

Meeting: IAASB Consultative Advisory Group (CAG)

Meeting Location: Virtual Zoom Meeting

Meeting Date: November 30, 2021

Agenda Item

A

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 IAASB CAG Representatives' views on the draft project proposal to revise ISA 240¹ and the conforming and consequential amendments to other relevant ISAs to enhance or clarify the auditor's responsibilities on fraud in an audit of financial statements; and
 - (b) Report back on Representatives' comments made at the March and September 2021 IAASB CAG meetings on the development of a project proposal to revise ISA 240.

Update on Activities Since the September 2021 IAASB CAG Meeting

2. Since the last update provided to the CAG at the September 2021 meeting, the Fraud Working Group (WG) held one hybrid meeting on October 13-14, 2021 and one virtual meeting on November 2, 2021 to discuss the summary of findings from the Additional Root Cause Analysis of Fraud Cases and the development of a project proposal to revise ISA 240.
3. **Appendix A** to this paper provides a history of previous discussions with the IAASB CAG and the IAASB on this topic, including links to the relevant IAASB CAG documentation.

Materials Presented

4. Other Agenda Items provided to support the IAASB CAG discussion in November 2021 include:

IAASB CAG Paper

Agenda Item A.1 Presentation

IAASB CAG Reference Papers

Agenda Item A.2 December 2021 IAASB Issues Paper on Fraud

Agenda Item A.3 December 2021 IAASB Project Proposal on Fraud

IAASB CAG Discussion in November 2021

5. For purposes of the IAASB CAG discussion in November 2021, the Fraud WG prepared a presentation (see **Agenda Item A.1**) highlighting the:

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

- (a) Common themes from the Additional Root Cause Analysis of Fraud Cases;²
- (b) Project objectives to achieve the public interest;
- (c) Stakeholders impacted by a project on fraud;
- (d) Key issues identified that will be addressed by the project;
- (e) Scope of the proposed project on fraud; and
- (f) Impact of a project on fraud.³

6. The question that is being asked of Representatives is set out below.

Matter for IAASB CAG Consideration:

1. Representatives are asked for views on the draft project proposal presented in **Agenda Item A.3** setting out the project objectives, the key issues identified and the scope of the proposed project to revise ISA 240.

Feedback

7. Extracts from the March and September 2021 IAASB CAG meeting minutes, as well as an indication of how the Fraud WG or the IAASB has responded to the Representatives' comments, are included below in Tables 1 and 2, respectively.

Table 1 – Report Back on the March 2021 IAASB CAG Meeting	
Representatives' Comments	Fraud WG/IAASB Response
Mr. Sobel and Ms. Yazar expressed support for the direction of the project and highlighted the importance for external auditors to liaise with internal auditors in view of the role of internal auditors in the detection of fraud. It was noted that several previous studies indicated that internal auditors tend to identify more fraudulent activities than external auditors because fraud can run a wider gamut than just financial reporting. Ms. Yazar highlighted a 2017 OECD ⁴ study, which indicated that 22% of identified foreign bribery and corruption schemes were detected by internal auditors. Mr. Sobel also suggested that the IAASB	<p>Points noted. Proposed actions within the scope of a project to revise ISA 240 that may highlight the role of internal auditors include:</p> <ul style="list-style-type: none"> • Standard setting to incorporate recent changes in ISA 315 (Revised 2019)⁶ to make fraud risk identification and assessment more robust, including proposals to: <ul style="list-style-type: none"> ○ Emphasize the entity's specific control activities to prevent and detect fraud.

² IAASB Staff performed additional work to respond to encouragement from respondents to the Discussion Paper, [Fraud and Going Concern in an Audit of Financial Statements: Exploring the Differences Between Public Perceptions About the Role of the Auditor and the Auditor's Responsibilities in a Financial Statement Audit](#), to further analyze the root cause(s) of recent fraud cases. The "Additional Root Cause Analysis" is further discussed in paragraphs 12-19 of **Agenda Item A.2**.

³ See **Agenda Item A.3** for details relating to 5(b) to 5(f).

⁴ Organisation for Economic Co-operation and Development (OECD)

⁶ ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*

Table 1 – Report Back on the March 2021 IAASB CAG Meeting	
Representatives' Comments	Fraud WG/IAASB Response
look into the COSO ⁵ Fraud Risk Management Guide as a useful reference material for the project.	<ul style="list-style-type: none"> ○ Update the fraud risk factors currently included in ISA 240 and consideration as to whether such risk factors should rather be included in application material. • Developing non-authoritative guidance that illustrates how ISA 240 should be applied in conjunction with the full suite of ISAs (including ISA 610 (Revised 2013)⁷) and highlights considerations from other standards that are critical when undertaking fraud-related procedures. • Developing non-authoritative guidance on inquiries of management and others within the entity (e.g., internal auditors) tailored for fraud considerations to help auditors ask the right questions, which will better inform auditors when performing procedures, such as the engagement team discussion and analytical procedures.
Ms. Meng encouraged the IAASB to actively engage with stakeholders in continuing to narrow the expectation gap. In addition to clarifying the auditor's responsibilities on fraud in an audit of financial statements, Messrs. Meng and Yazar also encouraged that consideration be given to other participants in the financial reporting ecosystem (i.e., to focus on the primary responsibility of management and those charged with governance (TCWG) to prevent and detect fraud).	<p>Point noted. Proposed "other actions" within the scope of a project to revise ISA 240 that may highlight the role of others in the financial reporting ecosystem include:</p> <ul style="list-style-type: none"> • Activities that are educational in nature (i.e., initiatives of an educational nature or other outreach where within the remit of the IAASB). • Engagement with others (i.e., continued dialogue and engagement with others on issues that relate to actions that are not solely within the IAASB's remit and require efforts from others in the financial reporting ecosystem).

⁵ Committee of Sponsoring Organizations of the Treadway Commission (COSO)

⁷ ISA 610 (Revised 2013), *Using the Work of Internal Auditors*

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Mmes. Yazar and Landell-Mills highlighted the importance of proposed actions that support a robust, principles-based standard recognizing that fraud requirements are governed by distinct jurisdictional laws and regulations (e.g., national company statute).	Point noted. The proposed actions are largely focused on developing more robust principle-based requirements for the auditor when undertaking procedures related to fraud.
Ms. Manabat noted many of the more recent fraud cases are driven by technology, and therefore, encouraged the IAASB to modernize the standard for technology considerations in the current environment. She also noted the need to clarify the definition of fraud.	<p>Point noted. Proposed actions within the scope of a project to revise ISA 240 that relate to technology and the definition of fraud include:</p> <ul style="list-style-type: none"> Enhancing application material in ISA 240 to reflect and describe fraud risks presented by use of technology, as well as the auditor's use of technology to perform fraud-related procedures (while remaining mindful of maintaining a balance of not 'dating' the standard by referring to technologies that may change and evolve), including consulting with a technology expert, as needed. Working collaboratively with the Technology Consultation Group to determine the need for further non-authoritative guidance that supports application of ISA 240 in the current environment. Enhancing application material to clarify how concepts such as bribery and corruption relate to the definition of fraud for purposes of an audit of financial statements.
Mr. Dalkin reiterated auditors might benefit from a stand-back that requires them to consider all facts collectively and 'see the big picture,' as opposed to only looking at the details. Mr. Dalkin added that if auditors had done this in some of the more high-profile frauds in recent years, they may have identified 'red flags.'	<p>Point noted. Proposed actions within the scope of a project to revise ISA 240 that requires auditors to consider all facts collectively and 'see the big picture' include:</p> <ul style="list-style-type: none"> Enhancing the requirements and application material in ISA 240 to strengthen the auditor's responses to assessed risks of material misstatement due to fraud, as necessary in light of the proposed actions

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	<p>addressing fraud risk identification and assessment and other fraud-related procedures, including:</p> <ul style="list-style-type: none"> ○ Considering a stand-back requirement in ISA 240 to evaluate all relevant audit evidence obtained, whether corroborative or contradictory, and whether sufficient appropriate audit evidence has been obtained in responding to the assessed risks of material misstatement due to fraud. ○ Enhancing application material in ISA 240 to encourage emphasis on management bias when considering the appropriateness of accounting estimates for fraud, and strengthening the link to the procedures required in ISA 540 (Revised).⁸
OTHER COMMENTS	
Mr. Hirai noted clear linkage to the underlying root causes of fraud and going concern issues would be very helpful considerations in developing proposed actions to address the issues identified.	<p>Point noted. In developing the draft project proposal, the Fraud WG has considered the work undertaken by IAASB Staff on recent fraud cases in response to encouragement from respondents to the Discussion Paper⁹ to further analyze the root causes of recent fraud cases. The “Additional Root Cause Analysis of Fraud Cases” serves as a background paper for the project proposal and explains the Fraud WG’s additional efforts (post March 2021), including:</p> <ul style="list-style-type: none"> • The detailed work undertaken (i.e., targeted outreach, and academic review and other research); and

⁸ ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

⁹ Discussion Paper, [Fraud and Going Concern in an Audit of Financial Statements: Exploring the Differences Between Public Perceptions About the Role of the Auditor and the Auditor's Responsibilities in a Financial Statement Audit](#)

Table 1 – Report Back on the March 2021 IAASB CAG Meeting	
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	<ul style="list-style-type: none"> A summary of the findings from that work.

Table 2 – Report Back on the September 2021 IAASB CAG Meeting	
Representatives' Comments	Fraud WG/IAASB Response
<i>Exploring revisions in ISA 240 to increase transparency in the auditor's report describing fraud related matters</i>	
Mr. Yoshii and Mmes. Meng and Landell-Mills expressed support for proposals to further explore more transparency in the auditor's report. They noted that describing fraud related matters in the auditor's report may be helpful in narrowing the expectation gap.	<p>Mrs. Provost expressed appreciation of the support for proposals to further explore more transparency in the auditor's report. She noted 'other' actions that may help in narrowing the expectation gap include emphasizing the importance of all stakeholders in the financial reporting ecosystem (i.e., all have a role to play in addressing issues raised on fraud).</p> <p>There are proposed actions within the draft project proposal to further explore whether, and how, more transparency within the auditor's report can be achieved.</p>
Ms. Landell-Mills emphasized that more transparency in the auditor's report is key from an investor's perspective, but expressed interest about the nature of the mixed views expressed.	<p>Mrs. Provost explained that respondents supporting more transparency in the auditor's report had varying views about matters to be disclosed in the auditor's report (e.g., description of fraud specific procedures performed, explanation of the extent the audit was capable of detecting irregularities, including fraud, fraud-specific key audit matters, identified significant control deficiencies and weaknesses relating to fraud, etc.). She further explained that respondents who did not support more transparency on fraud in the auditor's report noted the unintended consequences of undermining the effectiveness of the auditor's procedures by disclosing what the auditor does to all parties, including fraudsters. In addition, she added that some also had the view that more transparency in the auditor's report may not be as helpful because</p>

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	it can be susceptible to 'boilerplate' disclosures.
Ms. Meng encouraged continued outreach with key stakeholders to further explore more transparency in the auditor's report.	Point noted. Proposed actions within the scope of a project to revise ISA 240 include undertaking additional outreach with investor groups and other relevant stakeholders about the need for more transparency in the auditor's report.
<i>Enhancing transparency with TCWG</i>	
Mr. De Tullio and Ms. Blomme expressed support for proposals to strengthen the required communications in ISA 240 with TCWG. They noted such proposals may be helpful in emphasizing that role of TCWG in the prevention and detection of fraud. They also recognized the importance of the role of all stakeholders in the financial reporting ecosystem in addressing the issues related to fraud.	Support noted. Mrs. Provost explained that the issues related to fraud need to be addressed through the combined efforts in standard-setting by the IAASB and other actions from all participants in the financial reporting ecosystem, including TCWG. She highlighted 'tone at the top' and company culture as being critically important factors in the prevention and detection of fraud.
<i>Revising the introductory paragraphs in ISA 240 about responsibilities of the auditor and the inherent limitations of an audit</i>	
Mr. Munter expressed support for proposals to use clearer and more positive language on the role of the auditor in the introduction to ISA 240. He noted emphasizing the responsibilities of the auditors first before explaining the inherent limitations of an audit in the introduction to ISA 240 may be helpful in changing the mindset of auditors that the auditor's responsibilities are not diminished by the inherent limitations of an audit.	Support noted. Mrs. Provost noted that the proposed project includes proposals to revise and enhance the introductory paragraphs in ISA 240 to emphasize the auditor's responsibilities in relation to fraud.
<i>Using forensic specialists in an audit of financial statements</i>	
Messrs. Munter and Yoshii expressed support for proposals to require the consideration of the use of forensic specialists in certain circumstances. They noted such proposals may be helpful in strengthening risk identification and assessment and will also be an effective potential response to identified fraud risks, suspected fraud or actual	Support noted. Mrs. Provost noted the proposed project includes proposals to consider requirements and application material in ISA 240 for the auditor to consider the need for specialized skills, including forensic skills. Such proposals are intended to strengthen risk identification and assessment.

Table 2 – Report Back on the September 2021 IAASB CAG Meeting	
Representatives' Comments	Fraud WG/IAASB Response
fraud.	
Mr. Ishiwata encouraged continued outreach with key stakeholders regarding the use of forensic specialists to take into account the differences in the audit approaches and practices among countries and industries. He noted Japan's "Standard to Address Risks of Fraud in an Audit" provides examples of the use of forensic specialists (e.g., inquiries of management and journal entry testing).	Point noted. Proposed actions within the scope of a project to revise ISA 240 involve considering requirements and application material in ISA 240 on the need for specialized skills (e.g., forensic skills), including changes made by others in different jurisdictions relating to the use of specialized skills.
<i>Enhancing the application of professional skepticism</i>	
Mr. Yoshii expressed support for proposals regarding reinforcing the auditor's exercise of professional skepticism and the Board's decision not to introduce a concept of 'suspicious mindset' in the ISAs. He noted the concept of professional skepticism does not change the auditor's initially neutral view about management's integrity. However, he noted that a suspicious mindset seems to presuppose the existence of fraud, which may cause a strain in the auditor's relationship with TCWG and management (e.g., may cause difficulties for the auditor to obtain information about fraud). Instead of pursuing the concept of a suspicious mindset, he supported enhancing the application of the existing concept of professional skepticism.	Mrs. Provost expressed appreciation of the support for proposals regarding professional skepticism.
Mr. Dalkin asked for a clarification as to what enhancements to the application of professional skepticism would entail (i.e., whether it would entail enhanced documentation requirements regarding the exercise of professional skepticism, emphasis on the exercise of professional skepticism throughout the duration of the engagement, or another action).	Mrs. Provost explained that the 'how' of enhancing the application of professional skepticism would still need to be considered by the Fraud WG and would form part of the project. She added that one of the challenges in this area is how to document the exercise of professional skepticism, not just as it relates to fraud in ISA 240, but across the standards.
<i>Clarifying the definition of fraud</i>	
Mr. Hansen queried whether the concepts of	Mrs. Provost noted the proposed project will

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Representatives' Comments	Fraud WG/IAASB Response
bribery and corruption will be included in the definition of fraud for purposes of a financial statement audit.	include proposals to clarify the definition of fraud through application material to illustrate how concepts like bribery and corruption are interlinked with fraud for purposes of an audit of financial statements.
<i>Making the engagement team discussion more robust</i>	
Mr. Hansen noted it would be challenging to expand on what is required to change auditor behavior to make the engagement team discussion more robust.	Mrs. Provost agreed and recognized the challenges of positively changing auditor behavior through standard-setting.
<i>Technology considerations in the current environment</i>	
Mr. Yoshii expressed support for proposals regarding technology considerations in the current environment. He noted advances in new IT technologies are making it possible to audit all transactions rather than using audit sampling in performing audit procedures. He also noted there are existing research or studies about the use of artificial intelligence to detect fraud.	Mrs. Provost noted the support for proposals regarding technology considerations in the current environment.
<i>Clarifying the auditor's actions when non-material fraud is suspected or identified</i>	
Mr. Dalkin expressed support for the Board's decision not to expand the scope of the auditor's responsibilities to detect all non-material fraud.	Support noted.
Mr. Munter queried whether the proposals regarding non-material fraud need to emphasize that determining materiality considers both quantitative and qualitative factors. He added that quantitatively non-material amounts of risk of misstatement due to fraud may qualify as "material" when considering the relevant qualitative factors.	Mrs. Provost noted the proposed project includes proposals to clarify the auditor's actions when non-material fraud is suspected or identified. She further noted many frauds start small and grow more material over time, and that the proposals on non-material fraud aim to address this growth.
<i>Further considering the presumed risk of fraud in revenue recognition and what changes are needed</i>	
Ms. Blomme queried what forms the basis of the proposals regarding the rebuttable presumption of	Ms. Bahlmann noted issues regarding the rebuttable presumption of fraud in revenue

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fraud risk in revenue recognition. She noted this topic was not included in the scope of the Discussion Paper.	recognition were identified from the roundtable discussions; responses to the Discussion Paper; and other matters raised to date. She explained stakeholders called for clarity around the concept of the rebuttable presumption of fraud risk in revenue recognition (i.e., when, and how to rebut) and had mixed views as to whether it remains appropriate, or whether it should be extended to other areas of the audit. She highlighted the additional work performed to further analyze the root cause(s) of recent fraud cases indicated that revenue is still a primary area where fraud typically occurs. She also added that this finding supported the Board's decision not to expand or remove the rebuttable presumption of risks of fraud in revenue recognition.
Mr. Ishiwata encouraged continued outreach with key stakeholders regarding the rebuttable presumption of fraud risk in revenue recognition to take into account the differences in the audit approaches and practices among countries and industries.	Point noted. Proposed "other actions" within the scope of a project to revise ISA 240 include: <ul style="list-style-type: none"> Activities that are educational in nature (i.e., initiatives of an educational nature or other outreach within the remit of the IAASB). Engagement with others (i.e., continued dialogue and engagement with others on issues that relate to actions that are not solely within the IAASB's remit and require efforts from others in the financial reporting ecosystem).
<i>Strengthening requirements about the auditor's considerations for external confirmations</i>	
Ms. Blomme queried what forms the basis of the proposals regarding external confirmations. She noted this topic was not included in the scope of the Discussion Paper.	Ms. Bahlmann noted issues regarding external confirmation were identified from responses to the Discussion Paper; and areas of focus in the current environment. She noted although there was not a strong call for changes on external confirmations in relation to fraud, this is an area of focus in the current environment by many in the financial reporting ecosystem (i.e., due to recent frauds where external confirmations were problematic).

Table 2 – Report Back on the September 2021 IAASB CAG Meeting	
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<i>Other comments</i>	
Ms. McGeachy noted there are a number of key public interest issues related to fraud in an audit of financial statements. She therefore encouraged ongoing engagement with others throughout the duration of the project to properly inform the IAASB's decisions in addressing the key public interest issues related to fraud.	Point noted. Mrs. Provost agreed there are a number of key public interest issues related to fraud. She noted this highlights the importance of prioritizing topics that are key in addressing the public interest issues, or where there are mixed views. She added that it is anticipated that more time and resources would be needed to work through some of these issues where there are very strong views.
Mr. Dalkin reiterated auditors might benefit from a stand-back provision that requires them to consider all facts collectively (e.g., by also looking into analyst reports) and 'see the big picture,' as opposed to only looking at the details.	Ms. Bahlmann noted the proposed project includes proposals to incorporate recent changes in ISA 315 (Revised 2019), including the stand-back provision, to make fraud risk identification and assessment more robust. She also noted addressing this topic includes proposals to update the fraud risk factors currently included in ISA 240 (e.g., fraud risk factors identified from short sellers reports).

Appendix A

Project Details and History

Project: Fraud

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

Working Group Members

- Lyn Provost, IAASB Member and Working Group Chair
- Julie Corden, IAASB Member
- Len Jui, IAASB Deputy Chair
- Diane Larsen, IAASB Member
- Fabien Cerutti, IAASB Technical Advisor

Summary

	IAASB CAG Meeting	IAASB Meeting
Update on information-gathering activities and discussion on proposed Discussion Paper, Fraud and Going Concern in an Audit of Financial Statements: Exploring the Differences Between Public Perceptions About the Role of the Auditor and the Auditor's Responsibilities in a Financial Statement Audit	September 2020	August 2020
Update on information-gathering activities for fraud and discussion about preliminary Fraud WG views on issues and challenges identified to date with regard to specific requirements in ISA 240.	N/A	December 2020
Update on the responses received to the Discussion Paper and activities to date with regard to fraud. <i>IAASB Meeting only:</i> Obtained Board views on the proposed possible way forward for matters identified in the Discussion Paper.	March 2021	April 2021
Provided deeper analysis on six specific matters where mixed views or further analysis was considered appropriate based on Board discussion at the April 2021 meeting. Obtained Board views on the proposed possible way forward.	N/A	June 2021

	IAASB CAG Meeting	IAASB Meeting
<p>Provided deeper analysis on remaining four specific matters where mixed views or further analysis was considered appropriate based on Board discussion at the April 2021 meeting. Obtained Board views on the proposed possible way forward.</p> <p>Also obtained Board views on specific elements of the draft project proposal, including the key public interest issues, project objectives, and project scope.</p>	N/A	July 2021
<p>Provided an update on the status of the IAASB's work related to fraud and the Board discussions held to date.</p>	September 2021	N/A

IAASB CAG Discussions: Detailed References

Information gathering	<p><u>September 2020</u></p> <p>See IAASB CAG meeting material (Agenda Item F).</p>
Information gathering	<p><u>March 2021</u></p> <p>See IAASB CAG meeting material (Agenda Item C).</p>
Information gathering	<p><u>September 2021</u></p> <p>See IAASB CAG meeting material (Agenda Item I).</p>