

Agenda Item 3–A

Proposed ISA 240 (Revised), *The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements* Marked from June 2023

This Agenda Item includes a draft of proposed ISA 240 (Revised), which been marked from the draft that was discussed at the June 2023 IAASB meetings ([Agenda Item 3–G](#)).

ISA 240 Requirement	Application Material
Introduction	
Scope of this ISA	
1. This International Standard on Auditing (ISA) deals with the auditor’s responsibilities relating to fraud in an audit of financial statements and the implications for the auditor’s report. The requirements and guidance in this ISA refer to, or expand on, the application of other relevant ISAs, in particular ISA 200, ¹ ISA 220 (Revised), ² ISA 315 (Revised 2019), ³ ISA 330 ⁴ and ISA 701. ⁵	
Responsibilities of the Auditor, Management and Those Charged with Governance	Responsibilities of the Auditor, Management and Those Charged with Governance
<i>Responsibilities of the Auditor</i>	<i>Responsibilities of the Auditor</i> (Ref: Para. 2)

¹ International Standard on Auditing (ISA) 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

² ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*

³ ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*

⁴ ISA 330, *The Auditor’s Responses to Assessed Risks*

⁵ ISA 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*

ISA 240 Requirement	Application Material
<p>2. The auditor’s responsibilities relating to fraud when conducting an audit in accordance with this, and other relevant, ISAs are to: (Ref: Para. A1)</p> <p>(a) Plan and perform the audit to obtain reasonable assurance that the financial statements as a whole are free from material misstatement due to fraud. These responsibilities includes identifying and assessing risks of material misstatement in the financial statements due to fraud and designing and implementing responses to address those assessed risks the assessed risks of material misstatement due to fraud.</p> <p>(b) Communicate and report about matters related to fraud.</p>	<p>Considerations Specific to Public Sector Entities</p> <p>A1. The public sector auditor’s responsibilities relating to fraud may be a result of law, regulation or other authority applicable to public sector entities or separately covered by the auditor’s mandate. Consequently, the public sector auditor’s responsibilities may not be limited to consideration of risks of material misstatement of the financial statements, but may also include a broader responsibility to consider risks of fraud.</p>
<p><i>Responsibilities of Management and Those Charged with Governance</i></p> <p>3. The primary responsibility for the prevention and detection of fraud rests with both management and those charged with governance of the entity. It is important that management, with the oversight of those charged with governance, place a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place, and fraud deterrence, which could persuade individuals not to commit fraud because of the likelihood of detection and punishment. This involves a commitment to creating and maintaining a culture of honesty and ethical behavior that which can be reinforced by active oversight by those charged with governance.</p>	
<p>Key Concepts in this ISA</p>	<p>Key Concepts in this ISA (Ref: Para. 5, 7, 8, 10, 12 and 13)</p>
<p><i>Characteristics of Fraud</i></p> <p>4. Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether</p>	<p><i>Characteristics of Fraud</i> (Ref: Para. 5)</p>

ISA 240 Requirement	Application Material
<p>the underlying action that results in the misstatement of the financial statements is intentional or unintentional.</p>	
<p>5. Two types of intentional misstatements are relevant to the auditor – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets. (Ref: Para. A2–A6)</p>	<p>A2. Fraud, whether fraudulent financial reporting or misappropriation of assets, involves incentive or pressure to commit fraud, a perceived opportunity to do so and some rationalization of the act.</p> <div data-bbox="1178 496 1982 1321" style="border: 1px solid black; padding: 10px;"> <p>Examples:</p> <ul style="list-style-type: none"> • Incentive or pressure to commit fraudulent financial reporting may exist when management is under pressure, from sources outside or inside the entity, to achieve an expected (and perhaps unrealistic) earnings target or financial outcome — particularly where since the consequences to management for failing to meet financial goals can be significant. Similarly, individuals may have an incentive to misappropriate assets — for example, because the individuals are living beyond their means. • A perceived opportunity to commit fraud may exist when an individual believes internal controls can be overridden, for example, because the individual is in a position of trust or has knowledge of specific deficiencies in internal control. • Individuals may rationalize committing a fraudulent act as they may possess an attitude, character or set of ethical values that allow them to knowingly and intentionally to commit a dishonest act. However, even otherwise honest individuals can commit fraud in an environment that imposes sufficient pressure on them. </div> <p>A3. Fraudulent financial reporting involves intentional misstatements, including omissions of amounts or disclosures in financial statements.</p>

ISA 240 Requirement	Application Material
	<p>to deceive financial statement users. It can be caused by the efforts of management to manage earnings in order to deceive financial statement users by influencing their perceptions as to the entity's performance and profitability. Such earnings management may start out with small actions, or inappropriate adjustment of assumptions, and changes in judgments by management. Pressures and incentives may lead these actions to increase to the extent that they result in fraudulent financial reporting. Such a situation could occur when, due to pressures to meet market expectations or a desire to maximize compensation based on performance, management intentionally takes positions that lead to fraudulent financial reporting by materially misstating the financial statements. In some entities, management may be motivated to reduce earnings by a material amount to minimize tax or to inflate earnings to secure bank financing.</p> <p>A4. Fraudulent financial reporting may be accomplished by the following:</p> <ul style="list-style-type: none"> • Manipulation, falsification (including forgery), or alteration of accounting records or supporting documentation from which the financial statements are prepared. • Misrepresentation in, or intentional omission from, the financial statements of events, transactions or other significant information. • Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure. <p>A5. Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as intentionally:</p>

ISA 240 Requirement	Application Material
	<ul style="list-style-type: none"> ● Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives. ● Inappropriately adjusting assumptions and changing judgments used to estimate account balances. ● Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period. ● Omitting, obscuring or Misstating disclosures, <u>including omitting and obscuring disclosures</u>, required by the applicable financial reporting framework, or disclosures that are necessary to achieve fair presentation. ● Concealing facts that could affect the amounts recorded in the financial statements. ● Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity. ● Altering records and terms related to significant and unusual transactions. ● Altering reports that would highlight inappropriate activity or transactions. ● Taking advantage of inadequate information processing controls in information technology (IT) applications, including controls over and review of IT application event logs (e.g., modifying the application logic, or where users can access a common database using generic access identification, or modify access identification, to conceal activity).

ISA 240 Requirement	Application Material
	<p>A6. Misappropriation of assets involves the theft of an entity’s assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more able to disguise or conceal misappropriations in ways that are difficult to detect. <u>In addition, misappropriation of assets can involve third parties who are able to exploit the entity’s assets in order to obtain an unjust or illegal advantage.</u> Misappropriation of assets <u>can be accomplished in a variety of ways and</u> is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorization.</p> <div style="border: 1px solid black; padding: 5px; margin-top: 10px;"> <p>Examples:</p> <p>Misappropriation of assets can be accomplished in a variety of ways including:</p> <ul style="list-style-type: none"> • Embezzling funds<u>receipts</u> (for example, misappropriating collections of fr accounts receivable or diverting receipts in respect of written-off accounts to personal bank accounts). • Theft of Stealing physical <u>assets or intellectual property</u> (for example, stealing inventory for personal use or for sale, stealing scrap for resale, <u>theft of digital assets by exploiting a private key and in doing so allowing the perpetrator to control the entity’s funds, theft of intellectual property by colluding with a competitor toby discloseing</u> technological data in return for payment). • Causing an entity to pay for goods and services not received (for example, payments to fictitious vendors, kickbacks paid by vendors to the entity’s purchasing agents in return for inflating prices, payments to fictitious employees). </div>

ISA 240 Requirement	Application Material	
		<ul style="list-style-type: none"> Using an entity’s assets for personal use (for example, using the entity’s assets as collateral for a personal loan or a loan to a related party).
<p>Fraud or Suspected Fraud</p> <p>6. Although fraud is a broad legal concept, for the purposes of the ISAs, the auditor is concerned with a material misstatement of the financial statements due to fraud. While the auditor may identify or fraud-or suspecter-identify the occurrence of fraud as defined by this ISA, the auditor does not make legal determinations of whether fraud has actually occurred.</p>	<p>Fraud or Suspected Fraud (Ref: Para. 7)</p>	
<p>7. The auditor may identify Ffraud or suspected fraud may be identified during the audit when performing audit procedures in accordance with this and other ISAs. Suspected fraud may also be identified when allegations of fraud Allegations of fraud may also come to the auditor’s attention of the auditor during the course of the audit. (Ref: Para. A7–A10 <u>and A29</u>)</p>	<p>A7. Audit evidence obtained when performing risk assessment procedures and further audit procedures <u>in accordance with this ISA</u> may indicate the existence of fraud or suspected fraud.</p> <div data-bbox="1178 846 1982 1341" style="border: 1px solid black; padding: 5px;"> <p>Examples:</p> <ul style="list-style-type: none"> <u>When performing risk assessment procedures, the auditor observed that the entity had a substantial volume of small, expensive inventory items that resulted in and a fraud risk factor being was identified relating to the misappropriation of assets. —Analytical procedures were performed on the inventory account balance and unexpected fluctuations were noted. Based on the audit evidence obtained, the auditor assessed that there may be a risk of material misstatement due to fraud.</u> When performing further audit procedures to obtain audit evidence to respond to the assessed risk of material </div>	

ISA 240 Requirement	Application Material
	<div data-bbox="1178 261 1982 378" style="border: 1px solid black; padding: 5px; margin-bottom: 10px;"> misstatement due to fraud, audit evidence was obtained that identified the misappropriation of inventory by employees. </div> <p>A8. Other aAudit procedures that are performed to comply with otherthe ISAs may also bring instances of fraud or suspected fraud to the auditor’s attention such as those performed in accordance with ISA 600 (Revised);⁶ <u>for example</u>, when responding to assessed risks of material misstatement due to fraud arising from the consolidation process.</p> <p>A9. The auditor may use automated tools and techniques to perform audit procedures related to identifying and assessing the risks of material misstatement due to fraud or when responding to assessed significant risks. In such circumstances, the use of technology may be beneficial by providing the auditor, with, for example, deeper insights into large data sets at an entity that operates in a decentralized manner, or the ability to perform audit procedures related to journal entry testing in a more efficient and effective manner. However, using automated tools and techniques does not replace the <u>importance of maintaining professional skepticism and the exercise exercising</u>of professional judgment, and the importance of maintaining professional skepticism especially when undertaking work and drawing conclusions about fraud in an audit of the financial statements.</p>

⁶ ISA 600 (Revised), *Special Considerations-Audits of Group Financial Statements (Including the Work of Component Auditors)*, paragraph 38(d)

ISA 240 Requirement	Application Material
	<p>A10. -For the purpose of this ISA, allegations of fraud by another party are treated as suspected fraud <u>by the auditor</u> once the <u>allegations have come to auditor’s attention</u> auditor has been made aware of such allegations (e.g., as a result of inquiries made by the auditor of management, or an employee approaches the auditor directly with information about an alleged fraud). The party making the allegations <u>may be internal or external to the entity</u>. Accordingly, the auditor performs audit procedures to address the suspected fraud.</p>
<p>Nature of the Circumstances Giving Rise to the Fraud and the Identified Misstatements</p> <p>8. The auditor’s determination of whether a fraud is material to the financial statements involves the exercise of professional judgment. This includes Judgments about whether fraud could cause a material misstatement <u>involve</u> consideration of the nature of the circumstances giving rise to the fraud and the identified misstatement(s). Judgments about materiality involve both qualitative and quantitative considerations. (Ref: Para. A11)</p>	<p>Nature of the Circumstances Giving Rise to the Fraud and the Identified Misstatements (Ref: Para. 8)</p> <p>A11. The qualitative considerations of the auditor may vary for identified misstatements that are less than materiality determined in quantitative terms for the financial statements as a whole, for example, the auditor may consider: <u>Even when an identified misstatement due to fraud is not quantitatively material, it may be qualitatively material, depending on:</u></p> <ul style="list-style-type: none"> (a) Who has instigated or perpetrated the fraud – <u>an otherwise insignificant</u> fraud perpetrated by <u>a key member of senior management</u> is ordinarily may be considered material irrespective of the amount involved. This may in turn give rise to concerns about the integrity of management responsible for the entity’s system of internal control. (b) Why the fraud was perpetrated – misstatements that are not material quantitatively, either individually or in the aggregate, may have been made intentionally to “manage” key performance indicators <u>in order for the entity to meet the terms of certain debt covenants, that need to be met in order for the entity to conduct its business according to specific laws or</u>

ISA 240 Requirement	Application Material
	regulations. In such instances, the auditor's responsibilities in accordance with ISA 250 (Revised)⁷ also apply.
<p><i>Inherent Limitations</i></p> <p>9. While the risk of not detecting a material misstatement resulting from fraud is may be higher than the risk of not detecting one resulting from error, that does not diminish the auditor's responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement due to fraud. Reasonable assurance is a high, but not absolute, level of assurance.⁸</p>	<p><i>Inherent Limitations</i> (Ref: Para. 10)</p>
<p>10. Because of the significance of the inherent limitations as it relates to fraud, 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.⁹ However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less than persuasive audit evidence.¹⁰ (Ref: Para. A12)</p>	<p>A12. The risk of not detecting a material misstatement resulting from fraud exists because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. Such attempts at concealment may be even more difficult to detect when accompanied by collusion. Collusion may cause the auditor to believe that audit evidence is persuasive when it is, in fact, false. The auditor's ability to detect a fraud depends on factors such as the skillfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved.</p>

⁷ ~~ISA 250 (Revised), Consideration of Laws and Regulations in an Audit of Financial Statements~~

⁸ ISA 200, paragraph 5

⁹ ISA 200, paragraphs A53-A54

¹⁰ ISA 200, paragraph A54

ISA 240 Requirement	Application Material
<p>11. 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 controls designed to prevent similar frauds by other employees.</p>	
<p><i>Professional Skepticism and Professional Judgment</i></p> <p>12. In accordance with ISA 200,¹¹ the auditor engagement team is required to plan and perform the audit with professional skepticism and to exercise professional judgment. The auditor is required by this ISA to remain alert to the possibility that other audit procedures performed may bring information about fraud or, suspected fraud or alleged fraud to the auditor's attention. Accordingly, it is important that the auditor maintain professional skepticism throughout the audit.</p> <p><u>12A.</u> Professional judgment is exercised in making informed decisions about the courses of action that are appropriate in the circumstances, including when <u>the auditor identifies</u> fraud or suspected fraud is identified. Professional skepticism supports the quality of judgments made by the engagement team and, through these judgments, supports the overall effectiveness of the engagement team in achieving quality at the engagement level.</p> <p><u>12AB.</u> ISA 220 (Revised)¹² requires the engagement partner to take</p>	<p><i>Professional Skepticism and Professional Judgment</i> (Ref: Para. 12)</p> <p>A13. ISQM 1¹³ requires the firm to design, implement and operate a system of quality management for audits of financial statements. The firm's commitment to an effective system of quality management underpins the requirement for the auditor to exercise professional skepticism when performing the audit engagement. This commitment is recognized and reinforced in the governance and leadership component, including a:</p> <p>(a) Commitment to quality by the leadership of the firm, such as the tone at the top by leadership contributes to the firm's culture which in turn supports and encourages the auditor to focus on the auditor's responsibilities relating to fraud in an audit of financial statements.</p> <p>(b) Recognition that the resource needs are planned for and resources <u>are</u> obtained, are allocated, or assigned in a manner that is consistent with the firm's commitment to quality, such as resources with the appropriate specialized knowledge and skills</p>

¹¹ ISA 200, paragraphs 15-16

¹² ISA 220 (Revised), paragraph 14

¹³ International Standard on Quality Management (ISQM) 1, *Quality Management for Firms that Perform Audit or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*

ISA 240 Requirement	Application Material
<p>responsibility for clear, consistent and effective actions to be taken<u>being taken</u> that reflect the <u>firm's</u> commitment to quality and establish and communicate the expected behavior of engagement team members, including emphasizing the importance of each engagement team member maintaining<u>exercising</u> professional skepticism throughout the audit engagement. (Ref: Para. A13–A14)</p>	<p>that may be needed when performing audit procedures related to fraud in an audit of financial statements.</p> <p>A14. ISQM 1¹⁴ also explains that the quality of professional judgments exercised by the firm is likely to be enhanced when individuals making such judgments demonstrate an attitude that includes an inquiring mind.</p>
<p><i>Non-Compliance with Laws and Regulations</i></p> <p>13. <u>For the purposes of this, and other relevant ISAs, fraud constitutes an instance of non-compliance with laws and regulations. As such,</u> if the auditor identifies fraud or suspected fraud, 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: (Ref: Para. A15)</p> <p>(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, <u>and</u> determining whether further action is needed;</p> <p>(b) Communicating identified or suspected non-compliance with laws and regulations to other auditors (e.g., in an audit of group financial statements), or reporting such non-compliance to an</p>	<p><i>Non-Compliance with Laws and Regulations</i> (Ref: Para. 13)</p> <p>A15. Law, regulation, <u>or</u> relevant ethical requirements may require the auditor to perform additional procedures and take further actions. For example, the International Ethics Standards Board for Accountants' <i>International Code of Ethics for Professional Accountants (including International Independence Standards)</i> (IESBA Code) requires the group engagement partner to take steps to respond to identified or suspected non-compliance with laws and regulations in the context of an audit of group financial statements and determine whether further action is needed. Such steps may include <u>communicating to have</u> the matter communicated to those performing audit work at the components, legal entities, <u>or</u> business units that are part of a group for purposes other than the group audit for example a statutory audit, unless prohibited from doing so by law or regulation.¹⁶</p>

¹⁴ ISQM 1, paragraph A31

¹⁶ For example, paragraphs R360.16–R360.18 A1 of the IESBA Code provide requirements and application material relating to communication with respect to groups.

ISA 240 Requirement	Application Material
<p>appropriate authority outside the entity (e.g., regulatory, enforcement or supervisory authorities); and</p> <p>(c) Documentation requirements regarding identified or suspected non-compliance with laws and regulations.</p> <p>ISA 250 (Revised)¹⁵ deals with the auditor’s responsibility to consider laws and regulations in an audit of financial statements. Complying with this responsibility and any additional responsibilities relating to relevant ethical requirements 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>	
Relationship with Other ISAs	Relationship with Other ISAs (Ref: Para. 14)
<p>14. Some ISAs that address specific topics also have requirements and guidance that are applicable to the auditor’s work on the identification and assessment of the risks of material misstatement due to fraud and responses to address such assessed risks of material misstatement due to fraud. In these instances, the other ISAs expand upon how this ISA is applied. (Ref: Para. A16)</p>	<p>A16. Appendix 5 identifies other ISAs that address specific topics that reference fraud or suspected fraud.</p>
Effective Date	
<p>15. This ISA is effective for audits of financial statements for periods beginning on or after [DATE].</p>	

¹⁵ [ISA 250 \(Revised\), Consideration of Laws and Regulations in an Audit of Financial Statements](#)

ISA 240 Requirement	Application Material
Objectives	
<p>16. The objectives of the auditor are:</p> <ul style="list-style-type: none"> (a) To identify and assess the risks of material misstatement of the financial statements due to fraud; (b) To obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; (c) To respond appropriately to fraud or suspected fraud identified during the audit; and (d) To report in accordance with this ISA. 	
Definitions	
<p>17. For purposes of the ISAs, the following terms have the meanings attributed below:</p> <ul style="list-style-type: none"> (a) Fraud – An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage. (Ref: Para. A17–A20) (b) Fraud risk factors – Events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud. (Ref: Para. A21<u>A22</u>–A22A) 	<p><i>Relationship of Fraud with Corruption, Bribery and Money Laundering</i> (Ref: Para. 17(a))</p> <p>A17. As with fraud, Corruption<u>corruption</u>, bribery and money laundering are forms of illegal or unethical acts that may be associated with acts of deception to obtain an unjust or illegal advantage. In particular, corruption<u>Corruption</u>, bribery, and money laundering may also be carried out to facilitate or conceal fraudulent<u>fraud</u> activities.</p> <div style="border: 1px solid black; padding: 5px; margin-top: 10px;"> <p>Examples:</p> <ul style="list-style-type: none"> • Corruption – Management <u>colluded with other competing parties to raise prices or lower the quality of goods or services for purchasers who wish to acquire products or services through a bidding process (i.e., bid rigging)</u>receives </div>

ISA 240 Requirement	Application Material
	<div data-bbox="1184 261 1986 683" style="border: 1px solid black; padding: 5px;"> <p>an illegal payment for the selection of a specific supplier to provide equipment for the entity.</p> <ul style="list-style-type: none"> • Bribery – Management offers<u>offered</u> inducements to employees for concealing the misappropriation of assets by management. • Money laundering – An employee launders<u>laundered</u> money obtained from embezzling payments for fictitious purchases of inventory through the creation of false purchase orders, vendor shipping documents, and vendor invoices. </div> <p>A18. While the auditor may suspect or identify the occurrence of corruption, bribery, or money laundering, <u>as with fraud</u>, the auditor does not make legal determinations onef whether such acts have actually occurred.</p> <p>A19. Depending on the nature and circumstances of the entity, certain laws, regulations or aspects of relevant ethical requirements dealing with corruption, bribery or money laundering may be relevant to the auditor’s responsibilities to consider laws and regulations in an audit of financial statements in accordance with ISA 250 (Revised).¹⁷</p> <p><i>Third-Party Fraud</i> (Ref: Para. 17(a))</p> <p>A20. <u>Fraud as defined in paragraph 17(a) can include an intentional act by a third party.</u> Fraud or suspected fraud committed against the entity by customers, suppliers, service providers, or other external parties is generally described as third-party fraud.</p> <div data-bbox="1184 1247 1986 1315" style="border: 1px solid black; padding: 5px;"> <p>Examples:</p> </div>

¹⁷ ISA 250 (Revised), paragraphs 6 and A6

ISA 240 Requirement	Application Material
	<ul style="list-style-type: none"> • Management’s lack of oversight over significant business processes outsourced to a third-party service provider may create opportunities for the third-party service provider to engage in fraudulent activities affecting the entity <u>(e.g., opportunity for a payroll service provider to make payments to fictitious employees)</u>. • Cybersecurity risks¹⁸ may create opportunities for external parties that are completely unknown to the entity to gain unauthorized access to the entity’s data (e.g., <u>steal-theft of customer—related intangible assets such as licensed customer and subscriber lists or personally identifiable information</u>). <p><i>Fraud Risk Factors</i> (Ref: Para. 17(b))</p> <p>A21. In applying ISA 315 (Revised 2019)¹⁹ when identifying and assessing the risks of material misstatement whether due to fraud or error, the auditor obtains an understanding of how inherent risk factors affect the susceptibility of assertions to misstatement, which includes the susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk. [Deleted] [Not used]</p> <p>A22. Fraud risk factors may relate to incentives, pressures or opportunities that arise from events or conditions that create susceptibility to misstatement, before consideration of controls. Fraud risk factors, which include intentional management bias, are, insofar as they affect inherent risk, inherent risk factors. Fraud risk factors may also relate to events or conditions that may exist in the entity’s system of internal</p>

¹⁸ [ISA 315 \(Revised 2019\), paragraphs 19–20 of Appendix 5](#)

¹⁹ [ISA 315 \(Revised 2019\), paragraphs 12\(f\) and 19\(c\)](#)

ISA 240 Requirement	Application Material
	<p>control that provide an opportunity to commit fraud and may be an indicator that other fraud risk factors are present.</p> <p><u>A22A. While fraud risk factors may not necessarily indicate the existence of fraud, they have often been present in circumstances where frauds have occurred and therefore may indicate risks of material misstatement due to fraud.</u></p>
Requirements	
Professional Skepticism	Professional Skepticism (Ref: Para. <u>7</u> : 18–20)
<p>18. In accordance with ISA 200,²⁰ the auditor shall maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist. (Ref: Para. A23–A2<u>56</u>)</p>	<p>A23. Maintaining professional skepticism requires an ongoing questioning of whether the information and audit evidence obtained suggests that a material misstatement due to fraud may exist. It includes considering the reliability of the information intended to be used as audit evidence and identified controls in the control activities component, if any, over its preparation and maintenance. Due to the characteristics of fraud, the auditor’s professional skepticism is particularly important when considering the risks of material misstatement due to fraud.</p> <p>A24. Although the auditor cannot be expected to disregard past experience of the perceived honesty and integrity of the entity’s management and those charged with governance, the auditor’s professional skepticism is particularly important in considering the risks of material misstatement due to fraud because there may have been changes in circumstances. [Deleted] [Not used]</p>

²⁰ ISA 200, paragraph 15

ISA 240 Requirement	Application Material
	<p>A25. As explained in ISA 220 (Revised)²¹,</p> <p>(a) Conditions inherent in some audit engagements can create pressures on the engagement team that may impede the appropriate exercise of professional skepticism when designing and performing audit procedures and evaluating audit evidence. For example, a lack of cooperation or undue pressures imposed by management may negatively affect the engagement team's ability to resolve complex or contentious issues and may indicate the presence of fraud risk factors. Paragraphs A34-A36 of ISA 220 (Revised) list examples of impediments to the exercise of professional skepticism at the engagement level and actions that may be taken to mitigate impediments to the exercise of professional skepticism.</p> <div style="border: 1px solid black; padding: 5px;"> <p>Examples:</p> <ul style="list-style-type: none"> • <u>A lack of cooperation and undue time pressures imposed by management negatively affected the engagement team's ability to resolve a complex and contentious issue. These circumstances were, based on the engagement partner's professional judgment, indicative of possible efforts by management to conceal fraud. The engagement partner involved more experienced members of the engagement team to deal with members of management who were difficult to interact with and communicated with those charged with governance as to the nature of the challenging circumstances, including the possible effect on the audit.</u> • <u>Difficulties in obtaining access to records, facilities, certain employees, customers, vendors, or others, resulted in the engagement team seeking sources of audit evidence that</u> </div>

²¹ ISA 220 (Revised), paragraphs A33-A35

ISA 240 Requirement	Application Material
	<p><u>were more easily accessible to respond to assessed risks of material misstatement due to fraud. These circumstances were, based on the engagement partner’s professional judgment, indicative of possible efforts by management to conceal fraud. The engagement partner communicated with those charged with governance as to the nature of the challenging circumstances, including the possible effect on the audit.</u></p> <p>(b) Unconscious auditor bias may impede the exercise of professional skepticism, and therefore the reasonableness of professional judgments made by the engagement team.²² For example, the auditor may tend to evaluate audit evidence as less relevant and reliable when it contradicts the assertions in the financial statements (confirmation bias) and was received subsequent to audit evidence that corroborates the assertions (anchoring bias). This may occur when audit evidence is obtained near the end of the audit that is inconsistent with other audit evidence obtained in response to a risk of material misstatement due to fraud. The auditor may need to take explicit action to mitigate auditor bias when evaluating the sufficiency and appropriateness of audit evidence.</p> <p>A26. ISA 220 (Revised)²³ provides possible actions that the engagement team may take to mitigate impediments to the exercise of professional skepticism at the engagement level. [Paragraph A26 was combined with paragraph A25]</p>

²² Paragraph R112.1 of the IESBA Code requires that that the accountant, when complying with the principle of objectivity, exercise professional judgment without being compromised by bias

²³ ISA 220 (Revised), paragraph A36

ISA 240 Requirement	Application Material
<p>19. If conditions identified during the audit cause the auditor to believe that a record or document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, the auditor shall investigate further. (Ref: Para. A27–A28A)</p>	<p>A27. The reliability of information intended to be used as audit evidence deals with the degree to which the auditor may depend on such information. Authenticity is an attribute that may be considered by the auditor in considering the <u>degree to which reliability of the</u> information intended to be used as audit evidence <u>is reliable</u>. In doing so, the auditor may consider whether the source actually generated or provided the information, and was authorized to do so, and the information has not been inappropriately altered. Irrespective of the auditor’s consideration of the authenticity of the information intended to be used as audit evidence, the auditor is <u>neither not</u>-trained as, <u>nor</u> expected to be, an expert in the authentication of records or documents.²⁴</p> <p>[Moved last sentence and bullets to paragraph A28A]</p> <div style="border: 1px solid black; padding: 5px;"> <p>Examples:</p> <p>Conditions that, <u>if identified</u>, may <u>cause the auditor to believe that a record or indicate a document is not authentic or that terms in a document have been modified but not disclosed to the auditor</u> include:</p> <ul style="list-style-type: none"> • Unexplained alterations to documents received from external sources. • Serial numbers used out of sequence or duplicated. • Addresses and logos not as expected. • Document style different to others of the same type from the same source (for example, changes in fonts and formatting). </div>

²⁴ ISA 200, paragraph A52

ISA 240 Requirement	Application Material
	<div data-bbox="1178 261 1982 857" style="border: 1px solid black; padding: 5px;"> <ul style="list-style-type: none"> • Information that would be expected to be included is absent. • Invoice references or descriptors that differ from other invoices received from the entity. • Unusual terms of trade, such as unusual prices, interest rates, guarantees and repayment terms (for example, purchase costs that appear unreasonable for the goods or services being charged for). • Information that appears implausible or inconsistent with the auditor’s understanding and knowledge. • A change from authorized signatory. • “Copy” documents presented rather than originals. • Electronic documents with a last edited date that is after the date they were represented as finalized. </div> <p data-bbox="1102 881 1995 1024">A28. The auditor may use automated tools and techniques to identify conditions that indicate a document is not authentic or has been altered, such as document authenticity or integrity technology. [Deleted] [Not used]</p> <p data-bbox="1102 1149 1995 1333">A28A. However, wWhen <u>conditions are identified</u> the auditor identifies conditions that cause the auditor to believe that a record or document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, possible additional <u>audit</u> procedures to investigate further may include:</p>

ISA 240 Requirement	Application Material
	<ul style="list-style-type: none"> • <u>Discussing concerns with the entity’s management and those charged with governance.</u> • Confirming directly with the third party. • Using the work of an expert to <u>assess-evaluate</u> the document’s authenticity. • <u>Using automated tools and techniques, such as document authenticity or integrity technology, to evaluate the authenticity of the record or document.</u> <p>[Previously last sentence and bullets of paragraph A27]</p>
<p>20. The auditor shall remain alert throughout the audit engagement for information about fraud <u>or</u>, suspected fraud-or-alleged fraud. (Ref: Para. A29–A30B)</p>	<p>A29. The manner in which information about fraud <u>or</u>, suspected fraud-or-alleged fraud that affects the entity, comes to the auditor’s attention throughout the audit may vary.</p> <div style="border: 1px solid black; padding: 5px; margin-top: 10px;"> <p><u>Examples:</u></p> <p>For example, fraud or suspected fraud may be identified by:</p> <ul style="list-style-type: none"> • The auditor during the audit engagement (e.g., when performing audit procedures in accordance with ISA 550,²⁵ the auditor becomes aware of the existence of a related party relationship that management intentionally did not disclose to the auditor). </div>

²⁵ [ISA 550, Related Parties](#)

ISA 240 Requirement	Application Material
	<ul style="list-style-type: none"> • Those charged with governance (e.g., when members of the audit committee conduct an independent investigation of unusual journal entries or other adjustments). • <u>Management (e.g., when evaluating the results of the entity's risk assessment process).</u> • <u>Individuals within the internal audit function (e.g., when individuals conduct the annual compliance procedures related to the entity's system of internal control).</u> <p><u>For example, alleged fraud may be identified when:</u></p> <ul style="list-style-type: none"> • An employee <u>(e.g., by through-filinges a tip using the entity's whistleblower program).</u> • A former employee <u>(e.g., by when-sending a complaint via electronic mail to the internal audit function).</u> <p>A29A. [Moved to paragraph A155A]</p> <p>A30. Remaining alert for information about fraud <u>or</u> or <u>suspected</u> fraud <u>or</u> or <u>alleged fraud</u> throughout the audit is important, including when performing audit procedures near the end of the audit when time pressures to complete the audit engagement may exist. <u>For example, audit evidence may be obtained near the end of the audit in such circumstances, information may be obtained</u> that may call into question the reliability of <u>other</u> audit evidence obtained or cast doubt on the integrity of management and those charged with governance. <u>Appendix 3 contains examples of circumstances that may be indicative of fraud.</u></p> <div style="border: 1px solid black; padding: 5px; margin-top: 10px;"> <p>Examples:</p> </div>

ISA 240 Requirement	Application Material
	<p>Information that may be indicators that fraud or suspected fraud may exist includes:</p> <p>Audit evidence that is inconsistent with other audit evidence.</p> <p>Information about overly optimistic projections obtained from listening to the entity's earnings calls with analysts or by reading analysts' research reports that is contrary to information presented in the entity's internal forecasts used for budgeting purposes.</p> <p>Non-responses to a positive confirmation request, or a confirmation request returned undelivered.</p> <p>Management's refusal to:</p> <p>Provide a requested written representation.</p> <p>Allow the auditor to send a confirmation request.</p> <p>Allow a discussion between the auditor and management's third-party expert (e.g., an expert in taxation law) regarding a material post-close journal entry (e.g., transaction recorded based on tax advice received relating to an aggressive tax planning strategy).</p> <p>Correct a material misstatement of the other information included in the entity's annual report.</p> <p>[Examples incorporated into Appendix 3]</p> <p>A30A. When performing audit procedures at, or near the end of the audit engagement, circumstances may be encountered, such as time pressures imposed on members of the engagement team, <u>which</u> that may impede the exercise of professional skepticism or may create threats to compliance with relevant ethical requirements. ISA 220</p>

ISA 240 Requirement	Application Material
	<p>(Revised)²⁶ discusses that relevant ethical requirements, for example the IESBA Code, may contain provisions regarding the identification and evaluation of threats and how they are to be dealt with.²⁷</p> <p>A30B. The auditor may also address the threat to compliance with relevant ethical requirements, such as the principle of integrity, by communicating timely with those charged with governance, about the circumstances giving rise to the threat. This communication may include a discussion about any inconsistencies in audit evidence obtained at, or near the end of the audit for which a satisfactory explanation has not been provided by management.</p>
<u>The Auditor Identifies Fraud or Suspected Fraud</u>	
<p>21. If the auditor identifies any fraud or suspected fraud is identified, the auditor shall performs the additional audit procedures in accordance with paragraphs 54–63.</p>	
Engagement Resources	Engagement Resources (Ref: Para. 22)
<p>22. In applying ISA 220 (Revised),²⁸ the engagement partner shall determine that members of the engagement team collectively have the appropriate competence and capabilities, including appropriate specialized skills or knowledge to perform risk assessment</p>	<p>A30C. ISA 220 (Revised)²⁹ explains that the engagement partner's determination of whether additional engagement level resources are required to be assigned to the engagement team is a matter of professional judgment and is influenced by the nature and</p>

²⁶ ISA 220 (Revised), paragraph A44

²⁷ For example, paragraphs R111.1 and R113.1 of the IESBA Code require the accountant to be straightforward and diligent when complying with the principles of integrity, and professional competence and due care, respectively. Paragraph 111.1A1 of the IESBA Code explains that integrity involves having the strength of character to act appropriately, even when facing pressure to do otherwise. Paragraph 113.1 A3 of the IESBA Code explains that acting diligently also encompasses performing an assignment carefully and thoroughly in accordance with applicable technical and professional standards. These ethical responsibilities are required irrespective of the pressures being imposed, explicitly or implicitly, by management.

²⁸ ISA 220 (Revised), paragraphs 25–28

²⁹ ISA 220 (Revised), paragraph A77

ISA 240 Requirement	Application Material
<p>procedures, identify and assess the risks of material misstatement due to fraud, design and perform further audit procedures to respond to those risks, or evaluate the audit evidence obtained. (Ref: Para. A34A30C–A34A33)</p>	<p>circumstances of the audit engagement, taking into account any changes that may have arisen during the engagement. [Previously paragraph A34]</p> <p>A31. The nature, timing, and extent of the involvement of individuals with specialized skills or knowledge, such as forensic and information technology (IT) experts, may vary, throughout the audit based on the nature and circumstances of the audit engagement.</p> <div data-bbox="1178 558 1982 1375" style="border: 1px solid black; padding: 5px;"> <p>Examples:</p> <p>Matters that, individually or collectively, may affect the engagement partner's determination of whether specialized skills or knowledge are needed, include:</p> <ul style="list-style-type: none"> • The entity is investigating fraud or suspected fraud that may have a material effect on the financial statements (e.g., when it involves senior management). For example, an individual with forensic skills may assist in planning and performing audit procedures as it relates to the specific audit area where the fraud or suspected fraud was identified. • The entity is undergoing an investigation by an authority outside the entity for fraud or suspected fraud, or for instances of non-compliance or suspected non-compliance with laws and regulations (e.g., <u>tax evasion and money laundering</u>) that may have a direct or indirect material effect on the financial statements. For example, <u>tax and anti-money laundering</u> an experts with regulatory experience in the relevant jurisdiction may assist with identifying those aspects of the non-compliance or suspected non-compliance that may have a financial statement impact. </div>

ISA 240 Requirement	Application Material
	<ul style="list-style-type: none"> <li data-bbox="1188 272 1976 597"> <p>• The entity is in the process of offering its securities to the public for the first time (i.e., initial public offering) and applying to list its shares on a recognized stock exchange. This may create pressures to omit or obscure required disclosures that may negatively affect the entity's initial public offering price (e.g., pending litigation or regulatory approvals). For example, an individual with legal expertise may assist in reviewing disclosures in securities offering documents such as prospectuses. [Deleted]</p> <li data-bbox="1188 630 1976 1003"> <p>• The complexity of the entity's organizational structure and related party relationships, including the creation <u>or existence</u> of special purpose entities, may present an opportunity for management to misrepresent the financial position or financial performance of the entity. For example, an expert in taxation law may assist in understanding the business purpose and activities or business units within complex organizations, including how its structure for tax purposes may be different from its operating structure.</p> <li data-bbox="1188 1027 1976 1312"> <p>• The complexity of the industry or regulatory environment in which the entity operates may present an opportunity or pressure for management to engage in fraudulent financial reporting. For example, an individual specializing in bribery and corruption practices in a-specific emerging markets may assist in identifying <u>fraud risk factors or</u> where the financial statements may be susceptible to risks of material misstatement due to fraud.</p> <li data-bbox="1188 1336 1976 1403"> <p>• The complexity of contractual terms may present an opportunity for management (or a third party) to make false</p>

ISA 240 Requirement	Application Material
	<p>representations that are intended to induce a third party (or management) to agree to the terms of the contract. For example, an individual with legal expertise may assist in reviewing contracts for unclear or ambiguous language the purpose of which is to conceal false representations.</p> <ul style="list-style-type: none"> • The use of complex financial instruments or other complex financing arrangements may present an opportunity to inadequately disclose the risks and nature of complex structured products. For example, a valuation expert may assist in understanding the product’s structure, purpose, underlying assets, and market conditions, which may highlight fraud risk factors such as discrepancies between market conditions and the valuation of the structured product. <p>A32. Forensic skills, in the context of an audit of financial statements, may combine accounting, auditing and investigative skills. Such skills are applied in an investigation and evaluation of an entity’s accounting records to derive<u>obtain</u> possible evidence of fraudulent financial reporting or misappropriation of assets, or in performing audit procedures. The use of forensic skills may also assist the auditor in evaluating whether there is management override of controls or intentional management bias in financial reporting.</p> <p>Examples:</p> <p>Forensic skills may include specialized skills or knowledge in:</p> <ul style="list-style-type: none"> • Identifying and evaluating fraud risk factors. • Identifying and assessing the risks of material misstatement due to fraud.

ISA 240 Requirement	Application Material
	<ul style="list-style-type: none"> • Evaluating the effectiveness of controls implemented by management to prevent or detect fraud. • Analyzing the authenticity of information intended to be used as audit evidence. • Gathering, analyzing, and evaluating information or data to identify links, patterns, or trends that may be indicative of fraud. • Applying knowledge in fraud schemes, and techniques for interviews, information gathering and data analytics, in the detection of fraud. • Interviewing techniques used in discussing sensitive matters with management and those charged with governance. • Analyzing financial and non-financial information by using techniques to look for inconsistencies, unusual patterns, or anomalies that may indicate intentional management bias or that may be the result of management overriding-override of controls. <p>A33. In determining whether the engagement team has the appropriate competence and capabilities, the engagement partner may consider matters such as expertise in IT systems or IT applications used by the entity or automated tools or techniques that are to be used by the engagement team in planning and performing the audit (e.g., such as the testing of journal entries and other adjustments, or accounting estimates).</p> <p>A34. [Moved to paragraph A30C] [Not used]</p>
Engagement Performance	Engagement Performance (Ref: Para. 23–24)

ISA 240 Requirement	Application Material
<p>23. In applying ISA 220 (Revised),³⁰ the engagement partner shall determine that the nature, timing and extent of direction, supervision and review is responsive to the nature and circumstances of the audit engagementtake responsibility for the direction and supervision of the members of the engagement team and the review of their work, taking <u>into</u> account the: (Ref: Para. A35–A36)</p> <p>(a) Skills, knowledge, and experience of the individuals to be given significant engagement responsibilities; and</p> <p>(b) Risks of material misstatement due to fraud identified and assessed in accordance with ISA 315 (Revised 2019).</p>	<p>A35. The engagement partner may respond to identified risks of material misstatement due to fraud by, for example:</p> <ul style="list-style-type: none"> • _____, aAssigning additional individuals with specialized skills or knowledge, such as forensic and IT experts; • _____, aAssigning more experienced individuals to the engagement team; r or • cChanging the composition of the engagement team so that more experienced members of the engagement team conduct certain audit procedures for those specific audit areas that require significant auditor attention. <p>A36. The extent of supervision of members of the engagement team reflects the assessment of the risks of material misstatement due to fraud and the competencies and capabilities of the engagement team members assigned to perform the work. [Deleted] [Not used]</p>
<p>24. In <u>making the determination in paragraph 23</u>applying ISA 220 (Revised),³¹ the engagement partner shall determine that the nature, timing and extent of direction, supervision and review is responsive to the nature and circumstances of the audit engagement. In making this determination, the engagement partner shall consider matters identified during the course of the audit engagement, including: (Ref: Para. A37–A38)</p> <p>(a) Events or conditionsthat have subsequently been identified that indicate an incentive or pressure to commit fraud, or</p>	<p>A37. ISA 220 (Revised)³² explains that the identification of changes in the engagement circumstances may warrant reevaluation of the planned approach to the nature, timing or extent of direction, supervision or review. This may include changes that affect the susceptibility of the financial statements to material misstatement due to fraud. [Deleted] [Not used]</p> <div style="border: 1px solid black; padding: 5px; margin-top: 10px;"> <p>Example:</p> <p>During the audit engagement, new information came to the engagement team's attention regarding related party</p> </div>

³⁰ ISA 220 (Revised), paragraph 30(b);²⁹

³¹ ~~ISA 220 (Revised), paragraph 30(b)~~

³² ~~ISA 220 (Revised), paragraph A96~~

ISA 240 Requirement	Application Material
<p>provide an opportunity to commit fraud (i.e., additional fraud risk factors are present); (Ref: Para. A39)</p> <p>(b) Fraud, or suspected fraud, or alleged fraud; and</p> <p>(c) Control deficiencies related to the prevention or detection of fraud.</p>	<div data-bbox="1173 261 1982 613" style="border: 1px solid black; padding: 5px; margin-bottom: 10px;"> <p>transactions that resulted in an additional risk of material misstatement due to fraud being identified. As a result, the engagement partner modified the nature, timing and extent of direction, supervision and review by greater in-person oversight and more in-depth review of certain working papers. The engagement partner also updated the audit plan to reflect the changes to the risk assessment procedures and the extent of oversight and review of working papers as required by ISA 300.³³</p> </div> <p>A38. Depending on the nature and circumstances of the audit engagement, the engagement partner’s approach to direction, supervision and review may include increasing the extent and frequency of the engagement team discussions. <u>For example, in some circumstances it may be beneficial to hold additional engagement team discussions based on the occurrence of events or conditions that have impacted the entity, which may identify new or provide additional information about existing fraud risk factors.</u></p>

³³—ISA 300, *Planning an Audit of Financial Statements*, paragraphs 10-11

ISA 240 Requirement	Application Material
	<p>Examples:</p> <p>Circumstances where it may be beneficial to hold additional discussions among the engagement team members with a view to identifying new or additional fraud risk factors, include:</p> <ul style="list-style-type: none"> Sudden Changes in existing business activity or performance (e.g., decrease in operating cashflows of an entity arising from economic conditions resulting in increased pressure internally by management to meet publicly disclosed earnings targets). Unexpected changes in the senior management of the entity (e.g., the chief financial officer resigns, with no explanation given for the sudden departure, providing an opportunity for other employees in the treasury department to commit fraud given the lack of senior management oversight). <p>[Previously paragraph A39]</p> <p>A39. [Moved examples to paragraph A38] [Not used]</p>
<p>Ongoing Nature of Communications with Management and Those Charged with Governance</p>	<p>Ongoing Nature of Communications with Management and Those Charged with Governance (Ref: Para. 25)</p>
<p>25. The auditor shall communicate with management and those charged with governance matters related to fraud at appropriate times throughout the audit engagement. (Ref: Para. A40–A44)</p>	<p>A40. Robust two-way communication between management or those charged with governance, and the auditor assists in identifying and assessing the risks of material misstatement due to fraud.</p> <p>A41. The extent of the auditor’s communications with management and those charged with governance depends on the fraud-related facts</p>

ISA 240 Requirement	Application Material
	<p>and circumstances of the entity, as well as the progress and outcome of the fraud-related audit procedures performed in the audit engagement.</p> <p>A42. The appropriate timing of the communications may vary depending on the significance and nature of the fraud-related matters, and the expected action(s) to be taken by management or those charged with governance.</p> <div data-bbox="1184 553 1986 1339" style="border: 1px solid black; padding: 5px;"> <p>Examples:</p> <ul style="list-style-type: none"> • Making the required inquiries of management and those charged with governance about matters referred to in paragraphs 31(c)–31(d) and 32(b) may be performed early in the audit engagement as part of the auditor’s communications regarding planning matters. • When ISA 701 applies, the auditor may communicate preliminary views about key audit matters related to fraud risks when discussing the planned scope and timing of the audit. • Having it may be appropriate to have specific discussions with management and those charged with governance about matters related to fraud risks on a timely basis, as relevant audit evidence is obtained based on the auditor’s evaluation of the components of the entity’s system of internal control and assessment of the risks of material misstatement due to fraud. These discussions may form part of the auditor’s communications on significant findings from the audit. • Communicating, <u>on a timely basis in accordance with ISA</u> </div>

ISA 240 Requirement	Application Material
	<div data-bbox="1184 266 1984 505" style="border: 1px solid black; padding: 5px;"> <p><u>265</u>,³⁴ significant deficiencies in internal control (including those that are relevant to the prevention or detection of fraud) with the appropriate level(s) of management and those charged with governance on a timely basis in accordance with ISA 265³⁵ may assist them in taking necessary and timely remedial actions.</p> </div> <p><i>Assigning Appropriate Member(s) within the Engagement Team When with the Responsibility to Communicate with Management and Those Charged with Governance</i></p> <p>A43. ISA 220 (Revised)³⁶ deals with the engagement partner’s overall responsibility with respect to engagement resources and engagement performance. <u>Due to the nature and sensitivity of fraud, particularly those involving senior management, Assigning assigning tasks or actions to appropriately skilled or suitably experienced</u> members of the engagement team with the appropriate competence and capabilities and providing appropriate levels of direction, supervision, and review of their work is also important for the required communications in accordance with this ISA. This includes involving appropriately skilled or suitably experienced members of the engagement team when communicating <u>matters related to fraud</u> with management and those charged with governance.</p> <p>A44. ISA 220 (Revised)³⁷ deals with the engagement partner’s responsibility to make members of the engagement team aware of the relevant ethical requirements, including independence. <u>For example,</u></p>

³⁴ ISA 265, Communicating Deficiencies in Internal Control to Those Charged with Governance and Management

³⁵ ~~ISA 265, Communicating Deficiencies in Internal Control to Those Charged with Governance and Management~~

³⁶ ISA 220 (Revised), paragraphs 25–28 and 29–34

³⁷ ISA 220 (Revised), paragraph 17

ISA 240 Requirement	Application Material
	<p><u>the IESBA Code requires compliance with the principle of integrity, which involves standing one’s ground when confronted by dilemmas and difficult situations; or challenging others as and when circumstances warrant in a manner appropriate to the circumstances.</u> This <u>It</u> is important, especially for those members of the engagement team who will be engaging with management and those charged with governance about fraud-related <u>matters related to fraud</u>, to consider the content of the communications and the manner in which such communications are to be conducted.³⁸</p>
Risk Assessment Procedures and Related Activities	Risk Assessment Procedures and Related Activities (Ref: Para. 26)
<p>26. In applying ISA 315 (Revised 2019),³⁹ the auditor shall perform the procedures in paragraphs 3027–36 to obtain audit evidence that provides an appropriate basis for the: (Ref: Para. A45–A46)</p> <p>(a) Identification and assessment of risks of material misstatement due to fraud, at the financial statement and assertion levels, taking into account fraud risk factors; and</p> <p>(b) Design of further audit procedures in accordance with ISA 330.</p>	<p>A45. ISA 315 (Revised 2019) contains requirements and guidance regarding the auditor’s responsibility to obtain an understanding of the entity and its environment, the applicable financial reporting framework, and the entity’s system of internal control, and the identification and assessment of the risks of material misstatement whether due to fraud or error. The requirements and guidance in this ISA refer to, or expand on, what is required by ISA 315 (Revised 2019).</p> <p>A46. As explained in ISA 315 (Revised 2019),⁴⁰ obtaining an understanding of the entity and its environment, the applicable financial reporting framework and the entity’s system of internal control is a dynamic and iterative process of gathering, updating and analyzing information and continues throughout the audit. Therefore, the auditor’s expectations</p>

³⁸ ~~For example, paragraph R111.1 of the IESBA Code requires compliance with the principle of integrity. Paragraph 111.1 A2 explains that acting with integrity involves standing one’s ground when confronted by dilemmas and difficult situations; or challenging others as and when circumstances warrant in a manner appropriate to the circumstances.~~

³⁹ ISA 315 (Revised 2019), paragraph 13

⁴⁰ ISA 315 (Revised 2019), paragraph A48

ISA 240 Requirement	Application Material
	with respect to risks of material misstatements due to fraud may change as new information is obtained.
<p><i>Information from Other Sources</i></p> <p>27. In applying ISA 315 (Revised 2019),⁴¹ the auditor shall consider whether information from other sources obtained by the auditor indicates that one or more fraud risk factors are present. (Ref: Para. A47–A48)</p>	<p><i>Information from Other Sources</i> (Ref: Para. 27)</p> <p>A47. Information obtained from other sources <u>in accordance with paragraphs 15–16 of ISA 315 (Revised 2019)</u> may be relevant to the identification of fraud risk factors by providing information and insights about:</p> <ul style="list-style-type: none"> • The entity and the industry in which the entity operates, and its related business risks, which that may create pressures on the organization to meet targeted financial results. • Management’s commitment to integrity and ethical values, including management’s commitment to remedy known significant deficiencies in internal control on a timely basis. • Complexity in the application of the applicable financial reporting framework due to the nature and circumstances of the entity that may create opportunities for management to perpetrate and conceal fraudulent financial activity. <p>A48. In <u>conducting an initial audit engagement in accordance with ISA 510,⁴² in</u> some circumstances, subject to law, regulation or relevant ethical requirements, the proposed successor auditor may request the predecessor auditor to provide information regarding identified or suspected fraud. Such information may give an indication of the presence of fraud risk factors or may give an indication of fraud or suspected fraud.</p>

⁴¹ ISA 315 (Revised 2019), paragraphs 15–16

⁴² ISA 510, Initial Audit Engagements—Opening Balances

ISA 240 Requirement	Application Material
<p><i>Retrospective Review of the Outcome of Previous Significant Accounting Estimates</i></p> <p>28. In applying ISA 540 (Revised),⁴³ the auditor shall perform a retrospective review of management judgments and assumptions related to the outcome of previous significant accounting estimates, or where applicable, their subsequent re-estimation to assist in identifying and assessing the risks of material misstatement due to fraud in the current period. <u>The auditor shall take into account the characteristics of the accounting estimates in determining the nature and extent of that review.</u> (Ref: Para. A48A)</p>	<p><u><i>Retrospective Review of the Outcome of Previous Accounting Estimates</i></u> (Ref: Para. 28)</p> <p><u>A48A. The purpose of performing a retrospective review of management's judgments and assumptions related to accounting estimates reflected in the financial statements of the prior year is to evaluate whether there is an indication of a possible bias on the part of management. It is not intended to call into question the auditor's professional judgments made in the prior year that were based on information available at the time.</u></p>
<p><i>Engagement Team Discussion</i></p> <p>29. In applying ISA 315 (Revised 2019),⁴⁴ when holding the engagement team discussion, the engagement partner and other key engagement team members 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 may occur. In doing so, the engagement team discussion shall include: (Ref: Para. A49–A49B–A49A and A52)</p> <p>(a) <u>An exchange of ideas about:</u></p> <p>(i) <u>The entity's culture, management's commitment to integrity, and ethical values and related oversight by those charged with governance;</u> (Ref: Para. A49C)</p> <p>(ii) <u>F</u>raud risk factors, including: (Ref: Para. A50–A51)</p>	<p><i>Engagement Team Discussion</i> (Ref: Para. 29)</p> <p>A49. As explained in ISA 220 (Revised),⁴⁵ the engagement partner is responsible for creating an environment that emphasizes the importance of open and robust communication within the engagement team. The two-way engagement team discussion enables the engagement team members to share insights in a timely manner based on their skills, knowledge and experience about how and where the financial statements may be susceptible to material misstatement due to fraud.</p> <p>A49A.—Individuals who have specialized skills or knowledge, such as forensic and IT experts, may <u>be requested to</u> attend the engagement team discussion to provide deeper insights about the susceptibility of the entity's financial statements to material misstatement due to fraud.</p>

⁴³ ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*, paragraph 14

⁴⁴ ISA 315 (Revised 2019), paragraphs 17 and A42-A43

⁴⁵ ISA 220 (Revised), paragraphs 14 and 32

ISA 240 Requirement	Application Material
<p>a. Incentives or pressures for <u>on</u> management, those charged with governance, or employees <u>or third parties</u> to commit fraud;</p> <p>b. How one or more individuals among management, those charged with governance, or employees could perpetrate and conceal fraudulent financial reporting; and</p> <p>b. _____</p> <p>c. How assets of the entity could be misappropriated.</p> <p>(e)(b) <u>A consideration of any <u>fraud or suspected fraud that may impact the overall strategy and audit plan for the audit engagement, including:</u></u></p> <p>(i) Fraud that has occurred at the entity during the current or prior years that has an effect on the entity's financial statements of which engagement team members have been notified, including how such fraud may impact the overall strategy and audit plan for the audit engagement; and</p> <p>(ii) <u>Suspected fraud Allegations and that have come to the attention of engagement team members, including how to respond to <u>these any</u> allegations <u>of fraud.</u></u></p>	<p>The involvement and contributions of experts with specialized skills or knowledge may elevate the quality of the discussion taking place.</p> <p>A49B. In certain circumstances, an individual with expertise in a specialized area participating in the engagement team discussion may not be a member of the engagement team if that individual's involvement with the engagement is limited to consultation. ISA 220 (Revised)⁴⁶ explains that consultation outside the engagement team on a difficult or contentious matter may be an indicator the matter is a key audit matter. [Deleted] [Not used]</p> <p><u>A49C. The exchange of ideas may serve to inform the auditor's initial perspective about the tone at the top. The conversation may include a discussion of the actions and behaviors of management and those charged with governance, including whether there are clear, consistent, and frequent actions and communications about integrity and ethical behavior at all levels within the entity.</u></p> <p>A50. The exchange of ideas is intended to identify events or conditions that may indicate the presence of fraud risk factors. The following approaches may be useful to facilitate the exchange of ideas:</p> <ul style="list-style-type: none"> • 'What-if' scenarios – <u>these</u> may be helpful when discussing whether certain events or conditions create an environment at the entity where one or more individuals among management, those charged with governance, employees, or third parties have the incentive or pressure to commit fraud, a perceived opportunity to do so and some rationalization of the act, and if so, how the fraud may occur. • Automated tools and techniques – <u>these</u> may be used to support the discussion about the susceptibility of the entity's

⁴⁶ ISA 220 (Revised), paragraph A102

ISA 240 Requirement	Application Material
	<p>financial statements to material misstatement due to fraud, including techniques that further the understanding of incentives and pressures, such as industry or sector financial ratio benchmarking, which may indicate adverse ratios or trends compared to competitors.</p> <p>A51. The exchange of ideas may include, among other matters, whether:</p> <ul style="list-style-type: none"> • The interactions, as observed by the engagement team, among management (e.g., between the chief executive officer and the chief financial officer) or between management and those charged with governance may indicate a lack of cooperation or mutual respect among the parties. This circumstance in turn may be indicative of an environment that is conducive to the existence of fraud. • Any unusual or unexplained changes in behavior or lifestyle of management or employees thatwhich have come to the attention of the engagement team may indicate the possibility of fraudulent activity. • Known information <u>(e.g., obtained through reading trade journals, or accessing reports issued by regulatory bodies)</u>, about frauds impacting other entities that resulted in the misstatement of the financial statements of those entities, such as entities in the same industry or geographical region, may be indicative of risks of material misstatement due to fraud for the entity being audited. • Available information may indicate non-compliance with laws or regulations (e.g., <u>violation of environmental protection laws and regulations</u> payments of bribes) may be a common occurrence

ISA 240 Requirement	Application Material
	<p>in certain industries or geographical regions <u>such as the mining, and oil and gas industries</u>).</p> <ul style="list-style-type: none"> Disclosures, or lack thereof, may be used by management to provide misleading information that may obscure a proper understanding of the entity's financial statements (e.g., by including too much immaterial information, by using unclear or ambiguous language, or by a lack of disclosures such as those disclosures relating to off-balance sheet financing arrangements or leasing arrangements). <u>Events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern (e.g., a drug patent of an entity in the pharmaceutical industry expired leading to a decline in revenue). In such circumstances, there may be incentives or pressures for management to commit fraud in order for the entity to continue as a going concern.</u> or may indicate the existence of <u>The entity has significant related party relationships and transactions arrangements (e.g., the entity has a complex organizational structure that includes several special-purpose entities controlled by management). These circumstances may provide the opportunity for management to perpetrate fraud; for example by inflating earnings, or concealing debt that may be relevant to the identification and assessment of the risks of material misstatement due to fraud.</u> <p>A52. The engagement partner and other key engagement team members participating in the engagement team discussion may also, as applicable, use this as an opportunity to:</p>

ISA 240 Requirement	Application Material
	<ul style="list-style-type: none"> • Emphasize the importance of maintaining a questioning mind throughout the audit regarding the potential for material misstatement due to fraud. • Remind engagement team members of their role in serving the public interest by performing quality audit engagements, and the importance of engagement team members remaining objective in order to better facilitate the critical assessment of audit evidence obtained from persons within <u>or outside</u> the financial reporting or accounting functions, <u>or outside the entity</u>. • Consider the audit procedures that may be selected to respond appropriately to the susceptibility of the entity's financial statements to material misstatement due to fraud, including whether certain types of audit procedures may be more effective than others and how to incorporate an element of unpredictability into the nature, timing and extent of audit procedures to be performed.
<p><i>Inquiries of Management and Inconsistent Responses</i> [Previously heading above paragraph 38]</p> <p>29A. In applying ISA 500,⁴⁷ if the responses to inquiries of individuals within the internal audit function, management, those charged with governance, or others within the entity, are inconsistent with each other, the auditor shall:</p> <ul style="list-style-type: none"> (a) Determine what modifications or additions to audit procedures are necessary to understand and address the inconsistency; and (b) Consider the effect, if any, on other aspects of the audit. 	

⁴⁷ ISA 500, *Audit Evidence*, paragraph 11

ISA 240 Requirement	Application Material
<p>[Previously paragraph 38]</p>	
<p><i>Analytical Procedures Performed and Unusual or Unexpected Relationships Identified</i> [Previously heading above paragraph 39]</p> <p>29B. The auditor shall determine whether unusual or unexpected relationships that have been identified in performing analytical procedures, including those related to revenue accounts, may indicate risks of material misstatement due to fraud. (Ref: Para. A100A52A) [Previously paragraph 39]</p>	<p><i>Analytical Procedures Performed and Unusual or Unexpected Relationships Identified</i> (Ref: Para. 3929B) [Previously heading above paragraph A100]</p> <p>A52A.—The auditor may identify fluctuations or relationships when performing analytical procedures in accordance with ISA 315 (Revised 2019)⁴⁸ that are inconsistent with other relevant information or that differ from expected values significantly. [Previously paragraph A100]</p> <div style="border: 1px solid black; padding: 5px; margin-top: 10px;"> <p>Examples:</p> <ul style="list-style-type: none"> • When inspecting the interim financial statements of a midsized consumer bank that invested customer deposits in government bonds from countries with solid credit ratings, the auditor observed that the valuation of the portfolio was stable.—The auditor may identified—identify this as an unexpected relationship when the entity’s valuation of investment in government bonds remained stable,—since whereas the interest rates of central banks had increased to counter inflation and —which, in turn general, this led to a depreciation in the market values of government bonds.—The auditor concluded that the relevant assertions about the valuation of government bonds may indicate risks of material misstatement due to fraud. • The auditor <u>may identified—identify</u> an unusual relationship when comparing the actual rental income reported by a business segment, and the rental revenue projected to be </div>

⁴⁸ ISA 315 (Revised 2019), paragraph 14(b)

ISA 240 Requirement	Application Material
	<p>earned by the rental department of a real estate company based on a rolling forecast of realized rental income, actual rent and occupancy rates. The auditor concluded that the relevant assertions about revenue may indicate risks of material misstatement due to fraud.</p>
<p><i>Evaluation of Fraud Risk Factors</i> [Previously heading above paragraph 37]</p> <p>29C. The auditor shall evaluate whether the audit evidence obtained from the risk assessment procedures and related activities indicates that one or more fraud risk factors are present. (Ref: Para. A96A52B–A99A52E) [Previously paragraph 37]</p>	<p><i>Evaluation of Fraud Risk Factors</i> (Ref: Para. 3729C) [Previously heading above paragraph A96]</p> <p>A52B. Fraud risk factors cannot easily be ranked in order of importance. The significance of fraud risk factors varies widely. Some of these factors will be present in entities where the specific conditions do not present risks of material misstatement. Accordingly, the determination as to whether fraud risk factors, individually or in combination, indicates that there are risks of material misstatement due to fraud is a matter of professional judgment. [Previously paragraph A96]</p> <p>A52C. Examples of fraud risk factors related to fraudulent financial reporting and misappropriation of assets are presented in Appendix 1. These illustrative fraud risk factors are classified based on the three conditions that are generally present when fraud exists:</p> <ul style="list-style-type: none"> ● An incentive or pressure to commit fraud; ● A perceived opportunity to commit fraud; and ● An ability to rationalize the fraudulent action. <p>Fraud risk factors reflective of an attitude that permits rationalization of the fraudulent action may not be susceptible to observation by the auditor. Nevertheless, the auditor may become aware of the existence of such information through, for example, the required understanding</p>

ISA 240 Requirement	Application Material
	<p>of the entity’s control environment.⁴⁹ Although the fraud risk factors described in Appendix 1 cover a broad range of situations that may be faced by auditors, they are only examples and other risk factors may exist. [Previously paragraph A97]</p> <p>A52D. The size, complexity, and ownership characteristics of the entity have a significant influence on the consideration of relevant fraud risk factors. For example, depending on the nature and circumstances of the entity, there may be factors that generally constrain improper conduct by management, such as:</p> <ul style="list-style-type: none"> • Effective oversight by those charged with governance. • An effective internal audit function. • The existence and enforcement of a written code of conduct. <p>Furthermore, fraud risk factors considered at a business segment operating level may provide different insights when compared with those obtained when considered at an entity-wide level. [Previously paragraph A98]</p> <p>Scalability [Previously heading above paragraph A99]</p> <p>A52E. In the case of a smaller or less complex entity, some or all of these considerations may be inapplicable or less relevant. For example, a smaller or less complex entity may not have a written code of conduct but, instead, may have developed a culture that emphasizes the importance of integrity and ethical behavior through oral communication and by management example. Domination of management by a single individual in a smaller or less complex entity does not generally, in and of itself, indicate a failure by management to display and communicate an appropriate attitude regarding internal</p>

⁴⁹ ISA 315 (Revised 2019), paragraph 21

ISA 240 Requirement	Application Material
	control and the financial reporting process. In some entities, the need for management authorization can compensate for otherwise deficient controls and reduce the risk of employee fraud. However, domination of management by a single individual can be a potential deficiency in internal control since there is an opportunity for management override of controls. [Previously paragraph A99]
Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework and the Entity’s System of Internal Control	Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework and the Entity’s System of Internal Control
<p><i>Understanding the Entity and Its Environment, and the Applicable Financial Reporting Framework</i></p> <p>30. In applying ISA 315 (Revised 2019),⁵⁰ the auditor shall obtain an understanding of matters related to the:</p> <p>(a) Entity and its environment that may lead to an increased susceptibility to misstatement due to management bias or other fraud risk factors, including with respect to:</p> <p>(i) The entity’s organizational structure and ownership, governance, objectives and strategy, and geographic dispersion; (Ref: Para. A54–A57)</p> <p>(ii) The industry; and (Ref: Para. A58)</p> <p>(iii) The performance measures used, <u>whether internally and or externally</u>, that may create incentives or pressures to achieve financial performance targets. (Ref: Para. A59–A61)</p>	<p><i>Understanding the Entity and Its Environment</i> (Ref: Para. 30(a))</p> <p>A53. [Not used]</p> <p>The Entity’s Organizational Structure and Ownership, Governance, Objectives and Strategy, and Geographic Dispersion (Ref: Para. 30(a)(i))</p> <p>A54. Understanding the entity’s organizational structure and ownership assists the auditor in identifying fraud risk factors. An overly complex organizational structure involving unusual legal entities may indicate that a fraud risk factor is present.</p> <div data-bbox="1178 1024 1990 1222" style="border: 1px solid black; padding: 5px;"> <p>Example:</p> <p>Where there are complex intercompany transactions, this increases the risk that schemes may be in place to manipulate balances or create fictitious transactions.</p> </div> <p>A55. Understanding the nature of the entity’s governance arrangements assists the auditor in identifying fraud risk factors. For example, poor governance or accountability arrangements may weaken oversight</p>

⁵⁰ ISA 315 (Revised 2019), paragraph 19

ISA 240 Requirement	Application Material
<p>(b) Applicable financial reporting framework and the entity's accounting policies that may lead to an increased susceptibility to misstatement due to management bias or other fraud risk factors. (Ref: Para. A62)</p>	<p>and increase the opportunity for fraud (see also paragraphs A63–A72). In a larger or more complex entity, the entity may have assigned the responsibility for overseeing the processes for identifying and responding to fraud in the entity to a senior member of management or to someone with designated responsibility.</p> <div data-bbox="1178 464 1986 735" style="border: 1px solid black; padding: 5px;"> <p>Example:</p> <p>If the entity is undergoing significant digital transformation activities, poor governance arrangements over newly implemented technologies impacting the entity's information system relevant to the preparation of the financial statements, may increase the opportunity for fraud.</p> </div> <p>A56. Understanding the entity's objectives and strategy assists the auditor in identifying fraud risk factors. Objectives and strategy impact expectations, internally and externally, and may create pressures on the entity to achieve financial performance targets.</p> <div data-bbox="1178 919 1986 1117" style="border: 1px solid black; padding: 5px;"> <p>Example:</p> <p>When the entity has a very aggressive growth strategy, this may create pressures on personnel within the entity to commit fraud to meet the goals set.</p> </div> <p>A57. Understanding the entity's geographic dispersion assists the auditor in identifying fraud risk factors. The entity may have operations in locations that may be susceptible to dishonest, illegal or unethical transactions or activitiesacts, such as bribery and money laundering, or are high on a corruption perception index. [Last sentence was previously in the boxed example below]</p>

ISA 240 Requirement	Application Material
	<p>Examples:</p> <ul style="list-style-type: none"> • <u>Weak legal and regulatory framework that create a permissive environment for bribery or money laundering without significant consequences.</u> • <u>Offshore financial centers that have looser regulations and tax incentives to facilitate money laundering.</u> • <u>Cultural norms in which bribery is deeply ingrained as an accepted practice of doing business.</u> <p>Industry (Ref: Para. 30(a)(ii))</p> <p>A58. Understanding the industry in which the entity operates assists the auditor in identifying fraud risk factors. The auditor may obtain an understanding whether the entity is active in:</p> <ul style="list-style-type: none"> • An industry where there are greater incentives to commit fraud. (e.g., in the construction industry the revenue recognition policies may be complex and subject to judgment which may create an opportunity to commit fraud). • An industry that is under pressure (e.g., a high degree of competition or market saturation, accompanied by declining margins in that sector). Such characteristics may create an incentive to commit fraud as it may be harder to achieve the financial performance targets. • An industry that is susceptible to acts of corruption, bribery and money laundering- (e.g., the <u>banking, or gaming and gambling industry-industries</u> may be particularly vulnerable to money laundering).

ISA 240 Requirement	Application Material
	<p>Performance Measures Used, <u>Whether Internally and/or Externally</u> (Ref: Para. 30(a)(iii))</p> <p>A59. Performance measures, whether internal or external, may create pressures on the entity. These pressures, in turn, may motivate management or employees to take action to inappropriately improve the business performance or to misstate the financial statements. Internal performance measures may include employee performance measures and incentive compensation policies. External performance measures may include expectations from shareholders, analysts, or other users.</p> <div data-bbox="1178 667 1982 938" style="border: 1px solid black; padding: 5px;"> <p>Example:</p> <p>Automated tools and techniques, such as analysis of disaggregated data, for example by business segment or product line, may be used by the auditor to <u>understand—identify inconsistencies or anomalies in the data used in</u> performance measures.</p> </div> <p>A60. The auditor may consider listening to the entity’s earnings calls with analysts or reading analysts’ research reports. This may provide the auditor with information about whether analysts have <u>unduly</u> aggressive or unrealistic expectations about an entity’s financial performance. Auditors may also learn about management’s attitudes regarding those expectations based on how management interacts with analysts. Aggressive expectations by analysts that are met by commitments by management to meet those expectations may be indicative of pressures and rationalizations for management to manipulate key performance metrics.</p> <p>A61. Other matters that the auditor may consider include:</p>

ISA 240 Requirement	Application Material
	<ul style="list-style-type: none"> • Management’s compensation packagess. When a significant portion of management’s compensation packagess <u>are</u>s contingent on achieving financial targets, management may have an incentive to manipulate financial results. • Short-selling reports, negative media attention, <u>or</u> negative analyst reports. When management is under pressure or intense scrutiny to respond to these matters, management may have an incentive to manipulate financial results. <p><u>Understanding the Applicable Financial Reporting Framework and the Entity’s Accounting Policies</u> (Ref: Para. 30(b))</p> <p>A62. Matters related to the applicable financial reporting framework that the auditor may consider when obtaining an understanding of where there may be an increased susceptibility to misstatement due to management bias or other fraud risk factors, include:</p> <ul style="list-style-type: none"> • Areas in the applicable financial reporting framework that require: <ul style="list-style-type: none"> ○ A measurement basis that results in the need for a complex method relating to an accounting estimate. ○ Management to make significant judgments, such as accounting estimates with high estimation uncertainty or where an acceptable accounting treatment has not yet been established for new and emerging financial products (e.g., types of digital assets). ○ Expertise in a field other than accounting, such as actuarial calculations, valuations, or engineering data. Particularly where management can influences and direct work performeds and conclusions reached by management’s experts.

ISA 240 Requirement	Application Material
	<ul style="list-style-type: none"> • Changes in the applicable financial reporting framework. For example, management may intentionally misapply new accounting requirements relating to amounts, classification, manner of presentation, or disclosures. • The selection of and application of accounting policies by management. For example, management’s choice of accounting policy is not consistent with similar entities in the same industry. • The amount selected by management for recognition or disclosure in the financial statements of an accounting estimate. <div style="border: 1px solid black; padding: 5px; margin-top: 10px;"> <p>Examples:</p> <ul style="list-style-type: none"> • Management may consistently trend toward one end of a range of possible outcomes that provide a more favorable financial reporting outcome for management. • Management may use a model that applies a method that is not established or commonly used in a particular industry or environments. </div>
<p><i>Understanding the Components of the Entity’s System of Internal Control</i> Control Environment</p> <p>31. In applying ISA 315 (Revised 2019),⁵¹ the auditor shall:</p>	<p><i>Understanding the Components of the Entity’s System of Internal Control</i> Control Environment</p> <p>Entity’s culture and management’s commitment to integrity and ethical values (Ref: Para. 31(a))</p>

⁵¹ ISA 315 (Revised 2019), paragraph 21

ISA 240 Requirement	Application Material
<p>(a) Obtain an understanding of how management has created and maintained a culture of honesty and ethical behavior, including how management communicates with its employees its views on business practices and ethical behavior <u>with respect to the prevention and detection of fraud</u>. (Ref: Para. A63–A65)</p> <p>(b) Obtain an understanding of how those charged with governance exercise oversight of management’s processes for identifying and responding to the risks of fraud in the entity and the controls that management has established to address these risks. (Ref: Para. A66–A69)</p> <p>(c) Make inquiries of management regarding management’s communications to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity.</p> <p>(d) Make inquiries of those charged with governance about: (Ref: Para. A70–A73)</p> <p>(i) Whether they have knowledge of any fraud <u>or</u> suspected fraud, <u>including, –or– allegations of alleged</u> fraud, affecting the entity;</p> <p>(ii) Their views about whether and how the financial statements may be materially misstated due to fraud, including their views on possible areas that are susceptible to misstatement due to management bias or management fraud; and</p> <p>(iii) Whether they are aware of deficiencies in the system of internal control related to the prevention and detection of fraud, and the remediation efforts to address such deficiencies.</p>	<p>A63. Understanding aspects of the entity’s control environment that address the entity’s culture and understanding management’s commitment to integrity and ethical values assists the auditor in determining management’s attitude and tone at the top with regards to the prevention and detection of fraud.</p> <p>A64. In considering the extent to which management demonstrates a commitment to ethical behavior, the auditor may obtain an understanding through inquiries of management and employees, and through considering information from external sources, about:</p> <ul style="list-style-type: none"> • Management’s commitment to integrity and ethical values through their actions. Commitment from management through their actions <u>This</u> is important as employees may be more likely to behave ethically when management is committed to integrity and ethical behaviors. • The entity’s communications with respect to integrity and ethical values. For example, the entity may have a mission statement, a code of ethics, or a fraud policy <u>that sets out the expectations of entity personnel in respect to their commitment to integrity and ethical values regarding managing fraud risk</u>. In larger or more complex entities, management may also have set up a process that requires employees to annually confirm that they have complied with the entity’s code of ethics. • Whether the entity has developed fraud awareness training. For example, the entity may require employees to undertake ethics and code of conduct training as part of an ongoing or induction programme. In a larger or more complex entity, specific training may be required for those with a role in the prevention and detection of fraud (e.g., the internal audit function).

ISA 240 Requirement	Application Material
	<ul style="list-style-type: none"> • Management’s response to fraudulent activity. For example, where minor unethical practices are overlooked (e.g., petty theft, expenses frauds), this may indicate that more significant frauds committed by key employees may be treated in a similar lenient fashion. <p>A65. Depending on the nature and circumstances of the entity, the entity may have a formal whistleblower program; in such circumstances, obtaining an understanding of the program may assist the auditor in identifying risks of material misstatement due to fraud. The auditor may:</p> <ul style="list-style-type: none"> • Obtain an understanding of the whistleblower program reporting mechanisms (e.g., telephone hotline, online forms, in-person reporting), who is responsible for the program, including who receives the notifications, and how the entity addresses the matters raised. In a larger or more complex entity, the lack of a whistleblower program, or an ineffective one, may be indicative of weaknesses in the entity’s control environment. • Inspect whistleblower files for any tips <u>or complaints</u> that may allege fraud that are not under investigation by the entity, or for information that may raise questions about management’s commitment to creating and maintaining a culture of honesty and ethical behavior. • Follow up on matters that are under investigation by the entity as these matters may be indicative of suspected fraud with financial reporting implications that require a response from<u>by</u> the auditor. <p>Oversight exercised by those charged with governance (Ref: Para. 31(b))</p> <p>A66. In many jurisdictions, corporate governance practices are well developed and those charged with governance play an active role in</p>

ISA 240 Requirement	Application Material
	<p>oversight of the entity’s assessment of risks, including risks of fraud and the controls that address such risks. Since the responsibilities of those charged with governance and management may vary by entity and by jurisdiction, it is important that the auditor understands their respective responsibilities to enable the auditor to obtain an understanding of the oversight exercised by the appropriate individuals with respect to the prevention and detection of fraud.⁵²</p> <p>A67. An understanding of the oversight exercised by those charged with governance may provide insights regarding the susceptibility of the entity to management fraud, the adequacy of controls that address risks of fraud, and the competency and integrity of management. The auditor may obtain this understanding in a number of several ways, such as by attending meetings where such discussions take place, reading the minutes from such meetings, or making inquiries of those charged with governance.</p> <p>A68. The effectiveness of oversight by those charged with governance is influenced by their objectivity and familiarity with the controls management has put in place to prevent or detect fraud. For example, the oversight by those charged with governance of the effectiveness of controls to prevent or detect fraud is an important aspect of their oversight role and the objectivity of such evaluation is influenced by their independence from management.</p> <p>Considerations specific to smaller or less complex entities</p> <p>A69. In some cases, all of those charged with governance are involved in managing the entity. This may be the case in a smaller or less complex entity where a single owner manages the entity and no one else has a governance role. In these cases, there is ordinarily no action on the</p>

⁵² ISA 260 (Revised), paragraphs A1–A8 provide guidance about whom the auditor should be communicating with, including when the entity’s governance structure is not well defined.

ISA 240 Requirement	Application Material
	<p>part of the auditor because there is no oversight separate from management.</p> <p>Inquiries of those charged with governance (Ref: Para. 31(d))</p> <p>A70. The auditor may also inquire of those charged with governance about how the entity assesses the risk of fraud, the entity’s controls to prevent or detect fraud, the entity’s culture and management’s commitment to integrity and ethical values.</p> <p>A71. Specific inquiries on areas that are susceptible to misstatement due to management bias or management fraud may relate to both inherent risk and control risk. Specific inquiries may include management judgment when accounting for significant accounting estimates or unusual or complex transactions, including those in controversial or emerging areas, which may be susceptible to fraudulent financial reporting.</p> <p>A72. Inquiries on whether those charged with governance are aware of any control deficiencies in the system of internal control related to the prevention and detection of fraud may inform the auditor’s evaluation of the components of the entity’s system of internal control. Such inquiries may highlight conditions within the entity’s system of internal control that provide opportunity to commit fraud or that may affect management’s attitude or ability to rationalize fraudulent actions. For example, incentives or pressures on management that may result in intentional or unintentional management bias, which may help the auditor’s understanding of the entity’s risk assessment process and understanding of business risks. Such information may affect the auditor’s consideration of the effect on the reasonableness of significant assumptions made by, or the expectations of, management.</p>

ISA 240 Requirement	Application Material
	A73. When those charged with governance's ability to objectively assess the actions of management is insufficient or impaired, the auditor may consider performing additional or alternative risk assessment procedures or further audit procedures, seeking legal advice, or considering whether to continue the audit engagement.
<p>The Entity's Risk Assessment Process</p> <p>32. In applying ISA 315 (Revised 2019),⁵³ the auditor shall:</p> <p>(a) Obtain an understanding of how the entity's risk assessment process: (Ref: Para. A74–A83)</p> <p>(i) Identifies fraud risks related to the misappropriation of assets and fraudulent financial reporting, including any classes of transactions, account balances, or disclosures for which risks of fraud exist;</p> <p>(ii) Assesses the significance of the identified fraud risks, including the likelihood of their occurrence; and</p> <p>(iii) Addresses the assessed fraud risks.</p> <p>(b) Make inquiries of management and of other appropriate individuals within the entity about: (Ref: Para. A84–A86)</p> <p>(i) Whether they have knowledge of any fraud or suspected fraud, including, or alleged allegations of fraud, affecting the entity; and</p> <p>(ii) Their views that the financial statements may be materially misstated due to fraud.</p>	<p>The Entity's Risk Assessment Process</p> <p>The entity's process for identifying, assessing, and addressing fraud risks (Ref: Para. 32(a))</p> <p>A74. Management may place a strong emphasis on fraud prevention by implementing a fraud risk management program. The design of the fraud risk management program may be impacted by the nature and complexity of the entity and may include the following elements:</p> <ul style="list-style-type: none"> • Establishing fraud risk governance policies. • Performing a fraud risk assessment. • Designing and deploying fraud preventive and detective control activities. • Conducting investigations. • Monitoring and evaluating the total fraud risk management program. <p>Identifying fraud risks (Ref: Para. 32(a)(i))</p> <p>A75. The entity's fraud risk identification process may include an assessment of the incentives, pressures, and opportunities to commit fraud, or how the entity may be susceptible to third-party fraud. A fraud risk identification process may also consider the potential override of</p>

⁵³ ISA 315 (Revised 2019), paragraph 22

ISA 240 Requirement	Application Material
	<p>controls by management as well as areas where there are control deficiencies, including a lack of segregation of duties.</p> <p>A76. Where legal or regulatory requirements apply, management may consider risks relating to misappropriation of assets or fraudulent financial reporting in relation to the entity’s compliance with laws or regulations. For example, a fraud risk may include the preparation of inaccurate information for a regulatory filing in order to improve the appearance of an entity’s performance in order to avoid inspection by regulatory authorities or penalties.</p> <p>Assessing the significance of the identified fraud risks and addressing the assessed fraud risks (Ref: Para. 32(a)(ii)–(iii))</p> <p>A77. There are a number of several approaches management may use to assess fraud risks and the approach may vary depending on the nature and circumstances of the entity. The fraud risk assessment may be reported in different forms, such as a complex matrix of risk ratings or <u>a</u> simple narrative.</p> <p>A78. When determining the likelihood of fraud, management may consider both probability and frequency (i.e., the number of fraud incidents that can be expected). Other factors that management may consider in determining likelihood may include the volume of transactions, or the potential nature or quantitative benefit to the individual.</p> <p>A79. Management may address the likelihood of a fraud risk by taking action within the other components of the entity’s system of internal control or by making changes to certain aspects of the entity or its environment. To address fraud risks, an entity may choose to cease doing business in certain locations, reallocate authority among key personnel, or make changes to aspects of the entity’s business model.</p>

ISA 240 Requirement	Application Material
	<p>A80. Controls that prevent or detect fraud are generally classified as either preventive (designed to avoid a fraudulent event or transaction from occurring) or detective (designed to discover a fraudulent event or transaction after the initial processing has occurred). Addressing fraud risks may involve a combination of manual and automated fraud prevention and detection controls that enable the entity to monitor for indicators of fraud within the scope of its risk tolerance.</p> <div data-bbox="1178 537 1982 1313" style="border: 1px solid black; padding: 10px;"> <p>Examples:</p> <p>Preventive controls</p> <ul style="list-style-type: none"> • Clearly defined and documented decision makers using delegations, authorizations, and other instructions. • Access controls, including those that address physical security of assets against unauthorized access, acquisition, use or disposal and those that prevent unauthorized access to the entity’s IT environment and information, such as authentication technology. • <u>Controls over the process to design, program, test and migrate changes to the IT environment.</u> • Entry level checks, probationary periods, suitability assessments or security vetting <u>in order</u> to assess the integrity of new employees, contractors or third parties. • Sensitive or confidential information cannot leave the entity's IT environment without authority or detection. <p>Detective controls</p> </div>

ISA 240 Requirement	Application Material
	<div data-bbox="1178 261 1982 756" style="border: 1px solid black; padding: 5px;"> <ul style="list-style-type: none"> • Exception reports to identify activities that are unusual or not in the ordinary course of business and have to be for further investigated investigation. • Mechanisms for employees of the entity and third parties to make anonymous or confidential communications to appropriate persons within the entity about identified or suspected fraud. • Fraud detection software programs incorporated into the IT infrastructure that automatically analyzes transaction data or enables data monitoring and analysis to detect what is different from what is standard, normal, or expected and may therefore indicate fraud. </div> <p>A81. If the auditor identifies risks of material misstatement due to fraud that management failed to identify, the auditor is required to determine whether any such risks are of a kind that the auditor expects would have been identified by the entity’s risk assessment process and, if so, obtain an understanding of why the entity’s risk assessment process failed to identify such risks of material misstatement.⁵⁴ The auditor is also required to consider the implications for the auditor’s evaluation.⁵⁵</p> <p>Scalability</p> <p>A82. For some entities whose nature and circumstances are more complex, such as those operating in the insurance or banking industries, there may be more complex preventative and detective controls in place. These controls may also affect the extent to which specialized skills</p>

⁵⁴ ISA 315 (Revised 2019), paragraph 23(a)

⁵⁵ ~~ISA 315 (Revised 2019), paragraph 23(b)~~

ISA 240 Requirement	Application Material
	<p>are needed to assist the auditor in obtaining an understanding of the entity’s risk assessment process.</p> <p>A83. In smaller and less complex entities, and in particular owner-managed entities, the way the entity’s risk assessment process is designed, implemented, and maintained may vary with the entity’s size and complexity. When there are no formalized processes or documented policies or procedures, the auditor is still required to obtain an understanding of how management, or where appropriate, those charged with governance identify fraud risks related to the misappropriation of assets and fraudulent financial reporting, and assesses the significance of the identified fraud risks.</p> <p>Inquiries of management and others within the entity (Ref: Para. 32(b))</p> <p>A84. Management accepts responsibility for the entity’s system of internal control and for the preparation of the entity’s financial statements. Accordingly, it is appropriate for the auditor to make inquiries of management regarding management’s own assessment of the risk of fraud and the controls in place to prevent or detect it. The nature, extent and frequency of management’s assessment may vary from entity to entity. In some entities, management may make detailed assessments on an annual basis or as part of continuous monitoring. In other entities, management’s assessment may be less structured and less frequent. The nature, extent and frequency of management’s assessment are relevant to the auditor’s understanding of the entity’s control environment. For example, the fact that management has not made an assessment of the risk of fraud may in some circumstances be indicative of the lack of importance that management places on internal control.</p> <p>A85. Inquiries of management may provide useful information concerning the risks of material misstatements resulting from employee fraud.</p>

ISA 240 Requirement	Application Material
	<p>However, such inquiries are unlikely to provide useful information regarding the risks of material misstatement resulting from management fraud. Inquiries of others within the entity <u>may</u> provide additional insight into fraud prevention controls, tone at the top, and culture of the organization.</p> <div data-bbox="1178 464 1986 1130" style="border: 1px solid black; padding: 10px;"> <p>Examples:</p> <p>Others within the entity to whom the auditor may direct inquiries about the existence or suspicion of fraud include:</p> <ul style="list-style-type: none"> • Operating personnel not directly involved in the financial reporting process. • Employees with different levels of authority. • Employees involved in initiating, processing, or recording complex or unusual transactions and those who supervise or monitor such employees. • In-house legal counsel. • Chief ethics officer, chief compliance officer or equivalent person. • The person or persons charged with dealing with allegations of fraud. </div> <p>A86. Management is often in the best position to perpetrate fraud. Accordingly, when evaluating management’s responses to inquiries with an attitude of professional skepticism, the auditor may judge it necessary to corroborate responses to inquiries with information from other sources.</p>
The Entity’s Process to Monitor the System of Internal Control	The Entity’s Process to Monitor the System of Internal Control

ISA 240 Requirement	Application Material
<p>33. In applying ISA 315 (Revised 2019),⁵⁶ the auditor shall:</p> <p>(a) Obtain an Understand<u>understanding those of</u> aspects of the entity's process that address the ongoing and separate evaluations for monitoring the effectiveness of controls to prevent or detect fraud, and the identification and remediation of <u>related</u> control deficiencies. (Ref: Para. A87)</p> <p>(b) Make inquiries of appropriate individuals within the internal audit function (if the function exists) about whether they have knowledge of any fraud <u>or</u>, suspected fraud, <u>including</u> or alleged allegations of fraud, affecting the entity, and to obtain their views about the risks of fraud. (Ref: Para. A88–A89)</p>	<p>Ongoing and separate evaluations for monitoring the effectiveness of controls to prevent or detect fraud (Ref: Para. 33(a))</p> <p>A87. Matters that may be relevant for the auditor to consider when understanding those aspects of the entity's process that addresses the ongoing and separate evaluations for monitoring the effectiveness of controls to prevent or detect fraud, and the identification and remediation of such related control deficiencies identified, may include:</p> <ul style="list-style-type: none"> • Whether management has identified particular operating locations, or business segments for which the risk of fraud may be more likely to exist and whether management has introduced different approaches to monitor these operating locations or business segments. • How the entity may monitor fraud mitigation processes in each component of internal control, including the operating effectiveness of anti-fraud controls, and the remediation of control deficiencies as necessary. <p>Inquiries of internal audit (Ref: Para. 33(b))</p> <p>A88. The internal audit function of an entity may perform assurance and advisory activities designed to evaluate and improve the effectiveness of the entity's governance, risk management and internal control processes. In that capacity, the internal audit function may identify frauds or be involved throughout a fraud investigation process. Inquiries of appropriate individuals within the internal audit function may therefore provide the auditor with useful information about</p>

⁵⁶ ISA 315 (Revised 2019), paragraph 24

instances of actual ~~or~~, suspected fraud, including ~~or alleged~~ allegations of fraud, and the risk of fraud.

A89. ISA 315 (Revised 2019) and ISA 610 (Revised 2013) establish requirements and provide guidance relevant to audits of those entities that have an internal audit function.⁵⁷

Examples:

In applying ISA 315 (Revised 2019) and ISA 610 (Revised 2013) in the context of fraud, the auditor may, for example, inquire about:

- The entity's fraud risk assessment.
- The entity's controls to prevent or detect fraud.
- The entity's culture and management's commitment to integrity and ethical values.
- Whether the internal audit function is aware of any instances of management override of controls.
- The procedures performed, if any, by the internal audit function during the year to detect fraud and whether management and those charged with governance have satisfactorily responded to any findings resulting from those procedures.
- The procedures performed, if any, by the internal audit function in investigating frauds and suspected violations of the entity's code of ethics and values, and whether management and those charged with governance have satisfactorily responded to any findings resulting from those procedures.
- The fraud related reports, if any, or communications prepared by the internal audit function and whether management and those charged with governance have

ISA 240 Requirement	Application Material
	<p>satisfactorily responded to any findings resulting from those reports.</p> <ul style="list-style-type: none"> Control deficiencies identified by the internal audit function that are relevant to the prevention and detection of fraud, and whether management and those charged with governance have satisfactorily responded to any findings resulting from those deficiencies.
<p>The Information System and Communication</p> <p>34. In applying ISA 315 (Revised 2019),⁵⁸ the auditor shall obtain an understanding of the entity’s information system and communication relevant to the preparation of the financial statements, including understanding how journal entries are initiated, processed, <u>recorded</u>, and corrected as necessary. (Ref: Para. A90–A92)</p>	<p>The Information System and Communication (Ref: Para. 34)</p> <p>A90. Obtaining an understanding of the entity’s information system and communication relevant to the preparation of the financial statements includes the manner in which an entity incorporates information from transaction processing into the general ledger, which <u>This</u> ordinarily involves the use of journal entries, whether standard or non-standard, or automated or manual. This understanding enables the auditor to identify the population of all journal entries and other adjustments that are required to be tested in accordance with <u>paragraph 50(b)</u>. Obtaining an understanding of the population may provide the auditor with insights about journal entries and other adjustments that may be susceptible to unauthorized or inappropriate intervention or manipulation. This may assist the auditor in testing <u>designing and performing audit procedures over</u> journal entries and other adjustments in accordance with <u>paragraphs 50(c) and 50(d)</u>.</p> <p>A91. Appendix 4 includes additional considerations when selecting journal entries and other adjustments for testing, including matters that the required understanding provides the auditor knowledge about.</p>

⁵⁷ ISA 315 (Revised 2019), paragraphs 14(a) and 24(a)(ii), and ISA 610 (Revised 2013), *Using the Work of Internal Auditors*

⁵⁸ ISA 315 (Revised 2019), paragraph 25

ISA 240 Requirement	Application Material
	<p>A92. When performing risk assessment procedures, the auditor may consider changes in the entity's IT environment as a result of because <u>of</u> the introduction of new IT applications or enhancements to the IT infrastructure, which that may impact the susceptibility of the entity to fraud or create vulnerabilities in the IT environment. For example (e.g., changes to the databases involved in processing or storing transactions). There may also be an increased susceptibility to misstatement due to management bias or other fraud risk factors when there are complex IT applications used to initiate or process transactions or information, such as the use of artificial intelligence or machine learning algorithms to calculate and initiate accounting entries.</p>
<p>Control Activities</p> <p>35. In applying ISA 315 (Revised 2019),⁵⁹ the auditor shall obtain an understanding of: (Ref: Para. A92A)</p> <p>(a) Controls over journal entries, that prevent or detect fraud; and (Ref: Para. A93–A94 <u>and A94B</u>)</p> <p>(a)(b) Other controls that prevent or detect fraud, that the auditor considers are appropriate to enable the auditor to meet the objectives of paragraph 26 with respect to risks at the assertion level, based on the auditor's professional judgment. (Ref: Para. A94A–A94B)</p>	<p>Control Activities (Ref: Para. 35)</p> <p><u>A92A.</u>Management may make judgments on the nature and extent of the controls it chooses to implement, and the nature and extent of the risks it chooses to accept given the nature and circumstances of the entity. In determining which controls to implement to prevent or detect fraud, management considers the risks that the financial statements may be materially misstated due to fraud. [Previously paragraph A105]</p> <p>A93. ISA 315 (Revised 2019)⁶⁰ requires the auditor to obtain an understanding of controls over journal entries <u>as well as to evaluate their design and determine their implementation</u> as part of understanding the entity's system of internal control. This understanding addresses both fraud and error and focuses on the controls over journal entries that address risks of material misstatement at the assertion level. Paragraphs <u>49–50</u> of this ISA</p>

⁵⁹ ISA 315 (Revised 2019), paragraph 26

⁶⁰ ISA 315 (Revised 2019), paragraphs 26(a)(ii) and 26(d)

ISA 240 Requirement	Application Material
	<p>requires the auditor to test the appropriateness of journal entries and is specifically focused on the risks of material misstatement due to fraud.</p> <p>A94. Information from understanding controls <u>over journal entries</u>, that prevent or detect fraud over journal entries, may also be useful in identifying fraud risk factors that may affect the auditor's assessment of the risks of material misstatement due to fraud.</p> <p><u>A94A. Other controls that prevent or detect fraud, that the auditor considers are appropriate in accordance with paragraph 35(b), may include controls that address risks at the assertion level in:</u></p> <ul style="list-style-type: none"> • <u>Revenue recognition.</u> • <u>Accounting estimates.</u> • <u>Significant transactions outside the normal course of business.</u> <p><u>A94B. General IT controls may also be relevant to the prevention or detection of fraud.</u></p> <div style="border: 1px solid black; padding: 5px; margin-top: 10px;"> <p><u>Examples:</u></p> <ul style="list-style-type: none"> • <u>Controls that segregate access to make changes to a production (i.e., end user) environment.</u> • <u>Access controls to manage:</u> <ul style="list-style-type: none"> ○ <u>Privileged access – such as controls over administrative or powerful users' access.</u> ○ <u>Provisioning – such as controls to authorize modifications to existing users' access privileges, including non-personal or generic accounts that are not tied to specific individuals within the entity.</u> </div>

ISA 240 Requirement	Application Material
	<ul style="list-style-type: none"> Review of system logs that track access to the information system, enabling user activity to be monitored and security violations to be reported to management.
<p><i>Control Deficiencies Within the Entity’s System of Internal Control</i></p> <p>36. In applying ISA 315 (Revised 2019),⁶¹ based on the auditor’s evaluation of each of the components of the entity’s system of internal control, the auditor shall determine whether there are deficiencies in internal control identified that are relevant to the prevention or detection of fraud. (Ref: Para. A95–A95A)</p>	<p><i>Control Deficiencies Within the Entity’s System of Internal Control</i> (Ref: Para. 36)</p> <p>A95. In performing the evaluations of each of the components of the entity’s system of internal control, the auditor may determine that certain of the entity’s controls in a component are not appropriate to the nature and circumstances of the entity. Such a determination may be an indicator, which that which assists the auditor in identifying deficiencies in internal control that are relevant to the prevention and detection of fraud. If the auditor has identified one or more control deficiencies relevant to the prevention or detection of fraud, the auditor may consider the effect of those control deficiencies on the design of further audit procedures in accordance with ISA 330.</p> <p>A95A. Paragraph 66(c) of this ISA and ISA 265⁶² establish other requirements on identified deficiencies in internal controls.</p>
<p>Identifying and Assessing the Risks of Material Misstatement due to Fraud</p>	<p>Identifying and Assessing the Risks of Material Misstatement due to Fraud (Ref: Para. 40(a))</p>
<p>[Moved heading to above paragraph 29C]</p> <p>37. [Moved to paragraph 29C] [Not used]</p>	<p>[Moved heading to above paragraph A52B]</p> <p>A96. [Moved to paragraph A52B] [Not used]</p> <p>A97. [Moved to paragraph A52C] [Not used]</p> <p>A98. [Moved to paragraph A52D] [Not used]</p>

⁶¹ ISA 315 (Revised 2019), paragraph 27

⁶² [ISA 265, paragraph 8](#)

ISA 240 Requirement	Application Material
	<p>[Moved heading to above paragraph A52E]</p> <p>A99. [Moved to paragraph A52E] [Not used]</p>
<p><i>Evaluating the Audit Evidence Obtained from the Risk Assessment Procedures</i></p> <p>[Moved heading to above paragraph 29A]</p> <p>38. [Moved to paragraph 29A] [Not used]</p>	<p><i>Evaluating the Audit Evidence Obtained from the Risk Assessment Procedures</i></p>
<p>[Moved heading to above paragraph 29B]</p> <p>39. [Moved to paragraph 29B]</p>	<p>[Moved heading to above paragraph A52A]</p> <p>A100. [Moved to paragraph A52A]</p>
<p><i>Identifying and Assessing the Risks of Material Misstatement Due to Fraud</i></p> <p>40. In applying ISA 315 (Revised 2019),⁶³ the auditor shall:</p> <p>(a) Identify and assess the risks of material misstatement due to fraud and determine whether they exist at the financial statement level, or the assertion level for classes of transactions, account balances and disclosures, <u>taking into account fraud risk factors</u>. (Ref: Para. A101–A104)</p> <p>(b) Treat those assessed risks of material misstatement due to fraud as significant risks and accordingly, to the extent not already done so, the auditor shall obtain an understanding of the design and implementation of the entity’s related controls, including control activities, relevant to such risks. (Ref: Para. A105).</p>	<p><i>Identifying and Assessing the Risks of Material Misstatement Due to Fraud (Ref: Para. 40(a))</i></p> <p>A101. Identifying and assessing <u>Determining whether</u> the risks of material misstatement due to fraud exist at the financial statement level, or the assertion level for classes of transactions, account balances and disclosures, may assist the auditor in determining appropriate responses to address the assessed risks of material misstatement due to fraud.</p> <div style="border: 1px solid black; padding: 5px;"> <p>Examples:</p> <p>The following are examples of rRelevant assertions and the related classes of transactions, account balances or disclosures that may be particularly susceptible to material misstatement due to fraud <u>include</u>:</p> <ul style="list-style-type: none"> • Accuracy, — or valuation — or allocation of revenue from contracts with customers, — revenue from contracts with </div>

⁶³ ISA 315 (Revised 2019), paragraphs 28-34

ISA 240 Requirement	Application Material
	<p>customers may be susceptible to inappropriate estimates of the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer.</p> <ul style="list-style-type: none"> • Existence of cash balances — cash balances may be susceptible to the creation of falsified or altered external confirmations or bank statements. • Valuation of account balances involving significant accounting estimates — account balances involving significant accounting estimates such as goodwill and other intangible assets, <u>impairment of inventories</u>, expected credit losses, insurance contract liabilities, employee retirement benefits liabilities, environmental liabilities or environmental remediation provisions may be susceptible to high estimation uncertainty, significant subjectivity and management bias in making judgments about future events or conditions. • Presentation of profit before tax from continuing operations — profit before tax from continuing operations may be susceptible to misrepresentation (i.e., earnings management) for example, to minimize tax and other statutory obligations or to secure financing. • Presentation of disclosures — disclosures may be susceptible to omission, or incomplete or inaccurate presentation, for example, disclosures relating to contingent liabilities, off-balance sheet arrangements, financial guarantees, debt covenant requirements, or management defined performance measures (i.e., non-GAAP performance measures).

ISA 240 Requirement	Application Material
	<p>A102. [Not used]</p> <p>A103. In applying ISA 315 (Revised 2019),⁶⁴ the auditor may determine that the audit evidence obtained from the risk assessment procedures does not provide an appropriate basis for the identification and assessment of the risks of material misstatement due to fraud. In such circumstances, the auditor is required to perform additional risk assessment procedures until audit evidence has been obtained to provide such a basis.</p> <p>Considerations Specific to Public Sector Entities</p> <p>A104. For public sector entities, misappropriation of assets (i.e., misappropriation of funds) may be a common type of fraud.</p> <div data-bbox="1178 748 1986 1060" style="border: 1px solid black; padding: 5px;"> <p>Example:</p> <ul style="list-style-type: none"> • Fraud risk factors may be present when an individual with a significant role in a public sector entity has the sole authority to commit the public sector entity to sensitive expenditure, including travel, accommodation, or entertainment, and that sensitive expenditure provides personal benefits to the individual. </div> <p>Obtaining An Understanding of the Entity's Controls, Relevant to Assessed Risks of Material Misstatement Due to Fraud (Ref: Para. 40(b))</p> <p>A105. [Moved to paragraph A92A] [Not used]</p>
<p><i>Presumption of the Risks of Material Misstatement Due to Fraud in Revenue Recognition</i></p>	<p><i>Presumption of the Risks of Material Misstatement Due to Fraud in Revenue Recognition (Ref: Para. 41)</i></p>

⁶⁴ ISA 315 (Revised 2019), paragraph 35

ISA 240 Requirement	Application Material
<p>41. When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of material misstatement due to fraud in revenue recognition, determine which types of revenue, revenue transactions or relevant assertions give rise to such risks. In making this determination, if the auditor identifies, taking into account any related fraud risk factors related to revenue recognition as part of the evaluation in accordance with paragraph 37, the auditor shall take into account those fraud risk factors. (Ref: Para. A106–A111)</p>	<p>A106. Material misstatement due to fraudulent financial reporting in revenue recognition often results from an overstatement of revenues through, for example, premature revenue recognition or recording fictitious revenues. It may also result from an understatement of revenues through, for example, improperly deferring revenues to a later period.</p> <p>A107. The risks of material misstatement due to fraud in revenue recognition may be greater in some entities than others. For example, there may be pressures or incentives on management to commit fraudulent financial reporting through inappropriate revenue recognition in the case of listed entities when, for example, performance is measured in terms of year over year revenue growth or profit. Similarly, for example, there may be greater risks of material misstatement due to fraud in revenue recognition in the case of entities that generate a substantial portion of revenues through cash sales <u>that presents an opportunity for theft</u>, or that have complex revenue recognition arrangements (e.g., licenses of intellectual property or percentage of completion) <u>that is susceptible to management biases when determining percentage of completion for revenue recognition</u>.</p> <p>A108. Understanding the entity’s business and its environment, the applicable financial reporting framework and the entity’s system of internal control helps the auditor understand the nature of the revenue transactions, the applicable revenue recognition criteria and the appropriate industry practice related to revenue. This understanding may assist the auditor identify events or conditions relating to the types of revenue, revenue transactions, or relevant assertions, that could give rise to fraud risk factors.</p> <div data-bbox="1173 1276 1982 1416" style="border: 1px solid black; padding: 5px;"> <p>Examples:</p> <ul style="list-style-type: none"> • When there are changes in the financial reporting framework relating to revenue recognition, which may present an </div>

ISA 240 Requirement	Application Material
	<p>opportunity for management to commit fraudulent financial reporting or bring to light the lack of (or significant deficiency in) controls for managing changes in the financial reporting framework.</p> <ul style="list-style-type: none"> • When an entity's accounting principles for revenue recognition are more aggressive than, or inconsistent with, its industry peers. • When the entity operates in emerging industries. • When revenue recognition involves significant accounting estimates. • When revenue recognition is based on complex contractual arrangements with a high degree of estimation uncertainty, for example, construction-type or production-type contracts and multiple-element arrangements. • When there is contradictory evidence when performing risk assessment procedures. • When the entity has a history of significant adjustments for the improper recognition of revenue (e.g., premature recognition of revenue). • When circumstances indicate the recording of fictitious revenues. • When circumstances indicate the omission of required disclosures or presentation of incomplete or inaccurate disclosures regarding revenue, for example, to manipulate the entity's financial performance due to pressures to meet investor / market expectations, or due to the incentive for

ISA 240 Requirement	Application Material
	<div data-bbox="1173 266 1982 375" style="border: 1px solid black; padding: 5px;"> <p>management to maximize compensation linked to the entity's financial performance.</p> </div> <p>A109. When-If fraud risk factors related to revenue recognition are present, determining whether such fraud risk factors may indicate a risk of material misstatement due to fraud is a matter of professional judgment. The significance of fraud risk factors related to revenue recognition, individually or in combination, ordinarily makes it inappropriate to rebut the presumption that there are risks of material misstatement due to fraud in revenue recognition.</p> <p>A110. There may be circumstances where it may be appropriate to rebut the presumption that there are risks of material misstatement due to fraud in revenue recognition. The auditor may conclude that there are no risks of material misstatement due to fraud relating to revenue recognition in the case where the nature of the revenue transaction is simple and the applicable recognition criteria is straightforward and non-complex.</p> <div data-bbox="1173 943 1982 1369" style="border: 1px solid black; padding: 5px;"> <p>Examples:</p> <ul style="list-style-type: none"> • Leasehold revenue from a single unit of rental property, or multiple rental properties with a single tenant. • Rendering one type of service for a fixed fee. • Reselling one type of purchased good for a fixed price. • Simple or straightforward ancillary revenue sources, which are determined by fixed rates or externally published rates (e.g., interest or dividend revenue from investments with level 1 inputs). </div>

ISA 240 Requirement	Application Material
	A111. Paragraph 75(e) specifies the documentation required where the auditor concludes that the presumption is not applicable in the circumstances of the engagement and, accordingly, has not identified revenue recognition as a risk of material misstatement due to fraud.
<p><i>Significant Risk Related to Management Override of Controls</i></p> <p>42. Due to the unpredictable way in which management is able to override controls and irrespective of the auditor’s assessment of the risks of management override of controls, the auditor shall treat those risks as risks of material misstatement due to fraud and thus a significant risk. (Ref: Para. A112)</p>	<p><i>Significant Risk Related to Management Override of Controls</i> (Ref: Para. 42)</p> <p>A112. Management is in a unique position to perpetrate fraud because of management’s ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Although the level of risk of management override of controls will vary from entity to entity, the risk is nevertheless present in all entities. See also paragraphs 48–53.</p>
<p>Responses to the Assessed Risks of Material Misstatement Due to Fraud</p>	<p>Responses to the Assessed Risks of Material Misstatement Due to Fraud</p>
<p><i>Designing and Performing Audit Procedures in a Manner That Is Not Biased</i></p> <p>43. The auditor shall design and perform audit procedures in response to the assessed risks of material misstatement due to fraud in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory.</p>	
<p><i>Unpredictability in the Selection of Audit Procedures</i></p> <p>44. The auditor shall incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures when <u>in</u> determining responses to address the assessed risks of material</p>	<p><i>Unpredictability in the Selection of Audit Procedures</i> (Ref: Para. 30(c)44)</p> <p>A113. Incorporating an element of unpredictability in the selection of the nature, timing, and extent of audit procedures to be performed is essential, particularly where individuals within the entity who are familiar with the audit procedures normally performed on</p>

ISA 240 Requirement	Application Material
<p>misstatement due to fraud. (Ref: Para. A113–A115)</p>	<p>engagements may be more able to conceal fraudulent financial reporting. Incorporating an element of unpredictability in the selection of audit procedures may also be a possible action that the auditor uses to mitigate the effects of confirmation bias. It is therefore important that the auditor maintains an open mind to new ideas or different perspectives when selecting the audit procedures to be performed to address the risks of material misstatement due to fraud.</p> <div style="border: 1px solid black; padding: 5px;"> <p>A114. ISA 330⁶⁵ provides guidance that addresses incorporating an element of unpredictability in the selection of audit procedures when responding to the assessed risks of material misstatement at the assertion level, including when the risks of intentional misstatement or manipulation have been identified. Examples:</p> <ul style="list-style-type: none"> ● Performing further audit procedures on selected account balances or disclosures that were not determined to be material or susceptible to material misstatement. ● Performing tests of detail where the auditor performed substantive analytical procedures in previous audits. ● Adjusting the timing of audit procedures from that otherwise expected. ● Using different sampling methods or using different approaches to stratify the population. ● Performing audit procedures at different locations or at locations on an unannounced basis. ● Performing analytical procedures at a more detailed level or lowering thresholds when performing analytical procedures for further investigation of unusual or unexpected </div>

⁶⁵—ISA 330, paragraphs A11

ISA 240 Requirement	Application Material
	<p>relationships.</p> <ul style="list-style-type: none"> Using automated tools and techniques, such as anomaly detection or statistical methods, on an entire population to identify items for further investigation. <p>A114. [Not used]</p> <p>A115. The auditor may, when introducing<u>incorporating</u> an element of unpredictability in the <u>selection of the</u> nature, timing, and extent of audit procedures, refer to Appendix 2 of this ISA for examples of possible audit procedures to use when addressing the assessed risks of material misstatement due to fraud.</p>
<p><i>Overall Responses</i></p> <p>45. In accordance with ISA 330,⁶⁶ the auditor shall determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level. (Ref: Para. A116)</p>	<p><i>Overall Responses</i> (Ref: Para. 45)</p> <p>A116. Determining overall responses to address the assessed risks of material misstatement due to fraud <u>at the financial statement level</u> generally includes the consideration of how the overall conduct of the audit can reflect <u>the exercise of increased</u> professional skepticism, for example, through:</p> <div data-bbox="1178 987 1982 1312" style="border: 1px solid black; padding: 5px;"> <p>Examples:</p> <ul style="list-style-type: none"> Increased sensitivity in the selection of the nature and extent of documentation to be examined in support of material transactions. <u>Increased</u> recognition of the need to corroborate management's explanations or representations concerning material matters. </div>

⁶⁶ ISA 330, paragraph 5

ISA 240 Requirement	Application Material
	<ul style="list-style-type: none"> • <u>Increased involvement of auditor’s experts to assist the engagement team with complex or subjective areas of the audit.</u> • <u>Changing the composition of the engagement team by, for example, requesting that more experienced individuals with greater skills or knowledge or specific expertise are assigned to the engagement.</u> • Using direct extraction methods or technologies when obtaining data <u>from the entity’s information system</u> for use in automated tools and techniques to address the risk of data manipulation.
<p>46. In determining overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level, the auditor shall evaluate whether the selection and application of accounting policies by the entity, particularly those related to subjective measurements and complex transactions, may be indicative of fraudulent financial reporting resulting from management’s effort to manage earnings.</p>	
<p><i>Audit Procedures Responsive to the Assessed Risks of Material Misstatement Due to Fraud at the Assertion Level</i></p> <p>47. In accordance with ISA 330,⁶⁷ the auditor shall design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement due to fraud at the assertion level. (Ref: Para. A117–A125)</p>	<p><i>Audit Procedures Responsive to the Assessed Risks of Material Misstatement Due to Fraud at the Assertion Level</i> (Ref: Para. 47)</p> <p>A117. The auditor’s responses to address the assessed risks of material misstatement due to fraud at the assertion level may include changing the nature, timing and extent of audit procedures in the following ways: <u>In accordance with paragraph 40(b), assessed risks of material misstatement due to fraud are treated as significant risks. ISA 330</u></p>

⁶⁷ ISA 330, paragraph 6

ISA 240 Requirement	Application Material
	<p><u>requires the auditor to obtain more persuasive evidence the higher the auditor’s assessment of risk. When obtaining more persuasive audit evidence to respond to assessed risks of material misstatement due to fraud, the auditor may increase the quantity of the evidence, or obtain evidence that is more relevant and reliable, for example, by placing more emphasis on obtaining third party evidence or by obtaining audit evidence from a number of independent sources.</u></p> <p>Examples:</p> <p><u>Nature</u></p> <p>The nature of audit procedures to be performed may need to be changed to obtain audit evidence that is more relevant and reliable or to obtain additional corroborative information. This may affect both the type of audit procedures to be performed and their combination. For example, the auditor may:</p> <ul style="list-style-type: none"> • Physically observe or inspect certain assets to obtain more relevant and reliable audit evidence. For example, this may become important when the auditor has assessed risks of material misstatement due to fraud related to the misappropriation of those assets. <u>respond to</u> assessed risks of material misstatement due to fraud related to the misappropriation of those assets. • Design procedures to obtain additional corroborative information. For example, if <u>The</u> auditor identifies that management is under pressure to meet earnings expectations <u>and accordingly,</u> there may be a related risk that management is inflating sales by entering into sales agreements that include terms that preclude revenue recognition or by invoicing sales before delivery. In these

ISA 240 Requirement	Application Material
	<p>circumstances, the auditor may, for example, design external confirmations not only to confirm outstanding amounts, but also to confirm the details of the sales agreements, including date, any rights of return and delivery terms. In addition, the auditor may find it effective to supplement such external confirmations with inquiries of non-financial personnel in the entity regarding any changes in sales agreements and delivery terms.</p> <p><u>Timing</u></p> <ul style="list-style-type: none"> The timing of substantive procedures may need to be modified.—The auditor may conclude that performing substantive testing at or near the period end better addresses an assessed risk of material misstatement due to fraud. The auditor may conclude that, given the assessed risks of intentional misstatement or manipulation, audit procedures to extend audit conclusions from an interim date to the period end would not be effective. In contrast, because an intentional misstatement — for example, a misstatement involving improper revenue recognition — may have been initiated in an interim period, the auditor may elect to apply substantive procedures to transactions occurring earlier in or throughout the reporting period. <p><u>Extent</u></p> <p>The extent of the procedures applied reflects the assessment of the risks of material misstatement due to fraud. For example, increasing sample sizes or performing analytical procedures at a more detailed level may be appropriate.</p> <ul style="list-style-type: none"> The auditor may use automated tools and techniques to perform more extensive and relevant testing of digital

ISA 240 Requirement	Application Material
	<div data-bbox="1178 261 1986 578" style="border: 1px solid black; padding: 5px;"> <p>information. Such automated techniques may be used to test all items in a population, select specific items for testing that are responsive to risks of material misstatement due to fraud, or select items for testing when performing audit sampling. For example, the auditor may stratify the population based on specific characteristics to obtain more relevant audit evidence that is responsive to the risks of material misstatement due to fraud.</p> </div> <p>A117A. Automated tools and techniques may assist the auditor when performing audit procedures to obtain audit evidence about classes of transactions, account balances or disclosures where there are assessed risks of material misstatement due to fraud. For example, the auditor may fraud risk associated with compare the pattern of revenue recognition at period-end with activity during the month or that of previous months, where a risk of material misstatement due to fraud related to the cut-off of revenue has been identified. [Previously paragraph A119A]</p> <p>A118. ———— If the auditor identifies a risk of material misstatement due to fraud that affects inventory quantities, examining the entity's inventory records may help to identify locations or items that require specific attention during or after the physical inventory count. Such a review may lead to a decision to observe inventory counts at certain locations on an unannounced basis or to conduct inventory counts at all locations on the same date.</p> <p>A119. The auditor may identify a risk of material misstatement due to fraud affecting a number of accounts and assertions.</p>

ISA 240 Requirement	Application Material
	<p>These may include asset valuation, estimates relating to specific transactions (such as acquisitions, restructurings, or disposals of a segment of the business), and other significant accrued liabilities (such as pension and other post-employment benefit obligations, or environmental remediation liabilities). The risk may also relate to significant changes in assumptions relating to recurring estimates. Information gathered through obtaining an understanding of the entity and its environment may assist the auditor in evaluating the reasonableness of such management estimates and underlying judgments and assumptions. A retrospective review of similar management judgments and assumptions applied in prior periods may also provide insight about the reasonableness of judgments and assumptions supporting management estimates.</p> <p>A119A [Not used] [Moved to paragraph A117A]</p> <p>External Confirmation Procedures</p> <p>A120. In applying ISA 330,⁶⁸ external confirmation procedures may be considered useful when seeking audit evidence that is not biased towards to corroborating or contradicting a relevant assertion in the financial statements, especially in instances where <u>risks of material misstatement due to fraud</u>fraud risk factors have been identified related to the class of transactions, account balance or disclosure.</p> <p>A121. ISA 505⁶⁹ requires the auditor to maintain control over the external confirmation requests and to evaluate the implications of management's refusal to allow the auditor to send a confirmation request. If the auditor is unable to maintain control over the confirmation process or obtains an</p>

⁶⁸ ISA 330, paragraph 19.

⁶⁹ ISA 505, *External Confirmations*, paragraphs 7 and 8

ISA 240 Requirement	Application Material
	<p>unsatisfactory response as to why management refuses to allow the auditor to send a confirmation request, as applicable, then this may be an indication of a fraud risk factor.</p> <p>A122. The use of external confirmation procedures may be more effective or provide more persuasive audit evidence over the terms and conditions of a contractual agreement.</p> <div data-bbox="1178 516 1986 751" style="border: 1px solid black; padding: 5px;"> <p>Example:</p> <p>The auditor may request confirmation of the contractual terms for a specific class of revenue transactions, such as pricing, payment and discount terms, applicable guarantees and the existence, or absence, of any side agreements.</p> </div> <p>A123. ISA 505⁷⁰ includes factors that may indicate doubts about the reliability of a response to an external confirmation request, since all responses carry some risk of interception, alteration, or fraud.</p> <div data-bbox="1178 898 1986 1269" style="border: 1px solid black; padding: 5px;"> <p>Examples:</p> <p>Doubts about the reliability of a response may be due to an event or condition that indicates the existence of a fraud risk factor, such as when the response to a <u>A</u> confirmation request:</p> <ul style="list-style-type: none"> • Is sent from an e-mail address that is not recognized. • Does not include the original electronic mail chain or any other information indicating that the confirming party is responding to the auditor’s confirmation request. </div>

⁷⁰ ISA 505, paragraph A11

ISA 240 Requirement	Application Material
	<div data-bbox="1178 261 1982 391" style="border: 1px solid black; padding: 5px;"> <ul style="list-style-type: none"> • Contains unusual restrictions or disclaimers that do not corroborate the related terms in the signed lending agreement. </div> <p data-bbox="1102 415 1995 553"><u>A123A. ISA 505⁷¹ includes guidance for the auditor when a response to a confirmation request indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party.</u></p> <div data-bbox="1178 574 1982 837" style="border: 1px solid black; padding: 5px;"> <p>Example:</p> <p><u>A response to a confirmation request which includes information, such as volumes, prices, terms of sale, delivery addresses or contractual parties, contains differences with the entity's accounting records that may indicate the existence of fraudulent transactions, account balance or disclosures.</u></p> </div> <p data-bbox="1102 894 1995 1032">A124. ISA 505⁷² establishes requirements and provides guidance about non-responses and includes examples of alternative procedures that may be performed by the auditor. The alternative procedures may also be performed in instances where there are incomplete responses.</p> <p data-bbox="1102 1057 1608 1084">Examples of Other Further Audit Procedures</p> <p data-bbox="1102 1109 1995 1247">A125. Examples of possible audit procedures to address the assessed risks of material misstatement due to fraud are presented in Appendix 2. The Appendix includes examples of responses to the auditor's assessment of the risks of material misstatement resulting from both</p>

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ISA 505, paragraphs 14 and A21–A22

⁷² ISA 505, paragraphs 12 and A18-A19

ISA 240 Requirement	Application Material
	fraudulent financial reporting, including fraudulent financial reporting resulting from revenue recognition, and misappropriation of assets.
<i>Audit Procedures Responsive to Risks Related to Management Override of Controls</i>	<i>Audit Procedures Responsive to Risks Related to Management Override of Controls</i>
<p>48. Irrespective of the auditor’s assessment of the risks of management override of controls, the auditor shall design and perform the audit procedures in accordance with paragraphs 49–53, and determine whether other audit procedures are needed in addition to those in paragraphs 49–53, in order to respond to the identified risks of management override of controls.</p>	
<p>Journal Entries and Other Adjustments</p> <p>49. The auditor shall design and perform audit procedures to test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. (Ref: Para. A126–A129)</p> <p>50. In designing and performing audit procedures in accordance with paragraph 49, the auditor shall:</p> <p>(a) Make inquiries of individuals involved in the financial reporting process about their knowledge of inappropriate or unusual activity relating to the processing of journal entries and other adjustments;</p> <p>(b) Obtain audit evidence about the completeness of the population of all journal entries and other adjustments made in the preparation of the financial statements throughout the period; (Ref: Para. A131A132–A133 and A140)</p>	<p>Journal Entries and Other Adjustments (Ref: Para. 49–50)</p> <p>Why the testing of journal entries and other adjustments is performed</p> <p>A126. Material misstatements of financial statements due to fraud often involve the manipulation of the financial reporting process by recording inappropriate or unauthorized journal entries and other adjustments. This may occur throughout the year or at period end, or by management making adjustments to amounts reported in the financial statements that are not reflected in journal entries, such as through consolidation adjustments and reclassifications. [Previously paragraph A127]</p> <p>A127. Testing the appropriateness of journal entries and other adjustments (i.e.g., entries made directly to the financial statements such as eliminating adjustments for transactions, unrealized profits and intra-group account balances at group level) may assist the auditor in</p>

ISA 240 Requirement	Application Material
<p>(c) Select journal entries and other adjustments made at the end of a reporting period; and (Ref: Para. A134–A135, A137 and A139–A140)</p> <p>(d) Determine the need to test journal entries and other adjustments throughout the period. (Ref: Para. A134–A135 and A138–A140A139)</p>	<p>identifying fraudulent journal entries and other adjustments. [Previously paragraph A126]</p> <p>A128. The auditor's consideration of the risks of material misstatement associated with management override of controls over journal entries⁷³ is important since automated processes and controls may reduce the risk of inadvertent error but does not overcome the risk that management may inappropriately override such automated processes and controls, for example, by changing the amounts being automatically posted in the general ledger or to the financial reporting system. Further, where IT is used to transfer information automatically, there may be little or no visible evidence of such intervention in the information systems.</p> <p>A129. As part of their involvement in planning the audit,⁷⁴ <u>drawing on the experience and insight of</u> the engagement partner or other key members of the engagement team may need to draw on experience and insights helpful in designing audit procedures to test the appropriateness of journal entries and other adjustments, including planning for the appropriate resources, and determining the nature, timing and extent of the related direction, supervision, and review of the work being performed.</p> <p>A130. [Not Used]</p> <p>Obtaining audit evidence about the completeness of the population of all journal entries and other adjustments (<u>Ref: Para. 50(b)</u>)</p> <p>A131. [Not used]</p>

⁷³ ISA 315 (Revised 2019), paragraph 26(a)(ii)

⁷⁴ ISA 300, paragraphs 5, 9 and 11

ISA 240 Requirement	Application Material
	<p>A132. Prior to selecting items to test, the auditor may need to consider whether the integrity of the population of journal entries and other adjustments has been maintained throughout all stages of information processing based on the auditor’s understanding and evaluation of the entity’s information system and control activities (e.g., general IT controls that safeguard and maintain the integrity of financial information) in accordance with the requirements of ISA 315 (Revised 2019).⁷⁵</p> <p>A133. The auditor may also need to consider whether s Such a population may includes manual adjustments that are (e.g., batched in a spreadsheet), or other “top-side” adjustments that are made directly to the amounts reported in the financial statements. Failing de seto <u>obtain audit evidence about the completeness of the population</u> may limit the <u>effectiveness of the audit procedure’s effectiveness in responding to the risk of management override of controls to identify associated with</u> fraudulent journal entries and other adjustments that are intended to be responsive to the risk of management override of controls.</p> <p>Selecting journal entries and other adjustments <u>(Ref: Para. 50(c) and 50(d))</u></p> <p>A134. The auditor’s understanding of the entity and its environment, the applicable financial reporting framework, and the entity’s system of internal control may assist the auditor in selecting journal entries and other adjustments for testing.</p> <div data-bbox="1171 1182 1982 1245" style="border: 1px solid black; padding: 5px;"> <p>Examples:</p> </div>

⁷⁵ Proposed ISA 315 (Revised 2019), paragraphs 25-26

ISA 240 Requirement	Application Material
	<p>The process of to selecting journal entries and other adjustments for testing may be enhanced if the auditor leverages insights based on the auditor’s understanding about:</p> <ul style="list-style-type: none"> • <u>How the financial statements (including Events and transactions)—that</u> may be susceptible to material misstatement due to fraud, <u>particularly in areas where fraud risk factors are present.</u> • The application of accounting principles and methods that may be susceptible to material misstatement due to management bias. • Deficiencies in internal control that present opportunities for those charged with governance, management, or others within the entity to commit fraud. <p>A135. Appendix 4 provides additional considerations <u>that may be used</u> by the auditor when selecting journal entries and other adjustments for testing.</p> <p>A136. [Not used]</p> <p>Timing of testing journal entries and other adjustments <u>(Ref: Para. 50(c) and 50(d))</u></p> <p>A137. Fraudulent journal entries and other adjustments are often made at the end of a reporting period; consequently the auditor is required to select journal entries and other adjustments made at that time.</p> <div data-bbox="1173 1224 1982 1404" style="border: 1px solid black; padding: 5px;"> <p>Example:</p> <p>Among the journal entries and other adjustments most susceptible to management override of controls are manual adjusting journal entries and other adjustments directly made to the financial</p> </div>

ISA 240 Requirement	Application Material
	<p data-bbox="1178 266 1982 354">statements that, which occur after the closing of a financial reporting period and which that have little or no explanatory support.</p> <p data-bbox="1102 378 1992 553">A138. Further, because material misstatements in financial statements due to fraud can occur throughout the period and may involve extensive efforts to conceal how the fraud is accomplished, the auditor is required to determine whether there is also a need to test journal entries and other adjustments throughout the period.</p> <div data-bbox="1178 574 1982 1211" style="border: 1px solid black; padding: 5px;"> <p data-bbox="1188 597 1318 621">Examples:</p> <p data-bbox="1188 651 1969 748">The auditor's determination of the need to test journal entries and other adjustments throughout the period may lead the auditor to test journal entries and other adjustments associated with:</p> <ul data-bbox="1188 777 1969 1192" style="list-style-type: none"> <li data-bbox="1188 777 1969 1029">• Audit evidence obtained from the risk assessment procedures and related activities indicating that one or more fraud risk factors are present<u>Risks of material misstatement</u> that may be strongly linked to fraud schemes that can occur over a long period of time (e.g., complex related party transaction structures that may obscure its economic substance). <li data-bbox="1188 1053 1969 1192">• Anomalies or outliers in the journal entry data throughout the period that may be detected from the use of automated tools and techniques when testing journal entries and other adjustments. </div> <p data-bbox="1102 1235 1982 1300">Examining the underlying support for journal entries and other adjustments selected <u>(Ref: Para. 50(c) and 50(d))</u></p> <p data-bbox="1102 1325 1992 1422">A139. When testing the appropriateness of journal entries and other adjustments, the auditor may need to obtain and examine supporting documentation to determine the business rationale for recording them,</p>

ISA 240 Requirement	Application Material
	<p>including whether the recording of the journal entry reflects the substance of the transaction and complies with the applicable financial reporting framework. This may involve exercising professional skepticism by obtaining audit evidence that is not biased towards obtaining audit evidence that may be corroborative, or towards excluding audit evidence that may be contradictory.</p> <p>Considering the use of automated tools and techniques when testing journal entries and other adjustments (Ref: Para. 50(b) and 50(c))</p> <p>A140. The auditor may <u>Considering/consider</u> the use of automated tools and techniques by the auditor when testing journal entries and other adjustments (e.g., determining the completeness of the population or, <u>and</u> selecting items to test). <u>Such consideration</u> may be impacted by the entity's use of technology in processing journal entries and other adjustments.</p>
<p>Accounting Estimates</p> <p>51. The auditor shall review accounting estimates for <u>indicators of possible</u> management bias and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud. (Ref: Para. A141–A142A143)</p> <p>52. In designing and performing audit procedures in accordance with <u>paragraph 51</u>, the auditor shall:</p> <p>(a) Consider the audit evidence obtained from the retrospective review performed in accordance with <u>paragraph 28</u>; and</p> <p>(b) Evaluate whether the judgments and decisions made by management in making the accounting estimates included in the financial statements, even if they are individually reasonable, are indicators of possible management bias that may represent a risk of material misstatement due to fraud. If</p>	<p>Accounting Estimates (Ref: Para. 51–52)</p> <p>Why the review of accounting estimates for management bias is performed</p> <p>A141. The preparation of the financial statements requires management to make a number of judgments or assumptions that affect significant accounting estimates and to monitor the reasonableness of such estimates on an ongoing basis. Fraudulent financial reporting is often accomplished through intentional misstatement of accounting estimates. For example, this may be achieved by understating or overstating all provisions or reserves in the same fashion so as to be designed either to smooth earnings over two or more accounting periods, or to achieve a designated earnings level in order to deceive financial statement users by influencing their perceptions as to the entity's performance and profitability.</p> <p>A142. ISA 315 (Revised 2019) provides guidance that management bias is</p>

ISA 240 Requirement	Application Material
<p>so, the auditor shall reevaluate the accounting estimates taken as a whole. (Ref: Para. A143–A145)</p>	<p>often associated with certain conditions that have the potential to give rise to management not maintaining neutrality in exercising judgment (i.e., indicators of potential management bias), which could lead to a material misstatement of the information that would be fraudulent if intentional.⁷⁶</p> <p>Indicators of possible management bias</p> <p>A143. ISA 540 (Revised)⁷⁷ includes a requirement and related application material addressing indicators of possible management bias. ISA 540 (Revised) also provides guidance that when an accounting estimate is subject to a high degree of subjectivity, the accounting estimate is likely to be more susceptible to misstatement due to management bias or fraud.⁷⁸ Therefore, the auditor may need to focus evaluations made in accordance with paragraph 52(b) on accounting estimates that are subject to a high degree of subjectivity.</p> <div data-bbox="1173 829 1982 1224" style="border: 1px solid black; padding: 5px;"> <p>Examples:</p> <p>Indicators of possible management bias in how management made the accounting estimates that may represent a risk of material misstatement due to fraud include:</p> <ul style="list-style-type: none"> • Changes in methods, significant assumptions, sources, or items of data selected that are not based on new circumstances or new information, which may not be reasonable in the circumstances nor in compliance with the applicable financial reporting framework. </div>

⁷⁶ ISA 315 (Revised 2019), paragraph 2 of Appendix 2

⁷⁷ ISA 540 (Revised), paragraphs 32 and A133–A136

~~⁷⁸ ISA 540 (Revised), paragraph A79~~

ISA 240 Requirement	Application Material
	<div data-bbox="1173 261 1982 483" style="border: 1px solid black; padding: 5px;"> <ul style="list-style-type: none"> • Adjustments made to the output of the model(s), which are not appropriate in the circumstances when considering the requirements of the applicable financial reporting framework. • Selection of assumptions from the end of the range that resulted in the most favorable measurement outcome. </div> <p>A144. The auditor may use automated tools and techniques to review accounting estimates for management bias. For example, by:</p> <ul style="list-style-type: none"> • a Analyzing the activity in an estimate account during the year and comparing it to the current and prior period estimates; • b Benchmarking assumptions used for the estimate, using data visualization to understand the location of point estimates within the range of acceptable outcomes; or • Using predictive analytics to identify the likelihood of future outcomes based on historical data. <p>A145. Where If there are strong indicators of possible management bias that may be intentional, the auditor may consider it appropriate to involve individuals with forensic skills in performing the review of accounting estimates for management bias in accordance with paragraphs 51–52. Applying forensic skills through analyzing accounting records, conducting interviews, reviewing internal and external communications, investigating related party transactions, or reviewing internal controls may also assist the auditor in evaluating whether the indicators of possible management bias actually represent a risk of material misstatement due to fraud.</p>
Significant Transactions Outside the Normal Course of Business or Otherwise Appear Unusual	Significant Transactions Outside the Normal Course of Business or Otherwise Appear Unusual (Ref: Para. 53)

ISA 240 Requirement	Application Material
<p>53. For significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual given the auditor’s understanding of the entity and its environment and information from other sources obtained during the audit, the auditor shall evaluate whether the business rationale (or the lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets. (Ref: Para. A146–A147)</p>	<p>A146. Indicators that may suggest that significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual, may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets include:</p> <ul style="list-style-type: none"> • The form of such transactions appears overly complex (e.g., the transaction involves multiple entities within a consolidated group or multiple unrelated third parties). • Management has not discussed the nature of and accounting for such transactions with those charged with governance of the entity, and there is inadequate documentation. • Management is placing more emphasis on the need for a particular accounting treatment than on the underlying economics of the transaction. • Transactions that involve non-consolidated related parties, including special purpose entities, have not been properly reviewed or approved by those charged with governance of the entity. • <u>Unusual activities with no logical business rationale (e.g., the entity changes transaction payment methods with related parties to cryptocurrency).</u> • The transactions involve previously unidentified related parties or parties that do not have the substance or the financial strength to support the transaction without assistance from the entity under audit. <p>A147. The auditor may use automated tools and techniques to identify significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual. For example,</p>

ISA 240 Requirement	Application Material
	<p>reviewing journal entries with unusual characteristics such as a significant time lag between the posting date and the effective date of the journal entry. [Deleted] [Not used]</p>
Fraud or Suspected Fraud	Fraud or Suspected Fraud (Ref: Para. 54-63)
<p>54. When<u>If the auditor identifies</u> fraud or suspected fraudis identified, the engagement partner shall: (Ref: Para. A148–A149 and A155)</p> <p>(a) Obtain an understanding of the nature, timing and extent of the fraud or suspected fraud in order to determine the effect on the audit engagement; (Ref: Para. A150–A153)</p> <p>(b) Communicate with management and those charged with governance as required by in accordance with paragraphs 71–73; and (Ref: Para. A154–A154A)</p> <p>(c) Report to an appropriate authority outside the entity as required by in accordance with paragraph 74.</p>	<p>A148. When<u>If the auditor identifies</u> fraud or suspected fraudis identified, the firm’s policies and procedures may include appropriate actions for the engagement partner to take, depending on the facts and circumstances of the audit engagement. These actions<u>Examples of actions</u> may include one or more of the following:</p> <ul style="list-style-type: none"> • Consulting<u>ing</u> with others in the firm. • Obtain<u>ing</u> legal advice from external counsel to understand the engagement partner’s options and the professional or legal implications of taking any particular course of action. • Consulting<u>ing</u> on a confidential basis with a regulator or professional body (unless doing so is prohibited by law or regulation or would breach the duty of confidentiality). <p>[Reordered bullets]</p> <p>A149. In accordance with ISA 220 (Revised),⁷⁹ the engagement partner is required to take responsibility for making the engagement team aware of the firm’s policies or procedures related to relevant ethical requirements. This includes the responsibilities of members of the engagement team when they become aware of an instance of non-compliance with laws and regulations by the entity, <u>which includes instances of fraud.</u></p>

⁷⁹ ISA 220 (Revised), paragraph 17(c)

ISA 240 Requirement	Application Material
	<p>Obtain an Understanding of the Nature, Timing and Extent of the Fraud or Suspected Fraud</p> <p>A150. When obtaining an understanding of the nature, timing and extent of the fraud or suspected fraud, the engagement partner may do one or more of the following, as relevant to the facts and circumstances of the audit engagement:</p> <ul style="list-style-type: none"> • Involve an auditor’s expert, such as an individual with forensic skills. • Consider the implications on prior audit engagements<u>Make further inquiries of the internal audit function. Inspect whistleblower files for additional</u>information. • <u>Make further inquiries of:</u> <ul style="list-style-type: none"> ☐ <u>the entity’s in-house counsel or external legal counsel.</u> <u>☐</u> ☐ <u>Individuals within the internal audit function (if the function exists).</u> <u>☐</u> Request management or those charged with governance to develop a robust plan to investigate the fraud or suspected fraud, including a remediation plan to address the findings as applicable. <p>Request the entity engage an expert, such as a certified fraud examiner, to perform an independent forensic investigation.</p> <p>[Two bullets moved to paragraphs A154A and A157, respectively]</p>

ISA 240 Requirement	Application Material
	<p>A151. The extent of the understanding of the fraud or suspected fraud by the engagement partner needed to determine the effect on the audit engagement may vary based on the facts and circumstances.</p> <div style="border: 1px solid black; padding: 10px;"> <p>Examples:</p> <ul style="list-style-type: none"> • An engagement team member obtains audit evidence that a misappropriation of assets may have occurred <u>by an employee who does not have a significant role or authority in the entity</u>. It is determined by the engagement team member to have an immaterial impact on the financial statements. Based on the direction, supervision and review of the engagement team member’s work, the engagement partner agrees with the conclusions reached, including that management is not involved in the misappropriation of assets. The facts and circumstances are communicated to management and those charged with governance, as applicable, and the matter is appropriately addressed by the entity. Based on the discussions held and the engagement partner’s understanding, the matter is considered resolved to the engagement partner’s satisfaction. • A component auditor communicates timely to the group auditor about the existence of a fraud involving component management where the fraud has resulted in a material misstatement of the component’s <u>financial</u> information. Since the nature of the fraud involved a complex scheme of kickbacks paid to vendors, the engagement partner held extensive discussions with the component auditor to understand the identified fraud. Given the significance of the matter, the engagement partner <u>complied with the firm’s policies and procedures</u>, also consulted with others in the </div>

ISA 240 Requirement	Application Material
	<div data-bbox="1182 264 1982 578" style="border: 1px solid black; padding: 5px;"> <p>firm and made changes to the overall group audit strategy and group audit plan as well as the direction, supervision and review of the work being performed by the group auditor. Once the engagement partner had an appropriate understanding of the matter, the engagement partner communicated timely with management and those charged with governance, as applicable. The matter was then further investigated by the entity and resolved.</p> </div> <p>A152. The information obtained from the understanding (e.g., from the independent report requested by the entity to investigate the fraud or suspected fraud) may provide the engagement partner with audit evidence about whether for example, the fraud or suspected fraud affects the financial statements.</p> <p>A153. Understanding the nature of the fraud or suspected fraud may impacts whether and how the engagement partner adjusts the overall audit strategy and audit plan, especially in circumstances when information comes to the engagement partner’s attention that differs significantly from the information available when the audit procedures overall audit strategy was/were originally established/planned.⁸⁰</p> <div data-bbox="1182 1036 1982 1287" style="border: 1px solid black; padding: 5px;"> <p>Examples:</p> <ul style="list-style-type: none"> Based on a preliminary understanding of the matter, the auditor engagement partner believes/d the fraud or suspected fraud was/is inconsequential e.g., limited to the misappropriation of immaterial assets, and consequently the auditor engagement partner determines/d to continue with </div>

⁸⁰ ISA 300, paragraphs 10 and A15

ISA 240 Requirement	Application Material
	<p>other aspects of the audit engagement while the matter was being<u>is</u> resolved with-by management of the entity.</p> <ul style="list-style-type: none"> Based on a preliminary understanding of the fraud or suspected fraud, the engagement partner auditor<u>believes</u> the integrity of management was will<u>may be</u> in question. Given the significance and pervasiveness of the matter, the auditor-engagement partner believes<u>determined</u> that no further work may be performed <u>across the entire audit engagement</u> until the matter had been is appropriately resolved. <p>Communicate with Management and Those Charged with Governance</p> <p>A154. The timing of the communications is dependent on the extent of the understanding needed of the fraud or suspected fraud by the engagement partner in order to have a robust discussion with management and those charged with governance. As a result of these communications, information may be obtained that may inform<u>further inform</u> the engagement partner’s understanding of the nature, timing and extent of the fraud or suspected fraud.</p> <p><u>A154A. Depending on the understanding obtained about the fraud or suspected fraud, and the impact on the overall audit strategy, the engagement partner may determine that it is necessary to discuss</u> an extension of the audit reporting deadlines with management and those charged with governance, where an extension is possible under applicable law or regulation.</p> <p>[Previously last bullet of paragraph A150]</p> <p>Unable to Continue the Audit Engagement</p>

ISA 240 Requirement	Application Material
	<p>A155. In exceptional circumstances, based on the understanding obtained by the engagement partner, the engagement partner may be unable to continue the audit engagement (see paragraph 65). This may be the case, for example, where management or those charged with governance do not take appropriate action to address the fraud or suspected fraud, or and the engagement partner has significant concern about their competence or integrity.</p> <p>A155A. Appendix 3 contains examples of circumstances that may be indicative of fraud. [Previously paragraph A29A]</p>
55. [Not used]	
56. [Not used]	
<p>57. Based on the understanding obtained about the fraud or suspected fraud, the auditor shall determine whether to:</p> <p>(a) Pperform additional risk assessment procedures to provide an appropriate basis for the identification and assessment of the risks of material misstatement due to fraud in accordance with ISA 315 (Revised 2019),⁸⁴ or (Ref: Para. A156)</p> <p>(b) Design and perform further audit procedures to appropriately respond to the risks of material misstatement due to fraud in accordance with ISA 330.</p>	<p>[Not used] [Deleted] The determination required by paragraph 57 Performing the additional risk assessment procedures to address the risks of material misstatement due to fraud may involve complex considerations and professional judgment. Accordingly, the actions the auditor may consider taking include:</p> <p>Engaging an auditor's expert with specialized skills or knowledge in the matter.</p> <p>Consulting internally (e.g., within the firm or a network firm) in accordance with the firm's policies or procedures.</p>
58. [Not used]	

⁸⁴—ISA 315 (Revised 2019), paragraphs 35

ISA 240 Requirement	Application Material
<p>59. The auditor shall <u>also</u> perform <u>the following</u> additional audit procedures to address the identified fraud or suspected fraud, <u>including</u>:</p> <p>(a) Discuss <u>Make inquiries about</u> the matter and an approach <u>the process</u> to further investigate the matter with an appropriate level of management that is at least one level above those involved, and those charged with governance. (Ref. Para. A157) <u>[Previously paragraph 62(b)]</u></p> <p>(b) Assessing <u>Evaluate</u> whether remediation measures <u>the process to taken by management or those charged with governance to investigate</u> address the matter fraud or suspected fraud are <u>is</u> appropriate <u>in the circumstances</u>. (Ref. Para. A157A-A157B)</p> <p>(c) Determine <u>ing</u> if control deficiencies, <u>including significant deficiencies in internal control</u> related to the prevention or detection of fraud, <u>exist</u> relating to the identified fraud or suspected fraud. (Ref: Para. A157B)</p> <p>(e) <u>(d)</u> Determine <u>ing</u> <u>whether there are</u> additional responsibilities under law, regulation or relevant ethical requirements about the entity's non-compliance with laws or regulations in accordance with ISA 250 (Revised).</p> <p>(d) <u>(e)</u> -If applicable, consider <u>ing</u> the impact on other engagements, including audit engagements from prior years.</p> <p><u>[Sub-paragraphs reordered]</u></p>	<p>A157. <u>[Paragraph moved to paragraph A157B and replaced by a bullet from the list in A150]</u> <u>When making the inquiries in paragraph 59(a), the auditor R</u> <u>requests</u> management or those charged with governance to <u>provide an explanation of the process</u> develop a robust plan to investigate the <u>identified</u> fraud or suspected fraud, including a remediation plan to address the finding as applicable. <u>The extent of the process taken by management or those charged with governance may vary.</u></p> <div data-bbox="1171 646 1982 1302" style="border: 1px solid black; padding: 5px;"> <p><u>Examples:</u></p> <ul style="list-style-type: none"> • <u>New allegations of fraud were made by a disgruntled former employee. Management followed the policies and procedures in place at the entity and referred the matter to the legal and human resources departments. Since prior allegations by the disgruntled employee had been investigated and determined to be without merit, management believed that no further action was necessary.</u> • <u>A suspected fraud, involving a senior member of management, was reported to those charged with governance by an employee. Those charged with governance followed the policies and procedures in place at the entity and referred the matter to the legal and human resources departments. As a result, a certified fraud examiner was engaged, to perform an independent forensic investigation.</u> </div>

ISA 240 Requirement	Application Material
	<p>A157A. When evaluating assessing the appropriateness of the remediation measures taken, process taken in paragraph 59(b), the auditor may consider how management:</p> <p><u>(a) Whether the outcome of the process is likely to prevent the reoccurrence of the fraud or suspected fraud (e.g., new control activities are designed and implemented to prevent and detect the fraud or suspected fraud).</u></p> <p><u>(b) How management:</u></p> <ul style="list-style-type: none"> (i) Responded to any misstatements that were identified (e.g., the timeliness of when the identified misstatements were corrected by management). (ii) Responded to the fraud e.g., disciplinary, or legal sanctions imposed on the individuals involved in perpetrating the fraud. <u>(iii)</u> Addressed the control deficiencies regarding the prevention or detection of the fraud. <p><u>A157B.</u> ISA 265⁸² provides requirements and guidance about the auditor’s communication of significant deficiencies in internal control identified during the audit to those charged with governance. Examples of matters that the auditor considers in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency include:</p> <ul style="list-style-type: none"> • The susceptibility to loss due to fraud of the related asset or liability.

⁸² ISA 265, paragraphs 8 and A6-A7

ISA 240 Requirement	Application Material
	<ul style="list-style-type: none"> The importance of the controls to the financial reporting process, e.g., controls over the prevention and detection of fraud₇ <p>Indicators of significant deficiencies in internal control include₁ for example₁ evidence of ineffective aspects of the internal control environment₇ such as the identification of management fraud, whether or not material, that was not prevented by the entity's <u>system of</u> internal control.</p> <p>[Previously paragraph A157]</p>
<p>60. If, based on the additional procedures performed, the auditor identifies a misstatement due to fraud, the auditor shall: (Ref: Para. A158–A158A)</p> <p>(a) Determine the implications of the misstatement in relation to other aspects of the audit, including when the auditor has reason to believe that management (in particular, senior management) is involved; and (Ref: Para. A159)</p> <p>(b) Consider whether circumstances or conditions relating to the misstatement indicate possible collusion involving management, employees or third parties when reconsidering the reliability of management representations and audit evidence previously obtained.</p>	<p>A158. Since fraud involves incentive or pressure to commit fraud, a perceived opportunity to do so or some rationalization of the act, an instance of fraud is unlikely to be an isolated occurrence. Misstatements, such as numerous misstatements at a business unit or geographical location even though the cumulative effect is not material, may also be indicative of a risk of material misstatement due to fraud.</p> <p>A158A. [Not used] [Deleted] When responding to the risks of material misstatement due to fraud the auditor may obtain audit evidence that indicates that the identified misstatement is due to error.</p> <p>A159. The implications of an identified misstatement due to fraud on the reliability of information intended to be used as audit evidence depends on the circumstances. For example, an otherwise insignificant fraud may be significant if it involves senior management. In such circumstances, the reliability of information previously obtained and intended to be used as audit evidence may be called into question as, since there may be doubts about the completeness and truthfulness of representations made and about the <u>authenticity genuineness</u> of accounting records and documentation.</p>

ISA 240 Requirement	Application Material
<p>61. In applying ISA 450,⁸³ the auditor shall determine whether identified misstatements due to fraud are material by considering the nature of the qualitative or quantitative circumstances giving rise to the misstatement. In doing so, the auditor shall: (Ref: Para. A160–A161)</p> <p>(a) Conclude that the risk of material misstatements due to fraud has been reduced to an acceptably low level; or</p> <p>(b) Determine that a material misstatement due to fraud has been identified.</p>	<p>A160. ISA 450 and ISA 700 (Revised)⁸⁴ establish requirements and provide guidance on the evaluation of misstatements and the effect on the auditor’s opinion in the auditor’s report.</p> <p>A161.—The following are examples <u>of</u> qualitative or quantitative circumstances that may be relevant:</p> <div style="border: 1px solid black; padding: 10px;"> <p>Examples:</p> <p>Qualitative circumstances include whether a misstatement:</p> <ul style="list-style-type: none"> • Involves those charged with governance, management, related parties, or third parties that which may brings into question concerns the auditor may have about the integrity or competence of those involved. • —Affects compliance with law or regulation which may also affect the auditor’s consideration of the integrity of management, those charged with governance or employees. • — • —Affects compliance with debt covenants or other contractual requirements which may cause the auditor to question the pressures being exerted on management to meet certain earnings release expectations. <p>Quantitative circumstances include whether a misstatement:</p> <ul style="list-style-type: none"> • Affects key performance indicators such as earnings per share, net income and working capital, that may have a </div>

⁸³ ISA 450, *Evaluation of Misstatements Identified During the Audit*

⁸⁴ ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

ISA 240 Requirement	Application Material
	<p>negative effect on the calculation of compensation arrangements for senior management at the entity.</p> <ul style="list-style-type: none"> Affects multiple reporting periods such as when a misstatement has an immaterial effect on the current period's financial statements but is likely to have a material effect on future periods' financial statements.
<p>62. If the auditor determines that the financial statements are materially misstated due to fraud, the auditor shall:</p> <p>(a) Determine the implications for the audit under the auditor's opinion on the financial statements in accordance with ISA 705 (Revised).⁸⁵</p> <p>(b) [Moved to paragraph 59 (a)]</p> <p>(c) If appropriate, obtain advice from legal counsel.</p>	
<p>63. If the auditor is unable to conclude whether the financial statements are obtain sufficient appropriate audit evidence as relates to a materially misstatement as a result of due to fraud, the auditor shall determine the implications for the audit or the auditor's opinion on the financial statements in accordance with ISA 705 (Revised).</p>	
<p>Evaluation of the Sufficiency and Appropriateness of Audit Evidence (Ref: Para. A162)</p>	<p>Evaluation of the Sufficiency and Appropriateness of Audit Evidence (Ref: Para. 64)</p>
	<p>A162. ISA 330 requires the auditor, based on the audit procedures performed and the audit evidence obtained, to evaluate whether the assessments of the risks of material misstatement at the assertion</p>

⁸⁵ [ISA 705 \(Revised\), Modifications to the Opinion in the Independent Auditor's Report](#)

ISA 240 Requirement	Application Material
	<p>level remain appropriate.⁸⁶ This evaluation is primarily a qualitative matter based on the auditor’s judgment. Such an evaluation may provide further insights about the risks of material misstatement due to fraud and whether there is a need to perform additional or different audit procedures.</p> <p>A163. [Not used]</p> <p>A164. [Not used]</p>
<p>Analytical Procedures Performed Near the End of the Audit in Forming an Overall Conclusion</p> <p>64. <u>In applying ISA 520,</u>⁸⁷ The the auditor shall determine whether analytical procedures that are performed near the end of the audit, when forming an overall conclusion as to whether the financial statements are consistent with the auditor’s understanding of the entity, indicate a previously unrecognized risk of material misstatement due to fraud. (Ref: Para. A165–A166)</p>	<p>Analytical Procedures Performed Near the End of the Audit in Forming an Overall Conclusion (Ref: Para. 64)</p> <p>A165. ISA 520 explains that the analytical procedures performed near the end of the audit are intended to corroborate conclusions formed during the audit of individual components or elements of the financial statements.⁸⁸ However, the auditor may perform the analytical procedures at a more granular level for certain higher risk classes of transactions, account balances, and disclosures to determine whether certain trends or relationships may indicate a previously unidentified risk of material misstatement due to fraud. Determining which particular trends and relationships may indicate a risk of material misstatement due to fraud requires professional judgment. Unusual relationships involving year-end revenue and income are particularly relevant. These <u>might may</u> include, for example:</p> <ul style="list-style-type: none"> • Uncharacteristically large amounts of income being reported in the last few weeks of the reporting period.⁸⁹

⁸⁶ ISA 330, paragraph 25

⁸⁷ ISA 520, Analytical Procedures, paragraph 6

⁸⁸ ISA 520, Analytical Procedures, paragraphs ~~6 and~~ A17–A19

ISA 240 Requirement	Application Material
	<ul style="list-style-type: none"> • Unusual transactions; • Income that is inconsistent with trends in cash flow from operations; <ul style="list-style-type: none"> ○ Uncharacteristically low amounts of revenue at the start of the subsequent period; or ○ Uncharacteristically high levels of refunds or credit notes at the start of the subsequent period. <p>A166. The auditor may use automated tools and techniques to identify unusual or inconsistent transaction posting patterns in order to determine if there is a previously unrecognized risk of material misstatement due to fraud.</p>
Auditor Unable to Continue the Audit Engagement	Auditor Unable to Continue the Audit Engagement (Ref: Para. 65)
<p>65. 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 engagement, the auditor shall:</p> <ul style="list-style-type: none"> (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; (b) Consider whether it is appropriate to withdraw from the engagement, where withdrawal is possible under applicable law or regulation; and (c) If the auditor withdraws: 	<p>A167. Examples of exceptional circumstances that may arise and that may bring into question the auditor's ability to continue performing the audit include:</p> <ul style="list-style-type: none"> • The entity does not take the appropriate action regarding fraud that the auditor considers necessary in the circumstances; even where the fraud is not material to the financial statements; • The auditor's consideration of the risks of material misstatement due to fraud and the results of audit tests indicate a significant risk of material and pervasive fraud; • The auditor has significant concern about the competence or integrity of management or those charged with governance; or

ISA 240 Requirement	Application Material
<p>(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</p> <p>(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; and (Ref: Para. A167–A170)</p> <p>(d) <u>Where law or regulation prohibits the auditor from withdrawing from the engagement, consider whether the exceptional circumstances will result in a disclaimer of opinion on the financial statements.</u></p>	<ul style="list-style-type: none"> The auditor is unable to address a threat to compliance with the fundamental principles related to the relevant ethical requirements.⁸⁷ <p>A168. Because of the variety of circumstances that may arise, it is not possible to describe definitively when withdrawal from an engagement is appropriate. Factors that affect the auditor’s conclusion include the implications of the involvement of a member of management or of those charged with governance (which may affect the reliability of management representations) and the effects on the auditor of a continuing association with the entity.</p> <p>A169. The auditor has professional and legal responsibilities in such circumstances and these responsibilities may vary by country. In some countries, for example, the auditor may be entitled to, or required to, make a statement or report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities. Given the exceptional nature of the circumstances and the need to consider the legal requirements, the auditor may consider it appropriate to seek legal advice when deciding whether to withdraw from an engagement and in determining an appropriate course of action, including the possibility of reporting to shareholders, regulators or others.⁸⁹</p> <p><i>Considerations Specific to Public Sector Entities</i></p> <p>A170. In many cases in the public sector, the option of withdrawing from the engagement may not be available to the auditor due to the nature of the mandate or public interest considerations.</p>

⁸⁹ Section 320 of the IESBA Code provides requirements and application material on communications with the existing or predecessor accountant, or the proposed accountant.

ISA 240 Requirement	Application Material
Implications for the Auditor's Report	Implications for the Auditor's Report (Ref: Para. 66–69)
<p><i>Determining Key Audit Matters</i></p> <p>66. In applying ISA 701,⁹⁰ the auditor shall determine, from the fraud related matters <u>related to fraud</u> communicated with those charged with governance, those fraud-related matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following: (Ref: Para. A171–A177)</p> <ul style="list-style-type: none"> (a) Significant risks of material misstatement due to fraud; (b) The identification of fraud or suspected fraud; and (c) The identification of deficiencies in internal control that are relevant to the prevention and detection of fraud. 	<p><i>Determining Key Audit Matters</i></p> <p>A171. ISA 701⁹¹ requires the auditor to 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 is also required to take into account the matters-specific required considerations as set out in paragraph 66.</p> <p>A172. Users of financial statements have expressed an interest in fraud related matters <u>related to fraud</u> about which the auditor had a robust dialogue with those charged with governance and have called for additional transparency about those communications. The considerations in paragraph 66 focus on the nature of matters communicated with those charged with governance that are intended to reflect fraud-related matters <u>related to fraud</u> that may be of particular interest to intended users.</p> <p>A173. In addition to matters that relate to the specific required considerations in paragraph 66, there may be other fraud-related matters <u>related to fraud</u> communicated with those charged with governance that required significant auditor attention and that therefore may be determined to be key audit matters in accordance with paragraph 67.</p> <p>A174. Matters Fraud-related to fraud matters-often are <u>often</u> matters that require significant auditor attention <u>including</u>, for example:</p> <ul style="list-style-type: none"> • The identification of fraud or suspected fraud may require significant changes to the auditor's risk assessment and

⁹⁰ ISA 701, paragraph 9

⁹¹ ISA 701, paragraph 9

ISA 240 Requirement	Application Material
	<p>reevaluation of the planned audit procedures (i.e., a significant change in the audit approach).</p> <ul style="list-style-type: none"> • Significant transactions with related parties or significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual. The auditor may have had extensive discussions with management and those charged with governance at various stages throughout the audit about the effect on the financial statements of these transactions. <p>A175. Accounting estimates often are <u>often</u> the most complex areas of the financial statements because they may be dependent and may be highly dependent on significant management judgment. <u>Significant auditor attention may be required in accordance with paragraph 66(a) accounting estimates to respond to a significant risk of material misstatement due to fraud associated with an accounting estimate that involves significant management judgment. For example, Significant management judgment is often involved when an accounting estimate is subject to a high degree of estimation uncertainty and subjectivity, that have a significant effect on the financial statements or accounting estimates that are complex may have an increased susceptibility to misstatements due to intentional management bias and therefore the auditor may identify a risk of material misstatement due to fraud in the related class of transactions, account balance or disclosure. For example, management may have made difficult or complex judgments in relation to recognition, measurement, presentation or disclosures which may have had a significant effect on the auditor's overall procedures.</u></p> <div data-bbox="1173 1313 1982 1383" style="border: 1px solid black; padding: 5px;"> <p><u>Example:</u></p> </div>

ISA 240 Requirement	Application Material
	<p data-bbox="1178 269 1982 688"> <u>The auditor determines significant auditor attention was required to respond to the risk of material misstatement due to fraud associated with the entity’s estimate of expected credit losses. Management utilizes a model that requires a complex set of assumptions about future developments in a variety of entity-specific scenarios that are difficult to predict. Based on the auditor’s identification of aggressive profitability expectations of investment analysts about the entity, the auditor assessed a risk of material misstatement due to fraud because of the subjectivity involved in the expected credit losses estimate and the opportunity this creates for intentional management bias.</u> </p> <p data-bbox="1100 764 1997 1127"> A176. The auditor may communicate a significant deficiency in internal control to management and those charged with governance that is relevant to the prevention and detection of fraud. Significant deficiencies may exist even though the auditor has not identified misstatements during the audit. For example, the lack of a <u>reporting mechanism (e.g., whistleblower program)</u> may be indicative of weaknesses in the entity’s control environment, but it may not directly relate to a risk of material misstatement due to fraud. The auditor is required to communicate significant deficiencies in internal control in accordance with ISA 265. </p> <p data-bbox="1100 1149 1997 1403"> A177. This ISA requires management override of controls to be a risk of material misstatement due to fraud (see <u>paragraph 42</u>) and presumes that there are risks of material misstatement due to fraud in revenue recognition (see <u>paragraph 41</u>). The auditor may determine these matters to be fraud-related key audit matters <u>related to fraud</u> because significant risks <u>of material misstatement due to fraud</u> are often matters that <u>both</u> require significant auditor attention <u>and are of most</u> </p>

ISA 240 Requirement	Application Material
	<p><u>significance in the audit.</u> –However, <u>this may not be case for all these matters.</u> The auditor may determine that these risks of material misstatement <u>due to fraud</u> did not require significant auditor attention and, therefore, <u>these risks</u> would not be considered in the auditor's determination of key audit matters in accordance with <u>paragraph 667</u>.</p>
<p>67. In applying ISA 701,⁹² the auditor shall determine which of the matters determined in accordance with <u>paragraph 66</u> were of most significance in the audit of the financial statements of the current period and therefore are key audit matters. (Ref: Para. A178–A180)</p>	<p>A178. As described in ISA 701,⁹³ the auditor's decision-making process in determining key audit matters is based on the auditor's professional judgment about which matters were of most significance in the audit of the financial statements of the current period. Significance can be considered in the context of quantitative and qualitative factors, such as relative magnitude, the nature and effect on the subject matter and the expressed interests of intended users or recipients.⁹⁴</p> <p>A179. One of the considerations that may be relevant to<u>in</u> determining the relative significance of a matter that required significant auditor attention, and whether such a matter is a key audit matter, is the importance of the matter to intended users' understanding of <u>the</u> financial statements as a whole.⁹⁵ As users of financial statements have highlighted their interest in <u>matters related to fraud</u>related matters, these matters <u>are</u> ordinarily of<u>are</u>matters of most significance in the audit of the financial statements of the current period and therefore are key audit matters.</p> <p>A180. ISA 701⁹⁶ includes other considerations that may be relevant to determining which fraud-related <u>related to fraud</u> that required</p>

⁹² ISA 701, paragraph 10

⁹³ ISA 701, paragraph 10

⁹⁴ ISA 701, paragraph A1

⁹⁵ ISA 701, paragraph A29

⁹⁶ ISA 701, paragraph A29

ISA 240 Requirement	Application Material
	<p>significant auditor attention, were of most significance in the current period and therefore are key audit matters.</p>
<p><i>Communicating Fraud-Related Key Audit Matters <u>Related to Fraud</u></i></p> <p>68. In applying ISA 701,⁹⁷ in the Key Audit Matters section of the auditor’s report, the auditor shall use an appropriate subheading that clearly describes that the matter relates to fraud. (Ref: Para. A181–A183)</p>	<p><i>Communicating Fraud-Related Key Audit Matters <u>Related to Fraud</u></i></p> <p>A181. If a fraud-related matter <u>related to fraud</u> is determined to be a key audit matter and there are a number of separate, but related, considerations that were of most significance in the audit, the auditor may communicate the matters together in the auditor’s report. For example, long-term contracts may involve significant auditor attention with respect to revenue recognition, and revenue recognition may also be identified as a risk of material misstatement due to fraud. In such circumstances, the auditor may include in the auditor’s report one key audit matter related to revenue recognition with an appropriate subheading that clearly describes that the matter, <u>including that it</u> relates to fraud.</p> <p>A182. Relating a matter directly to the specific circumstances of the entity may help to minimize the potential that such descriptions become overly standardized and less useful over time. For example, revenue recognition or management override of controls may be regularly determined as fraud-related key audit matters <u>related to fraud</u>. In describing why the auditor considered the matter to be one of most significance in the audit, it may be useful for the auditor to highlight aspects specific to the entity (e.g., circumstances that affected the underlying judgments made in the financial statements of the current period) in order so as to make the description more relevant for intended users. This also may be important in describing a key audit matter that recurs over <u>multiple</u> periods. Similarly, in describing how the fraud-related key audit <u>matter related to fraud</u> was addressed in</p>

⁹⁷ ISA 701, paragraph 11

ISA 240 Requirement	Application Material
	<p>the audit, it may be useful for the auditor to highlight matters directly related to the specific circumstances of the entity, while avoiding generic or standardized language.</p> <p>A183. ISA 701,⁹⁸ describes that management or those charged with governance may decide to include new or enhanced disclosures in the financial statements or elsewhere in the annual report relating to a key audit matter in light of the fact that the matter will be communicated in the auditor’s report. Such new or enhanced disclosures, for example, may be included to provide more robust information about <u>identified the identification of</u> fraud or suspected fraud or <u>identified the identification of</u> deficiencies in internal control that are relevant to the prevention and detection of fraud.</p>
<p>69. In applying ISA 701,⁹⁹ if the auditor determines, depending on the facts and circumstances of the entity and the audit, that there are no <u>fraud-related</u> key audit matters <u>related to fraud</u> to communicate, the auditor shall include a statement to this effect in the Key Audit Matters section of the auditor’s report. (Ref: Para. A184–A187A)</p>	<p>A184. The requirement in <u>paragraph 69</u> may apply in <u>three</u> circumstances <u>when</u>:</p> <ul style="list-style-type: none"> (a) The auditor determines in accordance with <u>paragraph 67</u> that there are no <u>fraud-related</u> key audit matters <u>related to fraud</u> (see <u>paragraph A187</u>). (b) The auditor determines in accordance with <u>paragraph 14</u> of ISA 701 that a <u>fraud-related</u> key audit matter <u>related to fraud</u> will not be communicated in the auditor’s report (see <u>paragraph A187</u>) and no other matters have been determined to be fraud related key audit matters (see <u>paragraph A187</u>). (c) The only matters determined to be <u>fraud-related</u> key audit matters <u>related to fraud</u> are those communicated in accordance with <u>paragraph 15</u> of ISA 701.

⁹⁸ ISA 701, paragraph A37

⁹⁹ ISA 701, paragraph 16

ISA 240 Requirement	Application Material
	<p>A185. The determination of key audit matters involves making a judgment about the relative importance of matters that required significant auditor attention. Therefore, it may be rare that the auditor of a complete set of general purpose financial statements of a listed entity would not determine at least one fraud-related key audit matter <u>related to fraud</u>. However, in certain limited circumstances, the auditor may determine that there are no fraud-related matters <u>related to fraud</u> that are key audit matters in accordance with paragraph 67. [Previously paragraph A186]</p> <p>A186. The following illustrates the presentation in the auditor’s report if the auditor has determined there are key audit matters to communicate but these do not include fraud-related key audit matters <u>related to fraud</u>:</p> <p>[Except for the matter described in the Basis for Qualified (Adverse) Opinion section or Material Uncertainty Related to Going Concern section,] We have determined that there are no key audit matters related to fraud to communicate in our report. [Previously paragraph A185]</p> <p>Circumstances in Which a Matter Determined to Be a Key Audit Matter Is Not Communicated in the Auditor’s Report</p> <p>A187. ISA 701, paragraph 14(b), indicates that it will be extremely rare for a matter determined to be a key audit matter not to be communicated in the auditor’s report and includes guidance on circumstances in which <u>such</u> a matter determined to be a key audit matter is may not be communicated in the auditor’s report. For example:</p> <ul style="list-style-type: none"> • Lawr or regulation may preclude public disclosure by either management or the auditor about a specific matter determined to be a key audit matter.

ISA 240 Requirement	Application Material
	<ul style="list-style-type: none"> • There is presumed to be a public interest benefit in providing greater transparency about the audit for intended users. Accordingly, the judgment not to communicate a key audit matter is appropriate only in cases when the adverse consequences to the entity or the public as a result of such communication are viewed as so significant that they would reasonably be expected to outweigh the public interest benefits of communicating about the matter.¹⁰⁰ • The auditor may be required by law or regulation to communicate with applicable regulatory, enforcement or supervisory authorities in relation to the matter, regardless of whether the matter is communicated in the auditor's report. <p>A187A. It may be necessary for the auditor to consider the implications of communicating about a matter determined to be a key audit matter in light of relevant ethical requirements.¹⁰¹</p>
Written Representations	Written Representations (Ref: Para. 70)
<p>70. The auditor shall obtain written representations from management and, where appropriate, those charged with governance that: (Ref: Para. A188–A189)</p> <p>(a) They acknowledge their responsibility for the design, implementation, and maintenance of internal control to prevent</p>	<p>A188. ISA 580¹⁰² establishes requirements and provides guidance on obtaining appropriate representations from management and, where appropriate, those charged with governance in the audit. Although written representations are an important source of audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. In addition, since</p>

¹⁰⁰ ISA 701, paragraphs A53–A54

¹⁰¹ For example, except for certain specified circumstances, paragraph R114.2 of the IESBA Code does not permit the use or disclosure of information in respect of which the duty of confidentiality applies. As one of the exceptions, paragraph R114.3 of the IESBA Code permits the professional accountant to disclose or use confidential information where there is a legal or professional duty or right to do so. Paragraph 114.3 A1(b)(iv) of the IESBA Code explains that there is a professional duty or right to disclose such information to comply with technical and professional standards.

¹⁰² ISA 580, *Written Representations*

ISA 240 Requirement	Application Material
<p>or detect fraud and have appropriately fulfilled those responsibilities;</p> <p>(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;</p> <p>(c) They have disclosed to the auditor their knowledge of fraud₇ or suspected fraud, <u>including allegations of fraud</u>, affecting the entity involving:</p> <p>(i) Management;</p> <p>(ii) Employees who have significant roles in internal control; or</p> <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 fraud₇ or suspected fraud₇ affecting the entity’s financial statements communicated by employees, former employees, analysts, regulators₂ or others.</p>	<p>management are in a unique position to perpetrate fraud, it is important for the auditor to consider all audit evidence obtained, including audit evidence that is consistent or inconsistent with other audit evidence in drawing the conclusion required in accordance with ISA 330.¹⁰³</p> <p>A189. ISA 580¹⁰⁴ also addresses circumstances when the auditor has doubt as to the reliability of written representations. Doubts about the reliability of information from management may indicate a risk of material misstatement due to fraud.</p>
<p>Communications with Management and Those Charged with Governance</p>	<p>Communications with Management and Those Charged with Governance (Ref: Para. 71–73)</p>
	<p>A190. In some jurisdictions, law or regulation may restrict the auditor’s communication of certain matters with management and those charged with governance. Law or regulation may specifically prohibit a communication, or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act,</p>

¹⁰³ ISA 330, paragraph 26

¹⁰⁴ ISA 580, paragraphs 16–18

ISA 240 Requirement	Application Material
	including alerting the entity, for example, when the auditor is required to report the fraud to an appropriate authority pursuant to anti-money laundering legislation. In these circumstances, the issues considered by the auditor may be complex and the auditor may consider it appropriate to obtain legal advice.
<p><i>Communication with Management</i></p> <p>71. If the auditor identifies fraud or suspected fraud, 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 or detection of fraud of matters relevant to their responsibilities. (Ref: Para. A190–A191)</p>	<p><i>Communication with Management</i> (Ref: Para. 71)</p> <p>A191. When-If the auditor has obtained evidence that fraud exists or may exist, it is important that the matter be brought to the attention of the appropriate level of management as soon as practicable. This is so even if the matter may be considered inconsequential (e.g., a minor defalcation-misappropriation of funds by an employee at a low level in the entity's organization). The determination of which level of management is the appropriate one is a matter of professional judgment and is affected by such factors as the likelihood of collusion and the nature and magnitude of the suspected fraud. Ordinarily, the appropriate level of management is at least one level above the persons who appear to be involved with the fraud or suspected fraud.</p>
<p><i>Communication with Those Charged with Governance</i></p> <p>72. Unless all of those charged with governance are involved in managing the entity, if the auditor identifies fraud or suspected fraud involving:</p> <ul style="list-style-type: none"> (a) management; (b) employees who have significant roles in internal control; or 	<p><i>Communication with Those Charged with Governance</i> (Ref: Para. 72)</p> <p>A192. The auditor's communication with those charged with governance may be made orally or in writing. ISA 260 (Revised)¹⁰⁵ identifies factors the auditor considers in determining whether to communicate orally or in writing.¹⁰⁶ Due to the nature and sensitivity of fraud involving senior management, or fraud that results in a material misstatement in the financial statements, the auditor reports such matters on a timely basis and may consider it necessary to also report such matters in writing.</p>

¹⁰⁵ ISA 260 (Revised), *Communication with Those Charged with Governance*

¹⁰⁶ ISA 260 (Revised), paragraph A38

ISA 240 Requirement	Application Material
<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 identifies suspected fraud involving management, the auditor shall communicate the suspected fraud 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. (Ref: Para. A190 and A192–A194)</p>	<p>A193. In some cases, the auditor may consider it appropriate to communicate with those charged with governance when the auditor becomes aware of fraud involving employees other than management that does not result in a material misstatement. Similarly, those charged with governance may wish to be informed of such circumstances. The communication process is assisted if the auditor and those charged with governance agree at an early stage in the audit about the nature and extent of the auditor's communications in this regard.</p> <p>A194. In the exceptional circumstances where the auditor has doubts about the integrity or honesty of management or those charged with governance, the auditor may consider it appropriate to obtain legal advice to assist in determining the appropriate course of action.</p>
<p>73. 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 the responsibilities of those charged with governance. (Ref: Para. A190 and A195)</p>	<p>Other Matters Related to Fraud (Ref: Para. 73)</p> <p>A195. Other matters related to fraud to be discussed with those charged with governance of the entity may include, for example:</p> <ul style="list-style-type: none"> • Concerns about the nature, extent, and frequency of management's assessments of the controls in place to prevent or detect fraud and of the risk that the financial statements may be misstated. • A failure by management to appropriately address identified significant deficiencies in internal control, or to appropriately respond to an identified fraud. • The auditor's evaluation of the entity's control environment, including questions regarding the competence and integrity of management. • Actions by management that may be indicative of fraudulent financial reporting, such as management's selection and

ISA 240 Requirement	Application Material
	<p>application of accounting policies that may be indicative of management's effort to manage earnings in order to deceive financial statement users by influencing their perceptions as to the entity's performance and profitability.</p> <ul style="list-style-type: none"> Concerns about the adequacy and completeness of the authorization of transactions that appear to be outside the normal course of business.
Reporting to an Appropriate Authority Outside the Entity	Reporting to an Appropriate Authority Outside the Entity (Ref: Para. 74)
<p>74. If the auditor identifies fraud or suspected fraud, the auditor shall determine whether law, regulation or relevant ethical requirements: (Ref: Para. A196–A200)</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>	<p>A196. The reporting may be to applicable regulatory, enforcement, supervisory or other appropriate authority outside the entity.</p> <p>A197. ISA 250 (Revised)¹⁰⁷ provides further guidance with respect to the auditor's determination of whether reporting identified or suspected non-compliance with laws or regulations to an appropriate authority outside the entity is required or appropriate in the circumstances, including consideration of the auditor's duty of confidentiality.¹⁰⁸</p> <p>A198. Factors the auditor may consider in determining whether it is appropriate to report the matter to an appropriate authority outside the entity, when not prohibited by law, regulation, or relevant ethical requirements, may include:</p> <ul style="list-style-type: none"> Any views expressed by regulatory, enforcement, supervisory or other appropriate authority outside of the entity.

¹⁰⁷ ISA 250 (Revised), paragraphs A28–A34

¹⁰⁸ For example, paragraph R114.3 of the IESBA Code permits the professional accountant to disclose or use confidential information where there is a legal or professional right to do so. Paragraph 114.3 A1(b)(iv) of the IESBA Code explains that there is a professional duty or right to disclose such information to comply with technical and professional standards.

ISA 240 Requirement	Application Material
	<ul style="list-style-type: none"> Whether reporting the matter would be acting in the public interest. <p>A199. Reporting fraud matters to an appropriate authority outside the entity may involve complex considerations and professional judgments. In those circumstances, the auditor may consider consulting internally (e.g., within the firm or a network firm) or on a confidential basis with a regulator or professional body (unless doing so is prohibited by law or regulation or would breach the duty of confidentiality). The auditor may also consider obtaining legal advice to understand the auditor's options and the professional or legal implications of taking any particular course of action.</p> <p><i>Considerations Specific to Public Sector Entities</i></p> <p>A200. In the public sector, requirements for reporting fraud, whether or not discovered through the audit process, may be subject to specific provisions of the audit mandate or related law, regulation, or other authority.</p>
Documentation	Documentation (Ref: Para. 75)
<p>75. In applying ISA 230,¹⁰⁹ the auditor shall include the following in the audit documentation: (Ref: Para. A201)</p> <p>(a) The <u>matters discussed</u> among the engagement team regarding the susceptibility of the entity's financial statements to material misstatement due to fraud, the significant decisions reached, and the fraud risk factors identified, including audit</p>	<p>A201. ISA 230¹¹⁰ addresses circumstances when the auditor identifies information that is inconsistent with the auditor's final conclusion regarding a significant matter and requires the auditor to document how the auditor addressed the inconsistency.</p>

¹⁰⁹ ISA 230, *Audit Documentation*, paragraphs 8-11, A6-A7 and Appendix

¹¹⁰ ISA 230, paragraphs 11 and A15

ISA 240 Requirement	Application Material
<p>documentation relating to those fraud risk factors in accordance with paragraph 29(a).</p> <p>(b) Key elements of the auditor's understanding in accordance with paragraphs 30–354, the sources of information from which the auditor's understanding was obtained, the rationale for the significant decisions reached, and the risk assessment procedures performed.</p> <p>(c) The evaluation of the design of controls over journal entries that prevent or detect fraud, and the determination whether such controls have been implemented, in accordance with the requirement in paragraph 35. [Deleted] Not used]</p> <p>(d) The <u>identified and assessed risks of material misstatement significant risks</u> due to fraud at the financial statement level and at the assertion level, and the rationale for the significant judgments made.</p> <p>(e) If the auditor has concluded that the presumption that a risk of material misstatement due to fraud related to revenue recognition is not applicable in the circumstances of the engagement, the reasons for that conclusion.</p> <p>(f) The results of audit procedures performed, including those designed to address the risk of management override of controls, the significant professional judgments made, and the conclusions reached.</p> <p>(g) Fraud or suspected fraud identified, the results of audit procedures performed, the significant professional judgments made, and the conclusions reached.</p> <p>(h) Matters related to communications about fraud with management, those charged with governance, regulatory and</p>	

ISA 240 Requirement	Application Material
enforcement authorities, and others, including how management, and where applicable, those charged with governance have responded to the matters.	

Appendix 1

(Ref: Para. [A97A52C](#))

Examples of Fraud Risk Factors

The fraud risk factors identified in this Appendix are examples of such factors that may be faced by auditors in a broad range of situations. Separately presented are examples relating to the two types of fraud relevant to the auditor's consideration — that is, fraudulent financial reporting and misappropriation of assets. For each of these types of fraud, the risk factors are further classified based on the three conditions generally present when material misstatements due to fraud occur: (a) incentives/pressures, (b) opportunities, and (c) attitudes/rationalizations. Although the risk factors cover a broad range of situations, they are only examples and, accordingly, the auditor may identify additional or different risk factors. Not all of these examples are relevant in all circumstances, and some may be of greater or lesser significance in entities of different size or with different ownership characteristics or circumstances. Also, the order of the examples of risk factors provided is not intended to reflect their relative importance or frequency of occurrence.

Fraud risk factors may relate to incentives or pressures, or opportunities, that arise from conditions that create susceptibility to misstatement before consideration of controls (i.e., the inherent risk). Such factors are inherent risk factors, insofar as they affect inherent risk, and may be due to management bias. Fraud risk factors related to opportunities may also arise from other identified inherent risk factors (for example, complexity or uncertainty may create opportunities that result in a susceptibility to misstatement due to fraud). Fraud risk factors related to opportunities may also relate to conditions within the entity's system of internal control, such as limitations or deficiencies in the entity's internal control that create such opportunities. Fraud risk factors related to attitudes or rationalizations may arise, in particular, from limitations or deficiencies in the entity's control environment.

Risk Factors Relating to Misstatements Arising from Fraudulent Financial Reporting

The following are examples of risk factors relating to misstatements arising from fraudulent financial reporting.

Incentives/Pressures

Financial stability or profitability is threatened by economic, industry, geopolitical, or entity operating conditions, such as (or as indicated by):

- High degree of competition or market saturation, accompanied by declining margins.
- High vulnerability to rapid changes, such as changes in technology, product obsolescence, or interest rates.
- Increased volatility in financial and commodity markets due to fluctuations in interest rates and inflationary trends.
- Significant declines in customer demand and increasing business failures in either the industry or overall economy.
- Operating losses making the threat of bankruptcy, foreclosure, or hostile takeover imminent.
- Recurring negative cash flows from operations or an inability to generate cash flows from operations while reporting earnings and earnings growth.

- Rapid growth or unusual profitability especially compared to that of other companies in the same industry.
- New accounting, statutory, or regulatory requirements.
- Pandemics or wars triggering major disruptions in the entity's operations, financial distress and severe cashflow shortages.
- Economic sanctions imposed by governments and international organizations against a jurisdiction, including its companies and products.

Excessive pressure exists for management to meet the requirements or expectations of third parties due to the following:

- Profitability or trend level expectations of investment analysts, institutional investors, significant creditors, or other external parties (particularly expectations that are **unduly** aggressive or unrealistic), including expectations created by management in, for example, overly optimistic press releases or annual report messages.
- Need to obtain additional debt or equity financing, or qualify for government assistance or incentives, to avoid bankruptcy or foreclosure, or to stay competitive, **---** including financing of major research and development or capital expenditures.
- Marginal ability to meet exchange listing requirements or debt repayment or other debt covenant requirements.
- Perceived or real adverse effects of reporting poor financial results on significant pending transactions, such as initial public offerings, mergers and acquisitions, business combinations or contract awards.
- Management enters into significant transactions that places undue emphasis on achieving key performance indicators to stakeholders (e.g., meeting earnings per share forecasts or maintaining **the** stock price).

Information available indicates that the personal financial situation of management or those charged with governance is threatened by the entity's financial performance arising from the following:

- Significant financial interests in the entity.
- Significant portions of their compensation (for example, bonuses, stock options, and earn-out arrangements) being contingent upon achieving aggressive targets for stock price, operating results, financial position, cash flow, or other key performance indicators.¹¹¹
- Personal guarantees of debts of the entity.

There is excessive pressure on management or operating personnel to meet financial targets established by those charged with governance, including sales or profitability incentive goals.

Opportunities

The nature of the industry or the entity's operations provides opportunities to engage in fraudulent financial reporting that can arise from the following:

¹¹¹ Management incentive plans may be contingent upon achieving targets relating only to certain accounts or selected activities of the entity, even though the related accounts or activities may not be material to the entity as a whole.

- Significant related-party transactions not in the ordinary course of business or with related entities not audited or audited by another firm.
- A strong financial presence or ability to dominate a certain industry sector that allows the entity to dictate terms or conditions to suppliers or customers that may result in inappropriate or non-arm's-length transactions.
- Assets, liabilities, revenues, or expenses based on significant estimates that involve subjective judgments or uncertainties that are difficult to corroborate.
- Significant, unusual, or highly complex transactions, especially those close to period end that pose difficult "substance over form" questions.
- Significant operations located or conducted across international borders in jurisdictions where differing business environments and cultures exist.
- Use of business intermediaries for which there appears to be no clear business justification.
- ~~The entity has a history of m~~Modifying, revoking, or amending revenue contracts through the use of side agreements that are typically executed outside the recognized business process and reporting channels.
- Significant bank accounts or subsidiary or branch operations in tax-haven jurisdictions for which there appears to be no clear business justification.
- Non-traditional entry to capital markets by the entity, for example, through an acquisition by, or merger with, a special-purpose acquisition company.
- Aggressive stock promotions by the entity through press releases, investment newsletters, website coverage, online advertisements, email, or direct mail.

The monitoring of management is not effective as a result of the following:

- Domination of management by a single person or small group (in a non owner-managed business) without compensating controls.
- Oversight by those charged with governance over the financial reporting process and internal control is not effective.
- Weakened control environment triggered by a shift in focus by management and those charged with governance to address more immediate needs of the business such as financial and operational matters.

There is a complex or unstable organizational structure, as evidenced by the following:

- Difficulty in determining the organization or individuals that have controlling interest in the entity.
- Overly complex organizational structure involving unusual legal entities or managerial lines of authority.
- Overly complex IT environment relative to the nature of the entity's business, legacy IT systems from acquisitions that were never integrated into the entity's financial reporting system, or ineffective IT general controls.
- High turnover of senior management, legal counsel, or those charged with governance.

Deficiencies in internal control as a result of the following:

- Inadequate process to monitor the entity's system of internal control, including automated controls and controls over interim financial reporting (where external reporting is required).
- Inadequate fraud risk management program, including lack of a whistleblower program.
- Inadequate controls due to changes in the current environment, for example, increased data security risks from using unsecured networks that makes the entity's data and information more vulnerable to cybercrime that could result in breaches of customer data or the entity's proprietary information.
- High turnover rates or employment of staff in accounting, IT, or the internal audit function that are not effective.
- Accounting and information systems that are not effective, including situations involving significant deficiencies in internal control.

Attitudes/Rationalizations

- Management and those charged with governance have not created a culture of honesty and ethical behavior. For example, communication, implementation, support, or enforcement of the entity's values or ethical standards by management and those charged with governance are not effective, or the communication of inappropriate values or ethical standards.
- Non-financial management's excessive participation in or preoccupation with the selection of accounting policies or the determination of significant estimates.
- Known history of violations of securities laws or other laws and regulations, or claims against the entity, its senior management, or those charged with governance alleging fraud or violations of laws and regulations, including those dealing with corruption, bribery, and money laundering.
- Excessive interest by management in maintaining or increasing the entity's stock price or earnings trend.
- The practice by management of committing to analysts, creditors, and other third parties to achieve aggressive or unrealistic forecasts.
- Management and those charged with governance demonstrate an unusually high-risk tolerance or display an unusually high standard of lifestyle, a pattern of significant personal financial issues, or frequently engage in high risk activities.
- Management and those charged with governance make materially false or misleading statements about in other information included in the entity's annual report (e.g., key aspects of the entity's business, products, or technology).
- Management failing to remedy known significant deficiencies in internal control on a timely basis.
- An interest by management in employing inappropriate means to minimize reported earnings for tax-motivated reasons.
- Applying aggressive valuation assumptions in mergers and acquisitions to support high purchase prices or overvalue acquired intangible assets.
- Rationalizing the use of unreasonable assumptions affecting the timing and amount of revenue recognition, for example, in an attempt to alleviate the negative effects of severe economic downturns.
- Rationalizing the use of unreasonable assumptions used in projections to account for impairment of goodwill and intangible assets, for example, to avoid recognizing significant impairment losses.

- Low morale among senior management.
- The owner-manager makes no distinction between personal and business transactions.
- Dispute between shareholders in a closely held entity.
- Recurring attempts by management to justify marginal or inappropriate accounting on the basis of materiality.
- The relationship between management and the current or predecessor auditor is strained, as exhibited by the following:
 - Frequent disputes with the current or predecessor auditor on accounting, auditing, or reporting matters.
 - Unreasonable demands on the auditor, such as unrealistic time constraints regarding the completion of the audit or the issuance of the auditor's report.
 - Restrictions on the auditor that inappropriately limit access to people or information or the ability to communicate effectively with those charged with governance.
 - Domineering management behavior in dealing with the auditor, especially involving attempts to influence the scope of the auditor's work or the selection or continuance of personnel assigned to or consulted on the audit engagement.

Risk Factors Relating to Misstatements Arising from Misappropriation of Assets

Risk factors that relate to misstatements arising from misappropriation of assets are also classified according to the three conditions generally present when fraud exists: incentives/pressures, opportunities, and attitudes/rationalization. Some of the risk factors related to misstatements arising from fraudulent financial reporting also may be present when misstatements arising from misappropriation of assets occur. For example, ineffective monitoring of management and other deficiencies in internal control may be present when misstatements due to either fraudulent financial reporting or misappropriation of assets exist. The following are examples of risk factors related to misstatements arising from misappropriation of assets.

Incentives/Pressures

Personal financial obligations may create pressure on management or employees with access to cash or other assets susceptible to theft to misappropriate those assets.

Adverse relationships between the entity and employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets. For example, adverse relationships may be created by the following:

- Known or anticipated future employee layoffs.
- Recent or anticipated changes to employee compensation or benefit plans.
- Promotions, compensation, or other rewards inconsistent with expectations.

Opportunities

Certain characteristics or circumstances may increase the susceptibility of assets to misappropriation. For example, opportunities to misappropriate assets increase when there are the following:

- Large amounts of cash on hand or processed.

- Inventory items that are small in size, of high value, or in high demand.
- Easily convertible assets, such as bearer bonds, diamonds, or computer chips.
- Fixed assets which are small in size, marketable, or lacking observable identification of ownership.

Inadequate controls over assets may increase the susceptibility of misappropriation of those assets. For example, misappropriation of assets may occur because there is the following:

- Inadequate segregation of duties or independent checks.
- Inadequate oversight of senior management expenditures, such as travel and other reimbursements.
- Inadequate management oversight of employees responsible for assets, for example, inadequate supervision or monitoring of remote locations.
- Inadequate job applicant screening of employees with access to assets.
- Inadequate record keeping with respect to assets.
- Inadequate system of authorization and approval of transactions (for example, in purchasing).
- Inadequate physical safeguards over cash, investments, inventory, or fixed assets.
- Lack of complete and timely reconciliations of assets.
- Lack of timely and appropriate documentation of transactions, for example, credits for merchandise returns.
- Lack of mandatory vacations for employees performing key control functions.
- Inadequate management understanding of IT, which enables IT employees to perpetrate a misappropriation.
- Inadequate access controls over automated records, including controls over and review of computer systems event logs.
- Inadequate controls in vendor management, including changes in the supply chain, that may expose the entity to fictitious vendors, or unvetted vendors that pay kickbacks or are involved in other fraudulent or illegal activities.
- Oversight by those charged with governance over how management utilized financial aid from governments and local authorities (e.g., bailouts during pandemics, wars, or impending industry collapse) is not effective.

Attitudes/Rationalizations

- Disregard for the need for monitoring or reducing risks related to misappropriations of assets.
- Disregard for controls over misappropriation of assets by overriding existing controls or by failing to take appropriate remedial action on known deficiencies in internal control.
- Behavior indicating displeasure or dissatisfaction with the entity or its treatment of the employee.
- Changes in behavior or lifestyle that may indicate assets have been misappropriated.
- Tolerance of petty theft.

- Rationalizing misappropriations committed during severe economic downturns by paying the entity back when circumstances return to normal.

Appendix 2

(Ref: Para. A115 and A125)

Examples of Possible Audit Procedures to Address the Assessed Risks of Material Misstatement Due to Fraud

The following are examples of possible audit procedures to address the assessed risks of material misstatement due to fraud resulting from both fraudulent financial reporting and misappropriation of assets. Although these procedures cover a broad range of situations, they are only examples and, accordingly they may not be the most appropriate nor necessary in each circumstance. Also the order of the procedures provided is not intended to reflect their relative importance.

Consideration at the Assertion Level

Specific responses to the auditor's assessment of the risks of material misstatement due to fraud will vary depending upon the types or combinations of fraud risk factors or conditions identified, and the classes of transactions, account balances, disclosures and assertions they may affect.

The following are specific examples of responses:

- Visiting locations or performing certain tests on a surprise or unannounced basis. For example, observing inventory at locations where auditor attendance has not been previously announced or counting cash at a particular date on a surprise basis.
- Requesting that inventories be counted at the end of the reporting period or on a date closer to period end to minimize the risk of manipulation of balances in the period between the date of completion of the count and the end of the reporting period.
- Altering the audit approach in the current year. For example, contacting major customers and suppliers orally in addition to sending written confirmation, sending confirmation requests to a specific party within an organization, or seeking more or different information.
- Performing a detailed review of the entity's quarter-end or year-end adjusting entries and investigating any that appear unusual as to nature or amount.
- For significant and unusual transactions, particularly those occurring at or near year-end, investigating the possibility of related parties and the sources of financial resources supporting the transactions.
- Performing substantive analytical procedures using disaggregated data. For example, comparing sales and cost of sales by location, line of business or month to expectations developed by the auditor.
- Conducting interviews of personnel involved in areas where a risk of material misstatement due to fraud has been identified, to obtain their insights about the risk and whether, or how, controls address the risk.
- Conducting interviews with personnel outside of the financial reporting function. For example, sales and marketing personnel.
- When other independent auditors are auditing the financial statements of one or more subsidiaries, divisions, or branches, discussing with them the extent of work necessary to be performed to address

the assessed risk of material misstatement due to fraud resulting from transactions and activities among these components.

- If the work of an expert becomes particularly significant with respect to a financial statement item for which the assessed risk of material misstatement due to fraud is high, performing additional procedures relating to some or all of the expert's assumptions, methods or findings to determine that the findings are not unreasonable, or engaging another expert for that purpose.
- Performing audit procedures to analyze selected opening balance sheet accounts of previously audited financial statements to assess how certain issues involving accounting estimates and judgments, for example, an allowance for sales returns, were resolved with the benefit of hindsight.
- Performing procedures on account or other reconciliations prepared by the entity, including considering reconciliations performed at interim periods.
- ~~Performing~~ Using automated tools and techniques, such as data mining to test for anomalies in a population. For example, using automated tools and techniques to identify numbers that have been used frequently as there may be an unconscious bias by management or employees when posting fraudulent journal entries or other adjustments to use the same number repetitively.
- Testing the integrity of computer-produced records and transactions.
- Seeking additional audit evidence from sources outside of the entity being audited.

Specific Responses—Misstatement Resulting from Fraudulent Financial Reporting

Examples of responses to the auditor's assessment of the risks of material misstatement due to fraudulent financial reporting are as follows:

Revenue Recognition

- Performing substantive analytical procedures relating to revenue using disaggregated data, for example, comparing revenue reported by month and by product line or business segment during the current reporting period with comparable prior periods. Automated tools and techniques may be useful in identifying unusual or unexpected revenue relationships or transactions.
- Confirming with customers certain relevant contract terms and the absence of side agreements, because the appropriate accounting often is influenced by such terms or agreements and basis for rebates or the period to which they relate are often poorly documented. For example, acceptance criteria, delivery and payment terms, the absence of future or continuing vendor obligations, the right to return the product, guaranteed resale amounts, and cancellation or refund provisions often are relevant in such circumstances.
- Inquiring of the entity's sales and marketing personnel or in-house legal counsel regarding sales or shipments near the end of the period and their knowledge of any unusual terms or conditions associated with these transactions.
- Being physically present at one or more locations at period end to observe goods being shipped or being readied for shipment (or returns awaiting processing) and performing other appropriate sales and inventory cutoff procedures.

- For those situations for which revenue transactions are electronically initiated, processed, and recorded, testing controls to determine whether they provide assurance that recorded revenue transactions occurred and are properly recorded.
- Examining customer correspondence files at the entity for any unusual terms or conditions that raise questions about the appropriateness of revenue recognized.
- Analyzing the reasons provided for product returns received shortly after the end of the financial year (e.g., product not ordered, entity shipped more units than ordered).
- Determining ~~that~~whether revenue transactions are recorded in accordance with the applicable financial reporting framework and the entity's accounting policies. For example, goods shipped are not recorded as sales unless there is a transfer of legal title in accordance with the shipping terms especially in circumstances when the entity uses a freight forwarder or a third-party warehouse or fulfillment center.

Inventory Quantities

- Examining the entity's inventory records to identify locations or items that require specific attention during or after the physical inventory count.
- Observing inventory counts at certain locations on an unannounced basis or conducting inventory counts at all locations on the same date.
- Conducting inventory counts at or near the end of the reporting period to minimize the risk of inappropriate manipulation during the period between the count and the end of the reporting period.
- Performing additional procedures during the observation of the count, for example, more rigorously examining the contents of boxed items, the manner in which the goods are stacked (for example, hollow squares) or labeled, and the quality (that is, purity, grade, or concentration) of liquid substances such as perfumes or specialty chemicals. Using the work of an expert may be helpful in this regard.
- Comparing the quantities for the current period with prior periods by class or category of inventory, location or other criteria, or comparison of quantities counted with perpetual records.
- Using automated tools and techniques to further test the compilation of the physical inventory counts – for example, sorting by tag number to test tag controls or by item serial number to test the possibility of item omission or duplication.
- Verifying the accurate calibration of tools that are used to record, measure, or weigh the quantity of inventory items – for example, scales, measuring devices or scanning devices.
- Using an expert to confirm the nature of inventory quantities for specialized products – for example, the weight of the precious gemstones may be determinable, but an expert may assist with determining the cut, color, and clarity of precious gemstones. In circumstances when there is a management expert, the auditor may directly inquire about and discuss the management expert's methodology to determine cut, color and clarity and evaluate whether there are indicators of possible management bias.

Management Estimates

- Using an expert to develop an independent estimate for comparison ~~to~~with management's estimate.

- Extending inquiries to individuals outside of management and the accounting department to corroborate management's ability and intent to carry out plans that are relevant to developing the estimate.

Specific Responses—Misstatements Due to Misappropriation of Assets

Differing circumstances would necessarily dictate different responses. Ordinarily, the audit response to an assessed risk of material misstatement due to fraud relating to misappropriation of assets will be directed toward certain account balances and classes of transactions. Although some of the audit responses noted in the two categories above may apply in such circumstances, the scope of the work is to be linked to the specific information about the misappropriation risk that has been identified.

Examples of responses to the auditor's assessment of the risk of material misstatements due to misappropriation of assets are as follows:

- Counting cash or securities at or near year-end.
- Confirming directly with customers the account activity (including credit memo and sales return activity as well as dates payments were made) for the period under audit.
- Analyzing recoveries of written-off accounts.
- Analyzing inventory shortages by location or product type.
- Comparing key inventory ratios to industry norm.
- Reviewing supporting documentation for reductions to the perpetual inventory records.
- Performing a computerized match of the vendor list with a list of employees to identify matches of addresses or phone numbers.
- Performing a computerized search of payroll records to identify duplicate addresses, employee identification or taxing authority numbers or bank accounts.
- Reviewing personnel files for those that contain little or no evidence of activity, for example, lack of performance evaluations.
- Analyzing sales discounts and returns for unusual patterns or trends.
- Confirming specific terms of contracts with third parties.
- Obtaining evidence that contracts are being carried out in accordance with their terms.
- Reviewing the propriety of large and unusual expenses.
- Reviewing the authorization and carrying value of senior management and related party loans.
- Reviewing the level and propriety of expense reports submitted by senior management.

Appendix 3

(Ref: Para. [A29AA30](#))

Examples of Circumstances that May Be Indicative of Fraud

The following are examples of circumstances that may indicate that the financial statements may contain a material misstatement due to fraud.

Discrepancies in the accounting records, including:

- Transactions that are not recorded in a complete or timely manner or are improperly recorded as to amount, accounting period, classification, or entity policy.
- Unsupported or unauthorized balances or transactions.
- Last-minute adjustments that significantly affect financial results (e.g., inventory adjustments).
- ~~• [Moved to “Other”]~~
- ~~• [Moved to “Other”]~~

Conflicting or missing evidence, including:

- Missing documents.
- Missing approvals or authorization signatures.
- Signature or handwriting discrepancies.
- Documents that appear to have been altered.
- Unavailability of other than photocopied or electronically transmitted documents when documents in original form are expected to exist.
- Significant unexplained items on reconciliations.
- Unusual balance sheet changes, or changes in trends or important financial statement ratios or relationships – for example, receivables growing faster than revenues.
- Inconsistent, vague, or implausible responses from management or employees arising from inquiries or analytical procedures.
- Unusual discrepancies between the entity’s records and confirmation replies.
- ~~• [Moved to “Other”]~~ Large numbers of credit entries and other adjustments made to accounts receivable records.
- Subsidiary ledgers, which do not reconcile with control accounts.
- Unexplained or inadequately explained differences between the accounts receivable sub-ledger and the control account, or between the customer statements and the accounts receivable sub-ledger.
- Unexplained fluctuations in stock account balances, inventory variances and turnover rates.
- Missing or non-existent cancelled checks in circumstances where cancelled checks are ordinarily returned to the entity with the bank statement.
- Missing inventory or physical assets of significant magnitude.

- Unavailable or missing electronic evidence, inconsistent with the entity's record retention practices or policies.
- ~~Confirmation letters not returned.~~
- Fewer responses to confirmations than anticipated or a greater number of responses than anticipated.
- Inability to produce evidence of key systems development and program change testing and implementation activities for current-year system changes and deployments.
- Information about overly optimistic projections obtained from listening to the entity's earning's calls with analysts or by reading analysts' research reports that is contrary to information presented in the entity's internal forecasts used for budgeting purposes.

Problematic or unusual relationships between the auditor and management, including:

- Denial of access to records, facilities, certain employees, customers, vendors, or others from whom audit evidence might be sought.
- Denial of access to key IT operations staff and facilities, including security, operations, and systems development personnel.
- Undue time pressures imposed by management to resolve complex or contentious issues.
- Complaints by management about the conduct of the audit or management intimidation of engagement team members, particularly in connection with the auditor's critical assessment of audit evidence or in the resolution of potential disagreements with management.
- Unusual delays by the entity in providing requested information.
- An Unwillingness to facilitate auditor access to key electronic files for testing through the use of automated tools and techniques.
- An unwillingness to allow a discussion between the auditor and management's third-party expert (e.g., an expert in taxation law).
- An unwillingness by management to permit the auditor to meet privately with those charged with governance.
- An unwillingness to correct a material misstatement in the financial statements.
- An unwillingness to add or revise disclosures in the financial statements to make them more complete and understandable.
- An unwillingness to address identified deficiencies in internal control on a timely basis.
- —An unwillingness to allow the auditor to send a confirmation request.
- An unwillingness to provide a requested written representation.

Other

- ~~An uUnwillingness by management to permit the auditor to meet privately with those charged with governance.~~

- Extensive use of suspense accounts.
- Accounting policies that appear to be at variance with industry norms.
- Frequent changes in accounting estimates that do not appear to result from changed circumstances.
- Tolerance of violations of the entity's code of conduct.
- Discrepancy between earnings and lifestyle.
- Unusual, irrational, or inconsistent behavior.
- Electronic mail sent at unusual times, with unnecessary attachments, or to unusual ~~destination~~email addresses.
- Allegations of fraud through Anonymous-anonymous emails, letters ~~or~~, telephone calls, ~~including~~ tips or complaints that may come to the attention of the auditor ~~about alleged fraud.~~ ~~[Moved from "Discrepancies in the accounting records"]~~
- Evidence of employees' access to systems and records inconsistent with that necessary to perform their authorized duties. ~~[Moved from "Discrepancies in the accounting records"]~~
- Systems being accessed outside of normal hours or from outside the normal work area.
- Higher than average number of failed login attempts.
- Controls or audit logs being switched off.

Additional Considerations that May Be Used by the Auditor When Selecting Journal Entries and Other Adjustments for Testing

The following considerations are of relevance when selecting journal entries and other adjustments for testing:

- Understanding of the entity's information system and communication relevant to the preparation of the financial statements¹¹² (see also **paragraph 34** of this ISA) – obtaining this required understanding provides the auditor with knowledge about:
 - The entity's policies and procedures regarding (including the individuals within the entity responsible for) how transactions are initiated, recorded, processed, corrected as necessary, incorporated in the general ledger, and reported in the financial statements.
 - The types of journal entries (whether standard or non-standard) incorporated in the general ledger and, in turn, reported in the financial statements, including other adjustments made directly to the financial statements.
 - The process of how journal entries and other adjustments are recorded or made (whether automated or manual) as well as the supporting documentation required, based on the entity's policies and procedures.
 - The entity's financial statement closing process.
- Understanding of the entity's control activities relevant to controls that prevent or detect fraud over journal entries¹¹³ (see also **paragraph 35** of this ISA) – for many entities, routine processing of transactions involves a combination of manual and automated controls. Similarly, the processing of journal entries and other adjustments may involve both manual and automated controls across one or multiple IT systems. Where IT is used in the financial reporting process, journal entries and other adjustments may exist only in electronic form.
 - The types of controls that prevent or detect fraud over journal entries may include authorizations and approvals, reconciliations, verifications (such as edit and validation checks or automated calculations), segregation of duties, and physical or logical controls, including those addressing safeguarding of assets.
 - The ~~focus of the~~ requirement in **paragraph 35(a)** ~~is on~~covers controls over journal entries that address a risk(s) of material misstatement due to fraud at the assertion level, and that could be susceptible to unauthorized or inappropriate intervention or manipulation. These controls include:
 - Controls over non-standard journal entries ~~—~~ where the journal entries are automated or manual and are used to record non-recurring, unusual transactions or adjustments.

¹¹² ISA 315 (Revised 2019), paragraph 25

¹¹³ ISA 315 (Revised 2019), paragraph 26

- Controls over standard journal entries ~~—~~ where the journal entries are automated or manual and are susceptible to unauthorized or inappropriate intervention or manipulation.

[Moved certain text between bullets when compared to the presentation reflected in the June 2022 Board agenda materials]

- The effectiveness of controls that have been implemented over journal entries and other adjustments ~~—~~ effective controls over the preparation and posting of journal entries and other adjustments may reduce the extent of substantive testing necessary, provided that the auditor has tested the operating effectiveness of the controls.
- The identification and assessment of the risks of material misstatement due to fraud ~~—~~ the evaluation of information obtained from the risk assessment procedures and related activities, including the consideration of information obtained from other sources, could indicate the presence of fraud risk factors. Such fraud risk factors, particularly events or conditions that indicate incentives and pressures for management to override controls, opportunities for management override, and attitudes or rationalizations that enable management to justify override of controls, may assist the auditor to identify specific classes of journal entries and other adjustments for testing. These may include journal entries and other adjustments susceptible to unauthorized or inappropriate intervention or manipulation resulting from:
 - Pressures or incentives to meet or exceed performance measures used, internally and externally (e.g., auto-reversing journal entries made at year-end).
 - Pressures or incentives to minimize or avoid taxes (e.g., inappropriate journal entries to record premature or delayed revenue or expense recognition).
 - Pressures to comply with debt repayment or other debt covenant requirements (e.g., inappropriately offsetting assets and liabilities in the balance sheet by directly making adjustments ~~to~~ the financial statements to achieve a debt covenant on the entity's debt-to-equity ratio, even when the conditions for a right of setoff are not met).
 - Opportunities, arising from the inappropriate segregation of duties, for any individual in the entity to conceal or perpetrate fraud in the normal course of that individual's duties (e.g., journal entries and other adjustments relating to transactions affecting assets, where the individual is responsible for (a) the custody of assets, or (b) the authorization or approval of the related transactions affecting those assets, and (c) the recording or reporting of related transactions).
 - Opportunities arising from deficiencies in internal control (e.g., journal entries and other adjustments related to purchase payments to unauthorized vendors or made by terminated or transferred employees).
 - Opportunities arising from privileged access granted to individuals involved in the financial statement closing process (e.g., journal entries and other adjustments made by individuals with administrative or powerful users' access).
 - Opportunities arising from calculations based on end-user computing tools that support accounting estimates susceptible to misstatement due to management bias or fraud (e.g., journal entries and other adjustments based on calculations of impairment of goodwill and other intangible assets using spreadsheet software).

- The characteristics of fraudulent journal entries or other adjustments ~~—~~ inappropriate journal entries or other adjustments often have unique identifying characteristics. ~~The auditor may use recent information, such as data on actual perpetrated frauds or reports regarding trends in occupational fraud, to inform the auditor as to characteristics of fraudulent journal entries.~~ Such characteristics may include entries:
 - Made to unrelated, unusual, or seldom-used accounts.
 - Made by individuals who typically do not make journal entries.
 - Recorded at the end of the period or as post-closing entries that have little or no explanation or description.
 - Made either before or during the preparation of the financial statements that do not have account numbers.
 - Containing round numbers or consistent ending numbers.

The auditor may use recent information, such as data on actual perpetrated frauds or reports regarding trends in occupational fraud, to inform the auditor as to characteristics of fraudulent journal entries.
- The nature and complexity of the accounts ~~—~~ inappropriate journal entries or adjustments may be applied to accounts that:
 - Contain transactions that are complex or unusual in nature.
 - Contain significant estimates and period-end adjustments.
 - Have been prone to misstatements in the past.
 - Have not been reconciled on a timely basis or contain unreconciled differences.
 - Contain intercompany transactions.
 - Are otherwise associated with an identified risk of material misstatement due to fraud.
- Journal entries or other adjustments processed outside the normal course of business – non-standard journal entries may not be subject to the same nature and extent of controls as those journal entries used on a recurring basis to record transactions such as monthly sales, purchases, and cash disbursements.

Appendix 5

(Ref: Para. A16)

Other ISAs Addressing Specific Topics that Reference Fraud or Suspected Fraud

This Appendix identifies other ISAs with specific requirements that refer to fraud or suspected fraud. The list does not include other ISAs with requirements that refer to fraud or error (e.g., ISA 210,¹¹⁴ ISA 315 (Revised 2019), ISA 700 (Revised)). The list is not a substitute for considering the requirements and related application and other explanatory material in the ISAs.

- ISA 402, *Audit Considerations Relating to an Entity Using a Service Organization*, paragraph 19
- ISA 505, *External Confirmations* – paragraphs 8(b) and 11
- ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures* – paragraph 32
- ISA 550, *Related Parties* – paragraphs 19, 22(e) and 23(a)(i)
- ISA 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* – paragraphs 38(d), 45(h), 55, 57(d) and 59(g)(i)

¹¹⁴ ISA 210, *Agreeing the Terms of Audit Engagements*