

Fraud in an Audit of Financial Statements – Issues Paper

Objective

The objective of the IAASB discussion is to approve a project proposal for the revision of ISA 240¹ and the related conforming and consequential amendments to other International Standards on Auditing (ISAs).

Board Discussion

Agenda Item 3-A sets out the draft project proposal, which will be the focus of the IAASB discussion at the December 2021 meeting. The development of the draft project proposal, including a summary of the additional root cause analysis, is discussed in **Section II** of this paper and the structure of the draft project proposal is discussed in **Section III**.

Appendices to this Paper

The following appendices are included in this paper:

- **Appendix 1** – Relevant Extracts from the Public Interest Framework (PIF);
- **Appendix 2** – Extract from the Approved June 2021 IAASB Meeting Minutes;
- **Appendix 3** – Extract from the Approved July 2021 IAASB Meeting Minutes; and
- **Appendix 4** – Fraud Working Group (WG) Details and Update on Activities Since the July 2021 IAASB Meeting.

Other Agenda Items

Other Agenda Items provided to support the discussion in **Section II** on the development of the draft project proposal:

- **Agenda Item 3-B** – “Overall Analysis” discussed in paragraphs 9–11 of this paper; and
- **Agenda Item 3-C** – “Additional Root Cause Analysis” discussed in paragraphs 12–19 of this paper.

Approach to the Board Discussion

The Fraud WG Chair will walk through the “Matters for IAASB Consideration” in the order as included in this paper, which has been structured to pause for Board comments on relevant sections of the draft project proposal (see **Agenda Item 3-A**).

A revised draft project proposal will be provided (posted) on **Friday, December 10, 2021**, for Board approval on **Monday, December 13, 2021**.

Prior to the December 2021 meeting, Board members are requested to provide any significant matters or matters of an editorial nature to the Fraud WG by **Thursday, December 2, 2021**. All significant matters should still be raised and discussed in the Board plenary session. This process is to assist with the turnaround in the short timeframe.

I – Introduction

1. At the July 2021 IAASB meeting, the Board was initially presented with and requested to provide input on the following to assist with the development of the draft project proposal:

- (a) The possible project objectives;
- (b) The stakeholders' interests that will be served by a project on fraud;
- (c) The public interest issues that will be addressed; and
- (d) The project scope summarizing the proposed possible actions presented to and discussed with the Board at the April, June and July 2021 IAASB meetings.

The focus of those discussions was on items (a) – (c) above.

2. In addition, at that meeting the Board also discussed the possible actions on the following remaining four topics arising from the information gathering and research activities undertaken by the Fraud WG:²
 - Transparency in the auditor's report;
 - The audit engagement team discussion;
 - The relationship between ISA 240 and ISA 250 (Revised);³ and
 - Responding if instances of fraud or suspected fraud are identified.
3. The Board also provided feedback on the key public interest issues that had been proposed for development of the draft project proposal and was broadly supportive of the Fraud WG's efforts to incorporate aspects of the Public Interest Framework (PIF)⁴ into the project proposal.
4. Board members continued to express mixed views on the possible actions for some of the specific topics discussed and encouraged the Fraud WG to further consider the possible actions proposed. An extract of the approved July 2021 IAASB meeting minutes can be found in **Appendix 3**.

II – Development of the Draft Project Proposal on Fraud

5. At its discussions in July 2021, the Board concluded that it needed to be open-minded in its approach to any identified topics on fraud requiring attention, in particular the key public interest topics identified and the responsiveness of any actions to these.
6. The Board's discussions have been very helpful in further shaping the project proposal and the Fraud WG has redeliberated and reconsidered the areas that have been highlighted by Board members for further consideration. In recognition that the development of the fraud project proposal would benefit from further consideration by the Fraud WG to finalize for Board discussion, IAASB leadership took the decision to move the approval of the project proposal for fraud to the December 2021 IAASB meeting (which was previously planned for September 2021).
7. The draft project proposal set out in **Agenda Item 3-A** explains the proposed revision, enhancement and clarification of aspects of ISA 240.
8. The basis for the proposed actions in the draft project proposal is the extensive information

¹ International Standard on Auditing (ISA) 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

² All other issues and challenges identified on fraud were discussed with the Board in April and June 2021 (following extensive information gathering and research from March 2020 to March 2021, including the responses to the Discussion Paper and three roundtables). An extract of the minutes for the June 2021 IAASB meeting can be found in **Appendix 2**.

³ ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*

⁴ Public Interest Framework (PIF) published by the Monitoring Group in July 2020 (as part of their report "*Strengthening the International Audit and Ethics Standard-Setting System*")

gathering and research activities undertaken since March 2020. These activities, which are in line with the IAASB’s Framework for Activities (the “Framework”), included focused activities to:

- Further understand underlying factors causing issues and challenges related to the auditor’s work on fraud (including through roundtables, public consultation, review of academic research and other targeted outreach activities).
- Determine the most appropriate action for addressing identified issues and challenges.
- Scope a future project or other agreed actions.

The “Introduction” and the **Appendix** to the draft project proposal sets out the extensive range of activities undertaken. Input from IAASB members has also been instrumental in developing the project proposal.

Overall Analysis

9. The “Overall Analysis” set out in **Agenda Item 3-B** serves as a “background” paper and will not be specifically discussed at the December 2021 IAASB meeting. It sets out an overall analysis of the work of the Fraud WG to support the project proposal and summarizes all aspects of the work undertaken to develop the draft project proposal.
10. This Overall Analysis was used to facilitate the Fraud WG’s discussions at its October and November 2021 meetings in revisiting the issues identified and determining whether the proposed possible actions included in the draft scope of the project proposal are reflective of stakeholder views, Fraud WG deliberations and Board decisions or direction in light of the project objectives to achieve the public interest on fraud in an audit of financial statements.
11. The Overall Analysis summarizes the:
 - **Issues/themes identified** related to fraud in an audit of financial statements from the information gathering and research activities to date. Source(s) of issues/themes identified include the Discussion Paper,⁵ other matters raised to date (not included in the Discussion Paper), responses to the Discussion Paper, the roundtable discussions, a review of relevant academic research, and monitoring the current environment (e.g., developments in different jurisdictions).
 - **Fraud WG recommendations** comprising the initial proposed possible actions from the Fraud WG to address the issues/ themes identified, which were presented to the Board for discussion at the April, June and July 2021 IAASB meetings.
 - **Board decisions or direction, and comments** (as captured in the approved Board minutes of the relevant IAASB meetings) from the April, June and July 2021 IAASB meetings.
 - **Draft scope of the project proposal** comprising proposed possible actions for standard setting, the development of non-authoritative guidance or other actions, which agree to / align with the proposed actions described in the project proposal.
 - **Matters identified from the Additional Root Cause Analysis of Fraud Cases** as set out in **Agenda Item 3-C**.
 - **Changes in the draft scope of the project proposal**, which highlights changes to the proposed possible actions on a topic from the Board discussions, including changes from

⁵ Discussion Paper, [Fraud and Going Concern in an Audit of Financial Statements: Exploring the Differences Between Public Perceptions About the Role of the Auditor and the Auditor’s Responsibilities in a Financial Statement Audit](#)

the Fraud WG recommendations previously presented to the Board at the April, June and July 2021 IAASB meetings.

Additional Root Cause Analysis of Fraud Cases

12. In developing the draft project proposal, the Fraud WG has also considered the work undertaken by IAASB Staff on recent fraud cases in response to encouragement from respondents to the Discussion Paper to further analyze the root causes of recent fraud cases. The “Additional Root Cause Analysis of Fraud Cases” set out in **Agenda Item 3-C** also serves as a background paper for the project proposal and explains the Fraud WG’s additional efforts (post March 2021), including:
- (a) The detailed work undertaken (i.e., targeted outreach, and academic review and other research); and
 - (b) A summary of the findings from that work.

Targeted Outreach

13. To better understand the root causes of recent fraud cases, IAASB Staff performed additional outreach with targeted stakeholders, who have extensive knowledge of the nature of specific fraud cases. The following sets out the topics addressed in the summary of the targeted outreach:
- What auditors can do better to address fraud-related matters.
 - Nature of fraud in the current environment.
 - How frauds are executed and concealed.
 - Who is involved in the fraud.
 - Whether frauds involve related parties.
 - Financial accounts impacted by the fraud.
 - How frauds are detected, and by who.
 - Impact of technology on fraud.
 - Materiality of the fraud over time.

Academic Review and Other Research

14. IAASB Staff also reviewed targeted additional academic reports that covered studies of specific fraud cases. This review was intended to further supplement the initial desktop academic review performed in 2020. Other publicly available information was also reviewed to better understand the facts and circumstances surrounding specific ‘recent’ public fraud cases to determine whether there are any other areas that have not been identified that need to be addressed in the project proposal.
15. The review of these academic reports and recent public fraud cases demonstrates the variety of the types of fraud perpetrated. However, there were certain common issues and themes that were considered when developing the draft project proposal.

Association of Certified Fraud Examiners (ACFE) 2020 Report to the Nations

16. The [2020 Report to the Nations](#) published by the ACFE was reviewed to determine whether there were any further insights not already identified. This report presents findings of a study of 2,504 occupational fraud cases investigated between 2018 and 2019 in 125 countries. **Agenda Item 3-**

C sets out a summary of the key takeaways from the review undertaken.

Conclusion on the Additional Work Performed

17. The results of the additional work performed illustrates that each fraud is unique and often results from a number of contributing factors. This work affirmed that the significant areas where there are challenges and issues related to fraud in the context of an audit of financial statements, have already been broadly identified in the information gathering and research work undertaken to date (i.e., already forms part of the key issues identified that will be addressed by a project on fraud). It has also reinforced the appropriateness of the proposed possible actions in the scope of the draft project proposal.
18. The following summarizes the key takeaways for the Fraud WG from the additional work performed:
 - (a) The issues related to fraud will need to be addressed through combined efforts in standard setting by the IAASB (i.e., through a project to revise ISA 240), as well as action from all participants in the financial reporting ecosystem.⁶ The focus of the IAASB's activities will be on standard setting because this is the IAASB's mandate. However, the IAASB also recognizes the ability to use its global voice to encourage action from others. The IAASB will need to further consider how this can be done.
 - (b) Corporate culture and internal controls (particularly strong governance) are a key aspect of fraud prevention and detection. There are elements of these topics that cannot be addressed through audit standard setting without corresponding requirements for management. The focus of the IAASB will be on enhancements that can be made through actions within its remit.
 - (c) The exercise of professional skepticism in identifying and investigating "red flags" is a critical component of the financial statement audit as it relates to the risks of material misstatement due to fraud.
 - (d) Non-material fraud and third-party fraud are issues that deserve further consideration and it is proposed they are included in the IAASB project.
19. The Fraud WG will continue to monitor current fraud cases and consider possible implications for the IAASB's standards over the course of the project.

Incorporating Elements of the PIF in the Draft Project Proposal

20. As noted at the July 2021 IAASB meeting, the PIF will become effective during the life cycle of the proposed project, therefore the Fraud WG considered the PIF in developing the draft project proposal. Implementation of the PIF is in the initial planning phase, so not all elements of the framework are addressed in the current structure of an IAASB standard-setting project proposal. However, the key elements that have been included would be identified in a project proposal and include the stakeholders for whom standards are developed, what interests need to be served and possible qualitative characteristics of a standard's responsiveness to the public interest.
21. In incorporating the relevant elements of the PIF, IAASB Staff has used this opportunity to refine

⁶ The 'financial reporting ecosystem' includes those involved in the preparation, approval, audit, analysis and use of financial reports, for example, the entity and its management (i.e., preparers), Boards and audit committees, external auditors, governments, regulators, professional bodies, standard-setters, investors, analysts, lenders, and other financial statement users). Each participant of this ecosystem plays a unique and essential role that contributes towards high quality financial reporting.

the current structure of an IAASB project proposal.

22. Other changes have been made to the project proposal elements that were discussed at the July 2021 IAASB meeting as the Fraud WG and IAASB Staff have advanced their thinking about how to incorporate the PIF into a project proposal.

III – Structure of the Draft Project Proposal on Fraud

Overall Structure

23. The draft project proposal is set out in the following sections:
- (a) **Introduction** – sets out a broad explanation of the background of the project and a high-level overview of the extensive efforts to identify issues and challenges on fraud in an audit of financial statements. The **Appendix** to the draft project proposal sets out more detail about the outreach and information gathering activities undertaken.
 - (b) **Project Objectives to Achieve the Public Interest** – sets out the objectives to be achieved by a project on fraud. The objectives in the draft project proposal are derived from the “interests that need to be served”⁷ identified in the PIF. Specifically, the public interest will be met when the standards:
 - (i) Promote consistent practice and behaviors by auditors;
 - (ii) Facilitate identification of areas most relevant to the business of the audited company, and drive effective measures to respond to the related risks;
 - (iii) Reinforce the auditor’s professional skepticism needed in gathering evidence, challenging assumptions and developing conclusions; and
 - (iv) Ensure transparent, rigorous and balanced reporting that prompts the adoption of appropriate measures by those charged with governance (TCWG).
 - (c) **Stakeholders Impacted by a Project on Fraud** – outlines the five broad stakeholder groups which may have an interest in the standard. Different classes of stakeholders can have an interest in any given standard, and the PIF describes “for whom standards are developed.”⁸ The stakeholders set out in the project proposal are consistent (and unchanged) from the PIF. The Fraud WG are of the view that no changes to the list of stakeholders should be made because the list is broad and the last category “other” covers all stakeholders not specifically mentioned. This section of the draft project proposal also explains how the views of the IAASB’s stakeholders are weighed in the development of the proposed revisions (which is also explained in the PIF).
 - (d) **Key Issues Identified that Will Be Addressed by a Project on Fraud** – sets out the issues and challenges that have been identified in the information gathering and research phase (i.e., identifies the ‘stakeholder needs’). This section is further explained in paragraphs 24–26 below.
 - (e) **Scope of the Proposed Project on Fraud** – describes the detailed proposed actions to address the key issues and challenges that have been identified. This section also sets out those qualitative characteristics that will need to be considered as the revisions are progressed. This section is further explained in paragraphs 27–29 below.

⁷ See page 21 of the PIF. See Extract 1 of **Appendix 1**.

⁸ See page 20 of the PIF. See Extract 2 of **Appendix 1**.

- (f) **Project Timeline, Project Priorities and Resources** – sets out:
- (i) The overall targeted timeline for the project to completion. The targeted timeline follows the expected timing for a substantial IAASB project and assumes that IAASB meetings resume to an in-person meeting schedule from the beginning of 2022. Any further impacts of the pandemic and reduction in Board plenary time may impact this targeted timing.
 - (ii) That standard-setting activities will take priority in the IAASB’s proposed actions.
 - (iii) The resources describe the full ambit of all resources needed to progress and finalize a project on fraud.
- (g) **Project Output and Impact** – articulates the expected output from the project as well as considerations about the possible impact of the project. The Fraud WG’s considerations about the impact of a project on fraud is further explained in paragraphs 30–32 below.

Matters for IAASB Consideration:

1. The Board is asked for its views on:
 - (a) The overall structure of the draft project proposal described in paragraph 23 above (i.e., the overall structure of **Sections II to VIII of Agenda Item 3-A**);
 - (b) The proposed project objectives to achieve the public interest (see **Agenda Item 3-A, Section III**); and
 - (c) Whether the “interests that need to be served” within the PIF have been appropriately incorporated (see paragraph 23(b) of this paper).

Please note that other sections of the draft project proposal are covered in the remainder of this paper and Board members are requested to reserve their feedback as these are raised by the Fraud WG Chair during the Board session.

Key Issues Identified that Will Be Addressed by a Project on Fraud

24. The identified issues and challenges were developed from the matters that were raised by stakeholders from the wide range of information gathering and research activities described in the **Appendix** to the project proposal and the further root cause analysis (see paragraphs 12–19 above).
25. The detailed issues and challenges identified have been grouped by theme (or “key issue”). The key issues correspond to:
 - (a) *The project objectives* – the project objectives relate to the broad public interest issues to be addressed by a project on fraud; and
 - (b) *The scope of the project* – i.e., the proposed detailed actions in the draft project proposal that are intended to address the identified issues and challenges within each theme / “key issue.”
26. In response to Board comments received at the June and July 2021 IAASB meetings, and the additional work undertaken on root cause analysis, the Fraud WG further reflected on whether the list of identified issues and challenges included all of the matters / areas where issues or challenges have been identified from information gathering activities and in discussions with the IAASB in 2020 and 2021. Changes in this section have been made to:

- (a) Group the issues together in themes (i.e., group the issues together in themes / “key issues” that better reflect the public interest issues), including:
 - (i) Concerns about the clarity of the role of the auditor on fraud in an audit of financial statements;
 - (ii) Questions around the robustness of identifying and assessing risks of material misstatement due to fraud;
 - (iii) Questions around the adequacy of responses to the assessed risks of material misstatement due to fraud;
 - (iv) A need to more appropriately recognize the use of technology in ISA 240;
 - (v) Views that there is insufficient linkage of ISA 240 to the other ISAs to promote an integrated risk-based approach;
 - (vi) Further enhancements or clarity is needed for certain fraud-related procedures;
 - (vii) A need to reinforce the appropriate exercise of professional skepticism; and
 - (viii) Views that transparency about the auditor’s fraud-related procedures in communications between the auditor and TCWG and within the auditor’s report should be enhanced.
- (b) Incorporate the additional aspects from the further work performed on root cause analysis (paragraphs 12–19 above explain this work).
- (c) Check the completeness of the identified issues and challenges and make additions and/or revisions thereto to correspond to the planned proposed actions in the scope section where necessary.
- (d) Reconsider various items about whether standard setting is needed to address the identified issue or challenge.

Matters for IAASB Consideration:

- 2. The Board is asked for its views on whether the key issues identified that will be addressed by a project on fraud (see **Agenda Item 3-A, Section V**):
 - (a) Are complete based on the information gathering and research activities to date, as well as Board discussions;
 - (b) Appropriately reflect the additional insights obtained from the further root cause work undertaken (see paragraphs 12-19 of this paper); and
 - (c) Appropriately reflect the “key issues” to be addressed by this project.

Scope of the Proposed Project on Fraud

- 27. The scope of the project proposal sets out the proposed project actions including:
 - (a) *Standard setting.* The focus of the project is on standard-setting activities. The mandate of the IAASB is to set high-quality standards, and the project proposal has been developed to concentrate efforts on addressing public interest needs that have been identified that will enhance the auditor’s behaviors and procedures performed.
 - (b) *The development of non-authoritative support materials.* The project proposal includes the development of limited non-authoritative support materials, and is subject to available time

and resources. It is intended that any non-authoritative support materials will likely take the form of Frequently Asked Questions (FAQs), diagrams, flowcharts or other similar succinct documents. The timing of non-authoritative support materials will depend on whether the underlying requirements will be revised, and if so, the development of any materials would need to wait until the revised standard is finalized.

- (c) *Other actions.* The project proposal includes other actions including activities that are educational in nature where within the remit of the IAASB, and continued dialogue and engagement with others on issues that relate to actions that are not within the IAASB’s remit and require efforts from others in the financial reporting ecosystem. Although not necessarily part of the IAASB’s core mandate to set global standards, the Fraud WG recognizes the calls for the IAASB to use its global voice to encourage others in the financial reporting ecosystem to also act. Changes to the auditing standards are a very important part in addressing the issues and challenges that have been identified but are not the only part of the financial reporting ecosystem that needs to be addressed. Therefore, these “other actions” have also been proposed but are limited in nature (because resources will be focused on standard setting).

The order of the proposed actions for each key issue in the draft project proposal also reflects the relative importance of the proposed actions.

28. In response to Board comments received at the June and July 2021 IAASB meetings, the Fraud WG has revisited each of the proposed possible actions and redeliberated its original position where necessary. In redeliberating each of the proposed actions, the Fraud WG considered the responses to the Discussion Paper, the further work from the root cause analysis as well as comments and feedback from the Board’s discussions in April, June and July 2021. Changes have been made to:

- Strengthen the proposals where there was a strong message that the Fraud WG’s initial proposals were not sufficient to address some of the key public interest issues. In particular, the following proposed actions set out in the draft project proposal have been strengthened from what was previously presented to the Board:
 - The proposed actions to address issues and challenges in the introductory paragraphs in ISA 240 about the expectations and inherent limitations of an audit.
 - The proposed action about the auditor’s considerations for the need for specialized skills (relating to forensic type procedures), including in what circumstances.
 - The proposed actions to strengthen responses to the assessed risks of material misstatement due to fraud.
 - The proposed action to address how transparency in the auditor’s report could be addressed within the project. This topic continues to have mixed views about how it can be addressed, and the Fraud WG intends to further explore the different options to bring the matter back to the Board for further discussion early in 2022 (this proposed action has therefore been articulated as “explore” within the proposed actions for the project).
- The proposed actions for developing non-authoritative support materials. The Fraud WG reconsidered the topics that were originally identified as being options for the development of non-authoritative guidance and redeliberated whether any of those topics would be better addressed through standard setting (i.e., within the application material in ISA 240). For example, changes were made to propose standard setting (application material) to address

certain issues identified (e.g., unpredictability procedures, journal entry testing) rather than developing non-authoritative support materials.

How the Qualitative Characteristics Within the PIF Are Addressed in the Project Proposal

29. The PIF sets out the framework for the development of high-quality international standards by the IAASB that are responsive to the public interest. In explaining how the stakeholders' needs can be served, the PIF sets out qualitative characteristics to assess a project's responsiveness to the public interest.⁹ In developing and revising principles-based requirements in revised ISA 240, certain of the qualitative characteristics described in the PIF¹⁰ will be applicable to the changes being made as the project is being progressed, including:

- (a) *Scalability* (including proportionality to the standard's relative impact on different stakeholders).
- (b) *Relevance* (through recognizing and responding to emerging issues, changes in business or public practice environments, developments in accounting practices, or changes in technology).
- (c) *Comprehensiveness* (through limiting the extent to which there are exceptions to the principles set out).
- (d) *Clarity and conciseness* (to enhance understandability and minimize the likelihood of differing interpretations).
- (e) *Implementability and ability of being consistently applied and globally operable*.
- (f) *Enforceability* (through clearly stated responsibilities).

These relevant qualitative characteristics are explained in **Section VI** of the draft project proposal and it is intended that there is ongoing consideration of these qualitative characteristics as the project progresses through explicitly explaining how any proposed changes meet these characteristics.

Matters for IAASB Consideration:

- 3. The Board is asked for its views on the scope of a proposed project on fraud, which includes the proposed actions to address the key issues identified, including (see **Agenda Item 3-A, Section VI**):
 - (a) Whether the proposed actions are sufficient and appropriate in addressing the identified issues and challenges to achieve the project objectives; and
 - (b) Whether the qualitative characteristics within the PIF are adequately considered (see paragraph 29 of this paper).

⁹ See pages 22-23 of the PIF. See Extract 3 of **Appendix 1**.

¹⁰ The other qualitative characteristics apply more broadly, with some addressed by the matters set out in the draft project proposal, while others may need to be considered at the end of the proposed project.

Impact of a Project on Fraud

30. The impact of the changes can be ‘measured’ in a number of ways. However, articulating a specific measure for the effectiveness of the proposed changes to ISA 240 is challenging because:
- (a) Changes mean different things to different stakeholders.
 - (b) There are many factors that could affect the impact, which may vary significantly by jurisdiction. For example, audit inspectors in different jurisdictions (or in different inspection periods) can have different areas of focus, thereby making inspection findings difficult to compare.
 - (c) The impact of changes is not only impacted by auditing standards but are often impacted by a variety of other environmental influences as well (such as the pandemic, new financial reporting standards, etc.), so it is difficult to isolate the impact of the change in the auditing standards.
31. However, there are indicators whether the standard has been effective in achieving the objectives that have been set out. In order to assess whether the objectives set out in the draft project proposal have been achieved, a post-implementation review will need to be undertaken. Such a post-implementation review will need to focus on those stakeholders most relevant to the public interest (i.e., users) as well as other key stakeholders (including, for example, audit oversight bodies and regulatory authorities) and as to whether the revised standard has had the intended impact on auditor behavior.
32. At this stage, the Fraud WG is comfortable to recommend to the Board that the proposed project has been set up in a manner that is likely to deliver revisions that would drive the appropriate impacts as anticipated through the project objectives to achieve the public interest, and address the key issues identified as informed by the IAASB’s stakeholders based on the information gathering and research activities undertaken. In this regard, the project proposal will be used by the Task Force and the Board throughout the course of the project to guide the standard setting and other actions and therefore increase the likelihood of its success.

Matters for IAASB Consideration:

- 4. The Board is asked for its views on the description of the impact of a project on fraud in the draft project proposal (see **Agenda Item 3-A, Section VIII**).
- 5. The Board is asked whether there are any other matters within the draft project proposal that the Fraud WG should consider as it finalizes the project proposal, including any matters not already specifically addressed.
- 6. The Board is asked to approve the project proposal to revise ISA 240 (this question will be addressed on Monday, December 13, 2021).

III – Way Forward

33. The Fraud WG would be reconstituted as the Fraud Task Force (TF) and as such the Fraud TF would intend to move forward with the project as follows:
- (a) Continue to monitor the work of others, conduct outreach, coordinate with the International Ethics Standards Board for Accountants (IESBA), and coordinate with other IAASB workstreams as described in the “Ongoing Activities” section of the project proposal.

- (b) Taking into account the input received from the IAASB and the IAASB's Consultative Advisory Group (CAG) at their December 2021 and November 2021 meetings, respectively, continue to develop their thinking related to matters addressed in this paper and in the project proposal.
34. For the next two IAASB meetings (i.e., March and June 2022), the Fraud TF intends to discuss and bring to the Board for input the proposed actions included in the scope of the project proposal addressing the following three key issues identified:
- (a) Proposed actions addressing concerns about the clarity of the role of the auditor on fraud in an audit of financial statements.
 - (b) Proposed actions addressing questions around the robustness of identifying and assessing risks of material misstatement due to fraud.
 - (c) Proposed actions addressing views that transparency about the auditor's fraud-related procedures in communications between the auditor and TCWG and within the auditor's report should be enhanced.

Matter for IAASB Consideration:

- 7. Are there additional or different items that the IAASB believes should be prioritized by the Fraud TF over the course of the next two IAASB meetings (i.e., March and June 2022)?

Appendix 1

Relevant Extracts from the Public Interest Framework (PIF)

Extract 1

Extract from the PIF's section on "**What interests need to be served?**"¹¹

- **Promote consistent practice and behaviors by auditors** and assurance providers, other professional accountants in public practice, and professional accountants in business across jurisdictions;
- **Facilitate identification of areas most relevant to the business** of an audited company, and **drive effective measures to respond to related risks**;
- **Reinforce** the professional accountant's role and mindset and **the auditor's professional skepticism needed in gathering evidence, challenging assumptions, and developing conclusions**; and
- **Ensure transparent, independent, rigorous and balanced reporting that prompts the adoption of appropriate measures by those charged with governance**, as well as corrective action by oversight bodies, including prudential and market authorities, also to address any potential threat to financial stability."

Extract 2

Extract from the PIF's section on "**For whom are standards developed?**"¹²

- *Users of financial statements* ("the users") – mainly investors, lenders, and other creditors, who rely on the audited financial statements to make resource allocation decisions.
- The *profession* – all auditors and assurance providers, and other professional accountants in public practice and business who apply the standards.
- Those in charge of *adoption, implementation and enforcement* of the standards as well as monitoring of the capital markets who rely on such standards– including national standard setters, regulators and audit inspectors, market authorities, public sector bodies, and professional accountancy organizations.
- *Preparers* – management and professional accountants in business, for entities of all sizes, in either the public or private sectors, as well as those charged with governance (e.g., audit committees who oversee the audit process), the latter group being relevant to addressing the information asymmetries among different parties involved in the functioning of companies, and who also provide the basis for the auditor's work.
- *Other users* – the reliability of financial and non-financial information affects a very wide range of interests in society, including consumers, taxpayers, employees, competition and prudential authorities, central banks and bodies in charge of financial stability oversight, and those granting public contracts."

¹¹ See page 21 of the PIF.

¹² See page 20 of the PIF.

Extract 3

From the PIF's section on “**What qualitative characteristics should the standards exhibit?**”¹³

- “*Consistency* with priorities established through a strategic planning process, based on the assessment of public interest and stakeholder needs;
- *Coherence* with the overall body of standards, including that requirements addressing the same subject matter are not in conflict;
- Appropriate *scope* to address the identified key issues, and to clearly specify to whom the standard applies;
- *Scalability*, including the proportionality to the standard's relative impact on different stakeholders, e.g., how a standard addresses the audit or assurance needs of small and medium sized enterprises (SMEs) as well the needs of complex, listed entities;
- *Timeliness* in addressing identified needs without sacrificing quality;
- *Relevance*, through recognizing and responding to emerging issues, changes in business or public practice environments, developments in accounting practices, or changes in technology, and developing principles-based requirements that enable the objectives of those requirements to be achieved in differing circumstances;
- *Completeness*, in reflecting the results of broad consultation and in balancing stakeholder priorities;
- *Comprehensiveness*, through limiting the extent to which there are exceptions to the principles set out;
- *Clarity and conciseness*, to enhance understandability and minimize the likelihood of differing interpretations, and thus supporting proper intended application and facilitating implementation;
- *Implementability*, and ability of being *consistently applied and globally operable* across entities of all sizes and regions, respectively, as well as considerations of the different conditions prevalent in different jurisdictions. Standards that cannot be adopted, or cannot be implemented by practitioners are not of much use; and
- *Enforceability*, through clearly stated responsibilities that make it possible to ascertain the extent to which an auditor or professional accountant has complied with the standards.”

¹³ See pages 22 to 23 of the PIF.

Appendix 2

Extract from the Approved June 2021 IAASB Meeting Minutes

Mrs. Provost introduced the session and explained that the objective was to discuss possible actions for six specific topics raised by respondents to the Discussion Paper¹⁴ where mixed responses were received, as set out in **Agenda Item 3**. Mrs. Provost explained that this session would build on the recommendations made to the Board and discussions thereon in April 2021 and, together with the matters to be presented and related discussion to be held in July 2021, would inform the development of the project proposal to be presented to the Board in September 2021.

The IAASB Chair encouraged the Board, at this stage of developing the project proposal, to remain open to possible standard-setting solutions in particular on major public interest issues identified, and to not prejudge specific future actions that may limit the Board's options.

SUMMARY OF FEEDBACK RECEIVED

The Board provided feedback on possible actions recommended by the Fraud Working Group in response to the six matters highlighted by respondents to the Discussion Paper and summarized in **Agenda Item 3**.

Standard-Setting

The Board discussed the possible actions to address the challenges and issues identified on the six topics presented, and in some areas continued to express mixed views on these possible actions.

The Board provided comments and suggestions for the Fraud Working Group's consideration on the possible actions as it develops the project proposal:

Revising the introductory language in ISA 240¹⁵ about responsibilities of the auditor and inherent limitations of an audit.

In relation to the proposals of the Fraud Working Group, specific comments and suggestions included:

- That the reordering of paragraphs and enhancing application material would not be sufficient to set the right tone on this important issue, and the proposal was seen by several board members to be 'cosmetic' or insufficiently responsive. However, mixed views were expressed by various Board members about what may be needed; on one hand, a few Board members suggested changes and enhancements to the text of the introductory paragraphs to emphasize the auditor's role notwithstanding the inherent limitations, while on the other hand, some were cautious to imply that inherent limitations are less than currently described. After further deliberation, the Fraud Working Group was encouraged to further consider:
 - Making changes to the text of the introductory paragraphs to reduce the ambiguity around the inherent limitations of an audit. There was support for further considering the changes made in this area by the United Kingdom in their equivalent of ISA 240.
 - How the responsibilities of the auditor could be better emphasized and, in an appropriately balanced manner, clarify the respective responsibilities of others in relation to fraud. Other Board members, however, had the view that the auditor's responsibilities were clear in the ISAs and that this would not necessarily address the issues identified in relation to the

¹⁴ Discussion Paper, [Fraud and Going Concern in an Audit of Financial Statements: Exploring the Differences Between Public Perceptions About the Role of the Auditor and the Auditor's Responsibilities in a Financial Statement Audit](#)

¹⁵ ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

inherent limitations of an audit. Caution was also expressed about focusing on what may not be within the Board’s remit, with encouragement to focus on the standard-setting changes that would support enhanced audit quality.

- When revising the standard that any changes should not imply that the limitations in an audit are less than what is currently conveyed, as the limitations are inherent in nature and will not cease to exist.
- Monitoring what other jurisdictions have done to make enhancements in this area and consideration of those enhancements in informing the Board’s actions. It was also highlighted that developments in the environment around the world should also be considered when developing revisions in this area.
- How ‘education’ can be used, possibly in collaboration with others, to help users of financial statements and others better understand the inherent limitations of an audit.

The Working Group agreed to reconsider the proposals in this area.

At the conclusion, one Board member continued to express reservations about the adequacy of the Fraud Working Group’s original path forward and warned the IAASB on its messaging to the marketplace concerning the inherent limitations of an audit with respect to fraud.

Use of forensic specialists in an audit of financial statements.

Specific comments and suggestions included:

- The working group was encouraged by a Board member to consider proposals that would raise the bar in this area.
- Regarding paragraph 45 of the Issues Paper, possible clarification and requirements for the auditor’s considerations about when the use of forensic specialists may be appropriate, but being mindful of scalability when developing such enhancements, with a Board member encouraging the Fraud Working Group to give greater consideration to responses on the DP that were supportive of the IAASB doing work in this area.
- Support for defining what is meant by “forensic specialist,” while also taking into account how any terms used may be translated.
- Consideration of exploring trigger events where specialists should be considered for assistance in the risk assessment process.
- Considering how forensic specialists could be used in a ‘coaching’ role for auditors when appropriate.
- Support for making a connection between enhancements related to forensic specialists with paragraphs 25-28 in ISA 220 (Revised)¹⁶ related to engagement resources.
- Further consideration of whether forensic specialists should be required for higher-risk entities.

Clarifying the definition of fraud.

The Board was presented with two options regarding the definition of fraud. As a result, the Board discussed the adequacy of the options presented in clarifying the definition and assisting practice. Specific comments and suggestions included that:

¹⁶ ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*

- The definition of fraud should not be expanded. However, it was noted that the Board should clarify the definition, possibly through application material or non-authoritative guidance to illustrate how concepts like bribery and corruption are interlinked with fraud for purposes of an audit of financial statements. This may include the consideration of one or both of the options presented to the Board.
- There was a suggestion that the definition be reconsidered to include bribery and corruption, further clarified by the statement that as long as it was clear how the concepts were interlinked to fraud it may not be necessary to change the definition.

Enhancing application of professional skepticism.

Specific comments and suggestions included:

- Support for enhanced application material and non-authoritative guidance to illustrate the ‘ramp up’ of procedures and give practical examples of professional skepticism applied in certain circumstances.
- Recognize the linkage between professional skepticism and the potential role of forensic specialists.
- Provide more detail about future collaboration with other IAASB workstreams in the development of the project proposal, with encouragement to describe more specifically the detailed actions for the relevant workstreams.

Further considering the presumed risk of fraud in revenue recognition and what changes are needed.

Specific comments and suggestions included:

- Further exploration on how to shift focus from the auditor developing a rebuttal to the need for the auditor to perform robust risk identification and assessment.
- For enhancements to application material, shifting away from clarifying when it may be appropriate to rebut the presumption of risk of fraud in revenue recognition, and focusing instead on when it is *inappropriate* to rebut the presumption. It was also noted that this may be a good opportunity to provide more guidance on rebutting fraud risks in revenue recognition.

Strengthening requirements about the auditor’s considerations for external confirmations.

Specific comments and suggestions included:

- Consideration of scope to only explore enhancements specific to fraud. It was noted that broader enhancements related to external confirmations may need to be considered for a possible future project on ISA 505,¹⁷ with encouragement to coordinate with the Audit Evidence Task Force in this area.

AREAS WHERE NO FURTHER ACTION RECOMMENDED

Introducing the Concept of a ‘Suspicious Mindset’ Into the ISAs.

Specific comments and suggestions included:

- Support for not further pursuing the concept of a “suspicious mindset” but rather enhancing the application of the existing concept of professional skepticism.

¹⁷ ISA 505, *External Confirmations*

ACTIONS FOR OTHERS IN THE FINANCIAL REPORTING ECOSYSTEM

Board members encouraged that the Fraud Working Group consider any possible actions in terms of the broader financial reporting ecosystem, including education initiatives that may help enhance the understanding of the respective roles that auditors and others have in addressing the issues and challenges identified. However, there was caution to focus on actions that are within the remit of the IAASB.

PIOB OBSERVER REMARKS

Mr. Hafeman expressed support for the work of the IAASB on the fraud project and encouraged as much substantive enhancement to the standard as appropriate given the public interest importance of the issues. He also supported the Board's suggestions for strengthening the proposals made by the Fraud Working Group in some areas, in particular on what the auditor is required to do. He noted that the root cause analysis underway could also further inform the development of a robust project proposal.

WAY FORWARD

The Fraud Working Group will present possible actions for the remaining specific topics where mixed views were expressed at the July 2021 IAASB meeting and seek to obtain Board feedback on possible project objectives, project scope and public interest issues that will inform the development of a project proposal to be presented at the September 2021 meeting.

Appendix 3

Extract from the Approved July 2021 IAASB Meeting Minutes

Mrs. Provost introduced the session and explained that the objectives of the session were to (1) discuss possible actions for the remaining four specific topics raised by respondents to the Discussion Paper¹⁸ where mixed responses were received as set out in **Agenda Item 2**, and (2) discuss the overarching public interest issues that will be addressed by a project on fraud, as well as the possible project objectives and broad project scope. Mrs. Provost explained that this session would, together with the discussions in April and June 2021, inform the development of the project proposal to be presented to the Board in September 2021.¹⁹

SUMMARY OF FEEDBACK RECEIVED AND POSSIBLE ACTIONS

The Board provided feedback on possible actions recommended by the Fraud Working Group in response to the four matters highlighted by respondents to the Discussion Paper and summarized in **Agenda Item 2**.

In her introductory remarks, Mrs. Provost further explained the Fraud Working Group's position on transparency in the auditor's report, with clarification and further explanation of the position of the Fraud Working Group being given in relation to what had been presented in **Agenda Item 2**, including noting the omitted tick with regard to standard-setting in the summary box. Mr. Botha also made a clarification about the European Union (EU) requirement referenced in paragraph 14 of **Agenda Item 2**. He noted that there are different interpretations within the EU about the meaning of that requirement, and therefore there are different applications across jurisdictions.

The Board discussed the possible actions to address the challenges and issues identified on the four topics presented, and in some areas continued to express mixed views on the possible actions. The IAASB Chair reminded the Board of the importance at this stage of the project's development to take an open and ambitious approach to considering options for standard-setting action on major public interest issues, and to not limit options based on prejudging specific solutions.

The Board provided comments and suggestions for the Fraud Working Group's consideration on the possible actions as it develops the project proposal:

More Transparency in the Auditor's Report.

Mixed views were expressed by Board members about the Fraud Working Group's recommendations, but there was agreement that further consideration is needed as to whether more transparency in the auditor's report and exploration of how this could be done.

- Board members strongly encouraged the Fraud Working Group to further explore transparency in the auditor's report to determine the most appropriate way to address this key public interest issue.
 - Board members encouraged continued monitoring of changes made in local jurisdictions (e.g., the United Kingdom) for increased transparency related to fraud in the auditor's report.
- Some Board members strongly encouraged consideration of standard-setting in this area to require more transparency in the auditor's report.

¹⁸ *Fraud and Going Concern in an Audit of Financial Statements: Exploring the Differences Between Public Perceptions About the Role of the Auditor and the Auditor's Responsibilities in a Financial Statement Audit*

¹⁹ The approval of the project proposal has subsequently been moved to December 2021 to allow the Fraud Working Group sufficient time to address comments and issues raised by the Board in previous Board discussions.

- A Board member strongly believed standard-setting is needed in this area based on stakeholder responses to the Discussion Paper.
- The Chair noted that the possible action for this matter should be to explore and consider standard-setting, and again encouraged the Fraud Working Group to take an open and ambitious approach to addressing this issue.
- Some Board members expressed the following concerns with requiring more transparency in the auditor's report related to fraud:
 - It could add to the length of the report without adding substantive information (i.e., there is a risk of boilerplate disclosures).
 - Significant changes to the auditor's report had only recently been made, and encouragement to allow time for those requirements to settle before making changes to the auditor's report again.
 - Non-authoritative guidance could be useful in helping auditor's apply the current requirements, in particular in relation to the interaction of fraud and key audit matters (KAM).
- Some Board members encouraged the use of the existing KAM mechanism in ISA 701²⁰ to enhance transparency on fraud-related matters in the auditor's report. Board members encouraged the Fraud Working Group to remain open to solutions that may require standard-setting actions to revise or add application material in ISA 701.

Making the Engagement Team Discussion More Robust.

Although the Board broadly supported the proposals in this area, the Board encouraged the Fraud Working Group to:

- Further explore how an explicit consideration by the audit engagement team for a further engagement team discussion(s) could be incorporated into the standard, either through requirements or application material. Some Board members cautioned about the need to keep any new requirements scalable (i.e., a determination that is suitable to the nature and circumstances of the engagement).
- Consider whether additional topics for discussion should be required as part of the engagement team discussion. The Fraud Working Group were encouraged to further explore research that had been done in this area.
- Further explore how appropriate revisions for involving specialists in the engagement team can be made. A Board member cautioned that it was not only involving the specialists in the engagement team discussion that was important, but emphasized the need to explore how changes could be made to explain *how* those specialists are involved. It was added that any possible requirements should be robust and not merely capture existing practice in this area.
- Monitor and understand standard-setting actions taken in local jurisdictions related to this matter, including understanding how any changes made have been implemented and whether they are effective.

Clarifying the Relationship Between ISA 240²¹ and ISA 250 (Revised).²²

²⁰ ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

²¹ ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial statements*

²² ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*

The Fraud Working Group was encouraged to consider strengthened proposals to clarify the relationship between ISA 240 and ISA 250 (Revised).

- Board members encouraged openness about possible changes to address the issues identified.
- Board members encouraged consideration of a possible requirement in ISA 240 to consider the impacts of ISA 250 (Revised) when fraud is identified or detected. However, there was a caution as to how ISA 240 deals with non-compliance with laws and regulations as that is separately covered by ISA 250 (Revised).
- A Board member noted there is typically established firm practice, including escalation procedures, in this area that may be useful to consider when addressing this issue.
- Board members suggested that non-authoritative guidance should not be prioritized when considering the possible actions as law and regulations is jurisdictional and not the same globally, so it may be difficult to effectively develop such guidance.

Addressing Instances When Fraud or Suspected Fraud is Identified During the Audit.

Board members that commented broadly supported the proposals but encouraged the Fraud Working Group to also consider whether any enhancements are needed.

- Board members questioned whether re-ordering the requirements would change auditor behavior and challenged if more is needed.
- Board members encouraged the Fraud Working Group to look at requirements related to non-compliance with laws and regulations in the IESBA code.²³

KEY PUBLIC INTEREST ISSUES, PROJECT OBJECTIVES, AND PROJECT SCOPE

The Board provided feedback on the key public interest issues that had been identified. The Board was broadly supportive of the Fraud Working Group's efforts to incorporate the Public Interest Framework (PIF) into elements of the project proposal.

Key Public Interest Issues

While broadly supportive of the concepts behind the key public interest issues, Board members provided suggested revisions on the wording used to describe the key public interest issues.

- 'Determining' should be replaced with 'strengthening' in the first public interest issue.
- "Irrespective of the inherent limitations of an audit" in the first public interest issue should not be presented in this way to suggest that the inherent limitations of an audit can be overcome.
- For the second public interest issue, clarifying the intent of the action instead of referring to 'linkages' (i.e., fostering an integrated risk-based approach).
- Determining whether 'irregularities' should also be included in the third public interest issue.

Board members encouraged the Fraud Working Group to further reflect on whether the public interest issues, as described, really encapsulate all of the issues that have been identified. It was also added that all of the public interest issues needed to be described as issues and not solutions.

The Fraud Working Group was also encouraged to consider how the benefits of the actions that would be proposed could be described.

²³ The International Ethics Standards Board for Accountants' (IESBA) *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA Code)

Project Objectives

Board members noted it would be helpful to reconcile project objectives to the issues identified relating to the project scope.

The Fraud Working Group was encouraged that further consideration be given to prioritization of the topics to be addressed, as there were many.

Project Scope

Board members recognized this is a work in progress as the remaining topics were discussed at this meeting, but noted that this needed to be a complete analysis, adding that some matters had not yet been included.

Board members encouraged the Fraud Working Group to revise wording such that there is flexibility for further exploration of issues once the project commences.

- Board members suggested adding columns to indicate where changes to requirements are being proposed as opposed to other actions.

OTHER COMMENTS – DRAFT MINUTES FROM JUNE 2021 BOARD MEETING

In relation to the draft minutes presented in an appendix to **Agenda Item 2**, it was raised that these minutes did not accurately capture all of the comments made. Notwithstanding that it was noted that these minutes are still subject to review, a Board member and the PIOB representative highlighted that changes are needed to more accurately capture the discussions. Mr. Hafeman expressed concern at how certain issues and his comments were described in the draft minutes. He encouraged the Board and Staff to ensure minutes are expressed in a clear and complete manner in future. Mr. Seidenstein noted that the minutes will be amended, and a revised draft presented to the Board for approval at the September 2021 IAASB meeting.

IAASB CAG CHAIR REMARKS

Mr. Dalkin noted that CAG Representatives discussed considerations around whether additional required audit procedures may have prevented or detected recent fraud cases earlier if they had been in place, for example, reviewing publicly available contradictory information. Mr. Dalkin also noted that some CAG Representatives had expressed concerns that additional requirements for more transparency in the auditor's report related to fraud may cause users of the auditor's report to think financial statement audits are more forensic in nature than they are, which may increase the "expectation gap."

PIOB OBSERVER REMARKS

Mr. Hafeman supported the incorporation of the PIF into the approach to identify and describe the key public interest issues and other elements of the project proposal, noting that the development of the key public interest issues would be helpful in informing the PIOB's discussions. He encouraged revision of the project objectives so they are more specific and tied to the fraud project, in particular being clear about how the public interest issues will be addressed as this would help with communications with stakeholders. He supported the mapping of the issues in the project scope.

Mr. Hafeman noted that stakeholders give high priority to this topic and the PIOB expects the project proposal should be robust in response. He noted a project that only results in minor changes would not likely be worthwhile to undertake. He expressed concern that in the discussion of transparency, although most Board members supported exploration of a possible requirement, they often followed this with a list of concerns, which gave an overall impression of reluctance to consider a possible requirement. He

encouraged an open mindset and willingness to consider changes to the standard, including to the possibility of moving beyond not only the current requirements but perhaps even the current practices of the leading audit firms. Mr. Seidenstein noted that while Board members expressed caution on certain issues, there was strong support for an open and ambitious approach with regard to addressing issues on fraud.

WAY FORWARD

The Fraud Working Group will present a project proposal for discussion and approval at the September 2021²⁴ IAASB meeting.

²⁴ The approval of the project proposal has subsequently been moved to December 2021 to allow the Fraud Working Group sufficient time to address comments and issues raised by the Board in previous Board discussions.

Appendix 4

Fraud Working Group (WG) Details and Update on Activities Since the July 2021 IAASB Meeting

Fraud WG Members

1. Information about the Fraud WG members and the project can be found [here](#).

Fraud WG Activities Since the July 2021 IAASB Meeting (Virtual by Videoconferencing)

2. The Fraud WG held one hybrid meeting on October 13-14, 2021 and one virtual meeting on November 2, 2021. Owing to the nature of the activities being undertaken, substantial work was also progressed via electronic circulation of materials between members of the Fraud WG and the IAASB staff.
3. At the September 2021 IAASB CAG meeting, the Fraud WG provided CAG Representatives with an update on the status of the IAASB's work related to fraud and the Board discussions held to date.