

Fraud in an Audit of Financial Statements – Issues Paper

Objective

The objective of the IAASB discussion is to obtain the Board's input on the Fraud Task Force's (the Task Force):

- Views and recommendations on the way forward in relation to transparency in the auditor's report on fraud; and
- Drafting with respect to the sections in proposed ISA 240 (Revised)¹ that refer to, or expand on, ISA 315 (Revised 2019).²

Board Discussion

Issues Paper

This paper describes the issues addressed by the Task Force and for discussion with the IAASB at its September 2022 meeting as it relates to proposed revisions to ISA 240.³

Appendices to this Paper

The following appendices are included in this paper:

- **Appendix 1:** Fraud Task Force Members and Update on Activities Since the June 2022 IAASB Meeting;
- **Appendix 2:** Option 5: Reporting Identified Significant Deficiencies in Internal Control That Are Relevant to the Prevention and Detection of Fraud;
- **Appendix 3:** Transparency in the Auditor's Report – List of Users of the Financial Statements; and
- **Appendix 4:** Transparency in the Auditor's Report – Additional Questions for Outreach.

Other Agenda Items

The Task Force also presents:

- **Agenda Item 6-A:** Document Used for Outreach.
- **Agenda Item 6-B:** Proposed ISA 240 (Revised), Sections Building on ISA 315 (Revised 2019).
- **Agenda Item 6-C:** Explanation of Significant Changes (to the proposed drafting in Agenda Item 6-B).

Approach to the Board Discussion

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

² ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*

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

The Task Force Chair will go through the questions in the order they are set out in this Agenda Item.

Introduction

1. At the March 2022 IAASB meeting, the Board discussed the topic of transparency in the auditor's report on fraud. The Board discussed different options on the way forward for transparency in reporting on fraud and agreed that all options presented should be included in the planned targeted outreach with users of the financial statements. The Board also discussed and broadly agreed with the Task Force's proposals on changes to proposed ISA 240 (Revised) addressing the identification and assessment of the risks of material misstatement due to fraud.
2. At the [June 2022 IAASB meeting](#) the:
 - (a) Task Force provided the Board with an update with respect to its activities as it related to transparency in the auditor's report on fraud, including the number of options that the Task Force was going to present to the users of the financial statements and the period over which the outreach with users was to be conducted (June and July 2022).
 - (b) Board discussed the drafting of selected paragraphs of proposed ISA 240 (Revised), including the section of proposed ISA 240 (Revised) that is referring to, or expanding on, ISA 315 (Revised 2019). The Board broadly supported the direction of the Task Force but had several suggestions to further enhance this section of the proposed standard.
3. The draft June 2022 IAASB meeting minutes are available in [Agenda Item 1-A](#) of the September 2022 IAASB meeting.
4. This agenda item sets out the Task Force's views and recommendations for certain key issues and the related proposed actions identified in the [project proposal](#) as follows:
 - (a) Transparency in the auditor's report on fraud (see **Section I**)
 - (b) Identifying and assessing the risks of material misstatement due to fraud (see **Section II**)
 - (c) Way forward.

Section I: Transparency in the Auditor's Report on Fraud

Fraud Project Proposal – Key Issue

5. The project proposal included the following key issue (see paragraph 19):

- (h) *Transparency on the auditor's fraud-related procedures*
 - (i) ...
 - (ii) The auditor's report may not be transparent enough about the auditor's fraud-related responsibilities and procedures.

Fraud Project Proposal – Proposed Actions

6. The project proposal included the following proposed actions (see paragraph 25):

Requirements and Application Material – Transparency in the Required Communications

with TCWG and in the Auditor's Report

- ...
- *Explore⁴ 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, including:*
 - Exploring what changes may be needed to better describe the auditor's responsibilities and procedures related to fraud in an audit of financial statements, including:
 - Additional outreach with investor groups as well as other relevant stakeholders about the need for more transparency in the auditor's report, and how this can be done.
 - Consideration of changes made by others in different jurisdictions.
 - Considering revisions to clarify the interaction of key audit matters and fraud-related matters.

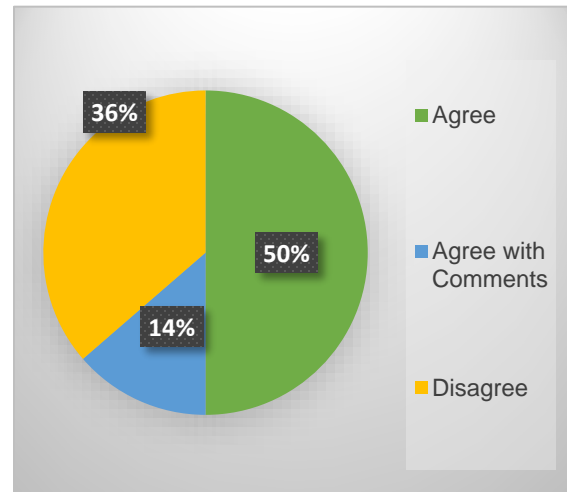
Discussion Paper

7. As part of the information gathering and research activities on fraud that were conducted to facilitate the development of the project proposal, the IAASB developed a [Discussion Paper](#),⁵ which was published in September 2020 for consultation, and held [virtual roundtables](#) in September and October 2020.
8. 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. Of the 66 respondents to the Discussion Paper who answered this question (19 respondents did not answer this question):

⁴ The term "explore" is used here because this is an area where significant mixed views were expressed by stakeholders and during Board deliberations on the need for enhanced transparency in the auditor's report and will require further consideration by the Task Force and the Board before possible actions can be proposed.

⁵ 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*.

- 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 – 50%;
- 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 – 14%; and
- 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 – 36%.



9. 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 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.
10. See [Agenda Item 3](#) (paragraphs 79–83) and [Agenda item 3-A.7](#) of the April 2021 Board meeting for a more detailed summary on this topic and for the related NVivo report addressing the question of transparency in the auditor's report with respect to fraud, respectively.
11. Given the mixed views on transparency in the auditor's report by respondents to the Discussion Paper 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, 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. It was proposed that these perspectives would be analyzed and assessed in combination with views from other stakeholders to determine an appropriate way forward.

Targeted Outreach with Users of the Financial Statements

Options Presented to Users of the Financial Statements

12. At the March 2022 Board meeting, the Task Force presented 4 options⁶ (see [Agenda Item 4](#), Section IV) that could enhance transparency in the auditor's report and that the Task Force anticipated presenting to users of the financial statements in order to solicit their input. These options were:
 - *Option 1:* Detailed description of the fraud risks identified, the auditor's response and the auditor's findings/ observations.

⁶ In the March 2022 meeting the Task Force used the word "alternative" instead of "option." Upon reflection the Task Force is of the view that the term option is more appropriate as these matters are not mutually exclusive. Hence this paper only uses the term option.

- *Option 2:* High-level description of the fraud risks identified and how the auditor addressed the fraud risks.
- *Option 3:* Explain to what extent the audit is considered capable of identifying and assessing risks of material misstatement due to fraud.
- *Option 4:* Other mechanism(s) to demonstrate the enhanced transparency that is being called for.

Based on the comments from the Board and to further clarify the options, including the interrelationships between the options, the Task Force made a number of changes (see approved March 2022 [Meeting Minutes](#)).

13. In developing the options to be presented to users of the financial statements, the Task Force determined to supplement the initial four options with a fifth option. This fifth option is intended to expand on the feedback received from respondents to the Discussion Paper that disclosure of internal control issues in the auditor's report, specifically highlighting significant deficiencies⁷ in the entity's system of internal control that were identified in the course of the audit in accordance with ISA 265,⁸ may address concerns about transparency in the auditor's report about fraud-related matters (see **Appendix 2** for an overview option 5).
14. Based on the above, the Task Force presented the following five options to users of the financial statements (see **Agenda Item 6-A**):
 - *Option 1:* Describing the auditor's approach to fraud risks.
 - *Option 2:* Describing the identified and assessed fraud risks, and the auditor's response to the assessed fraud risks.
 - *Option 3:* Describing the identified and assessed fraud risks, the auditor's response to the assessed fraud risks, and the auditor's findings/observations when responding to the assessed fraud risks.
 - *Option 4:* Emphasizing the use of the existing requirements for the communication of Key Audit Matters (KAMs) for listed entities where there is a fraud risk.
 - *Option 5:* Reporting identified significant deficiencies in internal control that are relevant to the prevention and detection of fraud.

Selecting Users of the Financial Statements

15. In selecting users of the financial statements, the Task Force endeavored to choose different types of users of the financial statements and users from different geographical backgrounds. The Task Force identified the users of the financial statements through:
 - Contacts from Board and Staff members;
 - The IAASB's Consultative Advisory Group; and
 - The roundtables that the IAASB held as part of its research and information gathering activities.

⁷ 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.

⁸ ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*

16. An overview of the users selected to participate in the interviews conducted is as follows (see **Appendix 3** for a list of the users of the financial statements):

- (a) 21 interviews were conducted with a total of 24 users of the financial statements;
- (b) 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.

17. The population of interviewees 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.
18. In responding to the questions posed, users of the financial statements interviewed provided perspectives about their needs for additional information to underpin their investment strategies, which included minority or majority investments in private hedge funds or entities in certain industries (e.g., regulated banking and financial services industry), geographical regions or emerging markets.
19. The diversity of views expressed by the users of the financial statements interviewed has provided the Task Force with an informed basis, together with the responses from the Discussion Paper and input from other information-gathering activities, to propose a way forward to enhance transparency in the auditor's report about fraud-related matters.

Advance Preparation

20. Users of the financial statements interviewed were provided with a short paper outlining the project, the purpose of the interview, the five options as well as two overarching questions (noted in [blue](#) below). The intention was for the advance preparation to be informative and succinct (see **Agenda Item 6-A** for a copy of the paper).
21. The Task Force prepared several additional questions to prompt conversation (see **Appendix 4** for a listing of the additional outreach questions). Depending on how the conversation ensued, these questions were asked.

Format of the Interviews

22. In almost all interviews, the Task Force member was accompanied by a Staff member. This was done in order to strive for consistency in the manner in which the interviews were conducted and to reaffirm more broadly what was heard across all the interviews. All interviews were conducted by way of videoconference.

What We Heard⁹

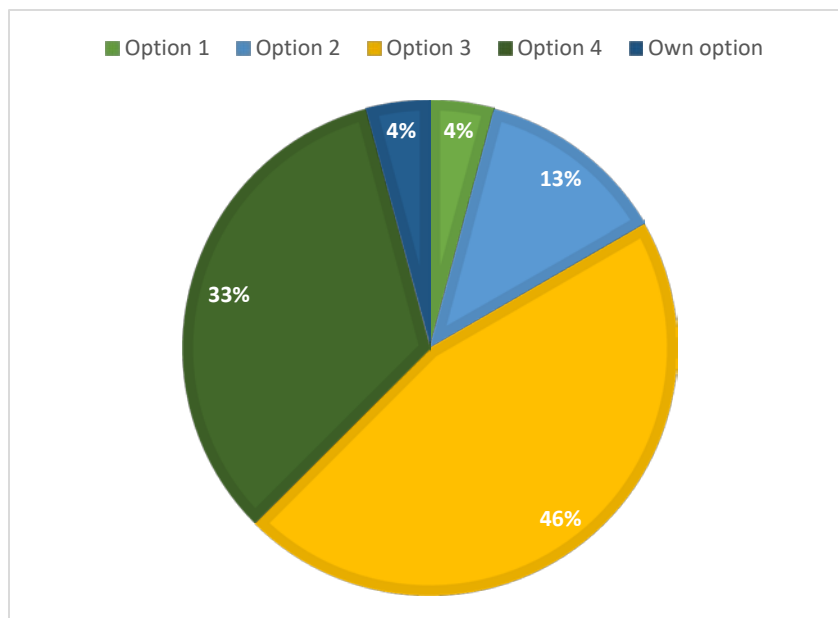
Question 1 – Which of the Options, If Any, Do You Prefer to Be Included in the Auditor's Report? Please Explain Why, or Why Not, and How You Would Use Such Information.

Additional Question 1(a) – What Are the Benefits of Option X To Your Understanding of the Auditor's Work Effort?

Additional Question 1(b) – What Are the Benefits of Option X To Your Investment Decisions?

Additional Question 2 – What Are the Challenges with Option X.

23. The Task Force discussed these individual questions, or combinations thereof, with all the users of the financial statements.
24. Except for 1 user of the financial statements that suggested an additional option, all other users of the financial statements indicated a preferred option from those presented i.e., options 1, 2, 3 or 4. None of the users of the financial statements were of the view that no changes to the auditor's report should be made. The chart below shows the preferred options to be included in the auditor's report. In addition, 17 of the 24 users of the financial statements were of the view that option 5 should also be included in the auditor's report i.e., in addition to option 1, 2, 3 or 4.



Benefits and Challenges

25. The table below provides an overview of the benefits and challenges that users of the financial statements noted for each of the options.

	Benefits	Challenges
Option 1	<ul style="list-style-type: none"> Users of the financial statements were of the view that option 1 provides a good 	<ul style="list-style-type: none"> Users of the financial statements were of the view that this option

⁹ When reference is made to “users of the financial statements” in the “What We Heard” and the “Task Force's Views and Recommendations” sections we refer to the users of the financial statements interviewed.

	Benefits	Challenges
	<p>overview of the auditor's responsibilities as it relates to the auditor's overall approach to fraud risks.</p> <ul style="list-style-type: none"> Separate section on fraud in the auditor's report would drive awareness and the focus of the users of the financial statements. 	<p>may result in boilerplate disclosures.</p>
Option 2	<ul style="list-style-type: none"> The matters highlighted under option 1 Users of the financial statements were of the view that the more entity-specific information about the fraud risk factors is useful to: <ul style="list-style-type: none"> Make better investment decisions; Compare entities with each other; and Compare the same entity year over year. Users of the financial statements highlighted that the auditor brings an independent view and is not biased. The information provided in the auditor's report is especially useful for investors when the: <ul style="list-style-type: none"> Entity is a start-up; Investor has a minority investment in the entity (and no other way in which to access information); Fraud risks for the entity change; and Entity is a joint venture and investors don't have access to management and those charged with governance (TCWG). Users of the financial statements were of the view that this option will help to have a more educated conversation with management and TCWG in the Annual General Meeting or other external forum. 	<ul style="list-style-type: none"> The matter highlighted under option 1. Users of the financial statements were of the view that the language in this option may become boilerplate because of: <ul style="list-style-type: none"> The risk of litigation. Language may therefore be drafted in a more neutral, risk averse manner. The risk of damaging existing client relationships. The auditor's work relating to fraud or suspected fraud may preempt conversations with management and TCWG that are difficult or contentious. In an effort to temper the conversations, the auditor may formulate the wording in a more neutral manner. The use of repetitive disclosures. The auditor may repeat the same fraud risks year over year. As a result, the disclosures in the auditor's report may not be specific enough and reflective of the work performed by the auditor to address the identified fraud risks.
Option 3	<ul style="list-style-type: none"> The matters highlighted under options 1 and 2. 	<ul style="list-style-type: none"> The matters highlighted under options 1 and 2.

	Benefits	Challenges
	<ul style="list-style-type: none"> Users of the financial statements noted that they are interested in consistent and useful information (e.g., specific findings and information about the discussions between the auditor and management and TCWG). Option 3 provides the possibility to include these matters in the auditor's report. Users of the financial statements are interested in more insight into the findings of the auditor that can then be used to engage in more targeted discussions with management and TCWG. 	<ul style="list-style-type: none"> Users of the financial statements were of the view that this option has a risk of being boilerplate because the findings of the work performed may not be tailored to the entity's circumstances. Users of the financial statements noted that some jurisdictions may not allow the auditor to disclose this information as it is considered confidential. More transparency in the auditor's report comes with a cost, including information with respect to findings by the auditor related to fraud. The cost to enter the capital markets should not be overly burdensome.
Option 4	<ul style="list-style-type: none"> Users of the financial statements noted that the auditor is used to communicating KAMs (as it is an existing mechanism) and KAMs provide entity-specific and useful information. They supported emphasizing the existing requirements for the communication of KAMs and they would welcome the reporting of more instances where fraud-related matters are determined to be KAMs. 	<ul style="list-style-type: none"> Users of the financial statements were of the view that this option may result in boilerplate disclosures, similar to how (in certain instances) KAMs have evolved.
Option 5	<ul style="list-style-type: none"> Users of the financial statements would like to know when a significant deficiency is identified, what it relates to and what the auditor has done when a significant deficiency has been identified. It was also noted that information about deficiencies is not readily available to users of the financial statements and that it would benefit the user's analysis of the entity. Users of the financial statements noted that it is important to have a strong control environment as fraud usually happens in areas where you do not expect it (the more focus there is on a 	<ul style="list-style-type: none"> Users of the financial statements noted that: <ul style="list-style-type: none"> This option may be challenging to apply in practice as there is judgement involved about whether a deficiency is significant or not. Disclosing a significant deficiency in internal control that is relevant to the prevention and detection on fraud in the auditor's report may create confusion and

	Benefits	Challenges
	<p>strong control environment the less likely it is that frauds become significant / material). It was noted that deficiencies in the system of internal control give an indication of “what could go wrong”. It was also recognized that the behavior of management may be addressed through an effective system of internal controls</p> <ul style="list-style-type: none"> • Users of the financial statements were of the view that this option will help to have a more educated conversation with management and TCWG in the Annual General Meeting or other external forum. • Users of the financial statements liked the “reporting by exception format” as this avoids boilerplate language. 	<p>may have unintended (negative) consequences in the market.</p> <ul style="list-style-type: none"> ○ Reporting a significant deficiency in the auditor's report is too late. It should be done when the significant deficiency is detected.

26. Users of the financial statements noted specifically that the length of the auditor's report was not a deterring factor. It was noted that financial statements are part of the information that investors use to assess the value of the entity, and ultimately make investment decisions. Often the financial statements are used to corroborate (or otherwise) other information the investors are already aware of. In contrast some users of the financial statements only focused on the auditor's report if there was a material uncertainty related to going concern or an emphasis of matter paragraph, as in many instances this contained unique information that was of relevance to the investor.

Question 2 – Do You Have Any Other Recommendations for Improving Transparency About Fraud in the Auditor's Report?

27. Users of the financial statements noted the following other recommendations for improving transparency in the auditor's report:
- (a) Using plain English.
 - (b) Describing areas of disagreement between the auditor and management and how the disagreement was resolved.
 - (c) Clarifying the description of the auditor's responsibility in the auditor's report as these are not clear to users of the financial statements.
 - (d) Describing the audit approach, i.e., “controls based” or substantive.
28. An additional option was suggested by 1 user of the financial statements. This proposed option addresses that since management and TCWG have primary responsibility for the prevention and detection of fraud, they are also best positioned to address any fraud risks that may be identified by the auditor. This option would require the auditor to report to TCWG its views on fraud risk factors and include in the auditor's report a negative statement along the lines of: “nothing has come to our attention that the financial statements are materially misstated due to fraud. In accordance with ISA 240 (Revised) we have reported identified fraud risks to TCWG.” By communicating the fraud risk

factors to TCWG the auditor passes on the responsibility to management and TCWG to develop a plan to mitigate the fraud risks that were identified. This will enable the auditor to describe their findings more freely as they won't be included in the auditor's report.

Additional Question 3 – Do You Think That Option X Will Drive Changes in the Auditor's Behavior?

29. The Task Force discussed this question with 16 users of the financial statements.
30. Generally, users of the financial statements were of the view that additional transparency in the auditor's report will drive changes in the auditor's behavior because of the focus on fraud. Users of the financial statements were also of the view that additional transparency in the auditor's report may drive enhanced communications between the auditor, and management and TCWG.
31. Users of the financial statements that preferred option 3 noted specifically that when the auditor discloses information about the identified fraud risks in the auditor's report, how the auditor responded to address the fraud risks, and the auditor's findings, if any, it will drive auditors to more closely focus on the fraud risks of the entity, for example by involving forensic specialist in the identification of fraud risks and the response to the assessed fraud risks.

Additional Question 4 – Do You Think That Option X Will Drive Changes in the Behavior of Management and Those Charged with Governance?

32. The Task Force discussed this question with 21 users of the financial statements.
33. Users of the financial statements that preferred options 3 and 5 were generally of the view that these options would drive changes in the behavior of management and TCWG:
 - (a) Of those users of the financial statements that preferred option 3 and who answered this question (11 users of the financial statements), 5 were of the view that this option would drive changes in the behavior of management and TCWG. There were 3 users of the financial statements that were of the view that it may drive changes in behavior. Users of the financial statements noted that if the auditor pays more attention to fraud, management and TCWG will do so too.
 - (b) Of those users of the financial statements that preferred option 5 and who answered this question (15 users of the financial statements), 9 were of the view that this option would drive changes in the behavior of management and TCWG. There were 2 users of financial statements that were of the view that it may drive changes in behavior. Users of the financial statements noted that management and TCWG would likely not want the auditor to disclose a significant deficiency in internal control relevant to the prevention and detection of fraud in the auditor's report as this disclosure may have unintended consequences, for example the information may cause volatility in the market that may be costly to the entity. Management and TCWG may therefore focus more on the system of internal controls such that this heightened focus will indirectly prevent and detect some frauds.

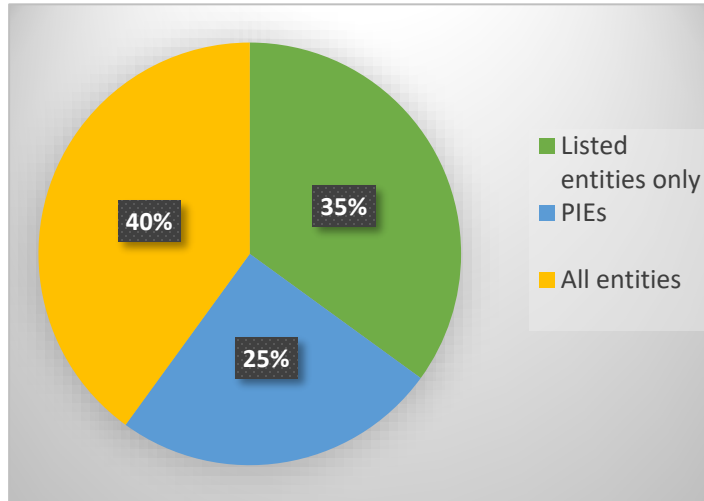
Additional Question 5 – Do you think the requirements should be applicable to: listed entities only; public interest entities only; or all entities?

34. The Task Force discussed this question with 20 users of the financial statements. See the results in the diagram to the right.

35. Users of the financial statements that were of the view that the requirements should be applicable to all entities (8 users of the financial statements) noted that in every entity the money of investors is at stake. It was also noted that many non-listed entities may have an initial public offering and prior auditor's report are therefore useful when

analyzing the entity. Of the users of the financial statements that were of the view that the requirements should be applicable to all entities, 6 were also of the view that initially the new requirements could apply to listed entities only.

36. Users of the financial statements that were of the view that the requirements should be applicable to listed entities (7 users of the financial statements) or public interest entities (PIEs) (5 users of the financial statements) were of the view that creditors of non-PIE entities often have other means of obtaining information about the entity. They also noted that the cost of more transparency in the auditor's report on fraud for non-PIE entities may outweigh the benefits.



Additional Question 6 – Do You Think Additional Disclosures from Management or Those Charged with Governance Would Provide You with Insightful Information That Will Impact Your Decision Making Related to the Entity? If So, Where Would You Like to See These Disclosures?

37. The Task Force discussed this question with 8 users of the financial statements.

38. Overall, there were mixed reviews on whether additional disclosures from management or TCWG will provide users of the financial statements with insightful information that will impact the decision making related to the entity.

39. Users of the financial statements noted management and TCWG may be biased and therefore preferred the auditor to provide transparency on fraud in the auditor's report. They also noted that additional disclosures by management or TCWG are not a substitute for more transparency in the auditor's report.

Additional Question 7 – [For Options 2, 3 And 5 Only] Do You Think Option X Will Work When Local Laws and Regulations Does Not Require Management to Make Disclosures About ... [Fraud Risk / Deficiencies in Internal Control Due to Fraud]?

40. The Task Force discussed this question with 13 users of the financial statements.

41. Users of the financial statements who supported option 5 and answered this question (8 users of the financial statements) were of the view that option 5 will work with local laws and regulations. Users of the financial statements who supported option 3 and answered this question (2 users of the financial statements) had mixed views on whether option 3 will work with local laws and regulations.

42. Users of the financial statements also noted that:
- (a) The IAASB should not be constrained by local laws and regulations. If local laws and regulations do not permit the auditor to disclose information, jurisdictions can change their laws and auditing standards accordingly.
 - (b) Even though management is not required to do so, management may make fraud related disclosures in the financial statements as they do not want the auditor to be the only one providing such information.

Other Matters Raised

43. Users of the financial statements also noted that, in addition to providing more transparency in the auditor's report, the auditor's responsibilities with respect to fraud should be enhanced more broadly. For example, the auditor should:
- (a) Read reports which indicate recent or ongoing regulatory investigations relating to fraud.
 - (b) Perform procedures on immaterial frauds as many frauds are initially not material.
 - (c) Look at external signals that may indicate that there is a risk of fraud (e.g., short-seller reports).
 - (d) Obtain an understanding of the entity's culture, including tone at the top enacted by management and TCWG. The tone at the top is important to prevent and detect fraud and the auditor should focus on that when obtaining an understanding of the entity's control environment. It was noted by 1 user of the financial statements that frauds seem to occur more often in entities with a charismatic leader that founded the entity.
 - (e) Have a skeptical mindset when auditing cash and suspense accounts balances as fraud often occurs in these areas.
 - (f) Include regular changes of the auditor as a fraud risk factor.
44. Users of the financial statements also noted the following additional matters:
- (a) All parties in the financial reporting ecosystem have a responsibility to prevent and detect fraud. Often the auditor is blamed for a fraud, but the main responsibility lies with management and TCWG.
 - (b) Auditors have a clear responsibility to detect fraud and auditors should do more than what they are currently doing.
 - (c) Often investors know or suspect a fraud before auditors because investors have an incentive to detect fraud – their money is invested in the entity. Auditors do not have this incentive, but they have a professional reputation that is on the line. Auditors therefore follow professional standards. Because of that different mindset auditors will struggle to detect frauds.
 - (d) Auditors should not forget that the audit is performed for investors and not management. Investors don't mind paying for an audit but want information in return.
 - (e) Education of users of the financial statements is needed. It was noted that some users of the financial statements (not those interviewed) may not fully understand why certain matters are included in the auditor's report, why these matters may be useful for users of the financial statements and where users of the financial statements may focus their attention when reading the auditor's report.

- (g) Even though KAMs are deemed boilerplate by some stakeholders, users of the financial statements still read through them to obtain information about the entity and to see what has changed year over year.

Key Take-Aways from the Outreach with Users of the Financial Statements

- 45. In addition to the responses provided to the questions posed by the Task Force and Staff, users of the financial statements provided some further insights into their perspectives. Based on the input from outreach, the Task Force has captured certain key take-aways which also serve to inform the development of the way forward. Users of the financial statements:
 - (a) Value more transparency about fraud in the auditor's report.
 - (b) Recognize that the prevention and detection of fraud is the primary responsibility of management and TCWG.
 - (c) Are generally looking for entity-specific information about fraud risks and not boilerplate statements.
 - (d) View insights about the system of internal controls to prevent and detect fraud as an indicator of "what could go wrong" at an entity.
 - (e) Noted that information provided in the auditor's report on fraud may assist users of the financial statements with their assessment of the entity including the integrity of management and TCWG.
 - (f) Trust, and value, the auditor's independent perspective.
 - (g) Reiterated that the auditor "works for" the users of the financial statements.
 - (h) Highlighted the importance of clarity in messaging in the auditor's report. Any additional information related to fraud should be clear, understandable, and the placement and content should be consistent.
 - (i) Indicated the importance, and highlighted the benefit, of educational material that explains the reasoning behind the requirements in the ISAs.

Task Force's Views and Recommendations

- 46. In determining a way forward, the Task Force took into account:

- (a) The [Public Interest Framework \(PIF\)](#), which includes a paragraph that states:¹⁰

"While the Framework recognizes the importance of all of the stakeholders, it focuses primarily on the interests of users, and more specifically the longer-term interests of creditors and investors and the protection of those interests. Creditor and investor decisions are key to the correct functioning of financial markets, but there are creditors and investors who may not always be equipped to contribute effectively to the standard-setting process. These include direct shareholders, debt holders, and those indirectly holding a company's equity or debt, for instance through investment funds or pension funds."

¹⁰ The PIF identifies the following groups of stakeholders: users of the financial statements, the profession, those in charge of adoption, implementation and enforcements of the standards, preparers and other users.

- (b) The weighting of the input received (see paragraph 17 of the project proposal):

“In order to address the public interest as contemplated by the PIF, and to achieve the objectives of this project proposal, the project on fraud will:

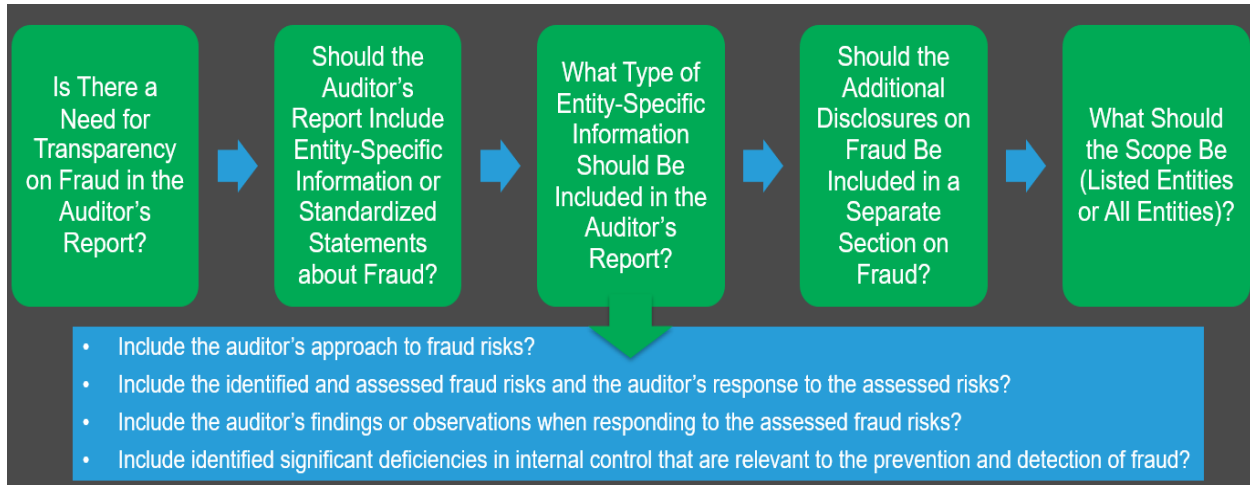
- (a) Consider all stakeholder input and identify the different stakeholder interests that affect the overall objectives that will achieve the public interest;*
- (b) Appropriately weigh the input in terms of the public interest impact of the relative stakeholder interests; and*
- (c) Appropriately balance alternative outcomes in terms of the expected responsiveness to the public interest.*

Although the PIF sets out a framework for how the public interest will be addressed, the approach to the consideration of stakeholder interests and how they are weighed is largely consistent with how stakeholder input is currently considered on IAASB projects (i.e., judgment is applied).

- (c) The qualitative characteristics to assess a project’s responsiveness to the public interest (see paragraph 26 of the project proposal). The relevant qualitative characteristics described in the project proposal are the following:

- (i) *Scalability* (including proportionality to the standard’s relative impact on different stakeholders).
- (ii) *Relevance* (through recognizing and responding to emerging issues, changes in business or public practice environments, developments in accounting practices, or changes in technology).
- (iii) *Comprehensiveness* (through limiting the extent to which there are exceptions to the principles set out).
- (iv) *Clarity and conciseness* (to enhance understandability and minimize the likelihood of differing interpretations).
- (v) *Implementability and ability of being consistently applied and globally operable.*
- (vi) *Enforceability* (through clearly stated responsibilities).

47. The Task Force developed a Framework with questions as depicted in the diagram below to determine the way forward. The Task Force is of the view that a hybrid option (so an option combining aspect of the options presented to the users of the financial statements) may be responsive to the public interest. In determining a way forward as described in paragraphs 48–67, the Task Force endeavored to faithfully represent the views of our stakeholders.



Is There a Need for Transparency on Fraud in the Auditor's Report?

48. The Task Force noted that users of the financial statements welcome more disclosures in the financial statements. Respondents to the Discussion Paper were generally of the view that more transparency in the auditor's report about the auditor's work in relation to fraud in an audit of financial statements is needed. Therefore, the Task Force is of the view that our stakeholders support more transparency in the auditor's report.

Should the Auditor's Report Include Entity-Specific Information or Standardized Statements about Fraud?

49. The Task Force noted that users of the financial statements are interested in entity-specific information as evidenced by their answers to several of the options provided for discussion. Respondents to the Discussion Paper that were in favor of more transparency in the auditor's report were also asking for entity-specific information and they cautioned against boilerplate statements. Because of this, the Task Force is of the view that our stakeholders would support the inclusion of entity-specific information.

What Type of Entity Specific Information Should Be Included in the Auditor's Report?

50. The Task Force discussed the nature of the information on fraud to be reflected in the auditor's report, including:
- The auditor's approach to fraud risks;
 - The identified and assessed fraud risks and the auditor's response to the assessed risks;
 - The auditor's findings or observations when responding to the assessed fraud risks; and
 - Identified significant deficiencies in internal control that are relevant to the prevention and detection of fraud in the financial statements.

Include the Auditor's Approach to Fraud Risk?

51. The Task Force noted that users of the financial statements are looking for entity-specific information and that a description of the auditor's approach to fraud risks may result in disclosures in the auditor's report that are standardized in nature and do not provide meaningful information to the stakeholders. Respondents to the Discussion Paper commented that enhancements to the auditor's report around auditor's procedures related to fraud should not be boilerplate in nature. Therefore, the Task Force is of the view that this general description should not be included in the auditor's report.
52. However, the Task Force is also of the view that exploring whether to include a more detailed description of the auditor's responsibilities would be useful. The Task Force recognizes that auditor's reports already include a high-level description of the auditor's responsibilities with respect to fraud but noted that a more detailed description may help to improve the users of the financial statements' understanding of the auditor's responsibility. This may also reduce the ambiguity between the inherent limitations of an audit and the auditor's responsibilities for fraud in an audit of financial statements. The description of the auditor's responsibilities should be drafted in a positive manner and should not be seen as a disclaimer. A more robust articulation of the auditor's responsibilities in the auditor's report will also provide the context in which the description of the identified and assessed fraud risks and the auditor's response to the assessed fraud risks should be read by the users of the financial statements (see paragraphs 53–54 below).

Include the Identified and Assessed Fraud Risks and the Auditor's Response to the Assessed Risks?

53. The Task Force noted strong support from users of the financial statements for including a description of the identified and assessed fraud risks in the auditor's report, and the auditor's response to such assessed risks (options 2, 3 and 4). Respondents to the Discussion Paper noted that more transparency is needed around the procedures the auditor performs in response to risks of material misstatement due to fraud.
54. The Task Force is of the view that a description of the identified and assessed fraud risk and the auditor's response to the assessed risks of material misstatement due to fraud could be included in the auditor's report and that this should be further explored.

Include the Auditor's Findings or Observations When Responding to the Assessed Fraud Risk?

55. The Task Force noted that users of the financial statements liked the option that includes auditor's findings or observations (option 3). Respondents to the Discussion Paper did not raise any matters with respect to including findings or observations in the auditor's report.
56. Based on the deliberations within the Task Force, the Task Force is of the view that auditors should not be required to disclose findings or observations but that they could voluntarily do so. The Task Force noted that:
 - (a) Including findings or observations would be inconsistent with the requirements for KAMs; and
 - (b) Local laws and regulations may preclude the disclosure of findings or observations for reasons of confidentiality.

Include Identified Significant Deficiencies in Internal Control that Are Relevant to the Prevention and Detection of Fraud in the Financial Statements?

57. The Task Force noted that 17 of the 24 users of the financial statements supported the auditor reporting identified significant deficiencies in internal control that are relevant to the prevention and detection of fraud. Therefore, the Task Force is of the view that the disclosure of these deficiencies should be explored.

Should the Additional Disclosures on Fraud Be Included in a Separate Section on Fraud?

58. The Task Force noted that this question wasn't asked specifically of users of the financial statements during the interviews conducted. However, users of the financial statements indicated that it would be appropriate to include the additional disclosures on fraud in a separate section in the auditor's report as portrayed in the illustrations included in the outreach document (see **Agenda Item 6-A** - options 1, 2 and 3 were presented in a separate section). The users noted this would drive consistency and comparability between auditor reports with respect to fraud.
59. The Task Force discussed whether the additional disclosures on fraud should be included in a new section or the KAM section of the auditor's report. The Task Force noted that while there was support for including the fraud-related disclosures in the KAM section, users of the financial statements also acknowledged that of primary importance was that the information be clear, and consistently disclosed in one location in the auditor's report.
60. The Task Force is therefore of the view that any additional disclosures on fraud should be included in a separate section because:
 - (a) It would provide a clear signpost to the users of the financial statements as to where to find all matters relating to fraud. Reflecting the fraud risks in the KAM section may not clearly highlight these matters.
 - (b) Determining a key audit matter is clearly set out in ISA 701¹¹. However, in certain circumstances, a fraud-related matter identified and addressed in the audit may not necessarily be determined to be a KAM in accordance with ISA 701.

What Should the Scope Be?

61. The Task Force noted that users of the financial statements had mixed views as to which audit engagements the enhanced auditor reporting requirements should apply to (see paragraph 33). The Task Force also had differing views on the way forward.
62. In discussing the scope of the proposed changes, the Task Force discussed whether the proposed standard should be for listed entities or all entities as the Task Force recognizes that currently the IAASB does not have requirements specific to PIEs. The Task Force did however note that 25% of users of the financial statements believe that the enhanced transparency in the auditor's report should only be applicable PIEs. This information will be shared with the Listed Entity and PIE Task Force as they advance their deliberations.
63. Some Task Force members were of the view that all audit engagements for which auditor reports are issued should be transparent about fraud. They noted that in every entity the money of investors is at stake and that more transparency in the auditor's report on fraud would be beneficial including, for example, charities, entities in the public sector and private equity companies.

¹¹ ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

64. Other Task Force members were of the view that the requirements should only apply to listed entities, with the option to voluntarily include the disclosures for other entities. In addition, these Task Force members noted that:
- (a) Including all entities in the scope would be disproportionate response to those smaller or less complex entities e.g., owner-manager entities, and that in these entities investors often have other means of obtaining information about the entity.
 - (b) Of the 8 users of the financial statements that were of the view that the requirements should be applicable to all entities, 6 were of the view that initially the new requirements could apply to listed entities only.

Summary

65. Based on consistent feedback received, the Task Force proposes to enhance transparency in the auditor's report on fraud by including a separate section that encompasses a description of:
- (a) The auditor's responsibilities as it relates to fraud in the audit of the financial statements;
 - (b) The identified and assessed fraud risks and the auditor's response to the assessed risks; and
 - (c) Identified significant deficiencies in internal control that are relevant to the prevention and detection of fraud in the financial statements.
66. The Task Force is of the view that the proposed direction as set out in paragraph 65 is responsive to calls from our stakeholders to be more transparent about fraud in the auditor's report. The Task Force proposes to further develop, for future consideration by the Board, how this may be accomplished. In doing so, the Task Force will consider which standards may be affected and what changes to the requirements may be needed (i.e., new or enhanced requirements).
67. The Task Force is also aware of other standard-setting projects in the IAASB's work plan that are presently considering actions related to enhanced transparency that may also result in changes to the auditor's report. The Task Force will coordinate with members of the Going Concern Task Force, and the Listed Entity and PIE Task Force, as well as the Auditor Reporting Consultation Group, where appropriate, as it advances its thinking on this topic.

Matters for IAASB Consideration

1. The Board is asked for its views on the proposed way forward as set out in paragraphs 48–67, based on the Task Force's summary and discussion of matters as presented in **Section I**. Specifically, the Board is asked for its views on the proposal to communicate in the auditor's report information about the proposal to include:
 - (a) The auditor's responsibilities as it relates to fraud in the audit of the financial statements;
 - (b) The identified and assessed fraud risks and the auditor's response to the assessed risks; and
 - (c) Identified significant deficiencies in internal control that are relevant to the prevention and detection of fraud in the financial statements.
2. The Board is asked for its views on whether the proposed changes should apply to listed entities or all entities.

Section II: Identifying and Assessing the Risks of Material Misstatement due to Fraud

Fraud Project Proposal – Key Issues

68. The project proposal included the following key issues (see paragraph 19):

- (a) *Identifying and assessing risks of material misstatement due to fraud*
 - (i) The auditor's risk identification and assessment process as it relates to fraud should be more robust (including that many aspects of the enhanced risk identification and assessment procedures in ISA 315 (Revised 2019) have not been reflected in ISA 240).
 - (ii) The engagement team discussion is not sufficiently robust with respect to the auditor's considerations of fraud throughout the audit.

Fraud Project Proposal – Proposed Actions

69. The project proposal included the following proposed actions (see paragraph 25) related to identifying and assessing the risks of material misstatements due to fraud:

B4: Requirements and Application Material – Identifying and Assessing Risks of Material Misstatement	Proposed ISA 240 (Revised)
<i>Enhance and clarify requirements and application material in ISA 240 to incorporate recent changes in ISA 315 (Revised 2019) to make fraud risk identification and assessment more robust, including:</i>	
<ul style="list-style-type: none"> • Clarifying that risk assessment procedures in ISA 240 are not separate from those in ISA 315 (Revised 2019). 	Paragraphs 17–28B
<ul style="list-style-type: none"> • Developing explicit fraud considerations in risk assessment procedures 	Paragraphs 17–24G
<ul style="list-style-type: none"> • Enhancing the requirements to consider information obtained from acceptance and continuance when obtaining an understanding of the entity and its environment, etc. 	Paragraph 24
<ul style="list-style-type: none"> • Describing the auditor’s specific considerations relating to fraud when obtaining an understanding of the entity and its environment, the applicable financial reporting framework and the entity’s system of internal control in accordance with ISA 315 (Revised 2019), with an emphasis on, for example: <ul style="list-style-type: none"> ○ The entity’s corporate culture. ○ Entity’s key performance indicators (KPIs). ○ Employee performance measures and incentive compensation policies. ○ The entity’s risk assessment process. ○ Specific control activities to prevent and detect fraud. ○ Other information, e.g., matters the auditor is aware of based on the performance of procedures in accordance with ISA 720 (Revised)¹² or the auditor’s knowledge obtained throughout the audit. 	Paragraphs 24B–24G
<ul style="list-style-type: none"> • Emphasizing in ISA 240 how fraud risk factors influence the identified risks of material misstatement due to fraud at the assertion level, and therefore in designing a more precise response to such a fraud risk. 	Pending
	Pending

¹² ISA 720 (Revised), *The Auditor’s Responsibilities Relating to Other Information*

<ul style="list-style-type: none"> Updating the fraud risk factors currently included in the Appendix to ISA 240 and considering whether the fraud risk factors should rather form part of the application material. Considering examples in ISA 240 to illustrate the scalability of the requirements, for example by providing examples that are more relevant to less complex entities (LCEs). 	Pending
---	---------

Background

70. Based on the nature and extent of the comments from the Board at the June 2022 IAASB meeting, the Task Force is of the view that the sections of proposed ISA 240 (Revised) that address the identification and assessment of the risks of material misstatement due to fraud would benefit from further Board input.
71. **Agenda Item 6-C** explains the significant changes made. This paper only explains the most fundamental changes that have been made in, being the:
- Restructuring of the sections in ISA 240 that build on ISA 315 (Revised 2019); and
 - Development of the application material.

Task Force's Views and Recommendations

Restructuring of the Sections in ISA 240 That Build on ISA 315 (Revised 2019)

72. In June 2022, the Board directed the Task Force to clarify that the risk assessment procedures performed in proposed ISA 240 (Revised) are intended to refer to, or expand on, and should not be duplicative of what is already required in ISA 315 (Revised 2019). The Board also directed the Task Force to align the requirements and application material more closely to ISA 315 (Revised 2019).
73. Based on these comments, the Task Force reviewed all requirements in the sections of proposed ISA 240 (Revised) that build on ISA 315 (Revised 2019) and decided to restructure the requirements.

Inquiries of Management, Those Charged with Governance, Internal Audit and Other Appropriate Individuals within the Entity

74. ISA 315 (Revised 2019)¹³ describes the type of risk assessment procedures to be performed. These procedures do not include specific inquiries. Therefore, the Task Force is of the view that the specific inquiries that were included in paragraphs 17A–22A of the [draft of proposed ISA 240 \(Revised\)](#) as presented to the Board in June 2022, should be placed elsewhere within the proposed standard.
75. The Task Force is of the view that these paragraphs are best moved to the section on obtaining an understanding of the entity and its environment, the applicable financial reporting framework and the

¹³ ISA 315 (Revised 2019), paragraph 14 states the following:

The risk assessment procedures shall include the following: (Ref: Para. A19–A21)

(a) *Inquiries of management and of other appropriate individuals within the entity, including individuals within the internal audit function (if the function exists). (Ref: Para. A22–A26)*

(b) *Analytical procedures. (Ref: Para. A27–A31)*

(c) *Observation and inspection. (Ref: Para. A32–A36)*

entity's system of internal control as the auditor would typically make these inquiries as part of obtaining such understanding. The Task Force concluded as follows in terms of the placement of the requirements paragraphs (and application material) related to the specific inquiries:

- Inquiries with TCWG were included in the requirement related to obtaining an understanding of the control environment. This revision was made because ISA 315 (Revised 2019)¹⁴ requires the auditor (as part of obtaining an understanding of the control environment) to obtain an understanding of the independence of, and oversight over the entity's system of internal control by those charged with governance.
- Inquiries with management and other appropriate individuals within the entity were included in the requirement related to obtaining an understanding the entity's risk assessment process. This revision was made because ISA 315 (Revised 2019)¹⁵ requires the auditor (as part of the entity's risk assessment process) to obtain an understanding of the entity's process for identifying business risks relevant to the financial reporting objectives.
- Inquiries with appropriate individuals within the internal audit function were included in the requirement related to the entity's process to monitor the system of internal control. This revision was made because ISA 315 (Revised 2019)¹⁶ requires the auditor (as part of obtaining an understanding of the entity's process to monitor the system of internal control) to obtain an understanding of the entity's internal audit function, if any, including its nature, responsibilities and activities.

76. The Task Force also moved the paragraph that addresses inconsistencies in responses between inquiries of management and inquiries with individuals within the internal audit function, TCWG, or others within the entity into the section that deals with evaluating the audit evidence obtained from risk assessment procedures. The Task Force is of the view that when evaluating the audit evidence obtained from risk assessment procedures, the auditor would also consider inconsistent responses.

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

77. Paragraph 24B in the draft of proposed ISA 240 (Revised) as presented to the Board in June 2022 was relatively long and perceived to be too complicated. Based on comments from the Board, the Task Force changed the construct of this paragraph. Instead of one paragraph, the Task Force decided to mirror the structure of ISA 315 (Revised 2019). Therefore, similar to ISA 315 (Revised 2019), this section now includes requirements for:

- Understanding the entity and its environment and the applicable financial reporting framework; and
- Each of the components of the entity's system of internal control, except for the component on the information system and communications. The Task Force did not include a requirement for this component of the system of internal as it could not identify any additional fraud consideration for this component.

¹⁴ ISA 315 (Revised 2019) paragraph 21(a)(ii)

¹⁵ ISA 315 (Revised 2019) paragraph 22(a)(i)

¹⁶ ISA 315 (Revised 2019) paragraph 24(a)(ii)

78. To further integrate this section with ISA 315 (Revised 2019) the Task Force also aligned the headings.

Identifying and Assessing the Risks of Material Misstatement

79. Extant ISA 240¹⁷ includes one requirement for the identification and assessment of the risks of material misstatement. In the draft of proposed ISA 240 (Revised) as presented to the Board in June 2022, the Task Force separated out the identification of the risks of material misstatements and the assessment of the risks of material misstatement. This was initially done to align the structure of proposed ISA 240 (Revised) more closely with ISA 315 (Revised 2019) as ISA 315 (Revised 2019) also includes separate requirements for the identification and assessment of the risks of material misstatement.
80. Given the Board's view that the requirements in proposed ISA 240 (Revised) should not be duplicative of what is already required in ISA 315 (Revised 2019) and comments received, the Task Force merged the paragraphs related to the identification and assessment of the risks of material misstatements. Other changes made to align this paragraph with ISA 315 (Revised 2019) have not been reversed.

Application Material for the Section on Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework and the Entity's System of Internal Control

81. In the draft of proposed ISA 240 (Revised) presented to the Board in the June 2022, the Task Force indicated several areas where application material needed to be developed. For the section on obtaining an understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control, the Task Force developed such application material (except for the control activities component of internal control).
82. In developing the application material, the Task Force focused on matters that are specific to fraud, thereby avoiding repeating content from ISA 315 (Revised 2019). The application material was developed based on suggestions from respondents to the Discussion Paper and discussions within the Task Force.
83. The Task Force recognizes that the following areas still need to be developed and will do so before the December 2022 Board meeting. These areas are:
- Describing the auditor's specific considerations relating to fraud when obtaining an understanding of the entity's control activities.
 - Emphasizing in proposed ISA 240 (Revised) how fraud risk factors influence the identified risks of material misstatement due to fraud at the assertion level, thereby providing the auditor with an enhanced understanding of the entity such that the auditor is able to design a more precise response to the identified fraud risks.
 - Updating the fraud risk factors currently included in the Appendix to ISA 240 and considering whether the fraud risk factors should rather form part of the application material.

¹⁷ Paragraph 26 of ISA 240 states the following: "In accordance with ISA 315 (Revised), the auditor shall identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures."

- Considering examples in proposed ISA 240 (Revised) to illustrate the scalability of the requirements, for example by providing examples that are more relevant to LCEs.

Matter for IAASB Consideration:

3. The Board is asked for its views on the drafting as presented in **Agenda Item 6-B** and particularly whether the restructuring has addressed the Board's concerns that the risk assessment procedures performed in proposed ISA 240 (Revised) are intended to refer to, or expand on, and should not be duplicative of what is already required in ISA 315 (Revised 2019).

Next Steps

84. Following the September 2022 IAASB meeting, the Task Force will continue to discuss the topics included in this issues paper. In doing so, the Task Force will consider the Board's feedback.
85. In addition, the Task Force will advance its thinking on the remaining topics outlined in the project proposal which are primarily focused on proposed actions to address specific fraud-related audit procedures. In December 2022, the Task Force will bring a near full draft of the proposed revised standard to the Board.
86. The Task Force will continue to liaise with other IAASB task forces, working groups and consultation groups as needed, and as outlined in the project proposal (in particular, the Technology Consultation Group). The Task Force will also continue to liaise with the International Ethics Standards Board for Accountants to identify any ethics considerations or matters of relevance in terms of fraud.

Appendix 1

Fraud Task Force Members and Update on Activities Since the June 2022 IAASB Meeting

Fraud Task Force Members

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

Fraud Task Force Activities

2. Since the June 2022 IAASB meeting, members of the Task Force met on July 11-12, in addition the Task Force held one virtual meeting on August 16. Owing to the nature of the activities being undertaken, work was also progressed via electronic circulation of materials between members of the Task Force and IAASB Staff.

Outreach

3. The topic of fraud was addressed in meetings with the following stakeholders during the third quarter as part of the general outreach program:
 - Institute of Chartered Accountants in England and Wales;
 - Koninklijke Nederlandse Beroepsorganisatie van Accountants;
 - De Autoriteit Financiële Markten; and
 - United States Securities and Exchange Commission.

See **Agenda Item 1** of the September 2022 meeting for further details

4. The Task Force Chair, members of the Task Force and Staff participated in 21 interviews, conducted via videoconference calls, with 24 users of the financial statements as part of the targeted outreach to advance the topic of transparency in the auditor's report (see **Appendix 3**).

Appendix 2

Option 5: Reporting Identified Significant Deficiencies in Internal Control That Are Relevant to the Prevention and Detection of Fraud

1. The Fraud Task Force notes that reporting deficiencies in an entity's system of internal control is a broader matter and relates to all audit procedures performed (i.e., is not just specific to audit procedures performed to address the risks of material misstatement due to fraud). However, as explained in paragraph 13 of this Agenda Item and further described below, the Task Force was of the view that the fifth option merits further consideration and therefore included it in the document used for outreach with users of the financial statements (see **Agenda Item 6-A**).
2. The Task Force was of the view that requiring the auditor to report significant deficiencies in internal control that are relevant to the prevention and detection of fraud in the auditor's report may be beneficial as it:
 - Addresses the question "will this additional disclosure in the auditor's report lead to a change in behavior" (in conjunction with all the other changes being proposed as part of the ISA 240 project). It is likely that management and TCWG would prefer that the auditor not disclose significant deficiencies in the system of internal control due to fraud in the auditor's report. This may therefore result in an increased focus by management and TCWG on their responsibility to prevent and detect fraud, including promoting a culture whereby internal control deficiencies due to fraud are addressed timely.
 - Appropriately places the focus on the entity and its environment, including how management and TCWG are addressing significant deficiencies in internal control relevant to the prevention and detection of fraud.
 - Encourages on-going and two-way communications between the auditor and TCWG throughout the audit to address deficiencies as they arise.
 - Assists in generating an engaging dialogue with users of the financial statements that may drive behavior changes in practice – both by the auditor and management and TCWG.

Relevant ISAs

3. ISA 240 notes that the primary responsibility for the prevention and detection of fraud rests with both management and TCWG of the entity. The purpose of the entity's system of internal controls is therefore to "prevent and detect fraud" when addressing the risk that the financial statements may be materially misstated due to fraud.
4. ISA 265¹⁸ deals with the auditor's responsibility to communicate appropriately to management and TCWG deficiencies in internal control that the auditor has identified in an audit of financial statements. The standard¹⁹ recognizes that "the auditor is required to obtain an understanding of internal control relevant to the audit when identifying and assessing the risks of material misstatement. In making those risk assessments, the auditor considers internal control 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 internal control. The auditor may identify deficiencies in internal control not only

¹⁸ ISA 265, paragraph 1

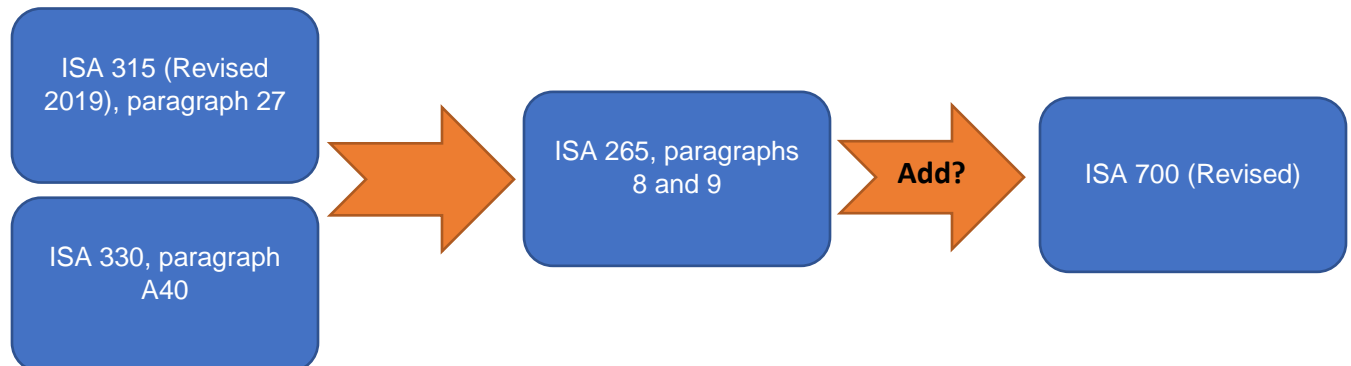
¹⁹ ISA 265, paragraph 2

during this risk assessment process but also at any other stage of the audit. This ISA specifies which identified deficiencies the auditor is required to communicate to management and TCWG.”

5. The definition²⁰ of “deficiency in internal control” addresses misstatements in the financial statements. While the definition is not explicit about error or fraud, the “error or fraud” is introduced in the definition of misstatement in ISA 450:²¹ “Misstatements – a difference between.....Misstatements can arise from error or fraud.”
6. Based on the auditor's evaluation of each of the components of the entity's system of internal control (see paragraph 27 of ISA 315 (Revised 2019)), one or more control deficiencies may be identified such that:
 - (a) A control which is designed, implemented or operated to prevent or detect fraud, is unable to prevent, or detect [and correct], misstatements due to fraud in the financial statements on a timely basis; or
 - (b) A control necessary to prevent, or detect [and correct], misstatements due to fraud in the financial statements on a timely basis is missing.

If a control deficiency is identified, ISA 265 applies.

7. The auditor may also identify a significant deficiency when performing audit procedures in response to assessed risks of material misstatement. ISA 330²², paragraph A40 states that: “A material misstatement detected by the auditor's procedures is a strong indicator of the existence of a significant deficiency in internal control.” If a control deficiency is identified, ISA 265 applies.



8. ISA 265 paragraph 8 “filters” the deficiencies as it requires the auditor to determine whether individually or in combination the deficiencies constitute significant deficiencies. The auditor is only required to communicate significant deficiencies in writing to TCWG (see ISA 265, paragraph 9). The auditor is not required to disclose the significant deficiencies in the auditor's report. However, the auditor's report includes the following statement:²³

“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.”

²⁰ ISA 265, paragraph 6

²¹ ISA 450, *Evaluation of Misstatements Identified During the Audit*, paragraph 4(a)

²² ISA 330, *The Auditor's Responses to Assessed Risks*

²³ ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraph 40(a)

9. Further, ISA 265 paragraph A5 notes the following:

The significance of a deficiency or a combination of deficiencies in internal control depends not only on whether a misstatement has actually occurred, but also on the likelihood that a misstatement could occur and the potential magnitude of the misstatement. Significant deficiencies may therefore exist even though the auditor has not identified misstatements during the audit.

10. In addition, paragraph A6 of ISA 265 provides examples of matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency. These matters include the susceptibility to loss or fraud of the related asset or liability and controls that may be of importance to the financial reporting process, such as controls over the prevention and detection of fraud.
11. Of note is that while KAMs are selected from the matters communicated with TCWG,²⁴ a significant deficiency may be a KAM but is not required to be.²⁵
12. The Task Force is of the view that the existing requirements and application material in ISA 315 (Revised 2019), ISA 330 and ISA 265 provided a sufficient basis to underpin the development of option 5.
13. The Task Force developed examples that are included in the document used for outreach with users of the financial statements (see **Agenda Item 6-A**, page 9). In both examples the auditor does not have a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements and the auditor has identified a significant deficiency in internal control that is relevant to the prevention and detection of fraud.

²⁴ ISA 701, paragraph 9

²⁵ The [Basis for Conclusions](#) for auditor reporting noted that: “One Monitoring Group member was of the view that additional communication in the auditor’s report might be necessary if any significant deficiencies in internal control or a combination of deficiencies is such that there a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented or detected on a timely basis.”

Appendix 3

Transparency in the Auditor's Report – List of Users of the Financial Statements

	Name	Organization / Affiliation	Jurisdiction	Meeting Date ²⁶	Fraud Task Force / Staff Member Conducting the Interview
1	Sandy Peters	CFA Institute	USA	June 30	Julie Corden Jasper van den Hout
2	Natasha Landell-Mills	International Corporate Governance Network	United Kingdom (UK)	July 14	Diane Larsen Sally Ann Bailey
3	Not disclosed	Not disclosed	USA	June 2	Lyn Provost Jasper van den Hout
4	Anthony Scilipoti	Veritas Investment Research	Canada	June 23	Diane Larsen Sally Ann Bailey
5	Mark Bentley	ShareSoc	UK	June 30	Josephine Jackson Jasper van den Hout
6	Mohammed Amin	UK Shareholders' Association ShareSoc	UK	June 23	Josephine Jackson Jasper van den Hout
7	Charles Henderson	UK Shareholders' Association	UK	June 28	Lyn Provost Jasper van den Hout
8	Martijn Bos	Eumedion	Netherlands	June 29	Jasper van den Hout
9	Shinya Tsujimoto	Nippon Life Global Investors Singapore Limited	Singapore	July 6	Len Jui Sally Ann Bailey
10	Jenn-Hui Tan Flora Wang	Fidelity International	Singapore	June 26	Len Jui Jasper van den Hout

²⁶ Meeting date based is based on Eastern Daylight Time.

	Name	Organization / Affiliation	Jurisdiction	Meeting Date²⁶	Fraud Task Force / Staff Member Conducting the Interview
11	Eric Chiang	CFA Society Hong Kong	Hong Kong SAR	June 27	Len Jui Jasper van den Hout
12	Kei Tsuchiya	The Securities Analysts Association of Japan	Japan	July 6	Len Jui Sally Ann Bailey
13	Koei Otaki	SMBC Nikko Securities Inc.	Japan	July 6	Len Jui Sally Ann Bailey
14	Kazuhiro Yoshii	Daiwa Securities Group Inc.	Japan	July 6	Len Jui Sally Ann Bailey
15	Goro Kumagai	Mizuho Securities Co., Ltd. / The Securities Analysts Association of Japan	Japan	July 6	Len Jui Sally Ann Bailey
16	Robert Oellermann	Laurium Capital	South Africa	July 1	Lyn Provost Jasper van den Hout
17	Didier Mena Campos	Grupo Financiero Santander Mexico	Mexico	June 20	Julie Corden Sally Ann Bailey Jasper van den Hout
	Luis Ignacio de la Luz Davalos	Grupo Financiero BBVA Mexico, SA de CV			
	Armando Leos Trejo	Grupo Financiero Citibanamex SA de CV			
18	Fiona Balzer	Australian Shareholders' Association	Australia	July 13	Lyn Provost Sally Ann Bailey
19	Oliver Mander	New Zealand Shareholders' Association	New Zealand	June 26	Lyn Provost Sally Ann Bailey

	Name	Organization / Affiliation	Jurisdiction	Meeting Date²⁶	Fraud Task Force / Staff Member Conducting the Interview
20	Javier de Frutos	European Federation of Financial Analysts' Societies	Spain	July 6	Julie Corden Jasper van den Hout
21	Kazim Razvi	Corporate Reporting Users' Forum European Financial Reporting Advisory Group	UK	July 11	Josephine Jackson Jasper van den Hout
22	Keiko Mizuguchi	Asian Development Bank Institute	Japan	July 17	Len Jui Sally Ann Bailey
23	Fortunatus Magambo	TCCIA Investment PLC	Tanzania	July 28	Lyn Provost Sally Ann Bailey
24	Kevin Harding	Investec	South Africa	July 29	Diane Larsen Sally Ann Bailey

Appendix 4

Transparency in the Auditor's Report – Additional Questions for Outreach

Below are some additional questions that the Task Force developed to prompt conversation with the various users of the financial statements.

1. (a) What are the benefits of option X to your understanding of the auditor's work effort?
(b) What are the benefits of option X to your investment decisions?
2. What are the challenges with option X?
3. Do you think that option X will drive changes in the auditor's behavior?
4. Do you think that option X will drive changes in the behavior of management and those charged with governance?
5. Do you think the requirements should be applicable to:
 - Listed entities only;
 - Public interest entities only; or
 - All entities.
6. Do you think additional disclosures from management or those charged with governance would provide you with insightful information that will impact your decision making related to the entity? If so, where would you like to see these disclosures?
7. [For options 2, 3 and 5 only] Do you think option X will work when local laws and regulations does not require management to make disclosures about ... [fraud risk / deficiencies in internal control due to fraud]