### Proposed ISA 240 Requirement

<table>
<thead>
<tr>
<th>Risk Assessment Procedures and Related Activities</th>
<th>Application Material</th>
</tr>
</thead>
<tbody>
<tr>
<td>17. In applying ISA 315 (Revised 2019), the auditor shall perform the procedures in paragraphs 24A–24B to obtain audit evidence that provides an appropriate basis for: (Ref: Para. A12E–A12F)</td>
<td>A12E. ISA 315 (Revised 2019) contains requirements and guidance regarding the auditor’s responsibility to obtain an understanding of the entity and its environment, the applicable financial reporting framework, and the entity’s system of internal control, and the identification and assessment of the risks of material misstatement whether due to fraud or error. The requirements and guidance in this ISA refer to, or expand on, what is required by included in ISA 315 (Revised 2019).</td>
</tr>
<tr>
<td>(a) The identification and assessment of risks of material misstatement due to fraud, at the financial statement and assertion levels, including obtaining an understanding of fraud risk factors; and</td>
<td>A12F. As explained in ISA 315 (Revised 2019), 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, Similarly, the auditor remains alert for fraud risk factors throughout the audit and the auditor’s expectations with respect to risk of material misstatements due to fraud may change as new information is obtained. [Previously paragraph A23D]</td>
</tr>
<tr>
<td>(b) The design of further audit procedures in accordance with ISA 330.</td>
<td>A12G. The auditor may perform the procedures in paragraphs 24A–24B simultaneously with the procedures in ISA 315 (Revised 2019) to obtain information audit evidence for use in identifying and assessing the risks of material misstatement due to fraud or error. [Previously paragraph A12F]</td>
</tr>
</tbody>
</table>

---

2. ISA 315 (Revised 2019), paragraph 13
3. ISA 315 (Revised 2019) paragraph A48
4. ISA 315 (Revised 2019), paragraph 14(a)
20. When obtaining an understanding and making inquiries of those charged with governance in accordance with paragraphs 21 and 22, the auditor shall discuss with those charged with governance:

(a) The fraud risk factors present in the entity, including those that are specific to the entity’s business sector;
(b) [Moved to paragraph 24C(b)(iii)]
(c) [Moved to paragraph 24C(b)(iv)]

22B. [Moved to paragraph 28B]

Information from Other Sources

In applying ISA 315 (Revised 2019),\(^5\) the auditor shall consider whether information from other sources provides additional relevant information that may affect the auditor’s procedures regarding acceptance or continuance of the client relationship.

\(^5\) ISA 315 (Revised 2019), paragraphs 15–16

\(^7\) ISA 315 (Revised 2019), paragraph 15–16
sources obtained by the auditor indicates that one or more fraud risk factors are present indicates risks of material misstatement due to fraud, including information obtained from the auditor's procedures regarding other information in accordance with ISA 720 (Revised). (Ref: Para. A22A–A23C)

or the audit engagement and, when applicable, other engagements performed by the engagement partner for the entity.

A23. Information obtained from other sources may also be relevant to the identification of fraud risk factors and assessment of the risks of material misstatement due to fraud by providing insights about:

- The nature of the entity and the industry in which the entity operates. For example, an entity may operate in an industry where the accounting is emerging or diverse in practice. This may present incentives or pressure to commit fraud by management.
- Management’s commitment to integrity and ethical values.
- Areas in the complexity in the application of the applicable financial reporting framework where the risk of material misstatement due to fraud is higher due to the nature and in the circumstances of the entity. For example, the applicable financial reporting framework may require a measurement basis that requires management to use complex models in making an accounting estimate which may create an opportunity for fraudulent financial reporting.

A23A. Other relevant sources of information include:

- The engagement team discussion. The engagement team discussion may provide information that is helpful in identifying and assessing risks of material misstatement due to fraud.
- Disclosures that are part of the entity’s annual report (e.g., management discussion and analysis). For example, information being disclosed outside of the financial statements in the annual report may be misleading or does not align with what is being disclosed in the financial statements. This may be an indicator of fraud.

A23B. Examples of information from other sources that may be relevant to the identification
of fraud risk factors:

- Information obtained during the acceptance and continuance process such as information that the organizational structure is overly complex with numerous legal entities or managerial lines of authority.

- Information obtained from other engagements performed by the engagement partner, such as a separate engagement to address regulatory reporting requirements.

- Information from the auditor’s previous experience with the entity, such as management’s failure to remedy known significant deficiencies in internal control on a timely basis.

A23C. Law, regulation, or relevant ethical requirements may require the successor auditor to request the predecessor auditor to provide known information regarding any facts or circumstances that, in the predecessor auditor’s judgment, the successor auditor needs to be aware of before deciding whether to accept the engagement. In some circumstances, the proposed successor auditor may request the predecessor auditor to provide information regarding identified or suspected fraud.

<table>
<thead>
<tr>
<th>Engagement Team Discussion</th>
<th>Engagement Team Discussion</th>
</tr>
</thead>
<tbody>
<tr>
<td>…</td>
<td>…</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework and the Entity’s System of Internal Control</th>
<th>Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework and the Entity’s System of Internal Control</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>The Entity’s Organizational Structure, Ownership, and Governance, and Its Business</td>
<td>The Entity’s Organizational Structure, Ownership, and Governance, and Its Business</td>
</tr>
</tbody>
</table>
24B. In applying ISA 315 (Revised 2019)\textsuperscript{8}, the auditor shall obtain an understanding of: (Ref: Para. A23D–A23G)

<table>
<thead>
<tr>
<th>The Entity and Its Environment</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) The entity’s organizational structure and its business model, including the locations in which the entity has its operations or activities; (Ref: Para. A23D)</td>
</tr>
<tr>
<td>(b) The industry; (Ref: Para. A23G)</td>
</tr>
<tr>
<td>(ac) The performance measures used, internally and externally, that may create incentives or pressures to achieve financial performance targets; (Ref: Para. A23H–A23J)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>The Applicable Financial Reporting Framework</th>
</tr>
</thead>
<tbody>
<tr>
<td>(bd) Matters related to the applicable financial reporting framework and the entity’s accounting policies, including how that may lead to an increased susceptibility to misstatement due to management bias or other transactions and other events or conditions are subject to, or affected by, fraud risk factors; (Ref: Para. A23K)</td>
</tr>
</tbody>
</table>

| (e) [Moved to paragraph 24C(a)(i)] |
| (f) (i) [Moved to paragraph 24D(a)(i)] |
| (ii) [Moved to paragraph 24D(a)(ii)] |

\textsuperscript{8} ISA 315 (Revised 2019), paragraphs 19–27
(iii) [Moved to paragraph 24D(a)(iii)]

(g) [Moved to paragraph 24E(a)]

(h) [Moved to paragraph 24F]

Industry, Regulatory and Other External Factors (Ref: Para. 24B)

A23G. 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. For example, in the construction industry the revenue recognition policies may be complex and subject to judgment which may create an incentive to commit fraud.

- An industry that is under pressure (e.g., 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.

Measures Used, Internally and Externally, to Assess the Entity’s Financial Performance (Ref: Para. 24B)

A23H. Understanding the measures used, internally and externally, to assesses the entity’s financial performance assists the auditor in identifying fraud risk factors. Performance measures, whether internal or external, may create pressures on the entity. These pressures, in turn, may motivate management 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. Accordingly, an understanding of the entity’s performance measures assists the auditor in considering whether pressures to achieve performance targets may result in incentives or pressures for management that increase the risks of material misstatement due to fraud.

A23I. The auditors may consider listening to the entity’s earnings calls with analysts or by reading analysts’ research reports. This may provide the auditor with information about whether analysts have unduly aggressive or unrealistic expectations about an entity’s financial performance. Auditors may also learn about management’s attitudes...
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. Based on this information the auditor may conclude that the financial statement accounts included in the calculation of key performance metrics may be at an increased risk of material misstatement due to fraud.

A23J. Other matters that the auditor may consider include:

- Management’s compensation package. When a significant portion of management’s compensation package is contingent on achieving aggressive financial targets, management may have an incentive to manipulate financial results.
- Short-selling reports, negative media attention, 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.

The Applicable Financial Reporting Framework and the Entity’s Accounting Policies Ref: Para. 24B(b))

A23K. 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:
  - Require-the use of complex processes or techniques.
  - Require-management to make significant judgements such as accounting estimates with high estimation uncertainty.
FRAUD IN AN AUDIT OF FINANCIAL STATEMENTS – PROPOSED ISA 240 (REVISED), SECTIONS BUILDING ON ISA 315 (REVISED 2019)

IAASB MAIN AGENDA (SEPTEMBER 2022)

Agenda Item 6-B Page 8 of 27

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

**Control Environment**

24C. In applying ISA 315 (Revised 2019), the auditor shall:

(a) **Obtain an understanding of:**

(i) How management communicates to its employees its views on business practices and ethical behavior; (Ref: Para. A24A–A24C) [Previously]

<table>
<thead>
<tr>
<th>Understanding the Components of the Entity’s System of Internal Control</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Control Environment</strong></td>
</tr>
<tr>
<td>Entity’s culture and management’s commitment to integrity and ethical values (Ref: Para. 24C(a)(i))</td>
</tr>
</tbody>
</table>

A24A. Understanding 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 to the prevention and detection of fraud.

A24B. In considering the extent to which management demonstrates a commitment to ethical behavior, the auditor may obtain an understanding through inquiries of

---

9 ISA 315 (Revised 2019), paragraph 21

---

**Expanding Responsibilities for Auditor:**

- Require expertise in a field other than accounting or auditing, such as actuarial calculations, valuations, or engineering data. Particularly where management can influence and direct conclusions reached.

- 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 may be aggressive in the interpretation of the accounting requirements accounting standards differs from similar entities in the same industry.

- The amount selected by management for recognition or disclosure in the financial statements of an accounting estimate. For example, management may consistently trend toward one end of a range of reasonable possible outcomes that provide a more favorable financial reporting outcome for management.
paragraph 24B(e)

(ii) Understand When those charged with governance are separate from management, management’s communications to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity. [Previously paragraph 17A(c)]

(iii) Unless all of those charged with governance are separate from management involved in managing the entity, the auditor shall 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 mitigate these risks. (Ref: Para. A24D–A24H) [Previously paragraph 21]

(b) When applying ISA 315 (Revised 2019), unless all of those charged with governance are separate from management involved in managing the entity, the auditor shall make inquiries of those charged with governance and employees, and through considering information from external sources, about:

- The entity’s formal communications with respect to integrity and ethical values. These communications may reduce the risk of fraudulent behavior which may also impact the assessed level of fraud risk evaluated within the entity’s risk assessment process. For example, the entity may have a mission statement, a code of ethics or a fraud policy. 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.

- The mechanism for employees of the entity to make anonymous or confidential communications about identified or suspected fraud. For example, communications to appropriate persons within the entity as part of a whistle blower program or ethics hotline (also see paragraph A24C).

- 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 programme. 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 commitment to integrity and ethical values through their actions. Commitment from management and ‘tone at the top’ are important as employees may be more likely to behave ethically when management is committed to integrity and ethical behaviors.

- 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.

---

10 ISA 260 (Revised), Communication with Those Charged with Governance, paragraph 13
to: (Ref: Para. A24I–A24K)

(i) Determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity; [Previously paragraph 22]

(ii) Obtain their views about that the financial statements may be materially misstated due to the risk of fraud [Previously paragraph 22]

(iii) Obtain their views on possible areas that are susceptible to misstatement due to management bias or management fraud; and [Previously paragraph 22A(b)]

(iv) Determine 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. [Previously paragraph 22A(c)]

A24C. If the entity has a whistleblower program, understanding this program may assist the auditor in identifying fraud risk factors. Therefore the auditor may: 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 effectiveness of the company’s whistleblower program reporting mechanisms (e.g., telephone hotline, online forms, in-person reporting, etc.), who is responsible for the program, including who receives the notifications, and how the entity addresses the matters raised. The lack of a whistleblower program, or an ineffective one, may be indicative of weaknesses in the entity’s control environment.

- Follow up on matters that are under investigation by the entity as these matters may be indicative of suspected fraud with financial reporting implications which the auditor will need to respond to during the audit

In a larger or more complex entity, the lack of a whistleblower program, or an ineffective one, may be indicative of weaknesses in the entity’s control environment. Obtaining an understanding of oversight exercised by those charged with governance (Ref: Para. 24C(a)(iii))

A24D. Those charged with governance of an entity oversee the entity’s systems for monitoring risk, financial control and compliance with the laws and regulations. In many countries, corporate governance practices are well developed and those charged with governance play an active role in oversight of the entity’s assessment of the 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 country jurisdiction, it is important that the auditor understands their respective responsibilities to enable the auditor to obtain an understanding of the
A24E. 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 a number of 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. [Moved from paragraph A21]

A24F. 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 and detect fraud. For example, the oversight evaluation by those charged with governance of the effectiveness of controls to prevent and detect fraud is an important aspect of their oversight role and the objectivity of such evaluation is influenced by their independence from management. [Moved from paragraph A21A]

A24G. When depending on 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. [Moved from paragraph A21B]

Considerations specific to smaller or less complex entities

A24H. In some cases, all of those charged with governance are involved in managing the entity. This may be the case in a small 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. [Moved from paragraph A20]

Inquiries of Those Charged with Governance (Ref: Para. 24C(b)) Specific Discussions as

11 ISA 260 (Revised), paragraphs A1–A8, discuss with whom the auditor communicates when the entity’s governance structure is not well defined.
A24I. The auditor may also inquire of those charged with governance about the entity’s fraud risk assessment, the entity’s controls to prevent and detect fraud, the entity’s culture and management’s commitment to integrity and ethical values. [Moved from paragraph A22A]

A24J. Specific inquiries on the possible areas that are susceptible to misstatement due to management bias or management fraud (i.e., fraud risk factors) may relate to both inherent risk and control risk. Specific inquiries on the possible areas that are susceptible to misstatement due to management bias may include management bias judgment over the accounting when accounting for significant accounting estimates or unusual or complex transactions, including those in controversial or emerging areas, which may be susceptible to fraudulent financial reporting. [Moved from paragraph A22C]

A24K. Specific inquiries discussions on whether those charged with governance are aware of any control deficiencies, may better inform the auditor’s evaluation of the components of the entity’s system of internal control. Such inquiries discussions 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, incentives or pressures on management that may result in intentional or unintentional management bias, which may help 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, and the expectations of, management. [Moved from paragraph A22D]
24D. In applying ISA 315 (Revised 2019), the auditor shall:

<table>
<thead>
<tr>
<th>(a)</th>
<th>Obtain an understanding of the entity’s risk assessment process for: (Ref: Para. A25A–A25Ia)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>Identifying fraud risks related to the misappropriation of assets and fraudulent financial reporting, including any classes of transactions, account balances, or disclosures for which a risk of fraud is likely to exist; [Previously paragraph 24B(f)(i)]</td>
</tr>
<tr>
<td>(ii)</td>
<td>Assessing the significance of the identified fraud risks, including the likelihood of their occurrence; and [Previously paragraph 24B(f)(ii)]</td>
</tr>
<tr>
<td>(iii)</td>
<td>Addressing the assessed fraud risks; [Previously paragraph 24B(f)(iii)]</td>
</tr>
</tbody>
</table>

(b) In applying ISA 315 (Revised 2019), the auditor shall: (Ref: Para. A25J–A25N)

| (i) | Determine whether they have knowledge of any actual, suspected or |

A25A. The auditor’s understanding of how the entity identifies fraud risks, and how it assesses and addresses those risks, assists the auditor in understanding whether fraud risks identified by the entity are appropriate to the nature and complexity of the entity, and assists the auditor in identifying fraud risk factors and risks of material misstatement due to fraud.

**Identifying fraud risks**

A25B. As part of the entity’s risk assessment process, management may consider the various ways that misappropriation of assets and fraudulent financial reporting could occur. A fraud risk identification process may include an assessment of the incentives, pressures, and opportunities to commit fraud. For example, incentive programs and the performance measures on which they are based can be used to identify where fraud might occur. 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.

A25C. 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 regulation. For example, a fraud risk may include the preparation of inaccurate regulatory reporting statements in order to improve the appearance of an entity’s performance in order to avoid inspection by regulatory authorities or penalties.

**Assessing the significance of the identified fraud risks and addressing the assessed fraud risks**

A25D. There are a number of approaches management may use to assess fraud risks and the approach will vary depending on the nature and circumstances of the entity. The

---

12 ISA 315 (Revised 2019), paragraph 22
13 ISA 315 (Revised 2019), paragraph 22
alleged fraud affecting the entity; and
[Previously paragraph 17A(a)]

(ii) Obtain their views that the financial statements may be materially misstated due to fraud. [Previously paragraph 17A(b)]

A25E. When determining the likelihood of fraud, management may consider both probability and frequency (the number of fraud incidents that can be expected). There are also other factors that management may consider in determining likelihood, such as the volume of transactions, or the potential nature or quantitative benefit to the individual.

A25F. 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 mitigate 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. For example, management may determine that the risk of fraudulent financial reporting may be reduced by using a shared service center for central management of IT processes in a group because a shared service center may be less vulnerable to management override by local personnel.

A25G. Controls that prevent or detect fraud are generally classified as either preventive (designed to avoid a fraudulent event or transaction at the time of initial occurrence) or detective (designed to discover a fraudulent event or transaction after the initial processing 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.

A25Ga. Examples of preventive and detective controls include:

Preventative controls

- Clearly defined and documented decision makers using delegations, authorizations and other instructions.
- Physical access controls, including those that address security of assets against unauthorized access, acquisition, use or disposal.
<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Entry level checks, probationary periods, suitability assessments or security vetting to assess the integrity of new employees, contractors or third parties.</td>
<td></td>
</tr>
<tr>
<td>Sensitive or confidential information cannot leave the entity's IT environment without authority or detection.</td>
<td></td>
</tr>
<tr>
<td>Detective controls</td>
<td></td>
</tr>
<tr>
<td>Exception reports to identify activities that are unusual or not in the ordinary course of business and should be further investigated.</td>
<td></td>
</tr>
<tr>
<td>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.</td>
<td></td>
</tr>
<tr>
<td>Fraud detection software programs incorporated into the IT infrastructure that automatically analyses transaction data to detect what is different from what is standard, normal, or expected and may therefore indicate fraud.</td>
<td></td>
</tr>
<tr>
<td>Ongoing training activity to support employees in detecting fraud, such as identifying red and understanding the entity’s policies and procedures if they identify or suspect fraud.</td>
<td></td>
</tr>
</tbody>
</table>

A25Gb. In some entities, there may also be controls in place to respond to fraud after it has occurred. These controls may be implemented to reduce the consequences or address additional consequences, such as setting up separation or termination controls, installing external electronic surveillance or creating a debt recovery process.

A25H. 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, which may also affect the specialized skills that are needed to assist the auditor in obtaining an understanding of the entity’s risk assessment process.
A25I. 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. The auditor is also required to consider the implications for the auditor’s evaluation.

**Scalability**

A25Ia. As explained in ISA 315 (Revised 2019) in some smaller or less complex entities, and particularly owner-manager entities, an appropriate risk assessment may be performed through the direct involvement of management or the owner-manager. The evidence of this risk assessment occurring in such entities may not be formally documented, but it may be evident from the auditor’s inquiries that management are in fact performing risk assessment procedures.

**Inquiries of Management and Others within the Entity (Ref: Para. 24D(b))**

A25J. 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 and detect it. The nature, extent and frequency of management’s assessment of such risk and controls may vary from entity to entity. In some entities, management may make detailed assessments on an annual basis or as part of continuous 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

---

14 ISA 315 (Revised 2019), paragraph 23(a)
15 ISA 315 (Revised 2019), paragraph 23(b)
16 ISA 315 (Revised 2019), paragraph A113
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. [Previously paragraph A23M]

A25K. The auditor's inquiries of management may provide useful information concerning the risks of material misstatements in the financial statements resulting from employee fraud. However, such inquiries are unlikely to provide useful information regarding the risks of material misstatement in the financial statements resulting from management fraud. Making inquiries of others within the entity may provide individuals with an opportunity to convey information to the auditor that may not otherwise be communicated. [Previously paragraph A16]

A25L. Examples of 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 or equivalent person.
- The person or persons charged with dealing with allegations of fraud. [Previously paragraph A17]

A25M. [Add application material that explains what the auditor may ask management, and others within the entity as appropriate in obtaining their views about the risk of fraud (e.g., the fraud risk factors present in the entity, possible areas that are susceptible to fraud, etc.)]

A25N. 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
The Entity's Process to Monitor the System of Internal Control

24E. In applying ISA 315 (Revised 2019), the auditor shall:

(a) Understand those aspects of the entity's process that addresses the ongoing and separate evaluations for monitoring the effectiveness of controls by management to prevent and detect fraud, and the identification and remediation of control deficiencies identified by management to prevent and detect fraud. (Ref: Para. A26A–A26B) [Previously paragraph 24B(g)]

(b) In applying ISA 315 (Revised 2019), the auditor shall make inquiries of appropriate individuals within the internal audit function (if the function exists) to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud. (Ref: Para. A26C–A26D) [Previously paragraph 20]

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

Scalability (Ref: Para. A24E(a))

A26A. In smaller or less complex entities, and in particular owner-manager entities, the auditor’s understanding of the entity’s process to monitor the system of internal control is often focused on how management or the owner-manager is directly involved in operations, as there may not be any other monitoring activities.

Ongoing and separate evaluations for monitoring the effectiveness of controls to prevent and detect fraud (Ref: Para. A24E(a))

A26B. 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 and detect fraud, and the identification and remediation of such control deficiencies identified, 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 monitoring for these operating locations or business segments.
- How the entity may monitor 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. 24E(b))

A26C. 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

---

17 ISA 315 (Revised 2019), paragraph 24
18 ISA 315 (Revised 2019), paragraphs 14(a)
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 with the internal audit function may therefore provide the auditor with useful information about instances of actual, suspected or alleged fraud and the risk of fraud.

A26D. 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. In carrying out the requirements of those ISAs in the context of fraud, the auditor may, for example, inquire about specific activities of the function including, for example:

- The entity’s fraud risk assessment.
- The entity’s controls to prevent and 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 company’s code of ethics and values and whether management and those charged with governance have satisfactorily responded to any findings resulting from those procedures.
- If any, the fraud related reports or communications prepared by the internal audit function and whether management and those charged with governance

---

19 ISA 315 (Revised 2019), paragraphs 14(a) and 24(a)(ii), and ISA 610 (Revised 2013), *Using the Work of Internal Auditors*
Control Deficiencies Within the Entity’s System of Internal Control

24G. In applying ISA 315 (Revised 2019), based on the auditor’s evaluation of each of the components of the entity’s system of internal control, the auditor shall determine whether one or more control deficiencies in controls for the prevention and detection of fraud have been identified. (Ref: Para. A28A–A28B)

Control Deficiencies Within the Entity’s System of Internal Control

A28A. 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 that assists the auditor in identifying control deficiencies in controls for the prevent and detection of fraud. If the auditor has identified one or more control deficiencies to prevent and detect fraud, the auditor may consider the effect of those control deficiencies on the design of further audit procedures in accordance with ISA 330.

Control Activities

24F. In applying ISA 315 (Revised 2019), the auditor shall identify controls to prevent and detect fraud over journal entries by management to prevent and detect fraud, including over journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments. [Previously paragraph 24B(h)]

Control Activities

[To develop application material about:

- Journal entry fraud (using accounting journal entries to fraudulently adjust financial statements).
- Inappropriate or unusual journal entries.]

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. [Previously paragraph A19]
A28B. If the auditor has identified one or more control deficiencies to prevent and detect fraud, ISA 265\(^{22}\) requires the auditor to determine whether, individually or in combination, the deficiencies constitute a significant deficiency. The auditor uses professional judgment in determining whether a deficiency represents a significant control deficiency.\(^{23}\)

<table>
<thead>
<tr>
<th>Identifying and Assessing the Risks of Material Misstatement due to Fraud</th>
<th>Identifying and Assessing the Risks of Material Misstatement due to Fraud</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Evaluation of Fraud Risk Factors</strong></td>
<td><strong>Evaluation of Fraud Risk Factors (Ref: Para. 25)</strong></td>
</tr>
</tbody>
</table>
| 25. The auditor shall evaluate whether the information obtained from the risk assessment procedures and related activities indicates that one or more fraud risk factors are present. (Ref: Para. A24–A28) | A24. The auditor may identify events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud (fraud risk factors). For example:
- The need to meet expectations of third parties to obtain additional equity financing may create pressure to commit fraud;
- The granting of significant bonuses if unrealistic profit targets are met may create an incentive to commit fraud; and
- A control environment that is not effective may create an opportunity to commit fraud.

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. |
| A25. Fraud risk factors cannot easily be ranked in order of importance. 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 |

---

\(^{22}\) ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*, paragraph 8

\(^{23}\) ISA 265, paragraphs A6–A7 set out indicators of significant deficiencies, and matters to be considered in determining whether a deficiency, or a combination of deficiencies, in internal control constitute a significant deficiency.
determination as to whether a fraud risk factor indicates there is a risk of material misstatement due to fraud is a matter of professional judgment.

A26. Examples of fraud risk factors related to fraudulent financial reporting and misappropriation of assets are presented in Appendix 1. These illustrative risk factors are classified based on the three conditions that are 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 may relate to incentives, pressures or opportunities that arise from 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 factors.\(^24\)

Fraud risk factors may also relate to 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. 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.\(^25\)

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.

A27. The size, complexity, and ownership characteristics of the entity have a significant influence on the consideration of relevant fraud risk factors. For example, in the case of a large entity, there may be factors that generally constrain improper conduct by management, such as:

---

\(^{24}\) ISA 315 (Revised 2019), paragraph 12(f)

\(^{25}\) ISA 315 (Revised 2019), paragraph 21
- 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.

Considerations Specific to Smaller Entities

A28. In the case of a small entity, some or all of these considerations may be inapplicable or less relevant. For example, a smaller 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 small 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 management authorization can compensate for otherwise deficient controls and reduce the risk of employee fraud. However, domination of management by a single individual can be a potential deficiency in internal control since there is an opportunity for management override of controls.

<table>
<thead>
<tr>
<th>Identifying the Risks of Material Misstatement Due to Fraud</th>
<th>Identifying the Risks of Material Misstatement Due to Fraud (Ref: Para. 26(a))</th>
</tr>
</thead>
<tbody>
<tr>
<td>26. In applying ISA 315 (Revised 2019), the auditor shall:</td>
<td>[To develop application material that explains how the inherent risk factors can be “taken into account” when identifying the ROMMs (related to inherent risks). For example, this application material could include examples explaining the impact of fraud risk factors on the identification of possible misstatements.]</td>
</tr>
<tr>
<td>(a) Identify and assess the risks of material misstatement due to fraud and determine</td>
<td>A28A. Determining whether the risks of material misstatement due to fraud exist at the</td>
</tr>
</tbody>
</table>

---

28 ISA 315 (Revised 2019), paragraph 28
whether they exist at the financial statement level or the assertion level for classes of transactions, account balances and disclosures. (Ref: Para. A28A–A28E)

(b) Treat those assessed risks of material misstatement due to fraud as significant risks. [Previously paragraph 28(b)]

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. The following are examples of relevant assertions and the related classes of transactions, account balances or disclosures that may be particularly susceptible to material misstatement due to fraud:

- Accuracy, valuation or classification 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 significant accounting estimates – account balances involving significant accounting estimates such as goodwill and other intangible assets, 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 secure financing.
- Presentation of disclosures – disclosures may be susceptible to the omission, 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., non-GAAP performance measures).
A28B. ISA 315 (Revised 2019) requires the auditor to identify the entity’s controls that address significant risks and evaluate their design and determine whether they have been implemented.\[^{27}\] [Previously paragraph A31B]

[To develop application material with examples to explain “how” the fraud risk factors affect the auditor’s assessment of control risk.]

**Considerations Specific to Public Sector Entities**

A28E. For public sector entities, misappropriation of assets (i.e., misappropriation of funds) may be a common type of fraud. For example, fraud risks from the authority of an individual with a significant role, to commit the public sector entity to sensitive expenditure, including travel, accommodation, or entertainment, and that sensitive expenditure provides personal benefits to the individual.

<table>
<thead>
<tr>
<th>Presumption of Fraud Risk in Revenue Recognition</th>
<th>Presumption of Fraud Risk in Revenue Recognition (Ref: Para. 27)</th>
</tr>
</thead>
<tbody>
<tr>
<td>...</td>
<td>...</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Unusual or Unexpected Relationships Identified</th>
</tr>
</thead>
<tbody>
<tr>
<td>27A. The auditor shall evaluate 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.</td>
</tr>
</tbody>
</table>

\[^{27}\] ISA 315 (Revised 2019), paragraphs 26(a)(i) and 26(d)
28. The auditor shall treat those assessed risks of material misstatement due to fraud as significant risks and accordingly, to the extent not already done so, the auditor shall obtain an understanding of the entity’s related controls, including control activities, relevant to such risks. (Ref: Para. A32–A33)

A32. 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 assume given in the nature and circumstances of the entity. In determining which controls to implement to prevent and detect fraud, management considers the risks that the financial statements may be materially misstated due to as a result of fraud.

A33. The auditor may therefore obtain an understanding of the controls that management has designed, implemented and maintained to prevent and detect fraud. Information from identifying and evaluating these controls that management has designed and implemented to prevent and detect fraud, and evaluating their design and determining whether they have been implemented, may also be useful in identifying fraud risks factors that may affect the auditor’s assessment of the risks that the financial statements may contain material misstatement due to fraud.

Assessing the Risks of Material Misstatement Due to Fraud
28. In applying ISA 315 (Revised 2019), the auditor shall:
   (a) Assess the risks of material misstatement due to fraud for identified risks of material misstatements at the financial statement level and at the assertion level.
   (b) [Moved to paragraph 26(b)]

Identifying and Assessing the Risks of Material Misstatement Due to Fraud and Understanding the Entity’s Related Controls (Ref: Para. 28)
A31B. [Moved to paragraph A28B]

Evaluating the Audit Evidence Obtained from the Risk Assessment Procedures
28A. In applying ISA 315 (Revised 2019), the auditor

---

28—ISA 315 (Revised 2019), paragraphs 32
29—ISA 315 (Revised 2019), paragraphs 35
Inconsistent responses

**28B.** In applying proposed ISA 500 (Revised), if the responses to inquiries of individuals within the internal audit function, those charged with governance, or others within the entity, are inconsistent with the responses to the inquiries of management, 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 determine the implications for the identification and assessment of the risks of material misstatement.

[Previously paragraph 22B]

---

Proposed ISA 500, paragraph 13A