Fraud in an Audit of Financial Statements

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IAASB CAG Meeting
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Agenda Item H.1
Approach to Revising ISA 240

- Proposed ISA 240 (Revised)
- Considering the qualitative standard-setting characteristics within the Public Interest Framework
- Addressing the proposed actions in the Fraud Project Proposal
- Expanding, through applying the fraud lens, on the requirements of certain Foundational Standards, including ISA 200, ISA 220 (Revised), ISA 315 (Revised 2019), and ISA 330; as well as leveraging the Reporting Mechanism in ISA 701
- Following the conventions in the CUSP Drafting Principles and Guidelines
Promoting Consistent Practice and Changing Auditor Behavior

PROFESSIONAL SKEPTICISM

Clarity and emphasis on the auditor’s responsibilities

Applying a fraud lens on risk identification and assessment

Transparency on Key Audit Matters (KAMs) related to fraud in the auditor’s report

Ongoing communications throughout the audit with management and TCWG about fraud-related matters

Robust work effort requirements if fraud or suspected fraud is identified

AUDIT DOCUMENTATION
Professional Skepticism

- Highlighting the interrelationship between professional skepticism and professional judgment
- Maintaining professional skepticism throughout the audit
- Further investigating the authenticity of a record or document when conditions are identified that indicate they may not be
- Remaining alert throughout the audit for information about fraud or suspected, including allegations of fraud
- Designing and performing audit procedures in a manner that is not biased towards obtaining corroborative or contradictory audit evidence
Responsibilities
• Auditor
• Management and TCWG

Key Concepts
• Fraud or suspected fraud
• Circumstances giving rise to fraud and the identified misstatements
• Inherent limitations

Relationship with Other ISAs, including ISA 250 (Revised), Consideration of Laws and Regulations in an Audit of Financial Statements
Ongoing Communications with Management and TCWG

- Overarching requirement to communicate with management and TCWG matters related to fraud at appropriate times throughout the audit engagement

- A combination of new, enhanced or extant requirements to make inquiries of TCWG, management, appropriate individuals within the internal audit function (if the function exists) and other appropriate individuals within the entity about certain fraud related matters

- If the auditor identifies fraud or suspected fraud, a requirement to make inquiries about the matter and the process to investigate the matter with an appropriate level of management that is at least one level above those involved, and TCWG

- Requirement to discuss with the appropriate level of management and TCWG the auditor’s withdrawal from the engagement and the reasons for the withdrawal

- Requirements to communicate with management and TCWG, if fraud or suspected fraud is identified

- Requirement to report to appropriate authorities outside the entity, including regulatory and enforcement authorities, if fraud or suspected fraud is identified

- **Clear signposting** for required communications with management and TCWG and reporting to an appropriate authority outside the entity, including regulatory and enforcement authorities, if fraud or suspected fraud is identified
Applying a *Fraud Lens* on Risk Identification and Assessment

Applying the appropriate *fraud lens* when referring to, or expanding on, what is already required in ISA 315 (Revised 2019)

Obtain an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework, and the Entity’s System of Internal Control

Fraud Risk Factors
Incentives, Pressures, or Opportunities to Commit Fraud
Risks of Material Misstatement (RoMMs) Due to Fraud
Robust Work Effort if Fraud or Suspected Fraud Is Identified

When fraud or suspected fraud is identified, the engagement partner

• Obtains an understanding of the fraud or suspected fraud in order to determine the effect on the audit engagement
• Communicates with management and TCWG, as required
• Reports to an appropriate authority outside the entity, as required

Linkages to ISA 315 (Revised 2019) and ISA 330

Based on the understanding obtained, the auditor determines whether to:

• Perform additional risk identification and assessment procedures; or
• Design and perform further audit procedures to respond to RoMMs due to fraud.

Additional audit procedures to address the identified fraud or suspected fraud

• Make inquiries about the matter and entity’s process to investigate the matter
• Evaluate the entity’s process to investigate the matter
• Determine if control deficiencies exist relating to the identified fraud or suspected fraud
• Determine additional responsibilities under law, regulation or relevant ethical requirement
• If applicable, consider impact on other engagements
Robust Work Effort if Fraud or Suspected Fraud Is Identified

- Required responses if the auditor identifies a misstatement due to fraud
- Determining whether identified misstatements due to fraud are material when considering the nature of the circumstances (qualitative or quantitative) giving rise to the misstatements
- Required responses if the auditor determines that the financial statements are materially misstated
- Addressing circumstances where the auditor is unable to obtain sufficient appropriate audit evidence as it relates to a material misstatement due to fraud
In applying ISA 701, the auditor determines, from the matters related to fraud communicated with TCWG, those matters that required **significant auditor attention**:

- In making the determination, the auditor takes the following into account:
  - Significant risk of material misstatements due to fraud.
  - The identification of fraud or suspected fraud.
  - The identification of deficiencies in internal control that are relevant to the prevention and detection of fraud.

In applying ISA 701, the auditor determines which of the matters related to fraud were of **most significance in the audit** of the financial statements of the current period and therefore are KAMs.

**Communicating KAMs Related to Fraud**

- In applying ISA 701, in the KAMs section of the auditor’s report, the auditor uses an appropriate subheading that clearly describes that the matter relates to fraud.

- In applying ISA 701, if the auditor determines that there are no KAMs related to fraud to communicate, the auditor includes a statement to this effect in the KAMs section of the auditor’s report.

**Principle Used**

Refer to, or expand on, ISA 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*
Audit Documentation

Key elements of the auditor’s understanding,* the sources of information from which the auditor’s understanding was obtained, and the risk assessment procedures performed.

The matters discussed discussion among the engagement team regarding the susceptibility of the entity’s financial statements to material misstatement due to fraud.

The identified and assessed risks of material misstatement at the financial statement level and at the assertion level, and the rationale for the significant judgments made.

If the auditor has concluded that the presumption that a RoMM due to fraud related to revenue recognition is not applicable in the circumstances of the engagement, the reasons for that conclusion.

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

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

Matters related to communications about fraud with management, TCWG, regulatory and enforcement authorities, and others, including how management, including how management, and where applicable, TCWG have responded to the matters.

* Understanding of the entity and its environment, the applicable financial reporting framework, and the entity’s system of internal control.
1. Representatives are asked for their views on the proposed changes presented in Agenda Item H.2 relating to
   (a) Clarity and emphasis on the auditor’s responsibilities
   (b) Applying fraud lens on risk identification and assessment
   (c) Robust work effort requirements if fraud or suspected fraud is identified
   (d) Transparency on KAMs related to fraud in the auditor’s report
2. Representatives are asked whether there are any other matters in Agenda Item H.2 that the Fraud TF should consider as it finalizes the enhancements to proposed ISA 240 (Revised) in December 2023
Way Forward

- **September 2023**
  - Discussion with the IAASB on a draft of proposed ISA 240 (Revised)

- **October – December 2023**
  - Progress proposed ISA 240 (Revised) based on feedback received
  - Collaboration (e.g., IESBA), engagement and outreach, as needed

- **December 2023**
  - Expected approval by the IAASB of exposure draft, proposed ISA 240 (Revised)