

Meeting: IAASB Consultative Advisory Group (CAG)

Meeting Location: Virtual Zoom Meeting

Meeting Date: September 7–8, 2022

Agenda Item G

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

Objectives of Agenda Item

1. The objectives of this Agenda Item are to:
 - (a) Obtain the IAASB CAG Representatives' views on the proposals of the Fraud Task Force (the Task Force) as the Task Force progresses its work related to revising ISA 240,¹ specifically the proposals with respect to the introduction and transparency in the auditor's report on fraud.
 - (b) Report back on Representatives' comments made at the March 2022 IAASB CAG meeting.

Update on Activities Since the March 2022 IAASB CAG Meeting

2. The **Appendix** to this paper provides a history of previous discussions with the IAASB CAG and the IAASB on this topic, including links to the relevant IAASB CAG documentation.
3. Since the March 2022 IAASB CAG meeting, the Task Force discussed the following topics with the Board:
 - (a) Structure of the standard;
 - (b) Introductory paragraphs of the standard;
 - (c) Specialized skills;
 - (d) Identifying and assessing the risks of material misstatement due to fraud;
 - (e) Presumption of fraud risks in revenue recognition;
 - (f) Journal entries;
 - (g) Communication with those charged with governance (TCWG); and
 - (h) Transparency in the auditor's report on fraud.
4. In May 2022, the Board published [non-authoritative guidance](#) illustrating the relationship between ISA 240, and other ISAs when planning and performing an audit engagement and reporting thereon. It also illustrates how ISA 240 is currently applied in conjunction with the full suite of ISAs.

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

Transparency in the Auditor's Report on Fraud

5. Given the mixed views on transparency in the auditor's report on fraud by respondents to the [Discussion Paper](#)² and by members of the IAASB, the Task Force was looking for an appropriate way forward that balances the different views. Except for one comment letter received, users of the financial statements did not directly respond to the Discussion Paper. The IAASB therefore supported that the Task Force conduct targeted outreach with this specific stakeholder group in order to obtain their perspectives on enhancing transparency in the auditor's report as it relates to fraud.
6. In June and July 2022, the Task Force conducted 21 interviews with a total of 24 users of the financial statements. The interviews were conducted with users of the financial statements located in 13 jurisdictions dispersed over the following geographic regions:
 - Americas – 4 users of the financial statements;
 - Europe – 7 users of the financial statements;
 - Asia and Oceania – 10 users of the financial statements; and
 - Africa / Middle East – 3 users of the financial statements.

In many instances the users of the financial statements, while located in a specific jurisdiction, had responsibilities that more broadly impacted the global capital market.

7. The population of interviewees also represented a diverse group of users of the financial statements and ranged from institutional investors such as global investment/portfolio managers and equity analysts, to policy and advocate managers whose mandate it is to represent retail investors.
8. The results of the outreach and the Task Force's views and recommendations are included in **Agenda Item G.3**, Section I. Task Force will present the results of the targeted outreach to the IAASB in September 2022.

Introduction

9. In June 2022, the Task Force discussed with the IAASB several key aspects relating to the proposed changes to the introductory section of proposed ISA 240 (Revised)³ including:
 - Clarifying and emphasizing the auditor's responsibilities regarding fraud as the Task Force believes that a clear and affirmative articulation of the responsibilities at the outset, unhindered by the inherent limitations, will set the overall tone for the proposed standard.
 - Clarifying the interrelationship between the proposed ISA 240 (Revised) and the suite of ISAs by explaining that these linkages are important especially with respect to how proposed ISA 240 (Revised) refers to, or expands on, the other ISAs such as ISA 315 (Revised 2019)⁴.
 - Enhancing the description of the auditor's responsibilities when fraud is identified or suspected by emphasizing that the characteristics to be considered by the auditor when making

² Discussion Paper, *Fraud and Going Concern in an Audit of Financial Statements: Exploring the Differences Between Public Perceptions About the Role of the Auditor and the Auditor's Responsibilities in a Financial Statement Audit*

³ Proposed ISA 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

⁴ ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*

judgments about whether an identified misstatement is material may be qualitative or quantitative.

Way Forward

10. Following the September 2022 IAASB meeting, the Task Force will continue to discuss the topics included in the issues papers for the June and September 2022 IAASB meetings. In doing so, the Task Force will consider the IAASB CAG's and the IAASB's feedback.

IAASB CAG Discussion in September 2022

11. For purposes of the IAASB CAG discussion, the Task Force prepared a presentation (**Agenda Item G.1**) highlighting its discussions and decisions on the following topics:
 - (a) Transparency in the auditor's report on fraud; and
 - (b) Introductory paragraphs of the standard.

In preparation for the IAASB CAG Discussion on Fraud, Representatives are encouraged to read:

- **Agenda Item G.2** (Document Used for Outreach);
- **Section I of Agenda Item G.3** (IAASB Issues Paper September 2022); and
- **Section II of Agenda Item G.4** (IAASB Issues Paper June 2022).

Matters for IAASB CAG Consideration

1. Representatives are asked for their views on the way forward to address transparency in the auditor's report on fraud as set out in **Section I of Agenda Item G.3**.
2. Representatives are asked whether there are any other matters the Task Force should consider as it develops the Introduction section of proposed ISA 240 (Revised) in addition to those set out in **Section II of Agenda Item G.4**.

Report Back

12. Extracts from the approved March 2022 IAASB CAG meeting minutes, as well as an indication of how the Task Force or the IAASB has responded to the Representatives' comments, are included below:

Representatives' Comments	Task Force / IAASB Response
TRANSPARENCY IN REPORTING ON FRAUD	
<ul style="list-style-type: none"> • Messrs. Hansen and Thompson noted that the alternatives for transparency in reporting on fraud need not be mutually exclusive. Representatives noted the following in respect to the alternatives: <ul style="list-style-type: none"> ○ Ms. Landell-Mills supported 	<p>Point noted.</p> <p>Mrs. Provost clarified that the IAASB is not seeking Representatives' input on a preferred alternative, but rather on whether the alternatives for transparency in reporting on fraud are appropriate to discuss with users of the financial statements.</p>

Representatives' Comments	Task Force / IAASB Response
<p>alternative 1 (i.e., detailed description of the fraud risks identified, the auditor's response and the auditor's findings/ observations in the auditor's report).</p> <ul style="list-style-type: none"> ○ Dr. Norberg, Messrs. Dalkin, Hansen, Thompson and Ms. Blomme supported alternative 2 (i.e., high-level description of the fraud risks identified and how the auditor addressed the fraud risks in the auditor's report). ○ Dr. Norberg, Mr. Dalkin, and Ms. Blomme supported alternative 3 (description of the extent to which the audit is considered capable of identifying and assessing risks of material misstatement due to fraud in the auditor's report). 	<p>Nonetheless, Mrs. Provost appreciated the Representatives' views as this provided indirectly insights in the viability of the alternatives presented. Mr. Dalkin added that, based on Representatives' views, the alternatives for transparency in reporting on fraud are appropriate to discuss with users of financial statements.</p> <p>Based on the comments from the Board and CAG, and to further clarify the options, and the interrelationships between the options, the Task Force made a number of changes to the options presented to the CAG in March 2022. The Task Force included all the options presented to the CAG in the outreach with users of the financial statements.</p> <p>The Task Force determined to supplement the initial options with a fifth option. Option 5 was intended to expand on feedback received that disclosure of internal control issues in the auditor's report, specifically highlighting significant deficiencies⁵ in the entity's system of internal control that were identified in the course of the audit, may address concerns about transparency in the auditor's report about fraud-related matters.</p>
<ul style="list-style-type: none"> • Dr. Norberg and Ms. Blomme noted that any alternative developed for increasing transparency in reporting on fraud by the auditor should be mirrored in the equivalent reporting requirements applicable to management. 	<p>Point noted.</p> <p>While the reporting requirements applicable to management are not within the IAASB's remit, the IAASB is committed to playing its role to instill confidence in financial reporting through standard setting and other activities, including outreach and continued dialogue to encourage action by others in the financial reporting ecosystem who also have a role to play.</p>
<ul style="list-style-type: none"> • Mr. Yoshii noted that users of financial statements may not fully understand the difference between the four alternatives presented, and therefore encouraged the 	<p>Point accepted.</p> <p>Mrs. Provost explained that the Fraud Task Force intended to provide examples in its outreach to users of the financial statements.</p>

⁵ A significant deficiency is a deficiency or combination of deficiencies in internal control that, in the auditor's professional judgment, is of sufficient importance to merit the attention of those charged with governance.

Representatives' Comments	Task Force / IAASB Response
IAASB to further clarify them.	See the Appendix to Agenda G.2 for “Examples of Transparency in the Auditor’s Report.”
<ul style="list-style-type: none"> Mmes. Vanich and Landell-Mills encouraged the IAASB to consider how transparency in reporting on fraud can be entity-specific as boilerplate disclosures are not meaningful to users of financial statements. 	<p>Point noted.</p> <p>A key takeaway from the outreach with users of the financial statements is that, generally, users of the financial statements are looking for specific information and no boilerplate statements. In developing a way forward this observation is considered – see Task Force’s proposals on the way forward as set out in Agenda Item G.3, Section I.</p>
<ul style="list-style-type: none"> Dr. Norberg, Mr. Thompson and Ms. McGeachy encouraged the IAASB to make its proposals related to reporting on fraud scalable, particularly for LCEs. 	<p>Point accepted.</p> <p>Mrs. Provost noted that scalability will be considered when making proposed changes to ISA 240.</p>
<ul style="list-style-type: none"> Messrs. Hansen and Thompson noted that the project is limited to fraud in an audit of financial statements and questioned whether the project should also address fraud in sustainability / ESG reporting (e.g., greenwashing). 	<p>Point noted.</p> <p>Mrs. Provost noted that fraud in sustainability / ESG reporting is out of scope of this project. However, IESBA Staff is developing guidance which is intended to highlight the provisions in the IESBA Code ⁶ that help address stakeholder concerns about “greenwashing” (i.e., corporate reporting that provides a misleading or false impression about how well a business or investment aligns with its sustainability goals). IAASB Fraud staff and IESBA staff are actively liaising on this matter and IAASB Fraud staff is providing input on the IESBA's staff publication.</p>
<ul style="list-style-type: none"> Mr. Dalkin and Ms. Landell-Mills noted that transparency in reporting on fraud should be limited to the risks of material misstatement due to fraud in the financial statements, or is tied to some other threshold. 	<p>Point noted.</p> <p>Mrs. Provost clarified that transparency in reporting on fraud is limited to the risks of material misstatement due to fraud in the financial statements.</p>
<ul style="list-style-type: none"> Mr. Akihito noted that the proposed changes addressing communication with TCWG 	<p>Point noted.</p>

⁶ The International Ethics Standards Board for Accountants’ (IESBA) *International Code of Ethics for Professional Accountants (including International Independence Standards)*

Representatives' Comments	Task Force / IAASB Response
<p>should be considered together with the proposed changes addressing transparency in reporting on fraud. He also noted that direct communication with “other auditors” may be useful and therefore suggested that the proposed changes should also consider the risk of disclosing confidential or sensitive information.</p>	<p>In addressing transparency on the auditor's fraud-related procedures, the Fraud Project Proposal considers both proposed actions on transparency in the required communications with TCWG and in the auditor's report.</p>
<p>IDENTIFYING AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENT DUE TO FRAUD</p>	
<ul style="list-style-type: none"> Ms. Vanich supported the proposed changes related to identifying and assessing the risks of material misstatement due to fraud. In this regard, she encouraged the IAASB to consider the PCAOB's integrated standard addressing risk identification and assessment and fraud: <i>Auditing Standard 2110: Identifying and Assessing Risks of Material Misstatement</i>. 	<p>Point accepted.</p> <p>Mrs. Provost noted that auditing standards on fraud in various jurisdictions (e.g., Japan, Netherlands, United Kingdom and the United States) will be considered in developing proposed ISA 240 (Revised).</p>
<p>OTHER COMMENTS</p>	
<ul style="list-style-type: none"> Ms. McGeachy noted that others in the financial reporting ecosystem also play an important role in addressing the “expectation gap.” 	<p>Point accepted.</p> <p>The Task Force is committed to playing its role to instill confidence in financial reporting through activities within its remit, including outreach and continued dialogue to encourage action to reduce the expectation gap by others in the financial reporting ecosystem who also have a role to play.</p>
<ul style="list-style-type: none"> Mr. Akihito noted that requiring too many fraud procedures and documentation may undermine the auditor's exercise of professional skepticism. 	<p>Point noted.</p> <p>The Task Force will take this point into consideration when developing proposed ISA 240 (Revised).</p> <p>Also, the Fraud Project Proposal includes specific actions to enhance the auditor' exercise of professional skepticism.</p>

Materials Presented – IAASB CAG Papers

Agenda Item G.1	Presentation
Agenda Item G.2	Document Used for Outreach

Materials Presented – IAASB CAG Reference Papers

Agenda Item G.3	IAASB Issues Paper September 2022
Agenda Item G.4	IAASB Issues Paper June 2022

Appendix

Project Details and History

Project: Fraud

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

Task Force Members

- Lyn Provost, IAASB Member and Task Force Chair
- Julie Corden, IAASB Member
- Josephine Jackson, IAASB Member
- Len Jui, IAASB Deputy Chair
- Diane Larsen, IAASB Member

Summary

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

IAASB CAG Discussions: Detailed References

Information gathering	<p><u>September 2020</u></p> <p>See IAASB CAG meeting material and IAASB CAG meeting minutes (Agenda Item F).</p> <p>https://www.iaasb.org/cag/meetings/iaasb-cag-meeting-september-8-9-2020-virtual</p> <p><u>March 2021</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Item C).</p>
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	<p>https://www.iaasb.org/cag/meetings/iaasb-cag-meeting-march-8-9-2021-virtual</p> <p><u>September 2021</u></p> <p>See IAASB CAG meeting material and IAASB CAG meeting minutes (Agenda Item I).</p> <p>https://www.iaasb.org/cag/meetings/iaasb-cag-meeting-september-8-9-2021-virtual</p>
Project Proposal	<p><u>November 2021</u></p> <p>See IAASB CAG meeting material and IAASB CAG meeting minutes (Agenda Item A).</p> <p>https://www.iaasb.org/cag/meetings/iaasb-cag-meeting-november-30-2021-virtual</p>
Development of Exposure Draft	<p><u>March 2022</u></p> <p>See IAASB CAG meeting material and IAASB CAG meeting minutes (Agenda Item H).</p> <p>https://www.iaasb.org/cag/meetings/iaasb-cag-meeting-march-8-9-2022</p>