

For reference of the IAASB, the following reproduces the ‘Objectives’ and ‘Requirements’ sections of redrafted ISA 240 presented in Agenda Item 9-C, and indicates the following:

- The source paragraph of extant ISA 240 (left-hand column); and
- Proposed new “should” statements (including those that clarify or extend an existing “should” requirement) arising from the review of present tense sentences contained in extant ISA 240. These are highlighted for review purposes.

Paragraph of Extant ISA 240	Redrafted ISA 240 (as per Agenda Item 9-C)
	THE AUDITOR’S RESPONSIBILITY TO CONSIDER FRAUD IN AN AUDIT OF FINANCIAL STATEMENTS
	Introduction
	Scope of this ISA
1	1. This International Standard on Auditing (ISA) deals with the auditor’s responsibility to consider fraud, and to design and perform procedures to detect material misstatement due to fraud, in an audit of financial statements. It sets out the objectives to be achieved by the auditor, and the requirements that are to be complied with in achieving those objectives. The requirements are to be understood and applied in the context of the application material that provides guidance on their application.
1	2. Other ISAs deal with various aspects of the audit, such as risk assessment (ISA 315, “Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement”), and responses to identified risks (ISA 330, “The Auditor’s Procedures in Response to Assessed Risks”), or specific topics, such as accounting estimates (ISA 540, “Audit of Accounting Estimates”). These and other ISAs deal with the risk of material misstatement of the financial statements due to fraud as well as to error, and the auditor’s objectives in complying with their requirements include the identification of, and appropriate response to, risks of material misstatement due to fraud. This ISA deals specifically with procedures that the auditor is required to perform in relation to fraud, and the auditor’s responses to identified cases of fraud or suspected fraud giving rise to material misstatement of the financial statements.
	Effective Date
112	3. This ISA is effective for audits of financial statements for periods beginning on or after December 15, 200x.
	Objectives to be Achieved
-	4. The objectives of the auditor in following the requirements of this ISA are: <ul style="list-style-type: none"> • To perform specific procedures designed to increase the likelihood of detecting material misstatement due to fraud; and

	<ul style="list-style-type: none"> • To deal appropriately with identified fraud.
	<p>Definitions</p> <p>5. The following terms and related meanings are introduced in this ISA:</p>
49	a) Fraud risk factors - Events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud.
8	b) Fraudulent financial reporting –Intentional misstatements, including omissions of amounts or disclosures in financial statements to deceive financial statement users. (Ref: Para. A1-A4)
11	c) Misappropriation of assets –The theft of an entity’s assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more able to disguise or conceal misappropriations in ways that are difficult to detect. (Ref: Para. A5)
	<p>Requirements</p> <p>Risk Assessment Procedures and Activities</p>
33	6. In addition to those used to obtain an understanding of the entity and its environment, the auditor should perform risk assessment procedures to obtain information for use in identifying the risks of material misstatement due to fraud. The required procedures, the objective of which is to obtain information about relevant risks from those with primary responsibility for the prevention and detection of fraud, are as follows:
34a	(a) Make inquiries of management regarding:
35	(i) Management’s assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments; (Ref: Para. A10)
34b	(ii) Management’s process for identifying and responding to the risks of fraud in the entity, including any specific risks of fraud that management has identified or account balances, classes of transactions or disclosures for which a risk of fraud is likely to exist; (Ref: Para. A11)
37	(iii) Management’s process to respond to internal or external allegations of fraud affecting the entity;
34c	(iv) Management’s communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity; and
34d	(v) Management’s communication, if any, to employees regarding its views on business practices and ethical behavior.
38	(b) Make inquiries of management, and others within the entity as appropriate, to determine whether they have knowledge of any actual, suspected or alleged

<p>38 & 40</p>	<p>fraud affecting the entity. (Ref: Para. A12-A14)</p> <p>(c) For those entities that have an internal audit function, make inquires of internal audit to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity. In doing so, the auditor should inquire about the views of the internal auditors regarding the risks of fraud, whether during the year the internal auditors have performed any procedures to detect fraud, and whether management has satisfactorily responded to any findings resulting from these procedures.</p>
<p>43</p>	<p>(d) Obtain an understanding of how those charged with governance exercise oversight of management’s processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks. Such an understanding may provide insights regarding the susceptibility of the entity to management fraud, the adequacy of such internal control and the competency and integrity of management. (Ref: Para. A15-A17)</p>
<p>46</p>	<p>(e) Make inquiries of those charged with governance to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity. These inquiries are made in part to corroborate the responses to the inquiries of management.</p>
	<p>Identification and Assessment of the Risks of Material Misstatement Due to Fraud</p>
	<p>INFORMATION OBTAINED FROM RISK ASSESSMENT PROCEDURES AND ACTIVITIES</p>
<p>48-49</p>	<p>7. The auditor should consider whether the information obtained from the procedures required by paragraph 6 indicates that one or more fraud risk factors are present. While fraud risk factors may not necessarily indicate the existence of fraud, they have often been present in circumstances where frauds have occurred. (Ref: Para. A18-A22)</p>
<p>-</p>	<p>8. ISA 315 requires the auditor to perform certain other risk assessment procedures and activities to obtain a satisfactory basis, supported by audit evidence, for making a reliable assessment of risks of material misstatement at the financial statement and assertion levels. In identifying and assessing the risks of material misstatement due to fraud, the auditor should consider:</p>
<p>53</p>	<p>(a) Unusual or unexpected relationships that have been identified in performing analytical procedures as risk assessment procedures that may indicate risks of material misstatement due to fraud, including those relationships identified from analytical procedures related to revenue accounts that may indicate fraudulent financial reporting.</p>
<p>55</p>	<p>(b) Whether other information obtained indicates risks of material misstatement due to fraud. (Ref: Para. A23)</p>
<p>Derived from</p>	<p>(c) The findings, including identified conditions, circumstances or factors, from the discussion amongst the engagement team about the susceptibility of the entity’s</p>

27 and 30	financial statements to material misstatement due to fraud. (Ref: Para. A24-A25)
	<p>RISKS OF FRAUD IN REVENUE RECOGNITION</p>
60	<p>9. Material misstatements due to fraudulent financial reporting often result from an overstatement of revenues or an understatement of revenues. The auditor should presume that there are risks of fraud in revenue recognition and should consider which types of revenue, revenue transactions or assertions may give rise to such risks. Those assessed risks of material misstatement due to fraud related to revenue recognition are significant risks which the auditor should address in accordance with the requirements of ISA 315 and 330. The objective of this requirement is to focus audit effort to an area generally recognized as having a higher risk of fraud, thereby increasing the likelihood of detecting material misstatement due to fraud. (Ref: Para. A26)</p>
	<p>Responses to the Risks of Material Misstatement Due to Fraud</p>
	<p>OVERALL RESPONSES</p>
66	<p>10. In determining overall responses to address the risks of material misstatement due to fraud at the financial statement level, the auditor should:</p>
66a and 67	<p>(a) Consider the assignment and supervision of personnel, including whether the knowledge, skill and ability of the individuals assigned significant engagement responsibilities are commensurate with the auditor’s assessment of the risks of material misstatement due to fraud for the engagement; (Ref: Para. A27-A28)</p>
66b and 68	<p>(b) Consider the accounting policies used by the entity, particularly those related to subjective measurements and complex transactions, and whether the selection and application of accounting policies may be indicative of fraudulent financial reporting resulting from management’s effort to manage earnings; and</p>
66c and 69	<p>(c) Incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures. An element of unpredictability is important as individuals within the entity who are familiar with the audit procedures normally performed on engagements may be more able to conceal fraudulent financial reporting. (Ref: Para. A29-A30)</p>
	<p>AUDIT PROCEDURES RESPONSIVE TO RISKS RELATED TO MANAGEMENT OVERRIDE OF CONTROLS</p>
74-76	<p>11. In addition to any responses to identified risks of material misstatement due to fraud, the auditor should design and perform audit procedures to respond to the risk of management override of controls that include the following: (Ref: Para. A31)</p>
76a	<p>(a) Test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of financial statements.</p>
77	<p>Material misstatements of financial statements due to fraud often involve the manipulation of the financial reporting process by recording inappropriate or</p>

	<p>unauthorized journal entries throughout the year or at period end, or making adjustments to amounts reported in the financial statements that are not reflected in formal journal entries, such as through consolidating adjustments and reclassifications.</p>
77c	<p>In designing and performing audit procedures to test the appropriateness of journal entries, the auditor should:</p>
77e and 79	<p>(i) Make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments; and</p> <p>(ii) Consider the need to test journal entries and other adjustments both at the end of a reporting period as well as throughout the period. (Ref: Para. A32-A33)</p>
76b and 81	<p>(b) Review accounting estimates for biases and evaluate whether the circumstances producing such a bias represent a risk of material misstatement due to fraud. (Ref: Para. A34-A35)</p>
76c	<p>(c) Obtain an understanding of the business rationale of significant transactions of which the auditor becomes aware that:</p>
82	<ul style="list-style-type: none"> • are outside the normal course of business for the entity, or • that otherwise appear to be unusual given the auditor’s understanding of the entity and its environment and other information obtained during the audit.
82	<p>In doing so, the auditor should evaluate whether the rationale (or the lack thereof) suggests that the transactions may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets. (Ref: Para. A36)</p>
	<p>Evaluation of Audit Evidence (Ref: Para. A37)</p>
85	<p>12. The auditor should consider whether analytical procedures that are performed at or near the end of the audit when forming an overall conclusion as to whether the financial statements as a whole are consistent with the auditor’s knowledge of the business indicate a previously unrecognized risk of material misstatement due to fraud. (Ref: Para. A38)</p>
86-87	<p>13. When the auditor identifies a misstatement, whether material or not, the auditor should consider whether such a misstatement may be indicative of fraud. The auditor should not assume that an instance of fraud is an isolated occurrence. If there is such an indication, the auditor should evaluate the implications of the misstatement in relation to other aspects of the audit, particularly the reliability of management representations. In doing so, if the matter involves higher-level management, the</p>
88	<p>auditor should reevaluate the assessment of the risks of material misstatement due to fraud and consider the possibility of collusion involving employees, management or</p>

<p>89</p>	<p>third parties when reconsidering the reliability of evidence. (Ref: Para. A39-A41)</p> <p>14. When the auditor confirms that, or is unable to conclude whether, the financial statements are materially misstated as a result of fraud the auditor should consider the implications for the audit.</p>
<p>103</p>	<p>Auditor Unable to Continue the Engagement (Ref: Para. A42-44)</p> <p>15. If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor’s ability to continue performing the audit, the auditor should:</p> <ul style="list-style-type: none"> (a) Consider the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities; (b) Consider the possibility of withdrawing from the engagement; and (c) If the auditor withdraws: <ul style="list-style-type: none"> (i) discuss with the appropriate level of management and those charged with governance the auditor’s withdrawal from the engagement and the reasons for the withdrawal; and (ii) consider whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor’s withdrawal from the engagement and the reasons for the withdrawal.
<p>90</p>	<p>Management Representations (Ref: Para. A45-A46)</p> <p>16. To meet the requirements of ISA 580, “Management Representations,” in the context of the risks of material misstatements due to fraud, the auditor should obtain written representations from management that:</p> <ul style="list-style-type: none"> (a) It acknowledges its responsibility for the design and implementation of internal control to prevent and detect fraud; (b) It has disclosed to the auditor the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud; (c) It has disclosed to the auditor its knowledge of fraud or suspected fraud affecting the entity involving: <ul style="list-style-type: none"> (i) management; (ii) employees who have significant roles in internal control, or (iii) others where the fraud could have a material effect on the financial statements; and (d) It has disclosed to the auditor its knowledge of any allegations of fraud, or

	<p>suspected fraud, affecting the entity’s financial statements communicated by employees, former employees, analysts, regulators or others.</p>
	<p>Communications With Management and Those Charged With Governance</p>
93	<p>17. If the auditor has identified a fraud or has obtained information that indicates that a fraud may exist, the auditor should communicate these matters as soon as practicable to the appropriate level of management. The objective of this requirement is to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities. (Ref: Para. A47)</p>
95	<p>18. If the auditor has identified fraud involving</p> <ul style="list-style-type: none"> (a) management; (b) employees who have significant roles in internal control; or (c) others where the fraud results in a material misstatement in the financial statements,
96	<p>the auditor should communicate these matters to those charged with governance as soon as practicable, in order to meet the communication requirements of ISA 260, “Communication of Audit Matters With Those Charged With Governance,” in the context of the of the risks of material misstatements due to fraud. If the auditor suspects fraud involving management, the auditor should communicate these suspicions to those charged with governance and discuss with them the nature, timing and extent of audit procedures necessary to complete the audit. (Ref: Para. A48-A49)</p>
101	<p>19. The auditor should consider whether there are any other matters related to fraud to be discussed with those charged with governance of the entity. (Ref: Para. A50)</p>
	<p>Communications to Regulatory and Enforcement Authorities</p>
102	<p>20. The auditor’s professional duty to maintain the confidentiality of client information may preclude reporting fraud to a party outside the client entity. The auditor may consider it appropriate to obtain legal advice to determine the appropriate course of action in such circumstances, the objective of which is to ascertain the steps necessary in considering the public interest aspects of identified fraud. The auditor’s legal responsibilities vary by country and in certain circumstances, the duty of confidentiality may be overridden by statute, the law or courts of law. (Ref: Para. A51)</p>
	<p>Documentation</p>
108b	<p>21. In addition to the documentation requirements of ISA 315 and ISA 330, the auditor should document the results of the audit procedures designed to address the risk of management override of controls.</p>
109	<p>22. The auditor should document communications about fraud made to management, those charged with governance, regulators and others.</p>
	<p>23. When the auditor has concluded that the presumption that there is a risk of material</p>

110	<p>misstatement due to fraud related to revenue recognition is not applicable in the circumstances of the engagement, the auditor should document the reasons for that conclusion.</p> <p>–24. The objective of the above requirements is to meet the requirements of ISA 230, “Audit Documentation,” in the context of the risks of material misstatements due to fraud.</p>
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