

# Agenda Item H.2 For Reference

**Please note: This is the IAASB Fraud Issues Paper that will be discussed by the Board at the March 2022 IAASB quarterly meeting (Agenda Item 4). This paper is provided to the IAASB CAG Representatives in March 2022 for reference purposes.**

## Revision of ISA 240<sup>1</sup> – Fraud in an Audit of Financial Statements

### Objective

The objective of the IAASB discussion is to obtain the Board's input on the Fraud Task Force's initial views and recommendations addressing selected topics on fraud in an audit of financial statements.

### Board Discussion

This paper (**Agenda Item 4**) will be the focus of the IAASB discussion at its March 2022 meeting.

#### *Appendices to this Paper*

The following appendices are included in this paper:

- **Appendix 1** – Fraud Task Force Members and Activities Since the December 2021 IAASB Meeting;
- **Appendix 2** – Extract from the Draft December 2021 IAASB Meeting Minutes;
- **Appendix 3** – Extract from ISA 700 (Revised),<sup>2</sup> Appendix, Illustrative Auditor's Report 1; and
- **Appendix 4** – New Requirements and Application Material in the Netherlands.

#### *Other Agenda Items*

Other Agenda Items provided to support the discussion in this paper include:

- **Agenda Item 4-A** – Draft Non-Authoritative Guidance: *The Fraud Lens – Interactions Between ISA 240 and Other ISAs*;
- **Agenda Item 4-B** – Extant ISA 240, Supplemented by the Conforming and Consequential Amendments Arising from ISA 315 (Revised 2019)<sup>3</sup> and ISA 600 (Revised);<sup>4</sup> and
- **Supplement to Agenda Item 4** – Examples of recent fraud disclosures in auditor's reports from the United Kingdom (UK) and the Netherlands.

#### *Approach to the Board Discussion*

The Fraud Task Force Chair will walk through the "Matters for IAASB Consideration" in the order as included in this paper.

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

<sup>2</sup> ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

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

<sup>4</sup> ISA 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

## Section I – Introduction

1. At the December 2021 IAASB meeting, the Board discussed and approved the [project proposal](#) for the revision of ISA 240 and the conforming and consequential amendments to other relevant ISAs. The project will be focused on specific standard-setting actions aimed at enabling consistent and improved auditor behavior. The project will seek to clarify the auditor's responsibilities and enhance the robustness of the required auditor's procedures and reporting on fraud in an audit of financial statements.
2. The following sections of the paper explore the Fraud Task Force's initial views and recommendations on the proposed changes to ISA 240 addressing selected topics on:
  - (a) Identifying and assessing the risks of material misstatement due to fraud (**Section II**);
  - (b) Communication with those charged with governance (**Section III**);
  - (c) Transparency in reporting on fraud (**Section IV**); and
  - (d) Developing non-authoritative guidance illustrating the relationship between and linkage of ISA 240 and other ISAs (**Section V**).

## Section II – Identifying and Assessing the Risks of Material Misstatement Due to Fraud

### Background

3. ISA 315 (Revised 2019) was finalized and approved in September 2019, with an effective date for periods commencing on or after December 15, 2021. The audit risk model was not changed (the overall requirements for the auditor to identify and assess the risks of material misstatement (ROMMs) due to error or fraud<sup>5</sup> were not changed in the revisions to ISA 315 (Revised 2019)), the project rather focused on how to require a more robust risk identification and assessment.
4. In revising ISA 315 (Revised),<sup>6</sup> the IAASB had initially considered whether enhancements were needed in the revised ISA 315 (Revised) in relation to the auditor's consideration of the risks of fraud. On balance, the IAASB believed that there were sufficient explicit references to fraud in ISA 315 (Revised) (recognizing that ISA 240 focuses on the auditor's work related to fraud, i.e., further expands on the auditor's requirements and considerations related to fraud when identifying and assessing the ROMMs). In the Board's discussions, it was agreed that it was important to maintain that balance between what ISA 315 (Revised 2019) addresses and what ISA 240 addresses (i.e., it was agreed that ISA 315 (Revised 2019) would focus on the broad requirements relating to risk identification and assessment, and ISA 240 would explain how to undertake those procedures with a "fraud lens"). However, it was also recognized at the time that more substantive changes were needed to ISA 240 to effectively embed the more robust procedures that had been introduced in the revision to ISA 315 (Revised).

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<sup>5</sup> Although the requirement to identify and assess ROMMs is not explicit about error or fraud, the "error or fraud" is introduced in the definition of misstatement in ISA 450, *Evaluation of Misstatements Identified During the Audit*. "Misstatements – a difference between.....Misstatements can arise from error or fraud" (paragraph 4(a) of ISA 450).

<sup>6</sup> ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

5. In light of the Board discussions on ISA 315 (Revised 2019), the following changes were made:
- (a) The introductory paragraphs to ISA 315 (Revised 2019) were enhanced to explain the need to also apply ISA 240 when identifying and assessing the ROMMs due to fraud.<sup>7</sup>
  - (b) The “susceptibility to misstatement due to management bias or other fraud risk factors” was added as an inherent risk factor<sup>8</sup> in ISA 315 (Revised 2019) (it was one of the five inherent risk factors explicitly included – *complexity, subjectivity, change, uncertainty and susceptibility to misstatement due to management bias or other fraud risk factors*). Inherent risk factors were a new concept introduced to assist auditors in identifying and assessing the ROMM of an assertion about a class of transactions, account balance or disclosure. The intention of introducing the inherent risk factors was to assist the auditor in focusing on those aspects of events or conditions that affect an assertion’s susceptibility to misstatement, which in turn facilitates a more focused identification of a ROMM(s). Taking into account the degree to which the inherent risk factors affect susceptibility to misstatement was also intended to assist in the assessment of inherent risk on the spectrum of inherent risk (i.e., the higher the ROMM due to the susceptibility of an assertion to misstatement, the higher on the spectrum of risk the ROMM would be designated).<sup>9</sup> Accordingly, as the auditor is undertaking work to comply with the revised requirements of ISA 315 (Revised 2019) related to inherent risk, they are also continually considering the susceptibility of relevant assertions to misstatement due to fraud (i.e., when identifying and assessing the ROMMs).
  - (c) A conforming amendment was made to Appendix 1 of ISA 240 to explain the relationship between inherent risk factors and fraud risk factors – inherent risk factors had already been introduced in the conforming and consequential amendment in the project to revise ISA 540 (Revised)<sup>10</sup> (see conforming amendments arising from the ISA 315 (Revised 2019) project in **Agenda Item 4-B**).
  - (d) Other conforming and consequential amendments were also made to ISA 240. **Agenda Item 4-B** sets out all of the changes that had been made to extant ISA 240 to conform with the changes being introduced in ISA 315 (Revised 2019) (these changes were made recognizing there would be a more substantial project to revise ISA 240 in the near future).<sup>11</sup>

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<sup>7</sup> See paragraph 6 of ISA 315 (Revised 2019).

<sup>8</sup> In the exposure draft to revise ISA 315 (Revised) (ED-315), “fraud” was included more broadly as an inherent risk factor, but there were mixed views from respondents to ED-315 about how fraud was captured in inherent risk factors, as fraud risks factors could be identified from conditions that relate to control risk as well as inherent risk. To alleviate concerns that the reference to fraud in the inherent risk factors went beyond its impact on inherent risk, the IAASB rearticulated the inherent risk factor to include “susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk” to recognize that the fraud risk factors to be considered are those that affect inherent risk rather than control risk (which are more explicitly addressed in ISA 240).

<sup>9</sup> Assessed ROMMs due to fraud are treated as significant risks (see paragraph 28 of ISA 240).

<sup>10</sup> ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

<sup>11</sup> Hereafter in this issues paper, any references to “ISA 240” are indicative of extant ISA 240 as amended for the conforming and consequential amendments resulting from the approval of ISA 315 (Revised 2019) (see **Agenda Item 4-B**).

### *Fraud Project Proposal – Proposed Actions*

6. The table in paragraph 25 of the project proposal to revise ISA 240 sets out details of the proposed actions to make the auditor's risk identification and assessment process and the engagement team discussion, as they relate to fraud, more robust (see proposed actions B.4 and B.5 in the project proposal). The rest of this section focuses on the proposed actions.

### *Relevant Requirements in ISA 240*

7. The following broadly describe the current requirements within ISA 240 related to identifying and assessing the ROMMs:
- (a) The objectives – one of the objectives of ISA 240 is to “identify and assess the risks of material misstatement of the financial statements due to fraud.”
  - (b) Paragraph 16 – addresses the requirements for the engagement team discussion about fraud related matters.
  - (c) Paragraph 17 – addresses the required procedures to understand the entity and its environment and the entity's system of internal control (under extant ISA 315 (Revised)) to obtain information for use in identifying and assessing the ROMMs due to fraud, and to identify and assess the ROMMs due to fraud.
  - (d) Paragraph 18 – focuses specifically on inquiries of management and others within the entity related to the identification and assessment of ROMMs, including management's process for identifying and responding to the risks of fraud.
  - (e) Paragraphs 19 and 20 – address requirements for inquiries of management, and others within the entity, including where relevant inquiries to relevant individuals in an internal audit department, about their knowledge of any actual, suspected or alleged fraud affecting the entity.
  - (f) Paragraphs 21 and 22 – address matters related to those charged with governance (TCWG).
  - (g) Paragraph 23 – requires the auditor to evaluate whether unusual or unexpected relationships have been identified in performing analytical procedures may indicate ROMMs due to fraud.
  - (h) Paragraph 24 – addresses whether “other information” obtained by the auditor indicates a ROMM due to fraud.
  - (i) Paragraph 25 – requires the auditor to evaluate whether the information obtained from the other risk assessment procedures and related activities indicates that one or more fraud risk factors are present.
  - (j) Paragraph 26 – contains the requirement to identify and assess the ROMMs arising from fraud.
  - (k) Paragraphs 27 and 28 – contain the requirements that address the presumption that there are risks of fraud in revenue recognition and treating assessed ROMMs due to fraud as significant risks.<sup>12</sup>

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<sup>12</sup> Paragraphs 27 and 28 of ISA 240 have not been further addressed in this paper as they are subject to specific revision in terms of the project proposal.

- (l) Paragraphs A13–A28 – explain the nature of the inquiries to the relevant parties, as well as some description about what the fraud risk factors are, how they are identified and what they are used for (including introducing the concept of the “fraud triangle”).
  - (m) Appendix 1 to ISA 240 – sets out examples of fraud risk factors that may be faced by auditors in a wide range of situations.
8. The rest of this section explains the proposed changes to ISA 240 with a focus on the auditor’s risk identification and assessment due to fraud.

## Task Force’s Views and Recommendations

### *Proposed Changes to ISA 240 When Identifying and Assessing the ROMMs Due to Fraud*

- 9. ISA 315 (Revised 2019) provides the “foundational procedures” for identifying and assessing ROMMs. ISA 240 translates how those procedures can be applied with a “fraud lens.” The following sets out how changes could be made to ISA 240 to build and expand, where applicable, on the strength of the robust procedures in ISA 315 (Revised 2019) for identifying and assessing ROMMs.
- 10. ISA 240 contains various requirements related to the identification and assessment of ROMMs (as explained in paragraph 7 above). However, these requirements do not necessarily correlate to ISA 315 (Revised 2019) because:
  - (a) ISA 240 does not follow the same structure as ISA 315 (Revised 2019).
  - (b) In some cases, there is insufficient explanation in ISA 240 as to how to apply a “fraud lens” when undertaking the foundational procedures in ISA 315 (Revised 2019).
  - (c) In some cases, the required procedures in ISA 240 are perfunctory and may not drive the behavioral change that is needed to perform robust procedures to identify and assess ROMMs due to fraud.
- 11. While it is recognized that new content needs to be incorporated to strengthen and enhance the robustness of the required procedures, the Fraud Task Force has the view that restructuring ISA 240 to follow a similar structure as ISA 315 (Revised 2019) would also help demonstrate the relationship between the two standards. This action will help synchronize any changes made in ISA 240, and help auditors better connect the considerations on fraud with the foundational ISA 315 (Revised 2019) procedures.
- 12. Therefore, in addition to strengthening and enhancing the requirements and application material in ISA 240 as explained further below, the Fraud Task Force proposes restructuring the relevant paragraphs in ISA 240 to align with how ISA 315 (Revised 2019) has been arranged. The following sets out the proposed restructure of the relevant headings (the proposed revisions to the content of the paragraphs are addressed further below).

<b>Proposed New Structure for ISA 240 – Identifying and Assessing the ROMMs</b>	<b>Extant Para # Reordered</b>
<b>Risk Assessment Procedures and Related Activities</b> (revise extant paragraph 17)	17

Proposed New Structure for ISA 240 – Identifying and Assessing the ROMMs	Extant Para # Reordered
<i>Management and Others Within the Entity</i> (in conjunction with strengthening communication with TCWG, changes may be made to inquiries of management and others within the entity in extant paragraphs 18–20)	18–20
<i>Those Charged with Governance</i> (revise extant paragraphs 21–22) (see <b>Section III</b> of this paper)	21–22
<b>Information from Other Sources</b> (revise extant paragraph 24 – “Other Information”)	24
<b>Engagement Team Discussion</b> (revise extant paragraph 16)	16
<b>Obtaining an Understanding of the Entity and Its Environment</b> [NEW heading] (develop new content as per project proposal and as explained further below)	NEW
<b>Obtaining an Understanding of the Applicable Financial Reporting Framework</b> [NEW heading] (develop new content as per project proposal and as explained further below)	NEW
<b>Obtaining an Understanding of the Entity’s System of Internal Control</b> [NEW heading] (develop new content as per project proposal and as explained further below)	NEW
<b>Identifying Risks of Material Misstatement</b> [NEW heading] (revise extant paragraphs 25–26 as appropriate, and develop new content as per project proposal)	25–26
<i>Presumption of Fraud Risk in Revenue Recognition</i> (revise extant paragraph 27 as per project proposal) <sup>13</sup>	27
<i>Unusual or Unexpected Relationships Identified</i> (revise extant paragraph 23 as per project proposal) <sup>14</sup>	23
<b>Assessing Risks of Material Misstatement</b> [NEW heading] (revise extant paragraph 26 as appropriate, and develop new content as per project proposal)	26
<i>Assess Risks of Material Misstatement Due to Fraud as Significant Risks</i>	28

<sup>13</sup> Proposed changes to the content have not been addressed in this paper. Proposed actions as set out in paragraph 25 of the project proposal (B.15) will be presented to the Board in June 2022.

<sup>14</sup> Proposed changes to the content have not been addressed in this paper. Proposed actions as set out in paragraph 25 of the project proposal (B.16) will be presented to the Board in June 2022.

Proposed New Structure for ISA 240 – Identifying and Assessing the ROMMs	Extant Para # Reordered
(revise extant paragraph 28 as per project proposal) <sup>15</sup>	

13. In considering the changes to the requirements and application material that could be made to demonstrate the integrated nature of ISA 240 and ISA 315 (Revised 2019), the Fraud Task Force has focused on making the link to ISA 315 (Revised 2019) stronger and looked to emphasize the importance of the auditor’s knowledge and leveraging that information when identifying and assessing whether there are ROMMs due to fraud.

#### Risk Assessment Procedures and Related Activities (Revising Extant Paragraph 17)

14. Paragraphs 13 and 14 of ISA 315 (Revised 2019) set out that risk assessment procedures are designed and performed to obtain audit evidence as an appropriate basis for the identification and assessment of the ROMMs and the design of further audit procedures under ISA 330,<sup>16</sup> and also explain the specific types of risk assessment procedures (i.e., inquiries, analytical procedures, and observation and inspection).
15. Extant paragraph 17 of ISA 240 links to other relevant paragraphs in ISA 240 to obtain information for use in identifying the ROMMs due to fraud. To make a stronger link to the broader risk assessment procedures in ISA 315 (Revised 2019), it is proposed that extant paragraph 17 of ISA 240 be revised to refer to the relevant paragraphs in ISA 315 (Revised 2019) (i.e., paragraphs 13 and 14). Application material could be developed to clarify that the risk assessment procedures in ISA 240 are not separate from those in ISA 315 (Revised 2019) and should be done simultaneously.

#### Management and Others within the Entity (Extant Paragraphs 18–20) / Those Charged with Governance (Revising Extant Paragraphs 21–22)

16. It is also proposed that the restructure (as explained in the table in paragraph 12 above) resituate the paragraphs for the inquiries and discussions with management and TCWG to the overall “risk assessment procedures.” This would align with where the “inquiries” are situated within ISA 315 (Revised 2019). The specific revisions proposed to extant paragraphs 21–22 of ISA 240 are separately focused on in **Section III** of this paper, and, where relevant, build on the changes that are being proposed in this section. Changes may be made, where appropriate, to inquiries of management and others within the entity in extant paragraphs 18–20 of ISA 240 in conjunction with strengthening communication with TCWG, for example, see proposed revisions relating to inquiries of others in the entity in paragraphs 66–67 below. However, changes to extant paragraphs 18–20 of ISA 240 are not the focus of **Section III** of this paper since there is no proposed action in the project proposal to specifically address inquiries of management and others within the entity.

<sup>15</sup> Proposed changes to the content were not included in the project proposal. Possible drafting changes may be considered in line with the draft Complexity, Understandability, Scalability and Proportionality (CUSP) Drafting Principles and Guidelines, but no changes have been proposed to the substance of this requirement.

<sup>16</sup> ISA 330, *The Auditor’s Responses to Assessed Risks*

#### Information from Other Sources (Revising Extant Paragraph 24)

17. Paragraphs 15 and 16 of ISA 315 (Revised 2019) address “information from other sources,” including from the acceptance and continuance of client engagements, other engagements performed by the engagement partner, as well as the relevance and reliability of information from the auditor’s previous experience with the audit. The broader requirement in extant paragraph 24 of ISA 240 more generally addresses “other information.”
18. To further strengthen the linkage between ISA 315 (Revised 2019) and ISA 240, it has been proposed that the relevant requirements on “other information” follow the overall requirements for “risk assessment procedures” (as detailed in the table in paragraph 12 above).
19. Although the broad requirement to consider other information is already within ISA 315 (Revised 2019), paragraph 15(a), it is proposed that extant paragraph 24 of ISA 240 be made more specific as to the sources of other information that should be considered with a “fraud lens,” such as from:
  - (a) Acceptance and continuance procedures;
  - (b) Procedures performed under ISA 720 (Revised);<sup>17</sup> and
  - (c) Performing other procedures to gather audit evidence.
20. Application material could be developed to further explain how this information can be useful to auditors when obtaining an understanding of the entity and its environment and the entity’s system of internal control, as well as how this other relevant information may affect the auditor’s identification and assessment of ROMMs. The application material could also:
  - (a) Highlight the importance of remaining alert to emerging external indicators (such as short-selling reports, negative media attention, negative analyst reports, etc.) and emphasize the auditor’s need to evaluate the impact of such developments on their risk assessment.
  - (b) Provide examples of relevant other sources such as:
    - (i) Sustainability / Environmental, Social, and Governance disclosures that are becoming more strategic and substantial in many entities’ financial reports globally. For example, whether the information in the annual report is misleading in some way or does not align with what is being disclosed in the financial statements and that could be an indicator of fraud.
    - (ii) Non-financial disclosures that are part of the entity’s annual report (e.g., management discussion and analysis).

#### Engagement Team Discussion (Revising Extant Paragraph 16)

21. To follow the flow of ISA 315 (Revised 2019), it has been proposed that the relevant requirements on the engagement team discussion be moved to after the “risk assessment procedures and related activities” (as detailed in the table in paragraph 12 above).
22. It is proposed that the requirement in extant paragraph 16 of ISA 240 be revised to specifically address the issues that have been identified, i.e., to make the engagement team discussion more robust by linking to the requirement in paragraph 17 of ISA 315 (Revised 2019) for the engagement team discussion and:
  - (a) Focusing on the individuals at the discussion and frequency of such discussions;

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<sup>17</sup> ISA 720 (Revised), *The Auditor’s Responsibilities Relating to Other Information*

- (b) Requiring specific topics to be discussed that provide explicit consideration by the engagement team about specific aspects of fraud, such as an exchange of ideas among engagement team members about fraud risk factors;
- (c) Enhancing the related application material in ISA 240 to explain when it may be beneficial to hold further engagement team discussion(s), including when the engagement is a group audit engagement; and
- (d) Enhancing the related application material in ISA 240 for when it may be beneficial for specialists (including internal or external specialists who may provide insights related to discussions about fraud) to attend the engagement team discussion.

#### Obtaining an Understanding of the Entity and Its Environment (New)

- 23. The project proposal sets out that enhancements to ISA 240 are needed to describe the auditor's specific considerations relating to fraud when obtaining an understanding of the entity and its environment.
- 24. The overall understanding of the entity and its environment (including the specific aspects of that understanding that are required) are contained in paragraph 19(a) of ISA 315 (Revised 2019). ISA 240 does not explicitly address any aspects of the required understanding (the requirement is very broad – see extant paragraph 17 of ISA 240).
- 25. To entrench the importance of various aspects of the required understanding of the entity and its environment in the auditor's consideration of fraud, enhancements to ISA 240 could include:
  - (a) Making a more explicit link in ISA 240 to paragraph 19(a) of ISA 315 (Revised 2019), detailing the more specific aspects that are required to be understood that are fraud focused, such as the entity's strategy and business risks, the entity's key performance indicators, employee performance measures and incentive compensation policies and the environment in which the entity operates (such as the business sector in which the entity operates and any external pressures arising therefrom (e.g., high degree of competition or market saturation, accompanied by declining margins in that sector)).
  - (b) Application material could explain "why" these aspects are important when considering fraud, and further describe "how" each matter should be considered as it relates to the auditor's fraud considerations through providing examples of matters to be considered.

#### Obtaining an Understanding of the Applicable Financial Reporting Framework (New)

- 26. Specific matters relating to the auditor's consideration of fraud when obtaining an understanding of the applicable financial reporting framework were not explicitly highlighted by the information gathering and research activities for the fraud project. However, enhancements to link the requirements in ISA 240 to paragraph 19(b) of ISA 315 (Revised 2019) are proposed in line with other changes being made to have a stronger link to the foundational requirements in ISA 315 (Revised 2019).
- 27. Frauds may manifest in the application of the applicable financial reporting framework, and the project to revise ISA 315 (Revised) recognized the importance of understanding the entity's reporting practices, the selection of appropriate accounting policies and where there may be changes in financial reporting. Revisions to ISA 240 to make a stronger link to the enhanced requirements in ISA 315 (Revised 2019) could further expand on particular areas where frauds could occur, bringing in the importance of understanding the inherent risk factors and how these

may lead to susceptibility to misstatement in applying the applicable financial reporting framework. For example:

- (a) When there are complex accounting processes in preparing the financial reporting information (including those in controversial or emerging areas) and such processes may therefore be inherently more difficult to apply (i.e., complexity is an inherent risk factor) there may be greater opportunity for fraud to be perpetrated; or
- (b) When management judgment about the application of a financial reporting principle is more subjective (i.e., subjectivity is an inherent risk factor), the susceptibility to misstatement due to management bias, whether unintentional or intentional, may also increase.

28. In addition, the application material could:

- (a) Explain “why” the understanding of the application of the financial reporting framework is important with regard to where and how fraud could occur.
- (b) Explain “how” to take the inherent risk factors into account as they relate to the auditor's considerations about fraud, in particular the susceptibility to misstatement due to management bias or other fraud risk factors. Such application material could explicitly reference the relevant fraud risk factors currently contained in Appendix 1 to ISA 240 (as examples).

#### Obtaining an Understanding of the Entity's System of Internal Control (New)

- 29. The revisions to ISA 315 (Revised 2019) focused on a more robust understanding by the auditor of each of the components of the entity's system of internal control (i.e., the control environment, the entity's risk assessment process, the entity's monitoring of the system of internal control, the information system and communication, and control activities). The changes also built in scalability by explaining that the required understanding was specific to the nature and circumstances of the entity (i.e., focused on what that understanding meant in terms of work effort, as well as scalability in context) (see paragraphs 21–26 of ISA 315 (Revised 2019)).
- 30. ISA 240 only addresses the understanding of the entity's system of internal control at a high level (see extant paragraph 17 of ISA 240). In deliberating the possible changes to the required understanding, the Fraud Task Force recognized the importance of the various aspects of internal control and the auditor's considerations of relevant fraud risk factors, in particular where deficiencies in any of the components of the system of internal control have been identified (including creating a stronger link to paragraph 27 of ISA 315 (Revised 2019) dealing with deficiencies in the system of internal control). Although the requirements in ISA 315 (Revised 2019) provide a robust base for understanding the entity's system of internal control, a stronger linkage to this understanding in ISA 240 is needed to focus the auditor on areas where and how fraud could occur. Therefore, it is proposed that the requirements in ISA 240 be enhanced to reflect more specifically the auditor's “fraud lens” for each of the components of the system of internal control thereby highlighting areas that may be susceptible to fraud, as well as the impact of any related identified deficiencies.
- 31. In addition, in deliberating the possible changes to ISA 240, the Fraud Task Force is of the view that there are *key aspects* of obtaining an understanding of the entity's system of internal control that directly link to the auditor's consideration of potential fraud risk. In particular, the Fraud Task Force recognizes the need to emphasize the importance of the auditor's understanding of the entity's culture (including tone at the top) when obtaining an understanding of the control environment.

32. Application material could be developed to explain “why” the relevant aspects highlighted are important when considering fraud, and further describe “how” each matter should be considered as it relates to the auditor’s fraud considerations through providing examples of matters to be considered (e.g., for culture (including tone at the top), examples of matters that should be considered could include management’s and TCWG’s approach to changes that are made within the entity, how management and TCWG demonstrate company culture day to day, whether “bad news” is held back while overinflating “good news” (as this may instill a lack of trust in management), the approach of individuals at the entity to the audit process, etc.).
33. The approach to understanding each of the components of the system of internal control in paragraphs 21–26 of ISA 315 (Revised 2019), includes (in tabular format) a description of the matters to be understood (broadly) and with the exception of the control activities component (addressed separately below) an “evaluation” of whether that component is appropriate in context of the specific entity. In the case of the control activities component, for identified controls the evaluation is more robust (i.e., evaluating whether the control is designed effectively to address ROMMs and determining whether the control has been implemented (D&I)). In addition to assisting in the identification and assessment of ROMMs, this process helps the auditor to identify whether there are any deficiencies in the system of internal control.
34. In proposing changes to the requirements in ISA 240, it is intended to expand on the matters for the “understanding required” in ISA 315 (Revised 2019) by specifically describing what needs to be understood from a fraud perspective. For example, expanding on ISA 315 (Revised 2019), the required understanding in ISA 240 related to fraud considerations could include:
- (a) *The control environment* – emphasizing the need to understand the entity’s culture (including tone at the top) and how that impacts the entity throughout, as this component is foundational to the effective operation of the other components of the system of internal control. Any deficiencies within this component of internal control could leave the other components of internal control susceptible to fraud (e.g., through opportunities to commit fraud).
  - (b) *The entity’s risk assessment process* – focusing on how the entity’s risk assessment process (in context of the nature and circumstances of the entity) captures or considers the potential for fraud, i.e., management’s and TCWG’s approach to preventing potential fraud or detecting and correcting fraud, such as fraud risks arising from incentives or pressures on management that may result in intentional or unintentional bias. Any deficiencies identified within this component may leave risks unaddressed and therefore the risk of fraud could be increased.
  - (c) *The entity’s system for monitoring controls* – determining whether there is an effective system for monitoring the controls in place (in context of the nature and circumstances of the entity) that will help the auditor identify whether there are areas that are susceptible to misstatement due to fraud (i.e., if deficiencies from assessing risks or other components of the system of internal control are not identified and remediated).
  - (d) *The information system and communication* – focusing auditors on “why” the understanding is obtained for the purpose of identifying those areas that are susceptible to fraud. In developing application material, it is intended to focus on technology and how frauds can be perpetrated using technology (for example, multiple different information technology (IT) systems, or more bespoke IT systems, could possibly increase the susceptibility to fraud).

- (e) *Control activities* – for those controls required to be identified in paragraph 26 of ISA 315 (Revised 2019), providing examples of controls relevant to possible fraud risks. Application material could also be developed to make the link to extant paragraph 28 of ISA 240 stronger (i.e., the requirement to determine a ROMM due to fraud as a significant risk and therefore highlighting that any controls related to that risk will fall into the control activities component and require D&I). This linkage could also highlight the iterative nature of the risk identification and assessment process.

#### Identifying and Assessing the Risks of Material Misstatement

- 35. The current requirement in ISA 240 for identifying and assessing the ROMMs is broad and contains very little guidance as to how this is done with a “fraud lens.” ISA 315 (Revised 2019) has now split these requirements with the relevant requirements for identifying the ROMMs and assessing the ROMMs separated. It is proposed the same approach be followed in ISA 240. This will allow relevant changes to be made with regard to identifying possible misstatements from inherent risk and matters relating to the assessment of control risk separately:
  - (a) Application material could be developed relevant to how the inherent risk factors can be “taken into account” when identifying the ROMMs (related to inherent risks). For example, this application material could include examples explaining the impact of fraud risk factors on the identification of possible misstatements.
  - (b) Application material with examples could also be developed to explain “how” the fraud risk factors affect the auditor’s assessment of control risk.
- 36. For the assessment of the ROMMs, application material could remind auditors that if a ROMM is due to fraud risk, then it is an “automatic” significant risk (with a link to the effect on the auditor’s response to that risk).

#### Fraud Risk Factors in Appendix 1 to ISA 240

- 37. Appendix 1 to ISA 240 sets out examples of fraud risk factors that may be faced by auditors in a wide range of situations. Conforming amendments arising from the project to revise ISA 315 (Revised) have been made to further explain the interaction of the newly introduced inherent risk factors and the fraud risk factors set out in Appendix 1 to ISA 240.
- 38. As directed in the project proposal, the Fraud Task Force considered whether to move the fraud risk factors into the application material. On balance, it was agreed that the list in the appendix would be left because having such a list that specifically covered the fraud risk factors was helpful to auditors, as well as educators and others. However, it was agreed that as ISA 240 is revised and additional application material developed, where useful the fraud risk factors would be used as examples to better illustrate the auditor’s considerations. In addition, in making the revisions the Fraud Task Force would also consider whether any other fraud risk factors needed to be added to the list currently in Appendix 1 to ISA 240.

#### Approach to Drafting the Changes

- 39. In addition to applying the draft CUSP Drafting Principles and Guidelines, in making any revisions to ISA 240, the Fraud Task Force is also mindful of the approach to drafting ISA 315 (Revised 2019), and intends to follow the same approach, that is:
  - (a) The requirements will largely be focused on “what” needs to be done; and

- (b) The application material will focus on “why” and “how” to implement the relevant requirements. Targeted guidance for auditors explaining how to apply the “fraud lens” will assist auditors in consistently performing more robust procedures when identifying and assessing ROMMs.

#### **Matters for IAASB Consideration**

1. The IAASB is asked for views on restructuring ISA 240 to follow a similar flow as ISA 315 (Revised 2019) as explained in paragraph 12 above.
2. The Board is asked for its views on:
  - (a) The proposed changes to the content of the restructured ISA 240 to enhance and strengthen the procedures for identifying and assessing ROMMs due to fraud as set out in paragraphs 13–36 above.
  - (b) Maintaining Appendix 1 on the fraud risk factors in ISA 240 as set in paragraph 38 above.
3. Are there any other changes from the revisions to ISA 315 (Revised 2019) that should be addressed in ISA 240 more explicitly or any other related matters the Fraud Task Force should consider as it develops the changes to revise ISA 240?

### **Section III – Communication with Those Charged with Governance**

#### **Background**

##### *Fraud Project Proposal – Proposed Actions*

40. The table in paragraph 25 of the project proposal to revise ISA 240 sets out details of the proposed actions addressing two-way communication with TCWG, including specific discussions about the entity’s ROMMs due to fraud, and emphasizing the ongoing nature of communication with TCWG about fraud throughout the audit (see proposed action D.27 in the project proposal). The rest of this section focuses on the proposed actions.

##### *Relevant Requirements in ISA 240*

41. The following broadly describes the current requirements within ISA 240 relating to risk assessment procedures and related activities involving TCWG:
- (a) Paragraph 21 – requires the auditor to obtain an understanding of how TCWG exercises oversight of management’s processes for identifying and responding to the risks of fraud, and controls that management has established for mitigating the risks of fraud in the entity.
  - (b) Paragraph 22 – requires the auditor to make inquiries of TCWG about actual, suspected or alleged fraud affecting the entity.
42. The following broadly describes the current requirements within ISA 240 relating to communication with TCWG:
- (a) Paragraph 42 – addresses requirements for the auditor to communicate, unless all of TCWG are involved in managing the entity, with TCWG on a timely basis, identified or suspected fraud involving management, employees with significant roles in internal control, and others where the fraud results in a material misstatement.
  - (b) Paragraph 43 – addresses requirements for the auditor to communicate, unless prohibited by law or regulation, with TCWG any other matters related to fraud that are, in the auditor’s

judgment, relevant to TCWG's responsibilities.

*Overarching Framework for the Auditor's Communication with TCWG in ISA 260 (Revised)*<sup>18</sup>

43. ISA 260 (Revised) provides an overarching framework for the auditor's communication with TCWG and identifies specific matters to be communicated with them. Additional matters to be communicated, which complement the requirements of ISA 260 (Revised), are identified in other ISAs (see Appendix 1 to ISA 260 (Revised)).
44. Matters to be communicated with TCWG in accordance with ISA 260 (Revised)<sup>19</sup> include:
- (a) The auditor's responsibilities in relation to the financial statement audit;
  - (b) The planned scope and timing of the audit, including significant risks identified by the auditor;
  - (c) Significant findings from the audit; and
  - (d) In the case of listed entities, compliance with relevant ethical requirements regarding auditor independence.

*Relevant Changes Made by Different Jurisdictions Addressing Risk Assessment Procedures and Related Activities, and Communication Involving TCWG*

45. In the UK, the Financial Reporting Council (FRC) published in May 2021 [ISA \(UK\) 240 \(Revised May 2021\)](#), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*. The revisions introduced the following new requirements for inquiries, discussions and communications involving TCWG (and other individuals, where applicable):
- Make inquiries of any other individuals who deal with allegations, if any, of fraud raised by employees or other parties.
  - Discuss the risks of material fraud in the entity, including those that are specific to the relevant business sector, with TCWG.
  - Evaluate the impact on the audit of any inconsistencies between responses to fraud inquiries of TCWG, or others within the entity, with the responses to inquiries of management.
  - Consider the matters, if any, to communicate to TCWG regarding management's process for identifying and responding to risks of fraud in the entity and the auditor's assessment of the ROMMs due to fraud.
46. In Japan, the Business Accounting Council established in 2013 a standard titled "[Standard to Address Risks of Fraud in an Audit](#)," applicable to publicly traded companies. The standard introduced relevant requirements addressing:
- Inquiries of management, TCWG, and others within the entity as appropriate, regarding the facts and knowledge that they have in relation to the risks of fraud.
  - Communication with TCWG (including appropriate discussions with TCWG) according to the nature and significance of the risks of fraud, at each stage during the audit.

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<sup>18</sup> ISA 260 (Revised), *Communication with Those Charged with Governance*

<sup>19</sup> See ISA 260 (Revised), paragraphs 14-17 and A9-A32.

- Communication with TCWG as soon as practicable when the auditor has determined that a suspicion of a material misstatement due to fraud exists. Discussions with TCWG address the nature, timing and extent of audit procedures necessary to complete the audit.
- Discussions with TCWG where the auditor suspects fraud involving management and requesting management to take appropriate remedial action. In such instances, the auditor also evaluates the effect of the fraud on the financial statements.

### **Task Force's Views and Recommendations**

#### *Proposed Changes to ISA 240 Addressing Communication with TCWG*

47. The Fraud Task Force recognizes the importance of two-way communication through specific discussions with TCWG about fraud-related matters and emphasizing the ongoing nature of communication with TCWG about fraud throughout the audit. This two-way communication may be performed as part of the auditor's related activities to obtain audit evidence that provides an appropriate basis for the identification and assessment of the ROMMs due to fraud in ISA 240. In addition, this two-way communication, together with the inquiries of TCWG in accordance with extant paragraph 22 of ISA 240, could be made in part to determine whether the responses of TCWG (and others within the entity) corroborate or contradict the responses to the inquiries of management (see paragraphs 66–67 below).
48. The Fraud Task Force also intends to leverage the overarching framework provided in ISA 260 (Revised) in developing proposed changes to ISA 240. This overarching framework assists auditors in determining:
  - (a) The fraud-related matters to be discussed as part of the two-way communication with TCWG (i.e., what to discuss and communicate).
  - (b) The appropriate person(s) within the entity's governance structure to be involved in the two-way communication with TCWG (i.e., with whom to discuss and communicate). It is crucial that the appropriate member(s) of the engagement team are assigned to participate in the two-way communication with TCWG.
  - (c) The timing of the communication with TCWG (i.e., when to discuss and communicate).

#### **Determining Fraud-Related Matters to Be Discussed as Part of the Two-Way Communication with TCWG**

49. The specific fraud-related matters to be discussed that could form part of the two-way communication with TCWG are outlined in the table in paragraph 54 below. These were developed when considering the matters to be discussed as noted in the project proposal, the revisions to ISA 315 (Revised 2019), as well as considering the current requirements when communicating with TCWG in ISA 240 and ISA 260 (Revised) as described in paragraphs 41–44 above.
50. Further, the Fraud Task Force notes that ISA 260 (Revised) already requires the auditor to communicate with TCWG the significant risks identified by the auditor. By complying with this requirement, the auditor effectively covers the communication of the auditor's assessment of the ROMMs due to fraud, given that the auditor is required to treat all assessed ROMMs due to fraud as significant risks.
51. However, the Fraud Task Force is of the view that specifically discussing the auditor's assessment of the ROMMs due to fraud could enhance audit quality by giving it added emphasis.

In this regard, the Fraud Task Force believes that such a discussion would further support effective two-way communication by providing TCWG insight into those areas for which the auditor determined specific fraud considerations were necessary, and thereby assists TCWG in fulfilling their responsibility in relation to the prevention and detection of fraud as addressed in ISA 240.<sup>20</sup>

52. In order to encourage effective two-way communication, the Fraud Task Force is of the view that the location of the proposed changes to ISA 240 is important because it could positively influence auditor behavior by driving the timeliness of the auditor's interactions with TCWG. Hence, the Fraud Task Force recommends that the location of such proposed changes be included along with the other requirements for TCWG in the "risk assessment procedures and related activities" section in revised ISA 240.

Specific discussions as part of the two-way communication involving TCWG in ISA 240

53. Based on the Fraud Task Force's deliberations on this topic, a key consideration is whether to expand upon the current requirements in extant paragraphs 21–22 of ISA 240, or whether to establish a new requirement that addresses the enhanced two-way communication that outlines the specific fraud-related matters to discuss. The Fraud Task Force is of the view that a new requirement would provide the necessary focus to drive the desired auditor behavior.
54. It is proposed that the new requirement be added in ISA 240 for the auditor to have two-way discussions with TCWG about the specific fraud-related matters outlined in the table below. The requirement could be placed between extant paragraphs 21 and 22 of ISA 240.

	Specific Fraud-Related Matters to be Discussed	Suggested Location in Revised ISA 240
<b>Identification of ROMMs</b>		Risk Assessment Procedures and Related Activities <i>Two-Way Communication</i>
(a)	The fraud risk factors present in the entity, including those that are specific to the entity's business sector. <sup>21</sup>	
(b)	Possible areas that are susceptible to misstatement due to management bias.	
(c)	The auditor's evaluation of the components of the entity's system of internal control (undertaken in accordance with ISA 315 (Revised 2019)) where such evaluation indicates that one or more fraud risk factors are present, as well as any identified control deficiencies and possible (or actual) misstatements due to fraud arising from those deficiencies, and the remediation to address such deficiencies and possible (or actual) misstatements.	

<sup>20</sup> See ISA 240 paragraph 4.

<sup>21</sup> The Fraud Task Force notes that new paragraph 21-1 has been added in ISA (UK) 240 (Revised May 2021) for the auditor to have a specific discussion with TCWG on the risks of material fraud in the audited entity, including those with business sector specific relevance.

	Specific Fraud-Related Matters to be Discussed	Suggested Location in Revised ISA 240
	<b>Assessment of ROMMs</b>	
(d)	The auditor's assessment of the ROMMs due to fraud. <sup>22</sup>	

55. The Fraud Task Force notes that such a requirement should allow for the two-way communication to occur with the appropriate person(s) within the entity (i.e., it needs to be scalable). For example, in a large multinational entity, TCWG may not necessarily have the detailed knowledge to respond to specific fraud-related discussions, rather TCWG may have an overview of management's processes for identifying and responding to the risks of fraud in the entity. Alternatively, in a less complex entity, where TCWG are involved with managing the entity, it is likely that TCWG are able to enter into two-way communication with the auditor and discuss all the matters noted in the table above at a more granular level. The matter of the appropriate person(s) with whom to communicate is further addressed in paragraphs 58–59 below.
56. In addition, new application material in ISA 240 could be developed to support the new requirement (including, where relevant, examples to illustrate matters that could be discussed with TCWG), including:
- (a) *Explaining “why” a two-way discussion is important* to the auditor's understanding, as well as highlighting that these discussions may result in the auditor having to update their risk identification and assessment in light of any new information (i.e., to illustrate the iterative nature of the standards).
  - (b) The *fraud risk factors* present in the entity (relating to both inherent risk and control risk). For example, this could include those fraud risk factors identified from the auditor's understanding of the entity and its environment, such as those that are specific to the entity's business sector (e.g., a high degree of competition or market saturation, accompanied by declining margins in that business sector or other information obtained from external sources (e.g., short-selling reports, negative media attention)).
  - (c) *Possible areas that are susceptible to misstatement due to management bias*. For example, management bias over the accounting for unusual or complex transactions, including those in controversial or emerging areas, which may be susceptible to fraudulent financial reporting. Explaining that management bias is often associated with certain events or conditions that have the potential to give rise to management not maintaining neutrality in exercising judgment (indicators of potential management bias), which could lead to a material misstatement of the information that would be fraudulent if intentional.
  - (d) The evaluation of the components of the entity's *system of internal control and related identified deficiencies* (i.e., 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:

<sup>22</sup> The Fraud Task Force notes that paragraph 42 of ISA (UK) 240 (Revised May 2021) has been supplemented to require that in communicating matters related to fraud, the auditor shall consider the matters, if any, to communicate regarding management's process for identifying and responding to the risks of fraud in the entity and the auditor's assessment of the ROMMs due to fraud.

- (i) 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. Explaining that such information may affect the auditor's consideration of the effect on the reasonableness of significant assumptions made by, and the expectations of, management.
- (ii) The effect on the risk identification and assessment of identified deficiencies in the components of the entity's system of internal control, including obtaining TCWG perspectives on these matters.

Determining Appropriate Person(s) Within the Entity's Governance Structure and Assigning Appropriate Member(s) of the Engagement Team to Participate in the Two-Way Communication with TCWG

57. The Fraud Task Force notes that determining the appropriate person(s) within the entity and assigning the appropriate member(s) within the engagement team to be involved in the two-way communication with TCWG in ISA 240 are important.

Determining appropriate person(s) within the entity

58. Based on the Fraud Task Force's deliberations on this topic, understanding the governance structures within the entity (when obtaining an understanding of the entity and its environment and the entity's system of internal control under ISA 315 (Revised 2019)) is a key auditor consideration that would need to be emphasized within the proposed revisions to ISA 240 when determining appropriate person(s) within the entity with whom to discuss or communicate matters regarding fraud.
59. ISA 260 (Revised)<sup>23</sup> already requires the auditor to "determine the appropriate person(s) within the entity's governance structure with whom to communicate." ISA 260 (Revised)<sup>24</sup> also includes requirements when communicating with a subgroup of TCWG, and when all of TCWG are involved in managing the entity. The Fraud Task Force is of the view that by leveraging current requirements in ISA 260 (Revised), the auditor should be able to appropriately determine with whom to have the required fraud-related discussions, recognizing that in certain instances this may be with different persons. Therefore, no further changes to ISA 240 are proposed.

Assigning appropriate member(s) within the engagement team<sup>25</sup>

60. When assigning the appropriate member(s) within the engagement team to perform the two-way communication with TCWG in revised ISA 240, the Fraud Task Force highlights the importance of assigning the performance of such procedures to appropriately skilled or suitably experienced members of the engagement team in accordance with ISA 220 (Revised).<sup>26</sup> The Fraud Task Force proposes that the changes to ISA 240 (i.e., new application material) highlight linkages to paragraphs 26 and 28 in ISA 220 (Revised) whereby the engagement partner needs to determine that the members of the engagement team, collectively have the appropriate competence and

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<sup>23</sup> See ISA 260 (Revised), paragraphs 11 and A1-A4.

<sup>24</sup> See ISA 260 (Revised), paragraphs 12 and A5-A7, and 13 and A8.

<sup>25</sup> The need for specialized skills, including forensic skills, have not been addressed in this paper as such topic will be separately addressed in the fraud project (see proposed action A.3 in the project proposal) and presented to the Board in June 2022.

<sup>26</sup> ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*

capabilities, and takes responsibility for the appropriate use of the resources assigned or made available to the engagement team.

61. The Fraud Task Force notes that ISA 240<sup>27</sup> already includes a direction, supervision, review requirement when determining overall responses to address the assessed ROMMs due to fraud. ISA 240 requires the auditor to assign and supervise personnel taking account of the knowledge, skill and ability of the individuals to be given significant engagement responsibilities and the auditor's assessment of the ROMMs due to fraud for the engagement. New application material in ISA 240 could be developed to emphasize that appropriate direction, supervision and review is equally important when performing the communications required by ISA 240 and in assigning the "right people" within the engagement team to perform the risk assessment procedures and related activities with a "fraud lens." This includes involving appropriately skilled or suitably experienced members of the engagement team in communication with TCWG.

#### Determining the Timing of the Communication with TCWG

##### Emphasizing the ongoing nature of communication with TCWG

62. The Fraud Task Force is of the view that emphasizing the ongoing nature of all communications with TCWG about fraud throughout the audit is an important aspect of effective two-way communication.
63. The Fraud Task Force notes that ISA 260 (Revised)<sup>28</sup> already requires the auditor to communicate with TCWG on a timely basis. In addition, relevant application material in ISA 260 (Revised)<sup>29</sup> provides guidance that the timely communication throughout the audit contributes to the achievement of a robust two-way dialogue between TCWG and the auditor. However, the appropriate timing for communications will vary with the circumstances of the engagement. Relevant circumstances include the significance and nature of the matter, and the action expected to be taken by TCWG. Application material in ISA 260 (Revised)<sup>30</sup> provides other factors that may be relevant to the timing of the communication. These ongoing communications may also assist TCWG in fulfilling their responsibility in relation to the prevention and detection of fraud as addressed in ISA 240. The Fraud Task Force developed two options for Board consideration.

##### Option 1 – proposed new requirement

64. To emphasize the ongoing nature of communication with TCWG about fraud throughout the audit, the Fraud Task Force is of the view that a possible new requirement in ISA 240 could supplement the original requirement in ISA 260 (Revised) regarding the timing of communication. The possible new requirement (which could be placed before extant paragraph 42 of ISA 240) could require the auditor to communicate with TCWG matters related to fraud at appropriate times throughout the audit. New application material could provide examples of the nature of communications that may occur at certain times during the audit process. It could further emphasize that the timely communication with TCWG of matters related to fraud throughout the audit contributes to the achievement of robust two-way dialogue between TCWG, and the auditor.

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<sup>27</sup> See ISA 240, paragraphs 30(a) and A35-A36.

<sup>28</sup> See ISA 260 (Revised), paragraph 21.

<sup>29</sup> See ISA 260 (Revised), paragraph A49.

<sup>30</sup> See ISA 260 (Revised), paragraph A50.

#### Option 2 – proposed new application material

65. New application material, in support of the current requirement in extant paragraph 43 of ISA 240, could be developed emphasizing the importance of communicating with TCWG at appropriate times throughout the audit those matters relating to fraud.

#### Corroborating Inquiries of Management with TCWG

66. The last sentence of extant paragraph 22 of ISA 240 indicates that inquiries of TCWG are made in part to corroborate the responses to the inquiries of management. The Fraud Task Force acknowledges that inquiries of others, such as the appropriate individuals in the internal audit function as referenced in extant paragraph 20 of ISA 240, may also serve to corroborate or contradict the responses to the inquiries of management.
67. In order to enhance these inquiries, the Fraud Task Force proposes that the last sentence of extant paragraph 22 of ISA 240, which is specific to inquiries with TCWG, be supplemented (see text in bold and italics) by indicating that inquiries of TCWG are made in part to ***determine whether the responses of TCWG corroborate or contradict, or are consistent or inconsistent with*** the responses to the inquiries of management.<sup>31</sup> Further, if the responses are contradictory or inconsistent then the auditor would be required to determine the implications for the audit in accordance with ISA 500.<sup>3233</sup> A similar approach may possibly be taken to enhance the requirements in ISA 240 to also address inquiries of others within the entity.

#### Assessing Whether the Remediation Measures Taken by Management and TCWG for Identified or Suspected Fraud are Appropriate

68. Following the proposed required two-way communication with TCWG, including discussions about the identified control deficiencies and misstatements due to fraud, and the remediation measures to address such deficiencies and misstatements (see paragraph 54(c) above), the Fraud Task Force proposes to develop a new requirement for the auditor to assess whether the remediation measures are appropriate. New application material could be developed to explain “why” and “how” such assessment is relevant to the auditor’s identification and assessment of ROMMs due to fraud, and to designing and performing appropriate responses to those risks.

#### Clarifying that the Effective Participation by TCWG Is Influenced by Their Independence from Management and Their Ability to Objectively Evaluate the Actions of Management

69. ISA 240<sup>34</sup> requires the auditor to obtain an understanding of how TCWG 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 mitigate these risks.

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<sup>31</sup> The Task Force notes that the last sentence of paragraph 21 in ISA (UK) 240 (Revised May 2021) has been supplemented to clarify that the inquiries with TCWG are made in part to determine whether the responses of TCWG corroborate or contradict the responses to the inquiries of management.

<sup>32</sup> The Task Force notes that new paragraph 21-2 was added in ISA (UK) 240 (Revised May 2021) to emphasize that if the responses to inquiries of TCWG, or others within the entity, are inconsistent with the responses to the inquiries of management, the auditor shall determine the implications for the audit in accordance with ISA (UK) 500.

<sup>33</sup> ISA 500, *Audit Evidence*

<sup>34</sup> See ISA 240, paragraph 21

70. Also, ISA 315 (Revised 2019)<sup>35</sup> provides guidance that an entity's control consciousness is influenced by TCWG, because one of their roles is to counterbalance pressures on management in relation to financial reporting that may arise from market demands or remuneration schemes. The effectiveness of the design of the control environment on participation by TCWG is therefore influenced by such matters as their independence from management and their ability to evaluate the actions of management.
71. The Fraud Task Force proposes to add new application material in ISA 240 to clarify that the effective participation by TCWG is influenced by their independence from management and their ability to objectively evaluate the actions of management. For example, evaluation by TCWG of the entity's susceptibilities to misstatement due to management bias. This proposed new application material in ISA 240 could be developed leveraging the original guidance provided in ISA 315 (Revised 2019).
72. In addition, the new application material could address those circumstances when the independence of TCWG from management is adversely affected and the auditor's consideration of the resulting implications for the audit. Depending on the nature and extent of impairment of TCWG's ability to objectively assess the actions of management, the application material could highlight possible actions that the auditor may consider, including for example, performing additional or alternative risk assessment procedures or further audit procedures, seeking legal advice, or considering whether to continue the engagement.

#### **Matters for IAASB Consideration**

4. The Board is asked for its views on the proposed changes in ISA 240 to enhance the two-way communication with TCWG and emphasize the ongoing nature of communication with TCWG about fraud throughout the audit (see paragraphs 47–72 above).
5. Are there any other changes that should be addressed in ISA 240 to enhance the communication with TCWG or any other related matters the Fraud Task Force should consider as it develops the changes to revise ISA 240?

## **Section IV – Transparency in Reporting on Fraud**

### **Background**

#### *Fraud Project Proposal – Proposed Actions*

73. The table in paragraph 25 of the project proposal to revise ISA 240 sets out the proposed actions addressing transparency in reporting on fraud. In particular, it proposed that the IAASB explore the need for more transparency in the auditor's report describing fraud-related matters, and if needed, how this may be done (see proposed action D.27 in the project proposal), and related revisions to requirements and enhancements to application material.

#### *Overview*

74. Several times over the last decade the Board discussed enhanced transparency in the auditor's report on the auditor's responsibilities related to fraud and whether to include the auditor's specific procedures performed to address ROMMs due to fraud. This section provides a high-level overview of the discussions and the Board's decisions to date.

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<sup>35</sup> See ISA 315 (Revised 2019), Appendix 3, paragraph 5.

## Auditor Reporting



75. In December 2009, the IAASB discussed the results of academic research in relation to informational value of the auditor's report and in May 2011 the Board issued a [Consultation Paper](#), *Enhancing the Value of Auditor Reporting: Exploring Options for Change*, to consult on the topic of auditor communications.
76. Among other matters, the Consultation Paper provided an explanation about the expectation gap and highlighted that "there continues to be a difference between public perceptions about the auditor's ability to detect financial statement fraud and the auditor's responsibilities relating to fraud under existing professional standards." The Consultation Paper further noted that "generally-worded paragraphs do little, if anything, to bridge the expectation gap relating to the financial statement audit" and that "some are of the view that the generally-worded paragraphs could say more about the respective responsibilities of management and of the auditor (for example, regarding fraud, going concern, risk, non-financial disclosures or auditor independence). In particular, it had been suggested that providing an expanded description of the auditor's responsibilities for the detection of fraud would be especially helpful in addressing the expectation gap."
77. In December 2011, a [summary of respondents' comments](#) on the Consultation Paper was discussed by the Board. It was noted that "many respondents, including users, auditors, regulators and preparers, expressed support for including standard wording in the auditor's report that highlights the auditor's responsibility for planning and performing the audit to obtain reasonable assurance that the financial statements, taken as a whole, are free of material misstatement, "whether due to error or fraud." There was some suggestion that part of the expectations gap results from the incorrect assumption that auditors have a broader responsibility to detect fraud (rather than fraud in the context of material misstatements), and that clarification of the responsibilities within the auditor's report, combined with other educational initiatives ..., may assist in this regard."
78. In response, the Auditor Reporting Working Group was of the view that they should explore increasing transparency to the audit process by enhancing the description of the auditor's responsibilities relating to fraud, disclosures, and other information.
79. The Board agreed with this as the June 2012 [Invitation to Comment: Improving the Auditor's Report](#) (ITC) included proposed enhancements to the description of the auditor's responsibilities in the auditor's report. The enhancements included a fuller description of the auditor's responsibilities in relation to specific matters cited as most important to users of the financial statements, including fraud.
80. Respondents to the ITC broadly agreed with the enhanced description of the auditor's responsibilities in the auditor's report. After the ITC, the Board continued to enhance the description of the auditor's responsibilities in the auditor's report but did not change the description significantly. See **Appendix 3** for an overview of what ISA 700 (Revised) requires to

be included in the auditor's report in relation to the responsibilities of management, TCWG and the auditor.

81. Except for clarifying the auditor's responsibilities in the auditor's report, including related to fraud, the Board did not further discuss whether to include in the auditor's report specific procedures or findings performed to address the ROMMs due to fraud. There were several reasons for that:
- The Board focused on key audit matters (KAMs) and going concern, given that these topics were deemed a higher priority. In addition, respondents to the ITC had concerns about the length of the auditor's report and the Board had to balance these views with the request for additional disclosures related to KAMs and going concern.
  - KAMs were deemed to (partly) address concerns that more transparency is needed about the auditor's work in relation to fraud in an audit of financial statements.
  - There were concerns of auditors disclosing "original information" in KAMs. Fraud was specifically noted as an area where this could be the case as entities may not have financial statement disclosures about their approach to managing the risk of fraud.
  - Respondents who commented that more transparency is needed about the auditor's work in relation to fraud in an audit of financial statements, had mixed views on what additional information should be included in the auditor's report.
82. The IAASB discussed whether KAMs communicated in the auditor's report might include matters related to fraud. For example, the [Exposure Draft](#) (issued in July 2013) included illustrative KAMs, including a KAM related to the fraud risk in revenue recognition of long-term contracts. Such examples were not included in the new and revised Auditor Reporting Standards<sup>36</sup> as the IAASB was of the view that practice should evolve and that KAMs should be specific to the entity and the facts and circumstances. Instead, the IAASB agreed that a limited number of examples of KAMs could be provided in [non-authoritative Staff guidance](#) to be issued concurrently with the final standards, rather than include such examples in ISA 700 (Revised) or ISA 701. Doing so would allow flexibility for the IAASB to refine the examples over time, if necessary, and also highlight other national developments and real-time examples.

#### Auditor Reporting Post Implementation Review

83. Given the significance of the new and revised Auditor Reporting Standards and the importance of improving communication between auditors and users of auditor's reports, the IAASB undertook a post-implementation review (PIR) of these new and revised standards. As part of the PIR, the IAASB published the Auditor Reporting PIR Stakeholder Survey in July 2020. The survey focused on the enhancements that were made to the auditor's report and, therefore, did not include a specific question related to transparency on fraud in the auditor's report.
84. In June 2021, the IAASB published a [Feedback Statement](#) summarizing key themes raised in response to the survey. A limited number of respondents asked the IAASB to explore what could

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<sup>36</sup> The new and revised Auditor Reporting Standards were approved by the IAASB in 2014 and issued in January 2015, after due process approval by the Public Interest Oversight Board. The new and revised Auditor Reporting Standards comprise: ISA 700 (Revised); ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*; ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*; ISA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*; ISA 570 (Revised), *Going Concern*; ISA 260 (Revised); and conforming amendments to other ISAs.

be done to enhance the transparency of the auditor's report in relation to fraud. Given that input, the Feedback Statement noted the following:

*Some support to explore communication about what the auditor has done with respect to fraud given the existing "expectation gap."*

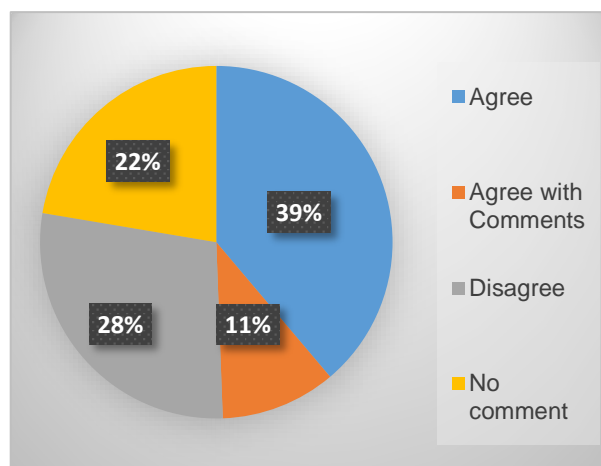
85. The auditor reporting PIR was concluded in September 2021 when the Board discussed and accepted the final recommendations of the Auditor Reporting Implementation Working Group. These recommendations included that the Auditor Reporting Implementation Working Group will continue to provide support and input to the Fraud Task Force as the Fraud Task Force explores further actions addressing transparency in the auditor's report. Subsequent discussions between Staff supporting the Fraud Task Force and Staff supporting the Auditor Reporting Implementation Working Group confirmed the original feedback from stakeholders as cited, above.

#### Fraud (Revision of ISA 240)

86. In September 2020 the Fraud and Going Concern Working Groups published a Discussion Paper, [\*Fraud and Going Concern in an Audit of Financial Statements\*](#). The Discussion Paper included a question on whether more transparency is needed about the auditor's work in relation to fraud in an audit of financial statements (Question 2(d)). If the response was affirmative, the Discussion Paper posed a follow-on question, asking what additional information is needed and how should this information be communicated. See paragraphs 87 and 88 below for a high-level summary of respondents' suggestions.

87. When analyzing this question just for the responses related to transparency in the auditor's report, responses were as follows (see the NVivo report for further details – Agenda item 3-A.7 of the April 2021 Board meeting):<sup>37</sup>

- 33 respondents agreed that more transparency is needed about the auditor's work in relation to fraud in an audit of financial statements, including one Monitoring Group member – 39%;
- 9 respondents agreed that more transparency is needed about the auditor's work in relation to fraud in an audit of financial statements but had comments or concerns – 11%;
- 24 respondents did not agree that more transparency is needed about the auditor's work in relation to fraud in an audit of financial statements – 28%; and
- 19 respondents did not have a specific response, including three Monitoring Group members – 22%.



88. Respondents who agreed that more transparency is needed about the auditor's work in relation to fraud in an audit of financial statements, had mixed views about what additional information in

<sup>37</sup> For more information about the comments made in relation to transparency in the auditor's report, see [Agenda Item 3](#) of the April 2021 Board meeting, paragraphs 79-83.

the auditor's report would provide the transparency being sought. Respondents were also of the view that more transparency in the auditor's report should not be seen as an alternative to carrying out appropriate audit procedures and enhanced requirements in the revised ISA 240.

89. The Fraud Working Group presented the feedback from the Discussion Paper at the July 2021 IAASB meeting, and the Board discussed the most appropriate way forward.
90. The Board had mixed views about the most appropriate way forward, but there was agreement that further consideration is needed as to whether more transparency in the auditor's report is needed and exploration of how this could be done. Broadly:
- Board members strongly encouraged the Fraud Working Group to further explore transparency in the auditor's report to determine the most appropriate way to address this key public interest issue. For example, Board members encouraged continued monitoring of changes made in local jurisdictions (e.g., the UK) for increased transparency related to fraud in the auditor's report.
  - Some Board members strongly encouraged consideration of standard-setting in this area to require more transparency in the auditor's report.
  - Some Board members expressed strong concern with requiring more transparency in the auditor's report related to fraud.
  - Some Board members encouraged the use of the existing KAM mechanism in ISA 701 to enhance transparency on fraud-related matters in the auditor's report. Board members encouraged the Fraud Working Group to remain open to solutions that may require standard-setting actions to revise or add application material in ISA 701.
91. In December 2021, the Board approved the [project proposal](#) to revise ISA 240. Because of the mixed views expressed at the July 2021 IAASB meeting with regard to the way forward on transparency in the auditor's report (see paragraph 90 above), the project proposal set out that the IAASB will "explore revisions to requirements and enhancements to application material to determine the need for more transparency in the auditor's report describing fraud-related matters, and if needed, how this may be done, ..."

#### Public Interest Oversight Board

92. Quarterly the Public Interest Oversight Board (PIOB) publishes an overview of the public interest issues related to the IAASB's projects. In its December 2021 overview (as updated on February 1, 2022), the PIOB noted the following related to the transparency in the auditor's report:

***"Reporting of instances of suspected or potential fraud"***

*Auditors should not only report fraud that they identify, but also provide early warning of suspected fraud or the risk of potential fraud. Requirements for communication with those charged with governance, external authorities and in the auditor's report should ensure appropriate communication of fraud risks, procedures performed and deficiencies identified by the auditor, and whether management has taken appropriate action to address the risks and deficiencies. The PIOB supports the inclusion of enhanced transparency, through communication with TCWG and reporting requirements in ISA 240 and other ISAs, among the objectives of the Fraud project proposal."*

## Fraud Initiatives in Other Countries

### UK

93. In 2016, the UK FRC updated their equivalent of ISA 700 (Revised) (i.e., ISA (UK) 700) for changes to the European Union's (EU) legislation. This included enhanced fraud disclosures as required by Article 10 of the EU Audit Regulation for Auditor Reports on Public Interest Entities (PIEs). Article 10 requires the auditor's report to "explain to what extent the statutory audit was considered capable of detecting irregularities, including fraud." These changes were effective as of June 2016. When ISA (UK) 700 was revised in 2019 following a post implementation review of the changes to the EU legislation, the FRC extended that requirement to apply to all audits, not just audits of PIEs.<sup>38</sup> ISA (UK) 700 (Revised November 2019) states that:

#### *Irregularities including Fraud*

*29-1. The auditor's report shall explain to what extent the audit was considered capable of detecting irregularities, including fraud. (Ref: Para. A39-1–A39-6)*

94. Another revision was made in May 2021. This new revision does not change requirement 29-1 in ISA (UK) 700 (Revised November 2019), but is intended to emphasize that the explanation should not be boilerplate. ISA (UK) 240 (Revised May 2021) states that:

*39-1. As required by ISA (UK) 700, the auditor's report shall explain to what extent the audit was considered capable of detecting irregularities, including fraud<sup>39</sup>. The explanation shall be specific to the circumstances of the audited entity and take account of how the auditor planned and performed procedures to address the identification and assessment of the risks of material misstatement.*

95. **Supplement to Agenda Item 4** includes several examples of fraud disclosures in UK auditor's reports.

### Netherlands

96. Similar to the UK, reviews into audit quality and effectiveness were performed in the Netherlands from 2017–2020. In one of those reviews, mandatory disclosures in the auditor's report on going concern and fraud were identified as matters that could enhance the value of, and restore trust in, the audit. In response, the Nederlandse Beroepsorganisatie van Accountants (NBA) formed a working group that issued an Exposure Draft in September 2021.
97. Key matters raised by respondents to the NBA Exposure Draft included the following in relation to more transparency in the auditor's report describing fraud related matters:
- (a) *Scope of the requirements.* Respondents had mixed views on when the auditor's report should include a section on fraud. Some respondents were of the view that such a section should always be included in the auditor's report, while others were of the view that the auditor should only include such a section when there is "something" to report. Because of the mixed views, the NBA decided that when a fraud risk required significant auditor attention, the auditor should have a section in the auditor's report which may include:

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<sup>38</sup> In December 2019, a review into the quality and effectiveness of the audit in the UK was completed by Sir Donald Brydon, which included recommendations for improvements related to fraud and going concern (the Brydon report). The Brydon report considered broader questions about what the expectations of auditors are, or should be, in respect of fraud, and the legal and regulatory framework which is required to deliver on those expectations.

<sup>39</sup> ISA (UK) 700 (Revised November 2019), *Forming an Opinion and Reporting on Financial Statements*, paragraph 29-1

- The fraud risks that required significant auditor attention during the audit;
- Reference to disclosures, if any, in the financial statements;
- A brief overview of the procedures performed;
- An indication of the outcome of the auditor's procedures; or
- Key observations with respect to the matter.

When a fraud risk did not require significant auditor attention, the auditor may summarize the work performed, the outcome and observations. In all cases, the auditor should avoid boiler plate language.

- (b) *Specific findings and observations.* A majority of respondents did not agree with including specific findings and observations in the section on fraud in the auditor's report. In finalizing the standard, the NBA recognized that (i) including specific findings and observations may enhance the informational value of the auditor's report, and (ii) that preparers of financial statements should also be more transparent about what they do to address fraud risks. Accordingly, the wording in the standard is purposely closely aligned with ISA 701 as ISA 701 also does not require a description of the specific findings and observations. However, it has been observed over time that auditors are more regularly including specific findings and observations in KAMs.
- (c) *Laws and regulations.* Respondents agreed to limit the auditor's disclosures to fraud only and not expand it to include the auditor's responsibilities to consider laws and regulations in an audit of financial statements.
98. In December 2021, the NBA approved new requirements and application material to be included in its equivalent of ISA 700 (Revised). For PIEs, the new disclosure requirements are effective for audits of financial statements beginning on or after January 1, 2021 (i.e., 2021 audits). For all other audits in scope, the new requirements will be effective for 2022 audits. The NBA will develop implementation guidance and is monitoring the implementation of the new requirements and application material.
99. See **Appendix 4** for Staff's translation of the new requirements and related application material. **Supplement to Agenda Item 4** includes several examples of recent fraud disclosures in Dutch auditor's reports.

### Task Force's View on the Way Forward

100. Because of the significant mixed views on this matter, this section sets out various alternatives to be considered, and a path on how further feedback can be obtained from users of the financial statements that will help inform the Board's direction on the way forward. After the March 2022 meeting, the Fraud Task Force will reach out to users of the financial statements to obtain their views on the alternatives being considered (see paragraph 104 below for the alternatives being considered).

### General

101. Based on the work performed to date as explained above, the Fraud Task Force notes that transparency in the auditor's report about fraud is a persistent theme that has come through since the IAASB's project on auditor reporting commenced, as discussed above. Despite previous consultations and enhancements to the auditor's report, it appears that this matter has not been satisfactorily resolved.

102. Given the mixed views on this topic by respondents to the Discussion Paper (see paragraph 87 above) and by the Board (see paragraph 90 above), the Fraud Task Force is moving to find an appropriate way forward that balances the different views, recognizing that there will always be robust discussions on this topic reflecting differing perspectives. The Monitoring Group's Public Interest Framework (PIF)<sup>40</sup> highlights that standard-setting should focus primarily on the interests of users of financial statements. Therefore, the Fraud Task Force intends to undertake targeted outreach to users of general-purpose financial reports to obtain their views on specific alternatives as presented in paragraph 104 below. In addition, the Fraud Task Force intends to share examples of recent fraud disclosures in UK and Dutch auditor's reports (as included in the **Supplement to Agenda Item 4**). This targeted outreach will help inform the Board about what additional information they are looking for from the auditor to provide greater transparency about the audit that was performed with regard to fraud, thereby informing changes to meet their needs.
103. When performing such targeted outreach, the Fraud Task Force will explore:
- What additional informational should be disclosed in the auditor's report in relation to fraud (e.g., the nature of the information that is needed, how entity specific that information needs to be or whether further clarification of the general statements about the auditor's responsibilities relating to fraud will suffice); and
  - Whether such information is needed in all cases or only for certain types of entities (e.g., for listed entities only).

The Fraud Task Force is considering who the users of financial statements with whom it can liaise with on the alternatives presented in this section. Users of the financial statements may include (institutional) investors, financial analysts, securities regulators, lenders and other creditors and public sector authorities. Board members are encouraged to share any contacts they may have with or about users of the financial statements with Staff supporting the Fraud Task Force to help the Fraud Task Force in identifying such users or user representative groups to reach out to.

#### *Additional Information to Be Disclosed*

104. In working through the responses to the Discussion Paper and considering the initiatives in the UK and the Netherlands, the Fraud Task Force identified several alternatives for the way forward (see table below).

Alternative	Possible Benefits for Users of the Financial Statements	Possible Challenges for Users of the Financial Statements
<b>Alternative 1</b>  Detailed description of the fraud risks identified, the auditor's response and the auditor's	<ul style="list-style-type: none"> <li>• Reduces aspects of the expectation gap (knowledge gap) in that users of the financial report understand what</li> </ul>	<ul style="list-style-type: none"> <li>• Auditor's reports may become long and difficult to understand because of too much information especially</li> </ul>

<sup>40</sup> See the PIF's section on "For whom are standards developed?" (on pages 20-21 of the Monitoring Group's report, "Strengthening the International Audit and Ethics Standard-Setting System").

Alternative	Possible Benefits for Users of the Financial Statements	Possible Challenges for Users of the Financial Statements
findings/ observations.	<p>the auditor has done in relation to fraud.</p> <ul style="list-style-type: none"> <li>Entity specific.</li> <li>Robustly reflects the nature, timing and extent of the work performed around fraud risk identification, assessment and response, thereby providing greater transparency about the specific audit that was performed.</li> </ul>	<p>when the communication is not sufficiently entity and audit-engagement specific.</p> <ul style="list-style-type: none"> <li>What can be reported by the auditor may be limited because of laws and regulations, auditor liability concerns and concerns about disclosing original information.</li> <li>The detailed descriptions may provide a “roadmap” of the auditor’s audit procedures to respond to ROMMs due to fraud for management or others committing fraud.</li> </ul>
<p><b>Alternative 2</b></p> <p>High-level description of the fraud risks identified and how the auditor addressed the fraud risks (e.g., similar to the reporting requirements in the Netherlands).</p>	<ul style="list-style-type: none"> <li>Reduces aspects of the expectation gap (knowledge gap) in that users of the financial report understand what the auditor has done in relation to fraud. However, to a more limited degree than under alternative 1.</li> <li>Entity specific.</li> <li>Provides a high-level overview<sup>41</sup> of potential areas of fraud that the auditor considered and what procedures they performed to deal with</li> </ul>	<ul style="list-style-type: none"> <li>Auditor’s reports may become long and difficult to understand because of too much information, especially when the communication is not sufficiently entity and audit-engagement specific. However, to a more limited degree than under alternative 1.</li> <li>Communications that are not sufficiently entity and audit-engagement specific may over time become boilerplate.</li> </ul>

<sup>41</sup> The level of detail included may be similar as what would be included in a KAM.

Alternative	Possible Benefits for Users of the Financial Statements	Possible Challenges for Users of the Financial Statements
	these fraud risks. Although the level of detail is less than under alternative 1, the enhanced transparency about the audit that was performed could still be sufficient to meet user needs.	<ul style="list-style-type: none"> <li>What can be reported by the auditor may be limited because of laws and regulations, auditor liability concerns and concerns about disclosing original information.</li> </ul>
<b>Alternative 3</b> Explain to what extent the audit is considered capable of identifying and assessing ROMMs due to fraud (e.g., similar to the reporting requirements in the UK).	<ul style="list-style-type: none"> <li>Limits expectation gap (knowledge gap) but to a lesser degree than the other alternatives.</li> <li>Entity specific but to a lesser degree than the other alternatives.</li> <li>Explains the extent to which the audit is considered capable of identifying and assessing ROMMs due to fraud (especially when viewed together with other reporting requirements, such as KAMs), thereby providing insights in the audit that was performed.</li> </ul>	<ul style="list-style-type: none"> <li>Auditor's reports may become long and difficult to understand because of too much information especially when the communication is not sufficiently entity and audit-engagement specific. However, to a lesser degree than the other alternatives.</li> <li>Communications that are not sufficiently entity and audit-engagement specific may over time become boilerplate.</li> </ul>
<b>Alternative 4<sup>42</sup></b> Recognizing that there is a call for more transparency in reporting on fraud, there could be other mechanism(s) to demonstrate the enhanced transparency that is being called for. For example, this transparency could include one or more of the following: <ul style="list-style-type: none"> <li>Emphasizing using the existing requirements for the communication of KAMs when there is a ROMM due to fraud.</li> </ul>		

<sup>42</sup> Alternative 4 is for those users of the financial statements that are of the view that more transparency is needed but question whether the auditor's report is the right place more transparency.

Alternative	Possible Benefits for Users of the Financial Statements	Possible Challenges for Users of the Financial Statements
<ul style="list-style-type: none"> <li>Strengthened communication and two-way discussions with TCWG about the ROMMs due to fraud, the auditor's responses to address the assessed ROMMs and the findings from those procedures.</li> </ul> <p>Aside from the mechanisms described above, there could be other mechanisms to achieve the desired result.</p>		

105. Alternatives 1–3 involve direct changes to the auditor's report. However, to recognize the mixed views on making changes to the auditor's report and the ability of such changes to fully address the issues that have been raised about transparency, alternative 4 has also been added. It recognizes that there is a strong call for more transparency, but suggests that this could be done in a different way than making enhancements to the auditor's report. It is intended that the four alternatives are provided to users of the financial statements targeted for further outreach. Questions will be asked about which alternative would better address the issue of transparency about fraud-related matters including whether there is anything else that the IAASB should consider.
106. In its revision of ISA 240 (Revised), the IAASB will work to address the challenges set out in paragraph 104. For example, to avoid long and difficult to understand auditor reports, the standard would need to articulate requirements in a manner that discourages bland, or boilerplate statements.
107. In addition to these three alternatives, the Fraud Task Force will further discuss with users of the financial statements whether there is anything that can be done to clarify the Auditor's Responsibilities for the Audit of Financial Statements section in the auditor's report. This change would be in addition to alternative 1–4 as described above as just clarifying the auditor's responsibilities relating to fraud in the auditor's report will not address concerns raised. Respondents who are in favor of more transparency in the auditor's report highlighted that if there is more to be said in the auditor report, it has to be bespoke and tailored to the audited entity and not involve the use of boilerplate statements with little specificity to the entity
108. Respondents to the Discussion Paper also noted that the following may address concerns about transparency in the auditor's report about fraud-related matters:
- Disclosure of internal control issues in the auditor's report (highlight significant deficiencies in those controls that were identified in the course of the audit in accordance with ISA 265<sup>43</sup>).
  - Disclose materiality judgements (explicitly note in the auditor's report the auditor's thresholds for identifying, assessing and responding to ROMMs).
109. The Fraud Task Force is of the view that the matters in paragraph 108 above will likely not address concerns about transparency in the auditor's report about fraud-related matters as these are matters that are broader and relate to the complete audit and not just fraud. Also, only a few respondents to the Discussion Paper raised this possible way forward. In relation to transparency about significant deficiencies in internal control, it was noted that this may widen the expectation

<sup>43</sup> ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*

gap as users of the financial statements may assume the extent of the auditor's work effort to be significant when in fact, many audits do not adopt a control reliant approach.

#### *Scope of the Enhanced Disclosures in the Auditor's Report*

110. The Discussion Paper did not include a specific question on the scope for enhanced transparency in the auditor's report about fraud related matters (e.g., for listed entities only, or for all entities). Therefore, many respondents did not comment on this and, if they did, respondents identified a minimum scope (e.g., at least for all audits of financial statements of PIEs). The Fraud Task Force also intends to obtain investors' and other users' views on the scope for the enhanced transparency in the auditor's report.

#### **Matters for IAASB Consideration**

The Fraud Task Force is interested in the Board's view on:

6. The alternatives presented in paragraph 104 above.
7. Whether the three alternatives presented in paragraph 104 above represent the views of respondents to the Discussion Paper and whether there are any other alternatives that should be presented to users of the financial statements.
8. The scope of enhanced disclosures in the auditor's report as set out in paragraph 110 above.

## **Section V – Developing Non-Authoritative Guidance Illustrating the Relationship Between and Linkage of ISA 240 and Other ISAs**

### **Background**

#### *Fraud Project Proposal – Proposed Actions*

111. The table in paragraph 25 of the project proposal sets out details of the proposed actions to develop non-authoritative guidance that illustrates how ISA 240 should be applied in conjunction with the full suite of ISAs (see proposed action B.13 in the project proposal). The Board committed, in the preliminary timetable outlined in paragraph 35 of the project proposal, to develop the non-authoritative guidance in the first half of 2022. The rest of this section focuses on the proposed action.

### **Task Force's Views and Recommendations**

#### *Format of the Non-Authoritative Support Material*

112. When determining the format of the non-authoritative guidance, consideration was given to the categories of non-authoritative support materials as outlined in the [IAASB Framework for Activities](#) (the "Framework"). Given the importance of this material in addressing one of the proposed actions in the project proposal, the Fraud Task Force is of the view that this "Task Force Publication" should be designated to follow the development and clearance for issue process laid out in Channel 3 of the Framework i.e., involvement of Board Members and negative clearance of the non-authoritative guidance by the Board.
113. It is intended that the publication be disseminated by those responsible for national standards or used in developing corresponding national material. In addition, the non-authoritative guidance may be used by firms in developing their training programs and internal guidance.

### Overall Presentation and Content

114. The Fraud Task Force discussed several alternative presentations to depict the linkages between ISA 240 and the other ISAs, including a narrative format, a tabular format and a diagram.
115. The Fraud Task Force believes that a higher-level depiction of the interrelationship between ISA 240 and the other ISAs is preferred at this time. This would encompass a holistic diagram, together with a narrative succinctly describing the important linkages between certain standards that underpin ISA 240, namely ISA 200,<sup>44</sup> ISA 315 (Revised 2019) and ISA 330, and other ISAs as depicted in the non-authoritative guidance. This diagram and accompanying narrative is intended to provide a high-level summary that highlights the three objectives of ISA 240 and the related requirements and how they link to the suite of ISAs, with a focus on the objectives for the auditor to identify and assess the ROMMs due to fraud and respond to the assessed fraud risks.
116. In making this decision, the Fraud Task Force discussed that a detailed depiction of the interrelationships between ISA 240 and the other ISAs is better suited to the end of the project. At that time additional non-authoritative guidance addressing this topic may be issued to provide a fuller illustration of the interactions between ISA 240 (Revised) and the other ISAs. The Fraud Task Force will then be able to capture all those linkages that have been strengthened, enhanced and clarified as a result of the fraud project.
117. **Agenda Item 4-A** sets out a draft of the proposed non-authoritative guidance.

#### Matters for IAASB Consideration

9. Does the Board agree that the non-authoritative guidance is designated as a “Task Force Publication” to be developed and cleared through Channel 3 as contemplated in the Framework?
10. The Board is asked for its views on the non-authoritative guidance as set out in **Agenda Item 4-A**, including the overall presentation and content.

### VI – Way Forward

118. Following the March 2022 IAASB meeting, the Fraud Task Force will continue to discuss the topics included in this issues paper. In doing so, the Fraud Task Force will consider the Board’s feedback on the issues outlined in this paper, including how the further developments of the draft CUSP Drafting Principles and Guidelines may influence the revisions to ISA 240.
119. In addition, the Fraud Task Force will develop its thinking on the introduction section, the definitions, the requirements related to journal entries, specialized skills and the presumption of fraud risk in revenue recognition, and the related application and other explanatory material.
120. In June 2022, the Task Force will bring the topics highlighted in this issues paper and the topics highlighted in paragraph 119 to the Board for discussions, including drafting for certain of these topics.
121. The Fraud Task Force will liaise with other IAASB task forces, working groups and consultation groups as needed. The Fraud Task Force will also liaise with the International Ethics Standards

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<sup>44</sup> ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

Board for Accountants to identify any ethics considerations or matters of relevance in terms of fraud.

## Appendix 1

### **Fraud Task Force Members and Activities Since the December 2021 IAASB Meeting**

#### **Task Force Members**

1. Information about the Fraud Task Force members and the project can be found [here](#).

#### **Task Force Activities Since the December 2021 IAASB Meeting (Hybrid Meeting)**

2. The Fraud Task Force held two virtual meetings on February 1-2 and 16. Owing to the nature of the activities being undertaken, substantial work was also progressed via electronic circulation of materials between members of the Task Force and IAASB staff.

## Appendix 2

### Extract from the Draft December 2021 IAASB Meeting Minutes

Mrs. Provost presented to the Board for discussion and approval a project proposal for the revision of ISA 240<sup>45</sup> and the conforming and consequential amendments to other relevant International Standards on Auditing (ISAs), as set out in **Agenda Item 3-A**. The following sets out the more significant comments, decisions and direction from the Board on the fraud project proposal.

#### OVERALL STRUCTURE (AND CONTENT)

The Board broadly supported the structure of the project proposal and the manner in which the Public Interest Framework (PIF) was incorporated. Board comments included:

- The level of specificity within the project proposal. There were comments about wanting more specificity to avoid “scope creep,” while other Board members noted the proposed actions needed to be more flexible. The Board agreed changes throughout to maintain the balance between being too specific and maintaining flexibility that is needed to progress the project to revise ISA 240 effectively and efficiently.
- Encouraging further emphasis on the role of others in the financial reporting ecosystem to explicitly highlight that standard-setting on its own would not address the expectation gap. Changes were agreed that would make this clearer.
- Highlighting matters within the project proposal that had been previously discussed with the Board and where no further actions were proposed (i.e., consideration of suspicious mindset, changes to the definition of fraud and engagement quality reviews).
- Clarifying the role of the PIF in a project, including explaining that all relevant aspects had been addressed in the project proposal but may be subject to further development, to avoid any potential misconception that only some aspects of the PIF had been included

#### PROJECT OBJECTIVES

The Board broadly supported the project objectives and changes were agreed to address Board comments as follows:

- Clarifying that the project was to “*support* the public interest” rather than “*achieve* the public interest.”
- Rearticulate the objective, where necessary, as an objective and not an action.

Although it was suggested that the project objectives be expanded to include conforming and consequential amendments and non-authoritative guidance, the Board agreed that these are not project objectives but rather actions within the project. The Board agreed to clarify within the project proposal that the project would include the conforming and consequential amendments, and non-authoritative guidance.

#### STAKEHOLDERS IMPACTED

While there were suggestions to tailor how “stakeholders impacted” should be described in the project

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<sup>45</sup> International Standard on Auditing (ISA) 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

proposal, the Board agreed to make no further changes as this was consistent with how it was described in the PIF. Board members also suggested to explain how to “weigh and balance” all stakeholder views, and changes were agreed to explain that this was based on judgment.

#### KEY ISSUES IDENTIFIED

The Board noted that the articulation of the ‘key issues’ was not, in some cases, describing the issue and were also not, in some cases, consistently described. The Board also suggested ensuring that a key issue was included for all proposed actions (in paragraph 25).

#### SCOPE OF THE PROJECT

The Board broadly supported the proposed actions to address the key issues identified, although encouraged to make clear that the scope included ‘strengthening’ the requirements for auditor. The Board also encouraged that the project proposal sets out that the scope also allows for further or other action if the circumstances deem it necessary as the project is progressed.

The Board discussed whether the revisions to ISA 240 need to explicitly address examples relevant to LCEs if there is going to be a separate standard for audits of LCEs. However, it was highlighted that the ISAs needed to remain robust for all sizes and complexities of entities, as well as for those jurisdictions that do not adopt the separate standard for audits of LCEs or when the separate standard is not used. The Board therefore encouraged that scalability be built in where appropriate.

The Board also called for certain clarifications and changes, including:

- De-prioritizing the proposed action to “reorder” the auditor’s responsibilities prior to the description of the inherent limitations of an audit within the introductory paragraphs. Board members noted that a more fundamental consideration is needed of how the inherent limitations are described, but at the same time, cautioned about the risk of unintentionally widening the expectation gap.
- Strengthening the proposed action related to the role and responsibilities of the auditor to articulating the auditor’s responsibilities in a proactive manner i.e., describe what are the responsibilities of the auditor versus the responsibilities of others, not merely focusing on the inherent limitations of an audit.
- When considering application material to the definition of fraud, adding money laundering because money laundering is often dealt with by the same regulations addressing bribery and corruption which will be considered in the project.
- Focusing on scalability when enhancing the requirements regarding the use of specialized skills.
- Distinguishing technology between technology related to the entity, and technology when used by the auditor to undertake their procedures.
- Clarifying the proposed action to test journal entries to address the extent of testing, and recognize the use of technology when undertaking the required procedures. It was cautioned that any changes made regarding the testing of journal entries should not further inflate the misconception that the ISA 315 (Revised 2019)<sup>46</sup> requirement is seen only as a management override of a fraud response.
- Moving the proposed action on the rebuttable presumption of fraud risk in revenue recognition as

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<sup>46</sup> ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*

it relates to risk assessment rather than response, which also affected its placement in the listing of key issues.

- Adding an action to address the “ramp-up” of procedures when fraud is identified or suspected through standard setting and not through non-authoritative guidance.
- Reverting to the original proposed action to require the auditor to assess whether the remediation measures taken by management and those charged with governance (TCWG) for identified or suspected fraud are appropriate (and not just a discussion).

In discussing the proposed action related to enhanced transparency in the auditor’s report, the Board deliberated the proposed actions but as mixed views continue to be expressed agreed that this proposed action should remain ‘explore’ to determine the most appropriate way forward with regards to changes to the auditor’s report. It was also cautioned that any proposed action does not provide a “roadmap” for how to perpetrate future frauds.

#### *Non-Authoritative Guidance*

Some Board members voiced concern over the inclusion the actions for non-authoritative guidance within the table, although other Board members had the view that to keep all actions related to an issue together gave a more appropriate holistic view of all the actions that would be undertaken to address the identified issue. It was therefore agreed to distinguish the non-authoritative guidance (through a light shading of such actions).

Board members also noted concern about the volume of non-authoritative guidance proposed and its timely development, in particular at the end of the project. Board members were of the view that some of the topics may be:

- Better addressed through standard setting.
- Developed now as it may not necessarily be contingent on any proposed enhancements of the standard, or may be developed by others (e.g., the International Federation of Accountants).

After further deliberation, the Board agreed to remove the proposed non-authoritative guidance on technology-related third-party fraud since it may be included with other proposed actions on technology. The Board also agreed with the Fraud Working Group’s view that the remaining proposed non-authoritative guidance are an integral part of the solution to addressing the specific issues that have been identified.

#### *Other Matters*

The Board broadly supported how the qualitative characteristics for the PIF had been incorporated in the project proposal, as well as supporting:

- The other actions proposed; and
- Ongoing activities, including coordination with other IAASB task forces, working groups and consultation groups.

#### PROJECT OUTPUT AND IMPACT OF A PROJECT ON FRAUD

The Board broadly supported how the impact of the project is described in the project proposal, as well as the targeted outputs from the project.

#### PROJECT TIMELINE

While the Board supported the project timeline, there were Board members who expressed concern about the proposed preliminary timetable, particularly the proposed IAASB approval of the revised standard in Q4 of 2024. After further deliberation, the Board agreed to:

- Present the timeline in half-year increments to provide flexibility to amend the timeline as needed.
- Note (in paragraph 35) that the project timeline will be advanced if there are opportunities to do so and the IAASB will use best endeavors to aim for an effective date not beyond December 2026.

#### CAG CHAIR REMARKS

Mr. Dalkin noted the importance of the project, and that the project proposal to revise ISA 240 is in the public interest. He added that the CAG looked forward to providing input as the project develops.

#### PIOB OBSERVER REMARKS

Ms. Van Diggelen noted the PIOB's overall support for the project to revise ISA 240 and the project's importance in addressing the public interest issues, including in narrowing the expectation gap. She highlighted that clarifying the role and responsibilities of the auditor for fraud in an audit of financial statements and more transparency in communications with TCWG and in the auditor's report regarding fraud are important aspects of the project. When executing the project, she encouraged the IAASB to look at the audit approach holistically from an audit risk perspective and to assess what further actions may be needed as the project progresses.

#### APPROVAL OF THE PROJECT PROPOSAL

After presenting an updated version of the project proposal and agreeing all necessary further changes, the IAASB unanimously approved the project proposal to revise ISA 240 with 18 affirmative votes out of the 18 IAASB members who participated in the hybrid meeting.

#### WAY FORWARD

The Fraud Task Force plans to discuss with the Board specific actions included in the scope of the project on fraud (regarding the role and responsibilities of the auditor, risk identification and assessment, and transparency with TCWG and in the auditor's report) at the March 2022 IAASB meeting.

## Appendix 3

### Extract from ISA 700 (Revised), Appendix, Illustrative Auditor's Report 1

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#### **Responsibilities of Management and Those Charged with Governance for the Financial Statements**

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRSs, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

#### **Auditor's Responsibilities for the Audit of the Financial Statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures

are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, actions taken to eliminate threats or safeguards applied.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

## Appendix 4

### New Requirements and Application Material in the Netherlands<sup>47, 48</sup>

29B. For statutory audits as referred to in Article 1, first paragraph, part p of the Auditor Firms Supervision Act for general purpose financial statements, the auditor shall describe in a separate section of the auditor's report under the heading "Audit approach to fraud risks", how the auditor has responded to fraud risks that could lead to a material misstatement. The description may be integrated, if applicable, in the section on key audit matters. The above is not applicable if:

- (a) Law or regulation precludes public disclosure about the matter; or
- (b) In extremely rare circumstances, the auditor determines that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication. This shall not apply if the entity has publicly disclosed information about the matter. (Ref: Para. A41B)

29C. The auditor shall include in the introductory language to the sections as referred to in paragraphs 29A and 29B that these matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters.

...

A41B The amount of detail to be provided in the auditor's report to describe how fraud risks that can lead to a material misstatement during the audit is a matter of professional judgment and may be adapted to the specific circumstances and complexity of the audit. The auditor may describe:

- The fraud risks that required significant auditor attention during the audit;
- Reference to disclosures, if any, in the financial statements;
- A brief overview of the procedures performed;
- An indication of the outcome of the auditor's procedures; or
- Key observations with respect to the matter.

Or some combination of these elements.

For fraud risks that can lead to a material misstatement, but did not require significant auditor attention, the auditor may summarize the work performed, outcomes or observations in an abbreviated form.

Law or regulation may preclude public disclosure by either management or the auditor. For example, law or regulation may specifically prohibit any public communication that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act (e.g., matters that are or appear to be related to money laundering).

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<sup>47</sup> The requirements and application material were translated by Staff. The NBA only published the requirements and application material in Dutch.

<sup>48</sup> The new requirements and application material are included in the Dutch equivalent of ISA 700 (Revised).

A41C. Communicating about going concern and fraud in the auditor's report as referred to in paragraphs 29A and 29B is in the context of the auditor having formed an opinion on the financial statements as a whole and is not:

- (a) A substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation;
- (b) A substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with ISA 705 (Revised);
- (c) A substitute for reporting in accordance with ISA 570 (Revised) when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern; or
- (d) A separate opinion on individual matters.