

Agenda Item D.2

For Reference

Please note: This is the IAASB Fraud Issues Paper that was discussed by the Board at the December 2022 IAASB quarterly meeting (Agenda Item 5). This paper is provided to the IAASB CAG Representatives in March 2023 for reference purposes.

During the IAASB CAG discussion Representatives will be asked for their views on the way forward as set out in Sections I and II of this paper.

Fraud in an Audit of Financial Statements – Issues Paper

Objective

The objective of the IAASB discussion is to obtain the Board's input on the Fraud Task Force's (the Task Force) views, recommendations and drafting for two topics:

- Fraud and suspected fraud; and
- Transparency in the auditor's report;

as well as the updated drafting following the Board's deliberations in June and September 2022.

Board Discussion

Issues Paper

This paper describes overarching issues addressed by the Task Force and for discussion with the IAASB at its December 2022 meeting as it relates to proposed revisions to ISA 240.¹

Appendices to this Paper

The following appendices are included in this paper:

- **Appendix 1:** Fraud Task Force Members and Update on Activities Since the September 2022 IAASB Meeting.
- **Appendix 2:** Illustrative Auditor's Reports – For Discussion Purposes Only.
- **Appendix 3:** Approach for the Discussion on the Updated Drafting.

Other Agenda Items

The Task Force also presents:

- **Agenda Item 5-A:** Explanation of Significant Changes to the proposed drafting.
- **Agenda Item 5-B:** Proposed ISA 240 (Revised) – Marked.
- **Agenda Item 5-C:** Proposed ISA 240 (Revised) – Clean.

Approach to the Board Discussion

The Task Force Chair will go through the questions in the order they are set out in this Agenda Item and referencing **Agenda Item 5-B** where applicable (see also **Appendix 3**).

Introduction

1. At the September 2022 IAASB meeting, the Board discussed and was supportive of the Task Force’s drafting for the sections in proposed ISA 240 (Revised)² that refer to, or expand on, ISA 315 (Revised 2019)³ The Board also discussed the Task Force’s proposals on transparency in the auditor’s report and provided feedback on the way forward.
2. The approved June 2022 IAASB meeting minutes are available [here](#), and the draft September 2022 IAASB meeting minutes are available in [Agenda Item 1-A](#) of the December 2022 IAASB meeting.
3. This agenda item sets out the Task Force’s views and recommendations for the following topics:
 - (a) Fraud and suspected fraud (see **Section I**)
 - (b) Transparency in the auditor’s report on fraud (see **Section II**)
 - (c) Updated drafting (see **Section III**)

Section I: Fraud and Suspected Fraud

Fraud Project Proposal – Key Issue

Relevant paragraphs in Agenda Item 5-B	4C–4CA, A5Aa, A28J–A28K, A33A–A33B
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Fraud Project Proposal – Key Issue and Proposed Action

4. The [project proposal](#) includes an action to address a key issue related to when fraud is identified or suspected (see paragraph 19(f)(v) for the key issue and paragraph 25B #17 for the proposed action).

Background

5. In determining a way forward, the Task Force took into account the feedback from the Discussion Paper⁴ that noted “requiring specific audit procedures to be performed when fraud or suspected fraud is identified may be too procedural. Because the ISAs are intended to be principles-based, and the nature and circumstances of each fraud would differ, introducing such specific procedures may not achieve the intended outcome and may also result in procedures being required that have no value in the circumstances.”⁵
6. However, the Task Force is also aware that stakeholders requested clearer direction in ISA 240 on how to respond appropriately to fraud or suspected fraud identified during the audit, and this was further reinforced in feedback received in June 2022 from certain Board members to clarify the distinction between fraud and suspected fraud and the risks of material misstatement (ROMMs) due to fraud.

¹ ISA 240, *The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements*

² Proposed ISA 240 (Revised), *The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements*

³ ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*

⁴ 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](#)

⁵ July 2021, Agenda Item 2 - [Fraud Issues Paper](#)

Task Force's Views and Recommendations

7. Paragraph 1A of Agenda Item 5-B states that “the auditor ... is responsible for planning and performing the audit to obtain reasonable assurance that the financial statements taken as a whole are free from material misstatement due to fraud”.
8. The reference to fraud is as defined in extant paragraph 12 of ISA 240:

Fraud – An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.
9. In developing its initial views in responding to the proposed action and the call for more clarity about fraud and suspected fraud, the Task Force discussed circumstances when fraud or suspected fraud is identified. In particular, fraud or suspected fraud may have been identified when performing:
 - (a) Risk assessment procedures in accordance with ISA 240 and ISA 315 (Revised 2019); or
 - (b) Further audit procedures in accordance with ISA 240 or the other ISAs.
10. The Task Force recognizes that fraud or suspected fraud may also be identified when performing other audit procedures that are performed to comply with the ISAs. However, in most circumstances the Task Force have assumed that the auditor will identify fraud or suspected fraud when performing risk assessment and further audit procedures.
11. When fraud or suspected fraud has been identified, the Task Force believes that in all instances certain additional audit procedures should be performed (see paragraph 16). Such additional audit procedures also take into account the iterative nature of the auditor's approach. For example, if during the performance of further audit procedures, the auditor identifies fraud or suspects fraud, the auditor may need to revise the risk assessment in accordance with ISA 315 (Revised 2019).
12. The Task Force developed a flowchart and related scenarios to assist the Task Force in developing initial drafting (depicted in the blue shaded boxes) that is intended to guide the auditor in responding appropriately when fraud or suspected fraud is identified.
13. **Flowchart** – Depicts what audit procedures the auditor may perform when identifying and assessing ROMMs due to fraud, and responding to the assessed risks, including when fraud or suspected fraud has been identified. In addition, the flowchart illustrates possible outcomes based on the audit evidence obtained. The flowchart also highlights the following 6 scenarios when fraud or suspected fraud is identified:

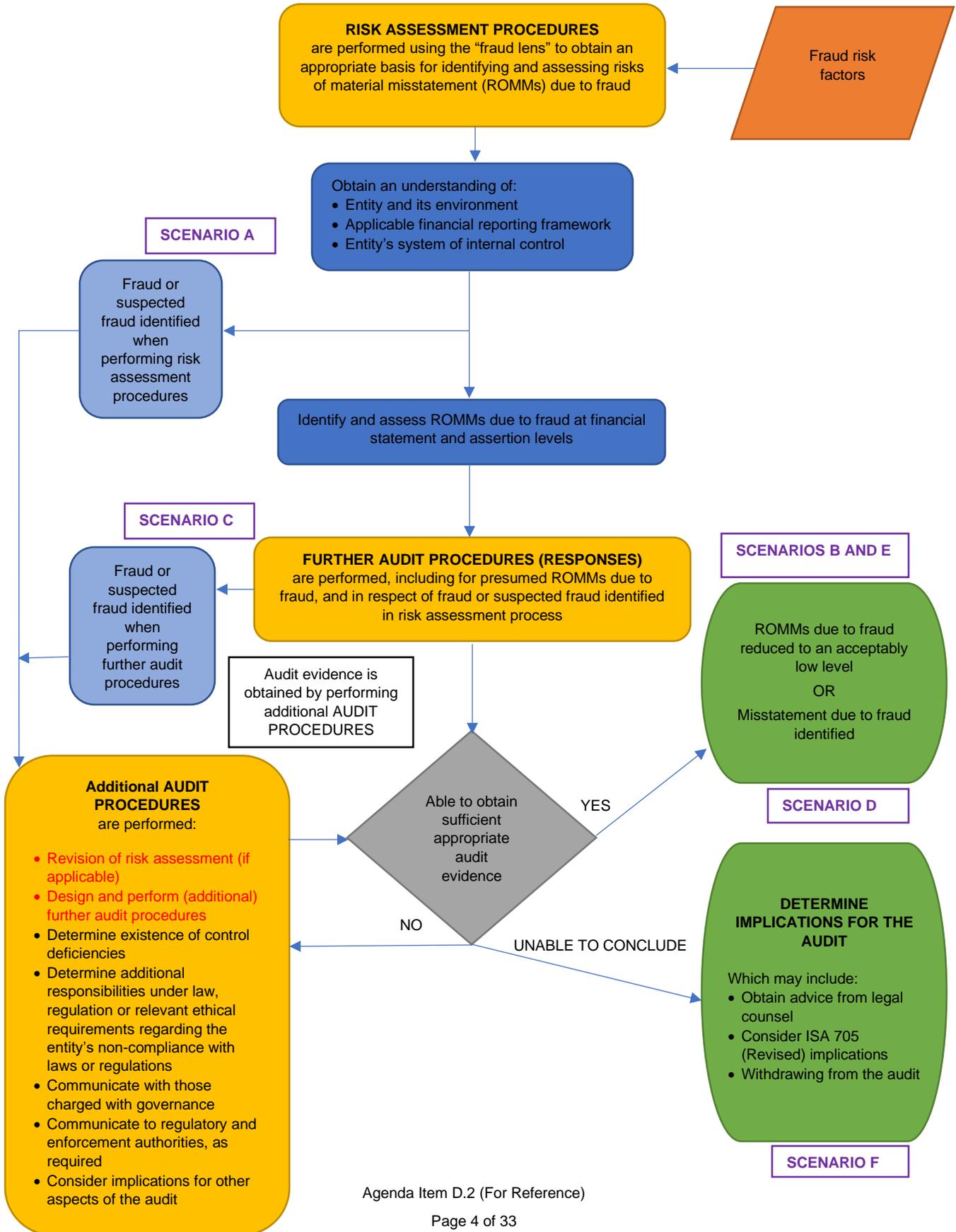
Risk assessment procedures

- Scenario A: *Fraud or Suspected Fraud is Identified*

Further audit procedures

- Scenario B: *Risks of Material Misstatement Due to Fraud Reduced to an Acceptably Low Level*
- Scenario C: *Fraud or Suspected Fraud Identified*
- Scenario D: *Fraud or Suspected Fraud Identified; Misstatement Due to Fraud Identified*
- Scenario E: *Fraud or Suspected Fraud Identified; Risks of Material Misstatement Due to Fraud Reduced to an Acceptably Low Level*
- Scenario F: *Fraud or Suspected Fraud Identified; Unable to Conclude*

Fraud and Suspected Fraud Flowchart



14. **Scenario - Risk assessment procedures** (see paragraphs A28J, A28K (extract below) and paragraph 16)

Extract from Agenda Item 5-B

A28J. ... Depending on the nature and circumstances, the auditor may determine that the audit evidence obtained from the risk assessment procedures no longer provides an appropriate basis for the identification and assessment of the risks of material misstatement due to fraud. In such circumstances, in accordance with ISA 315 (Revised 2019), the auditor is required to perform additional risk assessment procedures until audit evidence has been obtained to obtain such a basis.

A28K. Where fraud or suspected fraud has been identified when performing risk assessment procedures, the auditor is required to perform additional audit procedures in accordance with paragraph 34A. **(Scenario A)**

Scenario A *Fraud or Suspected Fraud is Identified*

Risk assessment procedures. The auditor performs risk assessment procedures to obtain audit evidence that provides an appropriate basis for the identification and assessment of ROMMs due to fraud. While performing the risk assessment procedures, the auditor also obtains audit evidence of suspected fraud (e.g., inquiries of management during risk assessment indicate that fraud may have occurred). The ROMMs due to fraud identified and assessed by the auditor take into account all the audit evidence obtained from the risk assessment procedures, including the evidence of the suspected fraud.

In such circumstances, the auditor designs and performs further audit procedures in response to the assessed ROMMs due to fraud. The auditor also performs additional audit procedures that the auditor is required to perform in all instances where fraud or suspected fraud is identified (see paragraph 16).

15. **Scenarios - Further audit procedures** (see paragraphs A33A (extract below) and paragraphs 16–17)

Extract from Agenda Item 5-B

A33A. Based on the audit procedures performed in response to the assessed risks of material misstatement due to fraud at the financial statement and assertion levels, the auditor may:

- (a) Obtain audit evidence that
 - (i) Reduces the risks of material misstatement due to fraud to an acceptably low level; **(Scenario B) (Scenario E)** (i.e., no misstatements due to fraud are identified)
 - (ii) Indicates the existence of fraud or suspected fraud; or **(Scenario C)**
 - (iii) A misstatement due to fraud has been identified. **(Scenario D)**
- (b) Be unable to obtain sufficient appropriate audit evidence to conclude **(Scenario F)**

- (i) The risks of material misstatement due to fraud have been reduced to an acceptably low level; or
- (ii) There is a misstatement due to fraud that may cause the financial statements to be materially misstated.

Scenario B – Risks of Material Misstatement Due to Fraud Reduced to an Acceptably Low Level

Risk assessment procedures. The auditor performs risk assessment procedures to obtain audit evidence that provides an appropriate basis for the identification and assessment of ROMMs due to fraud. The auditor identifies and assesses a ROMM due to fraud. The auditor does not identify fraud or suspected fraud. For example, inquiries of management during risk assessment do not indicate fraud or suspected fraud.

Further audit procedures. The auditor designs and performs further audit procedures to respond to the ROMM due to fraud. Fraud or suspected fraud is not identified. The auditor determines that based on the audit evidence obtained the ROMM due to fraud has been reduced to an acceptably low level. No further audit work is performed.

Scenario C – Fraud or Suspected Fraud Identified

Risk assessment procedures. The auditor performs risk assessment procedures to obtain audit evidence that provides an appropriate basis for the identification and assessment of ROMMs due to fraud. The auditor identifies and assesses a ROMM due to fraud. The auditor does not identify fraud or suspected fraud. For example, inquiries of management during risk assessment do not indicate fraud or suspected fraud.

Further audit procedures. The auditor designs and performs further audit procedures to respond to the ROMM due to fraud. During this process, the auditor identifies the existence of fraud or suspects fraud. For example, the auditor notes unusual activity when testing purchase orders that may indicate that a misstatement due to fraud may have occurred.

Additional audit procedures. The auditor performs the required additional audit procedures i.e., these procedures are performed in all instances where fraud or suspected fraud is identified by the auditor (see paragraph 16). This includes seeking to obtain audit evidence as to whether the fraud or suspected fraud identified has a financial statement impact, and in certain circumstances, revising the risk assessment as to whether the ROMM due to fraud remains appropriate in accordance with ISA 315 (Revised 2019).

Scenario D – Fraud or Suspected Fraud Identified; Misstatement Due to Fraud Identified

Risk assessment procedures. The auditor performs risk assessment procedures to obtain audit evidence that provides an appropriate basis for the identification and assessment of ROMMs due to fraud. The auditor identifies and assesses a ROMM due to fraud. The auditor does not identify fraud or suspected fraud. For example, inquiries of management during risk assessment do not indicate fraud or suspected fraud.

Further audit procedures. The auditor performs the further audit procedures and additional audit procedures in [Scenario C](#).

The auditor determines to revise the ROMM due to fraud and designs and performs further audit procedures to respond to the **revised** ROMM due fraud.

As a result of the additional work performed, the auditor identifies that there is a misstatement due to fraud. For example, the auditor determines that the unusual activity in the purchase order system was a deficiency in internal controls and goods purchased were never received the entity (the purchase ledger clerk was creating phantom (or related) suppliers and paying them, thereby creating false stock records). The auditor concludes that purchases and inventory was misstated.

The auditor then performs procedures to determine if the misstatement is material (when considering the nature of the fraud i.e., looking at quantitative or qualitative characteristics) in accordance with ISA 450⁶ and paragraphs 34E-34H of Agenda Item 5-B.

Additional audit procedures. It may be necessary for the auditor to perform certain of the required additional audit procedures again (see paragraph 16).

Scenario E – Fraud or Suspected Fraud Identified; Risks of Material Misstatement Due to Fraud Reduced to an Acceptably Low Level

Risk assessment procedures. The auditor performs risk assessment procedures to obtain audit evidence that provides an appropriate basis for the identification and assessment of ROMMs due to fraud. The auditor identifies and assesses a ROMM due to fraud. The auditor does not identify fraud or suspected fraud. For example, inquiries of management during risk assessment do not indicate fraud or suspected fraud.

Further audit procedures. The auditor performs the further audit procedures and additional audit procedures in **Scenario C**.

The auditor determines to revise the ROMM due to fraud and designs and performs further audit procedures to respond to the **revised** ROMM due fraud.

As a result of the additional work performed, the auditor determines based on the audit evidence obtained that the ROMM due to fraud has been reduced to an acceptably low level. For example, the auditor determines that the unusual activity in the purchase order system was due to two recent acquisitions made by the entity.

No further work is performed.

Scenario F – Fraud or Suspected Fraud Identified; Unable to Conclude

Risk assessment procedures. The auditor performs risk assessment procedures to obtain audit evidence that provides an appropriate basis for the identification and assessment of ROMMs due to fraud. The auditor identifies and assesses a ROMM due to fraud. The auditor does not identify fraud or suspected fraud. For example, inquiries of management during risk assessment do not indicate fraud or suspected fraud.

Further audit procedures. The auditor performs the further audit procedures and additional audit procedures in **Scenario C**.

The auditor determines to revise the ROMM due to fraud and designs and performs further audit procedures to respond to the **revised** ROMM due fraud.

⁶ ISA 450, *Evaluation of Misstatements Identified During the Audit*

As a result of the additional work performed, the auditor is unable to conclude based on the audit evidence obtained whether there is a misstatement due to fraud due to the nature and circumstances of the matter identified. For example, the auditor’s analysis of accounts receivable shows an amount of past due accounts receivable for related parties, for which there is no allowance for bad or doubtful debts, management is dismissive and believes uncollectible accounts are not impaired.

However, the audit evidence does lead the auditor to continue to believe, based on professional judgment, that the accounts receivable balance is likely to be misstated due to fraud, while not being able to obtain sufficient appropriate audit evidence for auditor to determine that the account balance is in fact misstated. The auditor determines the implications for the audit engagement as a whole, including the fact that there is a limitation on the scope of the audit evidence needed to provide an opinion on the financial statements (see paragraph 17).

Additional audit procedures. It may be necessary for the auditor to perform certain of the required additional audit procedures again (see paragraph 16).

16. Based on initial deliberations, including consideration of the scenarios, the requirements in extant ISA 240 and in ISA 250 (Revised),⁷ the Task Force believes that the auditor should perform the additional audit procedures (“steps”) outlined below whenever fraud or suspected fraud is identified. These additional audit procedures will be included in a separate section designated to address *Fraud or Suspected Fraud Identified by the Auditor* in proposed ISA 240 (Revised) in response to the action outlined in the project proposal. The steps are as follows:
 - (a) If applicable, evaluate whether the assessments of the ROMMs due to fraud remain appropriate.
 - (b) Design and perform further audit procedures to obtain additional audit evidence as it relates to the fraud or suspected fraud that has been identified. (When performing further audit procedures, the auditor is obtaining an understanding of the nature of the fraud or suspected fraud.)
 - (c) Determine whether control deficiencies exist related to the prevention or detection of fraud within the entity’s system of internal control.
 - (d) Determine what additional responsibilities the auditor may have under law, regulation or relevant ethical requirements regarding the entity’s non-compliance with laws and regulations, including the responsibility of the auditor to consider laws and regulations in an audit of financial statements in accordance with ISA 250 (Revised).
 - (e) Communicate with those charged with governance about the fraud or suspected fraud (see extant paragraphs 41, 42, 43 of ISA 240).
 - (f) Communicate to regulatory and enforcement authorities, as required (see extant paragraph 44 of ISA 240)
 - (g) Consider the implications for other aspects of the audit e.g., the integrity of management, reliability of management representations.

17. The Task Force believes that when the auditor determines the implications for the audit engagement as a whole, this may include one or more of the following actions:

⁷ ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*

- (a) Obtaining advice from legal counsel;
- (b) Considering the implications for the auditor’s report in accordance with ISA 705 (Revised);⁸ or
- (c) Withdrawing from the audit, when withdrawal is possible under applicable law or regulation.

Ongoing Deliberations

18. The Task Force is continuing its deliberations on the proposed action but is seeking directional input from the Board before progressing with developing new requirements, relocating existing requirements or elevating existing application material.

Matters for IAASB Consideration	
1.	The Board is asked for its views on the scenarios, including whether there are other circumstances the Task Force should consider when enhancing the requirements and application material to address the auditor’s response to fraud or suspected fraud identified by the auditor. See paragraphs 14 and 15.
2.	The Board is asked for its views on the proposed additional audit procedures (“steps”) that the auditor will be required to perform in all instances when fraud or suspected fraud is identified by the auditor. The Task Force is also interested if the Board believes other audit procedures should be performed. See paragraph 16.
3.	The Board is requested to provide feedback on the possible actions the auditor may consider when determining the implications for the audit engagement as a whole, including whether the auditor should be considering other actions. See paragraph 17.

Section II: Transparency in the Auditor’s Report on Fraud

Relevant paragraphs in Agenda Item 5-B	39A–39F, A58A–A58G
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Fraud Project Proposal – Key Issue and Proposed Action

19. The [project proposal](#) includes an action to address a key issue related to transparency in the auditor’s report (see paragraph 19(h)(ii) for the key issue and paragraph 25D #27 for the proposed action).

Background

20. In September 2022 the Task Force presented the results of its targeted outreach with users of the financial statements to the Board. The Task Force also proposed a way forward which was based on what was heard from the targeted outreach on the following:

“Based on consistent feedback received, the Task Force proposes to enhance transparency in the auditor’s report on fraud by including a separate section that encompasses a description of:

- (a) *The auditor’s responsibilities as it relates to fraud in the audit of the financial statements;*
- (b) *The identified and assessed fraud risks and the auditor’s response to the assessed risks; and*

⁸ ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor’s Report*

(c) *Identified significant deficiencies in internal control that are relevant to the prevention and detection of fraud in the financial statements.”*

21. Overall, the Board agreed that the auditor’s report should seek to appropriately enhance the description of the auditor’s responsibilities as it relates to fraud in the audit of the financial statements. The Board furthermore asked the Task Force to further explore a way forward on the following matters that may be included in the auditor’s report:

- Identified and assessed ROMMs due to fraud and the auditor’s response. The Board suggested exploring a reporting mechanism similar to what is used to communicate key audit matters. The Board also suggested to include a filter or a threshold, similar to key audit matters, and that the requirements be drafted in such a manner so as to encourage disclosures that are not boilerplate.
- Identified significant deficiencies in internal control that are relevant to the prevention and detection of fraud in the financial statements. In exploring a way forward, the Board asked the Task Force to balance the views of users of the financial statements, interviewed as part of the targeted outreach, who were proponents of disclosing the aforementioned information in the financial statements, with the concerns raised by the Board. The concerns raised included the following:
 - The audit of financial statements does not have as an objective and the auditor is not required to express an opinion on a company’s internal controls over financial reporting.
 - Depending on whether the auditor adopts a substantive or controls-based approach the auditor may get different outcomes as deficiencies in internal control.
 - There is a risk that the auditor may provide original information in the auditor’s report about significant deficiencies in internal control.
 - The proposal gives undue emphasis on the fraud aspect of ‘risks of material misstatement due to error or fraud’ as they do not extend to significant deficiencies in internal control that may result in a misstatement in the financial statements due to error.
- The Board suggested to holistically consider the changes proposed to the auditor’s report to evaluate the overall continued coherence of the report, noting that other projects, such as the projects on Going Concern and Listed Entity and Public Interest Entity (PIE), are also proposing changes to the auditor’s report.

22. For more details see the draft minutes of the September 2022 IAASB Meeting (**Agenda Item 1-B**).

Task Force’s Views and Recommendations

Mechanism to Filter the Identified Fraud Risks

23. The Task Force agreed with the Board that it would be useful to include a filter or a threshold, so that only the most significant ROMMs due to fraud (fraud risks) identified by the auditor would be communicated. In addition, the Task Force noted that not having a filter may create an imbalance between the number of fraud risks communicated and other matters.
24. In considering an appropriate filter, the Task Force noted that such mechanism already exists for key audit matters. This involves filtering matters that required significant auditor attention in performing the audit by determining which were of most significance and therefore are to be communicated in

the auditor’s report. The Task Force noted that a filtering mechanism similar to that for key audit matters would help the auditor in determining when and what to report about identified fraud risks and the auditor’s response.

25. Also, the Task Force was of the view that key audit matters, when applied appropriately, provide users of the financial statements with entity specific information (also see results of the [Auditor Reporting Post-Implementation Review](#)).

Communication in the Auditor’s Report

26. Based on comments from the Board regarding a holistic consideration of changes being proposed to the auditor’s report, the Task Force included all the proposed changes resulting thus far from the IAASB’s projects on Fraud, Going Concern and PIE in an illustrative auditor’s report.

27. **Appendix 2** presents two alternative formats which assisted the Task Force in its deliberations about the placement of the auditor’s communication about identified fraud risks and the auditor’s response in the auditor’s report (of a listed entity). The following illustrations are included to solicit the Board’s input as to such placement:

- Proposed Illustration 1: Separate section “Identified Fraud Risks and the Auditor’s Response” following the Going Concern or the Material Uncertainty Related to Going Concern sections, as applicable, in the auditor’s report.
- Proposed Illustration 2: Identified fraud risks (and the auditor’s response) clearly signposted under the heading “Key Audit Matters, including Fraud Risks” in the auditor’s report.

28. The illustrations reflect the proposed impact of the proposals of the Fraud, Going Concern and PIE projects currently being deliberated by the IAASB that address the auditor’s report. The illustrations were developed using the following sources:

- ISA 700 (Revised),⁹ Appendix: Illustration 1: An auditor’s report on financial statements of a listed entity prepared in accordance with a fair presentation framework;
- Exposure Draft issued in July 2022 – Proposed Narrow Scope Amendments to:
 - ISA 700 (Revised); and
 - ISA 260 (Revised),¹⁰

as a result of the revisions to the International Ethics Standards Board for Accountants’ International Code of Ethics for Professional Accountants (including International Independence Standards) that require a firm to publicly disclose when a firm has applied the independence requirements for Public Interest Entities (PIEs);

- IASB Liaison Working Group Publication issued in November 2022 – [Amendments to IAS1 and the Impact on the ISAs: Disclosure of Material Accounting Policy Information](#);
- September 2022, **Agenda Item 6-A** – Document Used for Outreach;¹¹ and

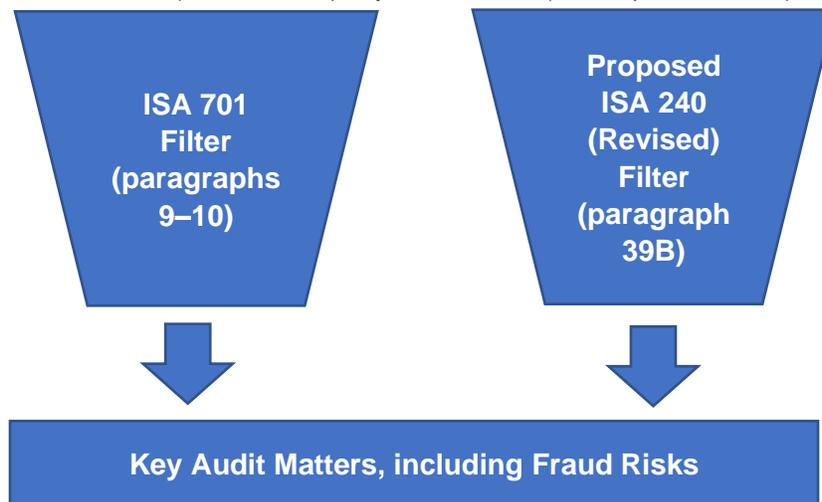
⁹ ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

¹⁰ ISA 260 (Revised), *Communication with Those Charged with Governance*

¹¹ The wording used to describe the fraud risks and the auditor’s response was sourced from a publicly available auditor’s report and amended as necessary for purposes of the proposed illustrations

- December 2022, **Agenda Item 4-A** – Proposed ISA 570 (Revised).¹²

29. The Task Force discussed the illustrative reports and noted that in illustrative report 1, the separate section on Identified Fraud Risks and the Auditor’s Response was overshadowing the Key Audit Matter section because of the location and length. This could potentially undermine or distract from the relative importance of the matters reported in the Key Audit Matters section. The Task Force was of the view that placing the Identified Fraud Risks and the Auditor’s Response section after the Key Audit Matters section could resolve some of the concerns noted, but not all.
30. Given the concerns, the Task Force preferred not to have a separate section on the identified fraud risks and the auditor’s response. The Task Force discussed two options. In both options the identified fraud risks are included in the Key Audit Matters section in the auditor’s report:
- Option 1: Include, within the Key Audit Matters section a subsection on the identified fraud risks and the auditor’s response.
 - Option 2: Integrate the identified frauds risks and the auditor’s response in the Key Audit Matters section (see illustrative report 2). Under this option there would still be a separate determination which of the ROMMs due to fraud were of most significance in the current period and therefore are a (fraud related) key audit matter (see depiction below).



31. The Task Force noted that the description of identified fraud risks and the auditor’s response are similar for both options. Taking into account the concerns set out in paragraph 29, a separate subsection on the identified fraud risks and the auditor’s response may overshadow key audit matters related to other aspects of the audit (e.g., those related to error). In addition, ISA 701, paragraph 11 already requires the use of an appropriate subheading for each key audit matter, which can be used to appropriately signpost that the matter relates to a ROMM due to fraud. Therefore, the Task Force preferred option 2.
32. The Task Force recognizes that users of the financial statements were of the view that the description of the identified fraud risks and the auditor’s response should be placed in a separate section and therefore suggests the following matters to highlight that identified fraud risks and the auditor’s response are included in the Key Audit Matters section:

¹² Proposed ISA 570 (Revised), *Going Concern*

- Include in the header of the Key Audit Matters section “including Fraud Risks.” The header would read: “Key Audit Matters, including Fraud Risks”; and
 - Clearly indicate in the subheading of the key audit matter that it relates to a ROMM due to fraud.
33. The Task Force was also of the view that the integration of the identified frauds risks and the auditor’s response in the Key Audit Matters section has several other benefits, including enhanced readability and clarity, and consistency with the key audit matter concept.
34. Given the advantages of linking the communication of identified fraud risks and the auditor’s response to a mechanism similar to key audit matters, the Task Force decided to base the requirements in the *Implications for the Auditor’s Report* section in proposed ISA 240 (Revised) on requirements in ISA 701.¹³ The table below provides an overview:

Paragraphs in Agenda Item 5-B	Related Paragraphs in ISA 701
Paragraph 39A	Paragraph 11
Paragraph 39B	Paragraphs 9 and 10
Paragraph 39C	Paragraph 13
Paragraph 39D	-
Paragraph 39E	Paragraph 14
Paragraph 39F	Paragraph 16

35. The Task Force also discussed the scenario where no fraud related key audit matters are communicated and noted that this would be rare given that the determination of fraud related key audit matters involves making a judgment about the relative importance of matters that required significant auditor attention. When no fraud related key audit matters are communicated, the Task Force is of the view that the auditor should include a statement to this effect in a separate section of the auditor’s report under the heading “Key Audit Matters, including Fraud Risks” (see paragraph 39F in **Agenda Item 5-B**).

Identified Significant Deficiencies in Internal Control that Are Relevant to the Prevention and Detection of Fraud in the Financial Statements

36. In determining a way forward on communicating identified significant deficiencies in internal control that are relevant to the prevention and detection of fraud, the Task Force tried to balance the views of the users of the financial statements and the concerns raised by the Board in its September 2022 meeting. The Task Force had preliminary discussions on this topic and recognizes that further discussions are warranted. For example, further discussions are needed to clarify to users of the financial statements that the auditor is not required to express an opinion on a company’s internal controls over financial reporting.

¹³ ISA 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*

37. In its deliberations, the Task Force was of the view that the communication of significant deficiencies in internal control that are relevant to the prevention and detection of fraud is only required for deficiencies that relate to a fraud related key audit matter. The Task Force was of the view that it would be rare that when a significant deficiency in internal control that is relevant to the prevention and detection of fraud is determined, the auditor would not also have determined it to be a fraud related key audit matter.
38. To further steer auditors to communicate significant deficiencies in internal control that are relevant to the prevention and detection of fraud, the Task Force emphasized that deficiencies may exist even though the auditor has not identified a ROMM due to fraud. The Task Force explained that in these circumstances the auditor may also describe such significant deficiency in internal control as a fraud related KAM (see paragraph A58C in **Agenda Item 5-B**).

Ongoing Deliberations

39. The Task Force is continuing its deliberations on this topic and therefore the Board is asked to take the following into account:
- The Task Force has not yet addressed whether other enhancements, if any, are needed to the auditor's responsibilities as it relates to fraud in an audit of financial statements and consequently the proposed illustrations do not reflect the revisions to the auditor's responsibilities.
 - The Task Force is not looking for comments on the wording in the illustrative reports as the Task Force is interested in the Board's views as to the placement of the auditor's communication about identified fraud risks and the auditor's response in the auditor's report.
 - The drafting related to transparency in the auditor's report (see **Agenda Item 5-B**, paragraphs 39A–39F) is indicative and is provided to the Board to support the discussion as set out above. In due course, the Task Force will also develop more application material.

Matters for IAASB Consideration

4. The Board is asked for its views on the proposed way forward on transparency in the auditor's report. In particular:
- (a) The mechanism the Task Force is proposing as a filter to determine the identified fraud risks to be communicated in the auditor's report. See paragraphs 23–25.
 - (b) The Task Force's proposals for communicating identified fraud risks and the auditor's response in the auditor's report. See paragraphs 26–35.
 - (c) The Task Force proposals to address the issue of identified significant deficiencies in internal control that are relevant to the prevention and detection of fraud in the financial statements. See paragraphs 36–38.
 - (d) The indicative drafting as presented in **Agenda Item 5-B**, paragraph 39A–39F and A58A–A58G

Section III: Updated Drafting

40. The Task Force updated the drafting based on the comments received during the June 2022 and September 2022 meetings. See **Agenda Item 5-B** for the changes to proposed ISA 240 (Revised) and **Agenda Item 5-A** for an explanation of significant changes since the June and September 2022 meeting. **Appendix 3** sets out the planned approach for the discussion, with references to the paragraphs in **Agenda Item 5-B**.

Matter for IAASB Consideration

5. The Board is asked for its views on proposed ISA 240 (Revised) as set out in **Agenda Item 5-B**. The Board is requested to provide comments on the requirements and the related application material at the same time.

Next Steps

41. Following the December 2022 IAASB meeting, the Task Force will consider the Board's feedback on the topics included in this issues paper.
42. In addition, the Task Force will advance its thinking on the remaining topics outlined in the project proposal which are primarily the proposed actions to address specific fraud-related audit procedures. In March 2023, the Task Force will bring a near full draft of the proposed revised standard to the Board.
43. The Task Force will continue to liaise with other IAASB task forces, working groups and consultation groups as needed, and as outlined in the project proposal (in particular, the Technology Consultation Group). The Task Force will also continue to liaise with the International Ethics Standards Board for Accountants to identify any ethics considerations or matters of relevance in terms of fraud.

Appendix 1

Fraud Task Force Members and Update on Activities Since the September 2022 IAASB Meeting

Fraud Task Force Members

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

Fraud Task Force Activities

2. Since the September 2022 IAASB meeting, members of the Task Force held one in-person meeting and two virtual meetings. Owing to the nature of the activities being undertaken, work was also progressed via electronic circulation of materials between members of the Task Force and IAASB Staff.

Outreach

3. Project specific outreach included the following:
 - A member of the Task Force met with the Canadian Public Accountability Board Representatives to discuss the proposals being deliberated by the Board.
 - Staff supporting the Task Force and a Board member met with the Fraud Working Group of the Koninklijke Nederlandse Beroepsorganisatie van Accountants.
 - IAASB Staff and members of the Task Force anticipate meeting in late November 2022 with Representatives from International Organizations of Securities Commissions' Committee on Issuer Accounting, Audit and Disclosure (Committee 1), Auditing Sub-Committee to discuss the fraud project.
4. In addition, the topic of fraud was specifically addressed in meetings with the following stakeholders during the fourth quarter as part of the general outreach program:
 - International Organization of Supreme Auditing Institutions, Financial Audit and Accounting Subcommittee;
 - International Federation of Accountants' (IFAC) Small and Medium Practices Advisory Group;
 - Basel Committee, Accounting and Audit Expert Group;
 - South Africa Outreach:
 - Leadership from certain Accounting Firms;
 - Investor Community Representatives;
 - Independent Regulatory Board for Auditors;
 - IFAC's Forum of Firms;
 - International Forum of Independent Audit Regulators; and
 - U.S. Public Company Accounting Oversight Board's technical staff.

Illustrative Auditor’s Reports – For Discussion Purposes Only

Objective

This Appendix presents two alternative formats which assisted the Task Force in its deliberations about the placement of the auditor’s communication about identified fraud risks and the auditor’s response in the auditor’s report (of a listed entity). The following illustrations are included to solicit the Board’s input as to such placement:

- **Proposed Illustration 1:** Separate section “Identified Fraud Risks and the Auditor’s Response” following the Going Concern or the Material Uncertainty Related to Going Concern sections, as applicable, in the auditor’s report.
- **Proposed Illustration 2:** Identified fraud risks (and the auditor’s response) clearly signposted under the heading “Key Audit Matters, including Fraud Risks” in the auditor’s report.

Given that the Task Force is interested in the Board’s views as to the placement of the auditor’s communication about identified fraud risks and the auditor’s response in the auditor’s report, the Task Force is not looking for comments on the wording in the illustrative reports.

Note

Red text – wording sourced from current projects or recently released publications

Blue text – proposed wording included by the Task Force for discussion purposes only

Illustration 1 – Auditor’s Report on Financial Statements of a Listed Entity Prepared in Accordance with a Fair Presentation Framework

For purposes of this illustrative auditor’s report, the following circumstances are assumed:

- **Audit of a complete set of financial statements of a listed entity using a fair presentation framework. The audit is not a group audit (i.e., ISA 600 (Revised)¹⁴ does not apply).**
- **The financial statements are prepared by management of the entity in accordance with IFRSs (a general purpose framework).**
- **The terms of the audit engagement reflect the description of management’s responsibility for the financial statements in ISA 210.¹⁵**
- **The auditor has concluded an unmodified (i.e., “clean”) opinion is appropriate based on the audit evidence obtained.**
- **The relevant ethical requirements that apply to the audit comprise the International Ethics Standards Board for Accountants’ *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA Code), together with**

¹⁴ ISA 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

¹⁵ ISA 210, *Agreeing the Terms of Audit Engagements*

the ethical requirements relating to the audit in the jurisdiction, and the auditor refers to both. The IESBA Code and the ethical requirements relating to the audit in the jurisdiction include differential independence requirements that are applicable to audits of financial statements of public interest entities. They also require the auditor to publicly disclose that the differential independence requirements applicable to audits of financial statements of public interest entities were applied.

- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist and no related-to events or conditions have been identified that may cast significant doubt on the entity’s ability to continue as a going concern in accordance with ISA 570 (Revised 202X).¹⁶
- Key audit matters have been communicated in accordance with ISA 701.¹⁷
- The auditor has obtained all of the other information prior to the date of the auditor’s report and has not yet identified a material misstatement of the other information.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law.

INDEPENDENT AUDITOR’S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

Report on the Audit of the Financial Statements¹⁸

Opinion

We have audited the financial statements of ABC Company (the Company), which comprise the statement of financial position as at December 31, 20X1, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including material accounting policy information ~~summary of significant accounting policies~~.

In our opinion, the accompanying financial statements present fairly, in all material respects, (or *give a true and fair view of*) the financial position of the Company as at December 31, 20X1, and (of) its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor’s Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the International

¹⁶ ISA 570 (Revised 202X), *Going Concern*

¹⁷ ISA 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*

¹⁸ The sub-title “Report on the Audit of the Financial Statements” is unnecessary in circumstances when the second sub-title “Report on Other Legal and Regulatory Requirements” is not applicable.

Ethics Standards Board for Accountants’ *International Code of Ethics for Professional Accountants (including International Independence Standards) (IESBA Code)*, as applicable to public interest entities, together with the ethical requirements for public interest entities that are relevant to our audit of the financial statements in [jurisdiction]. ~~and we~~ We have also fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Going Concern

We have concluded that management’s use of the going concern basis of accounting in the preparation of the financial statements is appropriate. Based on the audit evidence obtained, we have not identified a material uncertainty related to events or conditions that may cast significant doubt on the Company’s ability to continue as a going concern.

Identified Fraud Risks and the Auditor’s Response

We identified the following risks of material misstatement due to fraud (fraud risks):

Identified Fraud Risks	Our Response and Findings
<i>Risk of Fraud in Revenue Recognition</i>	
<p>As part of our risk assessment and based on a presumption that there are risks of fraud in revenue recognition, we evaluated which types of revenue transactions and assertions give rise to the risk of fraud in revenue recognition.</p> <p>The Company enters into contracts that are considered complex from a revenue recognition perspective. We focused on those contracts which include a fixed price element. The nature of those contracts require management to estimate the cost to complete, that impacts the revenue recognized.</p> <p>Estimates are inherently uncertain and might be subject to management bias. There might be incentives for management to use estimates in order to satisfy stakeholders, reach key performance indicators (KPIs) outlined in compensation plans and/or to meet debt covenants.</p>	<p>Where relevant to our audit, we assessed the design of the internal control measures related to revenue recognition and in the processes for generating and processing journal entries related to the revenue.</p>

	<p>We used a primarily substantive testing-based approach with respect to the cost to complete. The audit procedures included obtaining evidence to support applied hourly rates, challenging the number of expected hours to complete the project and reconciling changes in budgets to supporting evidence such as contract modifications. We also discussed the progress of the projects with the respective project managers and management of the operating companies. When performing these audit procedures, we remained alert to the inherent risk of management bias.</p> <div data-bbox="821 653 1414 1157" style="border: 1px solid black; padding: 5px;"> <p><i>Illustrative finding</i></p> <p>We have identified a significant deficiency in internal control relevant to the prevention and detection of fraud based on our understanding of the Company’s system of internal control as it relates to revenue recognition. We have communicated the significant deficiency in internal control to those charged with governance. The matter has been described in note XX to the financial statements, including management’s plans to remediate the significant deficiency.</p> </div>
<p><i>Risk of Management Override of Controls</i></p>	
<p>The risks of fraud and management’s ability to override the system of internal control are present in every entity.</p> <p>We therefore paid attention to the risk of management override of controls, including identifying fraud risks based on an analysis of potential interests of management such as the incentive by management to meet certain targets. Considering this analysis, we paid specific attention to the estimate of the cost to complete on revenue contracts.</p>	<p>We evaluated the design of the internal control environment that reduces the risk of a breach of internal controls. Also, we paid specific attention to user access management in the IT system and performed compensating procedures when necessary.</p> <p>We selected journal entries based on risk criteria and performed audit procedures to validate these entries.</p> <p>We also performed specific audit procedures regarding important estimates made by management, including the cost to complete revenue contracts for clients. In our assessment of estimates, we remained alert to the inherent risk of bias from management with regards to estimates.</p>

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key Audit Matter	Our Work and Findings
<p><i>Project Revenue Recognition and Valuation of Contract Assets (Refer to notes XY and YY of the financial statements)</i></p>	
<p>We consider this a key audit matter since project revenue recognition and the valuation of contract assets are significant to the financial statements based on materiality and because of the degree of management judgement involved.</p> <p>Management applies judgement to determine the cost to complete for contracts, which is the basis for revenue recognition and contract asset valuation, as well as for assessing provisions for onerous contracts.</p> <p>In addition, the valuation of contract assets requires significant management judgement in determining recoverability, especially in the XYZ region, considering the above average ageing and the magnitude of the contract assets.</p>	<p>We assessed the nature of the Company's revenue contracts. We performed substantive audit procedures on individually significant projects as well as high-risk projects. In addition, we took a sample over the remaining population to ensure sufficient coverage over all projects.</p> <p>These substantive procedures focused on the key assumptions applied by the Company to determine the cost to complete. The procedures included obtaining evidence to support applied hourly rates, challenging the number of expected hours to complete the project and reconciling changes in budgets to supporting evidence such as contract modifications. We also discussed the progress of the projects with the respective project managers and management of the operating companies. In these audit procedures, we were alert to management bias.</p> <p>With regards to the above average ageing, magnitude of the contract assets in the XYZ region, and the announced decision to reduce the Company's footprint in the XYZ region, specific attention has been given to the collection of trade receivables and valuation of several contracts with significant contract assets. We have discussed management's position papers for these projects with the responsible project managers, the contract solutions team and the regional CFO and CEO. We have obtained supporting documentation, which included support for contract modifications, correspondence with the client and minutes confirming the status of negotiations with the client.</p>

	<p>We assessed the adequacy of the disclosures relating to revenue recognition, in accordance with the requirements of IFRS 15.</p> <p>Our procedures did not result in material findings with respect to revenue recognition and the related disclosures.</p>
<p><i>Valuation of Goodwill and Intangible Assets (Refer to note ZZ of the financial statements)</i></p>	
<p>We focused on this area given the magnitude of the goodwill balance and because the executive board's assessment of the 'value in use' of the Company's eight Cash Generating Units (CGUs) is subject to significant estimation uncertainty. This involves significant judgement about the future revenue growth, operating earnings before interest tax and amortization (EBITA) margin, working capital developments and the discount rates applied to discount cash flow forecasts.</p> <p>Note ZZ to the financial statements discloses the key assumptions applied by management for goodwill impairment testing.</p> <p>We especially focused our audit efforts on those CGUs that had limited headroom, specifically the AA CGU.</p>	<p>Our audit procedures mainly included, an assessment of assumptions applied in the model, testing of the inputs to the model, assessing the disclosure note on goodwill, testing mathematical accuracy of the model and a reconciliation of the model to the five-year forecasts and long-term strategic plans that were approved by senior management. Our valuation experts supported us in the evaluation of the model in accordance with IAS 36, evaluation of the discount rate as well as other assumptions and methodologies used.</p> <p>We have challenged the assumptions applied by management. This was done by, amongst others, testing the expected margin increase, by comparing the margin and revenue growth to the historic performance of the Company, assessing the expected revenue growth by reviewing available market data for the industry outlook and development of the book-to-bill ratio.</p> <p>Discussions were held with local management of AA CGU, emphasizing the measures taken within the organization to reduce costs and improve margins.</p> <p>Further, we gained an understanding of local management strategic plans to improve the CGU's performance in the future and the inclusion thereof in the forecast used for impairment testing.</p> <p>We also have analyzed the sensitivity of the 'value in use' to changes in the respective assumptions.</p> <p>We assessed the adequacy of the disclosures relating to goodwill in accordance with the requirements of IAS 36.</p>

	Our procedures did not result in material findings with respect to the valuation of goodwill and the related disclosures.
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Other Information [or another title if appropriate such as “Information Other than the Financial Statements and Auditor’s Report Thereon”]

Management¹⁹ is responsible for the other information. The other information comprises the [information included in the X report,²⁰ but does not include the financial statements and our auditor’s report thereon.]

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements²¹

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRSs,²² and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company’s ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company’s financial reporting process.

Auditor’s Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor’s report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could

¹⁹ Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction

²⁰ A more specific description of the other information, such as “the management report and chairman’s statement,” may be used to identify the other information.

²¹ Throughout these illustrative auditor’s reports, the terms management and those charged with governance may need to be replaced by another term that is appropriate in the context of the legal framework in the particular jurisdiction.

²² Where management’s responsibility is to prepare financial statements that give a true and fair view, this may read: “Management is responsible for the preparation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards, and for such ...”

reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Paragraph 41(b) of this ISA explains that the shaded material below can be located in an Appendix to the auditor's report. Paragraph 41(c) explains that when law, regulation or national auditing standards expressly permit, reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities, rather than including this material in the auditor's report, provided that the description on the website addresses, and is not inconsistent with, the description of the auditor's responsibilities below.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.²³
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, actions taken to eliminate threats or safeguards applied.

²³ This sentence would be modified, as appropriate, in circumstances when the auditor also has a responsibility to issue an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor’s report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor’s report would vary depending on the nature of the auditor’s other reporting responsibilities prescribed by local law, regulation or national auditing standards. The matters addressed by other law, regulation or national auditing standards (referred to as “other reporting responsibilities”) shall be addressed within this section unless the other reporting responsibilities address the same topics as those presented under the reporting responsibilities required by the ISAs as part of the Report on the Audit of the Financial Statements section. The reporting of other reporting responsibilities that address the same topics as those required by the ISAs may be combined (i.e., included in the Report on the Audit of the Financial Statements section under the appropriate subheadings) provided that the wording in the auditor’s report clearly differentiates the other reporting responsibilities from the reporting that is required by the ISAs where such a difference exists.]

The engagement partner on the audit resulting in this independent auditor’s report is [name].

[Signature in the name of the audit firm, the personal name of the auditor, or both, as appropriate for the particular jurisdiction]

[Auditor Address]

[Date]

Illustration 2 – Auditor’s Report on Financial Statements of a Listed Entity Prepared in Accordance with a Fair Presentation Framework

For purposes of this illustrative auditor’s report, the following circumstances are assumed:

- Audit of a complete set of financial statements of a listed entity using a fair presentation framework. The audit is not a group audit (i.e., ISA 600 **(Revised)** does not apply).
- The financial statements are prepared by management of the entity in accordance with IFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of management’s responsibility for the financial statements in ISA 210.²⁴
- The auditor has concluded an unmodified (i.e., “clean”) opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit comprise the International Ethics Standards Board for Accountants’ *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA Code), together with the ethical requirements relating to the audit in the jurisdiction, and the auditor refers to both. **The IESBA Code and the ethical requirements relating to the audit in the jurisdiction include differential independence requirements that are applicable to audits of financial statements of public interest entities. They also require the auditor to publicly disclose that the differential independence requirements applicable to audits of financial statements of public interest entities were applied.**
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist **and no related to** events or conditions **have been identified** that may cast significant doubt on the entity’s ability to continue as a going concern in accordance with ISA 570 (Revised **202X**).
- Key audit matters have been communicated in accordance with ISA 701.²⁵
- The auditor has obtained all of the other information prior to the date of the auditor’s report and has not yet identified a material misstatement of the other information.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law.

INDEPENDENT AUDITOR’S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

²⁴ ISA 210, *Agreeing the Terms of Audit Engagements*

²⁵ ISA 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*

Report on the Audit of the Financial Statements²⁶

Opinion

We have audited the financial statements of ABC Company (the Company), which comprise the statement of financial position as at December 31, 20X1, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including material accounting policy information~~a summary of significant accounting policies~~.

In our opinion, the accompanying financial statements present fairly, in all material respects, (or *give a true and fair view of*) the financial position of the Company as at December 31, 20X1, and (of) its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards) (IESBA Code)*, as applicable to public interest entities, together with the ethical requirements for public interest entities that are relevant to our audit of the financial statements in [jurisdiction], ~~and w~~We have also fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Going Concern

We have concluded that management's use of the going concern basis of accounting in the preparation of the financial statements is appropriate. Based on the audit evidence obtained, we have not identified a material uncertainty related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern.

Key Audit Matters, including Fraud Risks

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. Key audit matters also include risks of material misstatement due to fraud (fraud risks) determined as such. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Project Revenue Recognition and Valuation of Contract Assets (Refer to notes XY and YY of the financial statements)

We consider this a key audit matter since project revenue recognition and the valuation of contract assets are significant to the financial statements based on materiality and because of the degree of management judgement involved.

²⁶ The sub-title "Report on the Audit of the Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

Management applies judgement to determine the cost to complete for contracts, which is the basis for revenue recognition and contract asset valuation, as well as for assessing provisions for onerous contracts.

In addition, the valuation of contract assets requires significant management judgement in determining recoverability, especially in the XYZ region, considering the above average ageing and the magnitude of the contract assets.

We assessed the nature of the Company's revenue contracts. We performed substantive audit procedures on individually significant projects as well as high-risk projects. In addition, we took a sample over the remaining population to ensure sufficient coverage over all projects.

These substantive procedures focused on the key assumptions applied by the Company to determine the cost to complete. The procedures included obtaining evidence to support applied hourly rates, challenging the number of expected hours to complete the project and reconciling changes in budgets to supporting evidence such as contract modifications. We also discussed the progress of the projects with the respective project managers and management of the operating companies. In these audit procedures, we were alert to management bias.

With regards to the above average ageing, magnitude of the contract assets in the XYZ region, and the announced decision to reduce the Company's footprint in the XYZ region, specific attention has been given to the collection of trade receivables and valuation of several contracts with significant contract assets. We have discussed management's position papers for these projects with the responsible project managers, the contract solutions team and the regional CFO and CEO. We have obtained supporting documentation, which included support for contract modifications, correspondence with the client and minutes confirming the status of negotiations with the client.

We assessed the adequacy of the disclosures relating to revenue recognition, in accordance with the requirements of IFRS 15.

Our procedures did not result in material findings with respect to revenue recognition and the related disclosures.

Valuation of Goodwill and Intangible Assets (Refer to note ZZ of the financial statements)

We focused on this area given the magnitude of the goodwill balance and because the executive board's assessment of the 'value in use' of the Company's eight Cash Generating Units (CGUs) is subject to significant estimation uncertainty. This involves significant judgement about the future revenue growth, operating earnings before interest tax and amortization (EBITA) margin, working capital developments and the discount rates applied to discount cash flow forecasts.

Note ZZ to the financial statements discloses the key assumptions applied by management for goodwill impairment testing.

We especially focused our audit efforts on those CGUs that had limited headroom, specifically the AA CGU.

Our audit procedures mainly included, an assessment of assumptions applied in the model, testing of the inputs to the model, assessing the disclosure note on goodwill, testing mathematical accuracy of the model and a reconciliation of the model to the five-year forecasts and long-term strategic plans that were approved by senior management. Our valuation experts supported us in the evaluation of the model in accordance with IAS 36, evaluation of the discount rate as well as other assumptions and methodologies used.

We have challenged the assumptions applied by management. This was done by, amongst others, testing the expected margin increase, by comparing the margin and revenue growth to the historic performance of the Company, assessing the expected revenue growth by reviewing available market data for the industry outlook and development of the book-to-bill ratio.

Discussions were held with local management of AA CGU, emphasizing the measures taken within the organization to reduce costs and improve margins.

Further, we gained an understanding of local management strategic plans to improve the CGU's performance in the future and the inclusion thereof in the forecast used for impairment testing.

We also have analyzed the sensitivity of the 'value in use' to changes in the respective assumptions.

We assessed the adequacy of the disclosures relating to goodwill in accordance with the requirements of IAS 36.

Our procedures did not result in material findings with respect to the valuation of goodwill and the related disclosures.

Fraud Risk: Revenue Recognition

As part of our risk assessment and based on a presumption that there are risks of fraud in revenue recognition, we evaluated which types of revenue transactions and assertions give rise to the risk of fraud in revenue recognition.

The Company enters into contracts that are considered complex from a revenue recognition perspective. We focused on those contracts which include a fixed price element. The nature of those contracts require management to estimate the cost to complete, that impacts the revenue recognized.

Estimates are inherently uncertain and might be subject to management bias. There might be incentives for management to use estimates in order to satisfy stakeholders, reach key performance indicators (KPIs) outlined in compensation plans and/or to meet debt covenants.

Where relevant to our audit, we assessed the design of the internal control measures related to revenue recognition and in the processes for generating and processing journal entries related to the revenue.

We used a primarily substantive testing-based approach with respect to the cost to complete. The audit procedures included obtaining evidence to support applied hourly rates, challenging the number of expected hours to complete the project and reconciling changes in budgets to supporting evidence such as contract modifications. We also discussed the progress of the projects with the respective project managers and management of the operating companies. When performing these audit procedures, we remained alert to the inherent risk of management bias.

Illustrative finding

We have identified a significant deficiency in internal control relevant to the prevention and detection of fraud based on our understanding of the Company's system of internal control as it relates to revenue recognition. We have communicated the significant deficiency in internal control to those charged with governance. The matter has been described in note XX to the financial statements, including management's plans to remediate the significant deficiency

Fraud Risk: Risk of Management Override of Controls

The risks of fraud and management's ability to override the system of internal control are present in every entity.

We therefore paid attention to the risk of management override of controls, including identifying fraud risks based on an analysis of potential interests of management such as the incentive by management to meet certain targets. Considering this analysis, we paid specific attention to the estimate of the cost to complete on revenue contracts.

We evaluated the design of the internal control environment that reduces the risk of a breach of internal controls. Also, we paid specific attention to user access management in the IT system and performed compensating procedures when necessary.

We selected journal entries based on risk criteria and performed audit procedures to validate these entries.

We also performed specific audit procedures regarding important estimates made by management, including the cost to complete revenue contracts for clients. In our assessment of estimates, we remained alert to the inherent risk of bias from management with regards to estimates

Other Information [or another title if appropriate such as “Information Other than the Financial Statements and Auditor’s Report Thereon”]

Management²⁷ is responsible for the other information. The other information comprises the [information included in the X report,²⁸ but does not include the financial statements and our auditor’s report thereon.]

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements²⁹

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRSs,³⁰ and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

²⁷ Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction

²⁸ A more specific description of the other information, such as “the management report and chairman’s statement,” may be used to identify the other information.

²⁹ Throughout these illustrative auditor’s reports, the terms management and those charged with governance may need to be replaced by another term that is appropriate in the context of the legal framework in the particular jurisdiction.

³⁰ Where management’s responsibility is to prepare financial statements that give a true and fair view, this may read: “Management is responsible for the preparation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards, and for such ...”

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Paragraph 41(b) of this ISA explains that the shaded material below can be located in an Appendix to the auditor's report. Paragraph 41(c) explains that when law, regulation or national auditing standards expressly permit, reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities, rather than including this material in the auditor's report, provided that the description on the website addresses, and is not inconsistent with, the description of the auditor's responsibilities below.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.³¹
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our

³¹ This sentence would be modified, as appropriate, in circumstances when the auditor also has a responsibility to issue an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements.

auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, actions taken to eliminate threats or safeguards applied.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities prescribed by local law, regulation or national auditing standards. The matters addressed by other law, regulation or national auditing standards (referred to as "other reporting responsibilities") shall be addressed within this section unless the other reporting responsibilities address the same topics as those presented under the reporting responsibilities required by the ISAs as part of the Report on the Audit of the Financial Statements section. The reporting of other reporting responsibilities that address the same topics as those required by the ISAs may be combined (i.e., included in the Report on the Audit of the Financial Statements section under the appropriate subheadings) provided that the wording in the auditor's report clearly differentiates the other reporting responsibilities from the reporting that is required by the ISAs where such a difference exists.]

The engagement partner on the audit resulting in this independent auditor's report is [name].

[Signature in the name of the audit firm, the personal name of the auditor, or both, as appropriate for the particular jurisdiction]

[Auditor Address]

[Date]

Appendix 3

Approach for the Discussion on the Updated Drafting

Section in Agenda Item 5-B	Paragraphs in Agenda Item 5-B
Introduction	1–9A, A1A–A7A
Engagement Resources Ongoing Nature of Communications with Management and Those Charged with Governance Risk Assessment Procedures and Related Activities	16A, A12A–A12E 16B, A12F–A12G 17–24, A12K–A23C
Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework and the Entity’s System of Internal Control (Part 1)	24B–24C, A23Da–A24L
Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework and the Entity’s System of Internal Control (Part 2)	24D–24G, A25A–A27A
Identifying and Assessing the Risks of Material Misstatement due to Fraud, including Presumption of the Risks of Material Misstatement due to Fraud in Revenue Recognition	25–28B, A28A–A33
Material Misstatements Due to Fraud	34E–34H, A49J–A49N