

### Fraud in an Audit of Financial Statements –Remaining Specific Issues and Development of a Project Proposal

#### Objectives of Agenda Item

The objectives of this Agenda Item are to:

- (a) Discuss the remaining topics 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 activities.
- (b) Discuss the overarching public interest issues that will be addressed by a project on fraud, and the possible project objectives and broad project scope.

The Board's views on these matters will help inform the Fraud Working Group (WG) in developing a project proposal, which will be presented for discussion at the September 2021 IAASB meeting.

#### Format of the Board Discussion

The WG Chair will walk through the matters in the order of this Agenda Item, following the slides in **Agenda Item 2-A**.

## I. Introduction

1. In progressing the fraud-related topics presented at the April 2021 IAASB meeting, the June 2021 IAASB meeting focused on several topics where mixed views were expressed by respondents to the DP. The remainder of the topics not yet discussed are addressed in this Agenda Item (see **Section II** below).
2. This Agenda Item also discusses the overarching public interest issues to be addressed by a project on fraud, the possible project objectives and broad project scope (see **Section III** below). The culmination of the Board discussions in April, June and July, together with the work performed on root causes, have been combined to identify the public interest issues on fraud in an audit of financial statements.
3. Since the June 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:
    - More transparency in the auditor's report through describing fraud related matters (see **Section II (A)** below);
    - Making the engagement team discussion on fraud considerations more robust (see **Section II (B)** below);

- Clarifying the relationship between ISA 240<sup>1</sup> and ISA 250 (Revised)<sup>2</sup> (see **Section II (C)** below); and
  - Addressing instances when fraud or suspected fraud is identified during the audit (see **Section II (D)** below).
- (b) Options for a possible way forward for each topic in paragraph 3(a).
- (c) Current thinking and preliminary views on the public interest issues of a possible project and related project objectives and broad project scope (see **Section III** below).
4. Staff undertook further root cause analysis of recent frauds, which had been encouraged by several respondents to the DP. This was done in June and July 2021 and the findings therefrom and how the project proposal will incorporate the identified root causes will be presented for discussion at the September 2021 IAASB meeting. For details on the activities to date for this root-cause analysis, refer to **Appendix B**.
5. The following appendices accompany this paper:

<b>Appendix A</b>	Draft Minutes from the June 2021 IAASB Meeting
<b>Appendix B</b>	Update on Activities Since the June 2021 IAASB Meeting
<b>Appendix C</b>	Summary of Extant Requirements and Application Material
<b>Appendix D</b>	Summary of Possible Actions for the Topics for Further Discussion Included in this Agenda Item
<b>Appendix E</b>	Draft Scope for Project Proposal on Fraud

## II. Specific Topics for Discussion

### Matters for IAASB Consideration

1. The IAASB is asked for its views on:
  - (a) Whether the key matters from respondents' comments were appropriately identified on the remaining topics explored in **Section II** of this Agenda Item; and
  - (b) The recommended possible actions for each of the topics to help inform the development of a project proposal.
6. The summarized feedback from DP respondents and input from other information gathering-activities for all topics is available in [Agenda Item 3](#) of the April 2021 IAASB meeting papers.
7. Symbols used to indicate the possible actions for each of the remaining specific issues set out in this Agenda Item:

<sup>1</sup> International Standard on Auditing (ISA) 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

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

Symbol	Description
<b>I</b>	<b>Standard-Setting (Introduction)</b> – New or changed language in the Introduction section of the ISA(s).
<b>R</b>	<b>Standard-Setting (Requirements)</b> – New or changed requirements in the ISA(s).
<b>A</b>	<b>Standard-Setting (Application Material)</b> – Changed or additional application material to clarify or further explain application of relevant requirement.
<b>G</b>	<b>Non-Authoritative Material</b> – Supporting materials and guidance developed outside of the ISAs.
<b>E</b>	<b>Education</b> – Educational initiatives or outreach (where within the remit of the IAASB).
<b>O</b>	<b>Actions for Others</b> – Where an issue or challenge identified does not relate to actions that are within the IAASB's remit but will need efforts from another participant in the financial reporting ecosystem to address it.
<b>N</b>	<b>No further action recommended.</b>

#### A. More Transparency in the Auditor's Report Through Describing Fraud Related Matters

##### *What the issue is:*

There were mixed views from DP respondents, including Monitoring Group members, and participants of other information-gathering activities, on whether or not more transparency is needed in the auditor's report describing fraud related matters.

##### *What the Board is being asked:*

Whether the IAASB should pursue standard-setting to require more transparency in the auditor's report or whether another, or no, action is needed.

8. For further details of the DP responses received on this topic, see NVivo report provided in [Agenda Item 3-A.7](#) for the April 2021 IAASB meeting.

#### Background for the WG's Deliberations

##### *Monitoring Group Member DP Responses*

9. A Monitoring Group member suggested the IAASB assess the costs and benefits of potentially enhancing the reporting by the auditor of how fraud risks have been addressed in the audit, for instance through expanding the auditor's report.
10. Another Monitoring Group member commented that it may be helpful for the auditor to clearly communicate any specific or general limitations in their audit, so that financial statement users understand the likelihood of fraud detection. However, they noted such communication should not be

viewed as an alternative to carrying out appropriate audit procedures. In addition, communication is likely to be less useful if it uses 'boilerplate' wording. They noted that setting out clearly what can be expected from auditors in relation to fraud and going concern should help to limit any expectation gap.

*Input from Other DP Respondents and Other Information-Gathering Activities*

11. There were mixed views from other respondents on whether or not more transparency is needed in the auditor's report about the auditor's work on fraud in an audit of financial statements.

**More Transparency on Fraud in the Auditor's Report Is Needed**

12. Respondents (regulators, audit oversight authorities, national standard setters (NSS), firms and other professional organizations) who supported more transparency on fraud in the auditor's report had varying views about matters to be included in the auditor's report, but broadly agreed it should not be "boilerplate" in nature (i.e., be entity-specific in the context of the audit that was performed).

**More transparency in the auditor's report through describing fraud related matters**

13. There were respondents (regulators, NSS, firms and other professional organizations) who suggested enhancing the auditor's report to require a description of various matters, including:
- (a) The auditor's specific procedures addressing both risks of material misstatement due to fraud and when fraud is identified or suspected, including the results of those procedures.
  - (b) Whether the auditor's procedures included testing of management's controls on their fraud risk identification and assessment (and / or other entity level controls). If not, why not (e.g., if there are no processes in place or the processes are insufficient for testing purposes, that fact should be stated).
  - (c) Actual fraud risks identified and how this compares to the risks identified by management (including context as to the basis for concluding what the fraud risks are).
  - (d) Details of any non-compliance with law or regulation and whether this was investigated by the client or not (and / or if investigations were performed and concluded, details of the conclusions and whether this gave rise to a fraud risk or not, as well as a basis for the conclusion).
  - (e) Details of any open investigations on fraud.
  - (f) Specific limitations, for example, no investigation being performed by management, details of suspicion and if / how this was escalated without investigation / legal interpretation, etc.
  - (g) Details of fraud related matters resolved since the last audit.
14. There were respondents (regulators, audit oversight authorities, firms and member bodies) who suggested a requirement for the auditor to explain the extent to which the audit was considered capable of detecting irregularities in the auditor's report (including fraud), similar to the requirements in ISA (UK) 700 (Revised November 2019)<sup>3</sup> and ISA (UK) 240 (Revised May 2021)<sup>4</sup> and as required

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<sup>3</sup> ISA (UK) 700 (Revised November 2019), *Forming an Opinion and Reporting on Financial Statements*, paragraph 29-1

<sup>4</sup> ISA (UK) 240 (Revised May 2021), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraph 39-1

by the European Union.<sup>5</sup> Such a requirement, which now applies to all audits in those jurisdictions, is not intended to be 'boilerplate' (i.e., it is required that this explanation be specific to the circumstances of the entity).

Paragraph 29-1 of ISA (UK) 700 (Revised November 2019):

*Irregularities including Fraud*

*"29-1. The auditor's report shall explain to what extent the audit was considered capable of detecting irregularities, including fraud."*

Paragraph 39-1 of ISA (UK) 240 (Revised May 2021):

*The Auditor's Report*

*"39-1. As required by ISA (UK) 700, the auditor's report shall explain to what extent the audit was considered capable of detecting irregularities, including fraud. This explanation shall be specific to the circumstances of the audited entity and take account of how the auditor planned and performed procedures to address the identification and assessment of the risks of material misstatement."*

15. A respondent (regulator) further noted that more transparency in the auditor's report could help reduce the knowledge gap, as stakeholders would be better informed about the auditor's work addressing fraud. It could also help reduce the performance gap, as having to make public what work has or has not been performed can help focus an auditor's attention on planning and performing the most appropriate procedures. It was noted that a specific requirement similar to the requirement in ISA (UK) 701 (Revised 2019) (Updated January 2020)<sup>6</sup> that requires for public interest entities (PIEs), as part of the reporting of key audit matters (KAMs), transparency about the auditor's description of the most significant assessed risks of material misstatement, response to those risks, including those due to fraud, and key observations on those risks for PIEs may be helpful.

Paragraph 13-1 of I ISA (UK) 701 (Revised 2019) (Updated January 2020)):<sup>7</sup>

*13-1. For audits of financial statements of public interest entities, in describing each of the key audit matters in accordance with paragraph 13, the auditor's report shall provide, in support of the audit opinion:*

- (a) A description of the most significant assessed risks of material misstatement, (whether or not due to fraud);*

<sup>5</sup> Article 10 of Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014, as amended by Regulation 82 of The Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2019 (SI 2019/177)

<sup>6</sup> ISA (UK) 701 (Revised 2019) (Updated January 2020), *Communicating Key Audit Matters in the Independent Auditor's Report*, paragraph 13-1

<sup>7</sup> For audits of financial statements of PIEs in the UK, the auditor is precluded from applying paragraph 16 of ISA (UK) 701 (Revised 2019) (Updated January 2020) (i.e., a requirement addressing instances when there are no KAMs to communicate) as UK legislation (The Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2019 (SI 2019/177) does not foresee a situation where there are no KAMs and accordingly the auditor is required to provide in the auditor's report the elements set out in paragraphs 13-1(a)–13-1(c) of ISA (UK) 701 (Revised 2019) (Updated January 2020).

*(b) A summary of the auditor's response to those risks; and*

*(c) Where relevant, key observations arising with respect to those risks.*

*Where relevant to the above information provided in the auditor's report concerning each of the most significant assessed risks of material misstatement (whether or not due to fraud), the auditor's report shall include a clear reference to the relevant disclosures in the financial statements.*

16. Other respondents (firms and other professional organization) suggested adding a dedicated section (similar to current inclusion of “Material Uncertainty Related to Going Concern” paragraphs) or a sub-category (such as, “Auditor’s Responsibility Related to Fraud”) that will provide a clear description of the auditor’s responsibility in this area. It was suggested that such a section could include succinctly stating the fraud-related procedures performed and their related limitations, which may serve to significantly narrow the expectation gap. This additional modification could explicitly communicate the client-specific, fraud-related procedures to those charged with governance (TCWG) (i.e., board of directors / audit committee) and those relying on the financial statements (i.e., investors and other stakeholders).
17. Respondents (NSS and firms) proposed greater transparency in the auditor’s report regarding identified significant control deficiencies and weaknesses relating to fraud. Respondents noted that if the auditor was required to provide more transparency in the auditor’s report on fraud, this should be coupled with more transparency on the responsibility for the prevention and detection of fraud by TCWG and management (i.e., changes may need to be made by other stakeholders to add management requirements in this regard). It was noted that this could be achieved through director certifications (i.e., director declarations or statements) on the content of financial statements as well as the entity’s internal control over financial reporting. A call was also made for additional information to be disclosed by management (e.g., management assessment of risk of fraud). It was noted that enhancements to management’s responsibilities for internal control to prevent or detect fraud, as well as increased corporate reporting about those responsibilities, could provide a basis for including in the auditor’s report information about significant deficiencies in those controls that were identified in the course of the audit in accordance with ISA 265.<sup>8</sup>
18. At the expectation gap roundtable facilitated by the IAASB in September 2020, participants noted the following about more transparency on fraud in the auditor’s report:
- (a) Participants called for more bespoke information to be disclosed by the auditor in the auditor’s report regarding the work performed and findings in respect of fraud.
  - (b) The need to maintain balance in the level of information disclosed was emphasized. The information must remain meaningful.
  - (c) Participants noted that greater transparency in the auditor’s report would likely lead to different behaviors. For example, greater transparency can lead to higher accountability pressure as management of the entity may expect their judgments to be scrutinized more comprehensively.

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<sup>8</sup> ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*

- (d) Participants also noted that greater transparency may also help demonstrate the value of an audit.
19. In his [“Report of the Independent Review into the Quality and Effectiveness of Audit”](#) (Brydon Report), Sir Donald Brydon noted auditors need to communicate what procedures they have undertaken to enable their opinion about the financial statements to be appropriate with regard to the risk of fraud. Sir Donald Brydon considers this would be an advantage even if the consequence is greater narrative (not in boiler-plate form) and a clearer statement of the reliance users may place on this work. Consequently, it was recommended that the auditor’s report explicitly state the work performed to conclude whether the directors’ statement regarding the actions they have taken to prevent and detect material fraud is appropriate.<sup>9</sup> Furthermore, it was noted that auditors should state what steps they have taken to assess the effectiveness of the relevant controls and to detect any such fraud.<sup>10</sup>
20. In line with the Brydon Review’s recommendation, as noted in the UK Department for Business, Energy, & Industrial Strategy (BEIS) [Consultation on “Restoring trust in audit and corporate governance”](#) published in March 2021, the UK Government intends to legislate to require the directors of PIEs to report on the steps they have taken to prevent and detect fraud. Also, they intend to legislate to require auditors of PIEs, as part of their statutory audit, to report on the work they performed to conclude whether the proposed directors’ statement regarding actions taken to prevent and detect material fraud is factually accurate, report on the steps taken to detect any material fraud and assess the effectiveness of relevant controls. This consultation closed on July 8, 2021.
21. Respondents to the auditor reporting post-implementation review (PIR) survey indicated some support to explore the inclusion of further insight about the auditor’s procedures with respect to fraud in the auditor’s report.<sup>11</sup>

Enhancing or clarifying the current description of the auditor’s responsibilities regarding fraud in the auditor’s report

22. There were respondents (audit oversight authority, NSS, firms, and other professional organizations) who suggested that the current wording describing the auditor’s responsibilities regarding fraud in an audit of financial statements be enhanced or clarified.

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<sup>9</sup> The requirement to produce a directors’ report in the UK is contained in section 415 of the Companies Act 2006 (“the Act”). Paragraph 14.2 of the Brydon Report noted it is clear that “the extent to which fraud can be detected is dependent on the quality and timeliness of management reporting, and the openness of the corporate culture,” and the first part of the UK standard on fraud stresses that management and the Board are responsible for preventing and detecting fraud. It was therefore recommended that directors should report on the actions they have taken to fulfil their obligations to prevent and detect material fraud against the background of their fraud risk assessment.

<sup>10</sup> Paragraph 27 of ISA (UK) 240 (Revised May 2021) indicates that the auditor shall treat those assessed risks of material misstatement due to fraud as significant risks and accordingly, to the extent not already done so, the auditor shall identify the entity’s controls, that address such risks, and evaluate their design and determine whether they have been implemented.

<sup>11</sup> On June 2, 2021, the IAASB published a [feedback statement](#) that summarizes key themes and views shared with the IAASB through the 2020 Auditor Reporting Post-Implementation Survey as well as a roundtable discussion held in September 2020. The feedback statement indicated some support to explore communication about what the auditor has done with respect to fraud given the existing ‘expectation gap.’

- (a) It was noted that a more prominent and clear description of the auditor's responsibilities for detecting fraud in the auditor's responsibilities section of the auditor's report would be beneficial.
  - (b) It was also noted that the auditor's report may benefit from a clearer indication about the risk of not detecting a material misstatement from fraud, for example, there is a specific requirement in paragraph 35(c) of AU-C 700<sup>12</sup> (audit standard updated in the clarity framework of the American Institute of Certified Public Accountants (AICPA) Accounting Standards Board) that could be incorporated into ISA 700 (Revised)<sup>13</sup> thus providing a more transparent description for users of ISA reports. While a similar requirement is also included in ISA 700 (Revised), it was noted that ISA 700 (Revised) presents three options for the location of the description of the auditor's responsibilities (which includes responsibilities regarding fraud) for the audit of the financial statements.<sup>14</sup> It was suggested that the description of the auditor's responsibilities, including responsibilities regarding fraud, be explicitly stated within the body of the auditor's report (i.e., remove the options to present it within an Appendix to the auditor's report, or by a specific reference within the auditor's report to the location of such a description on a website of an appropriate authority).
  - (c) It was also noted that instead of adding standard language to the auditor's report, it is more important to ensure that the auditor's report avoid use of highly technical terminology, and instead provide users with easy-to-understand information, as users may not even understand the current description of reasonable assurance. It was added that some readers may mistakenly interpret that "obtaining reasonable assurance" creates an obligation for the auditor to detect and prevent fraud that is indistinguishable from, or even greater than, the obligation of management and TCWG. It was suggested that (as part of the PIR of the auditor reporting standards) the IAASB engage with users of the financial statements to validate that the wording in the auditor's report is fit for purpose.
  - (d) It was suggested that more clarity with regard to how the responsibility for fraud is shared among various parties (TCWG, management, audit committee, auditors etc.) can be more directly stated in the auditors' report.
23. A respondent (NSS) suggested further clarifying or expanding what paragraph 39(b)(i) of ISA 700 (Revised) means: "The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentation, or the override of internal controls." Clarification of this statement would help explain what this statement is trying to communicate given that it could be interpreted in two ways:

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<sup>12</sup> AU-C Section 700, *Forming an Opinion and Reporting on Financial Statements*

<sup>13</sup> ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

<sup>14</sup> Paragraph 41 of ISA 700 (Revised) explains that the location of the description of the auditor's responsibilities for the audit of the financial statements can be: (a) within the body of the auditor's report; (b) within an Appendix to the auditor's report; or (c) by a specific reference within the auditor's report to the location of such a description on a website of an appropriate authority, where law, regulation or national auditing standards expressly permit the auditor to do so. The required description of the auditor's responsibilities in accordance with paragraphs 39-40 of ISA 700 (Revised) includes a statement that "the risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control."



- (a) The risk remains higher, notwithstanding all the work that was done in the audit; or
- (b) The risk is higher and therefore the auditor performed additional work.

More Transparency on Fraud in the Auditor's Report Is Not Needed

24. Respondents (regulators, audit oversight authority, NSS and firms) who did not support more transparency on fraud in the auditor's report noted the following reasons:
- (a) The focus should be on enhancing or adding specific requirements addressing fraud in ISA 240 instead of changes to the auditor's report. After concluding on any changes in ISA 240, the IAASB should revise the wording in the auditor's report to more clearly communicate the nature, extent and limitations of the auditor's responsibilities regarding fraud.
  - (b) Increasing the length and complexity of the auditor's report may reduce user understanding.
  - (c) Requiring additional disclosures in the auditor's report may become perfunctory and boilerplate over time, and therefore will not hold informational value for users.
  - (d) The extant standards provide for sufficient transparency on fraud in the auditor's report through the communication of KAMs. However, it was suggested that the IAASB enhance application material to assist practitioners in determining whether fraud, or fraud risk, may be considered a KAM.
    - (i) It was noted that areas of higher assessed risk of material misstatement, or significant risks (whether due to fraud or error) can be communicated as KAMs in the auditor's report. It was also noted that reporting KAMs under ISA 701<sup>15</sup> is the appropriate mechanism when matters about fraud risks rise to the level of matters of most significance in the audit. Views were also expressed that it may be appropriate for auditors to report significant internal control deficiencies as KAMs in the auditor's report.
    - (ii) When matters about fraud do not rise to the level of KAMs, it was noted that information about audit procedures performed to address fraud risks identified under ISA 240 (e.g., tests of journal entries, tests of revenue recognition, or other testing to address risks of fraud in specific accounts) would unlikely be effective in narrowing the expectation gap.
  - (e) Investors do not always read the auditor's report in detail, and therefore, enhanced requirements in the auditor's report may not be effective in narrowing the knowledge gap.
  - (f) The results from the auditor reporting PIR may need to be considered before making changes for more transparency on fraud in the auditor's report.
25. During an outreach meeting with the European Audit Committee Leadership Network, a participant cautioned against unintended consequences of requiring additional information on fraud in the auditor's report for every audit. Particularly, they noted that extensive information about fraud procedures may mislead users into thinking there are issues on fraud at that entity when that may not be the case.

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<sup>15</sup> ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

*Current Requirements and Application Material*

26. As noted above, there are no extant explicit requirements to describe in the auditor's report specific procedures performed to address risks of material misstatement due to fraud. However, the table in **Appendix C** includes the extant requirements and application material to:
- (a) Describe an audit by stating the auditor's responsibilities in the auditor's report (whether due to fraud or error); and
  - (b) Determine and communicate KAMs in the auditor's report (which may or may not involve matters about fraud).

**WG Deliberations**

27. Based on the feedback heard, the WG deliberated whether to enhance ISA 240 to require more transparency in the auditor's report about the auditor's work on fraud in an audit of financial statements, or if there were alternatives for how transparency could be provided. In its deliberations, the WG considered the possible benefits and challenges (including unintended consequences) that may arise from the possible actions.
28. The WG noted comments from a Monitoring Group member that encouraged the consideration of costs and benefits in this regard, including the potential usefulness of enhanced communications about the auditor's work if it was not 'boilerplate' (similar to other DP respondents). Furthermore, other DP respondents and participants of other outreach activities expressed mixed views on whether or not more transparency is needed in the auditor's report.
29. The WG discussed the benefits of requiring more transparency in the auditor's report, including those that were highlighted by DP respondents and participants in other information gathering activities. The WG was of the view that more transparency in the auditor's report:
- May help reduce aspects of the expectation gap by better informing stakeholders about the auditor's work on fraud in an audit of financial statements, especially if such communication is specific to the circumstances of the entity.
  - May incline auditors to be more accountable for the procedures performed if these are required to be described in the auditor's report and may affect the accountabilities of management and TCWG about their respective responsibilities on fraud.
30. The WG also considered the challenges from requiring more transparency in the auditor's report, including those that were highlighted by DP respondents and participants in other outreach activities. The WG was of the view that more transparency in the auditor's report may:
- Have unintended consequences of undermining the effectiveness of the auditor's procedures by disclosing what the auditor does to all parties, including fraudsters.
  - Inadvertently raise concerns or 'open questions' for intended users about the risk of fraud in terms of interpreting the significance of the disclosure in the context of the entity's financial statements as a whole (e.g., it may mislead users into thinking there are issues on fraud at the entity when that may not be the case).
  - Not be as helpful because it can be susceptible to 'boilerplate' disclosures.

31. The WG recognized that all entities can be susceptible to fraud and therefore users of the financial statements of all entities may benefit from more transparency in the auditor's report. However, the WG noted that requiring more transparency in the auditor's report for all audits may not be scalable or proportionate for audits of all entities globally.
32. The WG also recognized that more transparency on fraud in the auditor's report may be helpful in enhancing the degree of confidence of intended users in the financial statements for certain types of entities (e.g., for listed entities or PIEs,<sup>16</sup> for entities determined to be higher risk, or for entities where fraud or suspected fraud is identified). However, the WG also recognized that there may be challenges from imposing conditional transparency requirements for these types of entities. In the case of more transparency reporting for PIEs or 'higher risk' entities only, the WG determined that these terms may be undefined, have different definitions or described differently in various jurisdictions or regions and therefore any new requirements may be inconsistently applied. The WG also highlighted that there was already a mechanism for requiring more transparency in the auditor's report (in particular for listed entities, entities required under law or regulation, and voluntarily for other types of entities) through the reporting of KAMs (i.e., if matters about fraud or suspected fraud or fraud risks rise to the level of matters of most significance in the audit, these could be communicated as KAMs in the auditor's report under ISA 701).<sup>17</sup>
33. The WG was of the view that the existing requirements and application material on KAMs (as described below) already sufficiently address the public interest that needs to be served by a separate requirement for more transparency in the auditor's report on fraud. Paragraph A46 of ISA 701 provides guidance for the amount of detail to describe KAMs in the auditor's report.

Paragraph A46 of ISA 701:

*A46. The amount of detail to be provided in the auditor's report to describe how a key audit matter was addressed in the audit is a matter of professional judgment. In accordance with paragraph 13(b), the auditor may describe:*

- *Aspects of the auditor's response or approach that were most relevant to the matter or specific to the assessed risk of material misstatement;*
  - *A brief overview of procedures performed;*
  - *An indication of the outcome of the auditor's procedures; or*
  - *Key observations with respect to the matter,*
- or some combination of these elements.*

<sup>16</sup> PIE is not a defined term under the IAASB Standards. However, the IESBA's Definitions of Listed Entity and PIE Project is currently reviewing the definitions of the terms "listed entity" and "PIE" in the IESBA Code with a view to revising them as necessary so that they remain relevant for the current environment. The IAASB will also consider the impacts of any changes in the IESBA Code to the definition of listed entity and PIE and make changes to its International Standards accordingly.

<sup>17</sup> ISA 701 applies to audits of complete sets of general purpose financial statements of listed entities and circumstances when the auditor otherwise decides to communicate KAMs in the auditor's report. ISA 701 also applies when the auditor is required by law or regulation to communicate key audit matters in the auditor's report. However, ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*, prohibits the auditor from communicating KAMs when the auditor disclaims an opinion on the financial statements, unless such reporting is required by law or regulation.

*Law or regulation or national auditing standards may prescribe a specific form or content for the description of a key audit matter, or may specify the inclusion of one or more of these elements.*

34. In the case of more transparency in the auditor's report for entities where fraud or suspected fraud is identified, the WG noted the risks for auditors when disclosing "original information" (i.e., information about the entity that would not otherwise have been made available or disclosed by the entity), including potentially immaterial or confidential information.

*Enhancing Application Material in ISA 240, or Developing Non-Authoritative Guidance, to Assist Auditors in Determining When Fraud Related Matters May Be Considered as KAMs*

35. Notwithstanding that the requirement to report KAMs in certain instances already exists (or can be done voluntarily), the WG acknowledged that more may be needed to make the link between KAMs and fraud, and therefore considered enhancing the application material in ISA 240 to clarify the link to KAMs, or developing non-authoritative guidance, to assist auditors in determining when fraud related matters may be considered as KAMs.
36. In its deliberations, the WG also considered how this could be done within the application material, including considering the number of cross-references and repetition that may arise in the relevant ISAs that may be needed to illustrate when fraud related matters may be considered as KAMs. The WG was therefore of the view that developing non-authoritative guidance may be more practical to assist auditors in determining when fraud related matters may be considered as KAMs.

**WG Recommendations**

Possible Action #1:		I	R	A	G	E	O	N
<b>More Transparency in the Auditor's Report Through Describing Fraud Related Matters</b>					✓			
(a) On balance, when considering the benefits and challenges described above, as well as existing requirements, the WG does not recommend requiring more transparency in the auditor's report on fraud:								
(i) The WG was of the view that enhanced transparency on fraud for certain entities can be addressed through the communication of KAMs in the auditor's report. For audits of entities that are not required to communicate KAMs in the auditor's report, the WG also was of the view that extant requirements regarding communication of fraud matters with management, TCWG, or an appropriate authority outside of the entity, <sup>18</sup> together with the proposed possible action for revisions to these requirements and enhancements to application material (see 'Matters to Be Addressed' for 'Public Interest Issue #3' in <b>Appendix E</b> below) should adequately address calls for more transparency about fraud for those audits.								
(ii) The WG also noted the possible amendments to the auditor's responsibilities section of the auditor's report (which could affect the requirements in ISA 700 (Revised)) arising from the possible action to revise the introductory language in ISA 240 about the inherent limitations								

<sup>18</sup> ISA 240, paragraphs 41–44

of an audit (see ‘Matters to Be Addressed’ for ‘Public Interest Issue #1’ in **Appendix E** below).

- (b) The WG, however, recommends further exploration of similar requirements in ISA (UK) 700 (Revised November 2019) and ISA (UK) 240 (Revised May 2021) and as required by the European Union, for the auditor’s report to explain, specific to the circumstances of the audited entity, how the auditor planned and performed procedures to address the identification and assessment of the risks of material misstatement, including risks due to fraud.
- (c) The WG also recommends developing non-authoritative guidance, to be further explored in coordination with the Auditor Reporting Implementation Working Group, on when a fraud-related matter is a KAM. However, recognizing the variation in views about transparency more broadly, the WG would like to get further direction from the Board whether additional possible actions may need to be pursued.

## **B. Making the Engagement Team Discussion on Fraud Considerations More Robust**

### ***What the issue is:***

Questions have been raised whether to enhance the requirements for the engagement team discussion, the timing and frequency of the discussion, and the attendance of relevant specialists during the discussion, which was noted may be helpful in identifying and assessing risks of material misstatement due to fraud and responding appropriately to fraud risks, fraud or suspected fraud identified during the audit.

### ***What the Board is being asked:***

Whether the IAASB should pursue standard-setting requiring:

- (a) Specific topics to be included during the engagement team discussion,
- (b) Consideration of further engagement team discussion(s), including timing of those discussion(s), and
- (c) The attendance of specialists (including fraud specialists) engaged in the audit during the engagement team discussion,

or whether another, or no, action is warranted.

37. 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.

## **Background for the WG’s Deliberations**

### *Monitoring Group Member DP Responses:*

38. A Monitoring Group member suggested that the required engagement team discussion under ISA 315 (Revised 2019)<sup>19</sup> should sufficiently focus on broader aspects of the entity’s system of internal

<sup>19</sup> ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*, paragraph 17

control, risks on management override of controls and inherent risks before addressing more specific fraud risks.

*Input from Other DP Respondents and Other Information-Gathering Activities*

**Requiring Specific Topics to Be Included During the Engagement Team Discussion**

39. Respondents (regulators and firms) suggested enhancing the rigor of engagement team discussions by specifying more matters to be covered in the discussion and adding more examples in the application material. It was noted that this could be done by further focusing the discussions on:
- (a) The entity's control environment, including corporate culture (e.g., how TCWG and management promote a culture of honesty and integrity; what policies they have in place to facilitate and encourage reporting of fraud or suspected fraud; how they respond to any such reports; and what controls they have in place to prevent or detect fraud). It was highlighted that where the auditor identifies a control weakness as a result of these discussions, it would provide the opportunity for the auditor to develop further audit procedures responsive to the control weakness.
  - (b) Entity-specific fraud risk factors such as incentives for TCWG, management or others within the entity to commit fraud, how they could perpetrate and conceal fraudulent financial reporting, and how assets of the entity could be misappropriated.
40. During the expectation gap roundtable facilitated by the IAASB in September 2020, participants noted the IAASB should consider enhancing the standard to require a more robust discussion about the fraud risk factors that are relevant to the nature and circumstances of the audit engagement.
41. The Association of Chartered Certified Accountants publication titled "Closing the Expectation Gap in Audit" notes that sometimes the way standards are written may exacerbate bias. For example, the engagement team meeting to discuss areas of risk of material misstatement can be susceptible to 'groupthink.' It was highlighted that it is important that standard-setters draft standards as clearly as possible and avoid creating requirements that may introduce judgment biases or which are hard to implement in an objective way.

**Requiring Consideration of Further Engagement Team Discussion(s), Including Timing of Those Discussions**

42. Respondents (regulators and a firm) suggested considering the timing of engagement team discussions throughout the engagement by:
- (a) Emphasizing that risk assessment is an iterative process that occurs during all phases of the audit; and
  - (b) Requiring the engagement partner to determine if there is a need to have another engagement team discussion(s) later in the audit to confirm that identified and assessed fraud risks remain appropriate.
43. The academic report, "A Synthesis of Fraud-Related Research" (by Trompeter, Carpenter, Desai, Jones and Riley (2013)), synthesizes academic research on fraudulent financial reporting. It references one study (Brazel et al. 2010) that finds the quality of engagement team discussions is higher when the discussion occurs early in the audit process and when IT specialists attend the

session. They further suggest that the quality of engagement team discussions moderates the link between auditor's fraud risk assessments and fraud-related testing, suggesting that the benefits of discussions do not apply uniformly: low-quality sessions are likely incurring significant costs without attendant benefits.

#### **Requiring the Attendance of Specialists Engaged in the Audit During the Engagement Team Discussion**

44. Respondents (a regulator and other professional organizations) suggested requiring all specialists (i.e., not just forensic specialists) engaged in the audit (if any) to attend engagement team discussions. It was emphasized that specialists' perspectives are relevant to these discussions because of their involvement in complex areas of the audit, including accounting estimates with elevated levels of estimation uncertainty and subjectivity that are particularly susceptible to fraud.
45. At the Canadian Public Accountability Board (CPAB) fraud exchange, CPAB representatives noted that specialists engaged in audits participated in the engagement team discussions in two thirds of the audits they inspected. They noted it is beneficial for specialists engaged in audits to participate in such discussions.

#### ***Current Requirements and Application Material***

46. The table in **Appendix C** describes the extant requirements and application material on engagement team discussions, both in ISA 240 specific to fraud and more generally across the suite of ISAs. The ISAs, however, do not have an explicit requirement for specialists to attend the engagement team discussion.

#### **WG Deliberations**

47. The WG agreed with respondents' views that addressing the topics to be included in the discussion, the timing and frequency of the discussion, and the attendance of relevant specialists (including fraud specialists) during the discussion, may be helpful. The WG noted that it may be helpful in identifying and assessing risks of material misstatement due to fraud and responding appropriately to fraud risks, fraud or suspected fraud identified during the audit, and therefore support some of the other intended changes to make ISA 240 more robust in the risk identification and assessment process.
48. The WG considered various alternatives for changes in ISA 240 to make the engagement team discussion specific to fraud considerations more robust. In its deliberations, the WG considered the possible benefits and challenges (including unintended consequences) that may arise from the possible actions. The WG also acknowledged that scalability is an important consideration when developing the possible actions, for example, there may be matters that may be less relevant to LCEs.

#### ***Requiring Specific Topics to Be Included During the Engagement Team Discussion***

49. The WG recognized there are existing requirements and supporting application material in the ISAs addressing the engagement team discussion.
  - Paragraphs 17–18 of ISA 315 (Revised 2019) are the foundational requirements addressing the engagement team discussion, which are supported by application material in paragraphs A42–A47.

- Paragraph 16 of ISA 240 expands on how the foundational requirements on the engagement team discussion in ISA 315 (Revised 2019) are to be applied to risks of material misstatement due to fraud.
  - Paragraph A12 of ISA 240 includes application material on matters that may be included in the engagement team discussion.
50. In view of the existing requirements and application material regarding the engagement team discussion as described above, the WG considered how to make the engagement team discussion more robust, for example, elevating the existing application material to a requirement. The WG also considered adding specific topics suggested by a Monitoring Group member but not covered in the existing application material (see paragraph 52 below). In its deliberations, the WG noted that scalability is an important consideration when developing a possible requirement for the inclusion of specific topics in the engagement team discussion.
51. The WG looked at the work of others with similar enhancements to their local standards in this regard. The WG noted that paragraphs 15–1 to 15–3 of ISA (UK) 240 (Revised May 2021) may be useful reference materials in developing a requirement specifying topics to be included in the engagement team discussion.

Paragraphs 15–1 to 15–3 of ISA (UK) 240 (Revised May 2021):

*“15–1. The discussion shall include an exchange of ideas among engagement team members about fraud risk factors, including incentives for management or others within the entity to commit fraud, how management could perpetrate and conceal fraudulent financial reporting, and how assets of the entity could be misappropriated.*

*15–2. For a group audit, the discussion among the group engagement team shall include matters to discuss with the component auditor of a significant component about the susceptibility of the component to material misstatement of the financial information of that component due to fraud.*

*15–3. If allegations of fraud come to the auditor’s attention, the discussion shall include how to investigate and respond to those allegations.”*

52. In response to suggestions by a Monitoring Group member and other respondents, the WG considered that requiring specific topics to be included during the engagement team discussion could involve:
- (a) Elevating the following existing application material in paragraph A12 of ISA 240 to requirement:
- An exchange of ideas among engagement team members about how and where they believe the entity’s financial statements (including the individual statements and the disclosures) may be susceptible to material misstatement due to fraud, how management could perpetrate and conceal fraudulent financial reporting, and how assets of the entity could be misappropriated.
  - A consideration of the known external and internal factors affecting the entity that may create an incentive or pressure for management or others to commit fraud, provide the



opportunity for fraud to be perpetrated, and indicate a culture or environment that enables management or others to rationalize committing fraud.

- A consideration of any allegations of fraud that have come to the auditor's attention.
  - A consideration of the risk of management override of controls.
- (b) Adding the following specific topics not covered in the existing application material to the possible requirement:
- The broader aspects of the entity's system of internal control, including control activities of the entity designed and implemented by management to prevent and detect fraud, if any.
  - Risk of improper segregation of duties.

*Requiring Consideration of Further Engagement Team Discussion(s)*

53. The WG considered standard-setting (i.e., requirements or application material) for the auditor to consider further engagement team discussion(s) if the auditor obtains new information which is inconsistent with the audit evidence on which the auditor originally based the identification or assessments of the risks of material misstatement due to fraud. The WG agreed with respondents' views that considering further engagement team discussion(s) may be helpful in determining that identified and assessed risks of material misstatements due to fraud and the responses to those risks remain appropriate. The WG noted that the auditor's risk identification and assessment process is iterative and dynamic. The WG also noted the foundational requirement in paragraph 37 of ISA 315 (Revised 2019) on revision of risk assessment indicates that "if the auditor obtains new information which is inconsistent with the audit evidence on which the auditor originally based the identification or assessments of the risks of material misstatement, the auditor shall revise the identification or assessment."
54. The WG looked at the work of others that have similar enhancements to their local standards in this regard. The WG noted that paragraph A11–1 of ISA (UK) 240 (Revised May 2021) may be a useful reference material in developing application material in ISA 240 on considerations when it may be beneficial to hold further engagement team discussion(s).

Paragraph A11–1 of ISA (UK) 240 (Revised May 2021):

*"A11–1. Circumstances where it may be beneficial to have further discussion(s) among the engagement team at later stages in the audit may include, for example, when the auditor's evaluation of audit evidence has provided further insight about the risks of material misstatement due to fraud (see paragraph A49) or members of the audit team have identified:*

- *Fraud risk factors that were not covered in the original discussion.*
- *Actual or suspected fraud."*

55. The WG acknowledged that scalability is an important consideration when developing a possible requirement to consider further engagement team discussion(s) as it may not be necessary for LCEs (i.e., LCEs may have simpler risk identification and assessment processes). Having the engagement team discussion once during the audit may be all that is needed for LCEs but may not be the case

for more complex entities. On balance, the WG was of the view that developing application material in ISA 240 on considerations when it may be beneficial to hold further engagement team discussion(s) may be helpful to auditors. The WG further noted that the auditor would need to apply professional judgment based on the nature and circumstances of the engagement about when it may be appropriate to have further engagement team discussion(s).

*Requiring the Attendance of Specialists (Including Fraud Specialists) Engaged in the Audit During the Engagement Team Discussion*

56. The WG agreed with respondents' views that having the benefit of specialist perspectives already engaged in the audit (including internal fraud specialists (i.e., those that form part of the engagement team)<sup>20</sup> or external fraud specialists (i.e., the auditor has determined the need for an auditor's expert)<sup>21</sup>) may improve the rigor of the engagement team discussion(s). Accordingly, the WG considered standard-setting (i.e., requirement or application material) addressing the attendance of specialists (already engaged in the audit) during the engagement team discussion.
57. The WG acknowledged that developing a possible requirement for the attendance of specialists (including fraud specialists) during the engagement team discussion may not be scalable or proportionate for audits of all entities globally.
58. The WG noted that a separate requirement for the attendance of specialists already engaged in the audit during the engagement team discussion(s) may not be needed as it is already sufficiently addressed by a combination of existing requirements and application material that specifically address the assignment and supervision of personnel when considering fraud in an audit, and more broadly address engagement resources in an audit.
- Paragraph 30(a) of ISA 240 specifically addresses the assignment and supervision of personnel when considering fraud in an audit of financial statements. It states that "in determining overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level, the auditor shall 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."
  - Paragraph A35 of ISA 240 further notes that "the auditor may respond to identified risks of material misstatement due to fraud by, for example, assigning additional individuals with specialized skill and knowledge, such as forensic and IT experts, or by assigning more experienced individuals to the engagement."
  - Paragraphs 25–28 and A59–A79 of ISA 220 (Revised) also broadly address the engagement partner's responsibilities to determine sufficient and appropriate engagement resources for the audit.
  - Paragraph 18 of ISA 315 (Revised 2019) states that "when there are engagement team members not involved in the engagement team discussion, the engagement partner shall determine which matters are to be communicated to those members."

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<sup>20</sup> ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*, paragraphs 25–28

<sup>21</sup> ISA 620, *Using the Work of an Auditor's Expert*, paragraph 7

59. On balance of the benefits and challenges, and the existing requirements and application material as described above, the WG noted that developing application material in ISA 240 on considerations when it may be beneficial for specialists (including internal or external fraud specialists) already engaged in the audit to attend engagement team discussion(s) may be helpful to auditors. The WG further noted that the auditor would need to apply professional judgment based on the nature and circumstances of the engagement when it may be appropriate for specialists (including internal or external fraud specialists) to attend the engagement team discussion(s).

### WG Recommendations

Possible Action #2:  <b>Making the Engagement Team Discussion on Fraud Considerations More Robust</b>	I	R	A	G	E	O	N
		✓	✓				
<p>The WG recommends:</p> <p>(a) Requiring specific topics to be included during the engagement team discussion. While there are existing requirements and supporting application material addressing the engagement team discussion as noted above, such an enhanced requirement may be helpful in identifying and assessing risks of material misstatement due to fraud. In developing a possible requirement, the WG would consider scalability by addressing the needs of different stakeholders and extending to both more complex and less complex circumstances.</p> <p>(b) Developing application material in ISA 240 on considerations when it may be beneficial to hold further engagement team discussion(s). The WG was of the view that the existing requirement in paragraph 16 of ISA 240 sufficiently expands on how the foundational requirements on the engagement team discussion in ISA 315 (Revised 2019) are to be applied to risks of material misstatement due to fraud.</p> <p>(c) Developing application material in ISA 240 on considerations when it may be beneficial for specialists (including internal or external fraud specialists) already engaged in the audit to attend engagement team discussion(s).</p>							

### C. Clarifying the Relationship Between ISA 240 and ISA 250 (Revised)

<p><b><i>What the issue is:</i></b></p> <p>Since fraud is a matter that is often interrelated with non-compliance with laws and regulations and may often constitute an illegal act, it is unclear whether ISA 240 or ISA 250 (Revised) applies, or both.</p>
<p><b><i>What the Board is being asked:</i></b></p> <p>Whether the Board should pursue standard-setting to clarify whether acts by the entity, management, TCWG, etc., constitute fraud under ISA 240, non-compliance under ISA 250 (Revised), or both, or whether another, or no, action is warranted.</p>

60. 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.

## **Background for the WG's Deliberations**

### *Monitoring Group Member DP Responses:*

61. A Monitoring Group Member, although not explicitly addressing this issue, noted that through the IAASB's work on fraud, several related standards may be affected and should be considered. They pointed to ISA 250 (Revised) as an example.

### *Input from Other DP Respondents and Other Information-Gathering Activities*

Considering Whether Acts by the Entity, Management, TCWG, etc., Constitutes Fraud Under ISA 240, Non-compliance Under ISA 250 (Revised), or Both

62. Respondents (regulator, NSS, investor and individual) noted that fraud is a matter that is often interrelated with non-compliance with laws and regulations and may often constitute an illegal act.

Navigating Relevant Requirements When Responding to Instances of Identified Fraud or Suspected Fraud Under ISA 240 and Non-compliance Under ISA 250 (Revised)

63. Respondents (regulator, NSS, investor, firm and individual) suggested clarifying within ISA 240 the relationship between responding to instances of identified fraud or suspected fraud in ISA 240 and responding to non-compliance with laws and regulations in ISA 250 (Revised). Respondents noted it should be clear which actions need to be taken in the various circumstances and scenarios.

### *Current Requirements and Application Material*

64. The table in **Appendix C** describes the extant requirements and application material about the auditor's responsibilities about fraud in an audit of financial statements, and auditor's responsibility to consider laws and regulations in an audit of financial statements.

## **WG Deliberations**

*Considering Whether Acts by the Entity, Management, TCWG, etc., Constitutes Fraud Under ISA 240, Non-compliance Under ISA 250 (Revised), or Both*

65. The WG considered various alternatives for changes in ISA 240 in considering whether acts by the entity, management, TCWG, etc., constitutes fraud under ISA 240, non-compliance under ISA 250 (Revised), or both. In its deliberations, the WG considered the possible benefits and challenges (including unintended consequences) that may arise from the possible actions.
66. The WG recognized fraud is a broad legal concept and auditors do not make legal determinations of whether fraud has occurred. However, fraud is a matter that is often interrelated with non-compliance with laws and regulations and may often constitute an illegal act. The WG agreed with respondents' comments that the interrelationship between these two concepts is an important point to be highlighted in ISA 240. Accordingly, the WG considered the following standard-setting alternatives:
- Adding introductory material in ISA 240 highlighting the interrelationship between fraud and non-compliance with laws and regulations (i.e., fraud may also constitute an illegal act and therefore, may also fall under ISA 250 (Revised)). The WG noted that paragraph 9 of ISA 240 already indicates that the auditor may have additional responsibilities under law, regulation or relevant ethical requirements regarding an entity's non-compliance with laws and regulations,

including fraud, which may differ from or go beyond ISA 240 and other ISAs. The WG further noted that paragraph 9 of ISA 240 also indicates that complying with any additional responsibilities may provide further information that is relevant to the auditor's work in accordance with ISA 240 and other ISAs (e.g., regarding the integrity of management or, where appropriate, TCWG).

- Adding a requirement in ISA 240 for the auditor to consider whether fraud identified under ISA 240 also constitutes non-compliance under ISA 250 (Revised).
- Developing application material in ISA 240 highlighting the interrelationship between fraud and non-compliance (i.e., fraud may often constitute an illegal act and therefore, may also fall under ISA 250 (Revised)).

67. In its deliberations, the WG applied the proportionality test in weighing which of the proposed standard-setting alternatives described above would be adequately responsive to the public interest issue at hand (i.e., considering whether acts by the entity, management, TCWG, etc., constitutes fraud under ISA 240, non-compliance under ISA 250 (Revised), or both). In view of this public interest issue, the WG considered: (1) whether the absence of the proposed alternatives would adversely affect the quality or consistency of audits in an international context; and (2) whether ISA 240 and the relevant requirements in ISA 250 (Revised) would be consistently applied and would be globally operable across entities of all sizes and regions, considering the different laws and regulations prevalent in various jurisdictions. On balance, the WG considered that developing application material in ISA 240 may be helpful in highlighting that fraud may often constitute an illegal act and therefore, may also fall under ISA 250 (Revised).

*Navigating Relevant Requirements When Responding to Instances of Identified Fraud or Suspected Fraud Under ISA 240 and Non-compliance Under ISA 250 (Revised)*

68. Given the interconnectivity between the two concepts, the WG recognized there may still be confusion about the auditor's responsibilities when responding to fraud under ISA 240 or non-compliance with laws and regulations under ISA 250 (Revised). Accordingly, the WG considered enhancing application material in ISA 240, or developing non-authoritative guidance, to help auditors navigate relevant requirements under the two standards.
69. In its deliberations, the WG considered the length of the material and the number of cross-references that may be needed to: (1) illustrate the interconnectivity between the concepts of fraud and non-compliance; and (2) direct auditors to the required actions to be taken when responding to identified fraud or suspected fraud under ISA 240 or non-compliance under ISA 250 (Revised). On balance of these considerations, the WG noted that developing non-authoritative guidance (i.e., a decision tree) may be better placed (over enhancing application material in ISA 240) in guiding auditors when navigating the required actions to be taken when responding to identified fraud or suspected fraud under ISA 240 or non-compliance under ISA 250 (Revised).
70. The WG noted that developing non-authoritative guidance in this area would need to be jurisdiction neutral. Further, the WG noted that it should be made abundantly clear that any guidance developed to help auditors navigate the required actions to be taken when responding to identified fraud or suspected fraud under ISA 240 or non-compliance under ISA 250 (Revised) would need to be used in the context of the local legal and regulatory framework applicable to the entity and the industry or

sector in which the entity operates, including those applicable to the audit and the auditor (e.g., relevant ethical requirements).

71. The WG also noted that in developing non-authoritative guidance, it would be in the public interest to also consider the auditor's responsibilities when responding to non-compliance with laws and regulations (NOCLAR) under the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA Code), which may differ from or go beyond the ISAs. Coordination with IESBA would be needed in this regard.

### WG Recommendations

Possible Action #3:	I	R	A	G	E	O	N
<b>Clarifying the Relationship Between ISA 240 and ISA 250 (Revised)</b>			✓	✓			
<p>(a) With respect to considering whether acts by the entity, management, TCWG, etc., constitutes fraud under ISA 240, non-compliance with laws and regulations under ISA 250 (Revised), or both, the WG recommends developing application material in ISA 240 highlighting the interrelationship between fraud and non-compliance with laws and regulations (i.e., fraud may often constitute an illegal act and therefore, may also fall under ISA 250 (Revised)).</p> <p>(b) The WG also acknowledged that developing non-authoritative guidance that guides auditors in navigating the required actions to be taken when responding to identified fraud or suspected fraud under ISA 240, non-compliance under ISA 250 (Revised), and NOCLAR under the IESBA Code is a substantial work effort. Therefore, the WG would like to get direction from the Board whether developing such non-authoritative guidance should be prioritized as part of a possible project.</p>							

### D. Addressing Instances When Fraud or Suspected Fraud Is Identified During the Audit

<p><b>What the issue is:</b></p> <p>Respondents noted ISA 240 is not clear on how to respond appropriately to fraud or suspected fraud identified during the audit.</p>
<p><b>What the Board is being asked:</b></p> <p>Whether the IAASB should pursue standard-setting or other actions to explain how the auditor should respond if fraud or suspected fraud is identified during the audit, or whether another, or no, action is warranted.</p>

72. 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.

### Background for the WG's Deliberations

#### *Input from Other DP Respondents and Other Information-Gathering Activities*

73. Other respondents (regulators and NSS) suggested the following:

- (a) The standard should mandate an investigation be performed where suspected fraud is identified. For example, it was noted that there should be an option for: either management or TCWG to investigate the suspected fraud (as ultimately identifying and responding to fraud is their responsibility); OR for the auditor to investigate the suspected fraud on behalf of management or TCWG (with the use of forensic specialists identified by the auditor, if needed, and at the client's expense). This is because it is only possible to design an appropriate audit response when the issue is properly understood. It was noted that, in the absence of an investigation, it may be impossible to get to a "sufficient appropriate audit evidence" conclusion. If the investigation is refused, the auditor may then be able to modify the opinion, based on a scope limitation or take other appropriate action.
  - (b) The auditor should adopt a more robust approach when there are signals that indicate the possibility of a material misstatement due to fraud. Such signals could include, for example, lack of appropriate "tone at the top" at the audited entity's management level, relevant information received through whistle-blowing systems or public information.
  - (c) It would be useful for the firm to establish policies or procedures for consultation so that the members of the engagement team undertake consultation with others at the appropriate level within or outside the firm, as necessary, when the auditor has identified a circumstance that indicates the possibility of a material misstatement due to fraud or the auditor has determined that a suspicion of a material misstatement due to fraud exists.
74. Participants at the May 2020 NSS meeting noted there should be further guidance in situations when actual or suspected fraud is identified, including considerations about withdrawing from the engagement or the impact on the auditor's report.

#### *Current Requirements and Application Material*

75. The table in **Appendix C** describes the extant requirements and application material when fraud or suspected fraud is identified during the audit.

#### **WG Deliberations**

76. The WG considered various alternatives for changes in ISA 240 to address instances of fraud or suspected fraud identified during the audit. In its deliberations, the WG considered the possible benefits and challenges (including unintended consequences) that may arise from the possible actions.
77. The WG agreed with respondents' views that it may be helpful to provide clearer direction in ISA 240 on how to respond appropriately to fraud or suspected fraud identified during the audit. Accordingly, the WG considered whether standard-setting (i.e., requirement or application material) would be helpful in this regard.
78. The WG noted that there are existing requirements and supporting application material in ISA 240 addressing instances of fraud or suspected fraud identified during the audit.
- Paragraphs 39 and A55–A58 of ISA 240 address circumstances when the auditor is unable to continue the engagement as a result of a misstatement resulting from fraud or suspected fraud identified during the audit.

- Paragraphs 40 and A59–A60 of ISA 240 address written representations, including representations on fraud or suspected fraud identified during the audit.
  - Paragraphs 41–43 and A61–A66 of ISA 240 address communications to management and TCWG, including communications on fraud or suspected fraud identified during the audit.
  - Paragraphs 44 and A67–A69 of ISA 240 address reporting fraud or suspected fraud identified during the audit to an appropriate authority outside the entity.
  - Paragraphs 40 of ISA 240 requires the auditor to include in the audit documentation communications about fraud made to management, TCWG, regulators and others.
79. In its deliberations, the WG also noted that requiring specific audit procedures to be performed when fraud or suspected fraud is identified may be ‘too procedural.’ Because the ISAs are intended to be principles-based, and the nature and circumstances of each fraud would differ, introducing such specific procedures may not achieve the intended outcome and may also result in procedures being required that have no value in the circumstances.
80. Therefore, on balance, when considering the existing requirements and supporting application material and other considerations noted above, the WG considered that designating a separate section in ISA 240 for responding to instances of identified or suspected fraud and restructuring the existing requirements outlined above (without modifying content) may help direct auditors on the procedures when fraud or suspected fraud is identified. Corresponding changes would need to be made to the application material. The WG also considered whether non-authoritative guidance in this respect may be helpful.

### WG Recommendations

Possible Action #4:	I	R	A	G	E	O	N
<b>Addressing Instances When Fraud or Suspected Fraud Is Identified During the Audit</b>		✓	✓				
The WG recommends reorganizing the existing requirements and application material (recognizing that in doing so, enhancements could also be explored or become apparent) into a separate section in ISA 240 when fraud or suspected fraud is identified.							

### III. Public Interest Issues and Scoping a Project on Fraud

81. A project proposal for a standard-setting project on fraud will be presented to the Board at the September 2021 meeting for discussion (it is planned the project proposal will be approved at an IAASB videoconference in October 2021). To assist with development of the project proposal, which will be based on the extensive information gathering and research activities undertaken since March 2020 and discussions with the IAASB in 2020 and 2021, the Board’s views are requested on the following:
- (a) The public interest issues that will be addressed;
  - (b) The stakeholders’ interests that will be served by a project on fraud;
  - (c) The possible project objectives; and



- (d) The project scope. A table has been included in **Appendix E** that summarizes the current proposed project scope based on the discussions with the Board in April and June 2021. The topics set out in **Section II** of this paper will also be added to the project scope as applicable.
82. Staff are of the view that initial discussions with the IAASB on these matters will help in developing the project proposal for discussion at the September 2021 IAASB meeting.

*The Public Interest Issues—How a Project will Serve the Public Interest*

83. While not yet implemented and effective, the WG considered the [Public Interest Framework](#) (PIF) published by the Monitoring Group in July 2020 (as part of their report “*Strengthening the International Audit and Ethics Standard-Setting System*”) in developing the elements of the project proposal on fraud described in this Agenda Item. However, as implementation of the PIF is still in the initial planning phase, not all elements have necessarily been addressed in the recalibration of the structure of an IAASB standard-setting project proposal. As this project will likely continue during the time that the PIF is implemented, specific important aspects have been considered in presenting a restructured project proposal format, while still adhering to the due process requirements currently in place.
84. The PIF describes stakeholder interests that are relevant for standard setters to consider when responding to users’ needs. These interests are described below<sup>22</sup> and tailored towards how these have been considered specific to fraud.
- (a) Promote consistent practice and behaviors by auditors in fulfilling the fraud-related responsibilities of auditors.
  - (b) Facilitate identification of areas most relevant to the business of an audited entity for purposes of fraud-related audit procedures and drive effective measures to respond to related risks.
  - (c) Reinforce the auditor’s professional skepticism needed in gathering evidence, challenging assumptions, and developing conclusions in audit areas related to fraud.
  - (d) Ensure transparent, independent, rigorous and balanced reporting on fraud in an audit of financial statements in communications with management, TCWG or to an appropriate authority outside the entity, and in the auditor’s report, that prompts the adoption of appropriate measures by TCWG, as well as corrective action by oversight bodies, including prudential and market authorities, and address any potential threat to financial stability from the risk of fraud related to the financial statements of audited entities.
85. Several corporate failures and scandals across the globe in recent years have brought the topic of fraud to the forefront and led to questions around the role and responsibilities of the auditor. The IAASB is committed to playing its role to enhance the degree of confidence in financial reporting through activities within its remit as well as through outreach and continued dialogue with others in the financial reporting ecosystem who have a role to play.
86. It is intended that a project by the IAASB on fraud will build trust in the financial reporting process by serving the stakeholder interests described in paragraph 84 above. To help scope the project, the

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<sup>22</sup> The description of stakeholder interests is based on the description included in section “What interests need to be served?” in the PIF that was published by the Monitoring Group in July 2020 (as part of their report “[Strengthening the International Audit and Ethics Standard-Setting System](#)”).

WG has identified the public interest issues that will need to be addressed by a project on fraud. The key public interest issues have been developed from matters that were raised by stakeholders during the information-gathering process, and that have been discussed with the IAASB in 2020 and 2021.

87. The table below summarizes the key public interest issues that have been identified. The primary stakeholder interests that will be served by addressing the identified issues have also been highlighted.

#	Key Public Interest Issue	Summary of Proposed Actions (See <i>Appendix E</i> for further details)	Primary Stakeholder Interest(s) Served*			
			A	B	C	D
1	Determining the appropriate role and responsibilities of the auditor in relation to fraud in an audit of financial statements	Emphasizing the auditor's responsibilities in relation to fraud irrespective of inherent limitations of the audit and clarifying the interrelation between concepts such as bribery and corruption with the definition of fraud for purposes of a financial statement audit. Also, increasing the robustness of fraud-related audit requirements, for example, through requiring the auditor to consider the use of forensic specialists.	X	X	X	X
2	Enhancing the connection of ISA 240 to the IAASB's other standards and fostering an integrated risk-based approach	Fostering application of ISA 240 with the full suite of ISAs to promote integrated fraud-related audit procedures that result in high quality audits, including (but not limited to) enhancements to improve the integration of ISA 315 (Revised 2019), <i>Identifying and Assessing the Risks of Material Misstatement</i> , with fraud-related procedures and to clarify the auditor's responsibilities under ISA 250 (Revised), <i>Consideration of Laws and Regulations in an Audit of Financial Statements</i> , when fraud is identified or suspected.	X	X		
3	Facilitating appropriate transparency in communications between the auditor	Improving transparency with stakeholders around the auditor's responsibilities for fraud in financial statement audits and enhancing requirements to foster improved two-way				X

#	Key Public Interest Issue	Summary of Proposed Actions (See <i>Appendix E</i> for further details)	Primary Stakeholder Interest(s) Served*			
			A	B	C	D
	and TCWG and within the auditor's report	communication between the auditor and TCWG.				
4	Fostering the exercise of professional skepticism in the auditor's fraud-related procedures	Emphasizing and enhancing the concept of professional skepticism as it relates to the auditor's fraud-related audit procedures.	X		X	
5	Addressing advances in technology relevant to the auditor's responsibilities relating to fraud	Updating and enhancing ISA 240 (where appropriate pertaining to fraud procedures in an audit of financial statements) to be relevant for how technology is used in today's business environment, thereby recognizing and responding to emerging issues raised by stakeholders for changes in technology.	X	X	X	
<p>* Stakeholder Interests (which are described in paragraph 84 above) are denoted in the table above as follows:</p> <p><b>A</b> - Promote consistent practice and behaviours by auditors in fulfilling the fraud-related responsibilities of auditors.</p> <p><b>B</b> - Facilitate identification of areas most relevant to the business of an audited entity for purposes of fraud-related audit procedures and drive effective measures to respond to related risks.</p> <p><b>C</b> - Reinforce the auditor's professional skepticism needed in gathering evidence, challenging assumptions, and developing conclusions in audit areas related to fraud.</p> <p><b>D</b> - Ensure transparent, independent, rigorous and balanced reporting on fraud in an audit of financial statements in communications with management, TCWG or to an appropriate authority outside the entity, and in the auditor's report, that prompts the adoption of appropriate measures by TCWG, as well as corrective action by oversight bodies, including prudential and market authorities, and address any potential threat to financial stability from the risk of fraud related to the financial statements of audited entities.</p>						

**Matters for Board Consideration:**

2. Have the public interest issues relating to fraud been appropriately identified? Are there others that should be considered?
3. Have the public interest issues been appropriately mapped to the stakeholder interests to be served by addressing the issues?

*Project Objectives*

88. The public interest issues identified are explained above. To address these issues, the proposed project objectives are to:
- (a) Establish more robust requirements and appropriate application material in fraud-related procedures through revisions to ISA 240 and other relevant standards. It is intended that these revisions and enhancements will focus on key areas to enhance the robustness of the auditor's procedures on fraud, in particular in the risk identification and assessment process. It is anticipated that these revisions would also seek to emphasize the importance of the appropriate exercise of professional skepticism in fraud-related audit procedures.
  - (b) Provide clarity in areas where changes to requirements will not be made but where stakeholders expressed confusion or inconsistency in application of the extant requirements. It is anticipated that these activities will focus on the development or enhancement of application material that are relevant to the proper application of extant requirements. In addition, efforts will be undertaken to develop non-authoritative guidance to support implementation where needed or to further educate, where appropriate, the IAASB's stakeholders about existing concepts and practices on fraud in an audit of financial statements.
  - (c) For new and revised requirements, undertake first-time implementation support activities as contemplated in the [IAASB's Framework for Activities](#) to assist with the effective implementation and drive consistency in application of the new and revised requirements.
89. In addition, the IAASB will determine its role in encouraging others within the financial reporting ecosystem to engage in continued dialogue on the topic of fraud and further consider how they may help address issues raised by stakeholders where appropriate.

**Matter for Board Consideration:**

4. Have the project objectives been appropriately described to address the public interest issues that have been identified?

*Project Scope*

90. The substantial information gathering activities that have been undertaken since March 2020 and discussions held at the April and June 2021 IAASB meetings, and to be held at the July 2021 IAASB meeting, will help inform the basis for the development of the project scope to be included in the project proposal.

91. Based on work performed to date, the WG believes it is appropriate to develop revisions to ISA 240 to (1) revise and enhance or develop new specific requirements and (2) revise and develop application material to meet the proposed project objectives. In addition, the WG is of the view that development of non-authoritative guidance and / or “education activities” are needed for certain matters (either in conjunction with revisions to ISA 240 or for matters where ISA 240 will not be revised but further clarity is needed).
92. It is also essential that all stakeholders in the financial reporting ecosystem play a role in addressing issues raised on fraud, and therefore the WG also considers it necessary to engage with others in the financial reporting ecosystem as part of a proposed project on fraud.
93. The table in **Appendix E** summarizes the matters raised by stakeholders through information-gathering activities performed to date and the possible proposed actions recommended by the WG for inclusion in the project proposal (based on discussions with the IAASB on these matters). The table also summarizes the stakeholders most affected. The broad proposed actions are described below:
- (a) Standard-setting (**S**) – Proposed changes to requirements in ISA 240 and other relevant standards (e.g., consequential amendments), as well as to the application material to clarify or further explain application of the relevant requirement, or to the language in the introduction section of the ISA(s).
  - (b) Non-Authoritative Guidance (**G**) - Supporting materials to be developed outside of the ISAs.
  - (c) Education (**E**) - Educational initiatives or outreach to be performed (where within the remit of the IAASB).
  - (d) Engagement with Others (**O**) – Continued dialogue and engagement with others on issues that relate to actions that are not solely within the IAASB’s remit and require efforts from others in the financial reporting ecosystem.
94. Further consideration is needed about the nature of “educational activities.” For example, the IAASB could develop educational materials for the matters where ‘education’ is noted as a recommended possible action in **Appendix E**. Educational materials or actions may include short educational videos or webinars promoted on the IAASB’s website and social media accounts. These materials could be developed over the course of the project. In addition, it may also involve liaising with the International Federation of Accountants’ (IFAC) International Panel on Accountancy Education (IPAE), NSS, member bodies or other professional organizations to provide a summary of areas where DP respondents noted further education and training for auditors would be helpful. The latter is important recognizing the need to prioritize the efforts of the Board and IAASB staff to address standard-setting activities.
95. The WG will also encourage others in the financial reporting ecosystem to play a role in addressing issues on fraud through the activities described in Other Matter #1 of **Appendix E** over the course of the project.

**Matters for Board Consideration:**

5. Are the matters identified in **Appendix E** complete and are the recommended possible actions associated with each matter appropriate based on the WG’s views at this stage?

6. In reference to paragraphs 94 and 95, and recognizing the need to prioritize standard-setting activities, are there other educational materials or efforts, or other actions the WG should consider in developing the project proposal?

## APPENDIX A

### **Draft Minutes<sup>23</sup> from the June 2021 IAASB Meeting Fraud in an Audit of Financial Statements**

Ms. Provost explained that the objective of the session was to discuss possible actions forward for six specific topics raised by respondents to the discussion paper<sup>24</sup> where mixed responses were received as set out in **Agenda Item 3**. Ms. Provost explained that this session would build on the discussion held by the Board in April 2021 and, together with the discussion to be held in July 2021, would inform the development of the project proposal to be presented to the Board in September 2021.

#### SUMMARY OF FEEDBACK RECEIVED AND POSSIBLE ACTIONS

The Board provided feedback on possible actions recommended by the Fraud Working Group in response to the six matters highlighted by respondents to the discussion paper and summarized in Agenda Item 3.

#### STANDARD-SETTING

The Board discussed the possible actions to address the challenges and issues identified on the specific matters, and in some areas continued to express mixed views on these possible actions. The Board provided comments and suggestions for the Fraud Working Group's consideration on the possible actions as it develops the project proposal:

- *Revising the introductory language in ISA 240 about responsibilities of the auditor and inherent limitations of an audit.* Specific comments and suggestions relating to this possible action included:
  - Caution that the Fraud Working Group should not only focus on exploring changes on re-ordering the paragraphs and that possible actions may need to go beyond this, as the proposed possible actions may not be sufficiently responsive to stakeholder feedback raised. In particular, the Fraud Working Group were encouraged to further consider how to clarify and emphasize the auditor's responsibilities.
  - Caution that any changes made should not imply that inherent limitations in an audit are less than previously conveyed, as the limitations are inherent in nature and will not cease to exist.
  - Support for monitoring what other jurisdictions have done to make enhancements in this area.
- *Use of forensic specialists in an audit of financial statements.* Specific comments and suggestions relating to this possible action included:
  - Further considering how the auditor's considerations of when forensic specialists are appropriate could be enhanced within the standard, but with careful consideration of scalability when developing such enhancements.
  - Support for defining what is meant by "forensic specialist."

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<sup>23</sup> The draft minutes are still subject to review by the IAASB and further changes may be made arising from that review.

<sup>24</sup> *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*

- A suggestion for the Fraud Working Group to consider exploring trigger events where specialists should be considered for assistance in the risk assessment process.
- Support for making a connection between enhancements related to forensic specialists with paragraphs 25-28 in ISA 220 (Revised) related to engagement resources.
- Further consideration of whether forensic specialists should be required for higher-risk entities.
- *Clarifying the definition of fraud.* The Board expressed mixed views between the alternatives of enhancement of application material or the development of non-authoritative guidance, but broadly supported that both options may be further explored as they are not mutually exclusive. Specific comments and suggestions relating to this possible action included:
  - Agreement that the definition of fraud should not be expanded in the requirements, but support for clarification in the application material or in non-authoritative guidance to clearly illustrate how concepts like bribery and corruption are interlinked with fraud for purposes of an audit of financial statements.
  - Although it was suggested that the definition be reconsidered to include bribery and corruption, it was noted that as long as it was clear how the concepts were interlinked to fraud it would not be necessary to change the definition.
- *Enhancing application of professional skepticism.* Specific comments and suggestions relating to this possible action included:
  - Support for enhanced application material and non-authoritative guidance to illustrate the 'ramp up' of procedures and give practical examples of professional skepticism applied in such circumstances.
  - A suggestion to provide more detail about future collaboration with other IAASB workstreams in the development of the project proposal.
- *Further considering the presumed risk of fraud in revenue recognition and what changes are needed.* Specific comments and suggestions relating to this possible action included:
  - Further exploration on how to shift focus from developing a proper rebuttal to performing an appropriate risk assessment.
  - For enhancements to application material, shifting away from clarifying when it may be appropriate to rebut the presumption of risk of fraud in revenue recognition, and focusing instead on when it is inappropriate to rebut the presumption. It was also noted that this may be a good opportunity to provide more guidance on rebutting fraud risks in revenue recognition.
- *Strengthening requirements about the auditor's considerations for external confirmations.* Specific comments and suggestions relating to this possible action included:
  - Consideration of scope to only explore enhancements specific to fraud. Broader enhancements related to external confirmations may need be considered for a possible future project on ISA 505.



#### AREAS WHERE NO FURTHER ACTION RECOMMENDED

- *Introducing the concept of a ‘suspicious mindset’ into the ISAs.* Specific comments and suggestions relating to this possible action included:
  - Support for not further pursuing the concept of a “suspicious mindset” but rather enhancing the application of the existing concept of professional skepticism.

#### ACTIONS FOR OTHERS IN THE FINANCIAL REPORTING ECOSYSTEM

Board members encouraged that the Fraud Working Group consider any possible actions in terms of the broader financial reporting ecosystem, including what role others had in addressing the issues and challenges identified.

#### PIOB OBSERVER’S REMARKS

Mr. Hafeman expressed support for the work of the IAASB on the fraud project and possible strengthening of requirements in certain areas. He also expressed support for the root cause analysis underway in order to support the development of a robust project proposal.

#### WAY FORWARD

The Fraud Working Group will present possible actions for the remaining specific matters where mixed views were received at the July 2021 IAASB meeting and seek to obtain Board feedback on possible project objectives, project scope and public interest issues which will inform the development of a project proposal to be presented at the September 2021 meeting.

#### CLOSING

Mr. Seidenstein thanked the IAASB Members, TAs, and Staff and closed the meeting.

#### NEXT MEETING

The next IAASB meeting is the IAASB’s mid-quarter board call, which will be held via video conference between July 20-21, 2021.

## APPENDIX B

### Update on Activities Since the June 2021 IAASB Meeting

#### I. Root Cause Analysis Efforts

1. Since the June 2021 IAASB meeting, the Fraud WG continued its efforts to better understand the root causes of recent fraud cases. IAASB members and staff contacted police and crime commission representatives, fraud investigators, regulators, and audit firms and held 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 discussed 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.
3. A summary of the feedback received from the following outreach activities on the root causes of fraud will be provided and discussed at the September 2021 IAASB meeting. Root cause analysis findings will be considered in the development of the project proposal.

Outreach Group	Date(s) Held
<b>Ernst &amp; Young (EY) Representatives</b>	May 6, 2021
<b>Deloitte Representatives</b>	May 17, 2021
<b>Expert Witness for the Financial Crimes Squad at the New South Wales (NSW) Police Force</b>	May 19, 2021
<b>GT International (GTI) Representatives</b>	May 20, 2021
<b>PwC Representative</b>	June 14, 2021
<b>Japan Financial Services Authority (FSA) Representatives</b>	June 23, 2021
<b>Audit Oversight Board (AOB), Securities Commission Malaysia Representatives</b>	July 1, 2021

<b>Accounting and Corporate Regulatory Authority (ACRA) Representative</b>	July 1, 2021
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## II. Additional Outreach Meetings

4. Since the June 2021 IAASB meeting, the following additional outreach was performed.

<b>Outreach Group</b>	<b>Date(s) Held</b>	<b>Details</b>
<b>International Federation of Accountants (IFAC) Representatives, Including Staff Supporting the IPAE</b>	June 11, 2021	IAASB staff provided an update of high-level observations from the DP. IAASB staff and IFAC representatives, including staff supporting the IPAE, held initial discussions about developing a collaborative, multi-stakeholder solution by all participants in the financial reporting ecosystem through educational efforts, including using the IAASB's and IFAC's global voice in encouraging action for others, that effectively address the specific public interest issues on fraud in an audit of financial statements.

## APPENDIX C

### Summary of Extant Requirements and Application Material

#### I. More Transparency in the Auditor's Report Describing Fraud Related Matters

ISA Reference and Paragraph	Description
ISA 700 (Revised), paragraph 39(b)(i)	<p>"The Auditor's Responsibilities for the Audit of the Financial Statements section of the auditor's report shall further:</p> <p>...</p> <p>(a) Describe an audit by stating that the auditor's responsibilities are:</p> <p style="padding-left: 20px;">(i) To identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error; to design and perform audit procedures responsive to those risks; and to obtain audit evidence that is sufficient and appropriate to provide a basis for the auditor's opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.</p> <p>..."</p>
ISA 700 (Revised), paragraph A50	<p>"The description of the auditor's responsibilities as required by paragraphs 37–40 of this ISA may be tailored to reflect the specific nature of the entity, for example, when the auditor's report addresses consolidated financial statements. Illustration 2 in the Appendix to this ISA includes an example of how this may be done."</p>
ISA 701, paragraphs 9–10	<p><b>Determining Key Audit Matters</b></p> <p>"The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:</p> <p>(a) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with ISA 315 (Revised).</p> <p>(b) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that are subject to a high degree of estimation uncertainty.</p> <p>(c) The effect on the audit of significant events or transactions that occurred during the period.</p> <p>The auditor shall determine which of the matters determined in accordance with paragraph 9 were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters."</p>
ISA 701, paragraphs A9–A30	<p>The paragraphs referenced to the left provide application and other explanatory material when determining KAMs.</p>

ISA Reference and Paragraph	Description
ISA 701, paragraph 11	<p><b>Communicating Key Audit Matters</b></p> <p>“The auditor shall describe each key audit matter, using an appropriate subheading, in a separate section of the auditor’s report under the heading “Key Audit Matters,” unless the circumstances in paragraphs 14 or 15 apply. The introductory language in this section of the auditor’s report shall state that:</p> <p>(a) Key audit matters are those matters that, in the auditor’s professional judgment, were of most significance in the audit of the financial statements [of the current period]; and</p> <p>(b) These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor’s opinion thereon, and the auditor does not provide a separate opinion on these matters.”</p>
ISA 701, paragraphs A31–A33	The paragraphs referenced to the left provide application and other explanatory material when communicating KAMs.

## II. Making the Engagement Team Discussion on Fraud Considerations More Robust

ISA Reference and Paragraph	Description
ISA 240, paragraph 16	<p><b>Discussion among the Engagement Team</b></p> <p>“ISA 315 (Revised) requires a discussion among the engagement team members and a determination by the engagement partner of which matters are to be communicated to those team members not involved in the discussion. This discussion shall place particular emphasis on how and where the entity’s financial statements may be susceptible to material misstatement due to fraud, including how fraud might occur. The discussion shall occur setting aside beliefs that the engagement team members may have that management and those charged with governance are honest and have integrity.”</p>
ISA 240, paragraphs A11–A12	The paragraphs referenced to the left provide application and other explanatory material about the discussion among the engagement team.
ISA 315 (Revised 2019), paragraphs 17–18	<p>“The engagement partner and other key engagement team members shall discuss the application of the applicable financial reporting framework and the susceptibility of the entity’s financial statements to material misstatement. When there are engagement team members not involved in the engagement team discussion, the engagement partner shall determine which matters are to be communicated to those members.”</p>

ISA Reference and Paragraph	Description
ISA 315 (Revised 2019), paragraphs A42–A47	The paragraphs referenced to the left provide application and other explanatory material about the engagement team discussion.
ISA 315 (Revised 2019), paragraph 37	<p><i>Revision of Risk Assessment</i></p> <p>“If the auditor obtains new information which is inconsistent with the audit evidence on which the auditor originally based the identification or assessments of the risks of material misstatement, the auditor shall revise the identification or assessment.” (Ref: Para. A236)</p>
ISA 315 (Revised 2019), paragraph A236	The paragraph referenced to the left provide application and other explanatory material about the revision of risk assessment.
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> <p>...”</p>
ISA 240, paragraphs A35–A36	The paragraphs referenced to the left provide application and other explanatory material about the assignment and supervision of personnel, including assigning additional individuals with specialized skill and knowledge, such as forensic and IT experts.
ISA 220 (Revised), paragraphs 25–28	<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> <p>If, as a result of complying with the requirements in paragraphs 25 and 26, the engagement partner determines that resources assigned or made available are insufficient or inappropriate in the circumstances of the audit engagement, the engagement partner shall take appropriate action, including communicating with appropriate individuals about the need to assign or make available additional or alternative resources to the engagement.</p>

ISA Reference and Paragraph	Description
	The engagement partner shall take responsibility for using the resources assigned or made available to the engagement team appropriately, given the nature and circumstances of the audit engagement.”
ISA 220 (Revised), paragraphs A59–A79	The paragraphs referenced to the left provide application and other explanatory material about engagement resources.
ISA 220 (Revised), paragraphs A18–A19, A34, A36, A64, A71, A73, A79, A92	The paragraphs referenced to the left provide application and other explanatory material about the assignment and supervision of personnel, including assigning additional individuals with specialized skill and knowledge, such as forensic and IT experts.

### III. Clarifying the Relationship Between ISA 240 and ISA 250 (Revised)

ISA Reference and Paragraph	Description
ISA 240, paragraph 1	“This International Standard on Auditing (ISA) deals with the auditor’s responsibilities relating to fraud in an audit of financial statements. Specifically, it expands on how ISA 315 (Revised) and ISA 330 are to be applied in relation to risks of material misstatement due to fraud.”
ISA 240, paragraphs 5–9	<p><i>Responsibilities of the Auditor</i></p> <p>“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.</p> <p>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</p>

ISA Reference and Paragraph	Description
	<p>of individual amounts manipulated, and the seniority of those individuals involved. While the auditor may be able to identify potential opportunities for fraud to be perpetrated, it is difficult for the auditor to determine whether misstatements in judgment areas such as accounting estimates are caused by fraud or error.</p> <p>Furthermore, the risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud, because management is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information or override control procedures designed to prevent similar frauds by other employees.</p> <p>When obtaining reasonable assurance, the auditor is responsible for maintaining professional skepticism throughout the audit, considering the potential for management override of controls and recognizing the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud. The requirements in this ISA are designed to assist the auditor in identifying and assessing the risks of material misstatement due to fraud and in designing procedures to detect such misstatement.</p> <p>The auditor may have additional responsibilities under law, regulation or relevant ethical requirements regarding an entity's non-compliance with laws and regulations, including fraud, which may differ from or go beyond this and other ISAs, such as:</p> <ul style="list-style-type: none"> <li>(a) Responding to identified or suspected non-compliance with laws and regulations, including requirements in relation to specific communications with management and those charged with governance, assessing the appropriateness of their response to non-compliance and determining whether further action is needed;</li> <li>(b) Communicating identified or suspected non-compliance with laws and regulations to other auditors (e.g., in an audit of group financial statements); and</li> <li>(c) Documentation requirements regarding identified or suspected non-compliance with laws and regulations.</li> </ul> <p>Complying with any additional responsibilities may provide further information that is relevant to the auditor's work in accordance with this and other ISAs (e.g., regarding the integrity of management or, where appropriate, those charged with governance)."</p>
ISA 240, paragraph A6	<p>"Law, regulation or relevant ethical requirements may require the auditor to perform additional procedures and take further actions. For example, the International Ethics Standards Board for Accountants' International Code of Ethics for Professional Accountants (including International Independence Standards) (IESBA Code) requires the auditor to take steps to respond to identified or suspected non-compliance with laws and regulations and determine whether further action is needed. Such steps may include the</p>



ISA Reference and Paragraph	Description
	communication of identified or suspected non-compliance with laws and regulations to other auditors within a group, including a group engagement partner, component auditors or other auditors performing work at components of a group for purposes other than the audit of the group financial statements.”
ISA 250 (Revised), paragraph 1	“This International Standard on Auditing (ISA) deals with the auditor’s responsibility to consider laws and regulations in an audit of financial statements. This ISA does not apply to other assurance engagements in which the auditor is specifically engaged to test and report separately on compliance with specific laws or regulations.”
ISA 250 (Revised), paragraphs 5–9	<p><i>Responsibilities of the Auditor</i></p> <p>“The requirements in this ISA are designed to assist the auditor in identifying material misstatement of the financial statements due to non-compliance with laws and regulations. However, the auditor is not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.</p> <p>The auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether due to fraud or error. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements in the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the ISAs. In the context of laws and regulations, the potential effects of inherent limitations on the auditor’s ability to detect material misstatements are greater for such reasons as the following:</p> <ul style="list-style-type: none"> <li>• There are many laws and regulations, relating principally to the operating aspects of an entity, that typically do not affect the financial statements and are not captured by the entity’s information systems relevant to financial reporting.</li> <li>• Non-compliance may involve conduct designed to conceal it, such as collusion, forgery, deliberate failure to record transactions, management override of controls or intentional misrepresentations being made to the auditor.</li> <li>• Whether an act constitutes non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body.</li> </ul> <p>Ordinarily, the further removed non-compliance is from the events and transactions reflected in the financial statements, the less likely the auditor is to become aware of it or to recognize the non-compliance.</p> <p>This ISA distinguishes the auditor’s responsibilities in relation to compliance with two different categories of laws and regulations as follows:</p> <p>(a) The provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements such as tax and pension laws and regulations (see paragraph 14); and</p>

ISA Reference and Paragraph	Description
	<p>(b) Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business, to an entity's ability to continue its business, or to avoid material penalties (e.g., compliance with the terms of an operating license, compliance with regulatory solvency requirements, or compliance with environmental regulations); non-compliance with such laws and regulations may therefore have a material effect on the financial statements (see paragraph 15).</p> <p>In this ISA, differing requirements are specified for each of the above categories of laws and regulations. For the category referred to in paragraph 6(a), the auditor's responsibility is to obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations. For the category referred to in paragraph 6(b), the auditor's responsibility is limited to undertaking specified audit procedures to help identify non-compliance with those laws and regulations that may have a material effect on the financial statements.</p> <p>The auditor is required by this ISA to remain alert to the possibility that other audit procedures applied for the purpose of forming an opinion on financial statements may bring instances of non-compliance to the auditor's attention. Maintaining professional skepticism throughout the audit, as required by ISA 200, is important in this context, given the extent of laws and regulations that affect the entity.</p> <p>The auditor may have additional responsibilities under law, regulation or relevant ethical requirements regarding an entity's non-compliance with laws and regulations, which may differ from or go beyond this ISA, such as:</p> <ul style="list-style-type: none"> <li>(a) Responding to identified or suspected non-compliance with laws and regulations, including requirements in relation to specific communications with management and those charged with governance, assessing the appropriateness of their response to non-compliance and determining whether further action is needed;</li> <li>(b) Communicating identified or suspected non-compliance with laws and regulations to other auditors (e.g., in an audit of group financial statements); and</li> <li>(c) Documentation requirements regarding identified or suspected non-compliance with laws and regulations.</li> </ul> <p>Complying with any additional responsibilities may provide further information that is relevant to the auditor's work in accordance with this and other ISAs (e.g., regarding the integrity of management or, where appropriate, those charged with governance)."</p>
ISA 250 (Revised), paragraphs A1–A8	The paragraphs referenced to the left provide application and other explanatory material about the responsibility for compliance with laws and regulations.

#### IV. Addressing Instances When Fraud or Suspected Fraud Is Identified During the Audit

ISA Reference and Paragraph	Description
ISA 240, paragraph 11	<p>“The objectives of the auditor are:</p> <ul style="list-style-type: none"> <li>(a) To identify and assess the risks of material misstatement of the financial statements due to fraud;</li> <li>(b) To obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and</li> <li>(c) To respond appropriately to fraud or suspected fraud identified during the audit.”</li> </ul>
ISA 240, paragraph 39	<p><b>Auditor Unable to Continue the Engagement</b></p> <p>“If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor’s ability to continue performing the audit, the auditor shall:</p> <ul style="list-style-type: none"> <li>(a) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;</li> <li>(b) Consider whether it is appropriate to withdraw from the engagement, where withdrawal is possible under applicable law or regulation; and</li> <li>(c) If the auditor withdraws: <ul style="list-style-type: none"> <li>(i) Discuss with the appropriate level of management and those charged with governance the auditor’s withdrawal from the engagement and the reasons for the withdrawal; and</li> <li>(ii) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor’s withdrawal from the engagement and the reasons for the withdrawal.”</li> </ul> </li> </ul>
ISA 240, paragraphs A55–A58	The paragraphs referenced to the left provide application and other explanatory material when the auditor is unable to continue the engagement.
ISA 240, paragraph 40	<p><b>Written Representations</b></p> <p>“The auditor shall obtain written representations from management and, where appropriate, those charged with governance that:</p> <ul style="list-style-type: none"> <li>(a) They acknowledge their responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud;</li> <li>(b) They have disclosed to the auditor the results of management’s assessment of the risk that the financial statements may be materially misstated as a result of fraud;</li> <li>(c) They have disclosed to the auditor their knowledge of fraud, or suspected fraud, affecting the entity involving: <ul style="list-style-type: none"> <li>(i) Management;</li> <li>(ii) Employees who have significant roles in internal control; or</li> </ul> </li> </ul>

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ISA Reference and Paragraph	Description
	<p>(iii) Others where the fraud could have a material effect on the financial statements; and</p> <p>(d) They have disclosed to the auditor their knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others."</p>
ISA 240, paragraphs A59–A60	The paragraphs referenced to the left provide application and other explanatory material on written representations.
ISA 240, paragraphs 41–43	<p><b>Communications to Management and with Those Charged with Governance</b></p> <p>"If the auditor has identified a fraud or has obtained information that indicates that a fraud may exist, the auditor shall communicate these matters, unless prohibited by law or regulation, on a timely basis with the appropriate level of management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities.</p> <p>Unless all of those charged with governance are involved in managing the entity, if the auditor has identified or suspects fraud involving:</p> <p>(a) management;</p> <p>(b) employees who have significant roles in internal control; or</p> <p>(c) others where the fraud results in a material misstatement in the financial statements,</p> <p>the auditor shall communicate these matters with those charged with governance on a timely basis. If the auditor suspects fraud involving management, the auditor shall communicate these suspicions with those charged with governance and discuss with them the nature, timing and extent of audit procedures necessary to complete the audit. Such communications with those charged with governance are required unless the communication is prohibited by law or regulation.</p> <p>The auditor shall communicate, unless prohibited by law or regulation, with those charged with governance any other matters related to fraud that are, in the auditor's judgment, relevant to their responsibilities."</p>
ISA 240, paragraphs A61–A66	The paragraphs referenced to the left provide application and other explanatory material on communications to management and with TCWG.
ISA 240, paragraph 44	<p><b>Reporting Fraud to an Appropriate Authority Outside the Entity</b></p> <p>"If the auditor has identified or suspects a fraud, the auditor shall determine whether law, regulation or relevant ethical requirements:</p> <p>(a) Require the auditor to report to an appropriate authority outside the entity.</p> <p>(b) Establish responsibilities under which reporting to an appropriate authority outside the entity may be appropriate in the circumstances."</p>

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ISA Reference and Paragraph	Description
ISA 240, paragraphs A67– A69	The paragraphs referenced to the left provide application and other explanatory material on reporting fraud to an appropriate authority outside the entity.
ISA 240, paragraph 47	<p><b>Documentation</b></p> <p>...</p> <p>“The auditor shall include in the audit documentation communications about fraud made to management, those charged with governance, regulators and others.”</p>

## APPENDIX D

### Summary of Possible Actions for the Topics for Further Discussion Included in this Agenda Item

Issue/Theme	Standard-Setting - Introduction	Standard-Setting - Requirements	Standard-Setting – App. Material	Non-Authoritative Guidance	Education	Actions for Others	No Further Action Recommended
A. More Transparency in the Auditor's Report Through Describing Fraud Related Matters				<b>X</b>			
B. Making the Engagement Team Discussion on Fraud Considerations More Robust		<b>X</b>	<b>X</b>				
C. Clarifying the Relationship Between ISA 240 and ISA 250 (Revised)			<b>X</b>	<b>X</b>			
D. Addressing Instances When Fraud or Suspected Fraud Is Identified During the Audit		<b>X</b>	<b>X</b>				

## APPENDIX E

### Draft Scope for Project Proposal on Fraud

#	Key Public Interest Issue(s) (see Section II above)	Matters to Be Addressed	Proposed Action				Details of Proposed Action and Stakeholders Most Affected
			S	G	E	O	
1	Determining the appropriate role and responsibilities of the auditor in relation to fraud in an audit of financial statements	Revise introductory language in ISA 240 about inherent limitations of an audit	X		X		<p>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. As such, the IAASB proposes this project include:</p> <ul style="list-style-type: none"> <li>Possible standard-setting actions to clarify and emphasize the auditor's responsibilities in relation to fraud in the Introduction of ISA 240. Also, the IAASB proposes to emphasize the auditor's responsibilities by placing them prior to the description of inherent limitations of an audit.</li> <li>Further explore whether standard-setting is needed to enhance the application material in ISA 200 about fraud-related inherent limitations in an audit.</li> <li>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. Educational materials or actions may include short educational videos or webinars promoted on the IAASB's website and social media accounts.</li> </ul> <p><u>Stakeholders most affected:</u> Users of financial statements.</p>
		Clarify how concepts such as bribery and corruption relate to the definition of	X		X		<p>The IAASB has a definition of fraud for the purpose of the auditor's work on the financial statements, but there are other terms or concepts associated with fraud that are not directly addressed in the standard, such as bribery and corruption, which may result in different expectations about what the auditor is</p>

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			S	G	E	O	
		fraud for purposes of a financial statement audit					<p>considering when undertaking procedures on fraud. As part of this project, the IAASB proposes to:</p> <ul style="list-style-type: none"> <li>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.</li> <li>Educational efforts about the responsibilities of the auditor for fraud in a financial statement audit (including what the definition of fraud encompasses). Educational materials or actions may include short educational videos or webinars promoted on the IAASB's website and social media accounts.</li> </ul> <p><u>Stakeholders most affected:</u> Users of financial statements.</p>
		Enhance requirements and application material related to the use of forensic specialists	X				<p>Stakeholders had mixed views on whether to require auditors to use forensic specialists in financial statement audits. After weighing the feedback obtained, as part of this project, the IAASB proposes to:</p> <ul style="list-style-type: none"> <li>Consider adding a requirement for the auditor to consider the use of forensic specialists when there is identified or suspected fraud.</li> <li>Consider adding a requirement to consider the use forensic specialists to assist with risk assessment procedures, including in the engagement team discussion.</li> </ul> <p>In exploring the above requirements, 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>The IAASB also proposes to enhance application material as part of this project to provide clarity around the types of circumstances when it may be</p>



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			S	G	E	O	
							<p>appropriate to consider the use of forensic specialists in complying with paragraph 30(a) of extant ISA 240.</p> <p><u>Stakeholders most affected:</u> Users of financial statements, auditors, those in charge of adoption, implementation and enforcement of the standards, and preparers (including management and TCWG)</p>
2	Enhancing the connection of ISA 240 to the IAASB's other standards and fostering an integrated risk-based approach	Revise and enhance requirements in ISA 240 to incorporate recent changes in ISA 315 (Revised 2019) to make fraud risk identification and assessment more robust	X				<p>Stakeholders called for emphasis and clarity of how recent changes to ISA 315 (Revised 2019) apply in the context of fraud risk identification and assessment procedures. Therefore, as part of this project, the IAASB proposes to enhance requirements and application material within ISA 240 to:</p> <ul style="list-style-type: none"> <li>• Make risk assessment procedures more robust by specifically including fraud considerations.</li> <li>• Clarify that risk assessment procedures in ISA 240 are not separate from those in ISA 315 (Revised 2019) and therefore should be performed together as one integrated set of ISAs.</li> <li>• Strengthen the link between ISA 240 and the acceptance and continuance process and enhance requirements to consider information obtained during that process when obtaining an understanding of the entity and its environment (in particular, its corporate culture), and system of internal control, when identifying risks of material misstatement from fraud.</li> <li>• Describe the auditor's specific considerations relating to fraud when obtaining an understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control in accordance with ISA 315 (Revised 2019), with an emphasis on, for example: <ul style="list-style-type: none"> <li>○ The entity's corporate culture, including for example, how the general business environment impacts the corporate culture when obtaining an understanding of the control environment.</li> </ul> </li> </ul>

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			S	G	E	O	
							<ul style="list-style-type: none"> <li>○ Measures used by management to assess the entity's financial performance (e.g., key performance indicators (KPIs)).</li> <li>○ Employee performance measures and incentive compensation policies (e.g., how the CEO, CFO and other executives are paid; whether they are compensated based on stock performance and other KPIs).</li> <li>○ The entity's risk assessment process for identifying and analyzing fraud risks to achieving the entity's objectives, which forms the basis for how management or TCWG determine how fraud risks are to be managed.</li> <li>○ Specific control activities that management has designed and implemented to prevent and detect fraud, such as the entity's whistle-blower programs or other fraud specific controls.</li> <li>• Update the fraud risk factors currently included in the Appendix of ISA 240 and considering whether the fraud risk factors should rather be included in the application material to the standard, and how their use can be clarified when performing risk assessment procedures.</li> <li>• Describe fraud considerations when identifying and assessing the risks of material misstatement due to fraud, with emphasis on: <ul style="list-style-type: none"> <li>○ How fraud risk factors influence the auditor's assessment of the likelihood and magnitude of misstatement for the identified risks of material misstatement due to fraud at the assertion level.</li> <li>○ How the degree to which fraud risk factors affect the susceptibility of an assertion to misstatement assists the auditor in appropriately assessing inherent risk for risks of material misstatement due to fraud at the assertion level, and therefore in designing a more precise response to such a fraud risk.</li> </ul> </li> </ul>

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			S	G	E	O	
							<ul style="list-style-type: none"> <li>Strengthening the link between the identified and assessed risks of material misstatement due to fraud to further audit procedures addressing those risks.</li> <li>Requiring specific topics to be included during the engagement team discussion, for example, by elevating existing application material in paragraph A12 of ISA 240 to a requirement, which specifies matters to be included in the engagement team discussion, while also considering scalability. *</li> <li>Develop application material in ISA 240 on considerations when it may be beneficial to hold further engagement team discussion(s). *</li> <li>Develop application material in ISA 240 on considerations when it may be beneficial for specialists (including internal or external fraud specialists) already engaged in the audit to attend engagement team discussion(s). *</li> <li>Consider examples to illustrate the scalability of the requirements, for example by providing examples that are more relevant to LCEs.</li> </ul> <p><u>Stakeholders most affected:</u> Users of financial statements, auditors, and those in charge of adoption, implementation, and enforcement of the standards.</p> <p><i>*Note: This matter is pending discussion at the July 2021 Board meeting and will be modified as necessary based on that discussion.</i></p>
		Clarify the relationship between ISA 240 and ISA 250 (Revised)	X	X			<p>Stakeholders expressed it may be helpful to clarify the relationship between ISA 240 and ISA 250 (Revised). As part of this project, the IAASB proposes:</p> <ul style="list-style-type: none"> <li>Developing application material in ISA 240 highlighting the interrelationship between fraud and non-compliance with laws and regulations (i.e., fraud often constitutes an illegal act and therefore, may also fall under ISA 250 (Revised)).</li> </ul>

#	Key Public Interest Issue(s) (see Section II above)	Matters to Be Addressed	Proposed Action				Details of Proposed Action and Stakeholders Most Affected
			S	G	E	O	
							<ul style="list-style-type: none"> <li>Developing non-authoritative guidance that guides auditors in navigating the required actions to be taken when responding to identified fraud or suspected fraud under ISA 240, non-compliance under ISA 250 (Revised), and NOCLAR under the IESBA Code.</li> </ul> <p><u>Stakeholders most affected:</u> Users of financial statements, auditors, and those in charge of adoption, implementation, and enforcement of the standards.</p> <p><i>Note: This matter is pending discussion at the July 2021 Board meeting and will be modified as necessary based on that discussion.</i></p>
		How to consider full suite of integrated ISAs when performing fraud procedures		X			<p>In addition to ISA 315 (Revised) and ISA 250 (Revised), respectively, stakeholders commented it would be beneficial to understand how other ISAs relate with the procedures in ISA 240 and how the ISAs should be applied as one integrated set of standards. As part of this project, the IAASB proposes to develop non-authoritative guidance that illustrates how ISA 240 should be applied in conjunction with the full suite of ISAs and highlights considerations from other standards that are critical when undertaking fraud-related procedures.</p> <p><u>Stakeholders most affected:</u> Auditors.</p>
		Clarify requirements around the rebuttable presumption of fraud risk in revenue recognition	X	X			<p>Stakeholders called for clarity around the concept of the rebuttable presumption of fraud risk revenue recognition and had mixed views as to whether it remains appropriate, or whether it should be extended to other areas of the audit. As part of this project, the IAASB proposes enhancing the application material in ISA 240 to:</p> <ul style="list-style-type: none"> <li>Highlight other areas that may be susceptible to material misstatement due to fraud, for example, cash, asset impairment, provisions, and off-balance sheet arrangements.</li> </ul>

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			S	G	E	O	
							<ul style="list-style-type: none"> <li>Clarify when it is inappropriate to rebut the presumption of risks of fraud in revenue recognition.</li> <li>Describe public sector considerations (i.e., to explain how this requirement applies in public sector audits where the focus is not on revenue recognition generally).</li> </ul> <p>The IAASB also proposes development of non-authoritative guidance to clarify considerations related to the rebuttable presumption of fraud risk in revenue recognition specific to certain industries.</p> <p><u>Stakeholders most affected:</u> Auditors and those in charge of adoption, implementation, and enforcement of the standards.</p>
		Enhance requirements for when fraud is suspected or identified	X	X			<p>Stakeholders commented that it may be helpful to provide clearer direction in ISA 240 on how to respond appropriately to fraud or suspected fraud identified during the audit. As part of this project, the IAASB proposes reorganizing the requirements and application material (recognizing that in doing so, enhancements could also be explored or become apparent) into a separate section in ISA 240 when fraud is identified or suspected.</p> <p><u>Stakeholders most affected:</u> Users of financial statements, auditors, and those in charge of adoption, implementation, and enforcement of the standards.</p> <p><i>Note: This matter is pending discussion at the July 2021 Board meeting and will be modified as necessary based on that discussion.</i></p>
		Provide guidance on how to consider unpredictability procedures in		X			<p>Stakeholders commented that further guidance would be useful to understand the types of unpredictability procedures that may be considered when developing the plan for their fraud audit procedures. As part of this project, the IAASB proposes to develop non-authoritative guidance to help auditors with considerations around unpredictability procedures.</p>

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			S	G	E	O	
		the current environment					<u>Stakeholders most affected:</u> Auditors and preparers.
		Clarify the auditor's actions when non-material fraud is suspected or identified		X			Stakeholders supported further clarity around the auditor's responsibilities when a possible non-material fraud is identified. As part of this project, the IAASB proposes to develop non-authoritative guidance to clarify the auditor's responsibilities when a possible non-material fraud is identified (for example, that more work is required to conclude that it is a non-material fraud, taking into account the quantitative and qualitative characteristics of the misstatement) and to help auditors understand what actions are necessary when a possible non-material fraud is identified.  <u>Stakeholders most affected:</u> Users of financial statements, and auditors.
		Third-Party Fraud - guidance on the auditor's actions when third party fraud suspected or identified		X			Stakeholders supported further clarity around the auditor's responsibilities for third-party fraud. As part of this project, the IAASB proposes to develop non-authoritative guidance to clarify the auditor's responsibilities regarding the risk of material misstatement due to third-party fraud, and further implications for auditors. In addition, the WG will collaborate with the Technology Working Group to determine if non-authoritative guidance on cybercrime would be useful.  <u>Stakeholders most affected:</u> Users of financial statements, and auditors.
		Consideration of specific documentation requirements related to fraud	X				As the project on fraud progresses, the IAASB will consider whether there are documentation requirements specific to fraud that should be considered in ISA 240.  <u>Stakeholders most affected:</u> Auditors, and those in charge of adoption, implementation, and enforcement of the standards.

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			S	G	E	O	
		Provide guidance to illustrate how auditors can use key performance indicators (KPIs) in the procedures they are required to undertake (such as risk assessment procedures and journal testing)		X			KPIs (e.g., revenue, gross profit margin, net profit margin, current ratio, etc.), which measure an entity's output against a set of targets, objectives, or industry peers, may indicate unexpected or inconsistent performance compared with historical or budgeted performance or with other known factors. Stakeholders noted it would be helpful if guidance was provided on how KPIs can be used when performing fraud procedures. As part of this project, the IAASB proposes to issue guidance around how auditors can use KPIs in performing fraud procedures, such as fraud risk assessment procedures and journal entry testing. <u>Stakeholders most affected:</u> Auditors.
		Provide guidance to assist with implementation including fraud inquiries and how these are best tailored, to help the efficacy of the engagement team discussion and the use of internal and external information and analytics		X			In response to stakeholder feedback, the IAASB proposes to issue non-authoritative guidance to assist with implementation including fraud inquiries and how these are best tailored, to help the efficacy of the fraud brainstorming session and the use of internal and external information and analytics. <u>Stakeholders most affected:</u> Auditors.
3	Facilitating appropriate	Limited revisions to	X				Stakeholders called for enhanced transparency and two-way communication with TCWG on the topic of

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			S	G	E	O	
	transparency in communication s between the auditor and TCWG and within the auditor's report	requirements and enhancements to application material to strengthen required communication s for a subset of entities					<p>fraud. However, not all entities or jurisdictions require the same type of corporate governance structure. Therefore, as part of this project, the IAASB proposes to enhance requirements and application material within ISA 240 for a subset of entities (e.g., listed entities) as well as possible targeted enhancements in ISA 260 (Revised), with emphasis on the following:</p> <ul style="list-style-type: none"> <li>• Greater two-way communication with TCWG and management throughout the audit engagement by: <ul style="list-style-type: none"> <li>○ Requiring, in ISA 240, that the auditor has a specific discussion with TCWG (who are independent of management) about the entity's risks of material misstatement due to fraud, including susceptibility to misstatement due to management bias, and corroborating with TCWG inquiries of management regarding: <ul style="list-style-type: none"> <li>▪ Management's assessment of the risk that the financial statements may be materially misstated due to fraud.</li> <li>▪ Management's process for identifying and responding to the risks of fraud in the entity, including any specific risks of fraud that management has identified or that have been brought to management's attention, or classes of transactions, account balances, or disclosures for which a risk of fraud is likely to exist.</li> <li>▪ Management's communication, if any, to TCWG regarding its processes for identifying and responding to the risks of fraud in the entity.</li> </ul> </li> <li>○ Requiring, in ISA 240, that the auditor assess whether the remediation measures taken by management and TCWG for identified or suspected fraud are appropriate. This assessment will assist in the auditor's</li> </ul> </li> </ul>



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			S	G	E	O	
							<p>conclusion as to whether the auditor has obtained reasonable assurance about whether the financial statements are free from material misstatement due to fraud.</p> <ul style="list-style-type: none"> <li>Requiring, in ISA 260 (Revised), that the auditor communicate in writing with TCWG the auditor's responsibilities specific to fraud.</li> <li>Requiring, in ISA 260 (Revised), that the auditor communicate in writing with TCWG any potential indicators of management bias identified during the audit (for example when dealing with accounting estimates) to allow TCWG to monitor the bias and take appropriate actions, as needed.</li> <li>Clarifying in the application material of ISA 240 that effective participation by TCWG is influenced by their independence from management and their ability to evaluate the actions of management and highlighting the factors that should be considered by the auditor that may affect the auditor's assessment of risks of material misstatement due to fraud and the associated audit response.</li> </ul> <p><u>Stakeholders most affected:</u> Users of financial statements, auditors, those in charge of adoption, implementation and enforcement of the standards, and preparers (including management and TCWG)</p>
		Provide guidance on when a fraud-related item is a KAM		X			<p>In response to stakeholder feedback, the IAASB proposes to issue non-authoritative guidance to clarify considerations about when fraud-related matters may be KAMs.</p> <p><u>Stakeholders most affected:</u> Users of financial statements, auditors, those in charge of adoption, implementation and enforcement of the standards, and preparers.</p>

#	Key Public Interest Issue(s) (see Section II above)	Matters to Be Addressed	Proposed Action				Details of Proposed Action and Stakeholders Most Affected
			S	G	E	O	
							<i>Note: This matter is pending discussion at the July 2021 Board meeting and will be modified as necessary based on that discussion.</i>
4	Fostering the exercise of professional skepticism in the auditor's fraud-related procedures	Enhance and emphasize the requirements for professional skepticism in ISA 240	X	X			<p>Stakeholders called for enhancements and emphasis around the existing concept of professional skepticism to include changes that were made in recently approved standards such as ISA 540 (Revised)<sup>25</sup> and ISA 315 (Revised 2019). As such, the IAASB proposes this project include:</p> <ul style="list-style-type: none"> <li>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.</li> <li>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.</li> </ul> <p><u>Stakeholders most affected:</u> Users of financial statements, auditors, those in charge of adoption, implementation and enforcement of the standards, and preparers.</p>
5	Addressing advances in technology	Modernize the standard for technology	X	X			Stakeholders commented that ISA 240 should be modernized to consider how technology may be used by the auditor to perform fraud procedures, and also

<sup>25</sup> ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

#	Key Public Interest Issue(s) (see Section II above)	Matters to Be Addressed	Proposed Action				Details of Proposed Action and Stakeholders Most Affected
			S	G	E	O	
	relevant to the auditor's responsibilities relating to fraud	considerations in the current environment					<p>how it may result in additional fraud risks for an entity. Therefore, the IAASB proposes to:</p> <ul style="list-style-type: none"> <li>• Modernize and enhance application material in ISA 240 to reflect and describe fraud risks presented by use of modern technology as well as the auditor's use of technology to perform fraud-related procedures (such as more advanced and robust analytical procedures using modern technologies). In doing so, remaining mindful of maintaining a balance of not 'dating' the standard by referring to technologies that may change and evolve.</li> <li>• Working collaboratively with the Technology Working Group to develop non-authoritative guidance that supports application of ISA 240 in the current environment.</li> <li>• Monitoring technology-related developments in the ISA 500 project.</li> </ul> <p><u>Stakeholders most affected:</u> Auditors.</p>
		Provide clarity around requirements for journal entry testing and modernize the standard for current practice	X				<p>Stakeholders commented that further clarity is needed around the requirements for journal entry testing to improve consistency in application. Therefore, the IAASB proposes enhancements to requirements in ISA 240 to:</p> <ul style="list-style-type: none"> <li>• Clarify that the auditor's risk assessment procedures performed as part of ISA 315 (Revised 2019)) drive the approach to journal entry testing.</li> <li>• Modernize journal entry testing requirements with consideration of how journal entry testing is currently performed and the impact of technology.</li> </ul> <p>The IAASB also proposes enhancing application material to:</p> <ul style="list-style-type: none"> <li>• Clarify what the auditor's objectives are when testing journal entries, and help auditors understand how to determine the nature, timing</li> </ul>

#	Key Public Interest Issue(s) (see Section II above)	Matters to Be Addressed	Proposed Action				Details of Proposed Action and Stakeholders Most Affected
			S	G	E	O	
							<p>and extent of the auditor's procedures related to journal entry testing.</p> <ul style="list-style-type: none"> <li>Consider the impact of any proposed changes being made to ISA 500<sup>26</sup> (e.g., testing the completeness of the population of journal entries).</li> </ul> <p><u>Stakeholders most affected:</u> Auditors and those in charge of adoption, implementation, and enforcement of the standards.</p>
		Modernize ISA 240 for consideration of how external confirmations are used in current practice to respond to risks of material misstatement due to fraud	X				<p>As part of this project, the IAASB proposes to enhance the application material in ISA 240 related to fraud considerations for external confirmation procedures to:</p> <ul style="list-style-type: none"> <li>Modernize for current practice and developments in technology, including technology used in practice for external confirmations.</li> <li>Clarify auditor procedures when there are non-responses.</li> <li>Emphasize the usefulness of external confirmations as an audit procedure when there is a heightened risk of fraud.</li> </ul> <p><u>Stakeholders most affected:</u> Auditors and those in charge of adoption, implementation, and enforcement of the standards.</p>
		Analytical Procedures - providing guidance for current environment		X			<p>The IAASB proposes to issue non-authoritative guidance, with assistance from the Technology Working Group, to highlight how analytics may be used in the current environment to help target fraud procedures and identify anomalies worth investigating.</p> <p><u>Stakeholders most affected:</u> Auditors.</p>

In addition to the matters above within the IAASB's remit, the IAASB will also focus on the following as part of the project on fraud.

<sup>26</sup> ISA 500, *Audit Evidence*

#	Matters to Be Addressed	Proposed Action				Details of Proposed Action and Stakeholders Most Affected
		S	G	E	O	
1	Emphasis on the importance of all stakeholders in the financial reporting ecosystem to play a role in addressing issues raised on fraud				X	<p>Stakeholders emphasized the importance of all parties in the financial reporting ecosystem to address issues related to fraud. As part of this project, the IAASB proposes to:</p> <ul style="list-style-type: none"> <li>Continue outreach and discussion with stakeholders over the course of the project (e.g., regulators and audit oversight bodies, national standard setters, investors and other users of the financial statements, audit firms, public sector organizations, corporate governance experts, academics, member bodies, and other professional organizations); and</li> <li>Promote educational material as it is developed by the IAASB in conjunction with this project.</li> <li>Issue communications from the Chair of the IAASB about the importance of this topic and the role of others in the financial reporting ecosystem.</li> </ul> <p><u>Stakeholders most affected:</u> All stakeholders in the financial reporting ecosystem.</p>
2	Encourage others to foster education for others in the financial reporting ecosystem in targeted areas where stakeholder feedback indicated education would be useful, but where the matters are outside the remit of the IAASB.			X		<p>Stakeholders also commented on the following areas where further education and training for auditors would be helpful but fall outside the IAASB's remit. The IAASB will more broadly liaise and share these areas with the International Federation of Accountants (IFAC) International Panel on Accountancy Education (IPAE), member bodies or other professional organizations. Stakeholder feedback called for education to:</p> <ul style="list-style-type: none"> <li>Clarify the role of each party in the financial reporting ecosystem on the topic of fraud. It was emphasized that coordinated efforts would be needed.</li> <li>Educate TCWG on the development and execution of anti-fraud programs and controls (e.g., championed by accountancy organizations, board associations, shareholder groups etc.).</li> <li>Enhance training about fraud in auditor's continuing professional education, by both universities and professional accounting bodies (e.g., in the areas of fraud risk assessment, forensic skills, technological competence and applying a skeptical mindset (including topics such as</li> </ul>

Fraud in an Audit of Financial Statements –  
Discussion of Remaining Specific Issues and Development of a Project Proposal  
*IAASB Main Agenda (July 2021)*

#	Matters to Be Addressed	Proposed Action				Details of Proposed Action and Stakeholders Most Affected
		S	G	E	O	
						<p>behavioural science, e.g., concepts of conscious and unconscious bias)).</p> <ul style="list-style-type: none"> <li>• Train financial statement auditors about forensic skills and fraud awareness, including lessons learned from recent fraud cases.</li> </ul> <p><u>Stakeholders most affected:</u> All stakeholders in the financial reporting ecosystem.</p>