

Proposed ISA 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* and Conforming and Consequential Amendments – *Selected Paragraphs*

Marked from Agenda Item 2-C and 2-D

This Agenda Item includes the Fraud Task Force's proposed revisions to selected paragraphs in proposed ISA 240 (Revised) and conforming and consequential amendments to address targeted matters raised in the IAASB Plenary discussion on March 18, 2025.

PROPOSED ISA 240 (REVISED), THE AUDITOR'S RESPONSIBILITIES RELATING TO FRAUD IN AN AUDIT OF FINANCIAL STATEMENTS

Introduction

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Key Concepts in this ISA

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Non-Compliance with Laws and Regulations

14. For the purposes of this and other relevant ISAs, fraud ordinarily constitutes an instance of non-compliance with laws and regulations. As such, if the auditor identifies fraud or suspected fraud, the auditor also has responsibilities in accordance with ISA 250 (Revised).¹ (Ref: Para. A15–A16)

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Requirements

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Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework and the Entity's System of Internal Control

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Control Activities

36. In applying ISA 315 (Revised 2019),² the auditor's understanding of the entity's control activities shall include: ~~(Ref: Para. A101–A106)~~
- ~~(a)~~ identifying controls that address risks of material misstatement due to fraud at the assertion level, including controls over journal entries and other adjustments, designed to prevent or detect fraud. (Ref: Para. A101–A106);

¹ ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*

² ISA 315 (Revised 2019), paragraph 26

- ~~(b) Evaluating whether the controls are designed effectively to address the risk of material misstatement due to fraud, or effectively designed to support the operation of other controls; and~~
- ~~(c) Determining whether the controls have been implemented.~~

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Identifying and Assessing the Risks of Material Misstatement due to Fraud

39. In applying ISA 315 (Revised 2019),³ the auditor shall:

- (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, taking into account fraud risk factors. (Ref: Para. A112–A114)
- (b) Treat those assessed risks of material misstatement due to fraud ~~at the assertion level~~ as significant risks. Accordingly, to the extent not already done so, the auditor shall identify controls that address such significant risks, evaluate whether they have been designed effectively, ~~or designed effectively to support the operation of other controls,~~ and determine whether they have been implemented. (Ref: Para. A114A)

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Overall Evaluation Based on Audit Procedures Performed

53A. In applying ISA 330,⁴ the auditor shall evaluate, based on the audit procedures performed and audit evidence obtained, whether:

- (a) The assessments of the risks of material misstatement due to fraud remain appropriate; and
- (b) Sufficient appropriate audit evidence has been obtained in response to the assessed risks of material misstatement due to fraud.

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Written Representations

62. The auditor shall obtain written representations from management and, where appropriate, those charged with governance that: (Ref: Para. A191–A192)

- (a) They acknowledge their responsibility for the design, implementation, and maintenance of internal control to prevent or detect fraud and have appropriately fulfilled those responsibilities;
- (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;
- (c) They have disclosed to the auditor their knowledge of ~~any~~ fraud or suspected fraud, including allegations of fraud, affecting the entity involving:
 - (i) Management;
 - (ii) Employees who have significant roles in internal control; or

³ ISA 315 (Revised 2019), paragraphs 28–34

⁴ ISA 330, paragraphs 25-26, A62-A64

- (iii) Others where the fraud could have an effect on the financial statements; and
- (d) They have disclosed to the auditor their knowledge of suspected fraud, including allegations of fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators, or others.

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Application and Other Explanatory Material

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Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework and the Entity's System of Internal Control

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Understanding the Components of the Entity's System of Internal Control

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Control Activities (Ref: Para. 36)

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A103. ISA 315 (Revised 2019)⁵ requires the auditor to obtain an understanding of controls over journal entries as well as to evaluate their design and determine their implementation as part of understanding the entity's system of internal control. This understanding focuses on the controls over journal entries that address risks of material misstatement at the assertion level whether due to fraud or error. Paragraphs 48–49 of this ISA require the auditor to design and perform audit procedures to test the appropriateness of journal entries and are specifically focused on the risks of material misstatement due to fraud (see **Appendix 4** for additional considerations when testing journal entries).

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Identifying and Assessing the Risks of Material Misstatement due to Fraud (Ref: Para. 39~~(a)~~)

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A114A. Evaluating the design of controls that address significant risks, or support the operation of other controls that address significant risks, involves the auditor's consideration of whether the control, individually or in combination with other controls, is capable of effectively preventing, or detecting and correcting material misstatements due to fraud (i.e., the control objective). The auditor determines the implementation of an identified control by establishing that the control exists, and that the entity is using it. The controls in the control environment, the entity's risk assessment process and the entity's process to monitor the system of internal control are primarily indirect controls. Such controls may not be sufficiently precise to prevent, detect or correct misstatements due to fraud at the assertion level but which support other controls and may therefore have an indirect effect on the likelihood that a misstatement due to fraud will be prevented or detected on a timely basis. For

⁵ ISA 315 (Revised 2019), paragraphs 26(a)(ii) and 26(d)

example, a whistleblower program (or other program to report fraud) may be an indirect control within the control environment.

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Risks of Material Misstatement Due to Fraud Related to Management Override of Controls (Ref: Para. 40)

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A116. In certain circumstances, the auditor may determine that the risks of material misstatement due to fraud related to management override of controls affect individual assertions and related significant classes of transactions, account balances and disclosures. In such cases, in addition to the requirements in paragraphs 48–52, the auditor identifies these risks at the assertion level ~~in accordance with paragraph 39(b)~~ and designs and performs further audit procedures to address the assessed risks of material misstatement due to fraud at the assertion level in accordance with paragraph 46.

Examples:

- Based on the risk assessment procedures performed, the auditor identified an aggressive employee performance measure in management's incentive program related to the entities' profit and loss statement. Therefore, the auditor determined that risks of management override of controls also exist at the assertion level and identified a risk of material misstatement due to fraud related to management override of controls at the assertion level (and thus a significant risk). The auditor determined that the risk relates to the completeness of expenses, as the calculation of the performance measure management may be susceptible to manipulation ~~from management~~ the calculation of the performance measure via adjustments made to the expense accounts. In addition to the procedures performed as described in paragraphs 48–52, the auditor designed and performed further audit procedures to address this significant risk.
- Based on the risk assessment procedures performed, the auditor identified a pressure on management to meet the financial ratios for the entity's loan covenants to avoid ~~bankruptcy~~ insolvency. Therefore, the auditor identified a risk of material misstatement due to fraud related to management override of controls at the assertion level. The auditor determined that the risk relates to the valuation of inventory and completeness of liabilities, as the valuation methods management may be susceptible to be adjusted by management ~~ing valuation methods or manipulating records~~ be manipulated to understate ~~total net~~ liabilities. In addition to the procedures performed as described in paragraphs 48–52, the auditor designed and performed further audit procedures to address this significant risk.

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Responses to the Assessed Risks of Material Misstatement Due to Fraud

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Overall Responses (Ref: Para. 44)

~~A126. Determining overall responses to address the assessed risks of material misstatement due to fraud~~

at the financial statement level generally includes the consideration of how the overall conduct of the audit can reflect the exercise of professional skepticism. In accordance with paragraph 39(b), assessed risks of material misstatement due to fraud at the financial statement level are also treated as significant risks. This has a significant bearing on the auditor's general approach and thereby the auditor's overall responses to such risks.

Examples:

- Increased sensitivity in the selection of the nature and extent of documentation to be examined in support of material transactions.
- Increased recognition of the need to corroborate management's explanations or representations concerning significant matters.
- Increased involvement of auditor's experts to assist the engagement team with complex or subjective areas of the audit.
- 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.
- Increasing the extent and frequency of the direction and supervision of engagement team members and a more detailed review of their work.
- Using direct extraction methods or technologies when obtaining data from the entity's information system for use in automated tools and techniques to address the risk of data manipulation.
- Changing the auditor's approach with an emphasis on substantive procedures (i.e., test of details) or an approach that uses tests of controls as well as substantive procedures.

ISA 600 (REVISED), SPECIAL CONSIDERATIONS—AUDITS OF GROUP FINANCIAL STATEMENTS (INCLUDING THE WORK OF COMPONENT AUDITORS)

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Requirements

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Fraud or Suspected Fraud

Considerations When Component Auditors Are Involved

- 44A. In applying ISA 240 (Revised),⁶ if the component auditor identifies fraud or suspected fraud, the group auditor shall take responsibility for obtaining an understanding of the matter(s) identified fraud or suspected fraud, including fraud or suspected fraud identified by the component auditor, in order to determine the effect on the group audit engagement.

⁶ ISA 240 (Revised), paragraph 54