reasonable Assurance	7
Auditing	5
Fraud	5
Professional Skepticism	4
Responsibilities of Auditors	3
Scope and Limitations of Audit	3
Risk-based audit	2
Responsibilities of the Other Bodies in the Financial Ecosystem	1
Requirements	1
Assurance	1
Difference between disobedience and Fraud	1
Corporate Governance Requirements	1
Material Misstatements	1
Sampling	1
Responsibilities of management	1

In the document, the participants were also asked to state what concepts needed to be defined clearly, and the answers to this question seemed limited. It has been determined that there is a perception that the topics already discussed in the audit profession still need to be supported with explanations. It was stated that a more straightforward definition is needed for materiality, reasonable assurance, audit, and Fraud.

**Table 9.** Opinions on Whether the Requirements for Fraud Detection Should be Increased

<b>Organization</b>	<b>Yes</b>	<b>No</b>
Academician	2	-
Bank Oversight Board	1	-
Audit Firm	11	6
Certified Public Accountant	1	-
Professional Public Institution	7	2
Professional Organization	20	4
Non-governmental Organization	6	2
Regulators	2	1
International Professional Organization	1	-
<b>Total</b>	<b>51</b>	<b>15</b>

Regarding whether auditors should have more requirements regarding fraud detection in the audit of financial statements, 51 participants answered yes, and 15 answered no, and the answers according to the organizations are presented in Table 9. While eleven of the auditors answered yes to this question, six answered no, and it is seen that the auditors have different opinions on this issue. It is noteworthy that professional organizations also have high expectations for change in this regard. When the table is examined, it is seen that 51 out of 66 participants (approximately 77%) answered this question, considering that more regulations are necessary for fraud detection.

**Table 10.** Requirements for Auditors

<b>Requirement</b>	<b>Count</b>
Forensic accountants should be involved in case of suspicion	26
Data analytics and technology should be used	12
Internal controls should be assessed	10
Audit quality should be assessed	10
New audit procedures should be designed	8
Intense risk assessment processes should be applied	6
Management's/Company's approach to Fraud should be investigated	6
New audit procedures should be developed to avoid predictability	5
Additional disclosures in the audit report	4
Education on risk management and Fraud detection	3
Management override of controls should be investigated	3
Auditors should take more responsibility for fraud detection	2
More emphasis on revenues, expenses, and assets should be done	2
A particular approach should be taken if any mistake found is considered an indication of Fraud	2
Professional skepticism should be taken seriously	2
Accounting estimations should be investigated	2
Tools should be used to define/assess risks of material misstatements	2
Frauds below the materiality threshold should be investigated	2
Communication with management should be emphasized	2

It was reported that the auditors should have requirements in approximately 50 different categories, and the requirements received more than once are given in Table 10. It is seen that the most reported need is to include a forensic accountant in the audit procedures. Specific issues are also included in the responses. For example, the following issues are included as to be explained in the audit reports.

- When designing and performing audit procedures to respond to risks of material misstatement from Fraud, auditors should use different techniques based on differences in fraud-related circumstances.
- What has been done about Fraud should be explained in the audit reports.
- The description of responsibilities (of management and auditors) should be explained in the audit reports.
- The auditor should express an opinion on the assertion of the Company's perspective on Fraud.

In addition, the question "Is there a need for procedures developed only for certain organizations or for certain conditions?" is asked. Again, 31 people said yes, and 26 said no to the changes that should only be applied to certain businesses. Those types of companies are businesses with a high risk of Fraud, financial institutions, public interest entities, and listed organizations. Answers given on what developments are needed in this regard are presented in Table 11.

**Table 11.** Areas to be Improved

Areas	Count
Inclusion of forensic accountants	5
Using technology and data analytics	4
Additional guidance	2
Additional guidance on internal controls	2
Identification of fraud risk factors	3
New designs for audit procedures	4
Increasing the auditor communication	1
The role of external confirmations should be enhanced	1
Education	1
Review	1
Explanations on fraud detection	1
Qualifications of audit evidence	1
A new definition of professional skepticism	1
Better clarifications of accounting estimations	1
Expanding the subjects to be discussed with the auditees	1
Frauds below the materiality threshold	1
A more robust language on standards	1
Continuous audit	1
Case studies	1
Reporting requirements	1

Participants were also asked to indicate where they would suggest making these changes. Most of them suggested changes to ISAs in general (19). Other alternatives are ISA240 (11), additional guidance (4), outside of the standards (as a separate document set) (3), International Standard on Review Engagements (1), and International Standard on Related Services (1).

Opinions were requested on the concept of a "suspicious mindset" instead of "professional skepticism" in the discussion paper. Participants were asked to evaluate whether this concept change would contribute to the detection of Fraud and to explain the reason. Fourteen of the participants supported the change, while 53 of them stood against it. Reasons given to support the answers supporting the suspicious mindset concept are summarized in Table 12 below.

**Table 12.** Reasons for Not Supporting the Suspicious Mindset Concept

Reasons	Count
It will damage the relationship between the auditor and company management	30
Professional skepticism is enough if it is applied well	15
It could confuse understanding and application	11
Entity management may be less inclined to share what they considered or how they formed their views for fear that everything they have shared is being looked at with suspicion and ulterior motives	9
A suspicious mindset will affect the neutral position of the auditors	8
An increase in workload will cause an increase in costs	7
It is unnecessary	6
Increase in expectation gap	5
Professional skepticism is a state of mind which serves better	5
Because of the waste of time, there can be a decrease in audit quality	5
The concept of professional skepticism has become fully embedded in the IAASB's standards and firms' methodologies/tools, as well as in the behavior of engagement teams throughout each engagement	2
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	2
An unnecessary increase in audit effort	1
Starting with suspicion can increase the forensic specialist involvement unnecessarily (additional costs)	1
Unfairness to law-abiding companies	1
A suspicious mindset may be impacted by and may impact materiality	1
Just adding words does not affect the application	1
A heightened burden for the auditor, with a limited potential return	1
It is not easy to implement	1

When Table 12 is examined, it is seen that the most important reason for those who do not support the suspicious mindset is that it will damage the relationship between the auditor and the business management. In addition, it is seen that some of the participants found the concept of professional skepticism sufficient and thought that the concept of 'suspicious' could cause complexity. However, those who support the concept of the suspicious mindset have given the following explanations specifically.

Auditors are not trained enough and need to be more suspicious of the authenticity,

- It will make the auditor more alert,
- It will lead the auditor to scrutinize transactions and balances beyond their face value,
- It will attract the attention of the related parties to the subject,
- It will increase audit quality.

Another question asked to the participants in the discussion paper is "whether they feel there is a need for more transparency about the auditor's work concerning fraud in the audit of financial statements and what additional information is needed." Forty participants stated that more transparency is needed, and nine stated that the information in audit reports is enough. Participants who requested clarification were asked which subjects required clarification, and the responses received are summarized in Table 13 below.

**Table 13.** Subjects for Additional Disclosures

<b>Subject</b>	<b>Count</b>
Auditor's work on Fraud	22
Management controls and fraud risk assessments	10
Assessed risk(s) of material misstatement, how such risks were addressed in the audit and materiality judgments	8
Disclosures on adequate design and implementation of fraud risk management process and internal controls	8
Specific procedures performed by the auditor with Fraud	7
Management's responsibilities for internal control to prevent or detect Fraud, as well as increased corporate reporting about those responsibilities	7
Fraud risk identification/factors/judgment	6
Procedures for both addressing fraud risks and when Fraud is identified or suspected	6
The nature and the extent of the work performed around fraud risk assessment, identification, and response	4
A two-way discussion about the fraud risks identified, the controls that the entity has implemented to address those fraud risks, and the audit strategy to respond to the identified fraud risks	3
Disclosing the limitation of the auditor's responsibilities on frauds, and audit procedures and outcomes at the audit reports	3
Responsibilities of auditors	3
Auditor's role and responsibility relating the Fraud	3
Management's conclusion on fraud risk assessment and the policies and procedures implemented to mitigate it	3
The auditor's report should state explicitly the work performed to conclude whether the directors' statement regarding the actions they have taken to prevent and detect material Fraud is appropriate	2
What steps auditor have taken to assess the effectiveness of the relevant controls and to detect any such fraud	2
Conclusion of auditor's assessment of compliance with the policies and procedures established, indicating that as a result of their assessment, they did not identify indicative of Fraud	2
Clarity around materiality	2
Internal control and control environment deficiencies, if identified	2

The subjects that the participants expect to be clarified and expressed more than once are given in Table 13. It is seen that the most reported issue is the disclosure of the auditor's work on Fraud. When the requests, in general, are observed, it is seen that the Fraud concept and what the auditors do to detect Fraud are expected to be explained in the reports. In addition, it was determined that the participants also demanded clarification on the issues stated in Appendix 2.

Most participants (47) pointed to the auditor's report where the stated explanations would be made. While 17 participants stated that a statement should be made during the communication with those charged with governance, five stated that an additional report should be published for these disclosures.

## 5. CONCLUSION

Although the role of the independent audit activity around fraud detection and prevention has not changed for a long time, it is possible to talk about misperceptions or unrealistic expectations in this regard. For example, parties who do not have reasonable knowledge of auditing and financial reporting expect a fraud-oriented approach from the auditor, but the current version of ISA240 does not impose a responsibility on the auditor to meet this expectation. In the past, various explanations have been added to the audit reports to present better the audit's nature and the auditors' responsibilities. Nevertheless, the expectation gap remains vivid in the literature, and it continues to be a problem in auditing.

IAASB started a project on April 2020 to narrow the expectation gap caused by Fraud, and as a result of this project, some changes are possible in the ISA240 standard. In this context, a call letter with the title "Fraud and Going Concern in an Audit of Financial Statements: Exploring the Differences Between Public Perceptions About the Role of the Auditor and Auditor's Responsibilities in a Financial Statement Audit" has been published in order to receive feedback from the parties in the financial reporting ecosystem. The board intends to make changes based on the results, and the opinions and suggestions of the participants will be evaluated. In this study, the answers to the questions that the IAASB sought answers to and the organizations represented by the participants.

According to the research findings, the countries that represented the most are the United States and Europe, and it is seen that the participants are served in professional organizations and audit firms mostly. Results show that the audit report users do not provide sufficient participation. The fact that the users of the audit reports, which is an essential part of the expectation gap, do not show enough interest in this call or are unaware of this call can be considered a negative situation. Since the expectation gap is shaped according to the perspectives of interest groups, the study can only make sense and provide the highest benefit with the participation and collaboration of all parties.

According to the results of the research, it is stated that the most crucial reason for the expectation gap due to Fraud is the lack of knowledge (auditors and the public), but also incompetency in auditor performance draws attention. It is essential to emphasize that some independent audit firms either refer to the inadequacy of auditor performance. In general, it can be stated that the reasons for the expectation gap are consistent with the reasons for the expectation gap in the literature. There is a prevailing opinion that providing additional guidance will achieve the most significant impact on narrowing the expectation gap. Providing additional guidance to auditors on Fraud stands out as an essential demand, and the importance of educating the public has been emphasized in many responses. It has been observed that suggestions have been received from audit firms and other firms regarding the training of auditors. The vast majority of the participants stated that the IAASB should make these improvements.

Respondents to the call stated that materiality, reasonable assurance, auditing, Fraud, and professional skepticism should be clearly defined. In addition, it has been observed that professional organizations believe auditors need more information and training on Fraud. Another noteworthy study result is the importance of getting support from forensic accountants in their work on Fraud. Another issue that the IAASB proposes/seeks an answer to is the



concept of a suspicious mindset instead of professional skepticism. A large majority of respondents reported that using the suspicion concept is inappropriate because of the potential to damage the relationship between the auditor and the entity and create problems such as confusion in practice. Finally, it is seen that the participants agreed that it would be beneficial in terms of transparency if the auditors made more explanations about fraud investigations, their opinions on management controls, and fraud risk assessments.

According to the research results, lack of knowledge and inadequacies in performance is seen as the most important reasons for the expectation gap due to Fraud, and additional guidance on this issue is the solution offered in the first place. Therefore, the IAASB must focus on areas that require additional guidance and meet expectations. When the answers were examined, it was impossible to reach a definite conclusion about who the training should be for and how it would be done, which is the second most emphasized subject by the participants. In this respect, educating the public is not an efficient solution. Although the issue of training the auditors is relatively easy to solve, IAASB should determine the context and the areas that need to be focused on. In addition, although there have been various criticisms in the literature regarding the uncertainty of some concepts in auditing, it is remarkable that these issues are among the answers.

The participants agree that making amendments to ISA240 and improvements, especially in providing additional guidance and including the forensic experts when necessary, would be beneficial. In addition, the fact that the users of the audit reports did not participate sufficiently causes the concern that the expectations of this group, which represents an integral part of the expectation gap, cannot be met. Of course, it is impossible to fulfill the interests of all parties in the financial reporting ecosystem, which has a wide range of interests, due to the conflict of interests. However, considering and managing the differences in expectations is essential in independent auditing.

Since Fraud is a subject that leads to legal sanctions and penalties, it is not the right approach to deal with it only from an independent audit perspective. Therefore, although this is not the subject of this study, it is wanted to be emphasized to attract attention.

In future studies, more detailed research can be done on only certain organizational groups by focusing on the sub-branches of this study. As stated above, the opinions of the independent audit report users on the subject cannot be known clearly due to the low participation. In order to close this gap, a study specific to the group in question will significantly contribute to the literature. In addition, considering the project process of the IAASB, further developments can be subject to various quantitative and qualitative studies.

## **REFERENCES**

ACFE 2020 Report to the Nations, <https://legacy.acfe.com/report-to-the-nations/2020/> Erişim Tarihi: 09.12.2022.

ACFE 2022 Report to the Nations, <https://legacy.acfe.com/report-to-the-nations/2022/> Erişim Tarihi: 05.12.2022.

Bozkurt, Nejat (2009), *İşletmelerin Kara Deliği Hile*, Alfa Yayınları, İstanbul.

- Chandler, Roy – Edwards, John Richard (1996), "Recurring Issues in Auditing: Back to the Future?" *Accounting, Auditing & Accountability Journal*, Volume: 9(2), pp. 4-29.
- Cohen, Jeffrey – Ding, Yuan – Lesage, Cédric – Stolowy, Hervé (2017), "Media Bias and The Persistence of the Expectation Gap: An Analysis of Press Articles on Corporate Fraud" *Journal of Business Ethics*, 144(3), pp. 637-659.
- Cordoş, George-Silviu – Fülöp, Melinda-Timea (2015), "Understanding Audit Reporting Changes: Introduction of Key Audit Matters" *Accounting & Management Information Systems/Contabilitate si Informatica de Gestiune*, 14(1), pp. 128-152.
- Dibia, Ndukwe O. (2015), "Audit Expectations Gap and Perception of Financial Reporting," *International Journal of Managerial Studies and Research (IJMSR)*, Volume: 3:(3) 2015, pp. 23-31.
- Ebimobowei, Appah (2010), "An Evaluation of Audit Expectation Gap: Issues and Challenge" *International Journal of Economic development research and investment*, 1(2), pp. 129-141.
- Holder, Anthony- Karim, Khondkar – Lin, Karen Jingrong – Woods, Maef (2013), "A Content Analysis of the Comment Letters to the FASB and IASB: Accounting For Contingencies" *Advances in Accounting*, 29(1), pp. 134-153.
- IAASB, *Fraud and Going Concern in an Audit of Financial Statements*, 2020, <https://www.iaasb.org/publications/fraud-and-going-concern-audit-financial-statements> Erişim Tarihi: 15.12.2022
- IAASB, *Fraud Projects*, <https://www.iaasb.org/consultations-projects/fraud> Erişim Tarihi: 15.12.2022
- ISA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, IAASB.
- McEnroe, John E.- Martens, Stanley C. (2001), "Auditors' and Investors' Perceptions of the 'Expectation Gap", *Accounting Horizons*, Volume: 15:(4), pp. 345-358.
- Putri, Ni Putu Achintya Wibawa - Putra, I Nyoman Wijana Asmara - Wirakusuma, Made Gede - Suputra, I Dewa Gede Dharma (2022), "The Effect of Independence, Professionalism, and Experience of Internal Auditors on Fraud Prevention with Organizational Culture as Moderating Variable" *Linguistics and Culture Review*, Volume 6(S1), pp. 565-580.
- Sahla, Widya Ais - Ardianto, Ardianto (2022), "Ethical Values and Auditors Fraud Tendency Perception: Testing of Fraud Pentagon Theory", *Journal of Financial Crime*, Vol. ahead-of-print No. ahead-of-print. <https://doi.org/10.1108/JFC-04-2022-0086>
- Salehi, Mahdi - Azary, Zhila (2008), "Fraud Detection and Audit Expectation Gap: Empirical Evidence from Iranian Bankers", *International Journal of Business and Management*, Volume: 3(10), pp. 65-77.

- Sánchez-Aguayo, Marco - Urquiza-Aguilar, Luis - Estrada-Jiménez, Jose (2022), "Predictive Fraud Analysis Applying the Fraud Triangle Theory through Data Mining Techniques" *Applied Sciences*, 12(7), 3382, pp. 1-25.
- Sikka, Prem – Puxty, Anthony – Willmott, Hugh – Cooper, Christine (1998), "The Impossibility of Eliminating the Expectations Gap: Some Theory and Evidence", *Critical Perspectives on Accounting*, Volume: 9, pp. 299-300.
- Simnett, Roger - Huggins, Anna (2014), Enhancing the Auditor's Report: To What Extent is There Support for the IAASB's Proposed Changes? *Accounting Horizons*, 28(4), pp. 719-747.
- Sule, Safiyanu - Yusof, Nor Zalina Mohamad - Bahador, Ku Maissurah (2019), "Users' Perceptions on Auditors' Responsibilities for Fraud Prevention, Detection and Audit Expectation GAP in Nigeria" *Asian Journal of Economics, Business and Accounting*, Volume 10(1), pp. 1-10.
- Suryandari, Ni Nyoman Ayu - Gayatri, Gayatri (2022), Financial Fraud Scandal: Motivasi, Konsekuensi dan Upaya Memerangi Fraud. *Jurnal Samudra Ekonomi dan Bisnis*, 13(2), pp. 177-190.
- Tiron-Tudor, Adriana – Müller, Victor-Octavian (2009), "The European Position on Accounting for Joint Ventures" *International Journal of Liability and Scientific Enquiry*, 2(2), pp. 176-193.
- Yen, Alex C. - Hirst, D. Eric - Hopkins, Patrick. E. (2007), "A Content Analysis of the Comprehensive Income Exposure Draft Comment Letters" *Research in Accounting Regulation*, 19, pp. 53-79.

**APPENDIX 1- Other Solutions to Narrow the Expectation Gap**

- Collaboration with universities
- Inclusion of the non-English speaking community in the standard-setting procedures
- Be more open to the stakeholders and keep them aware related to changes
- Auditor rotation
- Auditors should collect more information
- More sources should be provided to auditors
- Information sharing between audit firms
- Efficient communication with audit committees
- The scope of the audit must be clearly defined
- Parties should share their experiences
- The role of external confirmation should be enhanced
- Transparency in financial reporting should be expanded
- An early warning system for Fraud should be set
- Fraud-focused assurance service should be performed
- Fraud risk should be presented in detail
- The motives behind the fraud attempts should be investigated
- Fraud cases should be collected and published
- IAASB should be more involved
- Communication between all the parties should be enhanced
- Quality control standards for audits should be developed
- Monitoring standards for audit should be developed
- Quality management standards for audit should be developed
- More disclosures in the key audit matters section should be made
- Critical controls should be disclosed
- Accounting standards should be revised
- Communication with policy setters should be enhanced
- Timely reporting should be encouraged
- Collaboration with stakeholders should be encouraged
- The connection between risk assessment procedures, professional skepticism, and sufficient and appropriate audit evidence should be investigated
- Attention should be paid to cyber risks
- Revisions on the standards should not be exaggerated
- Links between the standards should be developed
- Standards should be clear and simple
- In case of changes in the standards, educational materials and pieces of training should be published
- Fraud-related procedures should be explained in the standards
- Inconsistencies in the standards should be investigated
- Standards should cover all financial reporting ecosystem
- All stakeholders should be involved
- Continuous professional development should be encouraged
- International requirements should be determined
- An international language should be determined
- New audit techniques should be developed and used
- Company management should be more open to internal control
- Responsibilities of the management and board members should be enhanced
- Revenue transactions should be focused on
- Compulsory audit committees should be developed



**APPENDIX 2 – Other Areas that Need Clarification**

- A description of the most significant assessed risks of material misstatement (whether or not due to Fraud)
- Actual fraud risks identified and how this compares to the risks identified by management (including context as to the basis for concluding what the fraud risks are)
- Additional information from the management and board
- Additional reporting requirements
- An explanation of the extent to which the audit was considered capable of detecting irregularities, including Fraud
- Auditor's opinion to what extent the audit is deemed to be able to detect irregularities, including Fraud
- Auditor's response to material Fraud when it is suspected or detected
- Auditor's opinion on risk assessment and management procedures of the Company
- Clarity concerning how the responsibility of prevention and detection of Fraud is shared among various parties
- Details of any non-compliance and whether this is investigated by the client or not
- Enhanced disclosure of how management and governance manage the third-party risk
- Explicitly addressing the media representation of the profession
- If the auditor identified information that is inconsistent with the auditor's conclusion regarding a significant matter, the auditor should document how the auditor addressed the inconsistency
- Improved disclosure requirements that are like the key audit matters
- Key observations arising concerning assessed risks
- Management's evaluations on internal controls to prevent Fraud
- Nature of the communications on Fraud with the management and those charged with governance
- Procedures performed regarding risks of material misstatement due to Fraud
- Roles of the parties
- Significant findings from the audit
- Specific or general limitations of the audit related to Fraud
- The auditor's risk analysis, responses, findings, and-or conclusions similar to key audit matters
- There may be a benefit in enhancing the description of what the relevant parties' responsibilities are about Fraud, including possible explanation around the concept of materiality and how it impacts the auditor's work concerning Fraud
- Views related to the effects of the entity's corporate culture on fraud risks and whether those charged with governance have considered the elements of the fraud triangle in their understanding of fraud risks
- Warning signals detected by the auditors
- To what extent the statutory audit was considered capable of detecting irregularities, including Fraud
- What management does to detect and prevent Fraud
- Whether the entity has done any significant unusual transactions
- Whether the risk assessment process included testing of management's controls around fraud risk assessment and identification and, if not, why not