

Meeting: IAASB Consultative Advisory Group (CAG)
Meeting Location: New York, USA
Meeting Date: September 12–13, 2023

Agenda Item H

Fraud in an Audit of Financial Statements – Cover and Report Back

Objectives of Agenda Item

1. The objectives of this Agenda Item are to:
 - (a) Obtain the Representatives' views on the draft of proposed ISA 240 (Revised).¹
 - (b) Report back on the [March 2023 IAASB CAG meeting](#).

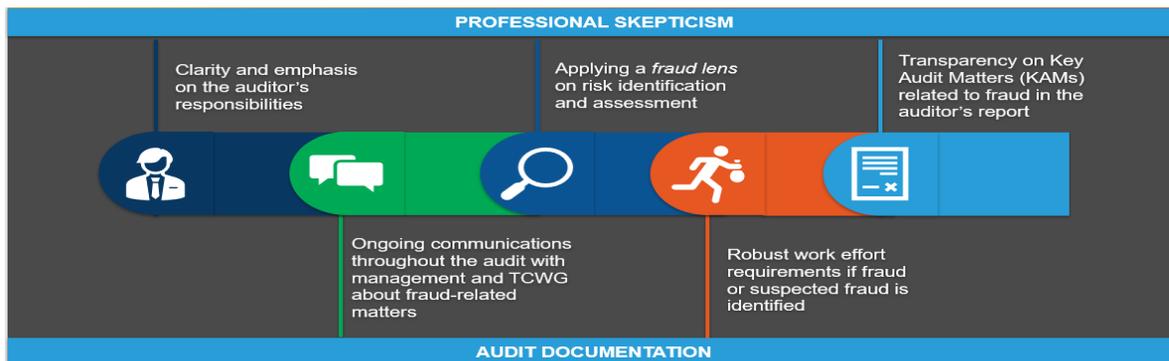
Project Status

2. Since the March 2023 IAASB CAG meeting, the Fraud Task Force (Fraud TF) presented and discussed a first full draft of proposed ISA 240 (Revised) with the Board at the [June 2023 IAASB meeting](#). In July and August 2023, the Fraud TF met to further refine their thinking on all topics previously discussed with and raised by the Board during the June 2023 meeting.
3. In developing the standard, the Fraud TF coordinated with:
 - The International Ethics Standards Board for Accountants (IESBA). Drafts of proposed ISA 240 (Revised) were shared with the IESBA Staff and the Liaison Board Member, to obtain their input on specific paragraphs in proposed ISA 240 (Revised) relating to the linkages (references) to the IESBA Code,² the definition of fraud and the appendix on fraud risk factors. Feedback received was considered and/or reflected in proposed ISA 240 (Revised).
 - IAASB Task Forces and Consultation Groups, including the Audit Evidence Task Force, Going Concern Task Force, Auditor Reporting Consultation Group, Professional Skepticism Consultation Group, and the Technology Working Group. Drafts of proposed ISA 240 (Revised) were shared with these IAASB Task Forces and Consultation Groups, to obtain their input on relevant paragraphs in proposed ISA 240 (Revised) that may impact, or may be impacted by their relevant projects or work.
4. The diagram below depicts and describe what the Fraud TF believes are the seven most important proposed changes addressing the key issues identified in the project proposal that will drive consistency in practice and change in auditor behavior; specifically: auditor's responsibilities, professional skepticism, communications with management and those charged with governance

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

² IESBA's *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA Code)

(TCWG), risk identification and assessment, fraud or suspected fraud, transparency in the auditor's report and documentation.



5. The **Appendix** to this paper provides a history of previous discussions with the IAASB CAG and the IAASB on this project, including links to the relevant IAASB CAG documentation.

Way Forward

6. The Fraud TF will continue to closely coordinate and liaise with IESBA on the proposed changes in the standard that may be relevant to the provision in the IESBA Code. In addition, the Fraud TF will continue to coordinate and collaborate with other task forces, working and consultation groups in addressing the key issues identified.
7. In September 2023, the Fraud TF will bring to the Board a full draft of proposed ISA 240 (Revised). Thereafter, the Fraud TF will continue to advance their discussions to reflect the decisions and directions that will be provided by the Board at the September 2023 IAASB meeting. In doing so, the Fraud TF will also consider the project proposal and the Representatives' feedback that will be provided at the September 2023 IAASB CAG meeting.
8. The expected approval of the exposure draft is December 2023.

IAASB CAG Discussion in September 2023

9. For purposes of the IAASB CAG discussion, the Fraud TF prepared a presentation (see **Agenda Item H.1**) highlighting the following key topics from the second full draft of proposed ISA 240 (Revised) (see **Agenda Item H.2**):
 - (a) Clarity and emphasis on the auditor's responsibilities;
 - (b) Professional skepticism;
 - (c) Ongoing communications with management and TCWG;
 - (d) Applying fraud lens on risk identification and assessment;
 - (e) Robust work effort requirements if fraud or suspected fraud is identified;
 - (f) Transparency on key audit matters (KAMs) related to fraud in the auditor's report; and
 - (g) Audit documentation.
10. In preparation for the IAASB CAG discussion on fraud, Representatives are requested to read **Agenda Items H.1** and **H.2** and are encouraged to read:

- The proposed conforming and consequential amendments presented in **Agenda Item H.3**;
- **Sections I and II of Agenda Item H.4** (IAASB Fraud Issues Paper June 2023); and
- **Sections I and II of Agenda Item H.5** (IAASB Fraud Issues Paper September 2023).

Matters for IAASB CAG Consideration

1. Representatives are asked for their views on the proposed changes presented in **Agenda Item H.2** relating to:
 - (a) Clarity and emphasis on the auditor’s responsibilities;
 - (b) Applying fraud lens on risk identification and assessment;
 - (c) Robust work effort requirements if fraud or suspected fraud is identified; and
 - (d) Transparency on KAMs related to fraud in the auditor’s report.
2. Representatives are asked whether there are any other matters in **Agenda Item H.2** that the Fraud TF should consider as it finalizes the enhancements to proposed ISA 240 (Revised) in December 2023.

Report Back

11. Extracts from the approved March 2023 IAASB CAG meeting minutes relevant to fraud, as well as an indication of how the Fraud TF or the IAASB has responded to the Representatives’ comments, are included below.

Report Back on the March 2023 IAASB CAG Meeting	
Representatives’ Comments	Task Force / IAASB Response
PROFESSIONAL SKEPTICISM	
Ms. Riggs suggested developing specific examples that may help practitioners demonstrate the exercise of professional skepticism throughout the audit (and not only when fraud or suspected fraud is identified).	Point noted. Ms. Corden responded that providing practical examples on professional skepticism will be addressed through developing non-authoritative guidance as indicated in the project proposal.
Mr. Ishiwata cautioned about requiring excessive fraud-related audit procedures that may impede the auditor from appropriately exercising professional skepticism when faced with resource constraints when performing the audit engagement. He encouraged a balanced approach that considered market needs and the entity’s risk profile, including changes made in different jurisdictions (e.g., in Japan, certain fraud-	Point noted. Ms. Corden explained that changes made to fraud-related standards in different jurisdictions have been considered when revising proposed ISA 240 (Revised), including those made by Japan, the Netherlands, the United Kingdom and other jurisdictions, as appropriate.

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related audit procedures and audit documentation are required only for listed entities).	
IDENTIFYING AND ASSESSING RISKS OF MATERIAL MISSTATEMENT DUE TO FRAUD	
Mr. Yurdakul highlighted the importance of the practitioner's consideration of fraud risk factors and the investigation of inconsistent or conflicting information that may be indicative of fraud.	<p>Point accepted.</p> <p>Ms. Corden noted that there are a number of proposed changes that address fraud risk factors, including an appendix, which was enhanced to provide an updated list of examples of fraud risk factors.</p> <p>Proposed ISA 240 (Revised) includes requirements addressing:</p> <ul style="list-style-type: none"> • Inconsistent responses to inquiries of individuals within the internal audit function, management, TCWG, or others within the entity. • The evaluation of fraud risk factors, including taking into account fraud risk factors when identifying and assessing the risks of material misstatement due to fraud.
Ms. Vanich emphasized the importance of the auditor's understanding of the entity when performing risk assessment procedures and considering where fraud could occur and when designing the audit procedures.	<p>Point noted.</p> <p>A focus point in the development of proposed ISA 240 (Revised) was emphasizing the importance of the auditor's understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control and leveraging such understanding when identifying and assessing risks of material misstatement due to fraud. Requirements and application material were added to drive the auditor to obtain a thorough understanding of the entity when performing risk assessment procedures and considering where fraud could occur.</p>

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JOURNAL ENTRY TESTING	
<p>Mr. Hansen supported the enhancement to determine the need to test journal entries and other adjustments throughout the period.</p>	<p>Support noted.</p> <p>Ms. Corden explained that the proposed enhancement strengthened the work effort requirement from a “consideration” to a “determination” of the need to test journal entries throughout the period which would include documentation of the auditor’s determination.</p>
<p>Mr. Hansen emphasized the importance of assigning more experienced individuals when testing journal entries and other adjustments. He noted that auditors should also have a more “questioning mindset” when examining the underlying information supporting the journal entries.</p>	<p>Point noted.</p> <p>Ms. Corden responded that the changes to proposed ISA 240 (Revised) address engagement performance, including responsibilities for the direction, supervision and review of the auditor’s work, taking into account the knowledge, skill and ability of the auditor performing the audit procedures. This enhancement is intended to address circumstances such as the work related to journal entry testing.</p>
<p>Mr. Dalkin added that “top side” management adjustments should also be considered when performing journal entry testing.</p>	<p>Point noted.</p> <p>Proposed ISA 240 (Revised) requires the auditor to “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.” Proposed ISA 240 (Revised) further provides guidance that such a population may include manual adjustments (e.g., batched in a spreadsheet), or other “top-side” adjustments that are made directly to the amounts reported in the financial statements.</p>
FRAUD OR SUSPECTED FRAUD IS IDENTIFIED	
<p>Ms. Riggs requested clarification about whether the proposed revision to “determine if control deficiencies related to the prevention or detection of fraud exist, when fraud or suspected fraud is identified” was intended to go beyond the</p>	<p>Point noted.</p> <p>Ms. Corden clarified that the proposed changes are to be considered in the context of a fraud or suspected fraud that has been identified and that the wording is aligned with other ISAs, including ISA</p>

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requirements in ISA 315 (Revised 2019) ³ . If this was not the intent, Ms. Riggs suggested aligning the requirement more closely with the relevant internal control requirements in ISA 315 (Revised 2019) and ISA 265. ⁴	315 (Revised 2019) and ISA 265.
Mr. Ishiwata supported the “ramping up” of audit procedures when fraud or suspected fraud is identified and suggested further demonstrating the ramping up of audit procedures (particularly when management is involved in fraud or suspected fraud) through communicating with TCWG, exercising professional skepticism and testing journal entries.	<p>Point noted.</p> <p>Proposed ISA 240 (Revised) includes robust work effort requirements if fraud or suspected fraud is identified, including:</p> <ul style="list-style-type: none"> • Obtaining an understanding of the fraud or suspected fraud. • Communicating with management and TCWG. • Performing certain required additional audit procedures, such as determining if control deficiencies related to the prevention or detection of fraud exist. <p>Proposed ISA 240 (Revised) also includes enhancements to reinforce the importance of maintaining professional skepticism when performing procedures related to fraud.</p>
While acknowledging the importance of performing robust audit procedures when addressing fraud in an audit of financial statements, particularly when fraud or suspected fraud is identified, Mr. Pavas was concerned whether audit clients have the appetite to bear the extra costs incurred by the auditor in performing the enhanced fraud-related audit procedures.	<p>Point noted.</p> <p>The costs of fraud to society at large are enormous and frauds have eroded the trust in the financial reporting ecosystem. Therefore, enhanced fraud-related audit procedures are warranted, including the costs that come with it.</p>
TRANSPARENCY IN THE AUDITOR’S REPORT ON FRAUD	
Messrs. Dalkin and Hansen supported the IAASB’s decision not to include a specific requirement to communicate identified significant	<p>Support noted.</p> <p>The IAASB agreed not to include a requirement in proposed ISA 240 (Revised) to communicate in the</p>

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

⁴ ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*

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<p>deficiencies in internal control that are relevant to the prevention and detection of fraud in the auditor's report.</p>	<p>auditor's report identified significant deficiencies in internal control that are relevant to the prevention and detection of fraud as:</p> <ul style="list-style-type: none"> • An audit of financial statements does not have as an objective and is not designed to identify significant deficiencies in internal control such as to conclude and report on the operating effectiveness of internal controls. • Depending on whether the auditor adopts a substantive or controls-based approach, the auditor may get different outcomes as deficiencies in internal control may be identified not only during the risk assessment process, but also during other stages of the audit.
<p>Mr. Hansen suggested providing guidance when there are identified significant deficiencies related to the prevention and detection of fraud (e.g., involving the entity's legal counsel and communicating to regulatory and enforcement authorities).</p>	<p>Point noted.</p> <p>Ms. Corden noted that when fraud or suspected fraud is identified, proposed ISA 240 (Revised) requires (among other matters) for the auditor to determine if control deficiencies related to the prevention or detection of fraud exist and communicate to regulatory and enforcement authorities, as required.</p>
<p>Mr. Dalkin recognized that the changes in proposed ISA 240 (Revised) for applying the KAM mechanism in ISA 701⁵ were "artful" in the manner it allowed the auditor an alternative when considering whether to include communicating identified significant deficiencies in internal control relevant to prevention and detection of fraud in the auditor's report.</p>	<p>Point noted.</p> <p>Proposed ISA 240 (Revised) requires the auditor, when determining KAMs, to take into account:</p> <ul style="list-style-type: none"> • Significant risks of material misstatement due to fraud; • The identification of fraud or suspected fraud; and • The identification of deficiencies in internal control that are relevant to the prevention and detection of fraud.
<p>Absent the communication of fraud-related</p>	<p>Point noted.</p>

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

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<p>findings / observations in the auditor's report, Ms. Riggs was concerned whether there would be meaningful progress in enhancing transparency in the auditor's report on fraud.</p>	<p>Proposed ISA 240 (Revised) does not require auditors to disclose findings or observations but they could voluntarily do so. The reason for this is that:</p> <ul style="list-style-type: none"> • Including findings or observations would be inconsistent with the requirements for KAMs; and • Local laws and regulations may preclude the disclosure of findings or observations for reasons of confidentiality.
<p>With respect to communicating KAMs related to fraud risks in the auditor's report, Mr. Hansen cautioned about the use of boilerplate language. He encouraged communicating KAMs related to fraud risks that are meaningful to the entity (i.e., include entity-specific information).</p>	<p>Point noted.</p> <p>Ms. Corden believes that the proposed changes for applying a fraud lens on risk identification and assessment, including requiring robust engagement team discussions about fraud-related matters and developing application material on the filter for communicating KAMs related to fraud, would drive the auditor to include entity-specific information and avoid the use of boiler-plate language.</p> <p>In developing proposed ISA 240 (Revised), the use of boilerplate language was avoided by:</p> <ul style="list-style-type: none"> • Encouraging the use of entity-specific information. This was accomplished by including application material that highlights the importance of relating KAMs directly to the specific circumstances of the entity. • Aligning the requirements with ISA 701. The Auditor Reporting Post Implementation Review showed that KAMs are valued and, generally, include entity-specific information and avoid the use of boilerplate language.
<p>With respect to the proposed change requiring a reference to the related disclosure(s), if any, in the financial statements, Mmes. Blomme and Riggs suggested clarifying, at least within application material, how the auditor may respond when there are no fraud-related disclosures in the financial</p>	<p>Point noted.</p> <p>Ms. Corden understood the concerns raised on this topic, but at the same time recognized that requirements over management disclosures about fraud-related matters in the financial statements relate to the applicable financial reporting</p>

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<p>statements.</p>	<p>framework and is therefore beyond the remit of the IAASB. Nevertheless, the Fraud TF will be conscious of this matter when progressing discussions in this area.</p> <p>Proposed ISA 240 (Revised) includes guidance dealing with circumstances in which a matter determined to be a KAM is not communicated in the auditor's report. For example:</p> <ul style="list-style-type: none"> • Law or regulation may preclude public disclosure by either management or the auditor about a specific matter determined to be a KAM. • 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 KAM 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. • 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>AUDIT DOCUMENTATION</p>	
<p>Ms. Riggs and Mr. Hansen suggested removing the words "by the auditor" within the new proposed requirement to document "fraud or suspected fraud identified by the auditor" to broaden it to include fraud or suspected fraud identified, whether by the auditor, management, TCWG and others within the entity (e.g., whistleblowers).</p>	<p>Point noted.</p> <p>Ms. Corden clarified that the proposed change is intended to be broader than just fraud or suspected fraud identified by the auditor. Hence, further refinements to the wording will be made to clarify this point.</p> <p>Proposed ISA 240 (Revised) clarifies what is meant by fraud or suspected fraud "identified by the</p>

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	auditor.” The auditor may identify fraud or suspected fraud when performing audit procedures in accordance with the proposed standard (e.g., through inquiries of management). The standard further clarifies that the manner in which information about fraud or suspected is identified by the auditor may vary (e.g., the auditor, TCWG, management, individuals within the audit function, an employee or former employee).
Ms. Wolf expressed support for enhancements to document “significant professional judgments made,” which is considered important within the actuarial community.	Support noted.
Dr. Norberg recognized that the proposed changes in audit documentation could drive changes in auditor behavior but encouraged a stronger and clearer indication of how the overall proposed revisions to ISA 240 (Revised) could change auditor behavior.	<p>Point noted.</p> <p>Ms. Corden clarified that the enhancements are aimed at promoting consistent practice and changing auditor behavior. Such proposed changes, in addition to the enhance audit documentation requirements, also include for example:</p> <ul style="list-style-type: none"> • Applying a fraud lens on risk identification and assessment. • Robust work effort requirements if fraud or suspected fraud is identified. • Transparency on KAMs related to fraud in the auditor’s report. <p>The seven most important changes in proposed ISA 240 (Revised) addressing the key issues identified in the project proposal, that will drive consistency in practice and change in auditor behavior are set out in paragraph 4 of this paper.</p>
OTHER TOPICS	
Mr. Ishiwata encouraged enhancing the requirements on communications to regulatory and enforcement authorities.	<p>Point noted.</p> <p>Proposed ISA 240 (Revised) includes requirements dealing with “reporting to an appropriate authority</p>

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Representatives' Comments	Task Force / IAASB Response
	outside the entity.”
Ms. Blomme encouraged considering scalability when revising proposed ISA 240 (Revised), which could improve its usability for smaller practitioners.	Point noted. Ms. Corden responded that scalability is top of mind when drafting requirements and application material in proposed ISA 240 (Revised) and is a continuing topic for discussion during the Fraud TF meetings. Proposed actions include coordinating with the Less Complex Entity (LCE) Task Force when considering examples to illustrate the scalability of the requirements.

Materials Presented – IAASB CAG Papers

- Agenda Item H.1 Fraud Presentation
- Agenda Item H.2 IAASB Proposed ISA 240 (Revised) (September 2023)

Materials Presented – IAASB CAG Reference Papers

- Agenda Item H.3 IAASB Fraud Conforming and Consequential Amendments (September 2023) (For Reference)
- Agenda Item H.4 IAASB Fraud Issues Paper June 2023 (For Reference)
- Agenda Item H.5 IAASB Fraud Issues Paper September 2023 (For Reference)

Project Details and History

Project: Fraud

Link to IAASB Project Page: [Fraud Project Page](#)

Task Force Members

- Julie Corden, IAASB Member and Task Force Chair
- William Edge, IAASB Member
- Josephine Jackson, IAASB Vice-Chair
- Sachiko Kai, IAASB Member
- Diane Larsen, IAASB Member

Summary

	IAASB CAG Meeting	IAASB Meeting
Information Gathering	September 2020 March 2021 September 2021	August 2020 December 2020 April 2021 June 2021 July 2021
Project Proposal	November 2021	December 2021
Development of Exposure Draft	March 2022 September 2022 March 2023	March 2022 June 2022 September 2022 December 2022 June 2023

IAASB CAG Discussions: Detailed References

Information gathering	<p><u>September 2020</u></p> <p>See IAASB CAG meeting material (Agenda Item F).</p> <p><u>March 2021</u></p> <p>See IAASB CAG meeting material (Agenda Item C).</p> <p><u>September 2021</u></p>
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	See IAASB CAG meeting material (Agenda Item I).
Project Proposal	<u>November 2021</u> See IAASB CAG meeting material (Agenda Item A).
Development of Exposure Draft	<u>March 2022</u> See IAASB CAG meeting material (Agenda Item H). <u>September 2022</u> See IAASB CAG meeting material (Agenda Item G). <u>March 2023</u> See IAASB CAG meeting material (Agenda Item D).