

Meeting: IAASB Consultative Advisory Group (CAG)

Meeting Location: New York, United States of America

Meeting Date: March 7–8, 2023

Agenda Item

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Fraud in an Audit of Financial Statements – Cover and Report Back

Objectives of Agenda Item

1. The objectives of this Agenda Item are to:
 - (a) Obtain the Representatives' views on certain of the proposals being put forward to revise ISA 240¹ as the Fraud Task Force (the Task Force) continues to progress its work in advance of the June 2023 IAASB meeting.²
 - (b) Report back on Representatives' comments made at the September 2022 IAASB CAG meeting.

Project Status

2. The **Appendix** to this paper provides a history of previous discussions with the IAASB CAG and the IAASB on this project, including links to the relevant IAASB CAG documentation.
3. Since the September 2022 IAASB CAG meeting, the Task Force discussed the following topics with the Board:
 - (a) Identifying and assessing the risks of material misstatement (RoMMs) due to fraud;
 - (b) Fraud or suspected fraud is identified; and
 - (c) Transparency in the auditor's report on fraud.
4. At the December 2022 Board meeting, the Task Force also presented updated drafting of proposed ISA 240 (Revised)³ based on the comments received from the Board at the June and September 2022 IAASB meetings and from the CAG at the September 2022 IAASB CAG meeting.
5. In February 2023, the Task Force met to advance their thinking on those topics previously discussed and raised with the Board during the plenary session, as well as to discuss initial views and recommendations on substantially all of the remaining proposed actions as outlined in the [project proposal](#).
6. The proposed changes presented in **Agenda Item D.1** cover certain key proposed actions discussed by the Task Force (see paragraphs 8–23). The proposed enhancements and clarifications in **Agenda Item D.1** include the decisions made, and consideration of the direction provided by, the IAASB through December 2022 as well as the preliminary outcomes of the February 2023 Task Force

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

² The topic of fraud in an audit of financial statements is not on the March 2023 IAASB agenda.

³ Proposed ISA 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

meeting discussions. The proposals, as reflected in **Agenda Item D.1**, are therefore subject to change as the Task Force continues to advance their discussions ahead of the June 2022 Board meeting.

7. Proposed actions designated by an asterisk are those topics that have **not** previously been discussed with the IAASB CAG.

*Professional Skepticism **

8. The Task Force discussed the overall approach to professional skepticism given the ongoing efforts of the IAASB to appropriately emphasize the importance of maintaining professional skepticism. The discussion was informed by:
 - The views of Representatives to encourage clarity around the auditor’s considerations in maintaining professional skepticism throughout the audit (when performing work relating to fraud in an audit of financial statements).
 - The perspectives of a Representative that the IAASB’s approach to professional skepticism should be reconsidered given the importance for the auditor to maintain professional skepticism throughout the audit, rather than emphasizing professional skepticism separately in each subject matter standard.
9. The Task Forces believes that it remains appropriate to highlight the importance of maintaining professional skepticism especially in the context of emphasizing the “fraud lens.” The Task Force is therefore proposing to retain the existing section on Professional Skepticism in ISA 240 with a focus on remaining alert for information about fraud, suspected fraud or alleged fraud.
10. In addition, the Task Force intends to address the proposed action in the project proposal by focusing on actions that emphasize a robust exercise of professional skepticism when performing procedures related to fraud. For example, the Task Force is proposing to take into account the principles in proposed ISA 500 (Revised)⁴ especially as it relates to:
 - Designing and performing audit procedures in a manner that is not biased towards obtaining audit evidence that may be corroborative, or towards excluding evidence that may be contradictory; and
 - Considering all audit evidence obtained, including audit evidence that is consistent or inconsistent with other audit evidence, and regardless of whether it appears to corroborate or contradict the assertions in the financial statements.

*Specific Fraud-Related Audit Procedures – Journal Entries **

11. In developing the proposals related to journal entries, the Task Force considered the direction from the IAASB in June 2022 to clarify the nature, timing and extent of testing journal entries and other adjustments as well as align the requirement to obtain audit evidence about the completeness of the population of journal entries and other adjustments to the relevant requirement in proposed ISA 500 (Revised).
12. The Task Force is of the view that obtaining audit evidence about the completeness of the population of all journal entries and other adjustments made in the preparation of the financial statement

⁴ Proposed ISA 500 (Revised), *Audit Evidence*

throughout the period is an attribute that is applicable in all instances when testing the appropriateness of journal entries.

13. In addition, the Task Force believes that the auditor should also determine the need to test journal entries and other adjustments throughout the period, rather than have this as a point of consideration by the auditor.

*Specific Fraud-Related Procedures – Audit Documentation **

14. The Task Force discussed enhancing the audit documentation requirements which included requiring specific aspects of the auditor’s work related to fraud to be included in the audit documentation. In developing their proposals, the Task Force built on the foundational standard ISA 230,⁵ as well as expanded on the requirements in ISA 315 (Revised 2019)⁶ and ISA 330.⁷

Identifying and Assessing RoMMs Due to Fraud (Discussed with the IAASB CAG in March 2022)

15. This topic was discussed more broadly by the Board at the March 2022 IAASB meeting and then specifically as it related to *Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework and the Entity’s System of Internal Control* at the June, September and December 2022 IAASB meetings. The Board supported the restructuring of the relevant sections in proposed ISA 240 (Revised) and agreed that the appropriate “fraud lens” was applied when referring to, or expanding on, what is already required in ISA 315 (Revised 2019) with minimal duplication noted.

*Specific Fraud-Related Procedures – Fraud or Suspected Fraud is Identified **

16. In December 2022, the IAASB discussed the overall approach when fraud or suspected fraud is identified. The Task Force also developed a flowchart and related scenarios intended to assist the Board in understanding the overall approach and direction taken by the Task Force when fraud or suspected fraud is identified. The Board supported the direction taken by the Task Force (see [Agenda Item 1](#) for the draft minutes of the December 2022 IAASB meeting).
17. In developing the proposals, the Task Force noted that for the purposes of proposed ISA 240 (Revised), the auditor is concerned with a material misstatement of the financial statement due to fraud. Therefore, irrespective of whether fraud or suspected fraud is identified, the auditor performs additional audit procedures to determine whether there is a material misstatement due to fraud.
18. The additional audit procedures include (among other required additional audit procedures when responding appropriately to fraud or suspected fraud identified during the audit):
 - If applicable, performing additional risk assessment procedures to revise the identification and assessment of the significant RoMMs due to fraud in accordance with ISA 315 (Revised 2019).
 - In an attempt to obtain further audit evidence, designing and implementing additional audit procedures to appropriately respond to the significant RoMMs due to fraud in accordance with ISA 330.

⁵ ISA 230, *Audit Documentation*

⁶ ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*

⁷ ISA 330, *The Auditor’s Responses to Assessed Risks*

19. Using the flowchart presented to the Board in December 2022, the Task Force further developed its drafting proposals with respect to:
- The required responses if the auditor identifies a misstatement due to fraud.
 - How to determine whether identified misstatements due to fraud are material when considering the nature of the circumstances (qualitative or quantitative) giving rise to the misstatements.
 - The required responses if the auditor determines that the financial statements are materially misstated.
 - Circumstances where the auditor is unable to obtain sufficient appropriate audit evidence as it relates to a material misstatement due to fraud.

Transparency in the Auditor's Report on Fraud (Discussed with the IAASB CAG in March and September 2022)

20. In September 2022, the Task Force presented to the IAASB the results of the targeted outreach with users of the financial statements regarding their perspectives on enhancing transparency in the auditor's report on fraud. Based on the results of that outreach, the views of the Board were sought as to a way forward. Based on the deliberations, the Board directed the Task Force to further explore a way forward on certain fraud-related matters that may be included in the auditor's report, such as including a filter or threshold similar to key audit matters (KAMs) so that only the most significant fraud risks would be communicated. In addition, the Board decided that the additional disclosures on fraud in the auditor's report should (see the approved [Minutes](#) of the September 2022 IAASB meeting):
- Be included in a separate section addressing fraud in order to provide clear signposting of fraud-related matters.
 - Apply only to audits of financial statements of listed entities.
21. Between the September and December 2022 IAASB meetings, the Task Force further advanced their thinking with respect to transparency in the auditor's report. Illustrative auditor's reports were drafted which included all the proposed changes to the auditor's reports resulting from the Fraud, Going Concern and Listed Entity and Public Interest Entity projects. Based on the illustrative auditor's reports, the Task Force was of the view that the communication of fraud-related KAMs would be best placed in the *Key Audit Matters* section of the auditor's report. In the related drafting, the Task Force also included a filter to communicate fraud-related KAMs and a requirement to communicate significant deficiencies in internal control that are relevant to the prevention and detection of fraud.
22. In December 2022, the Task Force discussed with the IAASB several key aspects of how to enhance transparency in the auditor's report on fraud. The Board provided direction on areas for the Task Force to consider and also decided to (see [Agenda Item 1](#) for the draft minutes of the December 2022 IAASB meeting):
- Use a filter for communicating about RoMMs due to fraud that is similar to the filter used to communicate KAMs.
 - Include the communication of fraud-related KAMs in the *Key Audit Matters* section of the auditor's report.

- Not require communications in the auditor’s report about identified significant deficiencies in internal control that are relevant to the prevention and detection of fraud.
23. In the February 2023 Task Force meeting, the Task Force discussed the comments from the Board and proposes to further align the requirements in proposed ISA 240 (Revised) to ISA 701.⁸

Way Forward

24. The Task Force will continue to discuss and refine the topics deliberated at its February 2023 Task Force meeting as well as address the remaining proposed action related to the use of technology. In doing so, the Task Force will consider the project proposal, and the IAASB CAG’s and the IAASB’s feedback.
25. The Task Force will also closely coordinate and liaise with the International Ethics Standards Board for Accountants (IESBA) on the proposed changes such that relevant provisions in the IESBA *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA Code) are holistically considered. For example, when the auditor has identified fraud or suspected fraud, or instances of an entity’s non-compliance with laws and regulations resulting from fraud. In addition, the Task Force will be coordinating and collaborating with other task forces, working and consultation groups in addressing the key issues identified.
26. In June and September 2023, the Task Force will bring to the Board a near full draft of proposed ISA 240 (Revised). Expected approval of the exposure draft is targeted for December 2023.

IAASB CAG Discussion in March 2023

27. For purposes of the IAASB CAG discussion, the Task Force prepared a presentation (**Agenda Item D.1**) highlighting the following topics:
- (a) Professional Skepticism;
 - (b) Specific Fraud-Related Procedures – Journal Entries;
 - (c) Specific Fraud-Related Procedures – Audit Documentation;
 - (d) Identifying and Assessing RoMMs Due to Fraud;
 - (e) Specific Fraud-Related Procedures – Fraud or Suspected Fraud Is Identified; and
 - (f) Transparency in the Auditor’s Report on Fraud.
28. The presentation includes further details on each of the topics to provide the necessary context and allow for a more informed discussion given that certain of these topics have not previously been included in agenda materials provided to the Board.
29. In preparation for the IAASB CAG discussion on fraud, Representatives are encouraged to read:
- The proposed changes presented in **Agenda Item D.1**; and
 - **Sections I and II of Agenda Item D.2.**

⁸ ISA 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*

Matters for IAASB CAG Consideration

1. Representatives are asked for their views on the proposed enhancements or clarifications presented in **Agenda Item D.1** for the following proposed actions:
 - (a) Professional Skepticism.
 - (b) Specific Fraud-Related Procedures – Journal Entries.
 - (c) Specific Fraud-Related Procedures – Audit Documentation.
 - (d) Identifying and Assessing RoMMs Due to Fraud.
2. Representatives are asked for their views on the way forward as set out in **Sections I and II of Agenda Item D.2** and the proposed enhancements or clarifications presented in **Agenda Item D.1** for the following proposed actions:
 - (a) Specific Fraud-Related Procedures – Fraud or Suspected Fraud Is Identified.
 - (b) Transparency in the Auditor’s Report on Fraud.
3. Representatives are asked whether there are any other matters the Task Force should consider as it considers the enhancements to proposed ISA 240 (Revised).

Report Back

30. Extracts from the draft September 2022 IAASB CAG meeting minutes, as well as an indication of how the Task Force or the IAASB has responded to the Representatives’ comments, are included below.

| Representatives’ Comments | Task Force / IAASB Response |
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| TRANSPARENCY IN REPORTING ON FRAUD | |
| Mses. Blomme and McGeachy and Mr. Stokhof noted that the responsibilities of management, those charged with governance and the auditor should be holistically addressed by the IAASB’s projects on Fraud and Going Concern. | Point noted. Mrs. Provost noted that the Fraud and Going Concern Task Forces will need to discuss how to address concerns raised that impacted both standard-setting projects. |
| Ms. Blomme noted that not aligning the disclosure requirements for management and the auditor may place the auditor in a difficult position, especially with respect to reporting identified significant deficiencies in internal control that are relevant to the prevention and detection of fraud. Ms. Blomme also noted that in the Netherlands auditors are required to describe the identified and assessed fraud risks, and the auditor’s response to the assessed fraud risks, and that this was difficult to implement as management doesn’t have the same | Point accepted. At the December 2022 meeting, the IAASB agreed not to include a requirement in proposed ISA 240 (Revised) to communicate in the auditor’s report identified significant deficiencies in internal control that are relevant to the prevention and detection of fraud as: <ul style="list-style-type: none"> • An audit of financial statements does not have as an objective and is not designed to identify significant deficiencies in internal |

| Representatives' Comments | Task Force / IAASB Response |
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| <p>responsibilities. In this regard, Ms. McGeachy observed that the role of the auditor seemed to be elevated while management's responsibilities are not.</p> | <p>control such as to conclude and report on the operating effectiveness of internal controls.</p> <ul style="list-style-type: none"> Depending on whether the auditor adopts a substantive or controls-based approach, the auditor may get different outcomes as deficiencies in internal control may be identified not only during the risk assessment process, but also during other stages of the audit. <p>The IAASB directed the Task Force to explore other options to provide more transparency over identified significant deficiencies in internal control that are relevant to the prevention and detection of fraud.</p> |
| <p>Mr. Sobel questioned whether the option on reporting identified significant deficiencies in internal control that are relevant to the prevention and detection of fraud is mutually exclusive from the other options presented to users of the financial statements.</p> | <p>Point noted.</p> <p>Mrs. Provost explained that this option is not mutually exclusive from the other options and that many users of the financial statements preferred this option together with one of the other options presented. She furthermore noted that users of the financial statements were of the view that the auditor could report on identified significant deficiencies in internal control that are relevant to the prevention and detection of fraud even if management is not required to do so.</p> <p>See above Task Force / IAASB response on communicating in the auditor's report identified significant deficiencies in internal control that are relevant to the prevention and detection of fraud.</p> |
| <p>Ms. McGeachy and Mr. Yoshi noted their preference for emphasizing the use of the existing requirements for the communication of KAMs for listed entities where there is a fraud risk. Mr. Yoshi added that the IAASB must respect the views of users of the financial statements.</p> | <p>Point noted.</p> <p>At the December 2022 meeting, the IAASB agreed with the Task Force's proposal to include the communication of fraud-related KAMs in the <i>Key Audit Matters</i> section of the auditor's report.</p> <p>The IAASB directed the Task Force to clarify how the auditor should communicate a matter that is determined to be both a KAM (as determined by ISA 701) and a fraud-related KAM (as determined by proposed ISA 240 (Revised)).</p> |

| Representatives' Comments | Task Force / IAASB Response |
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| <p>Given the importance of this topic, Dr. Cela noted his preference for describing the identified and assessed fraud risks, the auditor's response to the assessed fraud risks, and the auditor's findings/observations when responding to the assessed fraud risks.</p> | <p>Point noted.</p> <p>The Task Force notes that proposed ISA 240 (Revised) requires that the description of each KAM includes a reference to the related disclosure(s), if any, in the financial statements and address:</p> <ul style="list-style-type: none"> • Why the RoMM due to fraud was considered to be of most significance and therefore determined to be a KAM; and • How the RoMM due to fraud was addressed in the audit. <p>The Task Force also notes that the auditor is allowed to include findings / observations in the auditor's report as allowed by ISA 701.</p> <p>ISA 701, paragraph A46 states that "the auditor may describe:</p> <ul style="list-style-type: none"> • ... • An indication of the outcome of the auditor's procedures; or • Key observations with respect to the matter." <p>ISA 701, paragraph A51 states that "the auditor may also provide an indication of the outcome of the auditor's response in the description of the KAM in the auditor's report."</p> |
| <p>Mr. Dalkin supported the Task Force's proposal for the auditor to report identified significant deficiencies in internal control that are relevant to the prevention and detection of fraud but questioned how the auditor will determine whether a significant deficiency in internal control relates to fraud or error.</p> | <p>Point noted.</p> <p>Mrs. Provost explained that the Task Force will need to make this clear when developing proposed ISA 240 (Revised).</p> <p>See above Task Force / IAASB response on communicating in the auditor's report identified significant deficiencies in internal control that are relevant to the prevention and detection of fraud.</p> |
| <p>Ms. McGeachy questioned whether changes to local laws and regulations are needed given that the auditor may be disclosing confidential information.</p> | <p>Point noted.</p> <p>Mrs. Provost explained that the auditor may not be allowed to report certain matters if laws and regulations prohibit such disclosures. She</p> |

| Representatives' Comments | Task Force / IAASB Response |
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| | <p>furthermore noted that the Task Force had decided, as part of their initial recommendations to the Board, not to require the auditor to report findings or observations.</p> <p>The Task Force notes that paragraph 14 of ISA 701 already includes a requirement that addresses circumstances in which a matter determined to be a KAM is not communicated in the auditor's report. Hence, the Task Force was of the view that no further changes were needed in proposed ISA 240 (Revised) in this regard.</p> <p>In accordance with ISA 701, an auditor is required to describe each KAM in the auditor's report unless:</p> <ul style="list-style-type: none"> • Law or regulation precludes public disclosure about the RoMMs due to fraud; or • In extremely rare circumstances, the auditor determines that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication. This shall not apply if the entity has publicly disclosed information about the matter. |
| <p>Ms. McGeachy questioned whether the Task Force considered requiring the enhanced reporting requirements for non-for-profit audits.</p> | <p>Point noted.</p> <p>Mrs. Provost explained that the Task Force had mixed views on whether the enhanced reporting requirements should be applied to listed entities only or all entities and that the Task Force is open to the views of the Representatives.</p> <p>The Task Force notes that the proposed changes to communicate KAMs related to fraud risks in proposed ISA 240 (Revised) expand on the requirements to communicate KAMs in the auditor's report in accordance with ISA 701. Therefore, the applicability of the relevant proposed changes to ISA 240 for communicating KAMs related to fraud risks is subject to the scope of ISA 701.</p> |

| Representatives' Comments | Task Force / IAASB Response |
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| | <p>ISA 701 applies:</p> <ul style="list-style-type: none"> • To audits of listed entities; • To circumstances when the auditor otherwise decides to communicate KAMs in the auditor's report; or • When the auditor is required by law or regulation to communicate KAMs in the auditor's report. |
| <p>Ms. Blomme questioned whether the Task Force's proposal to enhance transparency in the auditor's report on fraud (by reporting the identified and assessed fraud risks) should only be for significant fraud risks as the Task Force also proposes the auditor to report significant deficiencies in internal control.</p> | <p>Point noted.</p> <p>Mrs. Provost explained that fraud risks are by definition significant risks.</p> |
| <p>Ms. Vanich noted that users of the financial statements are looking for entity specific fraud risks but that auditors often identify similar types of fraud risks such as fraud risks related to revenue recognition and the misappropriation of assets. She also noted that the misappropriation of assets is rarely determined to be a KAM.</p> | <p>Point noted.</p> <p>Mrs. Provost noted that the Task Force reviewed fraud disclosures in auditor's reports in the United Kingdom and the Netherlands and that there is a wide variety in how auditors report on fraud.</p> <p>At the December 2022 meeting, the IAASB directed the Task Force to draft requirements and application material in proposed ISA 240 (Revised) in such a manner that:</p> <ul style="list-style-type: none"> • Drive auditors to include entity-specific information. • Encourage auditors to include fraud-related KAMs other than revenue recognition and management override of controls. |
| <p>Ms. Vanich asked the Task Force to consider how the auditor will report on significant deficiencies in internal control that are relevant to the prevention and detection of fraud when the auditor applies a substantive approach.</p> | <p>Point noted.</p> <p>See above Task Force / IAASB response on communicating in the auditor's report identified significant deficiencies in internal control that are relevant to the prevention and detection of fraud.</p> |
| <p>Mr. Yurdakul noted that the identification of fraud has a huge impact on financial markets and</p> | <p>Point noted.</p> <p>Mrs. Provost thanked the Representatives for the</p> |

| Representatives' Comments | Task Force / IAASB Response |
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| <p>investors. Therefore, preparers would not like the auditor reporting on fraud in the auditor's report which may create tensions between the auditor and management. He suggested that the Task Force take this into account when determining a way forward on this topic.</p> | <p>views expressed on the way forward and noted that the IAASB will need to balance the views of its various stakeholders in finding a way forward.</p> <p>See above Task Force / IAASB response for circumstances in which a matter determined to be a KAM is not communicated in the auditor's report.</p> |
| <p>INTRODUCTION</p> | |
| <p>Mr. Ishiwata noted that the auditor needs to apply judgment when assessing whether fraud is material or not, and that the auditor should take into account qualitative factors when making this determination. He encouraged the Task Force to develop appropriate audit procedures for non-material fraud and include those procedures in proposed ISA 240 (Revised).</p> | <p>Point noted.</p> <p>The Task Force notes that the Introduction section of proposed ISA 240 (Revised) and its related application material provides guidance that the auditor's determination of whether a fraud is material or not is a matter that involves the exercise of professional judgment. Judgments about whether fraud could cause a material misstatement involve consideration of the nature of the circumstances giving rise to the fraud and the identified misstatements. Judgments about materiality involve both qualitative and quantitative considerations.</p> |
| <p>Mr. Hansen questioned whether the assessment of the materiality of fraud is based on quantitative or qualitative characteristics. Mr. Dalkin noted that in a large organization quantitative materiality may be very high and that frauds that are below the quantitative materiality level may have a very big impact.</p> | <p>Point noted.</p> <p>Mrs. Provost explained that materiality is based on quantitative and qualitative factors.</p> <p>See above Task Force / IAASB response on the nature of the circumstances giving rise to the fraud and the identified misstatements.</p> |

Material Presented – IAASB CAG Paper

Agenda Item D.1 Presentation

Material Presented – IAASB CAG Reference Paper

Agenda Item D.2 IAASB Issues Paper December 2022

Project Details and History

Project: Fraud

Link to IAASB Project Page: [Fraud Project Page](#)

Task Force Members

- Julie Corden, IAASB Member and Task Force Chair
- William Edge, IAASB Member
- Josephine Jackson, IAASB Vice-Chair
- Sachiko Kai, IAASB Member
- Diane Larsen, IAASB Member

Summary

| | IAASB CAG Meeting | IAASB Meeting |
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| Information Gathering | September 2020 March 2021 September 2021 | August 2020 December 2020 April 2021 June 2021 July 2021 |
| Project Proposal | November 2021 | December 2021 |
| Development of Exposure Draft | March 2022 September 2022 | March 2022 June 2022 September 2022 December 2022 |

IAASB CAG Discussions: Detailed References

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| Information gathering | <p><u>September 2020</u> See IAASB CAG meeting material (Agenda Item F).</p> <p><u>March 2021</u> See IAASB CAG meeting material (Agenda Item C).</p> <p><u>September 2021</u></p> |
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Fraud in an Audit of Financial Statements – Cover and Report Back
IAASB CAG Public Session (March 2023)

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| | See IAASB CAG meeting material (Agenda Item I). |
| Project Proposal | <u>November 2021</u> See IAASB CAG meeting material (Agenda Item A). |
| Development of Exposure Draft | <u>March 2022</u> See IAASB CAG meeting material (Agenda Item H). <u>September 2022</u> See IAASB CAG meeting material (Agenda Item G). |