

Fraud in an Audit of Financial Statements – Specific Issues

Objectives of Agenda Item

The objective of this Agenda Item is to progress the discussion on fraud-related topics during the April 2021 IAASB meeting by further exploring those matters where mixed views were expressed by respondents to the Discussion Paper (DP), [*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*](#) and other outreach. This will help inform the Fraud Working Group in developing a project proposal that is responsive to the public interest issues identified.

Format of the Board Discussion

The Fraud Working Group (WG) Chair will walk through the matters in the order of this Agenda Item, following the slides in **Agenda Item 3-A**.

Matters for IAASB Consideration

1. The IAASB is asked for its views on:
 - (a) Whether the key matters from respondents' comments have been appropriately identified in relation to the topics that are explored in this Agenda Item; and
 - (b) The recommended possible actions for each of the topics to help inform the development of a project proposal.
2. For Possible Action #3 specifically, the IAASB is also asked for its preference as to Option 1 or Option 2 presented.
3. The IAASB is also asked whether there are other matters the WG should consider as it progresses its work to develop a project proposal.

I. Introduction

1. For the April 2021 IAASB meeting, a comprehensive summary of the feedback received in response to the DP about fraud in an audit of financial statements was provided and discussed. The Board agreed to further discuss several topics where it was noted that further analysis and consideration was needed because mixed responses on these topics had been received. This Agenda Item addresses some of these topics, with the balance to be brought for discussion to the July 2021 IAASB meeting (identified in paragraphs 3 and 4 below). The Board's further input on these topics will help inform the WG's development of a project proposal that is responsive to the input from the DP consultation and other information gathering-activities undertaken, and that will have a public interest impact. The WG is targeting presenting a project proposal for discussion at the September 2021 IAASB meeting.

2. The summarized feedback from DP respondents and input from other information gathering-activities for all fraud-related topics identified is available in [Agenda Item 3](#) of the April 2021 IAASB meeting papers.
3. Since the April 2021 IAASB meeting, the WG met to discuss the following (which are the focus of this Agenda Item):
 - (a) A deeper analysis of the comments and considerations on:
 - The introductory language in ISA 240¹ about the responsibilities of the auditor and the inherent limitations of an audit (see **Section II(A)** below);
 - The use of forensic specialists in audits of financial statements (see **Section II(B)** below);
 - The definition of fraud (see **Section II(C)** below);
 - Considerations around whether elements of a suspicious mindset may be beneficial in certain circumstances (see **Section II(D)** below);
 - The rebuttable presumption of fraud risk in revenue recognition and related issues (see **Section II(E)** below); and
 - External confirmations (See **Section II(F)** below).
 - (b) Options for a possible way forward for each topic in paragraph 3(a).
4. The other topics for further analysis and discussion at the July 2021 IAASB meeting include:
 - (a) Transparency regarding the auditor's procedures on fraud in the auditor's report.
 - (b) Making the engagement team discussion more robust in relation to fraud considerations.
 - (c) Clarifying the relationship between ISA 240 and ISA 250 (Revised).²
 - (d) When fraud is suspected or identified.
 - (e) The development of non-authoritative guidance.
 - (f) Working with others in the financial reporting ecosystem as appropriate.
5. Staff are currently undertaking further root cause analysis for recent frauds, which had been encouraged by several respondents to the DP. This will be undertaken over June and July 2021 and the findings therefrom and how the project proposal addresses these matters will be presented for discussion at the September 2021 IAASB meeting. For details on planned activities for this root-cause analysis, refer to **Appendix B**.
6. Symbols have been used to indicate the possible actions for each of the topics set out in this Agenda Item. The symbols are as follows:

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

² ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*

Symbol	Description
I	Standard-Setting (Introduction) - New or changed language in the Introduction section of the ISA(s).
R	Standard-Setting (Requirements) – New or changed requirements in the ISA(s).
A	Standard-Setting (Application Material) – Changed or additional application material to clarify or further explain application of the relevant requirement.
G	Non-Authoritative material – Supporting materials and guidance developed outside of the ISAs.
E	Education – Educational initiatives or outreach (where within the remit of the IAASB)
O	Actions for others - Where an issue or challenge has been identified, but it does not relate to actions that are within the IAASB's remit and will need efforts from another participant in the financial reporting ecosystem to address it.

7. The following appendices accompany this paper:

Appendix A	Summary of Relevant Extant Requirements and Application Material
Appendix B	Update on Activities since April 2021 IAASB Meeting
Appendix C	Summary of Possible Actions for the topics included in this Agenda Item.
Appendix D	Draft Minutes from the April 2021 IAASB Meeting

II. Specific Topics for Discussion

A. Introductory Language in ISA 240 About Responsibilities of the Auditor and Inherent Limitations of an Audit

8. For further details of the DP responses received on this topic, see NVivo report provided in [Agenda Item 3-A.3](#) for the April 2021 IAASB meeting.

What the issue is:

There is strong encouragement from Monitoring Group members (and a limited number of other stakeholders) to reconsider the language in paragraphs 5 and 6 of ISA 240 (i.e., in the introductory paragraphs) to clarify the risks of the inherent limitations of an audit in relation to the auditor's responsibilities.

What the Board is being asked:

Whether the IAASB should pursue standard-setting for paragraphs 5 and 6 of ISA 240 (and related paragraphs in ISA 200), or whether another, or no, action is warranted.

Background for the Working Group's Deliberations

Monitoring Group Member DP Responses:

9. All Monitoring Group members who commented on this topic noted that the IAASB should consider whether changes to the introductory language in ISA 240 around the auditor's responsibilities and the inherent limitations of an audit³ are needed. The following observations were noted by Monitoring Group members:
- (a) The requirement "to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error"⁴ may be weakened, diluted or undermined by paragraph 6 in ISA 240, which states that "the potential effects of inherent limitations are particularly significant in the case of misstatement resulting from fraud," without clearly stating that the auditor's responsibilities are not affected by these limitations or increased difficulty.
 - (b) The IAASB should consider whether the requirements in auditing standards result in auditors providing the same level of assurance on both material fraud and error.
 - (c) The primary responsibility for the prevention and detection of fraud rests with both those charged with governance and management of the entity, though that does not lessen the auditor's responsibilities.
 - (d) Although the identification of material misstatements may be more difficult for material fraud than for material error, auditing standards and auditors should nevertheless strive to ensure that both are detected. The IAASB should clarify the responsibility of auditors and their role in identifying and mitigating material risks from fraud. It is important for auditors to consider how fraud may affect the risk of material misstatement or the quality and persuasiveness of the audit evidence that is gathered.
 - (e) The clarity of the objectives of any standard is critical to achieving consistent application of the requirements and related guidance for its specific subject matter.

Input from Other DP Respondents and Other Information-Gathering Activities

Description of Inherent Limitations of the Audit

10. Other DP respondents (an audit oversight body, a national standard setter, and a professional organization) noted the following about how the standard describes the limitations of an audit in the introductory paragraphs of ISA 240:
- (a) The emphasis on the inherent imitations when it comes to detecting fraud has contributed to a lack of clarity about what exactly is expected of auditors in this area.
 - (b) The IAASB should revisit whether the limitations described in the introductory paragraphs of ISA 240 continue to accurately reflect the capabilities of auditors in today's world, including considering advancements in audit technology.

³ ISA 240, paragraphs 5 and 6

⁴ ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraph 11

- (c) Supplemental text should be added to emphasize that the limitations do not diminish the auditor's responsibility to plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement due to fraud.
 - (d) A respondent commented that the material describing the difficulties the auditor may face could be moved to the application material, which would help strengthen the tone of the standard.
11. A DP respondent noted they are supportive of proposals that in their view would clarify or enhance certain existing requirements but would be concerned with proposals that they believe would aim to change the role and responsibilities of the auditor more broadly, as well as the concept of an 'audit' more fundamentally.
12. In his "[Report of the Independent Review into the Quality and Effectiveness of Audit](#)", Sir Donald Brydon focused on this area and noted that the messaging in ISA (UK) 240⁵ is somewhat ambiguous on what exactly is expected of auditors in the area of fraud. He states *"Some of this ambiguity stems from the introductory section of the standard. As well as stating that directors and management have primary responsibility for preventing and detecting fraud, it stresses that the auditor is less likely to detect a material misstatement due to fraud as a result of sophisticated efforts to conceal fraud. It also stresses that there is a higher risk of not detecting management fraud because of their ability to override controls and directly or indirectly manipulate accounting records. It is consequently understandable that there is both confusion and a gap between the reality and the expectations of performance of auditors in this area. If an auditor is giving an unmodified opinion, then he or she is stating effectively that they have obtained a "high level" of assurance that the financial statements are "true and fair" or "presented fairly in all material respects." But some would ask: how can this be so, if there has been a material fraud that the auditor has failed to detect? Relying on users fully understanding that auditors may have done enough work to reach a reasonable expectation of the financial statements being free of material misstatement is not a satisfactory answer."*
13. The UK Department for Business, Energy, & Industrial Strategy (BEIS) [Consultation on "Restoring trust in audit and corporate governance"](#) published in March 2021, notes that the UK Financial Reporting Council (FRC) considered Brydon's recommendation "to make clear that it is the obligation of an auditor to endeavor to detect material fraud in all reasonable ways" as part of a wider review of the UK auditing standard on fraud.
14. The UK FRC consulted on changes to its fraud standard in proposed ISA (UK) 240 (Revised 2021), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, with the comment period closing on January 29, 2021. The proposed ISA (UK) 240 has proposed adjustments to address the concerns that have been raised and includes proposed new paragraph 7.1 stating *"While...the risk of not detecting a material misstatement resulting from fraud may be higher than the risk of 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 are free of material misstatement due to fraud. Reasonable assurance is a high, but not absolute, level of assurance."* The consultation on the exposure draft closed in January 2021 and a final revised standard is expected at the end of May 2021.
15. The last significant revision to ISA 240 was approved by the IAASB in February 2004. At the February 2004 meeting, the IAASB deliberated whether the guidance in the standard adequately

⁵ ISA (UK) 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, is broadly based on ISA 240.

communicates the inherent limitations of the audit with respect to detection of fraud such that the public expectation gap is not inadvertently widened. After due consideration at that time, it was agreed that the standard gives appropriate recognition to the risk of not detecting fraud while establishing the procedures that are necessary to increase its detection. A representative from the International Organizations of Securities Commissions (IOSCO) attending the meeting as a public observer noted that IOSCO, while not necessarily in disagreement with the ED, had reached a consensus that the section of the standard on the auditor's responsibilities was somewhat negative as a result of including a discussion of the inherent limitations of an audit, and that separating positive statements about the auditors' responsibilities for fraud detection from the limitations would result in a more balanced document. The IAASB agreed to incorporate, to the extent appropriate, the suggested wording provided by IOSCO and agreed to a revised sub-heading for that section of the standard.

Clarity Needed on the Auditor's Responsibilities for Fraud

16. The IAASB also received input from other DP respondents and other information-gathering activities that the introductory paragraphs to the standard should clearly articulate the auditor's responsibilities for material fraud.
 - (a) DP respondents noted the auditor's current responsibility is to plan an audit to obtain reasonable assurance that the financial statements are not materially misstated due to fraud or error but highlighted that the work effort is different for fraud than it is for error.
 - (b) At the Expectation Gap Roundtable⁶ and the Less Complex Entities (LCE) Roundtable,⁷ participants noted that the role of the auditor may be misunderstood in some cases and the expectation of what the auditor does on fraud needs to be better understood by all. It was also highlighted that the auditor's procedures are meant to address error and fraud, but practice seemed to focus on finding material misstatements arising from errors, with fraud procedures sometimes appearing to be an "add-on." It was also highlighted that there was insufficient focus by auditors on procedures targeted at identifying fraud in some cases.

Current Requirements and Application Material

17. The table in **Appendix A** describes the extant requirements and application material for the responsibilities of the auditor and inherent limitations of an audit of financial statements, both in ISA 240 specific to fraud and more generally in ISA 200.

⁶ On September 28, 2020, the IAASB facilitated a roundtable to discuss what is expected of auditors in relation to fraud and going concern in audits of financial statements and possible IAASB actions or actions for others to address issues and challenges about fraud and going concern. Participants included investors, corporate governance experts, audit firms, academics, regulators, public sector representatives, and select others. The IAASB published a document titled "[Summary of Key Take-aways: IAASB Fraud and Going Concern Roundtables](#)" to summarize the key points raised by participants.

⁷ On October 7, 2020, the IAASB facilitated a roundtable focused on fraud and going concern procedures in audits of LCEs. Participants included auditors, audit methodology experts and representatives of third-party audit solution companies and professional accountancy bodies. The IAASB published a document titled "[Summary of Key Take-aways: IAASB Fraud and Going Concern Roundtables](#)" to summarize the key points raised by participants.

Working Group Deliberations

18. The WG considered various alternatives to address how inherent limitations and the responsibilities of the auditor related to fraud are described in ISA 240, and also considered whether changes were needed more generally in ISA 200. In its deliberations, the WG considered the possible benefits and challenges (including unintended consequences) that may arise from the possible actions.
19. The WG did not consider the removal of the explanation about the inherent limitations of an audit from the introductory language in paragraphs 5 and 6 of ISA 240 to be an action to pursue. This could be perceived as generally expanding the responsibilities of the auditor on fraud. It may also add confusion around the scope of a financial statement audit and further increase the expectation gap. It is the view of the WG that while enhancements to the auditor's fraud-related requirements are being considered in specific areas, the inherent limitations of the financial statement audit exist and should be appropriately described.
20. Further, the WG considered it would be unresponsive to stakeholder needs to recommend no further action on this matter due to the level of response from respondents to the DP and other information-gathering activities. The WG considers this matter to be a public interest issue that needs to be addressed.
21. The WG considered possible standard-setting in ISA 240 to re-order the paragraphs in the Introduction to the standard so that the auditor's responsibilities are presented prior to the explanation about the inherent limitations of an audit. The WG views this approach as a way to shift more focus onto the auditor's responsibilities without unintentionally causing a perception that the inherent limitations do not exist, or that the role of the auditor is fundamentally changed.
22. The WG also considered supplementing existing paragraphs 5 and 6 in ISA 240 with additional considerations from the application material in ISA 200 around inherent limitations, but ultimately thought a better approach would be to re-order the paragraphs as described in the preceding paragraph to avoid repetition of the same matters in both standards.
23. WG members had mixed views as to whether changes in ISA 200 are needed. Some WG members noted the changes should be made in ISA 200 and not only in ISA 240 because ISA 200 is overarching and is foundational for the audit. However, WG members also acknowledged that respondent comments were generally made in the context of ISA 240 as this is the source of perceived confusion around the auditor's responsibilities.
24. The WG also plans to monitor fraud initiatives performed in other jurisdictions. For example, the WG will monitor the final changes proposed in the UK to the Introduction to ISA (UK) 240 about inherent limitations of the audit once the revised standard is issued and further consider whether such changes could be feasible and address the issues that have been identified in a global context.
25. The WG does not have the view that the alternatives are mutually exclusive and believes that to effectively address the identified issues a more holistic approach may be needed. After weighing up the alternatives, the WG proposes the below possible actions.

Possible Action #1:	I	R	A	G	E	O	N
Revision of the Introductory Language in ISA 240 About Responsibilities of the Auditor and Inherent Limitations of an Audit and Consideration of Revision of Application Material in ISA 200	✓		✓		✓		
<p>The WG recommends:</p> <p>(a) Possible standard-setting actions to re-order the paragraphs in ISA 240 in the Introduction to the standard so that the auditor's responsibilities are presented prior to those addressing the inherent limitations of an audit and to explore if there are enhancements that can be made to clarify the auditor's responsibilities in relation to fraud.</p> <p>(b) Further explore whether standard-setting is needed to enhance the application material in ISA 200 about fraud-related inherent limitations in an audit.</p> <p>(c) Educational efforts to help inform financial statement users and others about the role and responsibilities of the auditor on fraud in a financial statement audit.</p>							

B. Using Forensic Specialists in an Audit of Financial Statements

26. For further details of the DP responses received about this topic, see NVivo report provided in [Agenda Item 3-A.3](#) for the April 2021 IAASB meeting.

What the Issue is:

Broadly the respondents to the DP and other outreach indicated that the IAASB should not require the use of forensic specialists on all audits. However, there were mixed views about whether to:

- (i) Require the use of forensic specialists in some circumstances (for example if a possible fraud has been identified);
- (ii) Require the use of forensic specialists for certain types of audits or in certain areas of the audit (based on the nature and characteristics of the entity such as listed entities); or
- (iii) Not require the use of forensic specialists and leave to the auditors' judgment about whether to involve a specialist, forensic or other.

In addition, respondents highlighted the possible benefits of requiring the auditor to undergo forensic training.

What the Board is being asked:

Whether the IAASB should pursue standard-setting to require the use of forensic specialists, and in what circumstances, or whether there is another appropriate action to address the issues identified.

Background for the Working Group's Deliberations

Monitoring Group Member DP Responses:

27. The Monitoring Group respondents that commented on the use of forensic specialists in an audit of financial statements noted the following:
- (a) A respondent expressed support for investigating the benefits that targeted utilization of forensic specialists may bring, particularly in the risk identification and assessment phase of a financial statement audit. They also support investigating whether requiring forensic specialist involvement in other phases of a financial statement audit is appropriate, depending on the entity's risk profile. They noted this may include planning of audit procedures or using forensic specialists in an unpredictable or surprise manner.
 - (b) A respondent noted that the benefits of engaging forensic specialists in the risk identification and assessment phase of an audit could be one avenue to introduce a forensic mindset to an engagement team at a critical juncture of an audit. Additionally, the interaction between audit engagement team members and forensic specialists could add educational value to less experienced team members to enhance their skillset, which could result in improvement in audit execution and ultimately audit quality.
 - (c) A respondent encouraged the IAASB to have an open mind, noting that the IAASB should be building solutions based on the audit "not being forensic in nature." It was noted that many audit firms do not have access to forensic specialists, which may limit achievement of the right outcomes. However, this respondent also noted the IAASB needs to be proportionate in any final proposals, and forensic expertise is unlikely to be necessary on all audits.
 - (d) A respondent encouraged the IAASB to explore whether the identification of material misstatements in the financial statements due to fraud requires the use of specialists, generally or in certain circumstances. They noted it may be helpful to understand the extent to which fraud specialists are currently engaged or included in audit teams and the nature of the procedures they are performing.

Input from Other DP Respondents and Other Information-Gathering Activities

Support for Enhancements to Requirements for Use of Forensic Specialists in Some Circumstances or for Certain Types of Audits

28. Other respondents including regulators and audit oversight bodies, national audit standard setters, public sector organizations, professional accountancy, and other professional organizations expressed support for enhanced requirements on the use of forensic specialists in some circumstances or for certain types of audits. Participants at the Expectation Gap roundtable also noted it may be beneficial to consider requiring forensic-type procedures in an audit but only in certain circumstances or in audits of certain types of entities. There was, however, a caution to maintain balance, scalability and proportionality if the procedures required were to be enhanced given the scope and purpose of an audit.
29. Most respondents who supported requirements for the use of forensic specialists noted that the IAASB should consider enhanced requirements in the following circumstances:

- (a) Audits of entities with high-risk profiles.
 - (i) Respondents noted it would be beneficial to require the use of forensic specialists in circumstances where acceptance and continuance, or risk assessment procedures, reveal a significant possibility of fraudulent activities.
 - (ii) A respondent noted there should be an evaluation by the engagement team of the specialized skills or knowledge needed to perform fraud risk assessments based on some of the following factors: the complexity of the business model, information systems, transactions, data flows, estimation models, related party transactions and fraud risks associates with the industry, and countries where the entity operate.
 - (b) Audits of entities where fraud is identified or suspected.
 - (i) Respondents encouraged the IAASB to consider adding a specific requirement for the auditor to determine if a forensic specialist is needed for further investigation when fraud is identified or suspected.
 - (ii) A respondent noted there should be a mandate to perform an investigation in response to suspected fraud which could be initiated either by management/those charged with governance or by the auditor with the use of forensic specialists.
 - (iii) Respondents encouraged the IAASB to explore whether the auditor should be required to use forensic specialists during the risk assessment procedures when there are signals or heightened risk of fraud or when a fraud involving management has been identified or suspected.
 - (c) A respondent commented that enhanced requirements for the use of forensic specialists should apply to listed entities, regulated entities, and high-risk entities.
30. The UK FRC proposed new paragraphs 24-1 and 27-1 in their consultation for proposed revised ISA (UK) 240, which require that the auditor shall determine whether the engagement team requires specialized skills or knowledge to perform particular procedures and, if the auditor identified a misstatement due to fraud or suspected fraud, the auditor shall determine whether a forensic expert is needed to investigate further. Application material was also added to give examples of matters that may affect the auditor's determination of whether the engagement team requires specialized skills or knowledge. The WG will consider the appropriateness of any related changes made in ISA (UK) 240 in a global context when the UK FRC publishes the final revised standard.

Opposition to Requirements for Use of Forensic Specialists in an Audit

31. Other respondents, including national audit standard setters, accounting firms, professional accountancy and other professional organizations, and a public sector organization did not support requirements for the use of forensic specialists during the audit. Reasons cited included:
- (a) The scope of a forensic engagement is very different to an audit.
 - (b) Requiring the use of forensic specialists on all audits is not scalable and would be challenging for smaller practitioners to implement.
 - (c) The cost likely outweighs the benefit to the entity.

- (d) Whether forensic specialists or other specialists are needed should be a decision for the engagement partner based on the circumstances of the engagement.
 - (e) Upskilling auditors in forensic techniques is a better alternative.
 - (f) Requiring the involvement of forensic specialists may become perfunctory or less effective over time.
 - (g) Many small- and medium-sized (SMP) firms would not have access to such skills, therefore the introduction of requirements for the use of a forensic specialist on all audits could have a disproportionate negative impact on SMPs.
 - (h) Requiring the involvement of forensic specialists may widen the expectation gap.
32. The difference in scope between a financial statement audit and a forensic audit was also emphasized at the Technology Roundtable⁸, where participants noted the purpose of a forensic audit is generally to investigate suspected or known fraud (i.e., a targeted examination focused on, for example, gathering evidence for legal proceedings). The mindset, questions and interview techniques of a forensic auditor are different to that of a financial statement auditor because they are for a different purpose. It was highlighted that forensic auditors investigate a very specific set of known or suspected circumstances.

Support for Forensic Training for Auditors

33. A few DP respondents expressed support for auditor training that deepens their understanding of fraud. They noted such training should be an ongoing activity.
34. Participants at the Expectation Gap Roundtable noted there may be benefits to requiring forensic training for auditors or incorporating forensic interview skills when performing inquiries with management. Participants noted that a financial statement audit should not be expanded to be forensic in nature, but there may be a role for forensic-type procedures or mindsets in various stages of the audit, such as planning or high-level analytic procedures.
35. At the LCE Roundtable, participants noted it may be effective to require that auditors of LCEs apply more forensic type interview skills when performing inquiries of management. However, participants noted there is a need to maintain balance, scalability and proportionality.
36. In his "[Report of the Independent Review into the Quality and Effectiveness of Audit](#)", Sir Donald Brydon noted that he considered a key part of the education necessary to be a successful auditor is to be found in the current training afforded to forensic accountants. He recommended that auditors be required to undergo initial and ongoing periodic training in forensic accounting and fraud awareness.

⁸ On September 1, 2020, the IAASB facilitated a roundtable to discuss how technology facilitates the perpetration of fraud, how technology is used in financial statement audits, and how technology is used in forensic audits. Participants included forensic auditors, financial statement auditors, fraud audit methodology experts, third party audit solution companies, regulators, academics, and public sector representatives. The IAASB published a document titled "[Summary of Key Take-aways: IAASB Fraud and Going Concern Roundtables](#)" to summarize the key points raised by participants.

Other Considerations

37. Respondents to the DP noted the use of forensic specialists would be beneficial in the following areas:
- (a) Assist in performance of risk identification and assessment, including participation in the engagement team discussion (i.e., brainstorming with the engagement team about matters related to fraud).
 - (b) Conduct further investigation when fraud is identified or suspected.
 - (c) Consider use of forensic specialists to perform unpredictability procedures.
38. A respondent to the DP noted that the use of a forensic specialist does not affect the extent of the auditor's responsibility for the audit. The auditor remains responsible for forming and expressing the audit opinion.
39. Respondents to the DP noted that guidance may be useful to assist engagement teams navigate when it is appropriate to involve forensic specialists and what types of procedures they can assist with.
40. If a requirement is added to require the use of forensic specialists, the IAASB will also need to consider what constitutes a "forensic specialist" as this term may not be clear in the IAASB's standards. For example, questions may arise as to whether members of the audit engagement team with prior expertise on fraud-related matters could qualify as a forensic specialist, or whether an expert with specific forensic training is required.

Current Requirements and Application Material

41. The table in **Appendix A** describes the extant requirements and application material about the use of resources with specialized skills and knowledge, both in ISA 240 specific to fraud and more generally across the suite of ISAs.
42. The extant requirements do not explicitly require the use of forensic specialists. However, the engagement partner should be satisfied that the engagement team has the appropriate competence and capabilities as the engagement partner takes overall responsibility for managing and achieving quality on the audit engagement, and the standards address using specialists more generally.

Working Group Deliberations

43. The WG noted there was no support from DP respondents or roundtable participants to require the use of forensic specialists in all audits and all circumstances. This alternative was therefore not considered further.
44. The WG considered various alternatives to address whether the use of forensic specialists should be required in a financial statement audit in certain circumstances or for some audits, recognizing there were significant mixed views from DP respondents.
45. The WG considered alternatives to require the use of forensic specialists or require the auditor to consider whether the use of a forensic specialist is needed when entities are determined to be higher risk. The WG did not favor these alternatives, noting that it would be very difficult to describe which entities are higher risk for this purpose, considering the unique circumstances of each engagement, jurisdiction, or industry.

46. Some WG members were supportive of an alternative that would require the auditor to consider whether the use of a forensic specialist is needed when fraud is identified or suspected. It was noted that this option provides the flexibility for an engagement team to apply judgment and decide whether a specialist is needed (through use of the word “consider”) and that requiring such a response from the auditor would be appropriate to the circumstances. However, this alternative is also stronger than other alternatives considered (e.g., to solely clarify current requirements through application material or guidance) as it introduces a new requirement, and it was also questioned how feasible this would be taking into account the number of forensic specialists available (especially for SMPs).
47. The WG also recognized the robustness that forensic auditors could bring to the risk assessment process of certain audits and were generally supportive of exploring when that would be appropriate.
48. It was also noted that if such requirements are pursued (i.e., if a fraud is suspected or identified, or for risk assessment purposes), the IAASB would need to provide clarity around the term “forensic specialist.”
49. Other WG members preferred alternatives to provide application material or guidance (in lieu of changes to requirements) to provide clarity around the types of circumstances when it may be appropriate to consider the use of forensic specialists in complying with paragraph 30(a) of extant ISA 240. These WG members noted concerns with scalability of requiring auditors to use forensic specialists. On balance the WG did not favor the alternative to provide only non-authoritative guidance as it does not address the public interest issues raised in the DP responses.
50. The WG noted that educational efforts for the broader financial reporting ecosystem may not be particularly useful in this area unless it is targeted to auditors to provide clarity on when it may be appropriate to consider the use of forensic specialists and explain their role in the audit.

Possible Action #2:	I	R	A	G	E	O	N
Required Use of Forensic Specialists		✓	✓	✓			
<p>After discussing the possible actions, the WG recommends:</p> <p>(a) Possible standard-setting action to require the auditor to consider the use of forensic specialists when there is identified or suspected fraud, i.e., assist the auditor to investigate the circumstances.</p> <p>(b) Exploring the role of forensic specialists to assist with risk assessment procedures, including in the engagement team discussion, to determine whether changes to the standard are appropriate.</p> <p>In exploring possible requirements for (a) and (b), the WG would consider scalability. The WG would also undertake work to describe the concept of a “forensic specialist” to clarify who may qualify as a forensic specialist, bearing in mind that the term may need to be re-titled.</p> <p>(c) Possible standard-setting actions to provide application material that provides clarity around the types of circumstances when it may be appropriate to consider the use of forensic specialists in complying with paragraph 30(a) of extant ISA 240.</p> <p>While forensic training for accountants is outside the remit of the IAASB, the WG recommends continued dialogue with others in the financial reporting ecosystem to foster further consideration about how such training could be encouraged (e.g., through IFAC’s International Panel on Accountancy Education).</p>							

C. Definition of Fraud

51. For further details of the DP responses received about this theme, see NVivo report provided in [Agenda Item 3-A.3](#) for the April 2021 IAASB meeting.

What the issue is:

The term “fraud” is used in different ways to how it is defined in ISA 240 for the purpose of an audit. Without a common understanding about how it applies in a financial statement audit, this may be contributing to the expectation gap (i.e., what is expected that auditor’s do on fraud in an audit of financial statements).

What the Board is being asked:

Whether possible changes to the definition of fraud should be explored in a project to revise ISA 240, or whether there is another appropriate action.

Background for the Working Group’s Deliberations

Input from Other DP Respondents and Other Information-Gathering Activities

52. Monitoring Group Respondents did not comment specifically on the definition of fraud. Other DP respondents (audit oversight bodies, national standard setters, a public sector organization, and other professional organizations) noted that the term “fraud” may be used in many contexts, which is sometimes not the same as the way that fraud is ‘defined’ in ISA 240 for the purpose of an audit (this was also highlighted as one of the reasons for the increasing expectation gap).
- (a) A respondent noted that fraud is a legal concept and that the definition of fraud in the law may be very broad and include any accounting, tax and social security fraud, any internal and external fraud, and any embezzlement organized for a moral or financial advantage.
 - (b) Respondents noted that bribery and corruption are not currently included in the definition of fraud in ISA 240. A respondent noted that while they believe corruption in monetary or other forms might very rarely be directly material to financial statements subject to audit, the potential impact of eventually resultant penalties may be far more material.
53. At an outreach meeting with the European Audit Committee Leadership Network (EACLN), participants commented that fraud comes in many forms and that many stakeholders associate all “bad” corporate behavior with fraud. They noted the importance of properly defining the term “fraud” in the auditing standards and making efforts to ensure there is a common understanding of what auditors’ responsibilities are in terms of what they are required to do.
54. During a meeting with representatives from the Chartered Institute of Public Finance and Accountancy (CIPFA) and the European Court of Auditors (ECA), it was noted that it is difficult to distinguish between fraud and corruption (or other terms commonly considered with fraud in the public sector) as there is often overlap in these concepts and suggested that further clarification of the definition of fraud is needed.

55. Other DP respondents and stakeholders (through the above-noted outreach meetings) encouraged the IAASB to:
- (a) Consider whether the definition of “fraud” in ISA 240 is sufficiently robust and relevant in the current environment for what is expected from auditors. Consideration should be given to whether the definition should include other concepts, for example, bribery, corruption, money laundering, financing of terrorism, internal or external fraud (or possible convergence with definitions of fraud used by forensic specialists, the public sector or others). In doing so, it was also noted that the difference between theft, embezzlement and fraud should be clarified.
 - (b) Clarify and explain the term fraud in the context of an audit to third parties through non-authoritative guidance or education.
 - (c) Clarify the relationship with non-compliance with laws and regulations (NOCLAR) as described in ISA 250 (Revised),⁹ as it is not clear what the distinction is. It is also not clear whether NOCLAR can also be fraud. The WG will further analyze comments received about the relationship between ISA 240 and ISA 250 (Revised) and bring further matters for consideration to the July 2021 IAASB meeting for discussion.
56. The International Ethics Standards Board for Accountants (IESBA), *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA Code), section 360 deals with responding to non-compliance with laws and regulations. Paragraph 360.5 A2 notes that section 360 addresses laws and regulations, including those that deal with fraud, corruption, and bribery. Paragraph R360.15 describes that the professional accountant shall comply with applicable requirements under auditing standards, including those relating to identifying and responding to non-compliance, including fraud.

Current Requirements and Application Material

57. The table in **Appendix A** describes the extant requirements and application material about the definition of fraud.
58. Paragraph 12(a) of ISA 240 defines fraud as “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”.

Other Considerations

59. What constitutes “fraud” depends on the purpose or circumstance for which the term is being used, which can vary significantly. Precise definitions and requirements vary among jurisdictions, with generally similar elements around intentional acts involving, depending whether civil or criminal, misrepresentation, concealment or theft. [The Report to the Nations 2020 Global Study on Occupational Fraud and Abuse](#) reports on three main types of frauds¹⁰ – asset misappropriation, corruption (e.g., bribery, conflicts of interest and extortion) and financial statement fraud (a material misstatement in the financial statements intentionally perpetrated).

⁹ ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*

¹⁰ The survey undertaken relates to frauds committed by employees of the organization.

60. Different meanings attributed to the term ‘fraud’ can be misleading unless it is clear what the term means for a specific purpose. The IAASB has a definition of fraud for the purpose of the auditor’s work on the financial statements, but some of the other terms or concepts associated with different definitions and uses of the term fraud may result in different expectations about what the auditor is considering when undertaking procedures on fraud.
61. In considering whether changes to the IAASB’s definition may be warranted, it is important to consider and understand the different terms that could be included, and that could be relevant to an audit of financial statements.
62. In considering frauds that could be perpetrated by employees of an entity (which would be the focus of the financial statement audit) and taking into account the areas considered by the Report of Nations Global Study referenced above, further consideration could be given to including bribery or corruption in the definition of fraud. While the definitions or descriptions of terms vary considerably depending on the source of information or jurisdiction where the acts are performed, the below provides general descriptions associated with each of the terms for purposes of discussion and consideration of a way forward.
- (a) *Corruption* is often associated with dishonest conduct by people in positions of power or authority. This may involve bribery, conflicts of interest, embezzlement, extortion or other activities used to acquire illicit benefit or abuse power for gain.
 - (b) *Bribery* is often associated with offering, giving, receiving or soliciting any item of value to influence the actions of another person (e.g., a public official or other person with influence).
63. While it may be interpreted based on the general definition of fraud in ISA 240 that bribery or corruption are types of fraud (i.e., these can be intentional acts involving the use of deception to obtain unjust or illegal advantage), bribery and corruption have not been explicitly included in the scope of the auditor’s responsibilities related to fraud.
64. Other concepts relating to fraud, such as embezzlement and theft, may also be considered. However, these have already been contemplated in ISA 240 and would likely be subsets of the two categories of fraud recognized in ISA 240 (fraudulent financial reporting or misappropriation of assets). For example, the current application material in paragraph A5 of ISA 240 notes that theft and embezzlement are ways to accomplish misappropriation of assets. The application material for ISA 250 (Revised), paragraph A6, describes that money-laundering may be a type of non-compliance with laws and regulations. Consideration may be given towards evaluating the current application material in ISA 240 and ISA 250 (Revised) and identify if there is a need to expand the application material or issue non-authoritative support materials on how some of these specific concepts relate to fraud in the context of a financial statement audit.

Working Group Deliberations

65. The WG considered whether the definition of fraud for purposes of a financial statement audit should be revised or not, and if so, what needed to change.
66. Making changes to the definition of fraud could result in unintended consequences, including the perception that the auditor’s responsibilities on fraud in an audit of financial statements have changed. The WG noted it is difficult to predict all possible unintended consequences of including other concepts, such as bribery and corruption, in the scope of the definition. There are varying

definitions of bribery and corruption which are interpreted differently across multiple jurisdictions, which adds to the complexity of bringing these concepts explicitly into the scope of the audit.

67. The WG did not favor an alternative to expand the definition of fraud to explicitly include concepts of bribery and corruption and did not believe that there was a strong call for this.
68. Transparency in financial reporting can be impaired by bribery and corruption (for example, a corrupt employee who causes employers to overpay for goods and services in which the employees have a conflict of interest). However, this might not necessarily overlap directly with fraudulent financial reporting or misappropriation of assets. Therefore, explicitly requiring focus on bribery and corruption may increase the scope of the financial statement audit significantly. It may be difficult to design audit procedures to obtain sufficient appropriate audit evidence in this regard due to the often-concealed nature of bribery and corruption. It may also result in significantly increased costs on all audits without proportionate benefit.
69. Although WG members did not believe that changes to the definition are needed, it was recognized that more was needed to help clarify what the definition encompasses for purposes of a financial statement audit as this could be contributing to the expectation gap. WG members therefore favored alternatives to provide application material or non-authoritative guidance to clarify how other concepts often associated with fraud (including bribery and corruption) interact with the concept of fraud for purposes of a financial statement audit, noting the following:
 - (a) While they do not always overlap, corruption, bribery or other concepts of wrongdoing may result in fraud that takes the form of fraudulent financial reporting or misappropriation of assets. In that regard, it may be considered that the two categories of fraud currently described in the extant requirements are sufficient and appropriate for the current environment.
 - (b) Clarification of how these concepts overlap in the application material or in non-authoritative guidance may be beneficial so that auditors are clear on the scope of the requirements for the purpose of an audit. For example, application material or non-authoritative guidance may be developed to explain that while bribery and corruption are not explicitly included in the definition, corruption and bribery can lead to fraudulent financial reporting or misappropriation of assets and those are within the scope of the auditor's responsibilities.
 - (c) Further, if corruption and bribery occur but have no material impact on the financial statements, if the auditor becomes aware of those activities, they should assess the impact on their risk assessment and consider the requirements in ISA 250 (Revised) about non-compliance with laws and regulations.
70. More broadly, it was also recognized that more is needed to help others in the financial reporting ecosystem understand what the responsibilities of the auditor are for fraud in a financial statement audit. An aspect of this 'education' relates to the definition of fraud in the financial statements. Therefore, any further 'education' should also include matters related to the definition of fraud and how other concepts that are commonly associated with fraud relate to the definition. Such efforts could also be seen to contribute to narrowing the expectation gap.

Possible Action #3:

I	R	A	G	E	O	N
		✓	✓	✓		

Consideration of the Definition of Fraud

The WG does not recommend expanding the definition of fraud to include other concepts such as bribery or corruption (or any other fraud related concepts). The concepts of bribery and corruption are very important to the public interest. However, the concepts have widespread interpretations across jurisdictions and introducing these concepts into ISA 240 may significantly increase the scope of the financial statement audit. Further, if acts of bribery and corruption lead to activities that overlap with the current concepts discussed in ISA 240 (misappropriation of assets or fraudulent financial reporting), they are already included within the current scope of the extant requirements. If not, and if the auditor identifies or suspects bribery or corrupt acts during their financial statement audit, the auditor should be considering the impact to their risk assessment as well as the requirements in ISA 250 (Revised).

From the WG's discussion, the WG recommends one of the following two options (for Board discussion):

- (a) Option 1: Enhance the application material to clarify how other concepts often associated with fraud (including bribery and corruption) interact with the concept of fraud for purposes of a financial statement audit.
- (b) Option 2: Issue non-authoritative guidance to clarify how other concepts often associated with fraud (including bribery and corruption) interact with the concept of fraud for purposes of a financial statement audit.

The WG also recommends efforts by the IAASB to help educate others in the financial reporting ecosystem about the responsibilities of the auditor for fraud in a financial statement audit (including what the definition of fraud encompasses).

D. Suspicious Mindset

71. For further details of the DP responses received about this theme, see NVivo reports provided in [Agenda Items 3-A.5 and 3-A.6](#) for the April 2021 IAASB meeting.

What the issue is:

Notwithstanding that the IAASB agreed to not further pursue the concept of 'suspicious mindset' more broadly in ISA 240, it was agreed to further explore whether the concept needed to be further considered for use in ISA 240 in limited circumstances.

What the Board is being asked:

Whether the concept of a suspicious mindset should be introduced in ISA 240 in limited or specific circumstances (and what those are).

Background for the Working Group's Deliberations

Input from DP Respondents and Other Information-Gathering Activities

72. For the April 2021 IAASB meeting as part of Agenda Item 3-A, the WG recommended not to further pursue the concept of a “suspicious mindset” more broadly in the ISAs, but rather to make changes within the ISAs to enhance the auditor’s considerations around professional skepticism.
73. Respondents to the DP, including Monitoring Group members, did not support broadly expanding the requirements to include the concept of a ‘suspicious mindset’ because:
- (a) It was unclear how a ‘suspicious mindset’ would contribute to enhanced fraud identification or add value when planning and performing an audit. It was highlighted by a Monitoring Group member that the difference between a suspicious mindset and a skeptical one is not adequately explained, and it is therefore not clear that this would be a helpful or necessary distinction.
 - (b) It may be a source of confusion and cause translation issues.
 - (c) The practical challenges and inherent limitations auditors are facing would not necessarily be addressed by introducing a new term.
 - (d) There may be unintended consequences of introducing a new term that could further widen the expectation gap and may have unintended consequences such as causing a disproportionate amount of audit effort in areas that did not warrant that focus. It was noted that moving to a concept where the auditor started from a base of suspicion (or presumptive doubt) could move the financial statement audit toward that of a forensic audit and may then not be timely or cost-effective.
 - (e) Professional skepticism is a universally accepted term that is used in audit and is adequate and appropriate to describe the quality that auditors must possess to be able to respond competently to the risks of fraud.
 - (f) It may damage the auditor-client relationship.
74. Respondents to the DP who were supportive of introducing a suspicious mindset *on all audits* did not necessarily support using the new concept broadly, but rather:
- (a) Applying the concept as the risk and materiality of the underlying balances and assertions being considered increased – i.e., enhanced procedures would be more extensive for high risk and material items, and less extensive for low risk and non-material items.
 - (b) Suggested it should be used together with professional skepticism, with sufficient clarity provided as to when there is merit for suspicion.
 - (c) Explained that it should only be used for identified fraud risks, with a focus on the authenticity and reliability of audit evidence for these fraud risks.
75. On balance the Board agreed with the WG (in April 2021) that there was not sufficient evidence to warrant further consideration of introducing the concept of ‘suspicious mindset’ broadly in ISA 240.
76. However, some Board members encouraged consideration of more targeted changes to introduce the concept of ‘suspicious mindset’ in specific circumstances (the Board had mixed views on this). Respondents to the DP who supported including the concept of a ‘suspicious mindset’ only in some

circumstances set out different circumstances where the concept of ‘suspicious mindset’ may be helpful, including:

- (a) For listed entities, and public interest entities (PIE) in those jurisdictions where PIEs are defined.
 - (b) When the nature and circumstances of the entity warrant it, such as when there have been previous suspicions or where there have been suspicious behaviors of executives.
 - (c) Where contradictory audit evidence or information has been obtained and (or) the auditor has doubts about the authenticity of documents.
 - (d) For certain elements of the audit. For example, during the engagement team discussion, the team may in effect apply a suspicious mindset when considering how management could perpetrate fraud.
 - (e) If the auditor identifies or suspects fraud. For example, if an auditor received contradictory information or documents that do not seem to be authentic, the auditor should be alert to a higher level.
77. During the Expectation Gap Roundtable, there was encouragement by some for a move towards a more suspicious or doubtful mindset as opposed to a neutral mindset. However, other participants cautioned the need to also consider how this may impact the auditor-client relationship and did not encourage introduction of a new concept in light of existing concepts used by the IAASB and IESBA.

Enhancements to the Japanese Fraud Standard

78. For listed entities and certain unlisted entities, Japan introduced a separate auditing standard, “*Standard to Address Risks of Fraud in an Audit*” (Japanese fraud standard)¹¹ in 2013 to respond to recent cases involving fraud in Japan at that time.
79. The new standard introduced requirements to make procedures more robust when there is a suspicion of a material misstatement due to fraud. In the Japanese Fraud Standard, the auditor is required to exercise increased professional skepticism in determining whether there is any suspicion of a material misstatement due to fraud and in performing the audit procedures to address such a suspicion. If the auditor identifies any circumstances that indicate the possibility of a material misstatement due to fraud during the audit, described as examples in Appendix 2 of the Japanese Fraud Standard, the auditor shall make inquiries of, and ask for explanations from, management and perform additional audit procedures in order to determine whether there is a suspicion of a material misstatement due to fraud.
80. When the auditor has determined that management’s explanations, together with the audit evidence obtained relevant thereto, are not considered reasonable in relation to a certain circumstance that indicates the possibility of a material misstatement due to fraud, or if the auditor is unable to obtain sufficient appropriate audit evidence for the assessed risk of fraud, even after performing additional audit procedures that the auditor determined necessary as a result of performing the audit procedure

¹¹ The following two basic concepts underlie the Japanese fraud standard: (1) the standard is not intended to change the purpose of the financial statement audit nor intended to expose fraud, and (2) the standard is not intended to uniformly require additional specified audit procedures to respond to risks of fraud in all financial statement audits. The Japanese fraud standard is based on the concept of a risk-based approach. Further details of the basic concepts underlying the Japanese fraud standard can be found [here](#).

originally designed in response to the assessed risk of fraud, the auditor shall treat it as a suspicion of a material misstatement due to fraud. When the auditor has concluded not to treat a circumstance as a suspicion of a material misstatement due to fraud, the auditor shall include in the audit documentation the conclusion and the rationale for that conclusion.

81. Requirements for auditors when an auditor concluded that a “suspicion of a material misstatement due to fraud” exists include:
- Modifying the audit plan to include audit procedures that are specifically responsive to the types of possible fraud (including sufficient investigation in response to such suspicion, in order to obtain sufficient appropriate audit evidence).
 - Requiring an enhanced engagement quality control review, in regard to the auditor’s responses to the “suspicion of a material misstatement due to fraud.”
 - Not expressing an audit opinion until the enhanced engagement quality control review (EQCR) is completed.

Current Requirements in the ISAs

82. When there is a heightened risk of fraud, under the extant requirements the auditor should consider this in their risk assessment procedures and in developing responses to the assessed risks.¹² ISA 330 requires the nature, timing and extent of audit procedures to be responsive to the assessed risks of material misstatement,¹³ and therefore the auditor should already be considering whether enhanced audit procedures are necessary in response to the assessed risks where these arise from fraud.

Working Group Deliberations

83. The WG considered various alternatives to address whether a suspicious mindset should be introduced in certain circumstances or certain areas of the audit.
84. The WG generally did not favor alternatives to enhance requirements to incorporate a suspicious mindset. They noted that:
- (a) It is important that auditors not be biased in a particular direction (i.e., presumption of guilt) when performing their audit.
 - (b) While incorporating elements of a suspicious mindset may contribute to more thorough audit procedures, the costs associated with requiring a suspicious mindset may outweigh the benefits obtained. In addition, introducing and defining a new ‘mindset concept’ may add confusion and complexity.
 - (c) The current concept of professional skepticism could rather be enhanced and emphasized.
85. The WG noted that the engagement team discussion may include a more “suspicious” mindset than other areas of the audit as the team discusses possible ways that management or others could commit fraud. However, WG members did not consider it necessary to introduce a new mindset concept.

¹² ISA 240, paragraphs A38 to A41 set out how the auditor can develop audit procedures responsive to assessed risks of material misstatement arising from fraud at the assertion level.

¹³ ISA 330, *The Auditor’s Responses to Assessed Risks*, paragraph 6

86. The WG agreed that it is not necessary to start from a suspicious mindset but noted there are certain circumstances where the auditor must clearly demonstrate their exercise of professional skepticism through more robust audit procedures to respond appropriately to increased risks of fraud (e.g., when evidence received is insufficient or inconsistent or where questionable behaviors are noted of management).
87. The WG preferred an alternative not to pursue the introduction of a suspicious mindset, but rather supported enhancing and clarifying the application of professional skepticism in fraud-related procedures to help illustrate how the mindset should be applied in practice, including when fraud is identified or suspected or when entities are determined to be high risk. In addition, non-authoritative guidance could be developed to illustrate the 'ramp up' of procedures when a fraud is identified or suspected and to give some practical examples of professional skepticism in such circumstances.

Possible Action #4:	I	R	A	G	E	O	N
Introducing a Suspicious Mindset in Certain Circumstances							✓
The WG does not recommend introducing the concept of a “suspicious mindset” in the ISAs.							
Enhancements to Professional Skepticism	I	R	A	G	E	O	N
Rather, the WG recommends:		✓	✓	✓			
(a) Enhancing and emphasizing the requirements and application material on the current concept of professional skepticism. In addition, non-authoritative guidance could be developed to illustrate the 'ramp up' of procedures when a fraud is identified or suspected and to give some practical examples of professional skepticism in such circumstances.							
(b) Collaborating with other IAASB workstreams, such as the Professional Skepticism Working Group and other active projects where professional skepticism is being considered (e.g., Audit Evidence, Going Concern) in developing possible enhancements (requirements or application material) or non-authoritative guidance related to professional skepticism.							

E. Rebuttable Presumption of Risks of Fraud in Revenue Recognition

88. For further details of the DP responses received on this theme, see NVivo report provided in [Agenda Item 3-A.3](#) of the April 2021 IAASB meeting.

What the issue is:

There were mixed views about how the issues and challenges identified on the rebuttable presumption of risks of fraud in revenue recognition could be addressed, which included:

- (i) Whether the rebuttable presumption of risks of fraud need to be expanded beyond revenue recognition.
- (ii) Whether the rebuttable presumption of risks of fraud in revenue recognition needed to be removed.

In addition, respondents noted clarity is needed about when and how to rebut the presumption of risks of fraud in revenue recognition.

What the Board is being asked:

For views about whether standard-setting or other actions are needed with respect to the rebuttable presumption of risks of fraud in revenue recognition.

Background for the Working Group's Deliberations

Monitoring Group Member DP Responses:

89. A Monitoring Group member encouraged the IAASB to explore and consider addressing how the rebuttable presumption of risks of fraud in revenue recognition is understood in practice (i.e., whether there is sufficient guidance about when and how to rebut the presumption of risks of fraud in revenue recognition).

Input from Other DP Respondents and Other Information-Gathering Activities

Expanding the Rebuttable Presumption of Risks of Fraud Beyond Revenue Recognition

90. Other respondents (a regulator and other professional organizations) suggested considering whether it remains appropriate to specify a rebuttable presumption of risks of fraud solely for revenue recognition. The focus on revenue recognition may result in insufficient attention given to the many other ways fraud may be perpetrated. It was noted that there are also other areas that are susceptible to material misstatement due to fraud, for example, inventory, property valuations and expenditures (which in light of the COVID-19 pandemic may be more susceptible to fraud). Expenditures may be more relevant in the case of LCEs where for example, targeting reduced tax liability is more common, particularly in owner-managed businesses. Similar views were raised by stakeholders during the IAASB's roundtable discussion on fraud and going concern for LCEs.

Removing the Presumption of Risks of Fraud in Revenue Recognition

91. A respondent (a national standard setter) questioned whether the presumption of risks of fraud in revenue recognition continues to be appropriate. It was noted that auditors are spending an undue amount of time designing and performing fraud procedures in areas where for many entities the risks of fraud are not high because of the nature of the entities' business. Focusing time on this area when it is not always relevant to an audit leads to inefficiencies. Based on this feedback, it was noted that the IAASB could perform additional research to determine whether the presumption of risks of fraud in revenue continues to be appropriate or should be removed.
92. In their publication "CPAB Exchange: An auditor's responsibilities related to fraud in an audit of financial statements", CPAB notes that the presumption of fraud risk in revenue recognition was rebutted in a quarter of audit files they reviewed, which they expressed was higher than expected based on the risk profiles of the audits selected for inspection.

Clarifying When and How to Rebut the Presumption of Risks of Fraud in Revenue Recognition

93. Respondents noted clarity is needed around when and how it may be appropriate to rebut the presumption of risks of fraud in revenue recognition. For example, it was noted that providing application material with factors to consider in deciding when to rebut the presumption will help build consistency in the application of the rebuttable presumption. It was also highlighted that the standard

could also provide more and better examples of when it may be appropriate to rebut this presumption. It was observed the current example in paragraph A31 of ISA 240 is simplistic.

94. ISA 240 requires auditors to evaluate which types of revenue, revenue transactions or assertions give rise to the presumed risks of fraud in revenue recognition. A respondent observed auditors limit their attribution of the presumed risk of fraud to the revenue cut-off assertion without evidencing a critical evaluation of whether the presumed risk of fraud also applies to other assertions or revenue transactions. It was encouraged that the IAASB develop more application guidance to help improve audit quality in this area.
95. During the May 2020 NSS Meeting and the Clarity Post-Implementation Monitoring Project, participants and respondents noted there is inconsistency around the interpretation of when it is appropriate to rebut the presumption of risks fraud in revenue recognition. It was also noted that further clarity is needed around whether the rebuttal should address all assertions.
96. Respondents to the LCE Discussion Paper noted that the current examples in the standard for the rebuttal of the presumption of fraud risks in revenue recognition are restrictive and may need enhancement for the context of LCEs.

Current Requirements and Application Material

97. The table in **Appendix A** describes the extant requirements and application material for the rebuttable presumption of risks of fraud in revenue recognition in ISA 240.

Working Group Deliberations

98. The WG considered the alternatives (i.e., expand, remove or clarify) to address issues and challenges related to the rebuttable presumption of risks of fraud in revenue recognition, recognizing there were mixed views from DP respondents in this area.
99. On balance and in consideration of the expectations on auditors in the current environment, the WG did not support removing the rebuttable presumption for fraud in revenue recognition. It was noted that the auditor's procedures in relation to fraud continues to be a focus area for many in the financial reporting ecosystem, and revenue continues to be an area highly susceptible to fraud. Therefore, to remove this requirement would not be in the public interest.
100. The WG considered expanding the rebuttable presumption of risks of fraud to areas beyond revenue recognition to recognize that there may be a focus on revenue (whether warranted or not) while there could be other areas that could be of equal, or higher risk, such as cash, asset impairment, provisions and off-balance sheet arrangements. The WG agreed that there was not a strong enough call to expand the requirement as it may lead to work that may not be needed in many cases. However, the WG agreed that the application material could be enhanced to highlight that there could be other areas of higher risk of fraud (in addition to revenue recognition) where the auditor may want to focus their attention.
101. The WG noted the strong call from DP respondents and roundtable participants for additional application material or non-authoritative guidance clarifying when it may be appropriate to rebut the presumption of risks of fraud in revenue recognition, and the importance of evaluating fraud risk for all significant revenue streams within the entity and how these evaluations should be performed and documented. It was also suggested to enhance application material in ISA 240 for public sector

considerations given that expenditures (rather than revenue) are more likely the focus for public sector audits.

Possible Action #5:	I	R	A	G	E	O	N
Addressing the Presumed Risks of Fraud in Revenue Recognition			✓	✓			
<p>The WG does not recommend expanding or removing the rebuttable presumption of risks of fraud in revenue recognition.</p> <p>Rather, the WG recommends enhancing the application material in ISA 240 to:</p> <ul style="list-style-type: none"> (a) Highlight other areas that may be susceptible to material misstatement due to fraud, for example, cash, asset impairment, provisions and off-balance sheet arrangements. (b) Clarify when it may be appropriate to rebut the presumption of risks of fraud in revenue recognition, and how this can be done (i.e., what needs to be demonstrated to explain why it was rebutted). (c) Public sector considerations (i.e., to explain how this requirement applies in public sector audits where the focus is not on revenue recognition generally). <p>The WG also recommends development of non-authoritative guidance to clarify considerations related to the rebuttable presumption of fraud risk in revenue recognition specific to certain industries.</p>							

F. External Confirmations

102. For further details of the DP responses received on this theme, see NVivo report provided in [Agenda Item 3-A.3](#) of the April 2021 IAASB meeting.

What the issue is:

Although there was not a strong call for changes on external confirmations in relation to fraud, this is an area of focus in the current environment by many in the financial reporting ecosystem. The WG had the view that further exploration was needed to determine whether changes to the ISAs should be proposed in the project proposal for external confirmations.

What the Board is being asked:

Whether the IAASB should pursue changes to the ISAs for issues and challenges relating to external confirmations, or whether another, or no, action is warranted.

Monitoring Group Member DP Responses:

103. A Monitoring Group member supportive of enhancements with respect to external confirmations suggested¹⁴:
- (a) Developing guidance on how to assess the reliability of external confirmations received having regard to the possibility of fraud.

¹⁴ A Monitoring Group member provided this comment in response to the DP and also in response to the IAASB Consultation on Proposed Strategy for 2020-2023 and Work Plan for 2020-2021.

- (b) Enhancing requirements in ISA 505 on how to respond where there is no reply to a confirmation request.
- (c) Strengthening ISA 505 to adapt to the complexities and technological advances that exist in today's global business environment (e.g., paper versus electronic confirmation) and considering whether further guidance is needed in evaluating evidence received from external sources.

Input from Other DP Respondents and Other Information-Gathering Activities

Emphasizing in ISA 240 that Auditors Need to be More Skeptical about the Reliability of Responses to Confirmation Requests

104. Other respondents (audit oversight bodies) noted that paragraph 14 of ISA 240 requires that, unless the auditor has a reason to believe the contrary, the auditor may accept records and documents as genuine and that if conditions that may suggest it is not genuine are identified, the auditor shall investigate further. It was encouraged that the IAASB emphasize the need for auditors to be more skeptical when evaluating audit evidence (including external confirmations) of crucial importance for obtaining reasonable assurance on specific issues.

Stronger Expectations to Obtain External Confirmation When Responding to Heightened Fraud Risks

105. A respondent (a firm) also encouraged the IAASB to consider expanding the role of external confirmations in addressing fraud risks. The respondent noted ISA 240 only provides a brief acknowledgement through an example that external confirmations may be a response to fraud risk (see paragraph A38 of ISA 240). Application material in ISA 240 could be enhanced, or alternatively, ISA 505 could be enhanced, to set stronger expectations for obtaining external confirmations when responding to fraud risks (e.g., existence of cash or other assets with higher assessed risks of material misstatement).

Current Requirements and Application Material

106. The table in **Appendix A** describes the extant requirements and application material addressing external confirmations in ISA 240 and ISA 505.

Working Group Deliberations

107. The WG considered whether changes are needed to address issues and challenges that had been raised on external confirmations, recognizing there were very few comments from DP respondents.
108. WG members noted external confirmations would also be relevant to the audit evidence project and highlighted the importance of coordinating with the Audit Evidence Task Force about work they may be doing on the matters being raised as issues and challenges related to external confirmations. The WG can then determine whether there are remaining aspects of external confirmations that should be addressed in the fraud project.
109. WG members supported exploring enhancements to ISA 505 addressing non-responses, as this is an issue that should be addressed in the fraud project.
110. WG members supported addressing the complexities and technological advances that exist in today's global business environment and how external confirmations are performed. It was observed that

audit firms are modernizing their confirmation processes, while their clients are also modernizing how they respond to confirmations (e.g., by using centralized services, or electronic platforms to respond). It was also suggested exploring modernization of the requirements for negative confirmations, in particular to reflect current practice. The WG noted modernization could possibly be done through non-authoritative guidance or application material.

111. The WG also supported explaining in the application material in ISA 240 how external confirmations can be helpful when responding to heightened risks of fraud (e.g., cash, revenues and the terms and conditions of customer contracts).

Possible Action #6:		I	R	A	G	E	O	N
Addressing External Confirmations				✓	✓			
The WG recommends:								
(a) Coordinating with the Audit Evidence Task Force as to which aspects of the issues raised by respondents may be addressed in the scope of that project and which aspects are in scope for the fraud project, particularly about the reliability of responses to confirmation requests.								
(b) Possible enhancements to modernize the application material in ISA 240 for developments on technology, including technology used in practice for external confirmations.								
(c) Exploring whether enhanced application material in ISA 240 or non-authoritative guidance is needed to address:								
(i) Clarification of auditor procedures when there are non-responses;								
(ii) Emphasis of the usefulness of external confirmations as an audit procedure when there is a heightened risk of fraud; and								
(iii) Considerations around modernizing negative confirmations in line with current practice.								

Summary of Relevant Extant Requirements and Application Material

I. Responsibilities of the Auditor and Inherent Limitations in an Audit of Financial Statements (Issues Paper, Section II(A))

ISA Reference and Paragraph	Description
ISA 240, paragraph 5	“An auditor conducting an audit in accordance with ISAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. Owing to the inherent limitations of an audit, 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.”
ISA 240, paragraph 6	“As described in ISA 200, the potential effects of inherent limitations are particularly significant in the case of misstatement resulting from fraud. The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is 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. While the auditor may be able to identify potential opportunities for fraud to perpetrated, it is difficult for the auditor to determine whether misstatements in judgment areas such as accounting estimates are caused by fraud or error.”
ISA 200, paragraph 5	“As the basis for the auditor’s opinion, ISAs require the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high level of assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (that is, the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. However, reasonable assurance is not an absolute level of assurance because there are inherent limitations of an audit which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor’s opinion being persuasive rather than conclusive.”

ISA 200, paragraph A47	<p>“The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor’s opinion being persuasive rather than conclusive. The limitations of an audit arise from:</p> <ul style="list-style-type: none"> • The nature of financial reporting; • The nature of the audit procedure; and • The need for the audit to be conducted within a reasonable period of time and at a reasonable cost.”
ISA 200, paragraph A53	<p>“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:</p> <ul style="list-style-type: none"> • Fraud, particularly fraud involving senior management or collusion. See ISA 240 for further discussion.”
ISA 200, paragraph A54	<p>“Because of the inherent limitations of an audit, there is 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 ISAs. Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with the ISAs. However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less than persuasive audit evidence. Whether the auditor has performed an audit in accordance with ISAs is determined by the audit procedures performed in the circumstances, the sufficiency and appropriateness of the audit evidence obtained as a result thereof and the suitability of the auditor’s report based on an evaluation of that evidence in light of the overall objectives of the auditor.”</p>

II. Use of Forensic Specialists (Issues Paper, Section II(B))

ISA Reference and Paragraph	Description
ISA 240, paragraph 30(a)	<p>“In determining overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level, the auditor shall:</p> <p>(a) Assign and supervise personnel taking account of the knowledge, skill and ability of the individuals to be given significant engagement responsibilities and the auditor’s assessment of the risks of material misstatement due to fraud for the engagement”.</p>
ISA 240, paragraph A35	<p>“The auditor may respond to identified risks of material misstatement due to fraud by, for example, assigning additional individuals with specialized skill</p>

	and knowledge, such as forensic and IT experts, or by assigning more experienced individuals to the engagement.”
ISA 220 (Revised) ¹⁵ , paragraph 14	<p>“The engagement partner shall be satisfied that the engagement team, and any auditor’s experts who are not part of the engagement team, collectively have the appropriate competence and capabilities to:</p> <ul style="list-style-type: none"> (a) Perform the audit engagement in accordance with professional standards and applicable legal and regulatory requirements; and (b) Enable an auditor’s report that is appropriate in the circumstances to be issued.”
ISA 220 (Revised) ¹⁶ , paragraphs 25-26 <i>(Effective for audits of financial statements for periods beginning on or after December 15, 2022)</i>	<p>“The engagement partner shall determine that sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team in a timely manner, taking into account the nature and circumstances of the audit engagement, the firm’s policies or procedures, and any changes that may arise during the engagement.</p> <p>The engagement partner shall determine that members of the engagement team and any auditor’s external experts and internal auditors who provide direct assistance who are not part of the engagement team, collectively have the appropriate competence and capabilities, including sufficient time, to perform the audit engagement.”</p>
ISA 300 ¹⁷ , paragraph 8(e)	<p>“In establishing the overall audit strategy, the auditor shall:</p> <p>...</p> <ul style="list-style-type: none"> (e) Ascertain the nature, timing, and extent of resources necessary to perform the engagement”.
ISA 300, paragraph A8	<p>“The process of establishing the overall audit strategy assists the auditor to determine, subject to the completion of the auditor’s risk assessment procedure, such matters as:</p> <ul style="list-style-type: none"> • The resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high-risk areas or the involvement of experts on complex matters”.
ISA 330 ¹⁸ , paragraph 5	<p>“The auditor shall design and implement overall responses to address the assessed risks of material misstatement at the financial statement level.”</p>
ISA 330, paragraph A1	<p>“Overall responses to address the assessed risks of material misstatement at the financial statement level may include:</p> <p>...</p> <ul style="list-style-type: none"> • Assigning more experienced staff or those with special skills or using experts.”

¹⁵ ISA 220, *Quality Control for an Audit of Financial Statements*

¹⁶ ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*

¹⁷ ISA 300, *Planning an Audit of Financial Statements*

¹⁸ ISA 330, *The Auditor’s Responses to Assessed Risks*

III. Definition of Fraud (Issues Paper, Section II(C))

ISA Reference and Paragraph	Description
ISA 240, paragraph 3	“Although fraud is a broad legal concept, for purposes of the ISAs, the auditor is concerned with fraud that causes a material misstatement in the financial statements. Two types of intentional misstatements are relevant to the auditor – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets. Although the auditor may suspect or, in rare cases, identify the occurrence of fraud, the auditor does not make legal determinations of whether fraud has actually occurred.”
ISA 240, paragraph 12(a)	“For purposes of the ISAs, the following terms have the meanings attributed below: (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.”
ISA 240, paragraphs A1-A5	The paragraphs referenced to the left provide application and other explanatory material on the characteristics of fraud, including examples of fraudulent financial reporting and misappropriation of assets.
ISA 250 (Revised), paragraph 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: <ul style="list-style-type: none"> • Fraud, corruption and bribery. • Money laundering, terrorist financing and proceeds of crime. ”

**IV. Rebuttable Presumption of Risks of Fraud in Revenue Recognition
(Issues Paper, Section II(E))**

ISA Reference and Paragraph	Description
ISA 240, paragraph 27	<p>Identification and Assessment of the Risks of Material Misstatement Due to Fraud</p> <p>...</p> <p>“When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks. Paragraph 48 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.”</p>
ISA 240, paragraph 48	<p>Documentation</p> <p>...</p> <p>“If the auditor has concluded that the presumption that there is a risk of material misstatement due to fraud related to revenue recognition is not applicable in the circumstances of the engagement, the auditor shall include in the audit documentation the reasons for that conclusion.”</p>
ISA 240, paragraphs A29-A31	The paragraphs referenced to the left provide application and other explanatory material on the risks of fraud in revenue recognition.

V. External Confirmations (Issues Paper, Section II(F))

ISA Reference and Paragraph	Description
ISA 240, paragraph 14	<p>Professional Skepticism</p> <p>...</p> <p>“Unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine. If conditions identified during the audit cause the auditor to believe that a 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.”</p>
ISA 240, paragraph A10	<p>Professional Skepticism</p> <p>...</p> <p>“An audit performed in accordance with ISAs rarely involves the authentication of documents, nor is the auditor trained as or expected to be</p>

	<p>an expert in such authentication. However, when the auditor identifies conditions that cause the auditor to believe that a document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, possible procedures to investigate further may include:</p> <ul style="list-style-type: none"> • Confirming directly with the third party. • Using the work of an expert to assess the document's authenticity."
ISA 505, paragraphs 10-11	<p><i>Reliability of Responses to Confirmation Requests</i></p> <p>"If the auditor identifies factors that give rise to doubts about the reliability of the response to a confirmation request, the auditor shall obtain further audit evidence to resolve those doubts."</p> <p>"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 the risk of fraud, and on the related nature, timing and extent of other audit procedures."</p>
ISA 505, paragraphs A11-A17	<p>The paragraphs referenced to the left provide application and other explanatory material on:</p> <ul style="list-style-type: none"> • The reliability of responses to confirmation requests; and • Unreliable responses.
ISA 505, paragraph 12	<p><i>Non-Responses</i></p> <p>"In the case of each non-response, the auditor shall perform alternative audit procedures to obtain relevant and reliable audit evidence."</p>
ISA 505, paragraphs A18-A19	<p>The paragraphs referenced to the left provide application and other explanatory material on non-responses.</p>
ISA 505, paragraph 15	<p>"Negative confirmations provide less persuasive audit evidence than positive confirmations. Accordingly, the auditor shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless all of the following are present:</p> <ul style="list-style-type: none"> (a) The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion; (b) The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous account balances, transactions or conditions; (c) A very low exception rate is expected; and (d) The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests."

ISA 505, paragraph A23	The paragraph referenced to the left provide application and other explanatory material on negative confirmations.
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APPENDIX B

Update on Activities since April 2021 IAASB Meeting

I. Root Cause Analysis Efforts

1. Since the April 2021 IAASB meeting, efforts have commenced to better understand the root causes of recent fraud cases. IAASB members and staff have contacted police and crime commission representatives, fraud investigators, regulators, and audit firms and are currently planning meetings to gather information on the following topics in relation to recent fraud cases:
 - (a) How frauds are being executed and concealed;
 - (b) Whether frauds involved related parties;
 - (c) What financial accounts were impacted;
 - (d) How the frauds were eventually detected, and by who;
 - (e) Whether and to what extent technology was involved;
 - (f) Whether material frauds started small but grew over time (and if so, what length of time), or whether the frauds were material from the start; and
 - (g) Any other details to help better understand the nature of the frauds and the root causes of the issues as to why they were not prevented or detected earlier.
2. Further, the IAASB plans to discuss supplemental topics with audit firms, such as:
 - (a) Whether there have been any changes to the audit firm's methodology or training in relation to fraud in recent years;
 - (b) Whether they have any views as to the root causes of perceived audit failures in relation to fraud; and
 - (c) To what extent forensic specialists are used and in what circumstances.

II. Additional Outreach Meetings

3. Since the April 2021 IAASB meeting, the following additional outreach was performed.

Outreach Group	Date(s) Held	Details
UK FRC	April 20, 2021	The UK FRC provided IAASB staff with an update on the responses to their consultation on proposed revisions to ISA (UK) 240.
Canadian Public Accountability Board (CPAB)	April 23, 2021	An IAASB member and IAASB staff provided an update of high-level observations from the DP. CPAB provided an update of activities performed in their jurisdiction.
Chartered Accountants Australia and New Zealand	April 27, 2021	Update on the research paper being prepared by ACCA, CA ANZ and CPA Canada. Plus discussion on the role of professional bodies in education and the various roles of the parties across the eco-system.
The Royal Netherlands Institute of Chartered Accountants (NBA)	May 12, 2021	The IAASB was provided with the background and details of an auditor reporting pilot initiative in the Netherlands for increased transparency for fraud and going concern. The initiative is in its early phases and the IAASB will continue to monitor as it progresses.

APPENDIX C

Summary of Possible Actions

Issue/Theme	Standard-Setting - Introduction	Standard-Setting - Requirements	Standard-Setting – App. Material	Non-Authoritative Guidance	Education	Actions for Others	No Further Action Recommended
Introductory Language in ISA 240 About Responsibilities of the Auditor and Inherent Limitations of an Audit	X (ISA 240)		X (ISA 200)		X		
Using Forensic Specialists in an Audit of Financial Statements		X	X				
Definition of Fraud			X¹⁹	X¹⁹			
Suspicious Mindset							X²⁰
Professional Skepticism		X	X	X			
Rebuttable Presumption of Fraud Risk in Revenue Recognition and Related Issues			X	X			
External confirmations			X	X			

¹⁹ The Board is asked for its feedback as to whether application material or non-authoritative guidance is preferred to clarify how other concepts often associated with fraud (including bribery and corruption) interact with the concept of fraud for purposes of a financial statement audit.

²⁰ The WG recommends not pursuing the concept of a suspicious mindset but rather recommends possible actions to enhance and emphasize the existing concept of professional skepticism.

1. Draft Minutes²¹ from the April 2021 IAASB Meeting Fraud in an Audit of Financial Statements

Mrs. Provost provided an overview of feedback received on the Discussion Paper²² and other information-gathering activities on fraud in an audit of financial statements as set out in **Agenda Item 3**.

SUMMARY OF FEEDBACK RECEIVED AND POSSIBLE ACTIONS

Overall, the Board commended the significant amount of feedback gathered by the Fraud Working Group from the fraud-related information-gathering activities that had been undertaken and the responses to the Discussion Paper. In particular, it was highlighted that the work done to analyze academic research in this area was beneficial.

The Board provided feedback on possible actions set out by the Fraud Working Group, which had been developed based on the responses to the Discussion Paper and input from the other information-gathering activities. The Board encouraged the Fraud Working Group to focus on a more holistic approach, including further consideration about how the IAASB's global voice could be used in encouraging action by others, to more effectively address the public interest issues on fraud in an audit of financial statements. While the Board recognized standard-setting as a possible action, the Board acknowledged that addressing the public interest issues on fraud would need to involve a collaborative, multi-stakeholder solution by all participants in the financial reporting ecosystem and could not be achieved solely through standard-setting by the IAASB.

STANDARD-SETTING

The Board noted that any changes to ISA 240²³ should be proportionate and responsive to the feedback received from the fraud information-gathering activities and should only be made if it was considered that they would make an impact. Specific comments and suggestions on standard-setting included the following:

- The Board supported strengthening the auditor's consideration of fraud when identifying and assessing the risks of material misstatement. There was support for the auditor to focus on specific control activities that management had designed and implemented to prevent and detect fraud, as well as strengthening the auditor's considerations around tone at the top and corporate culture. There was also support for possible changes within the standard for the auditor to focus on fraud risk factors specific to the entity and its circumstances.
- The Board supported changes to enhance the auditor's communications with those charged with governance (TCWG) through greater two-way communication throughout the audit engagement (e.g., specific discussion with TCWG about the entity's risks of material misstatement due to fraud, and challenging TCWG to demonstrate how they have addressed such risks).
- The Board considered possibly enhancing ISA 240 to make the auditors considerations around fraud that could occur in related parties stronger. However, it was noted that there is already sufficient

²¹ The draft minutes are still subject to review by the IAASB and further changes may be made arising from that review.

²² 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*

²³ International Standard on Auditing (ISA) 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

material in ISA 550²⁴ addressing fraud risk factors arising from related party relationships and transactions that are relevant to the identification and assessment of the risks of material misstatement due to fraud.

- The Board did not support further pursuing the concept of a “suspicious mindset” but rather possibly enhancing the application of the existing concept of professional skepticism. There were mixed views about further exploring whether the use of a ‘suspicious mindset’ could be incorporated in ISA 240 in limited, specific circumstances, as it may be difficult to establish how to “switch on and off” between a skeptical and suspicious mindset. It was also noted that the standard could be enhanced when fraud is suspected or identified and in demonstrating how the auditor applies professional skepticism in such circumstances.
- The Board supported clarifications around journal entry testing. However, there were mixed views about testing journal entries throughout the period given that this may involve a significant increase in the auditor’s work effort (unless appropriate to do so).
- The Board supported modernizing ISA 240 for advancements in technology through describing fraud risks introduced by the use of modern technology as well as the auditor’s use of technology to perform fraud-related procedures. There was also support for working collaboratively with the Technology Working Group to determine if non-authoritative guidance could be used to support the application of ISA 240.
- The Board did not support expanding the scope of the auditor to detect all non-material fraud. However, the Board supported possibly developing non-authoritative guidance to help auditor’s understand what actions are necessary when non-material fraud is identified.
- The Board supported enhancing application material by explaining the types of unpredictability procedures that may be considered in an audit. It was noted that consideration should also be given to how these types of procedures may be applied in audits of less complex entities.
- The Board had mixed views on considering whether additional fraud-related specific documentation requirements are needed. However, it was acknowledged that further consideration of this would be needed once the other changes within the standard had been made as such changes may necessitate new specific documentation requirements.
- The Board had mixed views about requiring analytical procedures at the appropriate level of disaggregation at the planning and closing stages of the audit (unless necessary).
- The Board supported enhancing the linkages in ISA 240 to other ISAs where the relationship between ISA 240 and the relevant other standard was not clear.
- The Board did not support expanding the role of the auditor to detect third-party fraud that is not directly related to a material misstatement in the financial statements. However, the Board supported collaborating with the Technology Working Group to determine if non-authoritative guidance on cybercrime would be useful.

NON-AUTHORITATIVE GUIDANCE

The Board supported further exploring what non-authoritative materials may be needed during the course

²⁴ ISA 550, *Related Parties*

of the project, as well as after changes have been made to ISA 240, as appropriate.

AREAS WHERE FURTHER DISCUSSION NEEDED

The Board broadly agreed with the following matters highlighted in the issues paper that warrant further analysis and consideration by the Fraud Working Group and the Board at the June 2021 and July 2021 IAASB meetings:

- Determining whether, and how, forensic type procedures may be appropriate in an audit.
- Further consideration about whether a change to the definition of fraud is needed.
- Exploring whether to consider requiring more transparency in the auditor's report about the auditor's procedures on fraud.
- Exploring whether changes are needed to the introductory paragraphs of ISA 240 about the inherent limitations of an audit.
- Making the engagement team discussion more robust for the auditor's considerations around fraud.
- Clarifying the relationship between ISA 240 and ISA 250 (Revised).
- Further considering whether the presumed risk of fraud in revenue recognition should be retained, and whether there are other areas of high fraud risk that should be similarly treated.
- Further considering what changes are needed related to procedures when fraud is detected or identified.
- Strengthening requirements about the auditor's considerations for external confirmations.

AREAS WHERE NO FURTHER ACTION RECOMMENDED

The Board broadly did not support enhancing requirements for engagement quality reviews.

The Board did not support further refining the description or developing a definition of the "expectation gap" as described in the Discussion Paper, or further exploring the primary causes of the expectation gap.

OTHER MATTERS AND GENERAL COMMENTS

There was support for the work to be undertaken to better understand how frauds are being committed, including how they are executed and concealed, who is involved, what financial accounts are impacted, and how they are eventually detected (i.e., root-cause analysis), and directly linking such understanding in developing possible actions addressing fraud in an audit of financial statements.

The Board also broadly supported possible actions for ongoing activities to monitor the work of others, outreach, coordination with IESBA and other IAASB workstreams.

IAASB CAG CHAIR'S REMARKS

Mr. Dalkin highlighted the importance of establishing a nexus or connection between the understanding of how frauds are being committed and the possible actions addressing fraud in an audit of financial statements. Mr. Dalkin also cautioned the Board from extending the length of the auditor's report in including more on the auditor's fraud procedures in the auditor's report.

PIOB OBSERVER'S REMARKS

Ms. Stothers recognized the comprehensive input from the fraud information gathering activities and the clear steer by the Board to focus on the possible actions that most effectively address the public interest issues on fraud in an audit of financial statements.

WAY FORWARD

The Fraud Working Group will focus on matters highlighted in the issues paper that warrant further analysis and consideration at the June 2021 and July 2021 IAASB meetings as it progresses its work to develop a project proposal addressing fraud in an audit of financial statements.