

Fraud in an Audit of Financial Statements

Julie Corden
Fraud Task Force Chair

IAASB CAG Meeting
March 7–8 , 2023
Agenda Item D.1

Topics Addressed Since the September 2022 CAG Meeting

Discussed
with the
Board and
the Task
Force



**Identifying and Assessing
Risks of Material
Misstatement (RoMMs) Due to
Fraud ***



**Fraud or Suspected Fraud Is
Identified ***



**Transparency in the Auditor's
Report on Fraud ***

Discussed
with the
Task Force
only



**Professional
Skepticism ***



**Engagement
Team Discussion**



**Unpredictability of
Audit Procedures**



Definition of Fraud



**Analytical
Procedures**



**External Party
Confirmations**



**Audit
Documentation ***



Third Party Fraud



**Responses to the
Assessed RoMMs,
including Journal Entries ***



**Written Management
Representations**

Professional Skepticism



Introduction

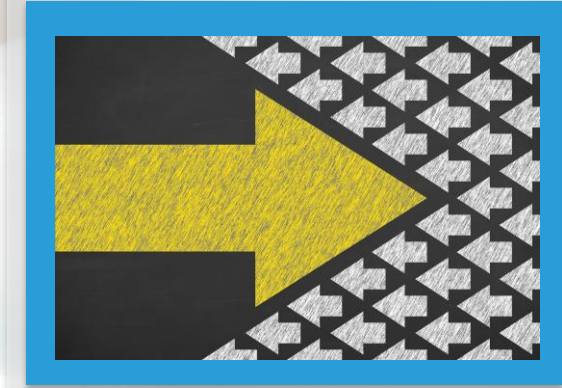
The appropriate exercise of professional skepticism may be demonstrated through the actions and communications of the engagement team, including emphasizing the importance of each engagement team member maintaining professional skepticism throughout the audit



Requirements

The auditor is required to remain alert throughout the audit engagement for information about fraud, suspected fraud, or alleged fraud

If any fraud, suspected fraud, or alleged fraud is identified, the auditor is required to perform the additional audit procedures



Requirements and Application Material

Builds on the concepts of proposed ISA 500 (Revised) that reinforce the exercise of professional skepticism

- Designing and performing audit procedures in a manner that is not biased towards obtaining audit evidence that may be corroborative, or towards excluding evidence that may be contradictory
- Considering all audit evidence obtained, including audit evidence that is consistent or inconsistent with other audit evidence, and regardless of whether it appears to corroborate or contradict the assertions in the financial statements

Specific Fraud-Related Audit Procedures – Journal Entries

Make inquiries about any knowledge of inappropriate or unusual activity relating to the processing of journal entries and other adjustments



Extant

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



New

Testing the Appropriateness of Journal Entries

Select journal entries and other adjustments made at the end of a reporting period



Extant

Determine the need to test journal entries and other adjustments throughout the period



Enhanced

Specific Fraud-Related Audit Procedures – Audit Documentation

Key elements of the auditor's understanding*, 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

New

The discussion 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

Enhanced

The evaluation of the design of identified controls that prevent or detect fraud over journal entries, and determination whether such controls have been implemented

Enhanced

The significant risks due to fraud at the financial statement level and at the assertion level, and the rationale for the significant judgments made

Enhanced

Fraud or suspected fraud identified by the auditor, the results of audit procedures performed, the significant professional judgments made, and the conclusions reached

New

The results of the audit procedures performed, including those designed to address the risk of management override of controls, the significant professional judgments made, and the conclusions reached

Enhanced

Matters related to communications about fraud with management, those charged with governance (TCWG), regulatory and enforcement authorities, and others, including how management, and where applicable, TCWG have responded to the matters

Enhanced

If the auditor has concluded that the presumption that a RoMM due to fraud related to revenue recognition is not applicable in the circumstances of the engagement, the reasons for that conclusion

Extant

* Understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control

Identifying and Assessing the RoMMs Due to Fraud



Applying the appropriate “fraud lens” when referring to, or expanding on, what is already required in ISA 315 (Revised 2019)




Matters for IAASB CAG Consideration


1. Representatives are asked for their views on the proposed enhancements or clarifications presented in **Agenda Item D.1** for the following proposed actions
 - (a) Professional Skepticism
 - (b) Specific Fraud-Related Procedures – Journal Entries
 - (c) Specific Fraud-Related Procedures – Audit Documentation
 - (d) Identifying and Assessing RoMMs Due to Fraud

Specific Fraud-Related Procedures – Fraud or Suspected Fraud Is Identified

When fraud or suspected fraud is identified, the auditor is required to perform additional audit procedures to determine if there is a material misstatement due to fraud



If applicable, the auditor is required to perform additional risk assessment procedures in order to revise the identification and assessment of the significant RoMMs due to fraud



In an attempt to obtain further audit evidence, the auditor is required to design and implement additional audit procedures to appropriately respond to the significant RoMMs due to fraud

Specific Fraud-Related Procedures – Fraud or Suspected Fraud Is Identified

The auditor is also required to ...



Determine if control deficiencies related to the prevention or detection of fraud exist



Determine 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)



Communicate with management and TCWG, as required



Communicate to regulatory and enforcement authorities, as required



If applicable, consider the impact on other engagements, including audit engagements from prior years

Specific Fraud-Related Procedures – Fraud or Suspected Fraud Is Identified

If the auditor identifies a misstatement due to fraud, the auditor is required to

- Determine the implications of the misstatement in relation to other aspects of the audit
- Consider whether it indicates possible collusion involving management, employees or third parties

In applying ISA 450, the auditor is required to determine whether identified misstatements due to fraud are material by considering the nature of the circumstances, qualitative or quantitative, giving rise to the misstatements

If the auditor is unable to obtain sufficient appropriate audit evidence as relates to a material misstatement due to fraud, the auditor is required to determine the implications for the audit or the auditor's opinion on the financial statements

If the auditor determines that the financial statements are materially misstated due to fraud, the auditor is required to

- Determine the implications for the audit or the auditor's opinion on the financial statements
- Discuss the matter with appropriate level of management and TCWG
- If appropriate, obtain advice from legal counsel

Transparency in the Auditor's Report on Fraud

Decisions
by the
Board in
December
2022

Use a filter for communicating about RoMMs due to fraud that is similar to the filter used to communicate key audit matters (KAMs)



Include the communication of fraud-related KAMs in the *Key Audit Matters* section of the auditor's report i.e., applicable only to listed entities



NOT to require communications in the auditor's report about identified significant deficiencies in internal control that are relevant to the prevention and detection of fraud



Transparency in the Auditor's Report on Fraud

Determining KAMs

- In applying ISA 701, determine, from the fraud related matters communicated with TCWG, those matters that required significant auditor attention* in performing the audit
- In making this determination, the following are taken into account
 - Significant RoMMs due to fraud
 - The identification of fraud or suspected fraud
 - The identification of deficiencies in internal control that are relevant to the prevention and detection of fraud
- In applying ISA 701, determine which matters were of most significance in the current period (i.e., KAMs)

Communicating KAMs Related to Fraud Risks

- In applying ISA 701, communicate KAMs related to fraud risks in the *Key Audit Matters, including Fraud Risks* section of the auditor's report
- In applying ISA 701, use an appropriate subheading that clearly describes that the matter relates to a RoMM due to fraud

Description of Individual KAMs

- Requires a reference to the related disclosure(s), if any, in the financial statements and requires the disclosures to address
 - Why the RoMM due to fraud was considered to be of most significance and therefore determined to be a KAM
 - How the RoMM due to fraud was addressed in the audit



If there are no KAMs that relate to fraud to communicate, include a statement to this effect in a separate section of the auditor's report under the heading "Key Audit Matters, including Fraud Risks"

* It is expected that fraud related matters communicated with TCWG will require significant auditor attention

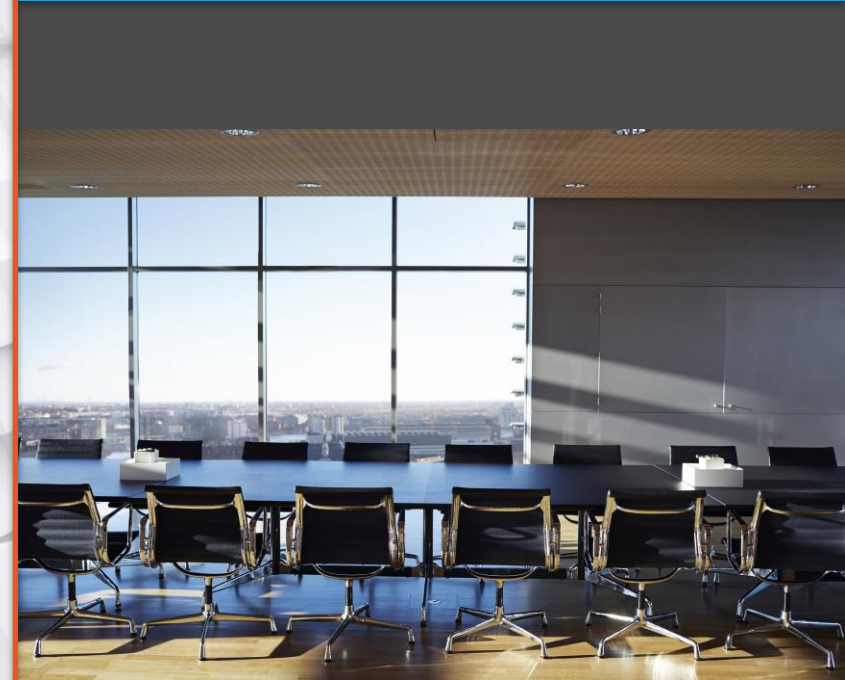
Matters for IAASB CAG Consideration

2. Representatives are asked for their views on the way forward as set out in **Sections I and II of Agenda Item D.2** and the proposed enhancements or clarifications presented in **Agenda Item D.1** for the following proposed actions
- (a) Specific Fraud-Related Procedures – Fraud or Suspected Fraud Is Identified
 - (b) Transparency in the Auditor's Report on Fraud

Matters for IAASB CAG Consideration

3. Representatives are asked whether there are any other matters the Task Force should consider as it considers the enhancements to proposed ISA 240 (Revised)

Proposed ISA 240 (Revised)



Way Forward

Discussions with the IAASB on a draft of proposed ISA 240 (Revised)

June and September 2023

Expected approval by the IAASB of exposure draft, proposed ISA 240 (Revised)

December 2023

September 2023

Discussion with the IAASB CAG on select topics of proposed ISA 240 (Revised)

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