MALAYSIAN INSTITUTE OF ACCOUNTANTS

**Exposure Draft**

*International Standard on Auditing*

# Proposed International Standard on Auditing 240 (Revised)

# The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

and

# Proposed Conforming and Consequential Amendments to Other ISAs

**Issued for Comment**

Response Due Date 30 April 2024

**THE AUDITING AND ASSURANCE STANDARDS BOARD INVITES COMMENTS ON THE PROPOSED INTERNATIONAL STANDARD ON AUDITING (ISA) 240 (REVISED) *THE AUDITOR'S RESPONSIBILITIES RELATING TO FRAUD IN AN AUDIT OF FINANCIAL STATEMENTS* AND PROPOSED CONFORMING AND CONSEQUENTIAL AMENDMENTS TO OTHER ISAs**

The Auditing and Assurance Standards Board ("AASB") of the Malaysian Institute of Accountants ("MIA") has approved the release of this Exposure Draft on 8 March 2024 for distribution to members, regulatory bodies and other interested parties for comment. The proposals in this Exposure Draft may be modified in the light of comments received before being issued in final form.

The International Auditing and Assurance Standards Board ("IAASB") released the Proposed International Standard on Auditing (ISA) 240 (Revised) *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* and Proposed Conforming and Consequential Amendments to Other ISAs on 6 February 2024.

As a member of the International Federation of Accountants ("IFAC"), MIA supports the work of IFAC by informing its members of every pronouncement issued by IFAC, to work towards implementation, when and to the extent possible under local circumstances, of those pronouncements and specifically to incorporate the IAASB's International Standards in national auditing pronouncements.

The explanatory memorandum provides background to, and an explanation of the Proposed ISA 240 (Revised) *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* and Proposed Conforming and Consequential Amendments to Other ISAs.

The AASB looks forward to receiving comments on this Exposure Draft from members, regulatory bodies and other interested parties. The AASB welcomes comments on all matters addressed in the Exposure Draft.

Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and, where appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in the Exposure Draft, it will be helpful for the AASB to be made aware of this view.

Comments are to be submitted through email by 30 April 2024.

Unless respondents request confidentiality, their comments are a matter of public record. All comments are to be directed to:

Email: technical@mia.org.my

# EXPLANATORY MEMORANDUM

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# Introduction

1. This memorandum provides background to, and an explanation of, the Exposure Draft of Proposed International Standard on Auditing (ISA) 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* (ED-240), which was approved for exposure by the IAASB in December 2023.

## Background

*Drivers for the Project*

2. High quality audits contribute to the efficiency of capital markets and financial stability. The public interest is best served when participants in the financial reporting system have confidence in audits of financial statements. However, corporate failures and scandals across the globe in recent years have brought the topic of fraud to the forefront and led to questions from stakeholders about the role and responsibilities of the auditor relating to fraud in an audit of financial statements.

3. Pursuant to the IAASB's focus on emerging public interest topics as described in the IAASB's Strategy for 2020-2023, the IAASB launched information-gathering activities on fraud in an audit of financial statements in early 2020. The objective of the information gathering and research activities was to further consider the issues and challenges in applying extant ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, in light of the changing environment, jurisdictional developments and changing public expectations.

4. In September 2020, the IAASB published a 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 (September 2020)*. The Discussion Paper was intended to seek the perspectives from stakeholders across the financial reporting ecosystem on whether extant ISA 240 needed to be updated to reflect the evolving external reporting landscape, and, if so, in what areas.

*Project to Revise Extant ISA 240*

5. As the feedback from the Discussion Paper indicated that extant ISA 240 should be updated, the IAASB approved, in December 2021, a project proposal that addresses the revision of extant ISA 240, and the conforming and consequential amendments to other relevant ISAs, to enhance or clarify the auditor's responsibilities on fraud in an audit of financial statements. The project objectives that support the public interest, which are described in Section III of the project proposal, included revising extant ISA 240 to:

   (a) Clarify the role and responsibilities of the auditor for fraud in an audit of financial statements.

   (b) Promote consistent behavior and facilitate effective responses to identified risks of material misstatement due to fraud through strengthening ISA 240 to establish more robust requirements and enhance and clarify application material where necessary.

   (c) Enhance ISA 240 to reinforce the importance, throughout the audit, of the appropriate exercise of professional skepticism in fraud-related audit procedures.

   (d) Enhance transparency on fraud-related procedures where appropriate, including strengthening communications with those charged with governance (TCWG) and the reporting requirements in ISA 240 and other relevant ISAs.

### Coordination with Other IAASB Task Forces, Working and Consultation Groups, and IESBA

*IAASB Task Forces, Working Groups and Consultation Groups*

6. Since the approval of the project proposal, the Fraud Task Force has coordinated with other IAASB task forces and consultation groups to inform the development of ED-240. This included coordination with the Audits of Less Complex Entities Task Force, Audit Evidence Task Force, Going Concern Task Force, Listed Entity and Public Interest Entity (PIE) Task Force (Tracks 1 and 2), Auditor Reporting Consultation Group, Professional Skepticism Consultation Group and Technology Consultation Group.

7. The IAASB notes that both the Going Concern Task Force and the Listed Entity and PIE Task Force have active projects that also include proposals that, if approved, would affect the auditor's report. The IAASB is aware of the possible impact the collective changes could have on the auditor's report and is mindful about coordinating the possible effective dates of ED-240 and the revised standards from these projects.

*International Ethics Standards Board for Accountants*

8. The Fraud Task Force liaised with the International Ethics Standards Board for Accountants (IESBA) to ensure that ED-240 is aligned with the IESBA's *International Code of Ethics for Professional Accountants (including International Independence Standards)* (the IESBA Code). Matters discussed included specific paragraphs in ED-240 relating to relevant key concepts in the standard, the definition of fraud, requirements addressing fraud or suspected fraud, the appendix on fraud risk factors, and the linkages (references) to the IESBA Code.

## Section 1 – Significant Matters

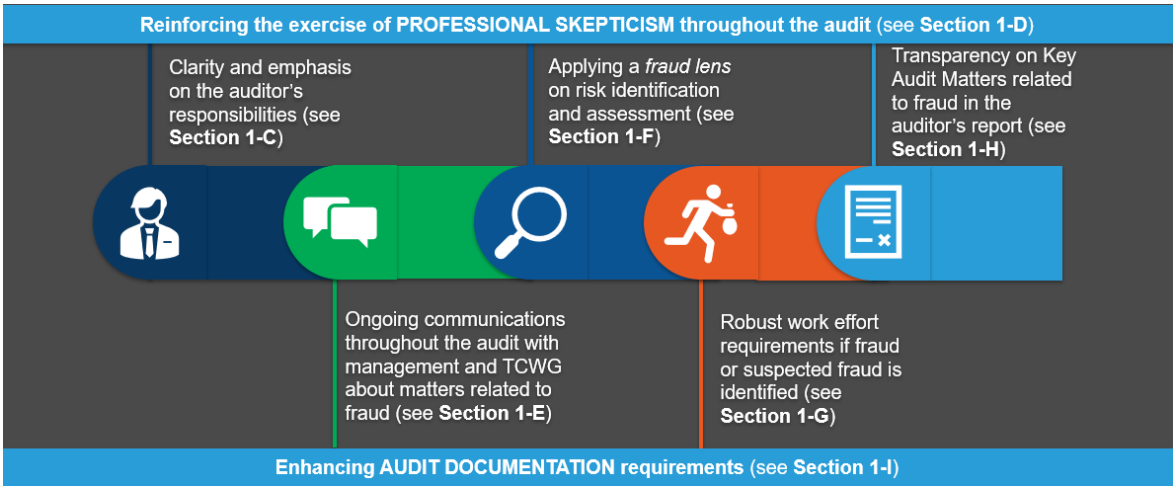
### Section 1-A – Public Interest Issues Addressed in ED-240

9. In developing ED-240, the IAASB considered the qualitative standard-setting characteristics set out in paragraph 26 of the project proposal and those included in the Public Interest Framework[1] as criteria to assess ED-240's responsiveness to the public interest.

10. The "Mapping of Key Changes Proposed in ED-240 to the Actions and Objectives in the Project Proposal that Support the Public Interest" ("Public Interest Issues Table") that accompanies this Explanatory Memorandum sets out a table that maps the proposed revisions to enhance or clarify extant ISA 240 to the standard-setting actions included in the project proposal as the actions are directly related to the project objectives that support the public interest. The Public Interest Issues Table also highlights what qualitative standard-setting characteristics were at the forefront, or of most relevance, when determining how to address each proposed action.

[1] See the Monitoring Group report *Strengthening the International Audit and Ethics Standard-Setting System* (pages 22–23 of the Public Interest Framework's section on "What qualitative characteristics should the standards exhibit?").

## Section 1-B – Overview of the Key Changes Proposed in ED-240




11. The diagram above depicts and describes what the IAASB believes to be the seven most significant proposed changes addressing the key issues identified in the project proposal. These changes are expected to drive consistency in practice and change in auditor behavior and are the following:

    (a) Responsibilities of the auditor (see **Section 1-C**);

    (b) Professional skepticism (see **Section 1-D**);

    (c) Ongoing nature of communications with management and TCWG (see **Section 1-E**);

    (d) Risk identification and assessment (see **Section 1-F**);

    (e) Fraud or suspected fraud (see **Section 1-G**);

    (f) Transparency on fraud-related responsibilities and procedures in the auditor's report (see **Section 1-H**); and

    (g) Documentation (see **Section 1-I**).

12. In addition, **Section 1-J** describes other significant revisions and deliberations and **Section 1-K** describes significant conforming and consequential amendments.

## Section 1-C – Responsibilities of the Auditor

13. The following are the key issues identified in paragraph 19 of the project proposal relating to the role and responsibilities of the auditor:

    (a) The introductory paragraphs in extant ISA 240 which deal with the inherent limitations of an audit related to detecting fraud can be misleading and result in a misunderstanding of the auditor's responsibilities.

    (b) Clarity is needed about the auditor's responsibilities relating to fraud in an audit of financial statements.

    (c) Clarity is also needed about the auditor's responsibilities relating to non-material fraud or suspected fraud identified during the audit.

*Inherent Limitations*

14. Respondents to the Discussion Paper noted that describing the inherent limitations relating to fraud of an audit of financial statements in the same paragraphs used to describe the auditor's responsibilities relating to fraud has conflated the two key concepts and contributed to a lack of clarity around what the auditor's responsibilities are (see extant ISA 240, paragraphs 5–7).

15. The IAASB proposes to "decouple" those key concepts in the introductory paragraphs of ED-240 by:

    - Describing the responsibilities of the auditor before the inherent limitations of the audit in paragraphs 2 and 9–11, respectively. The enhancement makes the description of the auditor's responsibilities more succinct and unencumbered by language that may be construed as diminishing the auditor's responsibilities relating to fraud in an audit of financial statements.
    - Introducing a statement in paragraph 9 which clarifies that the inherent limitations do not diminish the auditor's responsibilities relating to fraud (i.e., the auditor remains responsible for planning and performing the audit to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatements due to fraud). This statement was recently introduced in the United Kingdom's fraud auditing standard and is being introduced in ED-240 pursuant to the IAASB's commitment, as described in the project proposal, to leverage enhancements adopted by other jurisdictions to their fraud-related standards.

*The Auditor's Responsibilities Relating to Fraud*

16. Like in extant ISA 240, there is an acknowledgement in ED-240 that the primary responsibility for the prevention and detection of fraud rests with both management and TCWG of the entity. However, the IAASB also believes that the focus of an auditing standard relating to fraud in an audit of financial statements should be on the role and responsibilities of the auditor and, accordingly, the IAASB described the auditor's responsibilities in ED-240 before those of management and TCWG.

17. In making the changes described in paragraphs 14–16 above, the IAASB was not seeking to expand the role and responsibilities of the auditor relating to fraud in an audit of financial statements. The descriptions of the inherent limitations of the audit and the auditor's responsibilities relating to fraud in audits are consistent with how those concepts are described in extant ISA 240.

*The Auditor's Responsibilities Relating to Non-Material Fraud and Non-Material Suspected Fraud*

18. As described in paragraph 6 of ED-240, the auditor is concerned with a material misstatement of the financial statements due to fraud. The IAASB introduced a key concept in paragraph 8 of ED-240 which deals with circumstances giving rise to the fraud and the identified misstatements to clarify how the auditor goes about determining whether an identified misstatement due to fraud or suspected fraud is material to the financial statements. The new application material paragraph A11 clarifies that although an identified misstatement due to fraud may not be "quantitatively material", it may nevertheless be "qualitatively material" depending on who instigated the fraud (e.g., management of the entity) and why the fraud was perpetrated (e.g., to manage key performance metrics).

**Section 1-D – Professional Skepticism**

19. A key issue described in paragraph 19 of the project proposal is that the appropriate exercise of professional skepticism needs to be reinforced, including reminding the auditor of the importance of

remaining alert to conditions that may indicate possible fraud and maintaining professional skepticism throughout the audit.

20. The IAASB is proposing the following enhancements to reinforce the importance of exercising professional skepticism when applying ED-240:

- Highlighting the importance of professional skepticism in the introductory paragraphs.
- New and enhanced requirements and application material in the body of the standard.

21. In developing the proposed enhancements, the IAASB considered the work that had been carried out by IESBA including, in particular, the *Revisions to the Code to Promote the Role and Mindset Expected of Professional Accountants*, published by IESBA in October 2020.

*Introduction*

22. The IAASB moved some of the explanatory material included in paragraph 13 of extant ISA 240 into paragraphs 12 and 13 of the new Key Concepts section of ED-240. Those paragraphs highlight the importance of exercising professional skepticism when planning and performing an audit, as noted by the reference to ISA 200,[2] and describe how professional skepticism supports the exercise by the auditor of professional judgment. This approach is similar to the approach adopted by the IAASB in other recently revised ISAs; specifically, paragraph 7 of ISA 220 (Revised),[3] paragraph 3 of ISA 315 (Revised 2019)[4] and paragraph 9 of ISA 600 (Revised).[5]

*New or Enhanced Requirements and Application Material on Professional Skepticism*

Maintaining Professional Skepticism Throughout the Audit

23. Paragraph 19 of ED-240 retains the requirement in paragraph 13 of extant ISA 240 that the auditor maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist. However, the IAASB removed the last part of the requirement because it believes that referring to the auditor's preconceptions, based on past experience, about the honesty and integrity of management and TCWG may serve to undermine the exercise of professional skepticism.

24. The IAASB also included new application material in paragraph A25, which in turn refers to application material in ISA 220 (Revised), to highlight, for example, how efforts to conceal fraud could be manifested through pressures on the engagement team that impede the appropriate exercise of professional skepticism and actions that may be taken to mitigate those impediments.

Authenticity of Records and Documents

25. In revising the requirement in paragraph 14 of extant ISA 240 (see the corresponding requirement in paragraph 20 of ED-240), the IAASB proposes to delete the explanatory lead-in sentence: "Unless

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2 ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

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

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

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

the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine") for the following reasons:

- To respond to concerns that the sentence undermines the requirement for the auditor to respond appropriately when conditions are identified that indicate that a record or document may not be authentic or that terms in a document have been modified but not disclosed to the auditor.
- Paragraph A24 of ISA 200 already includes the sentence "The auditor may accept records and documents as genuine unless the auditor has reason to believe the contrary". The rest of paragraph A24 provides context about the intent and application of that sentence by stating that the auditor is nevertheless required to consider the reliability of information to be used as audit evidence and to investigate further when the auditor has doubts about the reliability of that information, including indications of possible fraud. Because the conditional requirement in paragraph 20 of ED-240 deals with those situations when there are indications of possible fraud, the IAASB feels that it is unwarranted to repeat the lead-in sentence in paragraph A24 of ISA 200 in the requirement in paragraph 20 of ED-240.

The proposed deletion of the lead-in sentence from paragraph 14 of extant ISA 240 (corresponding requirement is paragraph 20 of ED-240) is not intended to increase the work effort as it pertains to considering the authenticity of records and documents obtained during the audit.

26. The IAASB added application material in ED-240 to respond to concerns that extant ISA 240 is not clear about whether the auditor is required to design and perform procedures to identify the conditions referred to in the requirement in paragraph 20 (i.e., conditions that cause the auditor to believe that a record or document may not be authentic or that terms in a document have been modified but not disclosed to the auditor). Paragraphs A26 and A27 clarify that the requirement in paragraph 20 of ED-240 is triggered when the auditor identifies those conditions during the audit in the following circumstances:
    - When performing audit procedures in accordance with ED-240 or other ISAs, including ISA 500[6] which requires the auditor to consider the reliability of information intended to be used as audit evidence when designing and performing audit procedures; or
    - When those conditions come to the auditor's attention, including when they are brought to the auditor's attention by sources internal or external to the entity during the course of the audit.
27. The IAASB also included in paragraph A26 a list of examples of conditions that, if identified during the audit, may trigger the requirement in paragraph 20. On balance, the IAASB felt that the inclusion of a list of examples would be helpful to some audit firms that do not have such a list in their audit methodology manuals.

Remaining Alert for Information That is Indicative of Fraud or Suspected Fraud

28. The IAASB introduced a new requirement in paragraph 21 and application material (paragraphs A29–A32) to emphasize the importance of remaining alert throughout the audit for information that is indicative of fraud or suspected fraud. Paragraph A30, for example, highlights the importance of remaining alert when performing audit procedures near the end of the audit when time pressures to

[6] ISA 500, *Audit Evidence*

complete the audit engagement may exist that may impede the appropriate exercise of professional skepticism.

## Section 1-E – Ongoing Nature of Communications with Management and Those Charged with Governance

29. A key issue, identified in paragraph 19 of the project proposal, relating to required communications with TCWG on fraud considerations is that it may not be sufficiently robust in the current environment, including that such communications relating to fraud matters are not presently explicitly required throughout the audit.

*Communications with Management and Those Charged with Governance in ED-240*

30. The IAASB is of the view that communications with management and TCWG about matters related to fraud is important in all stages of the audit and has reflected this in both requirements and application material throughout ED-240. These communication requirements are not meant to be applied in a linear fashion but are intended to reflect the iterative nature of an audit. When matters related to fraud are communicated with management, TCWG, or others within the entity, this is intended to be a robust two-way and open dialogue with active participation by all parties.

31. The following sections provide an overview of the requirements in ED-240, as well as application material, relating to communications with management, TCWG and others within the entity about matters related to fraud.

Ongoing Nature of Communications with Management and Those Charged with Governance

32. The IAASB added a new overarching requirement in paragraph 25 to communicate with management and TCWG matters related to fraud at appropriate times throughout the audit engagement. New application material in paragraphs A39–A43 highlights the importance of robust two-way communications between management or TCWG and the auditor, the extent and the timing of such communications, as well as assigning appropriate member(s) within the engagement team with the responsibility for such communications.

Making Inquiries About Matters Related to Fraud

33. Extant ISA 240 included several requirements relating to making inquiries of management, TCWG and others within the entity. The IAASB has relocated and enhanced these requirements and added new requirements. The requirements for making inquiries about matters related to fraud are now placed in the following sections:

    (a) Obtaining an understanding of the entity's system of internal control. Paragraphs 34(c)–34(d), 35(b) and 36(b) of ED-240 are based on requirements in extant ISA 240 and require the auditor to make inquiries of management, TCWG, appropriate individuals within the internal audit function (if the function exists), or other appropriate individuals within the entity about matters related to fraud. Enhancements include requiring the auditor to make inquiries of TCWG whether they are aware of deficiencies in the system of internal control related to the prevention and detection of fraud, and the remediation efforts to address such deficiencies (see paragraph 34(d)(iii) of ED-240). Enhancements also include more robust application material on inquiries of TCWG, management and others within the entity, and inquiries of internal audit in paragraphs A75–A78, A89–A91 and A93–A94 of ED-240, respectively.

(b) Designing and performing audit procedures to test the appropriateness of journal entries and other adjustments. Paragraph 50(a) of ED-240 retains paragraph 33(a)(i) of extant ISA 240 and requires the auditor to make inquiries of individuals involved in the financial reporting process about their knowledge of inappropriate or unusual activity relating to the processing of journal entries and other adjustments.

(c) If the auditor identifies fraud or suspected fraud. A new requirement in paragraph 55(a) of ED-240 was added, which requires the auditor to make inquiries about the matter with a level of management that is at least one level above those involved and, when appropriate in the circumstances, to make inquiries about the fraud or suspected fraud with TCWG.

Auditor Unable to Continue the Audit Engagement

34. Paragraph 60(c)(i) of ED-240 retains paragraph 39(c)(i) of extant ISA 240 and requires the auditor to discuss with the appropriate level of management and TCWG the auditor's withdrawal from the engagement and the reasons for the withdrawal.

Communications with Management and Those Charged with Governance, and Reporting to an Appropriate Authority Outside the Entity

35. Enhancements have been made to paragraphs 41–44 of extant ISA 240 paragraphs 66–69 of ED-240) to align the terminology used in the communications and reporting requirements to the key concept of "fraud or suspected fraud" identified by the auditor.

**Section 1-F – Risk Identification and Assessment**

36. The following are the key issues identified in paragraph 19 of the project proposal relating to the auditor's risk identification and assessment process in extant ISA 240:

(a) Risk identification and assessment process – the auditor's risk identification and assessment process as it relates to fraud should be more robust (including that many aspects of the enhanced risk identification and assessment procedures in ISA 315 (Revised 2019) have not been reflected in extant ISA 240).

(b) Engagement team discussion – the engagement team discussion is not sufficiently robust with respect to the auditor's considerations of fraud throughout the audit.

(c) Analytical procedures – analytical procedures at the planning and completion stages of the audit are not robust enough to support the auditor's consideration of the risk of fraud and the planned audit response (nature, timing, extent of audit procedures).

(d) Presumption of fraud risk in revenue recognition – it is not clear when it may, or may not, be appropriate to rebut the presumption of fraud risk in revenue recognition, which has resulted in inconsistent application.

(e) Presumption of fraud risk in other account balances – stakeholders have questioned whether the presumption of fraud risk should be extended to include other account balances, such as goodwill.

*Background*

37. While extant ISA 240 contains various requirements related to the identification and assessment of risks of material misstatement due to fraud, the requirements do not necessarily correlate to ISA 315 (Revised 2019) because:

    (a) Extant ISA 240 does not follow the same structure as ISA 315 (Revised 2019).

    (b) In some cases, the relevance of the procedures in ISA 315 (Revised 2019) to specific fraud matters is not sufficiently clear (i.e., fraud 'lens').

    (c) In some cases, the required procedures in extant ISA 240 are perfunctory and may not drive the behavioral change that is needed to perform robust procedures to identify and assess risks of material misstatement due to fraud.

38. In developing the proposed changes relating to risk identification and assessment, the IAASB was mindful of maintaining the balance between what ISA 315 (Revised 2019) and ED-240 address and agreed that ED-240 would only need to explain how to undertake the procedures in ISA 315 (Revised 2019) with a fraud lens.

39. Accordingly, the IAASB:

    (a) Added new and enhanced requirements that are based on ISA 315 (Revised 2019) and other ISAs. As set out in the CUSP Drafting Principles and Guidelines, the linkage to other ISAs is highlighted by using the phrase "in applying ISA …" and adding in the related footnote a reference to the relevant requirement in the other ISA. The phrase "In applying ISA…" signals that a requirement is intended to be applied in addition to or alongside performing the relevant requirements of the foundational standard. In making these changes, the IAASB endeavored to present the foundational requirements with a fraud lens in ED-240 and not to duplicate nor repeat requirements from ISA 315 (Revised 2019) or other ISAs especially when enhancing or developing related application and other explanatory material in ED-240.

    (b) Restructured extant ISA 240 to follow a similar structure as ISA 315 (Revised 2019). This new structure helps demonstrate the integrated relationship between the two standards.

*The Auditor's Risk Identification and Assessment Process*

40. To make the auditor's risk identification and assessment process as it relates to fraud more robust (including many aspects of the enhanced risk identification and assessment procedures in ISA 315 (Revised 2019)), the IAASB made the following changes to ED-240:

    (a) Risk assessment procedures and related activities. The IAASB enhanced the overarching requirement in paragraph 17 of extant ISA 240 (paragraph 26 of ED-240). This paragraph requires the auditor to perform procedures to obtain audit evidence that provides the appropriate basis for the identification and assessment of risks of material misstatement due to fraud, taking into account fraud risk factors. This requirement expands on paragraph 13 of ISA 315 (Revised 2019).

    (b) Information from other sources. The IAASB enhanced the requirement in paragraph 24 of extant ISA 240 (paragraph 27 of ED-240). This paragraph requires the auditor to consider whether information from other sources obtained by the auditor indicates that one or more fraud risk factors are present. This requirement expands on paragraphs 15–16 of ISA 315

(Revised 2019).

(c) Evaluation of fraud risk factors. The IAASB enhanced the requirement in paragraph 25 of extant ISA 240 (paragraph 32 of ED-240). This paragraph requires the auditor to evaluate whether the audit evidence obtained from the risk assessment procedures and related activities indicates that one or more fraud risk factors are present. In adhering to the CUSP Drafting Principles and Guidelines, essential material in extant ISA 240 (i.e., second sentence of paragraph 25) was moved as application material to the definition of fraud risk factors in paragraph A23 of ED-240.

(d) Understanding the entity and its environment, and the applicable financial reporting framework. The IAASB added a new requirement in paragraph 33 of ED-240, that expands on paragraph 19 of ISA 315 (Revised 2019). The new requirement focuses on aspects of the auditor's understanding of the entity and its environment, and the applicable financial reporting framework, that may lead to an increased susceptibility to misstatement due to management bias or other fraud risk factors (e.g., performance measures used, whether internal or external, that may create incentives or pressures to achieve financial performance targets).

(e) Understanding the components of the entity's system of internal control. The IAASB included in paragraphs 34–38 of ED-240 a combination of new and enhanced requirements. These requirements expand on paragraphs 21–22 and 24–26 of ISA 315 (Revised 2019) and are focusing on aspects of the auditor's understanding of the components of the entity's system of internal control relating to:

  (i) How management communicates with its employees its views on business practices and ethical behavior with respect to the prevention and detection of fraud.

  (ii) How TCWG exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the controls that management has established to address these risks.

  (iii) The entity's fraud risk assessment process.

  (iv) The entity's process that addresses the ongoing and separate evaluations for monitoring the effectiveness of controls to prevent or detect fraud.

  (v) How journal entries are initiated, processed, recorded, and corrected as necessary (given that fraud often involves the manipulation of the financial reporting process by recording inappropriate or unauthorized journal entries and other adjustments).

  (vi) Controls that address risks of material misstatement due to fraud at the assertion level, including controls over journal entries, designed to prevent or detect fraud.

(f) Control deficiencies within the entity's system of internal control. The IAASB added a new requirement in paragraph 39 of ED-240 for the auditor to determine whether there are deficiencies in internal control identified that are relevant to the prevention or detection of fraud. This requirement expands on paragraph 27 of ISA 315 (Revised 2019).

(g) Identifying and assessing the risks of material misstatement due to fraud. The IAASB enhanced the requirement in paragraph 26 of extant ISA 240 (paragraph 40 of ED-240) by taking into account fraud risk factors and by more closely aligning it to ISA 315 (Revised 2019). This requirement expands on paragraphs 28–34 of ISA 315 (Revised 2019)).

*Engagement Team Discussion*

41. The IAASB made the requirement related to the engagement team discussion in paragraph 16 of extant ISA 240 (paragraph 29 of ED-240) more robust with respect to the auditor's considerations of fraud throughout the audit. The IAASB enhanced the requirement by aligning it closer to paragraph 17 of ISA 315 (Revised 2019)) and by requiring the engagement team discussion to explicitly include:

    (a) An exchange of ideas about the entity's culture, management's commitment to integrity and ethical values, and related oversight by TCWG, as well as fraud risk factors; and

    (b) A consideration of any fraud or suspected fraud, including allegations of fraud, that may impact the overall audit strategy and audit plan.

42. Paragraphs A38 and A49 of ED-240 include new application material regarding when it may be beneficial to hold additional engagement team discussions, and involve experts during engagement team discussions, respectively.

*Analytical Procedures at the Planning and Completion Stages of the Audit*

43. The IAASB made the requirements relating to analytical procedures at the planning and completion stages of the audit in paragraphs 23 and 35 of extant ISA 240 (paragraphs 31 and 54 of ED-240) more robust. Enhancements include changing the work effort verb from "evaluate" to "determine" to adhere to the CUSP Drafting Principles and Guidelines.[7]

*Presumption of the Risks of Material Misstatement Due to Fraud in Revenue Recognition and Other Items Susceptible to Material Misstatement Due to Fraud*

44. The IAASB clarified when it may, or may not, be appropriate to rebut the presumption of fraud risk in revenue recognition by:

    (a) Enhancing paragraph 27 of extant ISA 240 (paragraph 41 of ED-240) by requiring the auditor to take into account related fraud risk factors when determining which types of revenue, revenue transactions or relevant assertions give rise risks of material misstatements due to fraud. This enhancement is intended to improve the auditor's determination of which types of revenue, revenue transactions or assertions give rise to risks of material misstatement due to fraud. Similar to the enhancements to analytical procedures described in paragraph 43 above, the work effort verb was also changed from "evaluate" to "determine" in paragraph 41 of ED-240 to adhere to the CUSP Drafting Principles and Guidelines.

    (b) Developing new application material in paragraphs A109–A110 of ED-240 that provides examples of events or conditions relating to revenues that could give rise to fraud risk factors. It clarifies that the significance of fraud risk factors related to revenue recognition, individually or in combination, ordinarily makes it inappropriate for the auditor to rebut the presumption that there are risks of material misstatement due to fraud in revenue recognition.

45. The IAASB also proposes new application material in paragraph A104 to highlight that the auditor's risk response is based on the identification and assessment of risks of material misstatement due to

[7] **Appendix 2** of the CUSP Drafting Principles and Guidelines explains that if the preparation of the relevant subject matter or analysis (i.e., the source) is the responsibility of management or TCWG, the ISAs generally describe the work effort as "shall evaluate." However, if the preparation of the relevant information or analysis is the responsibility of the auditor, the ISAs generally describe the work effort as "shall determine."

fraud at the financial statement and assertion levels. Paragraph A104 also provides examples of relevant assertions and the related classes of transactions, account balances or disclosures that may be susceptible to material misstatement due to fraud.

*Other Enhancements*

Inquiries of Management and Inconsistent Responses

46. The IAASB enhanced paragraph 15 of extant ISA 240 (paragraph 30 of ED-240) by also addressing inconsistencies in the responses to inquiries of individuals within the internal audit function, or others within the entity (in addition to addressing inconsistencies in the responses to inquiries of management or TCWG in extant ISA 240), and by directly linking ED-240 to the requirement in paragraph 11 of extant ISA 500 when addressing such inconsistencies.

**Section 1-G – Fraud or Suspected Fraud**

47. The key issue identified in paragraph 19 of the project proposal relating to fraud or suspected fraud that is identified in the audit is a lack of clarity around the auditor's response in such circumstances.

48. The IAASB is proposing the following revisions in ED-240 to enhance clarity around the auditor's response when fraud or suspected fraud is identified in the audit:

- A separate section in ED-240 that includes the requirements that are applicable when fraud or suspected fraud is identified in the audit;
- New requirements, relocating existing requirements, elevating existing application material to requirements, and enhancing application material.

*Separate Section*

49. One of the objectives of the auditor, which is unchanged from extant ISA 240, is to respond appropriately to fraud or suspected fraud identified during the audit (see ED-240, paragraph 17(c)). However, to respond to the key issue described in paragraph 47 above, the IAASB introduced a number of requirements and reordered other ones to clarify the auditor's work effort (paragraphs 55–59, and 66–69 of ED-240).

*New and Enhanced Requirements and Application Material*

50. The most significant revision in ED-240 to the fraud or suspected fraud requirements is a new proposed requirement in paragraph 55 for the auditor to obtain an understanding of the fraud or suspected fraud. Although the need to obtain an understanding of the fraud or suspected fraud was implied in extant ISA 240, the IAASB is proposing to make that requirement explicit in paragraph 55 of ED-240.

51. The requirement in paragraph 55 describes how the auditor obtains the understanding of the fraud or suspected fraud (paragraph 55(a)) as well as the required elements of the auditor's understanding (paragraphs 55(b)–(c)). The application material paragraph A150 and A151 clarifies that the absence at the entity of a process to investigate and/or remediate the matter may, depending on the circumstances, be regarded by the auditor as an indicator of a significant deficiency in internal control.

52. Throughout the development of ED-240, there were mixed views about which procedures in this section, if any, could reasonably be expected to be directly fulfilled by the engagement partner. The

IAASB agreed that it is appropriate to require the engagement partner, based on the understanding obtained in accordance with paragraph 55, to make determinations about the effect of the fraud or suspected fraud on the audit in accordance with paragraph 56.

53. The rest of the fraud or suspected fraud requirements (paragraphs 57–58, and 66–69) were not significantly revised from the corresponding requirements in extant ISA 240.

*Scalability of the Fraud or Suspected Fraud Requirements*

54. The IAASB also sought to keep the fraud or suspected fraud requirements scalable. The IAASB addressed the following two questions relating to scalability:

    (a) Does the auditor apply the fraud or suspected fraud requirements to all instances of identified fraud or suspected fraud?

    (b) In applying the fraud or suspected fraud requirements, is it sufficiently clear whether the auditor needs to apply all of the requirements, including for fraud or suspected fraud that is considered inconsequential?

55. Regarding the first question, paragraphs A7–10 and A29 describe what the phrase "fraud or suspected fraud identified by the auditor" means for the purposes of applying ED-240. The phrase is intended to denote any fraud or suspected fraud affecting the entity that the auditor identifies:

    (a) Directly—when performing procedures in accordance with ED-240 and other ISAs; or

    (b) Indirectly—when a party internal or external to the entity brings an allegation of fraud to the auditor's attention during the course of the audit. Allegations of fraud that are brought to the auditor's attention are treated by the auditor as suspected fraud for the purposes of applying ED-240.

56. For all instances of fraud or suspected fraud identified by the auditor, ED-240 requires the auditor to apply at least some of the fraud or suspected fraud requirements that are applicable in the circumstances to determine the effect on the audit engagement. The basis for the IAASB's conclusion is that obtaining an understanding of the fraud or suspected in accordance paragraph 55, for example, is necessary to inform the engagement partner's determinations required in paragraph 56.

57. Regarding the second question, the IAASB notes that scalability has been introduced into ED-240 because, depending on the nature of the fraud or suspected fraud, some of the fraud or suspected fraud requirements may not be applicable. For example, after the auditor obtains an understanding of the fraud or suspected fraud in paragraph 55 and the engagement partner makes the required determinations in paragraph 56, the rest of the fraud or suspected fraud requirements may not be applicable depending on the facts and circumstances of the audit and the nature of the fraud.

### Section 1-H – Transparency on Fraud-Related Responsibilities and Procedures in the Auditor's Report

58. A key issue described in paragraph 19 of the project proposal relating to transparency is that the auditor's report may not be transparent enough about the auditor's fraud-related responsibilities and procedures.

59. As described in the project proposal, the IAASB set out to explore revisions to requirements and enhancements to application material to determine the need for more transparency in the auditor's report describing fraud-related matters, and if needed, how this may be done.

*Background*

60. The following section describes the significant deliberations of the IAASB that informed the IAASB's final proposal on how to best enhance the transparency of the auditor's report about matters related to fraud.

Outreach with Users of the Financial Statements

61. After publishing the project proposal, the IAASB carried out targeted outreach to users of general-purpose financial statements to obtain their views on how the auditor's report could be enhanced when dealing with matters related to fraud. See Appendix 3 of Agenda Item 6 of the September 2022 meeting for the list of users that participated in the targeted outreach. The IAASB had received little input from this stakeholder group and obtaining their views was considered important because of the focus on this stakeholder group in the Monitoring Group's Public Interest Framework.

62. Specifically, the targeted outreach sought to obtain a better understanding of the information users of financial statements would like to see included in the auditor's report relating to the auditor's fraud-related responsibilities and procedures. Users of financial statements were asked to select from the following five (non-mutually exclusive) alternatives (for more information see Agenda Item 6-A of the September 2022 IAASB meeting):

    (a) Option 1: Describing the auditor's approach to fraud risks.

    (b) Option 2: Describing the identified and assessed fraud risks, and the auditor's response to the assessed fraud risks.

    (c) Option 3: 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.

    (d) Option 4: Emphasizing the use of the existing requirements for the communication of Key Audit Matters (KAMs) for listed entities when there is a fraud risk.

    (e) Option 5: Reporting identified significant deficiencies in internal control that are relevant to the prevention and detection of fraud.

63. To respond to the feedback received but also considering the feedback received from other stakeholders on the Discussion Paper, the IAASB deliberated whether the auditor's report should include a separate section which describes the following:

    (a) The auditor's responsibilities as it relates to fraud in the audit of the financial statements;

    (b) The identified and assessed fraud risks of material misstatement and the auditor's responses to the assessed risks; and

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

64. The IAASB broadly supported describing the auditor's responsibilities as it relates to fraud in the audit of the financial statements in the auditor's report and decided to use a filtering mechanism, like the

one used to communicate KAMs in ISA 701,[8] to help the auditor determine which matters related to fraud required significant auditor attention including risks of material misstatement related to fraud. The IAASB noted that a filtering mechanism similar to that for KAMs would help the auditor in determining when and what to report. Also, the IAASB was of the view that KAMs, when applied appropriately, provide users of the financial statements with entity-specific information (also see results of the Auditor Reporting Post-Implementation Review).

65. Although the IAASB recognized that users of financial statements valued insights about an entity's internal control relevant to the prevention or detection of fraud as potential early indicator of "what could go wrong" at an entity, the IAASB identified a number of challenges associated with introducing a requirement to communicate significant deficiencies in internal control relevant to the prevention and detection of fraud in the auditor's report. Specifically, the IAASB noted the following:

    (a) The purpose of an audit of financial statements under the ISAs is not to test an entity's internal control to identify significant deficiencies or to express an opinion on an entity's internal control over financial reporting.

    (b) Depending on whether the auditor adopts a substantive approach or a combined approach (i.e., tests of controls as well as substantive procedures), the auditor may get different outcomes in terms of what the auditor identifies as deficiencies in internal control.

    (c) There is a risk that the auditor may provide original information in the auditor's report about significant deficiencies in internal control that have not been provided by the entity.

    (d) The requirement would give undue emphasis to fraud-related matters which is inconsistent with the auditor's broader responsibility, as described in paragraph 5 of ISA 200, to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.

    In view of these challenges, the IAASB believed that the broader demand to enhance transparency in the auditor's report about matters related to fraud could be met without introducing a specific requirement to communicate identified significant deficiencies in internal control. Rather, the identification of significant deficiencies in internal control should be a factor in determining which matters related to fraud to communicate and how to describe those matters in the auditor's report (see paragraph 72 below). This would also be consistent with the identified need for communicating entity-specific information in the auditor's report (see paragraph 75 below)

*The IAASB's Proposed Revisions in ED-240 to Enhance the Transparency of the Auditor's Report about Matters Related to Fraud*

66. The following section describes the IAASB's proposed revisions in ED-240 to enhance the transparency of the auditor's report regarding the auditor's fraud-related responsibilities and procedures. The IAASB decisions follow the initial discussions as described in paragraphs 61–65 above.

[8] ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

Clarifying the Auditor's Responsibilities Related to Fraud in the Auditor's Report

67. To enhance the transparency in the auditor's report about the auditor's responsibilities related to fraud in an audit of financial statements, the IAASB made the following consequential amendments to ISA 700 (Revised):[9]

    (a) Paragraph 40(a) of ISA 700 (Revised) was enhanced to include the auditor's responsibilities to communicate to TCWG identified fraud, suspected fraud or other fraud-related matters that are, in the auditor's judgment, relevant to the responsibilities of TCWG; and

    (b) Paragraph 40(c) of ISA 700 (Revised) was enhanced to reflect the new auditor's responsibilities with respect to KAMs related to fraud.

68. The IAASB also made conforming amendments to the illustrative auditor's reports in the appendix of ISA 700 (Revised) and other ISAs for the amendments to paragraphs 40(a) and 40(c) of ISA 700 (Revised).

Key Audit Matters Related to Fraud

Implications for the auditor's report

69. In making changes to the auditor's report for KAMs related to fraud, the IAASB recognized that the Going Concern, and Listed Entity and PIE Task Forces were also proposing changes to the auditor's report. The IAASB considered the aggregate impact of all the changes being proposed to the auditor's report to maintain the coherence of the auditor's report.

70. For KAMs related to fraud, the IAASB considered the following three options on where the KAMs related to fraud should be included in the auditor's report:

    (a) Option 1: Include KAMs related to fraud in a separate section;

    (b) Option 2: Include a subsection on KAMs related to fraud within the Key Audit Matters section;

    (c) Option 3: Integrate the KAMs related to fraud in the Key Audit Matters section but clearly signal in the subheading that the KAMs relate to fraud.

71. The IAASB agreed on option 3, including a modification of the naming convention for the section which includes Key Audit Matters in the auditor's report to: "Key Audit Matters Including Matters Relating to Fraud." The basis for selecting option 3 was that having a subsection (i.e., option 2) or separate section (i.e., option 1) dealing with KAMs related to fraud could create confusion regarding the relative importance of the other KAMs communicated in the auditor's report. The IAASB also felt that having a subsection or a separate section for KAMs related to fraud might give rise to practical challenges as some KAMs relate to both fraud and error.

Determining KAMs

72. The IAASB added in paragraph 61 of ED-240 a fraud lens to the filtering mechanism in paragraph 9 of ISA 701. Paragraph 61 lists the following specific required considerations:

    (a) Identified and assessed risks of material misstatement due to fraud;

    (b) The identification of fraud or suspected fraud; and

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

(c) The identification of significant deficiencies in internal control that are relevant to the prevention and detection of fraud.

Driving the auditor to communicate KAMs related to fraud

73. The IAASB sought to develop requirements and application material in ED-240 that drive an increase in reporting of KAMs related to fraud to satisfy the needs expressed by stakeholders for more transparency about matters related to fraud in the auditor's report. The IAASB introduced the following application material:

- Paragraph A168 states that "matters related to fraud are often matters that require significant auditor attention." In accordance with the CUSP Drafting Principles and Guidelines, the qualifier "often" is used to denote the second highest probability of occurrence,
- Paragraph A170 states that "one or more of the matters related to fraud that required significant auditor attention in performing the audit, determined in accordance with paragraph 61, would ordinarily be of most significance in the audit of the financial statements of the current period and therefore are key audit matters". In accordance with the CUSP Drafting Principles and Guidelines, the qualifier "ordinarily" is used to denote the highest probability of occurrence.

74. In addition, the IAASB enhanced paragraph A21 in ISA 701 through a consequential amendment as the IAASB was of the view that the first sentence of this application material may have driven auditors not to communicate KAMs related to fraud. The enhancement clarifies that the auditor's responsibilities to communicate KAMs related to fraud for management override of controls and the presumed risks of material misstatement due to fraud in revenue recognition, are key audit matters when the matters require significant auditor attention and are of most significance in the audit.

Reporting entity-specific information in KAMs related to fraud

75. The IAASB also sought to discourage the use by auditors of boilerplate language in KAMs related to fraud in the auditor's report by:

(a) Highlighting in paragraph A173 of the application material the importance of relating KAMs related to fraud to the specific circumstances of the entity to help minimize the potential that such descriptions become overly standardized and less useful over time.

(b) Aligning the requirements in ED-240 to the requirements in ISA 701. The IAASB's Auditor Reporting Post-Implementation Review showed that KAMs are valued and, generally, include entity-specific information and avoid the use of boilerplate language. By leveraging the requirements in ISA 701, the IAASB believes the same will hold true for KAMs related to fraud.

Applicability of the requirements to PIEs

76. Because the proposed requirements in ED-240 that deal with determining and communicating KAMs related to fraud in the auditor's report are intended to be applied in addition to or alongside the relevant requirements of the foundational standard, ISA 701, they effectively apply to audits of financial statements of listed entities.

77. In the December 2023 meeting, the IAASB approved an exposure draft with proposed narrow scope amendment to ISA 701 (i.e., among other narrow scope amendments to other standards) as part of

the IAASB's Listed Entity and PIE – Track 2 Project.[10] The proposals include expanding the applicability of ISA 701 to audits of financial statements of PIEs and would, if approved, also expand the applicability of the requirements in ED-240 for KAMs related to fraud to audits of financial statements of PIEs.

Conforming and consequential amendments to ISA 701

78. In addition to the conforming and consequential amendment to paragraph A21 of ISA 701 as discussed in paragraph 74 above, the IAASB made several other conforming and consequential amendments to ISA 701 given the changes in ED-240, including:

    (a) Throughout the standard, the IAASB updated the reference to the title of the KAM section. When there is a direct reference to the title of the KAM section, the name: "Key Audit Matters Including Matters Related to Fraud" is used. Otherwise, the IAASB kept the references to "Key Audit Matter section." The IAASB was of the view that always using the long form would add unnecessary words and added a footnote to paragraph 11 clarifying this.

    (b) Paragraph A8A: The IAASB added a paragraph to explain the relationship between ISA 701 and ED-240.

    (c) Paragraph A18A: The IAASB added a paragraph to link ISA 701 with the application material that was added to drive auditors to communicate KAMs related to fraud (see paragraphs 73–74 above).

    (d) Paragraph A58A: The IAASB added a paragraph referring the auditor to ED-240 for the appropriate presentation in the auditor's report when there are no KAMs related to fraud.

**Section 1-I – Documentation**

79. A key issue identified in paragraph 19 of the project proposal relating to documentation is that clarity is needed on what needs to be documented for fraud when identifying and assessing the risks of material misstatement, performing audit procedures and concluding.

80. In developing the revisions in ED-240, the IAASB built on the foundational standard on audit documentation (ISA 230[11]), as well as the documentation requirements in ISA 315 (Revised 2019) and ISA 330.[12] The revisions to the documentation requirements in paragraphs 45–48 of extant ISA 240 include the following:

    (a) Paragraph 70(a): This requirement is based on paragraph 45(a) of extant ISA 240. The IAASB enhanced the requirement by simplifying it to refer more broadly to "matters discussed" by the engagement team regarding the susceptibility of the entity's financial statements to material misstatement due to fraud.

    (b) Paragraph 70(b): Added a requirement that is aligned with ISA 315 (Revised 2019) paragraph 38(b) for the auditor to document the key elements of the auditor's understanding obtained in

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[10] Refer to Exposure Draft of *Proposed Narrow Scope Amendments to the ISQMs, ISAs, and ISRE 2400 (Revised)* as a Result of Revisions to the Definitions of Listed Entity and PIE in the IESBA Code (i.e., IAASB's Listed Entity and PIE – Track 2 Project)

[11] ISA 230, *Audit Documentation*

[12] ISA 330, *The Auditor's Responses to Assessed Risks*

accordance with paragraphs 33-38 of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control.

(c) Paragraph 70(c): Enhanced the requirement by requiring that, in addition to documenting the identified and assessed risks of material misstatement due to fraud at the both the financial statement and assertion level as required by extant ISA 240 paragraphs 45(b) and 45(c), the auditor also documents the rationale for the significant judgments made.

(d) Paragraph 70(d): Retained extant ISA 240 paragraph 48.

(e) Paragraph 70(e): Added a requirement for the auditor to document the results of audit procedures performed to address the risk of management override of controls, the significant professional judgments made, and the conclusions reached. This requirement is partly based on extant ISA 240, paragraph 46(a).

(f) Paragraph 70(f): Added a new requirement for the auditor to document fraud or suspected fraud identified, the results of audit procedures performed, the significant professional judgments made, and the conclusions reached.

(g) Paragraph 70(g): Enhanced the communication and reporting requirements related to circumstances when fraud or suspected fraud is identified in the audit. This requirement is based on extant ISA 240, paragraph 47.

**Section 1-J – Other Matters**

*Linkages to Other ISAs*

81. The following are the key issues identified in paragraph 19 of the project proposal relating to linkages between ED-240 and other ISAs:

(a) The relationship between ISA 240 and ISA 250 (Revised)[13] is unclear, i.e., more clarity is needed if a fraud is identified or suspected, whether the auditor is performing procedures to comply with ISA 240 or ISA 250 (Revised).

(b) The relationship between ISA 240 and other ISAs (e.g., standards addressing quality management, written representations, and external confirmations) should be clarified to promote an integrated risk-based approach with respect to fraud.

Clarifying the Relationship Between ED-240 and ISA 250 (Revised)

82. To clarify the interrelationship between ED-240 and ISA 250 (Revised), the IAASB enhanced the introductory material in paragraph 9 of extant ISA 240 (paragraph 14 of ED-240). Enhancements include clarifying that fraud constitutes an instance of non-compliance with laws and regulations and making an explicit reference to ISA 250 (Revised), which deals with the auditor's responsibility to consider laws and regulations in an audit of financial statements. In addition, the IAASB clarified in paragraph A16 of ED-240 that the identification by the auditor of fraud or suspected fraud affecting the entity that has been perpetrated by a third party may also give rise to additional responsibilities for the auditor under law, regulation, or relevant ethical requirements regarding an entity's non-compliance with laws and regulations.

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

Clarifying the Relationship Between ED-240 and Other ISAs

83. In its deliberations on how to clarify and reinforce the relationship between ED-240 and other ISAs, the IAASB focused on applying a fraud lens and the need to clearly articulate how the requirements in ED-240 build on the requirements in the foundational standards. The IAASB was of the view that ED-240's requirements and application material should promote an integrated risk-based approach with respect to fraud and, therefore, should not repeat the requirements and application material in other ISAs.

84. To clarify the linkages with other standards and to clarify that all ISAs apply to an audit of financial statements, the IAASB:

    (a) Clarified in the first paragraph of the standard that ED-240 deals with the auditor's responsibilities relating to fraud in an audit of financial statements and the implications for the auditor's report and that the requirements and guidance in ED-240 refer to, or expand on, the application of other relevant ISAs, in particular ISA 200, ISA 220 (Revised), ISA 315 (Revised 2019), ISA 330 and ISA 701.

    (b) When applicable, included a reference to the foundational standards in the requirement or application material. In such cases, the following construct is used: "In applying ISA …" or "In accordance with..."

    (c) Added a new section in the Introduction (paragraph 15 of ED-240), which explains the relationship between ED-240 and other ISAs. In doing so, the IAASB leveraged language from the issued non-authoritative guidance, *The Fraud Lens – Interactions Between ISA 240 and Other ISAs*.

    (d) Developed a new appendix (i.e., **Appendix 5**) that identifies other ISAs that address specific topics that reference fraud or suspected fraud.

*Use of Technology*

85. The following are the key issues identified in paragraph 19 of the project proposal relating to the impact of technology on entities and audits:

    (a) ISA 240 needs to consider the impact of the entity's ability to use technology to enable fraudulent activity on the auditor's procedures.

    (b) ISA 240 needs to be modernized for the auditor's considerations about how new and evolving technologies, and current practice, impact the auditor's procedures when considering fraud.

86. To respond to the key issues, the IAASB set out to enhance the application material in ED-240 to reflect and describe how technology may be used:

    (a) By the entity to enable fraudulent activity.

    (b) By the auditor to perform fraud-related procedures.

    In doing so, the IAASB was mindful of maintaining a balance of not "dating" the standard by referring to technologies that may change and evolve.

87. The IAASB carried out significant outreach to understand what enhancements were needed to the application material to deal with matters related to the use of technology, including hosting a virtual roundtable on Technology in September 2020 to explore:

(a) How technology facilitates the perpetration of fraud;

(b) How technology is used in financial statement audits; and

(c) How technology is used in forensic audits, and whether there are any aspects of this that may be helpful for the purpose of a financial statement audit.

Refer to the *Summary of Key-Take-Aways* for more information about the roundtable, including the list of participants. The IAASB also consulted with the IAASB's Technology Consultation Group, audit methodology experts and forensic experts.

88. The IAASB introduced considerations about the use of technology in application material paragraphs A5, A9, A28, A35, A51, A60, A64, A85, A97, A116, A117, A135, A139, A143, and in Appendices 2 and 4. Those paragraphs describe how technology used by the entity could give rise to fraud risk factors or fraud risks and how automated tools and techniques may be used by the auditor to perform fraud-related audit procedures. The following list includes some of those enhancements:

- Paragraph A28 refers to the possible use of automated tools and techniques, such as document authenticity or integrity technology, to evaluate the authenticity of the record or document after the auditor has identified conditions that cause the auditor to believe that a record or document may not be authentic or that terms in a document have been modified but not disclosed to the auditor.
- Paragraph A97 refers to how changes to the entity's information system due to the introduction of new IT applications or enhancements to the IT infrastructure may create susceptibilities at the entity to fraud. The paragraph also refers to increased susceptibility to fraud when the entity uses complex IT applications to initiate or process transactions or information, including IT applications that use artificial intelligence or machine learning algorithms.
- Paragraph A135 refers to the consideration by the auditor of the use of automated tools and techniques to test journal entries and other adjustments and that the auditor's consideration may, in turn, be impacted by the entity's use of technology to process of journal entries and other adjustments.
- Paragraph A143 refers to the possible use of automated tools and techniques, when performing analytical procedures near the end of the audit in forming an overall conclusion, to identify unusual or inconsistent transaction posting patterns in order to determine a previously unrecognized risk of material misstatement due to fraud.

*Definitions*

89. The following are the key issues identified in paragraph 19 of the project proposal relating to the definitions in extant ISA 240:

(a) There are terms and concepts associated with fraud, such as bribery, corruption, and money laundering, that are not directly addressed in the definition of fraud, and it has been noted that it is therefore unclear whether the auditor's procedures extend to include work related to such terms and concepts.

(b) Third party fraud – clarity is needed around the auditor's actions with respect to third party fraud.

Relationship of Fraud with Corruption, Bribery and Money Laundering

90. Corruption, bribery, and money laundering are terms often associated with fraud but are not directly addressed in the definition of fraud in extant ISA 240. In its deliberations, the IAASB agreed that the definition of fraud should not be expanded to include these terms considering how they may have varying definitions or interpretations across jurisdictions and how introducing these terms into the proposed standard may significantly increase the scope of an audit of financial statements. However, the IAASB clarified, in the application material, how concepts such as bribery and corruption, and money laundering, relate to the definition of fraud for purposes of an audit of financial statements. For example, the IAASB developed application material in ED-240:

    (a) Providing a linkage on how corruption, bribery and money laundering are addressed in ISA 250 (Revised) (see paragraph A18).

    (b) Clarifying, and providing examples of, how the concepts of corruption, bribery and money laundering relate to the definition of fraud (see paragraph A19).

    (c) Highlighting that the auditor does not make legal determinations of whether such acts have actually occurred (see paragraph A20).

Third-Party Fraud

91. The IAASB noted that the definition of fraud in extant ISA 240 already included fraud committed against the entity by third parties (i.e., third-party fraud). Extant ISA 240 defines fraud as "an intentional act by… third parties, involving the use of deception to obtain an unjust or illegal advantage." To clarify this point, the IAASB developed application material (paragraph A21):

    (a) Explaining that fraud as defined in paragraph 18(a) can include an intentional act by a third party; and

    (b) Describing third-party fraud as "fraud or suspected fraud committed against the entity by customers, suppliers, service providers, or other external parties."

92. In its deliberations of the auditor's work effort with respect to third-party fraud, the IAASB did not support expanding the role of the auditor to detect third-party fraud that is not directly related to a risk of material misstatement due to fraud in the financial statements. However, the IAASB enhanced the application material in paragraph A16 of ED-240 by explaining the auditor's action if third-party fraud or suspected fraud is identified by the auditor that may give rise to risks of material misstatement due to fraud (also see fraud or suspected fraud in **Section 1-G** above).

*Engagement Resources*

93. A key issue, identified in paragraph 19 of the project proposal, relating to engagement resources included calls for the auditor undertaking more forensic type procedures, or the need for forensic specialists on all, or some, audits due to the increasing use of forensic procedures on audits, including by forensic specialists.

94. In addressing the need for specialized skills (including forensic skills), the IAASB:

(a) Referred to and leveraged similar requirements and related application material to "determine the need for specialized skills" in ISA 540 (Revised),[14] and ISA (UK) 240 (Revised May 2021);[15] and

(b) Took into account current requirements and application material relating to specialized skills in extant ISA 240 and those relating more broadly to engagement resources in other standards (i.e., ISQM 1,[16] ISA 220 (Revised) [17] and ISA 300).[18]

95. Based on the above, the following changes in ED-240 address the need for specialized skills (including forensic skills):

(a) Engagement resources. The IAASB added a new requirement (paragraph 22 of ED-240) that emphasizes the importance of determining that the engagement team collectively has sufficient time and the appropriate specialized skills and knowledge (e.g., forensic, IT and other specialized skills), to perform risk assessment procedures, identify and assess the risks of material misstatement due to fraud, design and perform further audit procedures to respond to those risks, or evaluate the audit evidence obtained. This requirement expands on paragraphs 25–28 of ISA 220 (Revised).

(b) Describing forensic skills. Paragraph A35 of ED-240 describes forensic skills, explains how forensic skills in the context of an audit of financial statements may be used, and provides examples of forensic skills. This is intended to clarify what may qualify as forensic skills in light of respondents' comments on the Discussion Paper that this term is not commonly understood. In developing this application material, the IAASB leveraged how the term "forensic audit (or investigation)" was described in the Discussion Paper.

*Responses to the Assessed Risks of Material Misstatement Due to Fraud*

96. The following are the key issues identified in paragraph 19 of the project proposal relating to the auditor's responses to the assessed risks of material misstatement due to fraud:

(a) The auditor's responses to the assessed risks of material misstatement due to fraud should be more robust.

(b) Unpredictability of audit procedures – unclear as to the required actions or types of fraud related procedures to be undertaken by the auditor.

(c) External confirmations – clarity is needed as to whether the external confirmation process, as relevant to the auditor's considerations on fraud, should be more robust.

(d) Journal entries and other adjustments – uncertainty about how to select which journal entries to test that has resulted in inconsistent application.

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[14] ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*, paragraphs 15 and A61–A63

[15] ISA (UK) 240 (Revised May 2021), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraphs 24-1, A27-1, 33-1 and A48-1

[16] International Standard on Quality Management (ISQM) 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*, paragraphs 31(d), 32 and A79

[17] ISA 220 (Revised), paragraphs 25–28 and 35

[18] ISA 300, *Planning an Audit of Financial Statements*, paragraph 8(e)

More Robust Responses to the Assessed Risks of Material Misstatement due to Fraud

97. To drive more robust responses to assessed risks of material misstatement due to fraud, the IAASB enhanced the linkages in ED-240 to ISA 330 and ISA 540 (Revised). For example, paragraph A38 of extant ISA 240 was revised (paragraph A117 of ED-240) to clarify that, in accordance with ISA 330, the auditor is required to obtain more persuasive audit evidence when responding to assessed risks of material misstatement due to fraud.

98. The IAASB also introduced a new requirement in paragraph 43, given the importance of exercising professional skepticism when designing a robust response to assessed risks of material misstatement due to fraud, that audit procedures not be biased toward obtaining audit evidence that may corroborate management's assertions or towards excluding audit evidence that may contradict such assertions.

99. The IAASB also enhanced requirements and application material related to the following:

    (a) Unpredictability of audit procedures (see paragraph 101 below).

    (b) External confirmations (see paragraph 102 below).

    (c) Journal entries (see paragraphs 103–106 below).

100. Finally, in considering how to further drive a robust response to assessed risks of material misstatement due to fraud, the IAASB considered but decided against introducing a stand-back requirement in ED-240 for the reasons described in paragraphs 107–109 below.

Unpredictability of Audit Procedures

101. The IAASB sought to enhance the application material that deals with unpredictability of audit procedures by expanding the list of examples in paragraph A114 in ED-240 (paragraph A37 of extant ISA 240) of how to incorporate an element of unpredictability in the selection of the nature, timing, and extent of audit procedures. Paragraph A114 also introduces why it is important for the auditor to maintain an open mind to new ideas and different perspectives when selecting the audit procedures to be performed to address risks of material misstatement due to fraud. Paragraph A115 introduces a reference to Appendix 2 of ED-240 as a source for possible audit procedures to choose from when incorporating an element of unpredictability in the nature, timing and extent of audit procedures.

External Confirmations

102. The IAASB enhanced the application material in paragraphs A118–A122 related to fraud considerations for external confirmation procedures by emphasizing the usefulness of external confirmations as an audit procedure when there is a heightened risk of fraud. The IAASB also included additional factors that may indicate doubts about the reliability of a response to an external confirmation request and added examples where the use of external confirmation procedures may be more effective or provide more persuasive audit evidence over the terms and conditions of a contractual agreement and the auditor identifies exceptions in a response to an external confirmation request.

Journal Entries and Other Adjustments

103. In addressing journal entries and other adjustments in ED-240, the IAASB took into consideration the existing requirements and application material in extant ISA 240[19] and other standards (i.e., ISA 315 (Revised 2019),[20] ISA 330[21] and ISA 500[22]).

104. The enhancements included in ED-240 are intended to provide the auditor with a robust framework for testing journal entries and other adjustments that enables auditors to better identify fraudulent journal entries and other adjustments. This framework includes the following components:

    (a) *Clarifying the linkage between ISA 315 (Revised 2019) relating to journal entries and ED-240.* As discussed in **Section 1-F** (paragraph 40(e)) above, the new requirements in paragraphs 37–38 of ED-240 expand on requirements relating to journal entries in ISA 315 (Revised 2019). These requirements emphasize aspects of the auditor's risk assessment procedures performed as part of ISA 315 (Revised 2019) relating to journal entries that are also relevant to the auditor's decisions when testing the appropriateness of journal entries and other adjustments in paragraphs 49–50 of ED-240.

    (b) *Testing the appropriateness of journal entries and other adjustments.* When performing audit procedures responsive to risks related to management override of controls, paragraph 49 of ED-240 retains paragraph 33(a) of extant ISA 240 and requires the auditor to design and perform audit procedures to test the appropriateness of journal entries and other adjustments. Enhanced application material in paragraphs A124–A127 of ED-240 clarify why the testing of journal entries and other adjustments is performed.

    (c) *Designing and performing audit procedures to test the appropriateness of journal entries and other adjustments.* This includes the following matters:

        (i) Inquiries of individuals involved in the financial reporting process. Paragraph 50(a) of ED-240 retains paragraph 33(a)(i) of extant ISA 240 and requires the auditor to make inquiries of individuals involved in the financial reporting process about their knowledge of inappropriate or unusual activity relating to the processing of journal entries and other adjustments.

        (ii) Completeness of the population of all journal entries and other adjustments. The IAASB added a new requirement in paragraph 50(b) of ED-240 for the auditor to obtain audit evidence about the completeness of the population of all journal entries and other adjustments made in the preparation of the financial statements throughout the period. The IAASB believes addressing the completeness of the population of all journal entries and other adjustments is important to assist the auditor when responding to the significant risk(s) of management override of controls. In addition, journal entries and other adjustments comprise information generated internally from the entity's information system, which emphasizes the need to test the attribute of completeness.

        (iii) Testing journal entries and other adjustments made at the end of a reporting period.

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19 ISA 240, paragraphs 33(a) and A42–A45

20 ISA 315 (Revised 2019), paragraphs 25, 26(a)(ii), A131–A146, A160–A161 and A175–A181

21 ISA 330, paragraphs 20 and A52

22 ISA 500, paragraph 9

Paragraph 50(c) of ED-240 retains paragraph 33(a)(ii) of extant ISA 240 and requires the auditor to select journal entries and other adjustments made at the end of a reporting period.

(iv) Testing journal entries and other adjustments throughout the period. The IAASB enhanced the requirement in paragraph 33(a)(iii) of extant ISA 240 (paragraph 50(d) of ED-240). Enhancements include strengthening the work effort requirement from a "consideration" to a "determination" of the need to test journal entries throughout the period. This is intended to address the extent of testing journal entries to respond to risks related to management override of controls.

105. The IAASB also discussed enhancing the requirements in ED-240 to "consider the use of automated tools and techniques when testing journal entries." In its deliberations, the IAASB noted that the auditor's considerations for using automated tools and techniques in designing and performing audit procedures are only addressed within the application material of the Exposure Draft of Proposed ISA 500 (Revised), *Audit Evidence*, and other ISAs. The IAASB recognizes the importance of remaining consistent with the overall approach on how technology is addressed within the suite of ISAs. Accordingly, the IAASB developed new application material in paragraph A135 that explains how the auditor may use automated tools and techniques in testing journal entries.

106. The IAASB also developed new application material that explains how the auditor's design and performance of audit procedures over journal entries and other adjustments may be informed (see paragraphs A127 and A130 of ED-240). In addition, the IAASB added a new appendix with additional considerations that may inform the auditor when selecting journal entries and other adjustments for testing (see **Appendix 4** to ED-240).

Evaluation of the Sufficiency and Appropriateness of Audit Evidence – Considering a Separate Stand-back Requirement in ED-240

107. To make the auditor's responses to the assessed risks of material misstatement due to fraud more robust, the IAASB considered adding a separate stand-back requirement in ED-240 to evaluate all relevant audit evidence obtained, whether corroborative or contradictory, and whether sufficient appropriate audit evidence has been obtained in responding to the assessed risks of material misstatement due to fraud. Input obtained during the information gathering stage of the project suggested that such a stand-back requirement may be useful.

108. On one hand, the IAASB noted that, due to the nature of fraud, it is especially important that an overall evaluation needs to be performed that considers the outcome of the various risk assessment and further audit procedures, as well as any other observations in the aggregate. On the other hand, the IAASB noted that an additional stand-back requirement in ED-240 may not be needed considering that existing stand-back requirements and guidance in other ISAs (i.e., ISA 220 (Revised)[23], ISA 315 (Revised 2019),[24] ISA 330,[25] and ISA 540 (Revised)[26]) also apply to audit evidence obtained from audit procedures performed in accordance with ED-240. The IAASB is also mindful of the concern raised by stakeholders about the proliferation of stand-back requirements in the ISAs.

[23] ISA 220 (Revised), paragraphs 32 and A90–A94

[24] ISA 315 (Revised 2019), paragraphs 35 and A230–A232

[25] ISA 330, paragraphs 25–27 and A60–A62

[26] ISA 540 (Revised), paragraphs 33–35, A12–A13 and A137–A144

109. In the end the IAASB was of the view that a stand-back requirement is not needed in ED-240.[27] The IAASB noted that the new overarching requirement in paragraph 21 of ED-240 for the auditor to remain alert throughout the audit engagement for information that is indicative of fraud or suspected fraud provides a robust overall check for responses to the assessed risks of material misstatement due to fraud. This would also apply when performing audit procedures near the end of the audit when time pressures may exist.

*Written Representations*

110. A key issue identified in paragraph 19 of the project proposal is that the auditor is inappropriately relying on written representations provided by management addressing fraud in the entity (i.e., clarity is needed that written representations do not relieve the auditor of the responsibility to appropriately respond to the assessed risks of material misstatement due to fraud).

111. The IAASB enhanced the requirement in paragraph 65(a) of ED-240 by requiring the auditor to obtain an acknowledgement from management that they have appropriately fulfilled their responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud. The IAASB believes the acknowledgement serves to emphasize to management that they have the primary responsibility for the prevention and detection of fraud.

112. The IAASB also enhanced the related application material by:

- Strengthening the linkages to the foundational standard (i.e., ISA 580[28]).
- Clarifying in paragraph A180 that although written representations are an important source of audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. The paragraph also reminds the auditor that because management are in a unique position to perpetrate fraud, it is important for the auditor to consider all audit evidence obtained.
- Highlighting in paragraph A181 how the auditor may respond to doubts about the reliability of written representations by referring the auditor to ISA 580 to address such circumstances.

*Scalability Considerations*

113. The IAASB believes that it is important to address scalability considerations in ED-240 given that matters related to fraud are relevant to audits of all entities, regardless of size or complexity. The following describes how scalability and proportionality are addressed in ED-240 using the standard-setting toolbox in Section 3.1.3 of the CUSP Drafting Principles and Guidelines:

(a) Principles-based requirements. The requirements in ED-240 are sufficiently principles-based that allow the requirements to be applied in a wide range of circumstances (i.e., remaining neutral as to complexity, as well as being less prescriptive).

(b) Conditional requirements. The IAASB included conditional requirements in the standard that only apply when a certain condition is met. The conditionality for a requirement is highlighted at the beginning of the requirement to help make clear that there are limits to the relevance

[27] The IAASB notes that a member dissented on the approval of ED-240 based on this point.

[28] ISA 580, *Written Representations*

and applicability of the requirement in ED-240. The following are examples of conditional requirements in ED-240:

(i) Professional skepticism in paragraph 20.

(ii) Inquiries of management and inconsistent responses in paragraph 30.

(iii) Accounting estimates in paragraph 52(b).

(iv) Fraud or suspected fraud in paragraphs 55–59.

(v) The auditor being unable to continue the audit engagement in paragraph 60.

(vi) Communications with management and TCWG in paragraphs 66–67.

(vii) Reporting to an appropriate authority outside the entity in paragraph 69.

(viii) Documentation in paragraph 70(d).

(c) Differential requirements. Because transparency in the auditor's report about matters related to fraud is driven through the communication of KAMs, it currently applies to listed entities in accordance with ISA 701 (see paragraphs 76–77 above and paragraphs 61–64 of ED-240).

(d) Scalability considerations specific for smaller or less complex entities. The IAASB added new or retained scalability considerations specific for smaller or less complex entities in ED-240 (see application material in paragraphs A58, A74 and A87–A88 of ED-240). These are intended to help the auditor by illustrating how a particular requirement in ED-240 can be 'scaled' up for more complex entities or 'scaled' down for audits of less complex entities.

(e) Scalability in the context of the nature and circumstances of the audit engagement. The IAASB included examples in ED-240 to demonstrate how the nature and extent of the auditor's fraud related audit procedures may vary based on the nature and circumstances of the audit engagement. For example:

(i) Determining the need for specialized skills, as well as the nature, timing and extent of direction, supervision and review in accordance with paragraphs 22–24 of ED-240 would allow the application of judgment by the engagement partner in light of the varying circumstances of an audit (see relevant application material in paragraphs A34 and A38 of ED-240).

(ii) The appropriate timing of the communications with management and TCWG about matters related to fraud in accordance with paragraph 25 of ED-240 may vary depending on the significance and nature of the fraud-related matters and the expected action(s) to be taken by management or TCWG (see relevant application material in paragraph A41 of ED-240).

(iii) The extent of understanding of the fraud or suspected fraud identified in the audit, including the nature and extent of the entity's process to investigate the matter, in accordance with paragraph 55 of ED-240 may vary based on the facts and circumstances (see relevant application material in paragraphs A147–A148 of ED-240).

*Considerations Specific to Public Sector Entities*

114. The IAASB remains cognizant of the fact that matters related to fraud are also relevant to public sector entities. Considerations specific to public sector entities in paragraphs A7, A58 and A69 of

extant ISA 240 (paragraphs A1, A161 and A192 of ED-240) were substantially retained in ED-240 as the IAASB believes they remain relevant. Enhancements for public sector perspectives in ED-240 includes new application material in paragraph A106 highlighting that misappropriation of assets (e.g., misappropriation of funds) may be a common type of fraud for public sector entities.

*Effective Date*

115. Given that the requirements of ED-240 apply to the planning and performing stages of the audit engagement, the IAASB is of the view that the "beginning on or after" convention should be used in the effective date paragraph (see paragraph 16 of ED-240) in line with the CUSP Drafting Principles and Guidelines.

116. The IAASB anticipates that the final pronouncement will be approved in March 2025. Recognizing the need to coordinate effective dates with the IAASB's Going Concern project and the Listed Entity and PIE – Track 2 project that are also considering actions that may result in changes to the auditor's report, the IAASB believes that an appropriate effective date for the standard would be for financial reporting periods beginning at least 18 months after approval of the final pronouncement. The IAASB is of the view that this timeframe is adequate to allow jurisdictions sufficient time for translation of the final text of the standard, for national adoption processes to occur, and for practitioners to update templates and associated internal materials.

**Section 1-K– Conforming and Consequential Amendments**

117. The IAASB is proposing a number of conforming and consequential amendments arising from ED-240. Most changes relate to the alignment of the terminology and changes because of enhancing the transparency on fraud-related responsibilities and procedures in the auditor's report which are discussed in paragraphs 74 and 78 above.

118. To align the terminology used within the IAASB's suite of standards with the terminology used in ED-240 the following changes are proposed:

- The term "risk(s) of material misstatement due to fraud" is now only used in the context of the auditor's responsibilities.
- The terms "fraud risk(s)" are now only used in the context of the entity preparing the financial statements.

119. The IAASB also proposed consequential amendments to paragraphs 5A and A6A of ISA 450.[29] In paragraph 5A, the IAASB added a new requirement that "If the auditor identifies a misstatement, the auditor shall determine whether such a misstatement is indicative of fraud". In paragraph A6A, the IAASB added guidance and linkages to ED-240, for when the auditor identifies misstatements that may be a result of fraud.

[29] ISA 450, *Evaluation of Misstatements Identified during the Audit*

## Section 2 – Questions for Respondents

Respondents are asked to respond to the questions below using the Response Template as explained in the **Request for Comments** section on page 3 of this EM. The questions in the table each require a direct response on whether you agree with the proposals in ED-240. In each instance where you do not agree, **indicate your reasons, what you propose and why (e.g., an alternative or how proposals could be made clearer)**.

| Questions for Respondents | Reference to Sections or Paragraphs in This EM | Reference to Requirements in ED-240 |
|---|---|---|
| *Responsibilities of the Auditor* | | |
| 1. Does ED-240 clearly set out the auditor's responsibilities relating to fraud in an audit of financial statements, including those relating to non-material fraud and third-party fraud? | **Section 1-C**, paragraphs 13–18<br>**Section 1-J**, paragraphs 91–92 | Paragraphs 1–11 and 14 |
| *Professional Skepticism* | | |
| 2. Does ED-240 reinforce the exercise of professional skepticism about matters relating to fraud in an audit of financial statements? | **Section 1-D**, paragraphs 19–28 | Paragraphs 12–13 and 19–21 |
| *Risk Identification and Assessment* | | |
| 3. Does ED-240 appropriately build on the foundational requirements in ISA 315 (Revised 2019) and other ISAs to support a more robust risk identification and assessment as it relates to fraud in an audit of financial statements? | **Section 1-F**, paragraphs 36–46 | Paragraphs 26–42 |
| *Fraud or Suspected Fraud* | | |
| 4. Does ED-240 establish robust work effort requirements and application material to address circumstances when instances of fraud or suspected fraud are identified in the audit? | **Section 1-G**, paragraphs 47–57<br>**Section 1-E**, paragraph 35 | Paragraphs 55–59 and 66–69 |

| Questions for Respondents | Reference to Sections or Paragraphs in This EM | Reference to Requirements in ED-240 |
|---|---|---|
| *Transparency on Fraud-Related Responsibilities and Procedures in the Auditor's Report* | | |
| 5. Does ED-240 appropriately enhance transparency about matters related to fraud in the auditor's report? | **Section 1-H**, paragraphs 58–78 | Paragraphs 61–64 |
| 6. In your view, should transparency in the auditor's report about matters related to fraud introduced in ED-240 be applicable to audits of financial statements of entities other than listed entities, such as PIEs? | **Section 1-H**, paragraphs 76–77 | Paragraphs 61–64 |
| *Considering a Separate Stand-back Requirement in ED-240* | | |
| 7. Do you agree with the IAASB's decision not to include a separate stand-back requirement in ED-240 (i.e., to evaluate all relevant audit evidence obtained, whether corroborative or contradictory, and whether sufficient appropriate audit evidence has been obtained in responding to the assessed risks of material misstatement due to fraud)? | **Section 1-J**, paragraphs 107–109 | – |
| *Scalability* | | |
| 8. Do you believe that the IAASB has appropriately integrated scalability considerations in ED-240 (i.e., scalable to entities of different sizes and complexities, given that matters related to fraud in an audit of financial statements are relevant to audits of all entities, regardless of size or complexity)? | **Section 1-J**, paragraph 113 | – |

| Questions for Respondents | Reference to Sections or Paragraphs in This EM | Reference to Requirements in ED-240 |
|---|---|---|
| *Linkages to Other ISAs* | | |
| 9. Does ED-240 have appropriate linkages to other ISAs (e.g., ISA 200, ISA 220 (Revised), ISA 315 (Revised 2019), ISA 330, ISA 500, ISA 520,[30] ISA 540 (Revised) and ISA 701) to promote the application of the ISAs in an integrated manner? | **Section 1-J**, paragraphs 81–84 | – |
| *Other Matters* | | |
| 10. Are there any other matters you would like to raise in relation to ED-240? If so, please clearly indicate the requirement(s) or application material, or the theme or topic, to which your comment(s) relate. | – | – |
| *Translations* | | |
| 11. Recognizing that many respondents may intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents note in reviewing the ED-240. | – | – |

[30] ISA 520, *Analytical Procedures*

| **Questions for Respondents** | **Reference to Sections or Paragraphs in This EM** | **Reference to Requirements in ED-240** |
|---|---|---|
| *Effective Date* | | |
| 12. Given the need for national due process and translation, as applicable, and the need to coordinate effective dates with the Going Concern project and the Listed Entity and PIE – Track 2 project, the IAASB believes that an appropriate effective date for the standard would be for financial reporting periods beginning approximately 18 months after approval of the final standard. Earlier application would be permitted and encouraged. Would this provide a sufficient period to support effective implementation of the ISA? | **Section 1-J**, paragraphs 115–116 | Paragraph 16 |

# PROPOSED INTERNATIONAL STANDARD ON AUDITING 240 (REVISED)

# THE AUDITOR'S RESPONSIBILITIES RELATING TO FRAUD IN AN AUDIT OF FINANCIAL STATEMENTS

(Effective for audits of financial statements for periods beginning on or after [DATE])

**CONTENTS**

**Application and Other Explanatory Material**

# Introduction

## Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor's responsibilities relating to fraud in an audit of financial statements and the implications for the auditor's report. The requirements and guidance in this ISA refer to, or expand on, the application of other relevant ISAs, in particular ISA 200,[1] ISA 220 (Revised),[2] ISA 315 (Revised 2019),[3] ISA 330[4] and ISA 701.[5]

## Responsibilities of the Auditor, Management and Those Charged with Governance

*Responsibilities of the Auditor*

2. The auditor's responsibilities relating to fraud when conducting an audit in accordance with this ISA, and other relevant ISAs, are to: (Ref: Para. A1)

   (a) Plan and perform the audit to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement due to fraud. These responsibilities include identifying and assessing risks of material misstatement in the financial statements due to fraud and designing and implementing responses to address those assessed risks.

   (b) Communicate and report about matters related to fraud.

*Responsibilities of Management and Those Charged with Governance*

3. The primary responsibility for the prevention and detection of fraud rests with both management and those charged with governance of the entity. It is important that management, with the oversight of those charged with governance, place a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place, and fraud deterrence, which could persuade individuals not to commit fraud because of the likelihood of detection and punishment. This involves a commitment to creating and maintaining a culture of honesty and ethical behavior that can be reinforced by active oversight by those charged with governance. Oversight by those charged with governance includes considering the potential for override of controls or other inappropriate influence over the financial reporting process, such as efforts by management to manipulate earnings.

## Key Concepts in this ISA

*Characteristics of Fraud*

4. Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.

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1 ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

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

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

4 ISA 330, *The Auditor's Responses to Assessed Risks*

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

5. Two types of intentional misstatements are relevant to the auditor – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets. (Ref: Para. A2–A6)

Fraud or Suspected Fraud

6. Although fraud is a broad legal concept, for the purposes of the ISAs, the auditor is concerned with a material misstatement of the financial statements due to fraud. Although the auditor may identify or suspect the occurrence of fraud as defined by this ISA, the auditor does not make legal determinations of whether fraud has actually occurred.

7. The auditor may identify fraud or suspected fraud when performing audit procedures in accordance with this and other ISAs. Suspected fraud includes allegations of fraud that come to the auditor's attention during the course of the audit. (Ref: Para. A7–A10 and A29)

Circumstances Giving Rise to the Fraud and the Identified Misstatements

8. The auditor's determination of whether a fraud or suspected fraud is material to the financial statements involves the exercise of professional judgment. This includes consideration of the nature of the circumstances giving rise to the fraud or suspected fraud and the identified misstatement(s). Judgments about materiality involve both qualitative and quantitative considerations. (Ref: Para. A11)

*Inherent Limitations*

9. While the risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error, that does not diminish the auditor's responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement due to fraud. Reasonable assurance is a high, but not absolute, level of assurance.[6]

10. Because of the significance of the inherent limitations of an audit as it relates to fraud, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the ISAs.[7] However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less than persuasive audit evidence.[8] (Ref: Para. A12)

11. Furthermore, the risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud because management is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information, or override controls designed to prevent similar frauds by other employees.

*Professional Skepticism and Professional Judgment*

12. In accordance with ISA 200,[9] the auditor is required to plan and perform the audit with professional skepticism and to exercise professional judgment. The auditor is required by this ISA to remain alert

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6 ISA 200, paragraph 5

7 ISA 200, paragraphs A53-A54

8 ISA 200, paragraph A54

9 ISA 200, paragraphs 15-16

to the possibility that other audit procedures performed may bring information about fraud or suspected fraud to the auditor's attention. Accordingly, it is important that the auditor maintain professional skepticism throughout the audit. (Ref: Para. A13–A14)

13. Professional judgment is exercised in making informed decisions about the courses of action that are appropriate in the circumstances, including when the auditor identifies fraud or suspected fraud. Professional skepticism supports the quality of judgments made by the engagement team and, through these judgments, supports the overall effectiveness of the engagement team in achieving quality at the engagement level.

*Non-Compliance with Laws and Regulations*

14. For the purposes of this and other relevant ISAs, fraud constitutes an instance of non-compliance with laws and regulations. As such, if the auditor identifies fraud or suspected fraud, the auditor may have additional responsibilities under law, regulation or relevant ethical requirements regarding an entity's non-compliance with laws and regulations, which may differ from or go beyond this and other ISAs. ISA 250 (Revised)[10] deals with the auditor's responsibility to consider laws and regulations in an audit of financial statements. Complying with this responsibility and any additional responsibilities relating to relevant ethical requirements may provide further information that is relevant to the auditor's work in accordance with this and other ISAs (e.g., regarding the integrity of management or, where appropriate, those charged with governance). (Ref: Para. A15–A16)

**Relationship with Other ISAs**

15. Some ISAs that address specific topics also have requirements and guidance that are applicable to the auditor's work on the identification and assessment of the risks of material misstatement due to fraud and responses to address such assessed risks of material misstatement due to fraud. In these instances, the other ISAs expand on how this ISA is applied. (Ref: Para. A17)

**Effective Date**

16. This ISA is effective for audits of financial statements for periods beginning on or after [*DATE*].

## Objectives

17. The objectives of the auditor are:

    (a) To identify and assess the risks of material misstatement of the financial statements due to fraud;

    (b) To obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses;

    (c) To respond appropriately to fraud or suspected fraud identified during the audit; and

    (d) To report in accordance with this ISA.

## Definitions

18. For purposes of the ISAs, the following terms have the meanings attributed below:

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

(a) 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. (Ref: Para. A18–A21)

(b) Fraud risk factors – Events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud. (Ref: Para. A22–A23)

## Requirements

### Professional Skepticism

19. In applying ISA 200,[11] the auditor shall maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist. (Ref: Para. A24–A25)

20. If conditions identified during the audit cause the auditor to believe that a record or document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, the auditor shall investigate further. (Ref: Para. A26–A28)

21. The auditor shall remain alert throughout the audit for information that is indicative of fraud or suspected fraud. (Ref: Para. A29–A32)

### Engagement Resources

22. In applying ISA 220 (Revised),[12] the engagement partner shall determine that members of the engagement team collectively have the appropriate competence and capabilities, including sufficient time and appropriate specialized skills or knowledge to perform risk assessment procedures, identify and assess the risks of material misstatement due to fraud, design and perform further audit procedures to respond to those risks, or evaluate the audit evidence obtained. (Ref: Para. A33–A36)

### Engagement Performance

23. In applying ISA 220 (Revised),[13] the engagement partner shall determine that the nature, timing and extent of direction, supervision and review is responsive to the nature and circumstances of the audit engagement, taking into account the: (Ref: Para. A37)

(a) Skills, knowledge, and experience of the individuals to be given significant engagement responsibilities; and

(b) Risks of material misstatement due to fraud identified and assessed in accordance with ISA 315 (Revised 2019).

24. In making the determination in paragraph 23, the engagement partner shall consider matters identified during the course of the audit engagement, including: (Ref: Para. A38)

(a) Events or conditions that indicate an incentive or pressure to commit fraud, or provide an opportunity to commit fraud (i.e., fraud risk factors are present);

(b) Fraud or suspected fraud; and

(c) Control deficiencies related to the prevention or detection of fraud.

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[11] ISA 200, paragraph 15

[12] ISA 220 (Revised), paragraphs 25–28

[13] ISA 220 (Revised), paragraph 30(b)

**Ongoing Nature of Communications with Management and Those Charged with Governance**

25. The auditor shall communicate with management and those charged with governance matters related to fraud at appropriate times throughout the audit engagement. (Ref: Para. A39–A43)

**Risk Assessment Procedures and Related Activities**

26. In applying ISA 315 (Revised 2019),[14] the auditor shall perform the procedures in paragraphs 27–39 to obtain audit evidence that provides an appropriate basis for the: (Ref: Para. A44)

    (a) Identification and assessment of risks of material misstatement due to fraud at the financial statement and assertion levels, taking into account fraud risk factors; and

    (b) Design of further audit procedures in accordance with ISA 330.

*Information from Other Sources*

27. In applying ISA 315 (Revised 2019),[15] the auditor shall consider whether information from other sources obtained by the auditor indicates that one or more fraud risk factors are present. (Ref: Para. A45–A46)

*Retrospective Review of the Outcome of Previous Accounting Estimates*

28. In applying ISA 540 (Revised),[16] the auditor shall perform a retrospective review of management judgments and assumptions related to the outcome of previous accounting estimates, or where applicable, their subsequent re-estimation to assist in identifying and assessing the risks of material misstatement due to fraud in the current period. In doing so, the auditor shall take into account the characteristics of the accounting estimates in determining the nature and extent of that review. (Ref: Para. A47)

*Engagement Team Discussion*

29. In applying ISA 315 (Revised 2019),[17] when holding the engagement team discussion, the engagement partner and other key engagement team members shall place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud may occur. In doing so, the engagement team discussion shall include: (Ref: Para. A48–A49 and A53)

    (a) An exchange of ideas about:

        (i) The entity's culture, management's commitment to integrity and ethical values, and related oversight by those charged with governance; (Ref: Para. A50)

        (ii) Fraud risk factors, including: (Ref: Para. A51–A52)

            a. Incentives or pressures on management, those charged with governance, or employees to commit fraud;

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[14] ISA 315 (Revised 2019), paragraph 13

[15] ISA 315 (Revised 2019), paragraphs 15–16

[16] ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*, paragraph 14

[17] ISA 315 (Revised 2019), paragraphs 17 and A42–A43

b. How one or more individuals among management, those charged with governance, or employees could perpetrate and conceal fraudulent financial reporting; and

c. How assets of the entity could be misappropriated by management, those charged with governance, employees or third parties.

(b) A consideration of any fraud or suspected fraud, including allegations of fraud, that may impact the overall audit strategy and audit plan, including fraud that has occurred at the entity during the current or prior years.

*Inquiries of Management and Inconsistent Responses*

30. In applying ISA 500,[18] if the responses to inquiries of management, those charged with governance, individuals within the internal audit function, or others within the entity, are inconsistent with each other, the auditor shall:

(a) Determine what modifications or additions to audit procedures are necessary to understand and address the inconsistency; and

(b) Consider the effect, if any, on other aspects of the audit.

*Analytical Procedures Performed and Unusual or Unexpected Relationships Identified*

31. The auditor shall determine whether unusual or unexpected relationships that have been identified in performing analytical procedures, including those related to revenue accounts, may indicate risks of material misstatement due to fraud. (Ref: Para. A54)

*Evaluation of Fraud Risk Factors*

32. The auditor shall evaluate whether the audit evidence obtained from the risk assessment procedures and related activities indicates that one or more fraud risk factors are present. (Ref: Para. A22–A23 and A55–A58)

**Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework and the Entity's System of Internal Control**

*Understanding the Entity and Its Environment, and the Applicable Financial Reporting Framework*

33. In applying ISA 315 (Revised 2019),[19] the auditor shall obtain an understanding of matters related to the:

(a) Entity and its environment that may lead to an increased susceptibility to misstatement due to management bias or other fraud risk factors, including with respect to:

(i) The entity's organizational structure and ownership, governance, objectives and strategy, and geographic dispersion; (Ref: Para. A59–A62)

(ii) The industry; and (Ref: Para. A63)

[18] ISA 500, *Audit Evidence,* paragraph 11

[19] ISA 315 (Revised 2019), paragraph 19

(iii) The performance measures used, whether internal or external, that may create incentives or pressures to achieve financial performance targets. (Ref: Para. A64–A66)

(b) Applicable financial reporting framework and the entity's accounting policies that may lead to an increased susceptibility to misstatement due to management bias or other fraud risk factors. (Ref: Para. A67)

*Understanding the Components of the Entity's System of Internal Control*

Control Environment

34. In applying ISA 315 (Revised 2019),[20] the auditor shall:

(a) Obtain an understanding of how management's oversight responsibilities are carried out, such as the entity's culture and management's commitment to integrity and ethical values, including how management communicates with its employees its views on business practices and ethical behavior with respect to the prevention and detection of fraud. (Ref: Para. A68–A70)

(b) Obtain an understanding of how those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the controls that management has established to address these risks. (Ref: Para. A71–A74)

(c) Make inquiries of management regarding management's communications with those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity.

(d) Make inquiries of those charged with governance about: (Ref: Para. A75–A78)

(i) Whether they have knowledge of any fraud or suspected fraud, including allegations of fraud, affecting the entity;

(ii) Their views about whether and how the financial statements may be materially misstated due to fraud, including their views on possible areas that are susceptible to misstatement due to management bias or management fraud; and

(iii) Whether they are aware of deficiencies in the system of internal control related to the prevention and detection of fraud, and the remediation efforts to address such deficiencies.

The Entity's Risk Assessment Process

35. In applying ISA 315 (Revised 2019),[21] the auditor shall:

(a) Obtain an understanding of how the entity's risk assessment process: (Ref: Para. A79–A88)

(i) Identifies fraud risks related to the misappropriation of assets and fraudulent financial reporting, including any classes of transactions, account balances, or disclosures for which risks of fraud exist;

(ii) Assesses the significance of the identified fraud risks, including the likelihood of their occurrence; and

[20] ISA 315 (Revised 2019), paragraph 21

[21] ISA 315 (Revised 2019), paragraph 22

(iii) Addresses the assessed fraud risks.

(b) Make inquiries of management and of other appropriate individuals within the entity about: (Ref: Para. A89–A91)

(i) Whether they have knowledge of any fraud or suspected fraud, including allegations of fraud, affecting the entity; and

(ii) Their views on whether the financial statements may be materially misstated due to fraud.

The Entity's Process to Monitor the System of Internal Control

36. In applying ISA 315 (Revised 2019),[22] the auditor shall:

(a) Obtain an understanding of aspects of the entity's process that address the ongoing and separate evaluations for monitoring the effectiveness of controls to prevent or detect fraud, and the identification and remediation of related control deficiencies. (Ref: Para. A92)

(b) Make inquiries of appropriate individuals within the internal audit function (if the function exists) about whether they have knowledge of any fraud or suspected fraud, including allegations of fraud, affecting the entity and to obtain their views about the risks of fraud. (Ref: Para. A93–A94)

The Information System and Communication

37. In applying ISA 315 (Revised 2019),[23] the auditor's understanding of the entity's information system and communication relevant to the preparation of the financial statements shall include understanding how journal entries are initiated, processed, recorded, and corrected as necessary. (Ref: Para. A95–A97)

Control Activities

38. In applying ISA 315 (Revised 2019),[24] the auditor's understanding of the entity's control activities shall include identifying controls that address risks of material misstatement due to fraud at the assertion level, including controls over journal entries, designed to prevent or detect fraud. (Ref: Para. A98–A101)

*Control Deficiencies Within the Entity's System of Internal Control*

39. In applying ISA 315 (Revised 2019),[25] based on the auditor's evaluation of each of the components of the entity's system of internal control, the auditor shall determine whether there are deficiencies in internal control identified that are relevant to the prevention or detection of fraud. (Ref: Para. A102–A103)

[22] ISA 315 (Revised 2019), paragraph 24

[23] ISA 315 (Revised 2019), paragraph 25

[24] ISA 315 (Revised 2019), paragraph 26

[25] ISA 315 (Revised 2019), paragraph 27

**Identifying and Assessing the Risks of Material Misstatement due to Fraud**

40. In applying ISA 315 (Revised 2019),[26] the auditor shall:

    (a) Identify and assess the risks of material misstatement due to fraud and determine whether they exist at the financial statement level, or the assertion level for classes of transactions, account balances and disclosures, taking into account fraud risk factors. (Ref: Para. A104–A106)

    (b) Treat those assessed risks of material misstatement due to fraud as significant risks. Accordingly, to the extent not already done so, the auditor shall identify controls that address such risks, evaluate whether they have been designed effectively and determine whether they have been implemented.

*Presumption of the Risks of Material Misstatement Due to Fraud in Revenue Recognition*

41. When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of material misstatement due to fraud in revenue recognition, determine which types of revenue, revenue transactions or relevant assertions give rise to such risks, taking into account related fraud risk factors. (Ref: Para. A107–A112)

*Significant Risks Related to Management Override of Controls*

42. Due to the unpredictable way in which management is able to override controls and irrespective of the auditor's assessment of the risks of management override of controls, the auditor shall treat those risks as risks of material misstatement due to fraud and thus significant risks. (Ref: Para. A113)

**Responses to the Assessed Risks of Material Misstatement Due to Fraud**

*Designing and Performing Audit Procedures in a Manner That Is Not Biased*

43. The auditor shall design and perform audit procedures in response to the assessed risks of material misstatement due to fraud in a manner that is not biased towards obtaining audit evidence that may corroborate management's assertions or towards excluding audit evidence that may contradict such assertions.

*Unpredictability in the Selection of Audit Procedures*

44. The auditor shall incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures in determining responses to address the assessed risks of material misstatement due to fraud. (Ref: Para. A114–A115)

*Overall Responses*

45. In accordance with ISA 330, [27] the auditor shall determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level. (Ref: Para. A116)

46. In determining overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level, the auditor shall evaluate whether the selection and application of

[26] ISA 315 (Revised 2019), paragraphs 28–34

[27] ISA 330, paragraph 5

accounting policies by the entity, particularly those related to subjective measurements and complex transactions, may be indicative of fraudulent financial reporting.

*Audit Procedures Responsive to the Assessed Risks of Material Misstatement Due to Fraud at the Assertion Level*

47. In accordance with ISA 330,[28] the auditor shall design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement due to fraud at the assertion level. (Ref: Para. A117–A123)

*Audit Procedures Responsive to Risks Related to Management Override of Controls*

48. Irrespective of the auditor's assessment of the risks of management override of controls, the auditor shall design and perform the audit procedures in accordance with paragraphs 49–53, and determine whether other audit procedures are needed in addition to those in paragraphs 49–53, in order to respond to the identified risks of management override of controls.

Journal Entries and Other Adjustments

49. The auditor shall design and perform audit procedures to test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. (Ref: Para. A124–A127)

50. In designing and performing audit procedures in accordance with paragraph 49, the auditor shall:

    (a) Make inquiries of individuals involved in the financial reporting process about their knowledge of inappropriate or unusual activity relating to the processing of journal entries and other adjustments;

    (b) Obtain audit evidence about the completeness of the population of all journal entries and other adjustments made in the preparation of the financial statements throughout the period; (Ref: Para. A128–A129 and A135)

    (c) Select journal entries and other adjustments made at the end of a reporting period; and (Ref: Para. A130–A131, A132 and A134–A135)

    (d) Determine the need to test journal entries and other adjustments throughout the period. (Ref: Para. A130–A131 and A133–A134)

Accounting Estimates

51. In applying ISA 540 (Revised),[29] the auditor shall evaluate whether management's judgments and decisions in making the accounting estimates included in the financial statements, even if they are individually reasonable, are indicators of possible management bias that may represent a risk of material misstatement due to fraud. (Ref: Para. A136–A138)

52. In performing the evaluation in accordance with paragraph 51, the auditor shall:

    (a) Consider the audit evidence obtained from the retrospective review performed in accordance with paragraph 28; and

[28] ISA 330, paragraph 6

[29] ISA 540 (Revised), paragraph 32

(b) If indicators of possible management bias are identified, reevaluate the accounting estimates taken as a whole. (Ref: Para. A138–A140)

Significant Transactions Outside the Normal Course of Business or Otherwise Appear Unusual

53. For significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual given the auditor's understanding of the entity and its environment and information from other sources obtained during the audit, the auditor shall evaluate whether the business rationale (or the lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets. (Ref: Para. A141)

*Analytical Procedures Performed Near the End of the Audit in Forming an Overall Conclusion*

54. In applying ISA 520,[30] the auditor shall determine whether the results of analytical procedures that are performed near the end of the audit, when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity, indicate a previously unrecognized risk of material misstatement due to fraud. (Ref: Para. A142–A143)

**Fraud or Suspected Fraud** (Ref: Para. A7–A10, A29 and A144–A145)

55. If the auditor identifies fraud or suspected fraud, the auditor shall obtain an understanding of the matter in order to determine the effect on the audit engagement. In doing so, the auditor shall: (Ref: Para. A146–A151)

    (a) Make inquiries about the matter with a level of management that is at least one level above those involved and, when appropriate in the circumstances, make inquiries about the matter with those charged with governance;

    (b) If the entity has a process to investigate the matter, evaluate whether it is appropriate in the circumstances;

    (c) If the entity has implemented remediation measures to respond to the matter, evaluate whether they are appropriate in the circumstances; and

    (d) Determine whether control deficiencies exist, including significant deficiencies in internal control related to the prevention or detection of fraud, relating to the identified fraud or suspected fraud.

56. Based on the understanding obtained in accordance with paragraph 55, the engagement partner shall: (Ref: Para. A152–A153)

    (a) Determine whether:

        (i) To perform additional risk assessment procedures to provide an appropriate basis for the identification and assessment of the risks of material misstatement due to fraud in accordance with ISA 315 (Revised 2019);

        (ii) To design and perform further audit procedures to appropriately respond to the risks of material misstatement due to fraud in accordance with ISA 330; and

[30] ISA 520, *Analytical Procedures*, paragraph 6

(iii) There are additional responsibilities under law, regulation or relevant ethical requirements about the entity's non-compliance with laws or regulations in accordance with ISA 250 (Revised).

(b) If applicable, consider the impact on other engagements, including audit engagements from prior years.

57. If the auditor identifies a misstatement due to fraud, the auditor shall: (Ref: Para. A154–A157)

(a) Determine whether the identified misstatement is material by considering the nature of the qualitative or quantitative circumstances giving rise to the misstatement;

(b) Determine the implications of the misstatement in relation to other aspects of the audit, including when the auditor has reason to believe that management is involved; and

(c) Reconsider the reliability of management's representations and audit evidence previously obtained when the circumstances or conditions giving rise to the misstatement indicate possible collusion involving employees, management or third parties

58. If the auditor determines that the financial statements are materially misstated due to fraud, the auditor shall:

(a) Determine the implications for the audit and the auditor's opinion on the financial statements in accordance with ISA 705 (Revised);[31] and

(b) If appropriate, obtain advice from legal counsel.

59. If the auditor is unable to conclude whether the financial statements are materially misstated as a result of fraud, the auditor shall determine the implications for the audit or the auditor's opinion on the financial statements in accordance with ISA 705 (Revised).

**Auditor Unable to Continue the Audit Engagement**

60. If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit engagement, the auditor shall:

(a) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;

(b) Consider whether it is appropriate to withdraw from the engagement, where withdrawal is possible under applicable law or regulation;

(c) If the auditor withdraws:

(i) Discuss with the appropriate level of management and those charged with governance the auditor's withdrawal from the engagement and the reasons for the withdrawal; and

(ii) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal; and (Ref: Para. A158–A161)

[31] ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*

(d) Where law or regulation prohibits the auditor from withdrawing from the engagement, consider whether the exceptional circumstances will result in a disclaimer of opinion on the financial statements.

**Implications for the Auditor's Report**

*Determining Key Audit Matters*

61. In applying ISA 701,[32] the auditor shall determine, from the matters related to fraud communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following: (Ref: Para. A162–A168)

    (a) Identified and assessed risks of material misstatement due to fraud;

    (b) The identification of fraud or suspected fraud; and

    (c) The identification of significant deficiencies in internal control that are relevant to the prevention and detection of fraud.

62. In applying ISA 701,[33] the auditor shall determine which of the matters determined in accordance with paragraph 61 were of most significance in the audit of the financial statements of the current period and therefore are key audit matters. (Ref: Para. A169–A171)

*Communicating Key Audit Matters Related to Fraud*

63. In applying ISA 701,[34] in the Key Audit Matters section of the auditor's report, the auditor shall use an appropriate subheading that clearly describes that the matter relates to fraud. (Ref: Para. A172–A174)

64. In applying ISA 701,[35] if the auditor determines, depending on the facts and circumstances of the entity and the audit, that there are no key audit matters related to fraud to communicate, the auditor shall include a statement to this effect in the Key Audit Matters section of the auditor's report. (Ref: Para. A175–A179)

**Written Representations**

65. The auditor shall obtain written representations from management and, where appropriate, those charged with governance that: (Ref: Para. A180–A181)

    (a) They acknowledge their responsibility for the design, implementation, and maintenance of internal control to prevent or detect fraud and have appropriately fulfilled those responsibilities;

    (b) They have disclosed to the auditor the results of management's assessment of the risk that the financial statements may be materially misstated as a result of fraud;

    (c) They have disclosed to the auditor their knowledge of fraud or suspected fraud, including allegations of fraud, affecting the entity involving:

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[32] ISA 701, paragraph 9

[33] ISA 701, paragraph 10

[34] ISA 701, paragraph 11

[35] ISA 701, paragraph 16

(i) Management;

(ii) Employees who have significant roles in internal control; or

(iii) Others where the fraud could have a material effect on the financial statements; and

(d) They have disclosed to the auditor their knowledge of suspected fraud, including allegations of fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators, or others.

**Communications with Management and Those Charged with Governance**

*Communication with Management*

66. If the auditor identifies fraud or suspected fraud, the auditor shall communicate these matters, unless prohibited by law or regulation, on a timely basis with the appropriate level of management in order to inform those with primary responsibility for the prevention or detection of fraud of matters relevant to their responsibilities. (Ref: Para. A182 and A183)

*Communication with Those Charged with Governance*

67. Unless all of those charged with governance are involved in managing the entity, if the auditor identifies fraud or suspected fraud involving:

(a) management;

(b) employees who have significant roles in internal control; or

(c) others where the fraud results in a material misstatement in the financial statements,

the auditor shall communicate these matters with those charged with governance on a timely basis. If the auditor identifies suspected fraud involving management, the auditor shall communicate the suspected fraud with those charged with governance and discuss with them the nature, timing, and extent of audit procedures necessary to complete the audit. Such communications with those charged with governance are required unless the communication is prohibited by law or regulation. (Ref: Para. A182 and A184–A186)

68. The auditor shall communicate, unless prohibited by law or regulation, with those charged with governance any other matters related to fraud that are, in the auditor's judgment, relevant to the responsibilities of those charged with governance. (Ref: Para. A182 and A187)

**Reporting to an Appropriate Authority Outside the Entity**

69. If the auditor identifies fraud or suspected fraud, the auditor shall determine whether law, regulation or relevant ethical requirements: (Ref: Para. A188–A192)

(a) Require the auditor to report to an appropriate authority outside the entity.

(b) Establish responsibilities under which reporting to an appropriate authority outside the entity may be appropriate in the circumstances.

### Documentation

70. In applying ISA 230,[36] the auditor shall include the following in the audit documentation: (Ref: Para. A193)

    (a) The matters discussed among the engagement team regarding the susceptibility of the entity's financial statements to material misstatement due to fraud in accordance with paragraph 29.

    (b) Key elements of the auditor's understanding in accordance with paragraphs 33–38, the sources of information from which the auditor's understanding was obtained and the risk assessment procedures performed.

    (c) The identified and assessed risks of material misstatement due to fraud at the financial statement level and at the assertion level, and the rationale for the significant judgments made.

    (d) If the auditor has concluded that the presumption that a risk of material misstatement due to fraud related to revenue recognition is not applicable in the circumstances of the engagement, the reasons for that conclusion.

    (e) The results of audit procedures performed to address the risk of management override of controls, the significant professional judgments made, and the conclusions reached.

    (f) Fraud or suspected fraud identified, the results of audit procedures performed, the significant professional judgments made, and the conclusions reached.

    (g) The matters related to fraud or suspected fraud communicated with management, those charged with governance, regulatory and enforcement authorities, and others, including how management, and where applicable, those charged with governance have responded to the matters.

## Application and Other Explanatory Material

### Responsibilities of the Auditor, Management and Those Charged with Governance

*Responsibilities of the Auditor* (Ref: Para. 2)

Considerations Specific to Public Sector Entities

A1. The public sector auditor's responsibilities relating to fraud may be a result of law, regulation or other authority applicable to public sector entities or separately covered by the auditor's mandate. Consequently, the public sector auditor's responsibilities may not be limited to consideration of risks of material misstatement of the financial statements but may also include a broader responsibility to consider risks of fraud.

### Key Concepts in this ISA

*Characteristics of Fraud* (Ref: Para. 5)

A2. Fraud, whether fraudulent financial reporting or misappropriation of assets, involves incentive or pressure to commit fraud, a perceived opportunity to do so and some rationalization of the act.

[36] ISA 230, *Audit Documentation*, paragraphs 8–11, A6–A7 and Appendix

**Examples:**

- Incentive or pressure to commit fraudulent financial reporting may exist when management is under pressure, from sources outside or inside the entity, to achieve an expected (and perhaps unrealistic) earnings target or financial outcome — particularly when the consequences to management for failing to meet financial goals can be significant. Similarly, individuals may have an incentive to misappropriate assets — for example, because the individuals are living beyond their means.
- A perceived opportunity to commit fraud may exist when an individual believes controls can be overridden, for example, because the individual is in a position of trust or has knowledge of specific control deficiencies.
- Individuals may rationalize committing a fraudulent act as they may possess an attitude, character or set of ethical values that allow them to knowingly and intentionally commit a dishonest act. However, even otherwise honest individuals can commit fraud in an environment that imposes sufficient pressure on them.

A3. Fraudulent financial reporting involves intentional misstatements, including omissions of amounts or disclosures in financial statements, to deceive financial statement users. It can be caused by the efforts of management to manage earnings to deceive financial statement users by influencing their perceptions as to the entity's performance and profitability. Such earnings management may start out with small actions, or adjustment of assumptions, and changes in judgments by management. Pressures and incentives may lead these actions to increase to the extent that they result in material fraudulent financial reporting.

**Examples:**

- Management intentionally takes positions that lead to fraudulent financial reporting by materially misstating the financial statements due to pressures to meet market expectations or a desire to maximize compensation based on performance.
- Management reduces earnings by a material amount to minimize tax.
- Management inflates earnings to secure bank financing.

A4. Fraudulent financial reporting may be accomplished by the following:

- Manipulation, falsification (including forgery), or alteration of accounting records or supporting documentation from which the financial statements are prepared.
- Misrepresentation in, or intentional omission from, the financial statements of events, transactions or other significant information.
- Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure.

A5. Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as intentionally:

- Recording fictitious journal entries to manipulate operating results or achieve other objectives.

- Inappropriately adjusting assumptions and changing judgments used to estimate account balances.
- Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period.
- Misstating disclosures, including omitting and obscuring disclosures, required by the applicable financial reporting framework, or disclosures that are necessary to achieve fair presentation.
- Concealing facts that could affect the amounts recorded in the financial statements.
- Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.
- Altering records and terms related to transactions.
- Altering reports that would highlight inappropriate activity or transactions.
- Taking advantage of inadequate information processing controls in information technology (IT) applications, including controls over and review of IT application event logs (e.g., modifying the application logic, or where users can access a common database using generic access identification, or modify access identification, to conceal activity).

A6. Misappropriation of assets involves the theft of an entity's assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management, who are usually better positioned to disguise or conceal misappropriations in ways that are difficult to detect. In addition, misappropriation of assets can involve third parties who are able to exploit the entity's assets in order to obtain an unjust or illegal advantage. Misappropriation of assets can be accomplished in a variety of ways and is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorization.

**Examples:**

- Embezzling funds (e.g., misappropriating collections of accounts receivable or diverting receipts in respect of written-off accounts to personal bank accounts).
- Theft of assets (e.g., stealing inventory for personal use, stealing scrap for resale, theft of digital assets by exploiting a private key and in doing so allowing the perpetrator to control the entity's funds, theft of intellectual property by colluding with a competitor to disclose technological data in return for payment).
- Causing an entity to pay for goods and services not received (e.g., payments to fictitious suppliers, kickbacks paid by suppliers to the entity's purchasing agents in return for approving payment for inflated prices, or payments to fictitious employees).
- Using an entity's assets for personal use (e.g., using the entity's assets as collateral for a personal loan or a loan to a related party).

Fraud or Suspected Fraud (Ref: Para. 7 and 55–59)

A7. Audit evidence obtained when performing risk assessment procedures and further audit procedures in accordance with this ISA may indicate the existence of fraud or suspected fraud.

**Examples:**

- When obtaining an understanding of the entity's whistleblower program, the auditor identified a tip submitted to the entity's whistleblower hotline which alleged that management had inflated earnings by entering into transactions with related parties which lacked a business purpose.
- When performing further audit procedures to respond to assessed risks of material misstatement due to fraud at the assertion level for inventory, the auditor obtained audit evidence that indicated the possible misappropriation of products from the entity's warehouse by employees.

A8. Audit procedures performed to comply with other ISAs may also bring instances of fraud or suspected fraud to the auditor's attention including, for example, those performed in accordance with ISA 600 (Revised)[37] when responding to assessed risks of material misstatement due to fraud arising from the consolidation process.

A9. The auditor may use automated tools and techniques to perform audit procedures related to identifying and assessing the risks of material misstatement due to fraud or when responding to assessed risks of material misstatement due to fraud. In such circumstances, the use of technology may be beneficial by providing the auditor, for example, deeper insights into large data sets of an entity or the ability to perform audit procedures related to journal entry testing in a more efficient and effective manner. However, using automated tools and techniques does not replace the need to maintain professional skepticism and to exercise professional judgment, especially when undertaking work and drawing conclusions about fraud in an audit of the financial statements.

A10. For the purpose of this ISA, allegations of fraud by another party involving the entity are treated by the auditor as suspected fraud once the allegations have come to the auditor's attention (e.g., as a result of inquiries made by the auditor of management, or a whistleblower approaching the auditor directly with information about an alleged fraud). The party making the allegations may be internal or external to the entity. Accordingly, the auditor performs audit procedures in accordance with paragraphs 55–59 to address the suspected fraud.

Circumstances Giving Rise to the Fraud and the Identified Misstatements (Ref: Para. 8)

A11. Even when an identified misstatement due to fraud is not quantitatively material, it may be qualitatively material depending on:

(a) Who instigated or perpetrated the fraud – an otherwise insignificant fraud perpetrated by senior management is ordinarily considered qualitatively material irrespective of the amount involved. This may in turn give rise to concerns about the integrity of management responsible for the entity's system of internal control.

(b) Why the fraud was perpetrated – misstatements that are not material quantitatively, either individually or in the aggregate, may have been made intentionally by management to "manage" key performance indicators in order to, for example, meet market expectations, maximize compensation based on performance, or comply with the terms of debt covenants.

[37] ISA 600 (Revised), *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*, paragraph 38(d)

*Inherent Limitations* (Ref: Para. 10)

A12. The risk of not detecting a material misstatement resulting from fraud exists because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. Such attempts at concealment may be even more difficult to detect when accompanied by collusion. Collusion may cause the auditor to believe that audit evidence is persuasive when it is, in fact, false. The auditor's ability to detect a fraud depends on factors such as the skillfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved.

*Professional Skepticism and Professional Judgment* (Ref: Para. 12)

A13. ISQM 1[38] requires the firm to design, implement and operate a system of quality management for audits of financial statements. The firm's commitment to an effective system of quality management underpins the requirement for the auditor to exercise professional skepticism when performing the audit engagement. This commitment is recognized and reinforced in the governance and leadership component, including a:

(a) Commitment to quality by the leadership of the firm, such as the tone at the top by leadership contributes to the firm's culture which in turn supports and encourages the auditor to focus on the auditor's responsibilities relating to fraud in an audit of financial statements.

(b) Recognition that the resource needs are planned for and resources are obtained, allocated, or assigned in a manner that is consistent with the firm's commitment to quality, such as resources with the appropriate specialized knowledge and skills that may be needed when performing audit procedures related to fraud in an audit of financial statements.

A14. ISQM 1[39] also explains that the quality of professional judgments exercised by the firm is likely to be enhanced when individuals making such judgments demonstrate an attitude that includes an inquiring mind.

*Non-Compliance with Laws and Regulations* (Ref: Para. 14)

A15. Law, regulation, or relevant ethical requirements may require the auditor to perform additional procedures and take further actions. For example, the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA Code) requires the group engagement partner to take steps to respond to identified or suspected non-compliance with laws and regulations in the context of an audit of group financial statements and determine whether further action is needed. Such steps may include communicating the matter to those performing audit work at the components, legal entities, or business units that are part of a group for purposes other than the group audit, for example a statutory audit, unless prohibited from doing so by law or regulation.[40]

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[38] International Standard on Quality Management (ISQM) 1, *Quality Management for Firms that Perform Audit or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*

[39] ISQM 1, paragraph A31

[40] For example, paragraphs R360.16–R360.18 A1 of the IESBA Code provide requirements and application material relating to communication with respect to groups.

A16. The identification by the auditor of fraud or suspected fraud affecting the entity that has been perpetrated by a third party (see paragraphs 18(a) and A21) may also give rise to additional responsibilities for the auditor under law, regulation, or relevant ethical requirements regarding an entity's non-compliance with law and regulations.

**Example:**

- When obtaining an understanding of the entity's general IT controls, the auditor was informed of a cybersecurity breach involving unauthorized access by a third party to the entity's confidential customer files, including related banking information. After obtaining an understanding of the suspected fraud, the engagement partner determined that the cybersecurity breach likely violated local data protection laws. The engagement partner consulted with others within the firm to determine the engagement team's additional responsibilities under law, regulation and relevant ethical requirements.

**Relationship with Other ISAs** (Ref: Para. 15)

A17. **Appendix 5** identifies other ISAs that address specific topics that reference fraud or suspected fraud.

**Definitions** (Ref: Para. 18)

*Relationship of Fraud with Corruption, Bribery and Money Laundering* (Ref: Para. 18(a))

A18. Depending on the nature and circumstances of the entity, certain laws, regulations or aspects of relevant ethical requirements dealing with corruption, bribery or money laundering may be relevant to the auditor's responsibilities to consider laws and regulations in an audit of financial statements in accordance with ISA 250 (Revised).[41]

A19. Corruption, bribery and money laundering are forms of illegal or unethical acts. Corruption, bribery, and money laundering may be distinct concepts in law or regulation, however, they may also be fraudulent acts, or may be carried out to facilitate or conceal fraud.

**Examples:**

- Corruption involving fraud – Management colluded with other competing parties to raise prices or lower the quality of goods or services for purchasers who wish to acquire products or services through a bidding process (i.e., bid rigging). The bid rigging included monetary payments by the designated winning bidder to colluding parties using fraudulent consulting contracts for which no actual work took place.
- Bribery to conceal fraud – Management offered inducements to employees for concealing the misappropriation of assets by management.
- Money laundering to facilitate fraud – An employee laundered money, to an offshore bank account, that was illegally obtained from embezzling payments for fictitious purchases of inventory through the creation of false purchase orders, supplier shipping documents, and supplier invoices.

[41] ISA 250 (Revised), paragraphs 6 and A6

A20. While the auditor may identify or suspect corruption, bribery, or money laundering, as with fraud, the auditor does not make legal determinations on whether such acts have actually occurred.

*Third-Party Fraud* (Ref: Para. 18(a))

A21. Fraud as defined in paragraph 18(a) can include an intentional act by a third party. Fraud or suspected fraud committed against the entity by customers, suppliers, service providers, or other external parties is generally described as third-party fraud.

*Fraud Risk Factors* (Ref: Para. 18(b) and 32)

A22. Fraud risk factors may relate to incentives, pressures or opportunities that arise from events or conditions that create susceptibility to misstatement, before consideration of controls. Fraud risk factors, which include intentional management bias, are, insofar as they affect inherent risk, inherent risk factors. Fraud risk factors may also relate to events or conditions that may exist in the entity's system of internal control that provide an opportunity to commit fraud and may be an indicator that other fraud risk factors are present.

A23. While fraud risk factors may not necessarily indicate the existence of fraud, they have often been present in circumstances where frauds have occurred and therefore may indicate risks of material misstatement due to fraud. Examples of fraud risk factors are presented in **Appendix 1**.

**Professional Skepticism** (Ref: Para. 12–13 and 19–21)

A24. Maintaining professional skepticism requires an ongoing questioning of whether the information and audit evidence obtained suggests that a material misstatement due to fraud may exist. It includes considering the reliability of the information intended to be used as audit evidence and identified controls in the control activities component, if any, over its preparation and maintenance. Due to the characteristics of fraud, the auditor's professional skepticism is particularly important when considering the risks of material misstatement due to fraud.

A25. As explained in ISA 220 (Revised),[42] conditions inherent in some audit engagements can create pressures on the engagement team that may impede the appropriate exercise of professional skepticism when designing and performing audit procedures and evaluating audit evidence. Paragraphs A34–A36 of ISA 220 (Revised) list examples of impediments to the exercise of professional skepticism at the engagement level and actions that may be taken to mitigate impediments to the exercise of professional skepticism.

**Examples:**

- A lack of cooperation and undue time pressures imposed by management negatively affected the engagement team's ability to resolve a complex and contentious issue. These circumstances were, based on the engagement partner's professional judgment, indicative of possible efforts by management to conceal fraud. The engagement partner involved more experienced members of the engagement team to deal with members of management who were difficult to interact with and communicated with those charged with governance as to the nature of the challenging circumstances, including the possible effect on the audit.

[42] ISA 220 (Revised), paragraph A33

- Impediments imposed by management created difficulties for the engagement team in obtaining access to records, facilities, certain employees, customers, suppliers, and others. These circumstances were, based on the engagement partner's professional judgment, indicative of possible efforts by management to conceal fraud. The engagement partner reminded the engagement team not to be satisfied with audit evidence that was less than persuasive when responding to assessed risks of material misstatement due to fraud and communicated with those charged with governance as to the nature of the challenging circumstances, including the possible effect on the audit.

A26. The auditor is not required to perform procedures that are specifically designed to identify conditions that indicate that a record or document may not be authentic or that terms in a document have been modified. However, audit procedures performed in accordance with this or other ISAs, or information from other sources, may bring to the auditor's attention conditions that cause the auditor to believe that a record or document may not be authentic or that terms in a document have been modified but not disclosed to the auditor. Paragraph 20 applies if the auditor identifies such conditions during the course of the audit.

**Examples:**

Conditions that, if identified, may cause the auditor to believe that a record or document is not authentic or that terms in a document have been modified but not disclosed to the auditor include:

- Unexplained alterations to documents received from external sources.
- Serial numbers used out of sequence or duplicated.
- Addresses and logos not as expected.
- Document style different to others of the same type from the same source (e.g., changes in fonts and formatting).
- Information that would be expected to be included is absent.
- Invoice references or descriptors that differ from other invoices received from the entity.
- Unusual terms of trade, such as unusual prices, interest rates, guarantees and repayment terms (e.g., purchase costs that appear unreasonable for the goods or services being charged for).
- Information that appears implausible or inconsistent with the auditor's understanding and knowledge.
- A change from authorized signatory.
- Electronic documents with a last edited date that is after the date they were represented as finalized.

A27. ISA 500[43] requires the auditor to consider the reliability of information intended to be used as audit evidence when designing and performing audit procedures. The reliability of information intended to be used as audit evidence deals with the degree to which the auditor may depend on such information. Authenticity is an attribute of the reliability of information that the auditor may consider.

[43] ISA 500, paragraph 7

In doing so, the auditor may consider whether the source actually generated or provided the information, and was authorized to do so, and the information has not been inappropriately altered.

A28. When conditions are identified that cause the auditor to believe that a record or document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, possible additional audit procedures to investigate further may include:

- Confirming directly with the third party.
- Using the work of an expert to evaluate the document's authenticity.
- Using automated tools and techniques, such as document authenticity or integrity technology, to evaluate the authenticity of the record or document.

A29. The manner in which information that is indicative of fraud or suspected fraud that affects the entity comes to the auditor's attention throughout the audit may vary.

**Examples:**

Possible sources that may provide information that is indicative of fraud or suspected fraud that affects the entity include:

- The auditor (e.g., when performing audit procedures in accordance with ISA 550,[44] the auditor becomes aware of the existence of a related party relationship that management intentionally did not disclose to the auditor).
- Those charged with governance (e.g., when members of the audit committee conduct an independent investigation of unusual journal entries or other adjustments).
- Management (e.g., when evaluating the results of the entity's risk assessment process).
- Individuals within the internal audit function (e.g., when individuals conduct the annual compliance procedures related to the entity's system of internal control).
- An employee (e.g., by filing a tip using the entity's whistleblower program).
- A former employee (e.g., by sending a complaint via electronic mail to the internal audit function).

A30. Remaining alert for information that is indicative of fraud or suspected fraud throughout the audit is important, including when performing audit procedures near the end of the audit when time pressures to complete the audit engagement may exist. For example, audit evidence may be obtained near the end of the audit that may call into question the reliability of other audit evidence obtained or cast doubt on the integrity of management or those charged with governance. **Appendix 3** contains examples of circumstances that may be indicative of fraud.

A31. When performing audit procedures circumstances may be encountered, such as time pressures imposed on members of the engagement team, which may impede the exercise of professional skepticism or may create threats to compliance with relevant ethical requirements. ISA 220

[44] ISA 550, *Related Parties*

(Revised)[45] discusses that relevant ethical requirements, for example the IESBA Code, may contain provisions regarding the identification and evaluation of threats and how they are to be dealt with.[46]

A32. The auditor may also address the threat to compliance with relevant ethical requirements, such as the principle of integrity, by communicating on a timely basis with those charged with governance about the circumstances giving rise to the threat. This communication may include a discussion about any inconsistencies in audit evidence obtained for which a satisfactory explanation has not been provided by management.

**Engagement Resources** (Ref: Para. 22)

A33. ISA 220 (Revised)[47] explains that the engagement partner's determination of whether additional engagement level resources are required to be assigned to the engagement team is a matter of professional judgment and is influenced by the nature and circumstances of the audit engagement, taking into account any changes that may have arisen during the engagement.

A34. The nature, timing, and extent of the involvement of individuals with specialized skills or knowledge, such as forensic and other experts, or the involvement of more experienced individuals, may vary based on the nature and circumstances of the audit engagement.

**Examples:**

- The entity is investigating fraud or suspected fraud that may have a material effect on the financial statements (e.g., when it involves senior management). An individual with forensic skills may assist in planning and performing audit procedures as it relates to the specific audit area where the fraud or suspected fraud was identified.
- The entity is undergoing an investigation by an authority outside the entity for fraud or suspected fraud, or for instances of non-compliance or suspected non-compliance with laws and regulations (e.g., materially misstated tax provision related to tax evasion and materially misstated revenues due to such revenues being generated from illegal activities facilitated through money laundering). Tax and anti-money laundering experts may assist with identifying those fraudulent aspects of the non-compliance or suspected non-compliance that may have a financial statement impact.
- The complexity of the entity's organizational structure and related party relationships, including the creation or existence of special purpose entities, may present an opportunity for management to misrepresent the financial position or financial performance of the entity. For example, an expert in taxation law may assist in understanding the business purpose and activities or business units within complex organizations, including how its structure for tax purposes may be different from its operating structure.

[45] ISA 220 (Revised), paragraph A44

[46] For example, paragraphs R111.1 and R113.1 of the IESBA Code require the accountant to be straightforward and diligent when complying with the principles of integrity, and professional competence and due care, respectively. Paragraph 111.1A1 of the IESBA Code explains that integrity involves having the strength of character to act appropriately, even when facing pressure to do otherwise. Paragraph 113.1 A3 of the IESBA Code explains that acting diligently also encompasses performing an assignment carefully and thoroughly in accordance with applicable technical and professional standards. These ethical responsibilities are required irrespective of the pressures being imposed, explicitly or implicitly, by management.

[47] ISA 220 (Revised), paragraph A77

- The complexity of the industry or regulatory environment in which the entity operates may present an opportunity or pressure for management to engage in fraudulent financial reporting. For example, an individual specializing in fraud schemes in specific emerging markets may assist in identifying fraud risk factors or where the financial statements may be susceptible to risks of material misstatement due to fraud.
- The use of complex financial instruments or other complex financing arrangements may present an opportunity to inadequately disclose the risks and nature of complex structured products. For example, a valuation expert may assist in understanding the product's structure, purpose, underlying assets, and market conditions, which may highlight fraud risk factors such as discrepancies between market conditions and the valuation of the structured product.

A35. Forensic skills, in the context of an audit of financial statements, may combine accounting, auditing and investigative skills. Such skills may be applied in an investigation and evaluation of an entity's accounting records to obtain possible evidence of fraudulent financial reporting or misappropriation of assets, or in performing audit procedures. The use of forensic skills may also assist the auditor in evaluating whether there is management override of controls or intentional management bias in financial reporting.

**Examples:**

Forensic skills may include specialized skills or knowledge in:

- Identifying and evaluating fraud risk factors.
- Identifying and assessing the risks of material misstatement due to fraud.
- Evaluating the effectiveness of controls implemented by management to prevent or detect fraud.
- Analyzing the authenticity of information intended to be used as audit evidence.
- Gathering, analyzing, and evaluating information or data using automated tools and techniques to identify links, patterns, or trends that may be indicative of fraud.
- Applying knowledge in fraud schemes, and techniques for interviews, information gathering and data analytics, in the detection of fraud.
- Interviewing techniques used in discussing sensitive matters with management and those charged with governance.
- Analyzing financial and non-financial information by using automated tools and techniques to look for inconsistencies, unusual patterns, or anomalies that may indicate intentional management bias or that may be the result of management override of controls.

A36. In determining whether the engagement team has the appropriate competence and capabilities, the engagement partner may consider matters such as expertise in IT systems or IT applications used by the entity or automated tools or techniques that are to be used by the engagement team in planning and performing the audit (e.g., such as the testing of high volumes of journal entries and other adjustments, or complex accounting estimates, when responding to the significant risk related to management override of controls).

**Engagement Performance** (Ref: Para. 23–24)

A37. The engagement partner may plan for direction, supervision and review to respond to identified risks of material misstatement due to fraud by, for example:

- Assigning additional individuals with specialized skills or knowledge, such as forensic and other experts;
- Assigning more experienced individuals to the engagement team; or
- Changing the composition of the engagement team so that more experienced members of the engagement team conduct certain audit procedures for those specific audit areas that require significant auditor attention.

A38. Depending on the nature and circumstances of the audit engagement, the engagement partner's approach to direction, supervision and review may include increasing the extent and frequency of the engagement team discussions. It may be beneficial to hold additional engagement team discussions based on the occurrence of events or conditions that have impacted the entity, which may identify new, or provide additional information about existing, fraud risk factors (see **Appendix 1** for examples of fraud risk factors).

**Examples:**

- Sudden changes in business activity or performance (e.g., decrease in operating cashflows of an entity arising from economic conditions resulting in increased pressure internally by management to meet publicly disclosed earnings targets).
- Unexpected changes in the senior management of the entity (e.g., the chief financial officer resigns, with no explanation given for the sudden departure, providing an opportunity for other employees in the treasury department to commit fraud given the lack of senior management oversight).

**Ongoing Nature of Communications with Management and Those Charged with Governance** (Ref: Para. 25)

A39. Robust two-way communication between management or those charged with governance and the auditor assists in identifying and assessing the risks of material misstatement due to fraud.

A40. The extent of the auditor's communications with management and those charged with governance depends on the fraud-related facts and circumstances of the entity, as well as the progress and outcome of the fraud-related audit procedures performed in the audit engagement.

A41. The appropriate timing of the communications may vary depending on the significance and nature of the fraud-related matters and the expected action(s) to be taken by management or those charged with governance.

**Examples:**

- Making the required inquiries of management and those charged with governance about matters referred to in paragraphs 34(c)–34(d) and 35(b) as early as possible in the audit engagement, for example, as part of the auditor's communications regarding planning matters.
- When ISA 701 applies, the auditor may communicate preliminary views about key audit matters related to fraud when discussing the planned scope and timing of the audit.
- Having specific discussions with management and those charged with governance as relevant audit evidence is obtained relating to the auditor's evaluation of each of the components of the entity's system of internal control and assessment of the risks of material misstatement due to fraud. These discussions may form part of the auditor's communications on significant findings from the audit.
- Communicating, on a timely basis in accordance with ISA 265,[48] significant deficiencies in internal control (including those that are relevant to the prevention or detection of fraud) with the appropriate level(s) of management and those charged with governance may allow them to take necessary and timely remedial actions.

*Assigning Appropriate Member(s) within the Engagement Team with the Responsibility to Communicate with Management and Those Charged with Governance*

A42. ISA 220 (Revised)[49] deals with the engagement partner's overall responsibility with respect to engagement resources and engagement performance. Due to the nature and sensitivity of fraud, particularly those involving senior management, assigning tasks or actions to appropriately skilled or suitably experienced members of the engagement team and providing appropriate levels of direction, supervision, and review of their work is also important for the required communications in accordance with this ISA. This includes involving appropriately skilled or suitably experienced members of the engagement team when communicating matters related to fraud with management and those charged with governance.

A43. ISA 220 (Revised)[50] deals with the engagement partner's responsibility to make members of the engagement team aware of the relevant ethical requirements. For example, the IESBA Code requires compliance with the principle of integrity, which involves standing one's ground when confronted by dilemmas and difficult situations; or challenging others as and when circumstances warrant in a manner appropriate to the circumstances. It is important, especially for those members of the engagement team who will be engaging with management and those charged with governance about matters related to fraud, to consider the content of the communications and the manner in which such communications are to be conducted.

[48] ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*

[49] ISA 220 (Revised), paragraphs 25–28 and 29–34

[50] ISA 220 (Revised), paragraph 17

**Risk Assessment Procedures and Related Activities** (Ref: Para. 26)

A44. As explained in ISA 315 (Revised 2019),[51] obtaining an understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control is a dynamic and iterative process of gathering, updating and analyzing information and continues throughout the audit. Therefore, the auditor's expectations with respect to risks of material misstatements due to fraud may change as new information is obtained.

*Information from Other Sources* (Ref: Para. 27)

A45. Information obtained from other sources in accordance with paragraphs 15–16 of ISA 315 (Revised 2019) may be relevant to the identification of fraud risk factors by providing information and insights about:

- The entity and the industry in which the entity operates and its related business risks, which may create pressures on the organization to meet targeted financial results.
- Management's commitment to integrity and ethical values and management's commitment to remedy known significant deficiencies in internal control on a timely basis.
- Complexity in the application of the applicable financial reporting framework due to the nature and circumstances of the entity that may create opportunities for management to perpetrate and conceal fraudulent financial activity.

A46. In conducting an initial audit engagement in accordance with ISA 510,[52] in some circumstances, subject to law, regulation or relevant ethical requirements, the proposed successor auditor may request the predecessor auditor to provide information regarding identified or suspected fraud. Such information may give an indication of the presence of fraud risk factors or may give an indication of fraud or suspected fraud.

*Retrospective Review of the Outcome of Previous Accounting Estimates* (Ref: Para. 28)

A47. The purpose of performing a retrospective review of management's judgments and assumptions related to accounting estimates reflected in the financial statements of the previous period is to evaluate whether there is an indication of a possible bias on the part of management. It is not intended to call into question the auditor's judgments about previous period accounting estimates that were appropriate based on information available at the time they were made.

*Engagement Team Discussion* (Ref: Para. 29)

A48. As explained in ISA 220 (Revised),[53] the engagement partner is responsible for creating an environment that emphasizes the importance of open and robust communication within the engagement team. The engagement team discussion enables the engagement team members to share insights in a timely manner based on their skills, knowledge and experience about how and where the financial statements may be susceptible to material misstatement due to fraud.

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51 ISA 315 (Revised 2019), paragraph A48

52 ISA 510, *Initial Audit Engagements—Opening Balances*

53 ISA 220 (Revised), paragraph 14

A49. Individuals who have specialized skills or knowledge, such as forensic and other experts, may be invited to attend the engagement team discussion to provide deeper insights about the susceptibility of the entity's financial statements to material misstatement due to fraud. The involvement and contributions of experts with specialized skills or knowledge may elevate the quality of the discussion taking place.

A50. The exchange of ideas may serve to inform the auditor's initial perspective about the tone at the top. The conversation may include a discussion of the actions and behaviors of management and those charged with governance, including whether there are clear and consistent actions and communications about integrity and ethical behavior at all levels within the entity.

A51. The following approaches may be useful to facilitate the exchange of ideas:

- 'What-if' scenarios – these may be helpful when discussing whether certain events or conditions create an environment at the entity where one or more individuals among management, those charged with governance, or employees have the incentive or pressure to commit fraud, a perceived opportunity to do so and some rationalization of the act, and if so, how the fraud may occur.
- Automated tools and techniques – these may be used to support the discussion about the susceptibility of the entity's financial statements to material misstatement due to fraud, including techniques that further the understanding of incentives and pressures, such as industry or sector financial ratio benchmarking, which may indicate adverse ratios or trends compared to competitors.

A52. The exchange of ideas may include, among other matters, whether:

- The interactions, as observed by the engagement team, among management (e.g., between the chief executive officer and the chief financial officer) or between management and those charged with governance may indicate a lack of cooperation or mutual respect among the parties. This circumstance in turn may be indicative of an environment that is conducive to the existence of fraud.
- Any unusual or unexplained changes in behavior or lifestyle of management or employees that have come to the attention of the engagement team may indicate the possibility of fraudulent activity.
- Known information (e.g., obtained through reading trade journals, or accessing reports issued by regulatory bodies), about frauds impacting other entities that resulted in the misstatement of the financial statements of those entities, such as entities in the same industry or geographical region, may be indicative of risks of material misstatement due to fraud for the entity being audited.
- Disclosures, or lack thereof, may be used by management to obscure a proper understanding of the entity's financial statements (e.g., by including too much immaterial information, by using unclear or ambiguous language, or by a lack of disclosures such as those disclosures relating to off-balance sheet financing arrangements or leasing arrangements).
- Events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern (e.g., a drug patent of an entity in the pharmaceutical industry expired leading to a decline in revenue). In such circumstances, there may be incentives or pressures for

management to commit fraud in order to conceal a material uncertainty about the entity's ability to continue as a going concern.

- The entity has significant related party relationships and transactions (e.g., the entity has a complex organizational structure that includes several special-purpose entities controlled by management). These circumstances may provide the opportunity for management to perpetrate fraud; for example, by inflating earnings, or concealing debt.
- The entity has third party relationships that give rise to a fraud risk factor, or a risk of third-party fraud.

**Examples:**

- Based on the auditor's understanding of the entity's information processing activities, the auditor identified a fraud risk factor (i.e., opportunity to commit fraud) resulting from management's lack of oversight over significant business processes outsourced to a third-party service provider.
- During the audit, the auditor was made aware that a customer of the entity provided falsified documents to fraudulently obtain favorable credit terms from the entity. In response to the third-party fraud, the auditor performed audit procedures in accordance with paragraphs 55–59 and identified a material misstatement relating to recoverability of the loan receivable.

A53. The engagement partner and other key engagement team members participating in the engagement team discussion may also, as applicable, use this as an opportunity to:

- Emphasize the importance of maintaining a questioning mind throughout the audit regarding the potential for material misstatement due to fraud.
- Remind engagement team members of their role in serving the public interest by performing quality audit engagements and the importance of engagement team members remaining objective in order to better facilitate the critical assessment of audit evidence obtained from persons within or outside the financial reporting or accounting functions, or outside the entity.
- Consider the audit procedures that may be selected to respond appropriately to the susceptibility of the entity's financial statements to material misstatement due to fraud, including whether certain types of audit procedures may be more effective than others and how to incorporate an element of unpredictability into the nature, timing and extent of audit procedures to be performed.

*Analytical Procedures Performed and Unusual or Unexpected Relationships Identified* (Ref: Para. 31)

A54. The auditor may identify fluctuations or relationships when performing analytical procedures in accordance with ISA 315 (Revised 2019)[54] that are inconsistent with other relevant information or that differ from expected values significantly.

[54] ISA 315 (Revised 2019), paragraph 14(b)

**Example**:

- The auditor may identify an unexpected relationship when the entity's valuation of investment in government bonds remained stable, whereas the interest rates of central banks increased to counter inflation which, in turn, led to a depreciation in market values of government bonds.

*Evaluation of Fraud Risk Factors* (Ref: Para. 32)

A55. The significance of fraud risk factors varies widely. Some of these factors will be present in entities where the specific conditions do not present risks of material misstatement. Accordingly, the determination as to whether fraud risk factors, individually or in combination, indicate that there are risks of material misstatement due to fraud is a matter of professional judgment.

A56. Examples of fraud risk factors related to fraudulent financial reporting and misappropriation of assets are presented in **Appendix 1**. These illustrative fraud risk factors are classified based on the three conditions that are, individually or in combination, generally present when fraud exists:

- An incentive or pressure to commit fraud;
- A perceived opportunity to commit fraud; and
- An ability to rationalize the fraudulent action.

Fraud risk factors reflective of an attitude that permits rationalization of the fraudulent action may not be susceptible to observation by the auditor. Nevertheless, the auditor may become aware of the existence of such information through, for example, the required understanding of the entity's control environment.[55] Although the fraud risk factors described in **Appendix 1** cover a broad range of situations that may be faced by auditors, they are only examples and other risk factors may exist.

A57. The size, complexity, and ownership characteristics of the entity have a significant influence on the consideration of fraud risk factors. For example, depending on the nature and circumstances of the entity, there may be factors that generally constrain improper conduct by management, such as:

- Effective oversight by those charged with governance.
- An effective internal audit function.
- The existence and enforcement of a written code of conduct.

Furthermore, fraud risk factors considered at a business segment operating level may provide different insights when compared with those obtained when considered at an entity-wide level.

Scalability

A58. In the case of a smaller or less complex entity, some or all of these considerations may be inapplicable or less relevant. For example, a smaller or less complex entity may not have a written code of conduct but, instead, may have developed a culture that emphasizes the importance of integrity and ethical behavior through oral communication and by management example. Domination of management by a single individual in a smaller or less complex entity does not generally, in and of itself, indicate a failure by management to display and communicate an appropriate attitude regarding internal control and the financial reporting process. In some entities, the need for

[55] ISA 315 (Revised 2019), paragraph 21

management authorization can compensate for otherwise deficient controls and reduce the risk of employee fraud. However, domination of management by a single individual creates a conducive environment for management override of controls.

**Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework and the Entity's System of Internal Control**

*Understanding the Entity and Its Environment* (Ref: Para. 33(a))

The Entity's Organizational Structure and Ownership, Governance, Objectives and Strategy, and Geographic Dispersion (Ref: Para. 33(a)(i))

A59. Understanding the entity's organizational structure and ownership assists the auditor in identifying fraud risk factors. An overly complex organizational structure involving unusual legal entities may indicate that a fraud risk factor is present.

> **Example:**
>
> Where there are complex intercompany transactions, this increases the opportunity to manipulate balances or create fictitious transactions.

A60. Understanding the nature of the entity's governance arrangements assists the auditor in identifying fraud risk factors. For example, poor governance or accountability arrangements may weaken oversight and increase the opportunity for fraud (see also paragraphs A68–A77). In a larger or more complex entity, the entity may have assigned the responsibility for overseeing the processes for identifying and responding to fraud in the entity to a senior member of management or to someone with designated responsibility.

> **Example:**
>
> If the entity is undergoing significant digital transformation activities, poor governance arrangements over newly implemented technologies impacting the entity's information system relevant to the preparation of the financial statements may increase the opportunity for fraud.

A61. Understanding the entity's objectives and strategy assists the auditor in identifying fraud risk factors. Objectives and strategy impact expectations, internally and externally, and may create pressures on the entity to achieve financial performance targets.

> **Example:**
>
> When the entity has a very aggressive growth strategy, this may create pressures on personnel within the entity to commit fraud to meet the goals set.

A62. Understanding the entity's geographic dispersion assists the auditor in identifying fraud risk factors. The entity may have operations in locations that may be susceptible to fraud, or other illegal or unethical acts that may be carried out to facilitate or conceal fraud.

**Examples:**

- Weak legal and regulatory frameworks that create a permissive environment for fraudulent financial reporting without significant consequences.
- Offshore financial centers that have looser regulations and tax incentives that may facilitate fraud through money laundering.
- Cultural norms in which using bribery to conceal fraud is deeply ingrained as an accepted practice of doing business.

Industry (Ref: Para. 33(a)(ii))

A63. Understanding the industry in which the entity operates assists the auditor in identifying fraud risk factors. The auditor may obtain an understanding whether the entity is active in:

- An industry where there are greater incentives to commit fraud. (e.g., in the construction industry the revenue recognition policies may be complex and subject to significant judgment which may create an opportunity to commit fraud).
- An industry that is under pressure (e.g., a high degree of competition or market saturation, accompanied by declining margins in that sector). Such characteristics may create an incentive to commit fraud as it may be harder to achieve the financial performance targets.
- An industry that is susceptible to acts of money laundering (e.g., the banking, or gaming and gambling industries may be particularly vulnerable to money laundering, which could facilitate fraud).

Performance Measures Used, Whether Internal or External (Ref: Para. 33(a)(iii))

A64. Performance measures, whether internal or external, may create pressures on the entity. These pressures, in turn, may motivate management or employees to take action to inappropriately improve the business performance or to misstate the financial statements. Internal performance measures may include employee performance measures and incentive compensation policies. External performance measures may include expectations from shareholders, analysts, or other users.

**Example:**

Automated tools and techniques, such as analysis of disaggregated data, for example by business segment or product line, may be used by the auditor to identify inconsistencies or anomalies in the data used in performance measures.

A65. The auditor may consider listening to the entity's earnings calls with analysts or reading analysts' research reports. This may provide the auditor with information about whether analysts have aggressive or unrealistic expectations about an entity's financial performance. Auditors may also learn about management's attitudes regarding those expectations based on how management interacts with analysts. Aggressive expectations by analysts that are met by commitments by management to meet those expectations may be indicative of pressures and rationalizations for management to manipulate key performance metrics.

A66. Other matters that the auditor may consider include:

- Management's compensation packages. When a significant portion of management's compensation packages are contingent on achieving financial targets, management may have an incentive to manipulate financial results.
- Short-selling reports, negative media attention, or negative analyst reports. When management is under pressure or intense scrutiny to respond to these matters, management may have an incentive to manipulate financial results.

*Understanding the Applicable Financial Reporting Framework and the Entity's Accounting Policies* (Ref: Para. 33(b))

A67. Matters related to the applicable financial reporting framework that the auditor may consider when obtaining an understanding of where there may be an increased susceptibility to misstatement due to management bias or other fraud risk factors, include:

- Areas in the applicable financial reporting framework that require:
    - A measurement basis that results in the need for a complex method relating to an accounting estimate.
    - Management to make significant judgments, such as accounting estimates with high estimation uncertainty or where an accounting treatment has not yet been established for new and emerging financial products (e.g., types of digital assets).
    - Expertise in a field other than accounting, such as actuarial calculations, valuations, or engineering data. Particularly where management can influence, and direct work performed, and conclusions reached by management's experts.
- Changes in the applicable financial reporting framework. For example, management may intentionally misapply new accounting requirements relating to amounts, classification, manner of presentation, or disclosures.
- The selection of and application of accounting policies by management. For example, management's choice of accounting policy is not consistent with similar entities in the same industry.
- The amount selected by management for recognition or disclosure in the financial statements of an accounting estimate.

**Examples:**

- Management may consistently trend toward one end of a range of possible outcomes that provide a more favorable financial reporting outcome for management.
- Management may use a model that applies a method that is not established or commonly used in a particular industry or environment.

*Understanding the Components of the Entity's System of Internal Control*

Control Environment

Entity's culture and management's commitment to integrity and ethical values (Ref: Para. 34(a))

A68. Understanding aspects of the entity's control environment that address the entity's culture and understanding management's commitment to integrity and ethical values assists the auditor in determining management's attitude and tone at the top with regards to the prevention and detection of fraud.

A69. In considering the extent to which management demonstrates a commitment to ethical behavior, the auditor may obtain an understanding through inquiries of management and employees, and through considering information from external sources, about:

- Management's commitment to integrity and ethical values through their actions. This is important as employees may be more likely to behave ethically when management is committed to integrity and ethical behaviors.
- The entity's communications with respect to integrity and ethical values. For example, the entity may have a mission statement, a code of ethics, or a fraud policy that sets out the expectations of entity personnel in respect to their commitment to integrity and ethical values regarding managing fraud risk. In larger or more complex entities, management may also have set up a process that requires employees to annually confirm that they have complied with the entity's code of ethics.
- Whether the entity has developed fraud awareness training. For example, the entity may require employees to undertake ethics and code of conduct training as part of an ongoing or induction program. In a larger or more complex entity, specific training may be required for those with a role in the prevention and detection of fraud (e.g., the internal audit function).
- Management's response to fraudulent activity. For example, where minor unethical practices are overlooked (e.g., petty theft, expenses frauds), this may indicate that more significant frauds committed by key employees may be treated in a similar lenient fashion.

A70. Depending on the nature and circumstances of the entity, the entity may have a formal whistleblower program; in such circumstances, obtaining an understanding of the program may assist the auditor in identifying risks of material misstatement due to fraud. The auditor may:

- Obtain an understanding of the whistleblower program reporting mechanisms (e.g., telephone hotline, online forms, in-person reporting), who is responsible for the program, including who receives the notifications, and how the entity addresses the matters raised. In a larger or more complex entity, the lack of a whistleblower program, or an ineffective one, may be indicative of deficiencies in the entity's control environment.

- Inspect whistleblower files for any tips or complaints that may allege fraud that are not under investigation by the entity, or for information that may raise questions about management's commitment to creating and maintaining a culture of honesty and ethical behavior.
- Follow up on matters that are under investigation by the entity as these matters may be indicative of suspected fraud with financial reporting implications that require a response by the auditor.

Oversight exercised by those charged with governance (Ref: Para. 34(b))

A71. In many jurisdictions, corporate governance practices are well developed and those charged with governance play an active role in oversight of the entity's assessment of risks, including risks of fraud and the controls that address such risks. Since the responsibilities of those charged with governance and management may vary by entity and by jurisdiction, it is important that the auditor understands their respective responsibilities to enable the auditor to obtain an understanding of the oversight exercised by the appropriate individuals with respect to the prevention and detection of fraud.[56]

A72. An understanding of the oversight exercised by those charged with governance may provide insights regarding the susceptibility of the entity to management fraud, the adequacy of controls that address risks of fraud, and the competency and integrity of management. The auditor may obtain this understanding in several ways, such as by attending meetings where such discussions take place, reading the minutes from such meetings, or making inquiries of those charged with governance.

A73. The effectiveness of oversight by those charged with governance is influenced by their objectivity and familiarity with the controls management has put in place to prevent or detect fraud. For example, the oversight by those charged with governance of the effectiveness of controls to prevent or detect fraud is an important aspect of their oversight role and the objectivity of such evaluation is influenced by their independence from management.

Scalability

A74. In some cases, all of those charged with governance are involved in managing the entity. This may be the case in a smaller or less complex entity where a single owner manages the entity and no one else has a governance role. In these cases, there is ordinarily no action on the part of the auditor because there is no oversight separate from management.

Inquiries of those charged with governance (Ref: Para. 34(d))

A75. The auditor may also inquire of those charged with governance about how the entity assesses the risk of fraud, the entity's controls to prevent or detect fraud, the entity's culture and management's commitment to integrity and ethical values.

A76. Specific inquiries on areas that are susceptible to misstatement due to management bias or management fraud may relate to both inherent risk and control risk. Specific inquiries may include management judgment when accounting for complex accounting estimates or unusual or complex transactions, including those in controversial or emerging areas, which may be susceptible to fraudulent financial reporting.

[56] ISA 260 (Revised), *Communication with Those Charged with Governance,* paragraphs A1–A8 provide guidance about whom the auditor should be communicating with, including when the entity's governance structure is not well defined.

A77. Inquiries on whether those charged with governance are aware of any control deficiencies in the system of internal control related to the prevention and detection of fraud may inform the auditor's evaluation of the components of the entity's system of internal control. Such inquiries may highlight conditions within the entity's system of internal control that provide opportunity to commit fraud or that may affect management's attitude or ability to rationalize fraudulent actions. For example, understanding incentives or pressures on management that may result in intentional or unintentional management bias may inform the auditor's understanding of the entity's risk assessment process and understanding of business risks. Such information may affect the auditor's consideration of the effect on the reasonableness of significant assumptions made by, or the expectations of, management.

A78. When those charged with governance's ability to objectively assess the actions of management is insufficient or impaired, the auditor may consider performing additional or alternative risk assessment procedures or further audit procedures, seeking legal advice, or considering whether to continue the audit engagement.

The Entity's Risk Assessment Process

The entity's process for identifying, assessing, and addressing fraud risks (Ref: Para. 35(a))

A79. Management may place a strong emphasis on fraud prevention by implementing a fraud risk management program. The design of the fraud risk management program may be impacted by the nature and complexity of the entity and may include the following elements:

- Establishing fraud risk governance policies.
- Performing a fraud risk assessment.
- Designing and deploying fraud preventive and detective control activities.
- Conducting investigations.
- Monitoring and evaluating the total fraud risk management program.

Identifying fraud risks (Ref: Para. 35(a)(i))

A80. The entity's fraud risk identification process may include an assessment of the incentives, pressures, and opportunities to commit fraud, or how the entity may be susceptible to third-party fraud. A fraud risk identification process may also consider the potential override of controls by management as well as areas where there are control deficiencies, including a lack of segregation of duties.

A81. Where legal or regulatory requirements apply, management may consider risks relating to misappropriation of assets or fraudulent financial reporting in relation to the entity's compliance with laws or regulations. For example, a fraud risk may include the preparation of inaccurate information for a regulatory filing in order to improve the appearance of an entity's performance and thereby avoid inspection by regulatory authorities or penalties.

Assessing the significance of the identified fraud risks and addressing the assessed fraud risks (Ref: Para. 35(a)(ii)–(iii))

A82. There are several approaches management may use to assess fraud risks and the approach may vary depending on the nature and circumstances of the entity. The fraud risk assessment may be reported in different forms, such as a complex matrix of risk ratings or a simple narrative.

A83. When determining the likelihood of fraud, management may consider both probability and frequency (i.e., the number of fraud incidents that can be expected). Other factors that management may consider in determining the likelihood may include the volume of transactions or the quantitative benefit to the perpetrator.

A84. Management may address the likelihood of a fraud risk by taking action within the other components of the entity's system of internal control or by making changes to certain aspects of the entity or its environment. To address fraud risks, an entity may choose to cease doing business in certain locations, reallocate authority among key personnel, or make changes to aspects of the entity's business model.

A85. Controls designed to prevent or detect fraud are generally classified as either preventive (designed to prevent a fraudulent event or transaction from occurring) or detective (designed to discover a fraudulent event or transaction after the fraud has occurred). Addressing fraud risks may involve a combination of manual and automated fraud prevention and detection controls that enable the entity to monitor for indicators of fraud within the scope of its risk tolerance.

**Examples:**

Preventive controls

- Clearly defined and documented decision makers using delegations, authorizations, and other instructions.
- Access controls, including those that address physical security of assets against unauthorized access, acquisition, use or disposal and those that prevent unauthorized access to the entity's IT environment and information, such as authentication technology.
- Controls over the process to design, program, test and migrate changes to the IT system.
- Entry level checks, probationary periods, suitability assessments or security vetting in order to assess the integrity of new employees, contractors or third parties.
- Sensitive or confidential information cannot leave the entity's IT environment without authority or detection.

Detective controls

- Exception reports to identify activities that are unusual or not in the ordinary course of business for further investigation.
- Mechanisms for employees of the entity and third parties to make anonymous or confidential communications to appropriate persons within the entity about identified or suspected fraud.

- Fraud detection software programs incorporated into the IT infrastructure that automatically analyzes transaction data or enables data monitoring and analysis to detect what is different from what is standard, normal, or expected and may therefore indicate fraud.

A86. If the auditor identifies risks of material misstatement due to fraud that management failed to identify, the auditor is required to determine whether any such risks are of a kind that the auditor expects would have been identified by the entity's risk assessment process and, if so, obtain an understanding of why the entity's risk assessment process failed to identify such risks of material misstatement.[57]

Scalability

A87. For some entities whose nature and circumstances are more complex, such as those operating in the insurance or banking industries, there may be more complex preventative and detective controls in place. These controls may also affect the extent to which specialized skills are needed to assist the auditor in obtaining an understanding of the entity's risk assessment process.

A88. In smaller and less complex entities, and in particular owner-managed entities, the way the entity's risk assessment process is designed, implemented, and maintained may vary with the entity's size and complexity. When there are no formalized processes or documented policies or procedures, the auditor is still required to obtain an understanding of how management, or where appropriate, those charged with governance identify fraud risks related to the misappropriation of assets and fraudulent financial reporting and assesses the significance of the identified fraud risks.

Inquiries of management and others within the entity (Ref: Para. 35(b))

A89. Management accepts responsibility for the entity's system of internal control and for the preparation of the entity's financial statements. Accordingly, it is appropriate for the auditor to make inquiries of management regarding management's own assessment of the risk of fraud and the controls in place to prevent or detect it. The nature, extent and frequency of management's assessment may vary from entity to entity. In some entities, management may make detailed assessments on an annual basis or as part of ongoing monitoring. In other entities, management's assessment may be less structured and less frequent. The nature, extent and frequency of management's assessment are relevant to the auditor's understanding of the entity's control environment. For example, the fact that management has not made an assessment of the risk of fraud may in some circumstances be indicative of the lack of importance that management places on internal control.

A90. Inquiries of management may provide useful information concerning the risks of material misstatements resulting from employee fraud. However, such inquiries are unlikely to provide useful information regarding the risks of material misstatement resulting from management fraud. Inquiries of others within the entity may provide additional insight into fraud prevention controls, tone at the top, and culture of the organization.

[57] ISA 315 (Revised 2019), paragraph 23

**Examples:**

Others within the entity to whom the auditor may direct inquiries about the existence or suspicion of fraud include:

- Operating personnel not directly involved in the financial reporting process.
- Employees with different levels of authority.
- Employees involved in initiating, processing, or recording complex or unusual transactions and those who supervise or monitor such employees.
- In-house legal counsel.
- Chief ethics officer, chief compliance officer or equivalent person.
- The person or persons charged with dealing with allegations of fraud.

A91. Management is often in the best position to perpetrate fraud. Accordingly, when evaluating management's responses to inquiries with an attitude of professional skepticism, the auditor may judge it necessary to corroborate responses to inquiries with information from other sources.

The Entity's Process to Monitor the System of Internal Control

Ongoing and separate evaluations for monitoring the effectiveness of controls to prevent or detect fraud (Ref: Para. 36(a))

A92. Matters that may be relevant for the auditor to consider when understanding those aspects of the entity's process that addresses the ongoing and separate evaluations for monitoring the effectiveness of controls to prevent or detect fraud, and the identification and remediation of related control deficiencies may include:

- Whether management has identified particular operating locations, or business segments for which the risk of fraud may be more likely to exist and whether management has introduced different approaches to monitor these operating locations or business segments.
- How the entity monitors fraud mitigation processes in each component of internal control, including the operating effectiveness of anti-fraud controls, and the remediation of control deficiencies as necessary.

Inquiries of internal audit (Ref: Para. 36(b))

A93. The internal audit function of an entity may perform assurance and advisory activities designed to evaluate and improve the effectiveness of the entity's governance, risk management and internal control processes. In that capacity, the internal audit function may identify frauds or be involved throughout a fraud investigation process. Inquiries of appropriate individuals within the internal audit function may therefore provide the auditor with useful information about instances of fraud, suspected fraud, or allegations of fraud, and the risk of fraud.

A94. ISA 315 (Revised 2019) and ISA 610 (Revised 2013) establish requirements and provide guidance relevant to audits of those entities that have an internal audit function.[58]

[58] ISA 315 (Revised 2019), paragraphs 14(a) and 24(a)(ii), and ISA 610 (Revised 2013), *Using the Work of Internal Auditors*

**Examples:**

In applying ISA 315 (Revised 2019) and ISA 610 (Revised 2013) in the context of fraud, the auditor may, for example, inquire about:

- The entity's fraud risk assessment.
- The entity's controls to prevent or detect fraud.
- The entity's culture and management's commitment to integrity and ethical values.
- Whether the internal audit function is aware of any instances of management override of controls.
- The procedures performed, if any, by the internal audit function during the year to detect fraud and whether management and those charged with governance have satisfactorily responded to any findings resulting from those procedures.
- The procedures performed, if any, by the internal audit function in investigating frauds and suspected violations of the entity's code of ethics and values, and whether management and those charged with governance have satisfactorily responded to any findings resulting from those procedures.
- The fraud-related reports, if any, or communications prepared by the internal audit function and whether management and those charged with governance have satisfactorily responded to any findings resulting from those reports.
- Control deficiencies identified by the internal audit function that are relevant to the prevention and detection of fraud and whether management and those charged with governance have satisfactorily responded to any findings resulting from those deficiencies.

The Information System and Communication (Ref: Para. 37)

A95. Obtaining an understanding of the entity's information system and communication relevant to the preparation of the financial statements includes the manner in which an entity incorporates information from transaction processing into the general ledger. This ordinarily involves the use of journal entries, whether standard or non-standard, or automated or manual. This understanding enables the auditor to identify the population of all journal entries and other adjustments that are required to be tested in accordance with paragraph 50(b). Obtaining an understanding of the population may provide the auditor with insights about journal entries and other adjustments that may be susceptible to unauthorized or inappropriate intervention or manipulation. This may assist the auditor in designing and performing audit procedures over journal entries and other adjustments in accordance with paragraphs 50(c) and 50(d).

A96. **Appendix 4** includes additional considerations when selecting journal entries and other adjustments for testing, including matters that the required understanding provides the auditor knowledge about.

A97. When performing risk assessment procedures, the auditor may consider changes in the entity's IT environment because of the introduction of new IT applications or enhancements to the IT infrastructure, which may impact the susceptibility of the entity to fraud or create vulnerabilities in the IT environment (e.g., changes to the databases involved in processing or storing transactions). There may also be an increased susceptibility to misstatement due to management bias or other fraud risk

factors when there are complex IT applications used to initiate or process transactions or information, such as the use of artificial intelligence or machine learning algorithms to calculate and initiate accounting entries. In such circumstances, the auditor may assign individuals with specialized skills and knowledge, such as forensic and IT experts, or more experienced individuals to the engagement.

Control Activities (Ref: Para. 38)

A98. Management may make judgments on the nature and extent of the controls it chooses to implement and the nature and extent of the risks it chooses to accept given the nature and circumstances of the entity. In determining which controls to implement to prevent or detect fraud, management considers the risks that the financial statements may be materially misstated due to fraud.

A99. ISA 315 (Revised 2019)[59] requires the auditor to obtain an understanding of controls over journal entries as well as to evaluate their design and determine their implementation as part of understanding the entity's system of internal control. This understanding focuses on the controls over journal entries that address risks of material misstatement at the assertion level whether due to fraud or error. Paragraphs 49–50 of this ISA require the auditor to test the appropriateness of journal entries and is specifically focused on the risks of material misstatement due to fraud (see **Appendix 4** for additional considerations when testing journal entries).

A100. Information from understanding controls over journal entries, designed to prevent or detect fraud, or the absence of such controls, may also be useful in identifying fraud risk factors that may affect the auditor's assessment of the risks of material misstatement due to fraud.

A101. The following are examples of general IT controls that may address the risks arising from the use of IT and may also be relevant to the prevention or detection of fraud.

**Examples:**

- Controls that segregate access to make changes to a production (i.e., end user) environment.
- Access controls to manage:
  - Privileged access – such as controls over administrative or powerful users' access.
  - Provisioning – such as controls to authorize modifications to existing users' access privileges, including non-personal or generic accounts that are not tied to specific individuals within the entity.
- Review of system logs that track access to the information system, enabling user activity to be monitored and security violations to be reported to management.

*Control Deficiencies Within the Entity's System of Internal Control* (Ref: Para. 39)

A102. In performing the evaluations of each of the components of the entity's system of internal control, the auditor may determine that certain of the entity's controls in a component are not appropriate to the nature and circumstances of the entity. Such a determination may be an indicator, which assists the auditor in identifying deficiencies in internal control that are relevant to the prevention and detection of fraud. If the auditor has identified one or more control deficiencies relevant to the prevention or

[59] ISA 315 (Revised 2019), paragraphs 26(a)(ii) and 26(d)

detection of fraud, the auditor may consider the effect of those control deficiencies on the design of further audit procedures in accordance with ISA 330.

A103. Paragraph 61(c) of this ISA and ISA 265[60] establish other requirements on identified deficiencies in internal control.

**Identifying and Assessing the Risks of Material Misstatement due to Fraud** (Ref: Para. 40(a))

A104. Determining whether the risks of material misstatement due to fraud exist at the financial statement level, or the assertion level for classes of transactions, account balances and disclosures, may assist the auditor in determining appropriate responses to address the assessed risks of material misstatement due to fraud.

**Examples:**

Relevant assertions and the related classes of transactions, account balances or disclosures that may be susceptible to material misstatement due to fraud include:

- Accuracy or valuation of revenue from contracts with customers — revenue from contracts with customers may be susceptible to inappropriate estimates of the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer.
- Existence of cash balances — cash balances may be susceptible to the creation of falsified or altered external confirmations or bank statements.
- Valuation of account balances involving complex accounting estimates — account balances involving complex accounting estimates such as goodwill and other intangible assets, impairment of inventories, expected credit losses, insurance contract liabilities, employee retirement benefits liabilities, environmental liabilities or environmental remediation provisions may be susceptible to high estimation uncertainty, significant subjectivity and management bias in making judgments about future events or conditions.
- Presentation of profit before tax from continuing operations — profit before tax from continuing operations may be susceptible to misrepresentation (i.e., earnings management) for example, to minimize tax and other statutory obligations or to secure financing.
- Presentation of disclosures — disclosures may be susceptible to omission, or incomplete or inaccurate presentation, for example, disclosures relating to contingent liabilities, off-balance sheet arrangements, financial guarantees, debt covenant requirements, or management defined performance measures (i.e., performance measures that depart from those set forth in the financial reporting framework).

A105. In applying ISA 315 (Revised 2019),[61] the auditor may determine that the audit evidence obtained from the risk assessment procedures does not provide an appropriate basis for the identification and assessment of the risks of material misstatement due to fraud. In such circumstances, the auditor is required to perform additional risk assessment procedures until audit evidence has been obtained to provide such a basis.

[60] ISA 265, paragraph 8

[61] ISA 315 (Revised 2019), paragraph 35

Considerations Specific to Public Sector Entities

A106. For public sector entities, misappropriation of assets (e.g., misappropriation of funds) may be a common type of fraud.

**Example:**

- Fraud risk factors may be present when an individual with a significant role in a public sector entity has the sole authority to commit the public sector entity to sensitive expenditure, including travel, accommodation, or entertainment, and that sensitive expenditure provides personal benefits to the individual.

*Presumption of the Risks of Material Misstatement Due to Fraud in Revenue Recognition* (Ref: Para. 41)

A107. Material misstatement due to fraudulent financial reporting in revenue recognition often results from an overstatement of revenues through, for example, premature revenue recognition or recording fictitious revenues. It may also result from an understatement of revenues through, for example, improperly deferring revenues to a later period.

A108. The risks of material misstatement due to fraud in revenue recognition may be greater in some entities than others. For example, there may be pressures or incentives on management to commit fraudulent financial reporting through inappropriate revenue recognition in the case of listed entities when, for example, performance is measured in terms of year over year revenue growth or profit. Similarly, for example, there may be greater risks of material misstatement due to fraud in revenue recognition in the case of entities that generate a substantial portion of revenues through cash sales that present an opportunity for theft, or that have complex revenue recognition arrangements (e.g., licenses of intellectual property or percentage of completion) that are susceptible to management bias when determining percentage of completion for revenue recognition.

A109. Understanding the entity's business and its environment, the applicable financial reporting framework and the entity's system of internal control helps the auditor understand the nature of the revenue transactions, the applicable revenue recognition criteria and the appropriate industry practice related to revenue. This understanding may assist the auditor in identifying events or conditions (see examples below) relating to the types of revenue, revenue transactions, or relevant assertions, that could give rise to fraud risk factors.

**Examples:**

- When there are changes in the financial reporting framework relating to revenue recognition, which may present an opportunity for management to commit fraudulent financial reporting or bring to light the lack of (or significant deficiency in) controls for managing changes in the financial reporting framework.
- When an entity's accounting principles for revenue recognition are more aggressive than, or inconsistent with, its industry peers.
- When the entity operates in emerging industries.
- When revenue recognition involves complex accounting estimates.

- When revenue recognition is based on complex contractual arrangements with a high degree of estimation uncertainty, for example, construction-type or production-type contracts and multiple-element arrangements.
- When contradictory evidence is obtained from performing risk assessment procedures.
- When the entity has a history of significant adjustments for the improper recognition of revenue (e.g., premature recognition of revenue).
- When circumstances indicate the recording of fictitious revenues.
- When circumstances indicate the omission of required disclosures or presentation of incomplete or inaccurate disclosures regarding revenue, for example, to manipulate the entity's financial performance due to pressures to meet investor / market expectations, or due to the incentive for management to maximize compensation linked to the entity's financial performance.

A110. If fraud risk factors related to revenue recognition are present, determining whether such fraud risk factors indicate a risk of material misstatement due to fraud is a matter of professional judgment. The significance of fraud risk factors (see paragraphs A55–A57) related to revenue recognition, individually or in combination, ordinarily makes it inappropriate for the auditor to rebut the presumption that there are risks of material misstatement due to fraud in revenue recognition.

A111. There may be circumstances where it may be appropriate to rebut the presumption that there are risks of material misstatement due to fraud in revenue recognition. The auditor may conclude that there are no risks of material misstatement due to fraud relating to revenue recognition in the case where fraud risk factors are not significant.

Examples of revenue where fraud risk factors may not be significant include:

- Leasehold revenue from a single unit of rental property, or multiple rental properties with a single tenant.
- Rendering one type of service for a fixed fee.
- Reselling one type of purchased good for a fixed price.
- Simple or straightforward ancillary revenue sources, which are determined by fixed rates or externally published rates (e.g., interest or dividend revenue from investments with level 1 inputs).

A112. Paragraph 70(d) specifies the documentation required where the auditor concludes that the presumption is not applicable in the circumstances of the engagement and, accordingly, has not identified revenue recognition as a risk of material misstatement due to fraud.

*Significant Risks Related to Management Override of Controls* (Ref: Para. 42)

A113. Management is in a unique position to perpetrate fraud because of management's ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Although the level of risks of management override of controls will vary from entity to entity, the risk is nevertheless present in all entities. See also paragraphs 48–53.

**Responses to the Assessed Risks of Material Misstatement Due to Fraud**

*Unpredictability in the Selection of Audit Procedures* (Ref: Para. 44)

A114. Incorporating an element of unpredictability in the selection of the nature, timing, and extent of audit procedures to be performed is essential; particularly where individuals within the entity who are familiar with the audit procedures normally performed on engagements may be better positioned to conceal fraudulent financial reporting and misappropriation of assets. It is therefore important that the auditor maintains an open mind to new ideas or different perspectives when selecting the audit procedures to be performed to address the risks of material misstatement due to fraud.

**Examples:**

- Performing further audit procedures on selected account balances or disclosures that were not determined to be material or susceptible to material misstatement.
- Performing tests of detail where the auditor performed substantive analytical procedures in previous audits.
- Adjusting the timing of audit procedures from that otherwise expected.
- Using different sampling methods or using different approaches to stratify the population.
- Performing audit procedures at different locations or at locations on an unannounced basis.
- Performing analytical procedures at a more detailed level or lowering thresholds when performing analytical procedures for further investigation of unusual or unexpected relationships.
- Using automated tools and techniques, such as anomaly detection or statistical methods, on an entire population to identify items for further investigation.

A115. The auditor may, when incorporating an element of unpredictability in the selection of the nature, timing, and extent of audit procedures, refer to **Appendix 2** of this ISA for examples of possible audit procedures to use when addressing the assessed risks of material misstatement due to fraud.

*Overall Responses* (Ref: Para. 45)

A116. Determining overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level generally includes the consideration of how the overall conduct of the audit can reflect the exercise of professional skepticism.

**Examples:**

- Increased sensitivity in the selection of the nature and extent of documentation to be examined in support of material transactions.
- Increased recognition of the need to corroborate management's explanations or representations concerning material matters.
- Increased involvement of auditor's experts to assist the engagement team with complex or subjective areas of the audit.

- Changing the composition of the engagement team by, for example, requesting that more experienced individuals with greater skills or knowledge or specific expertise are assigned to the engagement.
- Using direct extraction methods or technologies when obtaining data from the entity's information system for use in automated tools and techniques to address the risk of data manipulation.

*Audit Procedures Responsive to the Assessed Risks of Material Misstatement Due to Fraud at the Assertion Level (*Ref: Para. 47)

A117. In accordance with paragraph 40(b), assessed risks of material misstatement due to fraud are treated as significant risks. ISA 330 requires the auditor to obtain more persuasive evidence the higher the auditor's assessment of risk. When obtaining more persuasive audit evidence to respond to assessed risks of material misstatement due to fraud, the auditor may increase the quantity of the evidence, or obtain evidence that is more relevant and reliable, for example, by placing more emphasis on obtaining third party evidence or by obtaining audit evidence from a number of independent sources.

**Examples:**

Nature

- Physically observe or inspect certain assets to respond to assessed risks of material misstatement due to fraud related to the misappropriation of those assets.
- The auditor identifies that management is under pressure to meet earnings expectations and accordingly there may be a related risk that management is inflating sales by entering into sales agreements that include terms that preclude revenue recognition or by invoicing sales before delivery. In these circumstances, the auditor may, for example, design external confirmations not only to confirm outstanding amounts, but also to confirm the details of the sales agreements, including date, any rights of return and delivery terms. In addition, the auditor may find it effective to supplement such external confirmations with inquiries of non-financial personnel in the entity regarding any changes in sales agreements and delivery terms.

Timing

- The auditor may conclude that performing substantive testing at or near the period end better addresses an assessed risk of material misstatement due to fraud. The auditor may conclude that, given the assessed risks of intentional misstatement or manipulation, audit procedures to extend audit conclusions from an interim date to the period end would not be effective. In contrast, because an intentional misstatement — for example, a misstatement involving improper revenue recognition — may have been initiated in an interim period, the auditor may elect to apply substantive procedures to transactions occurring earlier in or throughout the reporting period.

Extent

- The auditor may use automated tools and techniques to perform more extensive testing of digital information. Such automated techniques may be used to test all items in a population,

select specific items for testing that are responsive to risks of material misstatement due to fraud, or select items for testing when performing audit sampling. For example, the auditor may stratify the population based on specific characteristics to obtain more relevant audit evidence that is responsive to the risks of material misstatement due to fraud.

External Confirmation Procedures

A118. In applying ISA 330,[62] external confirmation procedures may be considered useful when seeking audit evidence that is not biased towards corroborating or contradicting a relevant assertion in the financial statements, especially in instances where risks of material misstatement due to fraud have been identified related to the class of transactions, account balance or disclosure.

A119. ISA 505[63] requires the auditor to maintain control over the external confirmation requests and to evaluate the implications of management's refusal to allow the auditor to send a confirmation request. If the auditor is unable to maintain control over the confirmation process or obtains an unsatisfactory response as to why management refuses to allow the auditor to send a confirmation request, as applicable, then this may be an indication of a fraud risk factor.

A120. The use of external confirmation procedures may be more effective or provide more persuasive audit evidence over the terms and conditions of a contractual agreement.

**Example:**

The auditor may request confirmation of the contractual terms for a specific class of revenue transactions, such as pricing, payment and discount terms, applicable guarantees and the existence, or absence, of any side agreements.

A121. ISA 505[64] includes factors that may indicate doubts about the reliability of a response to an external confirmation request, since all responses carry some risk of interception, alteration, or fraud. This may be the case when the response to a confirmation request:

- Is sent from an e-mail address that is not recognized.
- Does not include the original electronic mail chain or any other information indicating that the confirming party is responding to the auditor's confirmation request.
- Contains unusual restrictions or disclaimers.

A122. ISA 505[65] includes guidance for the auditor when a response to a confirmation request indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party.

**Example:**

A response to a bank confirmation request indicated that a bank account, in the name of wholly owned subsidiary incorporated in an offshore financial center, did not exist. Upon investigating the

62 ISA 330, paragraph 19

63 ISA 505, *External Confirmations*, paragraphs 7 and 8

64 ISA 505, paragraph A11

65 ISA 505, paragraphs 14 and A21–A22

> exception, the auditor determined that the entity misstated its financial statements by falsely using excess cash balances deposited in the bank account (which did not actually exist) to repurchase the entity's debt securities, when in fact those obligations still remained outstanding.

Examples of Other Further Audit Procedures

A123. Examples of possible audit procedures to address the assessed risks of material misstatement due to fraud are presented in **Appendix 2**. The Appendix includes examples of responses to the auditor's assessment of the risks of material misstatement resulting from both fraudulent financial reporting, including fraudulent financial reporting resulting from revenue recognition, and misappropriation of assets.

*Audit Procedures Responsive to Risks Related to Management Override of Controls*

Journal Entries and Other Adjustments (Ref: Para. 49–50)

Why the testing of journal entries and other adjustments is performed

A124. Material misstatements of financial statements due to fraud often involve the manipulation of the financial reporting process by recording inappropriate or unauthorized journal entries and other adjustments. This may occur throughout the year or at period end, or by management making adjustments to amounts reported in the financial statements that are not reflected in journal entries, such as through consolidation adjustments and reclassifications.

A125. Testing the appropriateness of journal entries and other adjustments (e.g., entries made directly to the financial statements such as eliminating adjustments for transactions, unrealized profits and intra-group account balances at the group level) may assist the auditor in identifying fraudulent journal entries and other adjustments.

A126. The auditor's consideration of the risks of material misstatement associated with management override of controls over journal entries[66] is important because automated processes and controls may reduce the risk of inadvertent error but do not overcome the risk that management may inappropriately override such automated processes and controls, for example, by changing the amounts being automatically posted in the general ledger or to the financial reporting system. Further, where IT is used to transfer information automatically, there may be little or no visible evidence of such intervention in the information systems.

A127. In planning the audit,[67] drawing on the experience and insight of the engagement partner or other key members of the engagement team may be helpful in designing audit procedures to test the appropriateness of journal entries and other adjustments (e.g., to address the risk of management override of controls), including planning for the appropriate resources, and determining the nature, timing and extent of the related direction, supervision, and review of the work being performed.

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66 ISA 315 (Revised 2019), paragraph 26(a)(ii)

67 ISA 300, paragraphs 5, 9 and 11

Obtaining audit evidence about the completeness of the population of all journal entries and other adjustments (Ref: Para. 50(b))

A128. Prior to selecting items to test, the auditor may need to consider whether the integrity of the population of journal entries and other adjustments has been maintained throughout all stages of information processing based on the auditor's understanding and evaluation of the entity's information system and control activities (e.g., general IT controls that safeguard and maintain the integrity of financial information) in accordance with the requirements of ISA 315 (Revised 2019).[68]

A129. The population of journal entries may include manual adjustments, or other "top-side" adjustments that are made directly to the amounts reported in the financial statements. Failing to obtain audit evidence about the completeness of the population may limit the effectiveness of the audit procedures in responding to the risk of management override of controls associated with fraudulent journal entries and other adjustments.

Selecting journal entries and other adjustments (Ref: Para. 50(c) and 50(d))

A130. The auditor's understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control may assist the auditor in selecting journal entries and other adjustments for testing.

**Examples:**

The process of selecting journal entries and other adjustments for testing may be enhanced if the auditor leverages insights based on the auditor's understanding about:

- How the financial statements (including events and transactions) may be susceptible to material misstatement due to fraud, particularly in areas where fraud risk factors are present.
- The application of accounting principles and methods that may be susceptible to material misstatement due to management bias.
- Deficiencies in internal control that present opportunities for those charged with governance, management, or others within the entity to commit fraud.

A131. **Appendix 4** provides additional considerations that may be used by the auditor when selecting journal entries and other adjustments for testing.

Timing of testing journal entries and other adjustments (Ref: Para. 50(c) and 50(d))

A132. Fraudulent journal entries and other adjustments are often made at the end of a reporting period; consequently, paragraph 50(c) requires the auditor to select journal entries and other adjustments made at that time.

**Example:**

- Among the journal entries and other adjustments most susceptible to management override of controls are manual adjusting journal entries and other adjustments directly made to the

[68] ISA 315 (Revised 2019), paragraphs 25–26

financial statements that occur after the closing of a financial reporting period and have little or no explanatory support.

A133. Paragraph 50(d) requires the auditor to determine whether there is also a need to test journal entries and other adjustments throughout the period because material misstatements due to fraud can occur throughout the period and may involve extensive efforts to conceal how the fraud is accomplished.

**Examples:**

- Risks of material misstatement that may be strongly linked to fraud schemes that can occur over a long period of time (e.g., complex related party transaction structures that may obscure their economic substance).
- Anomalies or outliers in the journal entry data throughout the period that may be detected from the use of automated tools and techniques.

Examining the underlying support for journal entries and other adjustments selected (Ref: Para. 50(c) and 50(d))

A134. When testing the appropriateness of journal entries and other adjustments, the auditor may need to obtain and examine supporting documentation to determine the business rationale for recording them, including whether the recording of the journal entry reflects the substance of the transaction and complies with the applicable financial reporting framework.

Considering the use of automated tools and techniques when testing journal entries and other adjustments (Ref: Para. 50(b) and 50(c))

A135. The auditor may consider the use of automated tools and techniques when testing journal entries and other adjustments (e.g., determining the completeness of the population or selecting items to test). Such consideration may be impacted by the entity's use of technology in processing journal entries and other adjustments.

Accounting Estimates (Ref: Para. 51–52)

Why the review of accounting estimates for management bias is performed

A136. The preparation of the financial statements requires management to make a number of judgments or assumptions that affect accounting estimates and to monitor the reasonableness of such estimates on an ongoing basis. Fraudulent financial reporting is often accomplished through intentional misstatement of accounting estimates. For example, this may be achieved by understating or overstating all provisions or reserves so as to be designed either to smooth earnings over two or more accounting periods, or to achieve a designated earnings level in order to deceive financial statement users by influencing their perceptions as to the entity's performance and profitability.

A137. ISA 315 (Revised 2019) provides guidance that management bias is often associated with certain conditions that have the potential to give rise to management not maintaining neutrality in exercising judgment (i.e., indicators of potential management bias), which could lead to a material misstatement of the information that would be fraudulent if intentional.[69]

[69] ISA 315 (Revised 2019), *paragraph 2 of Appendix 2*

Indicators of possible management bias

A138. ISA 540 (Revised)[70] includes a requirement and related application material addressing indicators of possible management bias.

> **Examples:**
>
> Indicators of possible management bias in how management made the accounting estimates that may represent a risk of material misstatement due to fraud include:
>
> - Changes in methods, significant assumptions, sources, or items of data selected that are not based on new circumstances or new information, which may not be reasonable in the circumstances nor in compliance with the applicable financial reporting framework.
> - Adjustments, made to the output of the model(s), that are not appropriate in the circumstances when considering the requirements of the applicable financial reporting framework.
> - Selection of assumptions from the end of the range that resulted in the most favorable measurement outcome.

A139. The auditor may use automated tools and techniques to review accounting estimates for management bias.

> **Examples:**
>
> - Analyzing the activity in an estimate account during the year and comparing it to the current and prior period estimates.
> - Benchmarking assumptions used for the estimate, using data visualization to understand the location of point estimates within the range of acceptable outcomes.
> - Using predictive analytics to identify the likelihood of future outcomes based on historical data.

A140. If there are indicators of possible management bias that may be intentional, the auditor may consider it appropriate to involve individuals with forensic skills in performing the review of accounting estimates for management bias in accordance with paragraphs 51–52. Applying forensic skills through analyzing accounting records, conducting interviews, reviewing internal and external communications, investigating related party transactions, or reviewing internal controls may also assist the auditor in evaluating whether the indicators of possible management bias represent a material misstatement due to fraud.

Significant Transactions Outside the Normal Course of Business or Otherwise Appear Unusual (Ref: Para. 53)

A141. Indicators that may suggest that significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual, may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets include:

- The form of such transactions appears overly complex (e.g., the transaction involves multiple entities within a consolidated group or multiple unrelated third parties).

[70] ISA 540 (Revised), *paragraphs 32 and A133–A136*

- Management has not discussed the nature of and accounting for such transactions with those charged with governance of the entity, and there is inadequate documentation.
- Management is placing more emphasis on the need for a particular accounting treatment than on the underlying economics of the transaction.
- Transactions that involve non-consolidated related parties, including special purpose entities, have not been properly reviewed or approved by those charged with governance of the entity.
- Unusual activities with no logical business rationale.
- The transactions involve previously unidentified related parties or parties that do not have the substance or the financial strength to support the transaction without assistance from the entity under audit.

*Analytical Procedures Performed Near the End of the Audit in Forming an Overall Conclusion* (Ref: Para. 54)

A142. ISA 520 explains that the analytical procedures performed near the end of the audit are intended to corroborate conclusions formed during the audit of individual components or elements of the financial statements.[71] However, the auditor may perform the analytical procedures at a more granular level for certain higher risk classes of transactions, account balances, and disclosures to determine whether certain trends or relationships may indicate a previously unidentified risk of material misstatement due to fraud. Determining which particular trends and relationships may indicate a risk of material misstatement due to fraud requires professional judgment. Unusual relationships involving year-end revenue and income are particularly relevant.

**Examples:**

- Uncharacteristically large amounts of income being reported in the last few weeks of the reporting period.
- Unusual transactions.
- Income that is inconsistent with trends in cash flow from operations:
  - Uncharacteristically low amounts of revenue at the start of the subsequent period; or
  - Uncharacteristically high levels of refunds or credit notes at the start of the subsequent period.

A143. The auditor may use automated tools and techniques to identify unusual or inconsistent transaction posting patterns in order to determine if there is a previously unrecognized risk of material misstatement due to fraud.

**Fraud or Suspected Fraud** (Ref: Para. 55–59)

A144. If the auditor identifies fraud or suspected fraud, the firm's policies and procedures may include actions for the engagement partner to take, depending on the facts and circumstances of the audit engagement and the nature of the fraud.

[71] ISA 520, paragraphs A17–A19

**Examples:**

- Consulting with others in the firm.
- Obtaining legal advice from external counsel to understand the engagement partner's options and the professional or legal implications of taking any particular course of action.
- Consulting on a confidential basis with a regulator or professional body (unless doing so is prohibited by law or regulation or would breach the duty of confidentiality).

A145. In accordance with ISA 220 (Revised),[72] the engagement partner is required to take responsibility for making the engagement team aware of the firm's policies or procedures related to relevant ethical requirements. This includes the responsibilities of members of the engagement team when they become aware of an instance of non-compliance with laws and regulations by the entity, which includes instances of fraud.

*Obtaining an Understanding of the Fraud or Suspected Fraud*

A146. When obtaining an understanding of the fraud or suspected fraud, the auditor may do one or more of the following depending on the facts and circumstances of the audit engagement and the nature of the fraud:

- Involve an auditor's expert, such as an individual with forensic skills.
- Inspect whistleblower files for additional information.
- Make further inquiries of:
  - The entity's in-house counsel or external legal counsel.
  - Individuals within the internal audit function (if the function exists).

A147. The extent of the understanding of the fraud or suspected fraud may vary based on the facts and circumstances.

**Examples:**

- The engagement team obtained audit evidence that indicated assets may have been misappropriated by an employee who does not have a significant role or authority in the entity. The engagement team inquired about the matter with management and learned that management had investigated the matter and implemented additional physical access controls to prevent a reoccurrence of the incident. Based on the understanding of the matter, the engagement partner determined that the matter did not give rise to the need for additional risk assessment procedures or further audit procedures and the matter was considered resolved to the engagement partner's satisfaction.
- A component auditor communicated to the group auditor the existence of a suspected fraud involving component management which resulted in a material misstatement of the component's financial information. The nature of the suspected fraud appeared to involve a complex scheme of kickbacks paid to suppliers by component management. The group engagement partner held extensive discussions with the component auditor and inquired

[72] ISA 220 (Revised), paragraph 17(c)

about the matter with group management and those charged with governance of the group, including group management's plan to investigate and remediate the matter. The group engagement partner complied with the firm's policies and procedures, consulted with others in the firm and made changes to the overall group audit strategy and group audit plan as well as the direction, supervision and review of the work being performed by the component auditor.

Evaluating the Entity's Process to Investigate and Remediate the Fraud or Suspected Fraud

A148. The nature and extent of the entity's process to investigate the fraud or suspected fraud undertaken by management or those charged with governance may vary based on the circumstances.

**Examples:**

- New allegations of fraud were made by a disgruntled former employee. Management followed the policies and procedures in place at the entity and referred the matter to the legal and human resources departments. Since the entity's policies and procedures were followed and prior allegations of a similar nature had been investigated and determined to be without merit, management determined that no further action was necessary.
- A suspected fraud involving a senior member of management was reported to those charged with governance by an employee. As a result, those charged with governance followed the policies and procedures in place at the entity and engaged a certified fraud examiner to perform an independent forensic investigation.

A149. When evaluating the appropriateness of the entity's process to investigate and remediate the fraud or suspected fraud in accordance with paragraphs 55(b) and 55(c), the auditor may consider:

- How management:
  - Responded to any misstatements that were identified (e.g., the timeliness of when the identified misstatements were corrected by management).
  - Responded to the fraud (e.g., disciplinary, or legal sanctions imposed on the individuals involved in perpetrating the fraud).
  - Addressed the control deficiencies regarding the prevention or detection of the fraud.
- Whether the outcome of the process is likely to prevent the reoccurrence of the fraud or suspected fraud (e.g., new control activities are designed and implemented to prevent and detect such frauds).

Determining if Control Deficiencies Exist

A150. ISA 265[73] provides requirements and guidance about the auditor's communication of significant deficiencies in internal control identified during the audit to those charged with governance. Examples of matters that the auditor considers in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency include:

- The susceptibility to loss due to fraud of the related asset or liability.

[73] ISA 265, paragraphs 8 and A6–A7

- The importance of the controls to the financial reporting process (e.g., controls over the prevention and detection of fraud).

A151. Indicators of significant deficiencies in internal control include, for example:

- Evidence of ineffective aspects of the control environment, such as the identification of management fraud, whether or not material, that was not prevented by the entity's system of internal control.
- The lack of a process to investigate the fraud or suspected fraud or a process to investigate the fraud or suspected fraud that is not appropriate in the circumstances.
- The lack of, or ineffective, remediation measures implemented by management to prevent or detect the reoccurrence of the fraud or suspected fraud.

Impact on the Overall Audit Strategy

A152. The understanding obtained about the fraud or suspected fraud impacts the engagement partner's determination of whether and how to adjust the overall audit strategy, including determining whether there is a need to perform additional risk assessment procedures or further audit procedures, especially in circumstances when information comes to the engagement partner's attention that differs significantly from the information available when the overall audit strategy was originally established.[74]

**Examples:**

- Based on an understanding of the suspected fraud, the engagement partner believed the suspected fraud was inconsequential because it was limited to the misappropriation of immaterial assets by employees. Consequently, the engagement partner determined to continue with other aspects of the audit engagement while the matter was being resolved by management of the entity.
- Based on an understanding of the suspected fraud, the engagement partner believed the integrity of management was in question. Given the significance and pervasiveness of the matter, the engagement partner determined that no further work was to be performed across the entire audit engagement until the matter had been appropriately resolved.

A153. Based on the understanding obtained about the fraud or suspected fraud and the impact on the overall audit strategy, the engagement partner may determine that it is necessary to discuss an extension of the audit reporting deadlines with management and those charged with governance, where an extension is possible under applicable law or regulation.

*The Auditor Identifies a Misstatement Due to Fraud*

A154. ISA 450[75] and ISA 700 (Revised)[76] establish requirements and provide guidance on the evaluation of misstatements and the effect on the auditor's opinion in the auditor's report.

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[74] ISA 300, paragraphs 10 and A15

[75] ISA 450, *Evaluation of Misstatements Identified During the Audit*

[76] ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

A155. The following are examples of qualitative or quantitative circumstances that may be relevant:

**Examples:**

Qualitative circumstances include whether a misstatement:

- Involves those charged with governance, management, related parties, or third parties that brings into question the integrity or competence of those involved.
- Affects compliance with law or regulation which may also affect the auditor's consideration of the integrity of management, those charged with governance or employees.
- Affects compliance with debt covenants or other contractual requirements which may cause the auditor to question the pressures being exerted on management to meet certain earnings expectations.

Quantitative circumstances include whether a misstatement:

- Affects key performance indicators such as earnings per share, net income and working capital, that may have a negative effect on the calculation of compensation arrangements for senior management at the entity.
- Affects multiple reporting periods such as when a misstatement has an immaterial effect on the current period's financial statements but is likely to have a material effect on future periods' financial statements.

A156. The implications of an identified misstatement due to fraud on the reliability of information intended to be used as audit evidence depends on the circumstances. For example, an otherwise insignificant fraud may be significant if it involves senior management. In such circumstances, the reliability of information previously obtained and intended to be used as audit evidence may be called into question as there may be doubts about the completeness and truthfulness of representations made and about the authenticity of accounting records and documentation.

A157. Since fraud involves incentive or pressure to commit fraud, a perceived opportunity to do so or some rationalization of the act, an instance of fraud is unlikely to be an isolated occurrence. Misstatements, such as numerous misstatements at a business unit or geographical location even though the cumulative effect is not material, may also be indicative of a risk of material misstatement due to fraud.

**Auditor Unable to Continue the Audit Engagement** (Ref: Para. 60)

A158. Examples of exceptional circumstances that may arise and that may bring into question the auditor's ability to continue performing the audit include:

- The entity does not take the appropriate action regarding fraud that the auditor considers necessary in the circumstances, even where the fraud is not material to the financial statements;
- The auditor's consideration of the risks of material misstatement due to fraud and the results of audit tests indicate a significant risk of material and pervasive fraud;
- The auditor has significant concern about the competence or integrity of management or those charged with governance; or

- The auditor is unable to address a threat to compliance with the fundamental principles related to the relevant ethical requirements.

A159. Because of the variety of circumstances that may arise, it is not possible to describe definitively when withdrawal from an engagement is appropriate. Factors that affect the auditor's conclusion include the implications of the involvement of a member of management or of those charged with governance (which may affect the reliability of management representations) and the effects on the auditor of a continuing association with the entity.

A160. The auditor has professional and legal responsibilities in such circumstances and these responsibilities may vary by jurisdiction. In some countries, for example, the auditor may be entitled to, or required to, make a statement or report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities. Given the exceptional nature of the circumstances and the need to consider the legal requirements, the auditor may consider it appropriate to seek legal advice when deciding whether to withdraw from an engagement and in determining an appropriate course of action, including the possibility of reporting to shareholders, regulators or others.[77]

*Considerations Specific to Public Sector Entities*

A161. In many cases in the public sector, the option of withdrawing from the engagement may not be available to the auditor due to the nature of the mandate or public interest considerations.

**Implications for the Auditor's Report** (Ref: Para. 61–64)

*Determining Key Audit Matters*

A162. ISA 701[78] requires the auditor to determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor is also required to take into account the specific required considerations as set out in paragraph 61.

A163. Users of financial statements have expressed an interest in matters related to fraud about which the auditor had a robust dialogue with those charged with governance and have called for additional transparency about those communications. The considerations in paragraph 61 focus on the nature of matters communicated with those charged with governance that are intended to reflect matters related to fraud that may be of particular interest to intended users.

A164. In addition to matters that relate to the specific required considerations in paragraph 61, there may be other matters related to fraud communicated with those charged with governance that required significant auditor attention and that therefore may be determined to be key audit matters in accordance with paragraph 62.

A165. Matters related to fraud are often matters that require significant auditor attention including, for example:

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[77] Section 320 of the IESBA Code provides requirements and application material on communications with the existing or predecessor accountant, or the proposed accountant.

[78] ISA 701, paragraph 9

- The identification of fraud or suspected fraud may require significant changes to the auditor's risk assessment and reevaluation of the planned audit procedures (i.e., a significant change in the audit approach).
- Significant transactions with related parties or significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual. The auditor may have had extensive discussions with management and those charged with governance at various stages throughout the audit about the effect on the financial statements of these transactions.

A166. Accounting estimates are often the most complex areas of the financial statements because they may be dependent on significant management judgment. Significant auditor attention may be required in accordance with paragraph 61(a) to respond to assessed risks of material misstatement due to fraud associated with an accounting estimate that involves significant management judgment. Significant management judgment is often involved when an accounting estimate is subject to a high degree of estimation uncertainty and subjectivity.

**Example:**

The auditor determines significant auditor attention was required to respond to the risk of material misstatement due to fraud associated with the entity's estimate of expected credit losses. Management utilizes a model that requires a complex set of assumptions about future developments in a variety of entity-specific scenarios that are difficult to predict. Based on the auditor's identification of aggressive profitability expectations of investment analysts about the entity, the auditor assessed a risk of material misstatement due to fraud because of the subjectivity involved in the expected credit losses estimate and the incentive this creates for intentional management bias.

A167. The auditor may communicate a significant deficiency in internal control to management and those charged with governance that is relevant to the prevention and detection of fraud. Significant deficiencies may exist even though the auditor has not identified misstatements during the audit. For example, the lack of a reporting mechanism (e.g., whistleblower program) may be indicative of weaknesses in the entity's control environment, but it may not directly relate to a risk of material misstatement due to fraud. The auditor is required to communicate significant deficiencies in internal control in accordance with ISA 265.

A168. This ISA requires management override of controls to be a risk of material misstatement due to fraud (see paragraph 42) and presumes that there are risks of material misstatement due to fraud in revenue recognition (see paragraph 41). The auditor may determine these matters to be key audit matters related to fraud because risks of material misstatement due to fraud are often matters that both require significant auditor attention and are of most significance in the audit. However, this may not be case for all these matters. The auditor may determine that certain risks of material misstatement due to fraud did not require significant auditor attention and, therefore, these risks would not be considered in the auditor's determination of key audit matters in accordance with paragraph 62.

A169. As described in ISA 701,[79] the auditor's decision-making process in determining key audit matters is based on the auditor's professional judgment about which matters were of most significance in the audit of the financial statements of the current period. Significance can be considered in the context of quantitative and qualitative factors, such as relative magnitude, the nature and effect on the subject matter and the expressed interests of intended users or recipients.[80]

A170. One of the considerations that may be relevant in determining the relative significance of a matter that required significant auditor attention, and whether such a matter is a key audit matter, is the importance of the matter to intended users' understanding of the financial statements as a whole.[81] As users of financial statements have highlighted their interest in matters related to fraud, one or more of the matters related to fraud that required significant auditor attention in performing the audit, determined in accordance with paragraph 61, would ordinarily be of most significance in the audit of the financial statements of the current period and therefore are key audit matters.

A171. ISA 701[82] includes other considerations that may be relevant to determining which matters related to fraud that required significant auditor attention, were of most significance in the current period and therefore are key audit matters.

*Communicating Key Audit Matters Related to Fraud*

A172. If a matter related to fraud is determined to be a key audit matter and there are a number of separate, but related, considerations that were of most significance in the audit, the auditor may communicate the matters together in the auditor's report. For example, long-term contracts may involve significant auditor attention with respect to revenue recognition and revenue recognition may also be identified as a risk of material misstatement due to fraud. In such circumstances, the auditor may include in the auditor's report one key audit matter related to revenue recognition with an appropriate subheading that clearly describes the matter, including that it relates to fraud.

A173. Relating a matter directly to the specific circumstances of the entity may help to minimize the potential that such descriptions become overly standardized and less useful over time. For example, revenue recognition or management override of controls may be regularly determined as key audit matters related to fraud. In describing why the auditor considered the matter to be one of most significance in the audit, it may be useful for the auditor to highlight aspects specific to the entity (e.g., circumstances that affected the underlying judgments made in the financial statements of the current period) so as to make the description more relevant for intended users. This also may be important in describing a key audit matter that recurs over multiple periods. Similarly, in describing how the key audit matter related to fraud was addressed in the audit, it may be useful for the auditor to highlight matters directly related to the specific circumstances of the entity, while avoiding generic or standardized language.

A174. ISA 701,[83] describes that management or those charged with governance may decide to include new or enhanced disclosures in the financial statements or elsewhere in the annual report relating to a key audit matter in light of the fact that the matter will be communicated in the auditor's report. Such

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[79] ISA 701, paragraph 10

[80] ISA 701, paragraph A1

[81] ISA 701, paragraph A29

[82] ISA 701, paragraph A29

[83] ISA 701, paragraph A37

new or enhanced disclosures, for example, may be included to provide more robust information about identified fraud or suspected fraud or identified deficiencies in internal control that are relevant to the prevention and detection of fraud.

A175. The requirement in paragraph 64 applies in three circumstances:

(a) The auditor determines in accordance with paragraph 62 that there are no key audit matters related to fraud.

(b) The auditor determines in accordance with paragraph 14 of ISA 701 that a key audit matter related to fraud will not be communicated in the auditor's report (see paragraph A178) and no other matters have been determined to be key audit matters related to fraud.

(c) The only matters determined to be key audit matters related to fraud are those communicated in accordance with paragraph 15 of ISA 701.

A176. The determination of key audit matters involves making a judgment about the relative importance of matters that required significant auditor attention. Therefore, it may be rare that the auditor of a complete set of general purpose financial statements of a listed entity would not determine at least one key audit matter related to fraud. However, in certain limited circumstances, the auditor may determine that there are no matters related to fraud that are key audit matters in accordance with paragraph 62.

A177. The following illustrates the presentation in the auditor's report if the auditor has determined there are key audit matters to communicate but these do not include key audit matters related to fraud:

[Except for the matter described in the Basis for Qualified (Adverse) Opinion section or Material Uncertainty Related to Going Concern section,] We have determined that there are no key audit matters related to fraud to communicate in our report.

Circumstances in Which a Matter Determined to Be a Key Audit Matter Is Not Communicated in the Auditor's Report

A178. ISA 701, paragraph 14(b), indicates that it will be extremely rare for a matter determined to be a key audit matter not to be communicated in the auditor's report and includes guidance on circumstances in which such a matter determined to be a key audit matter is not communicated in the auditor's report. For example:

- Law or regulation may preclude public disclosure by either management or the auditor about a specific matter determined to be a key audit matter.
- There is presumed to be a public interest benefit in providing greater transparency about the audit for intended users. Accordingly, the judgment not to communicate a key audit matter is appropriate only in cases when the adverse consequences to the entity or the public as a result of such communication are viewed as so significant that they would reasonably be expected to outweigh the public interest benefits of communicating about the matter.[84]
- The auditor may be required by law or regulation to communicate with applicable regulatory, enforcement or supervisory authorities in relation to the matter, regardless of whether the matter is communicated in the auditor's report.

[84] ISA 701, paragraphs A53–A54

A179. It may be necessary for the auditor to consider the implications of communicating about a matter determined to be a key audit matter in light of relevant ethical requirements.[85]

**Written Representations** (Ref: Para. 65)

A180. ISA 580[86] establishes requirements and provides guidance on obtaining appropriate representations from management and, where appropriate, those charged with governance in the audit. Although written representations are an important source of audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. In addition, since management are in a unique position to perpetrate fraud, it is important for the auditor to consider all audit evidence obtained, including audit evidence that is consistent or inconsistent with other audit evidence in drawing the conclusion required in accordance with ISA 330.[87]

A181. ISA 580[88] also addresses circumstances when the auditor has doubt as to the reliability of written representations, including if written representations are inconsistent with other audit evidence. Doubts about the reliability of information from management may indicate a risk of material misstatement due to fraud.

**Communications with Management and Those Charged with Governance** (Ref: Para. 66–68)

A182. In some jurisdictions, law or regulation may restrict the auditor's communication of certain matters with management and those charged with governance. Law or regulation may specifically prohibit a communication, or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act, including alerting the entity, for example, when the auditor is required to report the fraud to an appropriate authority pursuant to anti-money laundering legislation. In these circumstances, the issues considered by the auditor may be complex and the auditor may consider it appropriate to obtain legal advice.

*Communication with Management* (Ref: Para. 66)

A183. If the auditor identifies fraud or suspected fraud, it is important that the matter be brought to the attention of the appropriate level of management as soon as practicable, even if the matter may be considered inconsequential (e.g., a minor misappropriation of funds by an employee at a low level in the entity's organization). The determination of which level of management is the appropriate one is a matter of professional judgment and is affected by such factors as the likelihood of collusion and the nature and magnitude of the suspected fraud. Ordinarily, the appropriate level of management is at least one level above the persons who appear to be involved with the fraud or suspected fraud.

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85 For example, except for certain specified circumstances, paragraph R114.2 of the IESBA Code does not permit the use or disclosure of information in respect of which the duty of confidentiality applies. As one of the exceptions, paragraph R114.3 of the IESBA Code permits the professional accountant to disclose or use confidential information where there is a legal or professional duty or right to do so. Paragraph 114.3 A1(b)(iv) of the IESBA Code explains that there is a professional duty or right to disclose such information to comply with technical and professional standards.

86 ISA 580, *Written Representations*

87 ISA 330, paragraph 26

88 ISA 580, paragraphs 16–18

*Communication with Those Charged with Governance* (Ref: Para. 67)

A184. The auditor's communication with those charged with governance may be made orally or in writing. ISA 260 (Revised) identifies factors the auditor considers in determining whether to communicate orally or in writing.[89] Due to the nature and sensitivity of fraud involving senior management, or fraud that results in a material misstatement in the financial statements, the auditor reports such matters on a timely basis and may consider it necessary to also report such matters in writing.

A185. In some cases, the auditor may consider it appropriate to communicate with those charged with governance when the auditor becomes aware of fraud involving employees other than management that does not result in a material misstatement. Similarly, those charged with governance may wish to be informed of such circumstances. The communication process is assisted if the auditor and those charged with governance agree at an early stage in the audit about the nature and extent of the auditor's communications in this regard.

A186. In the exceptional circumstances where the auditor has doubts about the integrity or honesty of management or those charged with governance, the auditor may consider it appropriate to obtain legal advice to assist in determining the appropriate course of action.

Other Matters Related to Fraud (Ref: Para. 68)

A187. Other matters related to fraud to be discussed with those charged with governance of the entity may include, for example:

- Concerns about the nature, extent, and frequency of management's assessments of the controls in place to prevent or detect fraud and of the risk that the financial statements may be misstated.
- A failure by management to appropriately address identified significant deficiencies in internal control, or to appropriately respond to an identified fraud.
- The auditor's evaluation of the entity's control environment, including questions regarding the competence and integrity of management.
- Actions by management that may be indicative of fraudulent financial reporting, such as management's selection and application of accounting policies that may be indicative of management's effort to manage earnings in order to deceive financial statement users by influencing their perceptions as to the entity's performance and profitability.
- Concerns about the adequacy and completeness of the authorization of transactions that appear to be outside the normal course of business.

**Reporting to an Appropriate Authority Outside the Entity** (Ref: Para. 69)

A188. The reporting may be to applicable regulatory, enforcement, supervisory or other appropriate authority outside the entity.

A189. ISA 250 (Revised)[90] provides further guidance with respect to the auditor's determination of whether reporting identified or suspected non-compliance with laws or regulations to an appropriate authority

[89] ISA 260 (Revised), paragraph A38

[90] ISA 250 (Revised), paragraphs A28–A34

outside the entity is required or appropriate in the circumstances, including consideration of the auditor's duty of confidentiality.[91]

A190. Factors the auditor may consider in determining whether it is appropriate to report the matter to an appropriate authority outside the entity, when not prohibited by law, regulation, or relevant ethical requirements, may include:

- Any views expressed by regulatory, enforcement, supervisory or other appropriate authority outside of the entity.
- Whether reporting the matter would be acting in the public interest.

A191. Reporting fraud matters to an appropriate authority outside the entity may involve complex considerations and professional judgments. In those circumstances, the auditor may consider consulting internally (e.g., within the firm or a network firm) or on a confidential basis with a regulator or professional body (unless doing so is prohibited by law or regulation or would breach the duty of confidentiality). The auditor may also consider obtaining legal advice to understand the auditor's options and the professional or legal implications of taking any particular course of action.

*Considerations Specific to Public Sector Entities*

A192. In the public sector, requirements for reporting fraud, whether or not discovered through the audit process, may be subject to specific provisions of the audit mandate or related law, regulation, or other authority.

**Documentation** (Ref: Para. 70)

A193. ISA 230[92] addresses circumstances when the auditor identifies information that is inconsistent with the auditor's final conclusion regarding a significant matter and requires the auditor to document how the auditor addressed the inconsistency.

[91] For example, paragraph R114.3 of the IESBA Code permits the professional accountant to disclose or use confidential information where there is a legal or professional right to do so. Paragraph 114.3 A1(b)(iv) of the IESBA Code explains that there is a professional duty or right to disclose such information to comply with technical and professional standards.

[92] ISA 230, paragraphs 11 and A15

# Appendix 1

(Ref: Para. A23, A38, and A56)

## Examples of Fraud Risk Factors

The fraud risk factors identified in this Appendix are examples of such factors that may be faced by auditors in a broad range of situations. Separately presented are examples relating to the two types of fraud relevant to the auditor's consideration — that is, fraudulent financial reporting and misappropriation of assets. For each of these types of fraud, the risk factors are further classified based on the three conditions generally present when material misstatements due to fraud occur: (a) incentives/pressures, (b) opportunities, and (c) attitudes/rationalizations. Although the risk factors cover a broad range of situations, they are only examples and, accordingly, the auditor may identify additional or different risk factors. Not all of these examples are relevant in all circumstances, and some may be of greater or lesser significance in entities of different size or with different ownership characteristics or circumstances. Also, the order of the examples of risk factors provided is not intended to reflect their relative importance or frequency of occurrence.

Fraud risk factors may relate to incentives or pressures, or opportunities that arise from conditions that create susceptibility to misstatement before consideration of controls (i.e., the inherent risk). Such factors are inherent risk factors, insofar as they affect inherent risk, and may be due to management bias. Fraud risk factors related to opportunities may also arise from other identified inherent risk factors (e.g., complexity or uncertainty may create opportunities that result in a susceptibility to misstatement due to fraud). Fraud risk factors related to opportunities may also relate to conditions within the entity's system of internal control, such as limitations or deficiencies in the entity's internal control that create such opportunities. Fraud risk factors related to attitudes or rationalizations may arise, in particular, from limitations or deficiencies in the entity's control environment.

## Risk Factors Relating to Misstatements Arising from Fraudulent Financial Reporting

The following are examples of risk factors relating to misstatements arising from fraudulent financial reporting.

*Incentives/Pressures*

Financial stability or profitability is threatened by economic, industry, geopolitical, or entity operating conditions, such as (or as indicated by):

- High degree of competition or market saturation, accompanied by declining margins.
- High vulnerability to rapid changes, such as changes in technology, product obsolescence, or interest rates.
- Increased volatility in financial and commodity markets due to fluctuations in interest rates and inflationary trends.
- Significant declines in customer demand and increasing business failures in either the industry or overall economy.
- Operating losses making the threat of bankruptcy, foreclosure, or hostile takeover imminent.
- Recurring negative cash flows from operations or an inability to generate cash flows from operations while reporting earnings and earnings growth.

- Rapid growth or unusual profitability especially compared to that of other companies in the same industry.
- New accounting, statutory, or regulatory requirements.
- Pandemics or wars triggering major disruptions in the entity's operations, financial distress and severe cashflow shortages.
- Economic sanctions imposed by governments and international organizations against a jurisdiction, including its companies and products.

Excessive pressure exists for management to meet the requirements or expectations of third parties due to the following:

- Profitability or trend level expectations of investment analysts, institutional investors, significant creditors, or other external parties (particularly expectations that are aggressive or unrealistic), including expectations created by management in, for example, overly optimistic press releases or annual report messages.
- Need to obtain additional debt or equity financing, or qualify for government assistance or incentives, to avoid bankruptcy or foreclosure, or to stay competitive — including financing of major research and development or capital expenditures.
- Marginal ability to meet exchange listing requirements or debt repayment or other debt covenant requirements.
- Perceived or real adverse effects of reporting poor financial results on significant pending transactions, such as initial public offerings, mergers and acquisitions, business combinations or contract awards.
- Management enters into significant transactions that places undue emphasis on achieving key performance indicators to stakeholders (e.g., meeting earnings per share forecasts or maintaining the stock price).

Information available indicates that the personal financial situation of management or those charged with governance is threatened by the entity's financial performance arising from the following:

- Significant financial interests in the entity.
- Significant portions of their compensation (e.g., bonuses, stock options, and earn-out arrangements) being contingent upon achieving aggressive targets for stock price, operating results, financial position, cash flow, or other key performance indicators.[93]
- Personal guarantees of debts of the entity.

There is excessive pressure on management or operating personnel to meet financial targets established by those charged with governance, including sales or profitability incentive goals.

*Opportunities*

The nature of the industry or the entity's operations provides opportunities to engage in fraudulent financial reporting that can arise from the following:

[93] Management incentive plans may be contingent upon achieving targets relating only to certain accounts or selected activities of the entity, even though the related accounts or activities may not be material to the entity as a whole.

- Significant related-party transactions not in the ordinary course of business or with related entities not audited or audited by another firm.
- Assets, liabilities, revenues, or expenses based on significant estimates that involve subjective judgments or uncertainties that are difficult to corroborate.
- Significant, unusual, or highly complex transactions, especially those close to period end that pose difficult "substance over form" questions.
- Significant operations located or conducted across international borders in jurisdictions where differing business environments and cultures exist.
- Use of business intermediaries for which there appears to be no clear business justification.
- Modifying, revoking, or amending revenue contracts through the use of side agreements that are typically executed outside the recognized business process and reporting channels.
- Significant bank accounts or subsidiary or branch operations in tax-haven jurisdictions for which there appears to be no clear business justification.
- Non-traditional entry to capital markets by the entity, for example, through an acquisition by, or merger with, a special-purpose acquisition company.
- Aggressive stock promotions by the entity through press releases, investment newsletters, website coverage, online advertisements, email, or direct mail.

The monitoring of management is not effective as a result of the following:

- Domination of management by a single person or small group (in a non owner-managed business) without compensating controls.
- Oversight by those charged with governance over the financial reporting process and internal control is not effective.
- Weakened control environment triggered by a shift in focus by management and those charged with governance to address more immediate needs of the business such as financial and operational matters.

There is a complex or unstable organizational structure, as evidenced by the following:

- Difficulty in determining the organization or individuals that have controlling interest in the entity.
- Overly complex organizational structure involving unusual legal entities or managerial lines of authority.
- Overly complex IT environment relative to the nature of the entity's business, legacy IT systems from acquisitions that were never integrated into the entity's financial reporting system, or ineffective IT general controls.
- High turnover of senior management, legal counsel, or those charged with governance.

Deficiencies in internal control as a result of the following:

- Inadequate process to monitor the entity's system of internal control, including automated controls and controls over interim financial reporting (where external reporting is required).
- Inadequate fraud risk management program, including lack of a whistleblower program.

- Inadequate controls due to changes in the current environment, for example, increased data security risks from using unsecured networks that makes the entity's data and information more vulnerable to cybercrime that could result in breaches of customer data or the entity's proprietary information.
- High turnover rates or employment of staff in accounting, IT, or the internal audit function that are not effective.
- Accounting and information systems that are not effective, including situations involving significant deficiencies in internal control.

*Attitudes/Rationalizations*

- Management and those charged with governance have not created a culture of honesty and ethical behavior. For example, communication, implementation, support, or enforcement of the entity's values or ethical standards by management and those charged with governance are not effective, or the communication of inappropriate values or ethical standards.
- Non-financial management's excessive participation in or preoccupation with the selection of accounting policies or the determination of significant estimates.
- Known history of violations of securities laws or other laws and regulations, or claims against the entity, its senior management, or those charged with governance alleging fraud or violations of laws and regulations, including those dealing with corruption, bribery, and money laundering.
- Excessive interest by management in maintaining or increasing the entity's stock price or earnings trend.
- The practice by management of committing to analysts, creditors, and other third parties to achieve aggressive or unrealistic forecasts.
- Management and those charged with governance demonstrate an unusually high risk tolerance or display an unusually high standard of lifestyle, a pattern of significant personal financial issues, or frequently engage in high-risk activities.
- Management and those charged with governance make materially false or misleading statements in other information included in the entity's annual report (e.g., key aspects of the entity's business, products, or technology).
- Management failing to remedy known significant deficiencies in internal control on a timely basis.
- An interest by management in employing inappropriate means to minimize reported earnings for tax-motivated reasons.
- Applying aggressive valuation assumptions in mergers and acquisitions to support high purchase prices or overvalue acquired intangible assets.
- Rationalizing the use of unreasonable assumptions affecting the timing and amount of revenue recognition, for example, in an attempt to alleviate the negative effects of severe economic downturns.
- Rationalizing the use of unreasonable assumptions used in projections to account for impairment of goodwill and intangible assets, for example, to avoid recognizing significant impairment losses.
- Low morale among senior management.
- The owner-manager makes no distinction between personal and business transactions.

- Dispute between shareholders in a closely held entity.
- Recurring attempts by management to justify marginal or inappropriate accounting on the basis of materiality.
- The relationship between management and the current or predecessor auditor is strained, as exhibited by the following:
    - Frequent disputes with the current or predecessor auditor on accounting, auditing, or reporting matters.
    - Unreasonable demands on the auditor, such as unrealistic time constraints regarding the completion of the audit or the issuance of the auditor's report.
    - Restrictions on the auditor that inappropriately limit access to people or information or the ability to communicate effectively with those charged with governance.
    - Domineering management behavior in dealing with the auditor, especially involving attempts to influence the scope of the auditor's work or the selection or continuance of personnel assigned to or consulted on the audit engagement.

**Risk Factors Relating to Misstatements Arising from Misappropriation of Assets**

Risk factors that relate to misstatements arising from misappropriation of assets are also classified according to the three conditions generally present when fraud exists: incentives/pressures, opportunities, and attitudes/rationalization. Some of the risk factors related to misstatements arising from fraudulent financial reporting also may be present when misstatements arising from misappropriation of assets occur. For example, ineffective monitoring of management and other deficiencies in internal control may be present when misstatements due to either fraudulent financial reporting or misappropriation of assets exist. The following are examples of risk factors related to misstatements arising from misappropriation of assets.

*Incentives/Pressures*

Personal financial obligations may create pressure on management or employees with access to cash or other assets susceptible to theft to misappropriate those assets.

Adverse relationships between the entity and employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets. For example, adverse relationships may be created by the following:

- Known or anticipated future employee layoffs.
- Recent or anticipated changes to employee compensation or benefit plans.
- Promotions, compensation, or other rewards inconsistent with expectations.

*Opportunities*

Certain characteristics or circumstances may increase the susceptibility of assets to misappropriation. For example, opportunities to misappropriate assets increase when there are the following:

- Large amounts of cash on hand or processed.
- Inventory items that are small in size, of high value, or in high demand.

- Easily convertible assets, such as bearer bonds, diamonds, or computer chips.
- Fixed assets that are small in size, marketable, or lacking observable identification of ownership.

Inadequate controls over assets may increase the susceptibility of misappropriation of those assets. For example, misappropriation of assets may occur because there is the following:

- Inadequate segregation of duties or independent checks.
- Inadequate oversight of senior management expenditures, such as travel and other re-imbursements.
- Inadequate management oversight of employees responsible for assets, for example, inadequate supervision or monitoring of remote locations.
- Inadequate job applicant screening of employees with access to assets.
- Inadequate record keeping with respect to assets.
- Inadequate system of authorization and approval of transactions (e.g., in purchasing).
- Inadequate physical safeguards over cash, investments, inventory, or fixed assets.
- Lack of complete and timely reconciliations of assets.
- Lack of timely and appropriate documentation of transactions, for example, credits for merchandise returns.
- Lack of mandatory vacations for employees performing key control functions.
- Inadequate management understanding of IT, which enables IT employees to perpetrate a misappropriation.
- Inadequate access controls over automated records, including controls over and review of computer systems event logs.
- Inadequate controls in supplier management, including changes in the supply chain, that may expose the entity to fictitious suppliers, or unvetted suppliers that pay kickbacks or are involved in other fraudulent or illegal activities.
- Lack of oversight by those charged with governance over how management utilized financial aid from governments and local authorities (e.g., bailouts during pandemics, wars, or impending industry collapse) is not effective.

*Attitudes/Rationalizations*

- Disregard for the need for monitoring or reducing risks related to misappropriations of assets.
- Disregard for controls over misappropriation of assets by overriding existing controls or by failing to take appropriate remedial action on known deficiencies in internal control.
- Behavior indicating displeasure or dissatisfaction with the entity or its treatment of the employee.
- Changes in behavior or lifestyle that may indicate assets have been misappropriated.
- Tolerance of petty theft.
- Rationalizing misappropriations committed during severe economic downturns by intending to pay back the entity when circumstances return to normal.

## Appendix 2

(Ref: Para. A115 and A123)

## Examples of Possible Audit Procedures to Address the Assessed Risks of Material Misstatement Due to Fraud

The following are examples of possible audit procedures to address the assessed risks of material misstatement due to fraud resulting from both fraudulent financial reporting and misappropriation of assets. Although these procedures cover a broad range of situations, they are only examples and, accordingly they may not be the most appropriate nor necessary in each circumstance. Also, the order of the procedures provided is not intended to reflect their relative importance.

### Consideration at the Assertion Level

Specific responses to the auditor's assessment of the risks of material misstatement due to fraud will vary depending upon the types or combinations of fraud risk factors or conditions identified, and the classes of transactions, account balances, disclosures and assertions they may affect.

The following are specific examples of responses:

- Visiting locations or performing certain tests on a surprise or unannounced basis. For example, observing inventory at locations where auditor attendance has not been previously announced or counting cash at a particular date on a surprise basis.
- Requesting that inventories be counted at the end of the reporting period or on a date closer to period end to minimize the risk of manipulation of balances in the period between the date of completion of the count and the end of the reporting period.
- Altering the audit approach in the current year. For example, contacting major customers and suppliers orally in addition to sending written confirmation, sending confirmation requests to a specific party within an organization, or seeking more or different information.
- Performing a detailed review of the entity's quarter-end or year-end adjusting entries and investigating any that appear unusual as to nature or amount.
- For significant and unusual transactions, particularly those occurring at or near year-end, investigating the possibility of related parties and the sources of financial resources supporting the transactions.
- Performing substantive analytical procedures using disaggregated data. For example, comparing sales and cost of sales by location, line of business or month to expectations developed by the auditor.
- Conducting interviews of personnel involved in areas where a risk of material misstatement due to fraud has been identified, to obtain their insights about the risk and whether, or how, controls address the risk.
- Conducting interviews with personnel outside of the financial reporting function, for example, sales and marketing personnel.
- When other independent auditors are auditing the financial statements of one or more subsidiaries, divisions, or branches, discussing with them the extent of work necessary to be performed to address

the assessed risk of material misstatement due to fraud resulting from transactions and activities among these components.

- If the work of an expert becomes particularly significant with respect to a financial statement item for which the assessed risk of material misstatement due to fraud is high, performing additional procedures relating to some or all of the expert's assumptions, methods or findings to determine that the findings are not unreasonable or engaging another expert for that purpose.
- Performing audit procedures to analyze selected opening balance sheet accounts of previously audited financial statements to assess how certain issues involving accounting estimates and judgments, for example, an allowance for sales returns, were resolved with the benefit of hindsight.
- Performing procedures on account or other reconciliations prepared by the entity, including considering reconciliations performed at interim periods.
- Using automated tools and techniques, such as data mining to test for anomalies in a population. For example, using automated tools and techniques to identify numbers that have been used frequently as there may be an unconscious bias by management or employees when posting fraudulent journal entries or other adjustments to use the same number repetitively.
- Testing the integrity of computer-produced records and transactions.
- Seeking additional audit evidence from sources outside of the entity being audited.

**Specific Responses—Misstatement Resulting from Fraudulent Financial Reporting**

Examples of responses to the auditor's assessment of the risks of material misstatement due to fraudulent financial reporting are as follows:

*Revenue Recognition*

- Performing substantive analytical procedures relating to revenue using disaggregated data, for example, comparing revenue reported by month and by product line or business segment during the current reporting period with comparable prior periods. Automated tools and techniques may be useful in identifying unusual or unexpected revenue relationships or transactions.
- Confirming with customers certain relevant contract terms and the absence of side agreements, because the appropriate accounting often is influenced by such terms or agreements and basis for rebates or the period to which they relate are often poorly documented. For example, acceptance criteria, delivery and payment terms, the absence of future or continuing supplier obligations, the right to return the product, guaranteed resale amounts, and cancellation or refund provisions often are relevant in such circumstances.
- Inquiring of the entity's sales and marketing personnel or in-house legal counsel regarding sales or shipments near the end of the period and their knowledge of any unusual terms or conditions associated with these transactions.
- Being physically present at one or more locations at period end to observe goods being shipped or being readied for shipment (or returns awaiting processing) and performing other appropriate sales and inventory cutoff procedures.

- For those situations for which revenue transactions are electronically initiated, processed, and recorded, testing controls to determine whether they provide assurance that recorded revenue transactions occurred and are properly recorded.
- Examining customer correspondence files at the entity for any unusual terms or conditions that raise questions about the appropriateness of revenue recognized.
- Analyzing the reasons provided for product returns received shortly after the end of the financial year (e.g., product not ordered, entity shipped more units than ordered).
- Determining whether revenue transactions are recorded in accordance with the applicable financial reporting framework and the entity's accounting policies. For example, goods shipped are not recorded as sales unless there is a transfer of legal title in accordance with the shipping terms especially in circumstances when the entity uses a freight forwarder or a third-party warehouse or fulfillment center.

*Inventory Quantities*

- Examining the entity's inventory records to identify locations or items that require specific attention during or after the physical inventory count.
- Observing inventory counts at certain locations on an unannounced basis or conducting inventory counts at all locations on the same date.
- Conducting inventory counts at or near the end of the reporting period to minimize the risk of inappropriate manipulation during the period between the count and the end of the reporting period.
- Performing additional procedures during the observation of the count, for example, more rigorously examining the contents of boxed items, the manner in which the goods are stacked (e.g., hollow squares) or labeled, and the quality (that is, purity, grade, or concentration) of liquid substances such as perfumes or specialty chemicals. Using the work of an expert may be helpful in this regard.
- Comparing the quantities for the current period with prior periods by class or category of inventory, location or other criteria, or comparison of quantities counted with perpetual records.
- Using automated tools and techniques to further test the compilation of the physical inventory counts – for example, sorting by tag number to test tag controls or by item serial number to test the possibility of item omission or duplication.
- Verifying the accurate calibration of tools that are used to record, measure, or weigh the quantity of inventory items – for example, scales, measuring devices or scanning devices.
- Using an expert to confirm the nature of inventory quantities for specialized products – for example, the weight of the precious gemstones may be determinable, but an expert may assist with determining the cut, color, and clarity of precious gemstones.

*Management Estimates*

- Using an expert to develop an independent estimate for comparison with management's estimate.
- Extending inquiries to individuals outside of management and the accounting department to corroborate management's ability and intent to carry out plans that are relevant to developing the estimate.

**Specific Responses—Misstatements Due to Misappropriation of Assets**

Differing circumstances would necessarily dictate different responses. Ordinarily, the audit response to an assessed risk of material misstatement due to fraud relating to misappropriation of assets will be directed toward certain account balances and classes of transactions. Although some of the audit responses noted in the two categories above may apply in such circumstances, the scope of the work is to be linked to the specific information about the misappropriation risk that has been identified.

Examples of responses to the auditor's assessment of the risk of material misstatements due to misappropriation of assets are as follows:

- Counting cash or securities at or near year-end.
- Confirming directly with customers the account activity (including credit memo and sales return activity as well as dates payments were made) for the period under audit.
- Analyzing recoveries of written-off accounts.
- Analyzing inventory shortages by location or product type.
- Comparing key inventory ratios to industry norm.
- Reviewing supporting documentation for reductions to the perpetual inventory records.
- Performing a computerized match of the supplier list with a list of employees to identify matches of addresses or phone numbers.
- Performing a computerized search of payroll records to identify duplicate addresses, employee identification or taxing authority numbers or bank accounts.
- Reviewing personnel files for those that contain little or no evidence of activity, for example, lack of performance evaluations.
- Analyzing sales discounts and returns for unusual patterns or trends.
- Confirming specific terms of contracts with third parties.
- Obtaining evidence that contracts are being carried out in accordance with their terms.
- Reviewing the propriety of large and unusual expenses.
- Reviewing the authorization and carrying value of senior management and related party loans.
- Reviewing the level and propriety of expense reports submitted by senior management.

## Appendix 3

(Ref: Para. A30)

## Examples of Circumstances that May Be Indicative of Fraud

The following are examples of circumstances that may indicate that the financial statements may contain a material misstatement due to fraud.

*Discrepancies in the accounting records, including:*

- Transactions that are not recorded in a complete or timely manner or are improperly recorded as to amount, accounting period, classification, or entity policy.
- Unsupported or unauthorized balances or transactions.
- Last-minute adjustments that significantly affect financial results (e.g., inventory adjustments).

*Conflicting or missing evidence, including:*

- Missing documents.
- Missing approvals or authorization signatures.
- Signature or handwriting discrepancies and invalid electronic signatures.
- Documents that appear to have been altered.
- Unavailability of other than photocopied or electronically transmitted documents when documents in original form are expected to exist.
- Significant unexplained items on reconciliations.
- Unusual balance sheet changes, or changes in trends or important financial statement ratios or relationships – for example, receivables growing faster than revenues.
- Inconsistent, vague, or implausible responses from management or employees arising from inquiries or analytical procedures.
- Unusual discrepancies between the entity's records and confirmation replies.
- Large numbers of credit entries and other adjustments made to accounts receivable records.
- Subsidiary ledgers, which do not reconcile with control accounts.
- Unexplained or inadequately explained differences between the accounts receivable sub-ledger and the control account, or between the customer statements and the accounts receivable sub-ledger.
- Unexplained fluctuations in stock account balances, inventory variances and turnover rates.
- Missing inventory or physical assets of significant magnitude.
- Unavailable or missing electronic evidence, inconsistent with the entity's record retention practices or policies.
- Fewer responses to confirmations than anticipated or a greater number of responses than anticipated.
- Inability to produce evidence of key systems development and program change testing and implementation activities for current-year system changes and deployments.

- Information about overly optimistic projections obtained from listening to the entity's earning's calls with analysts or by reading analysts' research reports that is contrary to information presented in the entity's internal forecasts used for budgeting purposes.

*Problematic or unusual relationships between the auditor and management, including:*

- Denial of access to records, facilities, certain employees, customers, suppliers, or others from whom audit evidence might be sought.
- Denial of access to key IT operations staff and facilities, including security, operations, and systems development personnel.
- Undue time pressures imposed by management to resolve complex or contentious issues.
- Complaints by management about the conduct of the audit or management intimidation of engagement team members, particularly in connection with the auditor's critical assessment of audit evidence or in the resolution of potential disagreements with management.
- Unusual delays by the entity in providing requested information.
- An unwillingness to facilitate auditor access to key electronic files for testing through the use of automated tools and techniques.
- An unwillingness to allow a discussion between the auditor and management's third-party expert (e.g., an expert in taxation law).
- An unwillingness by management to permit the auditor to meet privately with those charged with governance.
- An unwillingness to correct a material misstatement in the financial statements, or in other information included in the entity's annual report.
- An unwillingness to add or revise disclosures in the financial statements to make them more complete and understandable.
- An unwillingness to address identified deficiencies in internal control on a timely basis.
- An unwillingness to allow the auditor to send a confirmation request.
- An unwillingness to provide a requested written representation.

*Other*

- Extensive use of suspense accounts.
- Accounting policies that appear to be at variance with industry norms.
- Frequent changes in accounting estimates that do not appear to result from changed circumstances.
- Tolerance of violations of the entity's code of conduct.
- Discrepancy between earnings and lifestyle.
- Unusual, irrational, or inconsistent behavior.
- Allegations of fraud through anonymous emails, letters, telephone calls, tips or complaints that may come to the attention of the auditor.

- Evidence of employees' access to systems and records inconsistent with that necessary to perform their authorized duties.
- Controls or audit logs being switched off.

## Appendix 4

(Ref: Para. A96, A99 and A131)

## Additional Considerations that May Inform the Auditor When Selecting Journal Entries and Other Adjustments for Testing

The following considerations are of relevance when selecting journal entries and other adjustments for testing:

- Understanding of the entity's information system and communication relevant to the preparation of the financial statements[94] (see also paragraph 37 of this ISA) – obtaining this required understanding provides the auditor with knowledge about:
    - The entity's policies and procedures regarding (including the individuals within the entity responsible for) how transactions are initiated, recorded, processed, corrected as necessary, incorporated in the general ledger, and reported in the financial statements.
    - The types of journal entries (whether standard or non-standard) incorporated in the general ledger and, in turn, reported in the financial statements, including other adjustments made directly to the financial statements.
    - The process of how journal entries and other adjustments are recorded or made (whether automated or manual) as well as the supporting documentation required, based on the entity's policies and procedures.
    - The entity's financial statement closing process.
- Understanding of the entity's controls designed to prevent or detect fraud over journal entries[95] (see also paragraph 38 of this ISA) – for many entities, routine processing of transactions involves a combination of manual and automated controls. Similarly, the processing of journal entries and other adjustments may involve both manual and automated controls across one or multiple IT systems. Where IT is used in the financial reporting process, journal entries and other adjustments may exist only in electronic form.
    - The types of controls designed to prevent or detect fraud over journal entries may include authorizations and approvals, reconciliations, verifications (such as edit and validation checks or automated calculations), segregation of duties, and physical or logical controls.
    - The requirement in paragraph 38 covers controls over journal entries that address a risk(s) of material misstatement due to fraud at the assertion level, and that could be susceptible to unauthorized or inappropriate intervention or manipulation. These controls include:
        - Controls over non-standard journal entries — where the journal entries are automated or manual and are used to record non-recurring, unusual transactions or adjustments.
        - Controls over standard journal entries — where the journal entries are automated or manual and are susceptible to unauthorized or inappropriate intervention or manipulation.

[94] ISA 315 (Revised 2019), paragraph 25

[95] ISA 315 (Revised 2019), paragraph 26

- The effectiveness of controls that have been implemented over journal entries and other adjustments — effective controls over the preparation and posting of journal entries and other adjustments may reduce the extent of substantive testing necessary, provided that the auditor has tested the operating effectiveness of the controls.
- The identification and assessment of the risks of material misstatement due to fraud — the evaluation of information obtained from the risk assessment procedures and related activities, including the consideration of information obtained from other sources, could indicate the presence of fraud risk factors. Such fraud risk factors, particularly events or conditions that indicate incentives and pressures for management to override controls, opportunities for management override, and attitudes or rationalizations that enable management to justify override of controls, may assist the auditor to identify specific classes of journal entries and other adjustments for testing. These may include journal entries and other adjustments susceptible to unauthorized or inappropriate intervention or manipulation resulting from:
    - Pressures or incentives to meet or exceed performance measures used, internally and externally (e.g., auto-reversing journal entries made at year-end).
    - Pressures or incentives to minimize or avoid taxes (e.g., inappropriate journal entries to record premature or delayed revenue or expense recognition).
    - Pressures to comply with debt repayment or other debt covenant requirements (e.g., inappropriately offsetting assets and liabilities in the balance sheet by directly making adjustments to the financial statements to achieve a debt covenant on the entity's debt-to-equity ratio, even when the conditions for a right of setoff are not met).
    - Opportunities, arising from the inappropriate segregation of duties, for any individual in the entity to conceal or perpetrate fraud in the normal course of that individual's duties (e.g., journal entries and other adjustments relating to transactions affecting assets, where the individual is responsible for (a) the custody of assets, or (b) the authorization or approval of the related transactions affecting those assets, and (c) the recording or reporting of related transactions).
    - Opportunities arising from deficiencies in internal control (e.g., journal entries and other adjustments related to purchase payments to unauthorized suppliers or made by terminated or transferred employees).
    - Opportunities arising from privileged access granted to individuals involved in the financial statement closing process (e.g., journal entries and other adjustments made by individuals with administrative or powerful users' access).
    - Opportunities arising from calculations based on end-user computing tools that support accounting estimates susceptible to misstatement due to management bias or fraud (e.g., journal entries and other adjustments based on calculations of impairment of goodwill and other intangible assets using spreadsheet software).
- The characteristics of fraudulent journal entries or other adjustments — inappropriate journal entries or other adjustments often have unique identifying characteristics. Such characteristics may include entries:
    - Made to unrelated, unusual, or seldom-used accounts.
    - Made by individuals who typically do not make journal entries.

- Recorded at the end of the period or as post-closing entries that have little or no explanation or description.
- Made either before or during the preparation of the financial statements that do not have account numbers.
- Containing round numbers or consistent ending numbers.

The auditor may use recent information, such as data on actual perpetrated frauds or reports regarding trends in occupational fraud, to inform the auditor as to characteristics of fraudulent journal entries.

- The nature and complexity of the accounts — inappropriate journal entries or adjustments may be applied to accounts that:
  - Contain transactions that are complex or unusual in nature.
  - Contain significant estimates and period-end adjustments.
  - Have been prone to misstatements in the past.
  - Have not been reconciled on a timely basis or contain unreconciled differences.
  - Contain intercompany transactions.
  - Are otherwise associated with an identified risk of material misstatement due to fraud.
- Journal entries or other adjustments processed outside the normal course of business – non-standard journal entries may not be subject to the same nature and extent of controls as those journal entries used on a recurring basis to record transactions such as monthly sales, purchases, and cash disbursements.

## Appendix 5

(Ref: Para. A17)

## Other ISAs Addressing Specific Topics that Reference Fraud or Suspected Fraud

This Appendix identifies other ISAs with specific requirements that refer to fraud or suspected fraud. The list does not include other ISAs with requirements that refer to fraud or error (e.g., ISA 210,[96] ISA 315 (Revised 2019), ISA 700 (Revised)). The list is not a substitute for considering the requirements and related application and other explanatory material in the ISAs.

- ISA 402*, Audit Considerations Relating to an Entity Using a Service Organization*, paragraph 19
- ISA 505*, External Confirmations* – paragraphs 8(b) and 11
- ISA 540 (Revised)*, Auditing Accounting Estimates and Related Disclosures* – paragraph 32
- ISA 550, *Related Parties* – paragraphs 19, 22(e) and 23(a)(i)
- ISA 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* – paragraphs 38(d), 45(h), 55, 57(d) and 59(g)(i)

[96] ISA 210, *Agreeing the Terms of Audit Engagements*

# PROPOSED CONFORMING AND CONSEQUENTIAL AMENDMENTS TO OTHER ISAs ARISING FROM PROPOSED ISA 240 (REVISED) – MARKED FROM EXTANT

# ISA 200, OVERALL OBJECTIVES OF THE INDEPENDENT AUDITOR AND THE CONDUCT OF AN AUDIT IN ACCORDANCE WITH INTERNATIONAL STANDARDS ON AUDITING

## Introduction

### An Audit of Financial Statements

…

9. The auditor may also have certain other communication and reporting responsibilities to users, management, those charged with governance, or parties outside the entity, in relation to matters arising from the audit. These may be established by the ISAs or by applicable law or regulation.[1]

…

## Application and Other Explanatory Material

…

**Professional Skepticism** (Ref: Para. 15)

…

A24. The auditor may accept records and documents as genuine unless the auditor has reason to believe the contrary. Nevertheless, the auditor is required to consider the reliability of information to be used as audit evidence.[2] In cases of doubt about the reliability of information or indications of possible fraud (for example, if conditions identified during the audit cause the auditor to believe that a document may not be authentic or that terms in a document may have been falsified), the ISAs require that the auditor investigate further and determine what modifications or additions to audit procedures are necessary to resolve the matter.[3]

…

**Sufficient Appropriate Audit Evidence and Audit Risk** (Ref: Para. 5 and 17)

…

*Inherent Limitations of an Audit*

…

Other Matters that Affect the Inherent Limitations of an Audit

---

[1] See, for example, ISA 260 (Revised), Communication with Those Charged with Governance; and ISA 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraph ~~44~~66–69

[2] ISA 500, *Audit Evidence*, paragraphs 7–9

[3] ISA 240 (Revised), paragraph ~~14~~20; ISA 500, paragraph 11; ISA 505, *External Confirmations*, paragraphs 10–11, and 16

A56. In the case of certain assertions or subject matters, the potential effects of the inherent limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include:

- Fraud, particularly fraud involving senior management or collusion. See ISA 240 (Revised) for further discussion.
- The existence and completeness of related party relationships and transactions. See ISA 550[4] for further discussion.
- The occurrence of non-compliance with laws and regulations. See ISA 250 (Revised)[5] for further discussion.
- Future events or conditions that may cause an entity to cease to continue as a going concern. See ISA 570 (Revised)[6] for further discussion.

…

## ISA 220 (REVISED), QUALITY MANAGEMENT FOR AN AUDIT OF FINANCIAL STATEMENTS

…

### Application and Other Explanatory Material

…

**Leadership Responsibilities for Managing and Achieving Quality on Audits** (Ref: Para. 13–15)

…

*Professional Skepticism (Ref: Para. 7)*

…

A36. Possible actions that the engagement team may take to mitigate impediments to the exercise of professional skepticism at the engagement level may include:

…

- Modifying the nature, timing and extent of direction, supervision or review by involving more experienced engagement team members, more in-person oversight on a more frequent basis or more in-depth reviews of certain working papers for:
  - Complex or subjective areas of the audit;
  - Areas that pose risks to achieving quality on the audit engagement;

---

4 ISA 550, *Related Parties*

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

6 SA 570 (Revised), *Going Concern*

- Areas where there may be a higher risk of material misstatement, including a risk of material misstatement due to fraud~~with a fraud risk~~; and
- Identified or suspected non-compliance with laws or regulations.

…

**Acceptance and Continuance of Client Relationships and Audit Engagements** (Ref: Para. 22–24)

…

A54. Information obtained during acceptance and continuance may also be relevant in complying with the requirements of other ISAs, as well as this ISA, for example with respect to:

…

- Identifying and assessing risks of material misstatement, whether due to error or fraud, in accordance with ISA 315 (Revised 2019) and ISA 240 (Revised);[7]

…

## ISA 230, AUDIT DOCUMENTATION

…

### Application and Other Explanatory Material

…

### Appendix

(Ref: Para. 1)

This appendix identifies paragraphs in other ISAs that contain specific documentation requirements. The list is not a substitute for considering the requirements and related application and other explanatory material in ISAs.

…

- ISA 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* – paragraph~~s 45–48~~70

…

## ISA 250 (REVISED), CONSIDERATION OF LAWS AND REGULATIONS IN AN AUDIT OF FINANCIAL STATEMENTS

…

### Application and Other Explanatory Material

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

**Responsibility for Compliance with Laws and Regulations** (Ref: Para. 3–9)

…

*Responsibility of the Auditor*

…

Categories of Laws and Regulations (Ref: Para. 6)

A6. The nature and circumstances of the entity may impact whether relevant laws and regulations are within the categories of laws and regulations described in paragraphs 6(a) or 6(b). Examples of laws and regulations that may be included in the categories described in paragraph 6 include those that deal with:

- ~~Fraud, c~~Corruption and bribery.
- Money laundering, terrorist financing and proceeds of crime.
- Securities markets and trading.
- Banking and other financial products and services.
- Data protection.
- Tax and pension liabilities and payments.
- Environmental protection.
- Public health and safety.

…

## ISA 260 (REVISED), COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

…

### Application and Other Explanatory Material

…

### Appendix 1

(Ref: Para. 3)

### Specific Requirements in ISQM 1 and Other ISAs that Refer to Communications with Those Charged with Governance

This appendix identifies paragraphs in ISQM 1 and other ISAs that require communication of specific matters with those charged with governance. The list is not a substitute for considering the requirements and related application and other explanatory material in ISAs.

- …
- ISA 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* – paragraphs ~~22, 39(c)(i)~~25, 34(d), 55(a), 60(c)(i) and ~~41–43~~67–68

- …

…

# ISA 265, COMMUNICATING DEFICIENCIES IN INTERNAL CONTROL TO THOSE CHARGED WITH GOVERNANCE AND MANAGEMENT

…

## Application and Other Explanatory Material

…

**Significant Deficiencies in Internal Control** (Ref: Para. 6(b), 8)

…

A6. Examples of matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency include:

- ...
- The susceptibility to loss or fraud of the related asset or liability.
- ...
- The importance of the controls to the financial reporting process; for example:
  - …
  - Controls over the prevention ~~and~~ or detection of fraud.
  - …

…

**Communication of Deficiencies in Internal Control**

…

*Communication of Deficiencies in Internal Control to Management* (Ref: Para. 10)

…

Communication of Significant Deficiencies in Internal Control to Management (Ref: Para. 10(a))

…

A21. ISA 250 (Revised) establishes requirements and provides guidance on the reporting of identified or suspected non-compliance with laws and regulations, including when those charged with governance are themselves involved in such non-compliance.[8] ISA 240 (Revised) establishes requirements and provides guidance regarding communication to those charged with governance when the auditor has identified fraud or suspected fraud involving management.[9]

…

[8] ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*, paragraphs 23–29

[9] ISA 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraph ~~42~~67

# ISA 300, PLANNING AN AUDIT OF FINANCIAL STATEMENTS

…

## Application and Other Explanatory Material

…

**Involvement of Key Engagement Team Members** (Ref: Para. 5)

A4. The involvement of the engagement partner and other key members of the engagement team in planning the audit draws on their experience and insight, thereby enhancing the effectiveness and efficiency of the planning process.[10]

…

# ISA 315 (REVISED 2019), IDENTIFYING AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENT

## Introduction

…

**Key Concepts in this ISA**

…

6. Risks of material misstatement identified and assessed by the auditor include both those due to error and those due to fraud. Although both are addressed by this ISA, the significance of fraud is such that further requirements and guidance are included in ISA 240 (Revised)[11] in relation to risk assessment procedures and related activities to obtain information that is used to identify, assess and respond to the risks of material misstatement due to fraud.

…

## Definitions

12. For purposes of the ISAs, the following terms have the meanings attributed below:

…

(f) Inherent risk factors – Characteristics of events or conditions that affect susceptibility to misstatement, whether due to fraud or error, of an assertion about a class of transactions, account balance or disclosure, before consideration of controls. Such factors may be qualitative or quantitative, and include complexity, subjectivity, change, uncertainty or

---

[10] ISA 315 (Revised 2019), paragraphs 17 and 18, establishes requirements and provides guidance on the engagement team's discussion of the susceptibility of the entity to material misstatements of the financial statements. ISA 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraph ~~16~~29, provides guidance on the emphasis given during this discussion to the susceptibility of the entity's financial statements to material misstatement due to fraud.

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

susceptibility to misstatement due to management bias or other fraud risk factors[12] insofar as they affect inherent risk. (Ref: Para. A7–A8)

…

(l) Significant risk – An identified risk of material misstatement: (Ref: Para. A10)

…

(ii) That is to be treated as a significant risk in accordance with the requirements of other ISAs.[13]

…

## Application and Other Explanatory Material

…

**Risk Assessment Procedures and Related Activities** (Ref: Para. 13–18)

A11. The risks of material misstatement to be identified and assessed include both those due to fraud and those due to error, and both are covered by this ISA. However, the significance of fraud is such that further requirements and guidance are included in ISA 240 (Revised) in relation to risk assessment procedures and related activities to obtain information that is used to identify and assess the risks of material misstatement due to fraud.[14] In addition, the following ISAs provide further requirements and guidance on identifying and assessing risks of material misstatement regarding specific matters or circumstances:

…

*Engagement Team Discussion* (Ref: Para. 17–18)

Why the Engagement Team Is Required to Discuss the Application of the Applicable Financial Reporting Framework and the Susceptibility of the Entity's Financial Statements to Material Misstatement

A42. The discussion among the engagement team about the application of the applicable financial reporting framework and the susceptibility of the entity's financial statements to material misstatement:

…

ISA 240 (Revised) requires the engagement team discussion to place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud may occur.[15]

…

**Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework and the Entity's System of Internal Control** (Ref: Para. 19–27)

…

---

[12] ISA 240 (Revised), paragraphs ~~A24–A27~~A55–A57

[13] ISA 240 (Revised), paragraph ~~27~~40(b) and ISA 550, *Related Parties*, paragraph 18

[14] ISA 240 (Revised), paragraphs ~~12–27~~26–42

[15] ISA 240 (Revised), paragraph ~~16~~29

*Why an Understanding of the Entity and Its Environment, and the Applicable Financial Reporting Framework Is Required* (Ref: Para. 19–20)

A50. The auditor's understanding of the entity and its environment, and the applicable financial reporting framework, assists the auditor in understanding the events and conditions that are relevant to the entity, and in identifying how inherent risk factors affect the susceptibility of assertions to misstatement in the preparation of the financial statements, in accordance with the applicable financial reporting framework, and the degree to which they do so. Such information establishes a frame of reference within which the auditor identifies and assesses risks of material misstatement. This frame of reference also assists the auditor in planning the audit and exercising professional judgment and professional skepticism throughout the audit, for example, when:

- Identifying and assessing risks of material misstatement of the financial statements in accordance with ISA 315 (Revised 2019) or other relevant standards (e.g., relating to risks of material misstatement due to fraud in accordance with ISA 240 (Revised) or when identifying or assessing risks related to accounting estimates in accordance with ISA 540 (Revised));

…

*The Entity and Its Environment* (Ref: Para. 19(a))

…

Measures Used by Management to Assess the Entity's Financial Performance (Ref: Para. 19(a)(iii))

Why the auditor understands measures used by management

A74. An understanding of the entity's measures assists the auditor in considering whether such measures, whether used externally or internally, create pressures on the entity to achieve performance targets. These pressures may motivate management to take actions that increase the susceptibility to misstatement due to management bias or fraud (e.g., to improve the business performance or to intentionally misstate the financial statements) (see ISA 240 (Revised) for requirements and guidance in relation to the risks of material misstatement due to fraud).

…

*The Applicable Financial Reporting Framework* (Ref: Para. 19(b))

…

How Inherent Risk Factors Affect Susceptibility of Assertions to Misstatement (Ref: Para. 19(c))

…

The effect of inherent risk factors on a class of transactions, account balance or disclosure

…

A89. Events or conditions that may affect susceptibility to misstatement due to management bias may also affect susceptibility to misstatement due to other fraud risk factors. Accordingly, this may be relevant information for use in accordance with paragraph ~~24~~32 of ISA 240 (Revised), which requires the auditor to evaluate whether the audit evidence obtained from the risk assessment procedures and related activities indicates that one or more fraud risk factors are present.

*Understanding the Components of the Entity's System of Internal Control* (Ref: Para. 21–27)

…

Control Environment, The Entity's Risk Assessment Process and the Entity's Process to Monitor the System of Internal Control (Ref: Para. 21–24)

…

Obtaining an understanding of the entity's risk assessment process (Ref: Para. 22–23)

Understanding the entity's risk assessment process (Ref: Para. 22(a))

A109. As explained in paragraph A62, not all business risks give rise to risks of material misstatement. In understanding how management and those charged with governance have identified business risks relevant to the preparation of the financial statements, and decided about actions to address those risks, matters the auditor may consider include how management or, as appropriate, those charged with governance, has:

…

- Considered the potential for fraud when considering the risks to achieving the entity's objectives.[16]

…

Control Activities (Ref: Para. 26)

…

Scalability (Ref: Para. 26)

…

A157. It may be less practicable to establish segregation of duties in less complex entities that have fewer employees. However, in an owner-managed entity, the owner-manager may be able to exercise more effective oversight through direct involvement than in a larger entity, which may compensate for the generally more limited opportunities for segregation of duties. Although, as also explained in ISA 240 (Revised), domination of management by a single individual can be a potential control deficiency since there is an opportunity for management override of controls.[17]

Controls that address risks of material misstatement at the assertion level (Ref: Para. 26(a))

Controls that address risks that are determined to be a significant risk (Ref: Para. 26(a)(i))

…

A159. ISA 240 (Revised)[18] requires the auditor to understand controls related to assessed risks of material misstatement due to fraud (which are treated as significant risks), and further explains that it is

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[16] ISA 240 (Revised), paragraph ~~19~~35(b)

[17] ISA 240 (Revised), paragraph ~~A28~~A58

[18] ISA 240 (Revised), paragraphs ~~28~~40(b) and ~~A33~~A98

important for the auditor to obtain an understanding of the controls that management has designed, implemented and maintained to prevent and detect fraud.

…

**Identifying and Assessing the Risks of Material Misstatement** (Ref: Para. 28–37)

…

*Assessing Risks of Material Misstatement at the Assertion Level*

…

Significant Risks (Ref: Para. 32)

…

Determining significant risks

…

A220. The determination of which of the assessed risks of material misstatement are close to the upper end of the spectrum of inherent risk, and are therefore significant risks, is a matter of professional judgment, unless the risk is of a type specified to be treated as a significant risk in accordance with the requirements of another ISA. ISA 240 (Revised) provides further requirements and guidance in relation to the identification and assessment of the risks of material misstatement due to fraud.[19]

**Example:**

…

- An entity is in negotiations to sell a business segment. The auditor considers the effect on goodwill impairment, and may determine there is a higher likelihood of possible misstatement and a higher magnitude due to the impact of inherent risk factors of subjectivity, uncertainty and susceptibility to management bias or other fraud risk factors. This may result in goodwill impairment being determined to be a significant risk.

…

## Appendix 2

(Ref: Para. 12(f), 19(c), A7–A8, A85–A89)

**Understanding Inherent Risk Factors**

This appendix provides further explanation about the inherent risk factors, as well as matters that the auditor may consider in understanding and applying the inherent risk factors in identifying and assessing the risks of material misstatement at the assertion level.

**The Inherent Risk Factors**

1. Inherent risk factors are characteristics of events or conditions that affect susceptibility of an assertion about a class of transactions, account balance or disclosure, to misstatement, whether due to fraud

[19] ISA 240 (Revised), paragraphs ~~26–28~~40–42

or error, and before consideration of controls. Such factors may be qualitative or quantitative, and include complexity, subjectivity, change, uncertainty or susceptibility to misstatement due to management bias or other fraud risk factors[20] insofar as they affect inherent risk. In obtaining the understanding of the entity and its environment, and the applicable financial reporting framework and the entity's accounting policies, in accordance with paragraphs 19(a)–(b), the auditor also understands how inherent risk factors affect susceptibility of assertions to misstatement in the preparation of the financial statements.

2. Inherent risk factors relating to the preparation of information required by the applicable financial reporting framework (referred to in this paragraph as "required information") include:

- …
- *Susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk*— susceptibility to management bias results from conditions that create susceptibility to intentional or unintentional failure by management to maintain neutrality in preparing the information. Management bias is often associated with certain conditions that have the potential to give rise to management not maintaining neutrality in exercising judgment (indicators of potential management bias), which could lead to a material misstatement of the information that would be fraudulent if intentional. Such indicators include incentives or pressures insofar as they affect inherent risk (for example, as a result of motivation to achieve a desired result, such as a desired profit target or capital ratio), and opportunity, not to maintain neutrality. Factors relevant to the susceptibility to misstatement due to fraud in the form of fraudulent financial reporting or misappropriation of assets are described in paragraphs ~~A1~~A2 to ~~A5~~A6 of ISA 240 (Revised).

…

## Appendix 4

(Ref: Para 14(a), 24(a)(ii), A25–A28, A118)

## Considerations for Understanding an Entity's Internal Audit Function

This appendix provides further considerations relating to understanding the entity's internal audit function when such a function exists.

…

### Inquiries of the Internal Audit Function

…

5. In addition, in accordance with ISA 240 (Revised),[21] if the internal audit function provides information to the auditor regarding any ~~actual,~~ fraud or suspected ~~or alleged~~ fraud, including allegations of fraud, the auditor takes this into account in the auditor's identification of risk of material misstatement due to fraud.

…

[20] ISA 240 (Revised), paragraphs ~~A24A27~~A55–A57

[21] ISA 240 (Revised), paragraph ~~19~~35(b)

# ISA 330, THE AUDITOR'S RESPONSES TO ASSESSED RISKS

…

## Application and Other Explanatory Material

…

### Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Assertion Level

*The Nature, Timing and Extent of Further Audit Procedures* (Ref: Para. 6)

…

Timing

A11. The auditor may perform tests of controls or substantive procedures at an interim date or at the period end. The higher the risk of material misstatement, the more likely it is that the auditor may decide it is more effective to perform substantive procedures nearer to, or at, the period end rather than at an earlier date, or to perform audit procedures unannounced or at unpredictable times (for example, performing audit procedures at selected locations on an unannounced basis). This is particularly relevant when considering the response to the risks of material misstatement due to fraud. For example, the auditor may conclude that, when the risks of intentional misstatement or manipulation have been identified, audit procedures to extend audit conclusions from interim date to the period end would not be effective.

…

# ISA 450, EVALUATION OF MISSTATEMENTS IDENTIFIED DURING THE AUDIT

…

## Requirements

…

### Consideration of Identified Misstatements as the Audit Progresses

5A. If the auditor identifies a misstatement, the auditor shall determine whether such a misstatement is indicative of fraud. (Ref: Para. A6A)

6. The auditor shall determine whether the overall audit strategy and audit plan need to be revised if:
   (a) The nature of identified misstatements and the circumstances of their occurrence indicate the other misstatements may exist that, when aggregated with misstatements accumulated during the audit, could be material; or (Ref: Para. A7)
   (b) The aggregate of misstatements accumulated during the audit approaches materiality determined with ISA 320. (Ref: Para. A8)

7. If, at the auditor's request, management has examined a class of transactions, account balance or disclosure and corrected misstatements that were detected, the auditor shall perform additional audit procedures to determine whether misstatements remain. (Ref: Para. A9)

…

## Application and Other Explanatory Material

**Definition of Misstatement** (Ref: Para. 4(a))

A1. Misstatements may result from:

…

Examples of misstatements arising from fraud are provided in ISA 240 (Revised).[22]

…

**Consideration of Identified Misstatements as the Audit Progresses** (Ref: Para. 5A–7)

A6A. The nature of identified misstatements and the circumstances of their occurrence may indicate that the misstatements may be a result of fraud. In such cases, the auditor also performs the procedures required by ISA 240 (Revised), recognizing that an instance of fraud is unlikely to be an isolated occurrence.

A7. A misstatement may not be an isolated occurrence. Evidence that other misstatements may exist include, for example, where the auditor identifies that a misstatement arose from a breakdown in internal control or from inappropriate assumptions or valuation methods that have been widely applied by the entity.

…

**Evaluating the Effect of Uncorrected Misstatements** (Ref: Para. 10–11)

…

A22. ISA 240 (Revised)[23] explains how the implications of a misstatement that is, or may be, the result of fraud ought to be considered in relation to other aspects of the audit, even if the size of the misstatement is not material in relation to the financial statements. Depending on the circumstances, misstatements in disclosures could also be indicative of fraud, and, for example, may arise from:

- Misleading disclosures that have resulted from bias in management's judgments; or
- Extensive duplicative or uninformative disclosures that are intended to obscure a proper understanding of matters in the financial statements.

When considering the implications of misstatements in classes of transactions, account balances and disclosures, the auditor exercises professional skepticism in accordance with ISA 200.[24]

…

---

[22] ISA 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraphs ~~A1~~A2–~~A7~~A6

[23] ISA 240 (Revised), paragraph ~~36~~57

[24] ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraph 15

# ISA 500, AUDIT EVIDENCE

…

## Application and Other Explanatory Material

…

### Information to Be Used as Audit Evidence

*Relevance and Reliability* (Ref: Para. 7)

…

Reliability

…

A37. ISA 240 (Revised) deals with circumstances where the auditor has reason to believe that a document may not be authentic, or may have been modified without that modification having been disclosed to the auditor.[25]

…

# ISA 505, EXTERNAL CONFIRMATIONS

## Introduction

…

### External Confirmation Procedures to Obtain Audit Evidence

…

3. Other ISAs recognize the importance of external confirmations as audit evidence, for example:

   …

   - ISA 240 (Revised) indicates that the auditor may design external confirmation procedures ~~requests~~ to obtain audit evidence ~~additional corroborative information~~ as a response to address the assessed risks of material misstatement due to fraud at the assertion level.[26]

…

## Requirements

…

### Management's Refusal to Allow the Auditor to Send a Confirmation Request

8. If management refuses to allow the auditor to send a confirmation request, the auditor shall:

---

[25] ISA 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraph ~~14~~20

[26] ISA 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraphs ~~A38~~A117–A122

(a) Inquire as to management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness; (Ref: Para. A8)

(b) Evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risks of material misstatement due to~~of~~ fraud, and on the nature, timing and extent of other audit procedures; and (Ref: Para. A9)

(c) Perform alternative audit procedures designed to obtain relevant and reliable audit evidence. (Ref: Para. A10)

…

**Results of the External Confirmation Procedures**

*Reliability of Responses to Confirmation Requests*

…

11. If the auditor determines that a response to a confirmation request is not reliable, the auditor shall evaluate the implications on the assessment of the relevant risks of material misstatement, including risks of material misstatement due to~~of~~ fraud, and on the related nature, timing and extent of other audit procedures. (Ref: Para. A17)

…

## Application and Other Explanatory Material

**External Confirmation Procedures**

…

*Designing Confirmation Requests* (Ref: Para. 7(c))

…

A4. Factors to consider when designing confirmation requests include:

- The assertions being addressed.
- Specific identified risks of material misstatement, including risks of material misstatement due to fraud ~~risks~~.
- The layout and presentation of the confirmation request.
- Prior experience on the audit or similar engagements.
- The method of communication (for example, in paper form, or by electronic or other medium).
- Management's authorization or encouragement to the confirming parties to respond to the auditor. Confirming parties may only be willing to respond to a confirmation request containing management's authorization.
- The ability of the intended confirming party to confirm or provide the requested information (for example, individual invoice amount versus total balance).

…

**Management's Refusal to Allow the Auditor to Send a Confirmation Request**

…

*Implications for the Assessment of Risks of Material Misstatement* (Ref: Para. 8(b))

A9. The auditor may conclude from the evaluation in paragraph 8(b) that it would be appropriate to revise the assessment of the risks of material misstatement at the assertion level and modify planned audit procedures in accordance with ISA 315 (Revised 2019).[27] For example, if management's request to not confirm is unreasonable, this may indicate a fraud risk factor that requires evaluation in accordance with ISA 240 (Revised).[28]

…

**Results of the External Confirmation Procedures**

*Reliability of Responses to Confirmation Requests* (Ref: Para. 10)

A11. ISA 500 indicates that even when audit evidence is obtained from sources external to the entity, circumstances may exist that affect its reliability.[16] All responses carry some risk of interception, alteration or fraud. Such risk exists regardless of whether a response is obtained in paper form, or by electronic or other medium. Factors that may indicate doubts about the reliability of a response include that it:

- Was received by the auditor indirectly; or
- Appeared not to come from the originally intended confirming party.

…

*Unreliable Responses* (Ref: Para. 11)

A17. When the auditor concludes that a response is unreliable, the auditor may need to revise the assessment of the risks of material misstatement at the assertion level and modify planned audit procedures accordingly, in accordance with ISA 315 (Revised 2019).[29] For example, an unreliable response may indicate a fraud risk factor that requires evaluation in accordance with ISA 240 (Revised).[30]

*Non-Responses* (Ref: Para. 12)

…

A19. The nature and extent of alternative audit procedures are affected by the account and assertion in question. A non-response to a confirmation request may indicate a previously unidentified risk of material misstatement. In such situations, the auditor may need to revise the assessed risk of material misstatement at the assertion level, and modify planned audit procedures, in accordance with ISA 315 (Revised 2019).[31] For example, fewer responses to confirmation requests than anticipated, or a

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27 ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*, paragraph 37

28 ISA 240 (Revised), paragraph ~~25~~32

29 ISA 315 (Revised 2019), paragraph 37

30 ISA 240 (Revised), paragraph ~~25~~32

31 ISA 315 (Revised 2019), paragraph 37

greater number of responses than anticipated, may indicate a previously unidentified fraud risk factor that requires evaluation in accordance with ISA 240 (Revised).[32]

…

*Exceptions* (Ref: Para. 14)

A21. Exceptions noted in responses to confirmation requests may indicate misstatements or potential misstatements in the financial statements. When a misstatement is identified, the auditor is required by ISA 450[33] ~~ISA 240~~ to determine ~~evaluate~~ whether such misstatement is indicative of fraud.[34] Exceptions may provide a guide to the quality of responses from similar confirming parties or for similar accounts. Exceptions also may indicate a deficiency, or deficiencies, in the entity's internal control over financial reporting.

…

## ISA 540 (REVISED), AUDITING ACCOUNTING ESTIMATES AND RELATED DISCLOSURES

## Application and Other Explanatory Material

…

### Risk Assessment Procedures and Related Activities

…

*Reviewing the Outcome or Re-Estimation of Previous Accounting Estimates* (Ref: Para. 14)

…

A57. A retrospective review of management judgments and assumptions related to ~~significant~~ accounting estimates is required by ISA 240 (Revised).[35] As a practical matter, the auditor's review of previous accounting estimates as a risk assessment procedure in accordance with this ISA may be carried out in conjunction with the review required by ISA 240 (Revised).

…

**Indicators of Possible Management Bias** (Ref: Para. 32)

…

A136. In addition, in applying ISA 240 (Revised), the auditor is required to evaluate whether management's judgments and decisions in making the accounting estimates included in the financial statements, even if they are individually reasonable, are ~~indicate~~ indicators ~~a~~ of possible management bias that may represent a risk of material misstatement due to fraud.[36] Fraudulent financial reporting is often accomplished through intentional misstatement of accounting estimates, which may include

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[32] ISA 240 (Revised), paragraph ~~25~~32

[33] ISA 450, *Evaluation of Misstatements Identified during the Audit*, paragraph 5A

[34] ~~ISA 240, paragraph 36~~

[35] ISA 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraph ~~33(b)(ii)~~28

[36] ISA 240 (Revised), paragraph~~s 33(b)~~51–52

intentionally understating or overstating accounting estimates. Indicators of possible management bias that may also be a fraud risk factor, may cause the auditor to reassess whether the auditor's risk assessments, in particular the assessment of risks of material misstatement due to fraud ~~risks~~, and related responses remain appropriate.

…

# ISA 550, RELATED PARTIES

## Introduction

### Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor's responsibilities relating to related party relationships and transactions in an audit of financial statements. Specifically, it expands on how ISA 315 (Revised 2019),[37] ISA 330,[38] and ISA 240 (Revised)[39] are to be applied in relation to risks of material misstatement associated with related party relationships and transactions.

…

### Responsibilities of the Auditor

…

5. In addition, an understanding of the entity's related party relationships and transactions is relevant to the auditor's evaluation of whether one or more fraud risk factors are present as required by ISA 240 (Revised),[40] because fraud may be more easily committed through related parties.

…

## Requirements

### Risk Assessment Procedures and Related Activities

11. As part of the risk assessment procedures and related activities that ISA 315 (Revised 2019) and ISA 240 (Revised) require the auditor to perform during the audit,[41] the auditor shall perform the audit procedures and related activities set out in paragraphs 12–17 to obtain information relevant to identifying the risks of material misstatement associated with related party relationships and transactions. (Ref: Para. A8)

Understanding the Entity's Related Party Relationships and Transactions

12. The engagement team discussion that ISA 315 (Revised 2019) and ISA 240 (Revised) require[42] shall include specific consideration of the susceptibility of the financial statements to material misstatement

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

38 ISA 330, *The Auditor's Responses to Assessed Risks*

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

40 ISA 240 (Revised), paragraph ~~25~~32

41 ISA 315 (Revised 2019), paragraph 13; ISA 240 (Revised), paragraph ~~17~~26

42 ISA 315 (Revised 2019), paragraph 17; ISA 240 (Revised), paragraph ~~16~~29

due to fraud or error that could result from the entity's related party relationships and transactions. (Ref: Para. A9–A10)

…

**Identification and Assessment of the Risks of Material Misstatement Associated with Related Party Relationships and Transactions**

…

19. If the auditor identifies fraud risk factors (including circumstances relating to the existence of a related party with dominant influence) when performing the risk assessment procedures and related activities in connection with related parties, the auditor shall consider such information when identifying and assessing the risks of material misstatement due to fraud in accordance with ISA 240 (Revised). (Ref: Para. A6, A29–A30)

…

**Responses to the Risks of Material Misstatement Associated with Related Party Relationships and Transactions**

…

*Identified Significant Related Party Transactions outside the Entity's Normal Course of Business*

23. For identified significant related party transactions outside the entity's normal course of business, the auditor shall:

    (a) Inspect the underlying contracts or agreements, if any, and evaluate whether:

        (i) The business rationale (or lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets;[43] (Ref: Para. A38–A39)

        (ii) The terms of the transactions are consistent with management's explanations; and

        (iii) The transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework; and

    (b) Obtain audit evidence that the transactions have been appropriately authorized and approved. (Ref: Para. A40–A41)

…

## Application and Other Explanatory Material

…

**Risk Assessment Procedures and Related Activities**

…

[43] ISA 240 (Revised), paragraph ~~33(c)~~53

*Understanding the Entity's Related Party Relationships and Transactions*

…

The Entity's Controls over Related Party Relationships and Transactions (Ref: Para. 14)

…

A19. Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively.[44] The risk of management override of controls is higher if management has relationships that involve control or significant influence with parties with which the entity does business because these relationships may present management with greater incentives and opportunities to perpetrate fraud. For example, management's financial interests in certain related parties may provide incentives for management to override controls by (a) directing the entity, against its interests, to conclude transactions for the benefit of these parties, or (b) colluding with such parties or controlling their actions. Examples of possible fraud include:

- Creating fictitious terms of transactions with related parties designed to misrepresent the business rationale of these transactions.
- Fraudulently organizing the transfer of assets from or to management or others at amounts significantly above or below market value.
- Engaging in complex transactions with related parties, such as special-purpose entities, that are structured to misrepresent the financial position or financial performance of the entity.

…

**Identification and Assessment of the Risks of Material Misstatement Associated with Related Party Relationships and Transactions**

*Fraud Risk Factors Associated with a Related Party with Dominant Influence* (Ref: Para. 19)

A29. Domination of management by a single person or small group of persons without compensating controls is a fraud risk factor.[45] Indicators of dominant influence exerted by a related party include:

- The related party has vetoed significant business decisions taken by management or those charged with governance.
- Significant transactions are referred to the related party for final approval.
- There is little or no debate among management and those charged with governance regarding business proposals initiated by the related party.
- Transactions involving the related party (or a close family member of the related party) are rarely independently reviewed and approved.

Dominant influence may also exist in some cases if the related party has played a leading role in founding the entity and continues to play a leading role in managing the entity.

…

[44] ISA 240 (Revised), paragraphs ~~32~~42 and ~~A4~~A5

[45] ISA 240 (Revised), Appendix 1

**Responses to the Risks of Material Misstatement Associated with Related Party Relationships and Transactions** (Ref: Para. 20)

A31. The nature, timing and extent of the further audit procedures that the auditor may select to respond to the assessed risks of material misstatement associated with related party relationships and transactions depend upon the nature of those risks and the circumstances of the entity.[46]

…

A33. If the auditor has assessed a significant risk of material misstatement due to fraud as a result of the presence of a related party with dominant influence, the auditor may, in addition to the general requirements of ISA 240 (Revised), perform audit procedures such as the following to obtain an understanding of the business relationships that such a related party may have established directly or indirectly with the entity and to determine the need for further appropriate substantive audit procedures:

…

*Identification of Previously Unidentified or Undisclosed Related Parties or Significant Related Party Transactions*

…

Intentional Non-Disclosure by Management (Ref: Para. 22(e))

A37. The requirements and guidance in ISA 240 (Revised) regarding the auditor's responsibilities relating to fraud in an audit of financial statements are relevant where management appears to have intentionally failed to disclose related parties or significant related party transactions to the auditor. The auditor may also consider whether it is necessary to re-evaluate the reliability of management's responses to the auditor's inquiries and management's representations to the auditor.

…

## ISA 580, WRITTEN REPRESENTATIONS

…

### Application and Other Explanatory Material

…

### Appendix 1

(Ref: Para. 2)

### List of ISAs Containing Requirements for Written Representations

This appendix identifies paragraphs in other ISAs that require subject-matter specific written representations. The list is not a substitute for considering the requirements and related application and other explanatory material in ISAs.

[46] ISA 330 provides further guidance on considering the nature, timing and extent of further audit procedures. ISA 240 (Revised) establishes requirements and provides guidance on appropriate responses to assessed risks of material misstatement due to fraud.

- ISA 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* – paragraph ~~40~~65

…

## Appendix 2

(Ref: Para. A21)

## Illustrative Representation Letter

The following illustrative letter includes written representations that are required by this and other ISAs. It is assumed in this illustration that the applicable financial reporting framework is International Financial Reporting Standards; the requirement of ISA 570 (Revised)[1] to obtain a written representation is not relevant; and that there are no exceptions to the requested written representations. If there were exceptions, the representations would need to be modified to reflect the exceptions.

…

Information Provided

- We have provided you with:[47]
- Access to all information of which we are aware that is relevant to the preparation of the financial statements, such as records, documentation and other matters;
- Additional information that you have requested from us for the purpose of the audit; and
- Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.
- All transactions have been recorded in the accounting records and are reflected in the financial statements.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud. (ISA 240 (Revised))
- We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity and involves:
  - Management;
  - Employees who have significant roles in internal control; or
  - Others where the fraud could have a material effect on the financial statements. (ISA 240 (Revised))
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others. (ISA 240 (Revised))

[47] If the auditor has included other matters relating to management's responsibilities in the audit engagement letter in accordance with ISA 210, *Agreeing the Terms of Audit Engagements,* consideration may be given to including these matters in the written representations from management or those charged with governance.

- We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements. (ISA 250)
- We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware. (ISA 550)
- [Any other matters that the auditor may consider necessary (see paragraph A11 of this ISA).]

…

## ISA 600 (REVISED), SPECIAL CONSIDERATIONS—AUDITS OF GROUP FINANCIAL STATEMENTS (INCLUDING THE WORK OF COMPONENT AUDITORS)

…

### Application and Other Explanatory Material

**Scope of this ISA** (Ref: Para. 1–2)

…

*Professional Skepticism (Ref: Para. 9)*

…

A17. The exercise of professional skepticism in a group audit may be affected by matters such as the following:

...

- The complex structure of some groups may introduce factors that give rise to increased susceptibility to risks of material misstatement. In addition, an overly complex organizational structure may be a fraud risk factor in accordance with ISA 240 (Revised)[48] and therefore may require additional time or expertise to understand the business purpose and activities of certain entities or business units.

…

**Understanding the Group and Its Environment, the Applicable Financial Reporting Framework and the Group's System of Internal Control** (Ref: Para. 30)

…

*Engagement Team Discussion* (Ref: Para. 30)

…

A92. The discussion provides an opportunity to:

…

- Exchange ideas about how and where the group financial statements may be susceptible to material misstatement due to fraud or error. ISA 240 (Revised)[49] requires the engagement

[48] ISA 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, Appendix 1

[49] ISA 240 (Revised), paragraph ~~16~~29

team discussion to place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud may occur.

…

**Identifying and Assessing the Risks of Material Misstatement** (Ref: Para. 33)

…

*Fraud*

A113. In applying ISA 240 (Revised),[50] the auditor is required to identify and assess the risks of material misstatement of the financial statements due to fraud, and to design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement due to fraud at the assertion level. Information used to identify the risks of material misstatement of the group financial statements due to fraud may include the following:

- Group management's assessment of the risk that the group financial statements may be materially misstated due to fraud.
- Group management's process for identifying and responding to the fraud risks ~~of fraud~~ in the group financial statements, including any specific fraud risks identified by group management, or classes of transactions, account balances, or disclosures for which a fraud risk ~~of fraud~~ is higher.
- Whether there are particular components that are more susceptible to risks of material misstatement due to fraud.
- Whether any fraud risk factors or indicators of management bias exist in the consolidation process.
- How those charged with governance of the group monitor group management's processes for identifying and responding to the fraud risks ~~of fraud~~ in the group, and the controls group management has established to mitigate these risks.
- Responses of those charged with governance of the group, group management, appropriate individuals within the internal audit function (and when appropriate, component management, the component auditors, and others) to the group auditor's inquiry about whether they have knowledge of any fraud or ~~actual,~~ suspected fraud, including allegations of ~~, or alleged~~ fraud, affecting a component or the group.

…

**Responding to the Assessed Risks of Material Misstatement** (Ref: Para. 37)

…

*Element of Unpredictability*

A136. Incorporating an element of unpredictability in the type of work to be performed, the entities or business units at which procedures are performed and the extent to which the group auditor is involved in the work, may increase the likelihood of identifying a material misstatement of the

[50] ISA 240 (Revised), paragraphs ~~26~~40, ~~31~~47

components' financial information that may give rise to a material misstatement of the group financial statements due to fraud.[51]

…

**Evaluating the Component Auditor's Communication and the Adequacy of Their Work**

*Communication about Matters Relevant to the Group Auditor's Conclusion with Regard to the Group Audit* (Ref: Para. 45)

A144. Although the matters required to be communicated in accordance with paragraph 45 are relevant to the group auditor's conclusion with regard to the group audit, certain matters may be communicated during the course of the component auditor's procedures. In addition to the matters in paragraphs 32 and 50, such matters may include, for example:

…

- Newly arising significant risks of material misstatement, including risks of material misstatement due to~~of~~ fraud;

…

**Communication with Group Management and Those Charged with Governance of the Group**

*Communication with Group Management* (Ref: Para. 54–56)

…

A160. ISA 240 (Revised)[52] contains requirements and guidance on the communication of fraud to management and, when management may be involved in the fraud, to those charged with governance.

…

## Appendix 2

(Ref: Para. A88)

## Understanding the Group's System of Internal Control

…

**The Group's Risk Assessment Process**

3. The group auditor's understanding of the group's risk assessment process may include matters such as group management's risk assessment process, that is, the process for identifying, analyzing and managing business risks, including the fraud risk~~ of fraud~~, that may result in material misstatement of the group financial statements. It may also include an understanding of how sophisticated the group's risk assessment process is and the involvement of entities and business units in this process.

…

[51] ISA 240 (Revised), paragraph ~~30(c)~~44

[52] ISA 240 (Revised), paragraphs ~~41–43~~66–68

# ISA 610, USING THE WORK OF INTERNAL AUDITORS

…

## Application and Other Explanatory Material

…

### Using the Work of the Internal Audit Function

*Discussion and Coordination with the Internal Audit Function* (Ref: Para. 21)

…

A26. ISA 200[53] discusses the importance of the auditor planning and performing the audit with professional skepticism, including being alert to information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence. Accordingly, communication with the internal audit function throughout the engagement may provide opportunities for internal auditors to bring matters that may affect the work of the external auditor to the external auditor's attention.[54] The external auditor is then able to take such information into account in the external auditor's identification and assessment of risks of material misstatement. In addition, if such information may be indicative of a heightened risk of a material misstatement of the financial statements or may be regarding any ~~actual,~~ fraud or suspected ~~or alleged~~ fraud, including allegations of fraud, the external auditor can take this into account in the external auditor's identification of risk of material misstatement due to fraud in accordance with ISA 240 (Revised).[55]

…

### Determining Whether, in Which Areas and to What Extent Internal Auditors Can Be Used to Provide Direct Assistance

…

*Determining the Nature and Extent of Work that Can Be Assigned to Internal Auditors Providing Direct Assistance* (Ref: Para. 29–31)

…

A36. In determining the nature of work that may be assigned to internal auditors, the external auditor is careful to limit such work to those areas that would be appropriate to be assigned. Examples of activities and tasks that would not be appropriate to use internal auditors to provide direct assistance include the following:

- Discussion of fraud risks. However, the external auditors may make inquiries of internal auditors about fraud risks in the organization in accordance with ISA 315 (Revised 2019).[56]
- Determination of unannounced audit procedures as addressed in ISA 240 (Revised).

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53 ISA 200, paragraphs 15 and A21

54 ISA 315 (Revised 2019), Appendix 4

55 ISA 315 (Revised 2019), Appendix 4 in relation to ISA 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

56 ISA 315 (Revised 2019), paragraph 14(a)

…

# ISA 700 (REVISED), FORMING AN OPINION AND REPORTING ON FINANCIAL STATEMENTS

…

## Requirements

…

### Auditor's Report

…

*Auditor's Report for Audits Conducted in Accordance with International Standards on Auditing*

…

Auditor's Responsibilities for the Audit of the Financial Statements

…

40. The Auditor's Responsibilities for the Audit of the Financial Statements section of the auditor's report also shall: (Ref: Para. A50)

    (a) State that the auditor communicates with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any:

        (i) ~~s~~Significant deficiencies in internal control that the auditor identifies during the audit;

        (ii) Identified fraud or suspected fraud; and

        (iii) Other matters related to fraud that are, in the auditor's judgment, relevant to the responsibilities of those charged with governance;

    (b) For audits of financial statements of listed entities, state that the auditor provides those charged with governance with a statement that the auditor has complied with relevant ethical requirements regarding independence and communicates with them all relationships and other matters that may reasonably be thought to bear on the auditor's independence, and where applicable, actions taken to eliminate threats or safeguards applied; and

    (c) For audits of financial statements of listed entities and any other entities for which key audit matters are communicated in accordance with ISA 701, state that, from the matters communicated with those charged with governance, the auditor determines 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, which includes matters related to fraud. The auditor describes ~~these~~ the key audit matters, including matters related to fraud in the auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, the auditor determines that a 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. (Ref: Para. A53)

…

**Appendix**

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

…

## INDEPENDENT AUDITOR'S REPORT

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

### Report on the Audit of the Financial Statements[57]

***…***

**Key Audit Matters Including Matters Related to Fraud**

…

**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.

…

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.

…

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:

- ~~s~~Significant deficiencies in internal control that the auditor identifies during our audit;
- Identified fraud or suspected fraud; and
- Other matters related to fraud that are, in the auditor's judgment, relevant to the responsibilities of those charged with governance.

[57] 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.

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 consolidated financial statements of the current period and are therefore the key audit matters, which includes matters related to fraud. We describe ~~these~~ the key audit matters, including matters related to fraud 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.

…

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

**…**

## INDEPENDENT AUDITOR'S REPORT

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

### Report on the Audit of the Consolidated Financial Statements[58]

…

**Key Audit Matters Including Matters Related to Fraud**

…

**Auditor's Responsibilities for the Audit of the Consolidated Financial Statements**

Our objectives are to obtain reasonable assurance about whether the consolidated 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 consolidated financial statements.

…

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

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

- Identify and assess the risks of material misstatement of the consolidated 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.

…

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:

- ~~s~~Significant deficiencies in internal control that the auditor identifies during our audit;
- Identified fraud or suspected fraud; and
- Other matters related to fraud that are, in the auditor's judgment, relevant to the responsibilities of those charged with governance.

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, which includes matters related to fraud. We describe ~~these~~ the key audit matters, including matters related to fraud 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.

…

**Illustration 4 – Auditor's Report on Financial Statements of an Entity Other than a Listed Entity Prepared in Accordance with a General Purpose Compliance Framework**

…

## INDEPENDENT AUDITOR'S REPORT

…

**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.

…

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.

…

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:

- ~~s~~Significant deficiencies in internal control that the auditor identifies during our audit;
- Identified fraud or suspected fraud; and
- Other matters related to fraud that are, in the auditor's judgment, relevant to the responsibilities of those charged with governance.

…

## ISA 701, COMMUNICATING KEY AUDIT MATTERS IN THE INDEPENDENT AUDITOR'S REPORT

…

### Requirements

…

#### Communicating Key Audit Matters

11. The auditor shall describe each key audit matter, using an appropriate subheading, in a separate section of the auditor's report under the heading "Key Audit Matters Including Matters Related to Fraud,"[59] unless the circumstances in paragraphs 14 or 15 apply. The introductory language in this section of the auditor's report shall state that:

    (a) Key audit matters are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements [of the current period]; and

    (b) These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters. (Ref: Para. A31–A33)

[59] Unless specifically referring to the title of the section, reference is made to the Key Audit Matters section throughout this ISA.

*Form and Content of the Key Audit Matters Section in Other Circumstances*

16. If the auditor determines, depending on the facts and circumstances of the entity and the audit, that there are no key audit matters to communicate or that the only key audit matters communicated are those matters addressed by paragraph 15, the auditor shall include a statement to this effect in a separate section of the auditor's report under the heading "Key Audit Matters Including Matters Related to Fraud." (Ref: Para. A57–A59)

…

## Application and Other Explanatory Material

**Scope of this ISA** (Ref: Para. 2)

…

*Relationship between Key Audit Matters, the Auditor's Opinion and Other Elements of the Auditor's Report* (Ref: Para. 4, 12, 15)

…

A8A. ISA 240 (Revised)[60] includes requirements for the auditor to determine which matters related to fraud, from those communicated with those charged with governance, are key audit matters. The requirements and guidance in ISA 240 (Revised) refer to, or expand on, the application of this ISA.

**Determining Key Audit Matters** (Ref: Para. 9–10)

…

*Considerations in Determining Those Matters that Required Significant Auditor Attention* (Ref: Para. 9)

…

A18A. ISA 240 (Revised)[61] notes that matters related to fraud are often matters that require significant auditor attention and that, given the interest of users of the financial statements, one or more of the matters related to fraud that required significant auditor attention in performing the audit, determined in accordance with paragraph 61 of ISA 240 (Revised), would ordinarily be of most significance in the audit of the financial statements of the current period and therefore are key audit matters.

Areas of Higher Assessed Risk of Material Misstatement, or Significant Risks Identified in Accordance with ISA 315 (Revised 2019) (Ref: Para. 9(a))

…

A20. ISA 315 (Revised 2019) defines a significant risk as an identified risk of material misstatement for which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which the inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur.[62] Areas of significant management judgment and significant unusual transactions may often

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[60] ISA 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraphs 61–64

[61] ISA 240 (Revised), paragraphs A165 and A170

[62] ISA 315 (Revised 2019), paragraph 12(l)

be identified as significant risks. Significant risks are therefore often areas that require significant auditor attention.

A21. ~~However, this may not be the case for all significant risks. For example,~~ ISA 240 (Revised) presumes that there are risks of fraud in revenue recognition and requires the auditor to treat those assessed risks of material misstatement due to fraud as significant risks.[63] In addition, ISA 240 (Revised) indicates that, due to the unpredictable way in which management override of controls could occur, it is a risk of material misstatement due to fraud and thus a significant risk.[64] The auditor may determine these matters to be key audit matters related to fraud because risks of material misstatement due to fraud are often matters that both require significant auditor attention and are of most significance in the audit. However, this may not be the case for all these matters. The auditor may determine certain risks of material misstatement due to fraud did not require significant auditor attention~~Depending on their nature, these risks may not require significant auditor attention,~~ and, therefore, these risks would not be considered in the auditor's determination of key audit matters ~~in accordance with paragraph 10~~.

…

**Communicating Key Audit Matters**

…

*Circumstances in Which a Matter Determined to Be a Key Audit Matter Is Not Communicated in the Auditor's Report* (Ref: Para. 14)

A52. Law or regulation may preclude public disclosure by either management or the auditor about a specific matter determined to be a key audit matter. For example, law or regulation may specifically prohibit any public communication that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act (e.g., matters that are or appear to be related to money laundering).

…

A55. It may also be necessary for the auditor to consider the implications of communicating about a matter determined to be a key audit matter in light of relevant ethical requirements.[65] In addition, the auditor may be required by law or regulation to communicate with applicable regulatory, enforcement or supervisory authorities in relation to the matter, regardless of whether the matter is communicated in the auditor's report. Such communication may also be useful to inform the auditor's consideration of the adverse consequences that may arise from communicating about the matter.

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63 ISA 240 (Revised), ~~*The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*~~, paragraphs ~~27–28~~40–41

64 ISA 240 (Revised), paragraph ~~32~~42

65 For example, except for certain specified circumstances, paragraph R114.2 of the IESBA Code does not permit the use or disclosure of information in respect of which the duty of confidentiality applies. As one of the exceptions, paragraph R114.3 of the IESBA Code permits the professional accountant to disclose or use confidential information where there is a legal or professional duty or right to do so. Paragraph 114.3 A1(b)(iv) of the IESBA Code explains that there is a professional duty or right to disclose such information to comply with technical and professional standards.

*Form and Content of the Key Audit Matters Section in Other Circumstances* (Ref: Para. 16)

A57. The requirement in paragraph 16 applies in three circumstances:

(a) The auditor determines in accordance with paragraph 10 that there are no key audit matters (see paragraph A59).

(b) The auditor determines in accordance with paragraph 14 that a key audit matter will not be communicated in the auditor's report and no other matters have been determined to be key audit matters.

(c) The only matters determined to be key audit matters are those communicated in accordance with paragraph 15.

A58. The following illustrates the presentation in the auditor's report if the auditor has determined there are no key audit matters to communicate:

**Key Audit Matters Including Matters Related to Fraud**

[Except for the matter described in the *Basis for Qualified (Adverse) Opinion* section or *Material Uncertainty Related to Going Concern* section,] We have determined that there are no [other] key audit matters, including matters related to fraud to communicate in our report.

A58A. ISA 240 (Revised)[66] includes guidance that illustrates the presentation in the auditor's report if the auditor has determined there are key audit matters to communicate but these key audit matters do not relate to fraud.

A59. The determination of key audit matters involves making a judgment about the relative importance of matters that required significant auditor attention. Therefore, it may be rare that the auditor of a complete set of general purpose financial statements of a listed entity would not determine at least one key audit matter from the matters communicated with those charged with governance to be communicated in the auditor's report. However, in certain limited circumstances (e.g., for a listed entity that has very limited operations), the auditor may determine that there are no key audit matters in accordance with paragraph 10 because there are no matters that required significant auditor attention.

…

# ISA 705 (REVISED), MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT

…

## Application and Other Explanatory Material

…

### Circumstances When a Modification to the Auditor's Opinion Is Required

…

*Nature of an Inability to Obtain Sufficient Appropriate Audit Evidence* (Ref: Para. 6(b))

[66] ISA 240 (Revised), paragraph A177

…

A9. An inability to perform a specific procedure does not constitute a limitation on the scope of the audit if the auditor is able to obtain sufficient appropriate audit evidence by performing alternative procedures. If this is not possible, the requirements of paragraphs 7(b) and 9–10 apply as appropriate. Limitations imposed by management may have other implications for the audit, such as for the auditor's assessment of risks of material misstatement due to fraud ~~risks~~ and consideration of engagement continuance.

…

## ISA 800 (REVISED), SPECIAL CONSIDERATIONS—AUDITS OF FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH SPECIAL PURPOSE FRAMEWORKS

…

### Application and Other Explanatory Material

…

### Appendix

(Ref: Para. A14)

### Illustrations of Independent Auditor's Reports on Special Purpose Financial Statements

…

**Illustration 3: An auditor's report on a complete set of financial statements of a listed entity prepared in accordance with the financial reporting provisions established by a regulator (for purposes of this illustration, 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 that have been prepared by management of the entity in accordance with the financial reporting provisions established by a regulator (that is, a special purpose framework) to meet the requirements of that regulator. Management does not have a choice of financial reporting frameworks.**

…

- **The auditor is required by the regulator to communicate key audit matters in accordance with ISA 701.**

…

…

### INDEPENDENT AUDITOR'S REPORT

…

**Key Audit Matters Including Matters Related to Fraud**

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. In addition to the matter described in the Material Uncertainty Related to Going Concern section above, we have determined the matters described below to be key audit matters to be communicated in our report.

*[Description of each key audit matter in accordance with ISA 701 as applied to this audit.]*

…

**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.

…

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.

…

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:

- ~~s~~Significant deficiencies in internal control that we identify during our audit;
- Identified fraud or suspected fraud; and
- Other matters related to fraud that are, in the auditor's judgment, relevant to the responsibilities of those charged with governance.

…

## ISA 805 (REVISED), SPECIAL CONSIDERATIONS—AUDITS OF FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH SPECIAL PURPOSE FRAMEWORKS

…

### Application and Other Explanatory Material

…

**Considerations When Planning and Performing the Audit** (Ref: Para. 10)

A10. The relevance of each of the ISAs requires careful consideration. Even when only a specific element of a financial statement is the subject of the audit, ISAs such as ISA 240 (Revised),[67] ISA 550[68] and ISA 570 are, in principle, relevant. This is because the element could be misstated as a result of fraud, the effect of related party transactions, or the incorrect application of the going concern basis of accounting under the applicable financial reporting framework.

…

# IAPN 1000 SPECIAL CONSIDERATIONS IN AUDITING FINANCIAL INSTRUMENTS

…

## Section I—Background Information about Financial Instruments

…

### Purpose and Risks of Using Financial Instruments

…

18. The principal types of risk applicable to financial instruments are listed below. This list is not meant to be exhaustive and different terminology may be used to describe these risks or classify the components of individual risks.

    …

    (d) Operational risk relates to the specific processing required for financial instruments. Operational risk may increase as the complexity of a financial instrument increases, and poor management of operational risk may increase other types of risk. Operational risk includes:

        …

        (vi) The risk of loss resulting from inadequate or failed internal processes and systems, or from external events, including the fraud risk ~~of fraud~~ from both internal and external sources;

…

19. Other considerations relevant to risks of using financial instruments include:

    - The fraud risk ~~of fraud~~ that may be increased if, for example, an employee in a position to perpetrate a financial fraud understands both the financial instruments and the processes for accounting for them, but management and those charged with governance have a lesser degree of understanding.

…

### Completeness, Accuracy and Existence

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

[68] ISA 550, *Related Parties*

…

*Trade Confirmations and Clearing Houses*

…

26. Not all transactions are settled through such an exchange. In many other markets there is an established practice of agreeing the terms of transactions before settlement begins. To be effective, this process needs to be run separately from those who trade the financial instruments to minimize the fraud risk ~~of fraud~~. In other markets, transactions are confirmed after settlement has begun and sometimes confirmation backlogs result in settlement beginning before all terms have been fully agreed. This presents additional risk because the transacting entities need to rely on alternative means of agreeing trades. These may include:

…

## Section II—Audit Considerations Relating to Financial Instruments

…

### Assessing and Responding to the Risks of Material Misstatement

…

*Fraud Risk Factors*[69]

86. Incentives for fraudulent financial reporting by employees may exist where compensation schemes are dependent on returns made from the use of financial instruments. Understanding how an entity's compensation policies interact with its risk appetite, and the incentives that this may create for its management and traders, may be important in assessing the risk of material misstatement due to fraud.

…

*Procedures Relating to Completeness, Accuracy, Existence, Occurrence and Rights and Obligations*

…

104. Procedures that may provide audit evidence to support the completeness, accuracy, and existence assertions include:

    …

    - Reviewing journal entries and the controls over the recording of such entries. This may assist in, for example:
        - Determining if entries have been made by employees other than those authorized to do so.
        - Identifying unusual or inappropriate end-of-period journal entries, which may be relevant to risks of material misstatement due to fraud ~~risk~~.

…

[69] See ISA 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, for requirements and guidance dealing with fraud risk factors.

# ISRE 2410 (REVISED), REVIEW OF INTERIM FINANCIAL INFORMATION PERFORMED BY THE INDEPENDENT AUDITOR OF THE ENTITY

…

## Management Representations

…

34. The auditor should obtain written representation from management that:

    …

    (e) It has disclosed to the auditor the results of its assessment of the risks that the interim financial information may be materially misstated as a result of fraud;[70]

…

# ISAE 3000 (REVISED), ASSURANCE ENGAGEMENTS OTHER THAN AUDITS OR REVIEWS OF HISTORICAL FINANCIAL INFORMATION

…

## Application and Other Explanatory Material

…

### Planning and Performing the Engagement

*Planning* (Ref: Para. 40)

A86. Planning involves the engagement partner, other key members of the engagement team, and any key practitioner's external experts developing an overall strategy for the scope, emphasis, timing and conduct of the engagement, and an engagement plan, consisting of a detailed approach for the nature, timing and extent of procedures to be performed, and the reasons for selecting them. Adequate planning helps to devote appropriate attention to important areas of the engagement, identify potential problems on a timely basis and properly organize and manage the engagement in order for it to be performed in an effective and efficient manner. Adequate planning also assists the practitioner to properly assign work to engagement team members, and facilitates the direction, supervision, and the review of their work. Further, it assists, where applicable, the coordination of work done by other practitioners and experts. The nature and extent of planning activities will vary with the engagement circumstances, for example the complexity of the underlying subject matter and criteria. Examples of the main matters that may be considered include:

    …

    - The extent to which the risk of material misstatement due to ~~of~~ fraud is relevant to the engagement.

…

[70] Paragraph ~~36~~57 of ISA 240 (Revised), *The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements*, explains that the nature, extent and frequency of such an assessment vary from entity to entity and that management may make a detailed assessment on an annual basis or as part of continuous monitoring. Accordingly, this representation, insofar as it relates to the interim financial information, is tailored to the entity's specific circumstances.

# ISAE 3410, ASSURANCE ENGAGEMENTS ON GREENHOUSE GAS STATEMENTS

…

## Application and Other Explanatory Material

…

**Understanding the Entity and Its Environment, Including the Entity's Internal Control, and Identifying and Assessing Risks of Material Misstatement** (Ref: Para. 23–26)

…

*Risks of Material Misstatement at the GHG Statement Level* (Ref: Para. 33L(a)–33R(a))

…

A80. Risks at the GHG statement level may derive in particular from a deficient control environment. For example, deficiencies such as management's lack of competence may have a pervasive effect on the GHG statement and may require an overall response by the practitioner. Other risks of material misstatement at the GHG statement level may include, for example:

…

- Risk of material misstatement due to~~of~~ fraud, for example, in connection with emissions trading markets.

...

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