



**INTERNATIONAL FEDERATION
OF ACCOUNTANTS**

535 Fifth Avenue, 26th Floor
New York, New York 10017
Internet: <http://www.ifac.org>

Tel: +1 (212) 286-9344
Fax: +1 (212) 856-9420

Agenda Item

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Committee: IAASB
Meeting Location: Melbourne
Meeting Date: 17-21 March 2003

Auditor's Responsibility for Fraud

Objectives of Agenda Item

1. To provide IAASB with a status update and present a revised timetable
2. To consider the proposed treatment of error

Background

The IAASB discussed Fraud at its December 2002 meeting. The IAASB agreed:

- The revision of ISA 240 should be built from the existing ISA, and not based on the US SAS 99, as the latter is very detailed and does not follow an ISA structure.
- The basic principles and essential procedures contained in the US SAS 99 should be incorporated as appropriate into the revised ISA 240.
- Elements of fraud and error should be dealt with separately. ISA 240 should only deal with fraud. Guidance on the auditor's responsibility for the detection of errors should be covered in other existing Standards.
- The proposed revised ISA 240 should provide guidance on aggressive earnings management.
- The exhibit appended to the US SAS 99 should not be appended to the proposed revised ISA 240.

Activities Since Last IAASB Discussions

The Task Force met on February 3-4, 2003 to:

- Review SAS 99 to identify the black lettered paragraphs and agree on how they should be incorporated into the revised ISA 240;
- Consider how the revised ISA 240 should be conformed with the audit risk model;
- Agree on how to deal with the parts of existing ISA 240 that deal with error;
- Review the IAASB comment letter to the US ED and determine how any outstanding items will be addressed in the revised ISA 240. This included a discussion on how the revised ISA 240 will address aggressive earnings management; and
- Consider the proposed timetable.

The Task Force reconsidered the project timetable for two reasons:

- The EU requires adoption of ISAs by 2005, releasing a revised ISA 240 in December 2004 would likely provide insufficient adoption time; and
- At the National Standards Setters Meeting in January 2003, Canada expressed concern with approval of a final standard in December 2004.

In light of these reasons, and the importance of this project, the Task Force has concluded that the project timetable can be accelerated. Assuming that there is a May 2003 meeting, the Task Force plans to work to the following timetable.

Date	Meeting
2003	
March 17-21	IAASB – Discussion TF – Discussion
April 22-23	TF – Discussion of draft ED
May 12-15(?)	IAASB – First read of ED
June 3-4	TF – Revisions to draft
July 21-25	IAASB – Approval of ED
Oct 15	Exposure period ends
Nov	TF – Revisions
Dec 8-12	IAASB – First read of final standard
2004	
Jan	TF – Revisions
Feb or March	IAASB – Approve final

The above timetable would allow the IAASB to issue a revised ISA 240 in February or March 2004. The Task Force believes this timetable is achievable and is willing to hold additional conference calls as necessary in order to meet the deadline.

One of the consequences of this timetable is that it will not always be possible for the Task Force to have Board agenda material available five weeks before a Board meeting.

Parts of ISA 240 that deal with error

At the December 2002 meeting, the IAASB agreed that elements of fraud and error should be dealt with separately. ISA 240 should only deal with fraud and guidance on the auditor's responsibility for the detection of error should be covered in other existing Standards.

The Task Force has reviewed existing ISA 240, identifying all references to error and has determined where the guidance on the auditor's responsibility for the detection of error should be located. The Task Force has concluded that the references to error can either be:

- Deleted, because they are adequately dealt with elsewhere in the ISAs for example, in the Audit Risk ED;
- Retained, because they are needed as background to fraud because they differentiate fraud from error; or
- Incorporated in existing or proposed ISAs.

TO BE INCORPORATED INTO ISA 200

17. The auditor's opinion on the financial statements is based on the concept of obtaining reasonable assurance; hence, in an audit, the auditor does not guarantee that material misstatements, whether from fraud or error, will be detected. Therefore, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not, in and of itself, indicate:
- (a) a failure to obtain reasonable assurance,
 - (b) inadequate planning, performance or judgment,
 - (c) the absence of professional competence and due care, or,
 - (d) a failure to comply with ISAs.

TO BE INCORPORATED INTO ARM OR PLANNING

22. When planning the audit, the auditor should make inquiries of management:
- (d) to determine whether management has discovered any material errors.

TO BE INCORPORATED INTO ISA 580 MANAGEMENT REPRESENTATIONS OR IN ED MATERIALITY

51. The auditor should obtain written representations from management that:
- (a) it acknowledges its responsibility for the implementation and operations of accounting and internal control systems that are designed to prevent and detect fraud and error;
 - (b) it believes the effects of those uncorrected financial statement misstatements aggregated by the auditor during the audit are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. A summary of such items should be included in or attached to the written representation;

TO BE INCORPORATED INTO MATERIALITY ED

56. When the auditor identifies a misstatement resulting from fraud, or a suspected fraud, or error, the auditor should consider the auditor's responsibility to communicate that information to management, those charged with governance and, in some circumstances, to regulatory and enforcement authorities
57. Communication of a misstatement resulting from fraud, or a suspected fraud, or error to the appropriate level of management on a timely basis is important because it enables management to take action as necessary. 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 nature, magnitude and frequency of the misstatement or suspected fraud. Ordinarily, the appropriate level of management is at least one level above the persons who appear to be involved with the misstatement or suspected fraud.
58. The determination of which matters are to be communicated by the auditor to those charged with governance is a matter of professional judgment and is also affected by any understanding between the parties as to which matters are to be communicated. Ordinarily, such matters include:
- Material misstatements resulting from error.

59. If the auditor has identified a material misstatement resulting from error, the auditor should communicate the misstatement to the appropriate level of management on a timely basis, and consider the need to report it to those charged with governance in accordance with ISA 260, *Communication of Audit Matters with Those Charged with Governance*.
60. The auditor should inform those charged with governance of those uncorrected misstatements aggregated by the auditor during the audit that were determined by management to be immaterial, both individually and in the aggregate, to the financial statements taken as a whole.
61. As noted in paragraph 54, the uncorrected misstatements communicated to those charged with governance need not include the misstatements below a designated amount.

Action Requested

IAASB is asked to review and provide input the proposed disposition of the references to error.