

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

#### Objective

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

#### Board Discussion

##### Issues Paper

This paper describes the issues addressed by the Task Force and for discussion with the IAASB at its June 2022 meeting.

##### *Appendices to this Paper*

The following appendices are included in this paper:

- [Appendix 1](#) – Task Force Members and Activities Since the March 2022 IAASB Meeting;
- [Appendix 2](#) – Extract from the Draft March 2022 IAASB Meeting Minutes; and
- [Appendix 3](#) – Approach for the Discussion of the Agenda Items.

##### Proposed ISA 240 (Revised)<sup>2</sup>

The Task Force also presents:

- **Agenda Item 7-A** – Draft of Proposed ISA 240 (Revised) marked from extant ISA 240; and
- **Agenda Item 7-B** – Draft of Proposed ISA 240 (Revised) in clean.

##### Approach to the Board Discussion

[Appendix 3](#) sets out the planned approach for the discussion, with references to the paragraphs in **Agenda Item 7-A** and this paper. The Board is requested to provide comments on the requirements and the related application material at the same time.

#### Background

1. At the March 2022 IAASB meeting, the Board discussed and broadly agreed with the Task Force's proposals on changes in proposed ISA 240 (Revised) addressing the identification and assessment of the risks of material misstatement due to fraud and communication with those charged with governance (TCWG) about fraud-related matters. The Board also discussed different alternatives on the way forward for transparency in reporting on fraud and agreed that all options presented should be included in the planned outreach with users of financial statements. The Board was broadly

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

<sup>2</sup> Proposed ISA 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

supportive of the non-authoritative guidance illustrating the relationship between and the linkage of extant ISA 240 and other ISAs. The Task Force finalized and published the guidance in May 2022.

2. This Issues Paper includes certain topics that were deliberated by the Board at the [March 2022 meeting](#) and encompasses the resulting direction provided by the Board as reflected in the draft minutes (see [Appendix 2](#)).
3. The following sections of the paper further explore the Task Force's views and recommendations on the proposed changes in ISA 240 (Revised) addressing selected topics on:
  - (a) Structure ([Section I](#));
  - (b) Introduction ([Section II](#));
  - (c) Specialized Skills ([Section III](#));
  - (d) Identifying and assessing the risks of material misstatement due to fraud ([Section IV](#));
  - (e) Presumption of fraud risk in revenue recognition ([Section V](#));
  - (f) Journal entries ([Section VI](#));
  - (g) Communications with those charged with governance ([Section VII](#));
  - (h) Transparency in the auditor's report ([Section VIII](#)); and
  - (i) Way forward.

#### **Approach to Addressing the Actions Included in the Project Proposal**

4. As the Task Force progresses its work to develop the Exposure Draft for proposed ISA 240 (Revised), and while formulating its views and recommendations for the other standard-setting actions, the Task Force intends to further develop, align, and refine its proposals for certain aspects of the issues discussed in this Agenda Item. Such matters will be subject to further deliberation by the IAASB at its December 2022.
5. Where appropriate, the Task Force has indicated placeholders or has highlighted aspects of the issues discussed in this Agenda Item that will need further consideration by the Task Force as the work under the project is progressed.
6. When drafting proposed ISA 240 (Revised), the Task Force and Staff will remain cognizant of the recently approved *Complexity, Understandability, Scalability and Proportionality (CUSP) Drafting Principles and Guidelines*.

#### **Liaison with Task Forces and Others**

7. The Task Force's Chair and Staff met with the Chair and Staff of the Audit Evidence Task Force to discuss matters of mutual interest, including possible conforming amendments to ISA 240. Subsequent meetings were held between Staff supporting the Task Force and the Staff supporting the Audit Evidence Task Force related to the testing of journal entries.
8. Staff also met with Staff of the International Ethics Standards Board for Accountants (IESBA) to discuss matters of mutual interest, including IESBA's project on Sustainability. Staff and the Chair of the Task Force intend to liaise with IESBA regularly.

## Section I – Structure

9. The Task Force discussed the structure of proposed ISA 240 (Revised). In doing so, the layout, including headings and related content, of recently revised ISAs was considered, namely ISA 315 (Revised 2019),<sup>3</sup> ISA 540 (Revised)<sup>4</sup> and ISA 600 (Revised).<sup>5</sup> The following structure of the requirements was discussed by the Task Force and will be used as a basis for revising the standard. The Task Force acknowledges that the layout will evolve based on:

- (a) Feedback provided by the IAASB with respect to each of the sections outlined in this issues paper and subsequent issues papers; and
- (b) How the proposed actions in the [project proposal](#) are addressed by the Task Force, including the interrelationships between the various sections and sub-sections.

EXTANT ISA 240	PROPOSED ISA 240 (REVISED)	RELATED SECTION IN ISSUES PAPER
<b>Introduction</b>	<b>Introduction</b>	<a href="#">Section II</a>
<b>Scope of this ISA</b>	<b>Scope of this ISA</b>	
	<b>Responsibilities of the Auditor, Management and Those Charged with Governance</b>	
	<i>Responsibilities of the Auditor</i>	
	<i>Responsibilities of Management and Those Charged with Governance</i>	
<b>Characteristics of Fraud</b>		
<b>Responsibility for the Prevention and Detection of Fraud</b>		
<i>Responsibilities of the Auditor</i>		
	<b>Key Concepts in this ISA</b>	
	<i>Characteristics of Fraud</i>	
	<i>Inherent Limitations</i>	
	<i>Professional Skepticism</i>	
	<i>Inherent Risk Factors and Fraud Risk Factors</i>	
	<i>Non-Compliance with Laws and Regulations</i>	

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

<sup>4</sup> ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

<sup>5</sup> ISA 600 (Revised), *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*

EXTANT ISA 240	PROPOSED ISA 240 (REVISED)	RELATED SECTION IN ISSUES PAPER
	<i>Relationship with Other ISAs</i>	
<b>Effective Date</b>	<b>Effective Date</b>	
<b>Objectives</b>	<b>Objectives</b>	
<b>Definitions</b>	<b>Definitions</b>	
<b>Requirements</b>	<b>Requirements</b>	
<b>Professional Skepticism</b>	<b>Professional Skepticism</b>	
	<b>Engagement Resources</b>	<a href="#">Section III</a>
<b>Discussion among the Engagement Team</b>		
<b>Risk Assessment Procedures and Related Activities</b>	<b>Risk Assessment Procedures and Related Activities</b>	
<i>Management and Others within the Entity</i>	<i>Management and Others within the Entity</i>	<a href="#">Section IV</a>
<i>Those Charged with Governance</i>	<i>Those Charged with Governance</i>	<a href="#">Section IV</a> and <a href="#">Section VII</a>
	<i>Inconsistent Responses</i>	<a href="#">Section IV</a>
<i>Unusual or Unexpected Relationships Identified</i>		
<i>Other Information</i>	<i>Information from Other Sources</i>	<a href="#">Section IV</a>
	<i>Engagement Team Discussion</i>	
<i>Evaluation of Fraud Risk Factors</i>		<a href="#">Section IV</a>
	<b>Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework and the Entity’s System of Internal Control</b>	<a href="#">Section IV</a>
	<i>The Entity and Its Environment</i>	
	<i>The Applicable Financial Reporting Framework</i>	
	<i>The Entity’s System of Internal Control</i>	
	Control Environment	
	The Entity’s Risk Assessment Process	
	The Entities Process to Monitor the	

<b>EXTANT ISA 240</b>	<b>PROPOSED ISA 240 (REVISED)</b>	<b>RELATED SECTION IN ISSUES PAPER</b>
	System of Internal Control	
	Control Activities	
	Control Deficiencies Within the Entity's System of Internal Control	
<b>Identification and Assessment of the Risks of Material Misstatement Due to Fraud</b>	<b>Identifying and Assessing the Risks of Material Misstatement Due to Fraud</b>	
	<i>Evaluation of Fraud Risk Factors</i>	<a href="#">Section IV</a>
	<i>Identifying the Risks of Material Misstatement Due to Fraud</i>	<a href="#">Section IV</a>
	Presumption of Fraud Risk in Revenue Recognition	<a href="#">Section V</a>
	Unusual or Unexpected Relationships Identified	<a href="#">Section IV</a>
	<i>Assessing Risks of Material Misstatement Due to Fraud</i>	<a href="#">Section IV</a>
	<i>Evaluating the Audit Evidence Obtained from the Risk Assessment Procedures</i>	<a href="#">Section IV</a>
<b>Responses to the Assessed Risks of Material Misstatement Due to Fraud</b>	<b>Responses to the Assessed Risks of Material Misstatement Due to Fraud</b>	
<i>Overall Responses</i>	<i>Overall Responses</i>	
<i>Audit Procedures Responsive to Assessed Risks of Material Misstatement Due to Fraud at the Assertion Level</i>	<i>Audit Procedures Responsive to Assessed Risks of Material Misstatement Due to Fraud at the Assertion Level</i>	
<i>Audit Procedures Responsive to Risks Related to Management Override of Controls</i>	<i>Audit Procedures Responsive to Risks Related to Management Override of Controls</i>	<a href="#">Section VI</a>
	<b>Audit Procedures Responsive to Fraud or Suspected Fraud Identified During the Audit</b>	
	<i>Fraud is Not Material</i>	
<b>Evaluation of Audit Evidence</b>	<b>Evaluation of Audit Evidence</b>	

EXTANT ISA 240	PROPOSED ISA 240 (REVISED)	RELATED SECTION IN ISSUES PAPER
<b>Auditor Unable to Continue the Engagement</b>	<b>Auditor Unable to Continue the Engagement</b>	
<b>Written Representations</b>	<b>Written Representations</b>	
<b>Communications to Management and with Those Charged with Governance</b>	<b>Communication with Management and Those Charged with Governance</b>	<a href="#">Section VII</a>
	<i>Communication of Identified Deficiencies in Internal Control</i>	
<b>Reporting Fraud to an Appropriate Authority Outside the Entity</b>	<b>Reporting Fraud to an Appropriate Authority Outside the Entity</b>	
<b>Documentation</b>	<b>Documentation</b>	

## Section II – Introduction

### Fraud Project Proposal – Key Issues

10. The project proposal included the following key issues (see paragraph 19) where the related proposed actions impacted the Introduction section:

- (a) *Role and responsibilities of the auditor on fraud in an audit of financial statements*
  - (i) The introductory paragraphs in ISA 240 explaining the inherent limitations of an audit can be misleading and result in misunderstanding of the auditor’s obligations.
  - (ii) A need has been expressed to clarify and emphasize the auditor’s responsibilities regarding fraud in an audit of financial statements.

...
- (e) *Relationship between and linkage of ISA 240 with respect to ISA 250 (Revised)<sup>6</sup> and the other ISAs*
  - (i) The relationship between ISA 240 and ISA 250 (Revised) is unclear, i.e., more clarity is needed if a fraud is identified or suspected, whether the auditor is performing procedures to comply with ISA 240 or ISA 250 (Revised).
  - (ii) The relationship between ISA 240 and other ISAs (e.g., standards addressing quality management, written representations, and external confirmations) should be clarified to promote an integrated risk-based approach with respect to fraud.

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<sup>6</sup> ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*

- (f) *Specific fraud-related audit procedures*
- (vii) Non-material fraud – clarity is needed with respect to the auditor’s responsibilities and whether more should be done when a possible non-material fraud is identified or suspected.

**Fraud Project Proposal – Proposed Actions**

11. The project proposal included the following proposed actions<sup>7</sup> (see paragraph 25):

<p><b>A1: Introductory Paragraphs in ISA 240 – Emphasis on the Auditor’s Responsibilities</b></p> <p>Enhance and clarify the introductory paragraphs in ISA 240 to emphasize the auditor’s responsibilities regarding fraud, including:</p> <ul style="list-style-type: none"> <li>• Considering whether the auditor’s responsibilities should be placed prior to the description of inherent limitations of an audit.</li> <li>• Considering changes and enhancements made by others in different jurisdictions in their equivalent of ISA 240 to reduce the ambiguity between the inherent limitations of an audit and the auditor’s responsibilities for fraud in an audit of financial statements.</li> <li>• Considering whether to provide context for the auditor’s responsibilities by explaining the responsibilities of others in the financial reporting ecosystem (relevant to the financial statement audit) within the introductory paragraphs.</li> </ul> <p><b>B11: Introductory Paragraphs and Application Material in ISA 240 – Relationship Between ISA 240 and ISA 250 (Revised), and Other ISAs</b></p> <p>Enhance the introductory paragraphs and consider application material in ISA 240 to clarify the relationship between ISA 240 and ISA 250 (Revised), including:</p> <ul style="list-style-type: none"> <li>• Highlighting the interrelationship between fraud and non-compliance with laws and regulations (i.e., fraud usually constitutes an illegal act and therefore, also falls under ISA 250 (Revised)).</li> </ul>	<p><b>Proposed ISA 240 (Revised)</b></p> <p>Paragraphs 1A–1B</p> <p>Paragraphs 1A– B; paragraphs 5–7</p> <p>Paragraph 9</p>
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<sup>7</sup> In certain instances, the bullets of the proposed actions for each of the sections have been reordered to facilitate the flow and readability of the Issues Paper.

<ul style="list-style-type: none"> <li>Enhance, within the standards, the linkages between ISA 240 and the other ISAs with cross-referencing as appropriate.</li> </ul>	<p>Paragraph 9A</p>
<p><b>B19: Introductory Paragraphs and Application Material in ISA 240 – Non-Material Fraud</b></p>	
<p>Enhance the introductory paragraphs and consider application material in ISA 240 to describe the auditor’s responsibilities when non-material fraud is identified or suspected (e.g., that more work is required to conclude that it is a non-material fraud, taking into account the quantitative and qualitative characteristics of a possible misstatement).</p>	<p>Paragraph 4D</p>

### Task Force’s Views and Recommendations

#### *Emphasis on the Auditor’s Responsibilities Regarding Fraud*

Considering Whether the Auditor’s Responsibilities Should Be Placed Prior to the Description of Inherent Limitations of an Audit (Structure of the Introduction)

12. In developing the recommendation to place added emphasis and focus on the importance of the auditor’s responsibilities as it relates to fraud, the Task Force:
  - (a) Looked at the suite of ISAs and the placement of the heading “Responsibilities of the Auditor” (or similar headings), noting that the heading typically follows on after the description of the responsibility of management [and TCWG]. For example, see ISA 250 (Revised), ISA 550,<sup>8</sup> ISA 570 (Revised),<sup>9</sup> ISA 610 (Revised 2013)<sup>10</sup> and ISA 620.<sup>11</sup>
  - (b) Reviewed the overall layout of the introductory sections of recently issued ISA 540 (Revised), ISA 315 (Revised 2019) and ISA 600 (Revised).
13. The Task Force believes that given the focus by the stakeholders on the auditor’s responsibilities specific to fraud, it is imperative that the responsibilities are prominently presented at the outset of the introductory section. The Task Force also believes that a clear and affirmative articulation of the auditor’s responsibilities will set the overall tone for the requirements and application and other explanatory material that follows in proposed ISA 240 (Revised). The Task Force determined to re-order the paragraphs as presented in the proposed structure in paragraph 9.
14. As part of the restructuring, a section to address key concepts was introduced in proposed ISA 240 (Revised). The “Key Concepts in this ISA” section is included in ISA 540 (Revised) and ISA 315 (Revised 2019). The section includes certain of the underlying concepts such as the characteristics

<sup>8</sup> ISA 550, *Related Parties*

<sup>9</sup> ISA 570 (Revised), *Going Concern*

<sup>10</sup> ISA 610 (Revised 2013), *Using the Work of Internal Auditors*

<sup>11</sup> ISA 620, *Using the Work of an Auditor’s Expert*

of fraud, the inherent limitations of an audit (also found in paragraphs A47 and A53–A54 of ISA 200)<sup>12</sup> and other relevant information that is crucial to the auditor's understanding of the ISA.

#### Reduce The Ambiguity Between the Inherent Limitations of an Audit and The Auditor's Responsibilities for Fraud in an Audit of Financial Statements

15. The Task Force believes that the first sentence of paragraph 5 of extant ISA 240 should be retained under the heading "Responsibilities of the Auditor" (see paragraph 1A of proposed ISA 240 (Revised)). The remainder of paragraph 5 of extant ISA 240 relating to the inherent limitations of the audit being relocated under the sub-heading "Inherent Limitations." By doing so, the auditor's responsibilities are more succinct and unencumbered by language that may be perceived to diminish the auditor's responsibilities.
16. In addition, the Task Force believes that the auditor's responsibilities may be further clarified, by leveraging the overall objectives in paragraph 11(b) of ISA 200, to encompass reporting on fraud-related matters, for example by communicating to management or TCWG or in the auditor's report as required by proposed ISA 240 (Revised) (see paragraph 1A of proposed ISA 240 (Revised)).
17. The Task Force also considered changes and enhancements made by others in different jurisdictions in their equivalent ISA 240. In doing so, the Task Force referenced both Public Company Accounting Oversight Board Auditing Standard (AS) 1001, [Responsibilities and Functions of the Independent Auditor](#) and ISA (UK) 240 (Revised May 2021), [The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements](#).<sup>13</sup> The Task Force agreed that paragraph 7-1<sup>14</sup> of ISA (UK) 240 (Revised May 2021) provided additional context when considering the auditor's responsibilities and agreed to add the text with minor edits to proposed ISA 240 (Revised) (see paragraph 1B of proposed ISA 240 (Revised)) .
18. The Task Force was of the view that collectively these proposed changes will provide for an auditor's responsibilities section that is clear and concise in terms of what the auditor is accountable for with respect to fraud in an audit of the financial statements.

#### Considering Whether to Provide Context for the Auditor's Responsibilities by Explaining the Responsibilities of Others in the Financial Reporting Ecosystem

19. While paragraph 4 of extant ISA 240 makes it clear that the primary responsibility for the prevention and detection of fraud rests with both management and TCWG of the entity, it is less clear as to the responsibilities of others in the financial reporting ecosystem (relevant to the financial statement audit).
20. The Task Force was of the view that proposed ISA 240 (Revised) should not articulate, in the introductory section, the responsibilities of others in the financial reporting ecosystem over which the IAASB has no remit. Instead, when considering information from other sources that may indicate a risk of material misstatement due to fraud, the auditor may obtain relevant information from others in the financial reporting ecosystem (e.g., fraud may be detected by an external regulatory or prudential

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<sup>12</sup> ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

<sup>13</sup> Published by the Financial Reporting Council (FRC) in May 2021.

<sup>14</sup> This requirement reflects the FRC text in ISA (UK) 240 (Revised May 2021) that supplement the requirements in ISA 240.

body with oversight responsibilities of the entity, the results of which have been made publicly available and have financial reporting implications). The Task Force will consider whether it is appropriate to add an example to address this circumstance in the application material in paragraph A23A of proposed ISA 240 (Revised).

*Clarify the Relationship Between ISA 240 and ISA 250 (Revised), and Other ISAs*

21. The interrelationship between ISA 250 (Revised) and relevant ethical requirements (e.g., the IESBA's *International Code of Ethics for Professional Accountants (including International Independence Standards)*) has been strengthened by making explicit reference to ISA 250 (Revised) and the inclusion of a sub-heading "Non-Compliance with Laws and Regulations" (see paragraph 9 of proposed ISA 240 (Revised)).
22. The Task Force enhanced the introductory section by including a paragraph that explicitly addresses that there are linkages between proposed ISA 240 (Revised) and other ISAs. In doing so, the Task Force has proposed language that leverages the recently issued non-authoritative guidance, [\*The Fraud Lens – Interactions Between ISA 240 and Other ISAs\*](#). This paragraph has been included under a sub-heading "Relationship with Other ISAs" (see paragraph 9A of proposed ISA 240 (Revised)).

*Describe the Auditor's Responsibilities When Non-Material Fraud Is Identified or Suspected*

23. The Task Force discussed whether to clarify, under the "Responsibilities of the Auditor" sub-heading, the responsibilities of the auditor as it relates to fraud that is not material. The Task Force agreed that the objective of the audit should not be expanded to identify and assess the risks of misstatement of the financial statements due to fraud to those risks that are not material.
24. The Task Force however, determined that in order to be responsive to the proposed action, proposed ISA 240 (Revised) should clarify the characteristics that are to be considered by the auditor when making judgments about whether or not a misstatement is material i.e., the considerations may be qualitative or quantitative.
25. The Task Force noted that amendments were made to paragraph 3 of These amendments have been used as the basis for the text in paragraph 4D of proposed ISA 240 (Revised).
26. The Task Force included an example to illustrate that a fraud may be considered qualitatively material even if the potential misstatement is less than materiality determined in quantitative terms for the financial statements as a whole. The Task Force determined to address this aspect under the sub-heading "Characteristics of Fraud."

*Other Matters Addressed by the Task Force*

27. The Task Force believes that it is appropriate to clarify that the auditor is concerned with both actual fraud and suspected fraud. This is especially important when considering the nature of the circumstances and the characteristics of the fraud or suspected fraud (e.g., qualitative considerations may give rise to a possible material misstatement as a result of suspected fraud). In certain instances where the auditor is making inquiries, the auditor may also discuss with management, TCWG and others within the entity, if these parties are aware of any allegations of fraud made by other individuals (see paragraph 4C of proposed ISA 240 (Revised)).
28. The linkage between proposed ISA 240 (Revised) and ISA 315 (Revised 2019) was further clarified to explain the interrelationship between inherent risk factors and fraud risk factors. In doing so, the

Task Force sought to expand on paragraph 12(f) of ISA 315 (Revised 2019) (see paragraph 8B of proposed ISA 240 (Revised)).

*Next Steps*

29. In discussing the interrelationship between extant ISA 240 and ISA 250 (Revised), the Task Force will give consideration to adding application material to proposed ISA 240 (Revised) that may be helpful in highlighting that fraud usually constitutes an illegal act, and therefore, in such instances ISA 250 (Revised) would also apply.
30. In further deliberating the response of the auditor when fraud that is not material is identified or suspected, the Task Force will give consideration to enhancing the application material to clarify the auditor's work effort in such circumstances (e.g., what additional work is required to conclude that it is a non-material fraud, taking into account the quantitative and qualitative characteristics of a possible misstatement).

**Matters for IAASB Consideration**

1. The Board is asked for its views on the changes made to proposed ISA 240 (Revised) as set out in paragraphs 1–9A of **Agenda Item 7-A** (and related application material). The Task Force is specifically interested in the Board's perspectives on the:
  - (a) Appropriate balance between the auditor's responsibilities and the inherent limitations in the introductory paragraphs;
  - (b) Introduction of the "Key Concepts in the ISA" section, including the use of sub-headings that clearly highlight the interrelationship between proposed ISA 240 (Revised), ISA 250 (Revised), and other ISAs;
  - (c) Enhancements to address fraud that is not material to the financial statements, specifically that judgments about whether an identified misstatement is material involves qualitative and quantitative considerations; and
  - (d) Clarification that the term "fraud" is inclusive of actual fraud and suspected fraud.
2. In relation to the Introduction, the Board is asked whether there are any other related matters, the Task Force should consider as it develops the Introduction section of proposed ISA 240 (Revised).

**Section III – Specialized Skills**

**Fraud Project Proposal – Key Issues**

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

- (a) *Role and responsibilities of the auditor on fraud in an audit of financial statements*  
 ...  
 (iv) Calls for the auditor undertaking more forensic type procedures, or the need for forensic specialists on all, or some, audits have been made due to the increasing use of forensic procedures on audits, including by forensic specialists.

**Fraud Project Proposal – Proposed Actions**

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

<p><b>A3: Requirements and Application Material – Specialized Skills</b></p>	<p><b>Proposed ISA 240 (Revised)</b></p>
<p><i>Consider enhancing requirements and application material in ISA 240 on the need for specialized skills (including forensic skills):</i></p>	
<ul style="list-style-type: none"> <li>• Consider changes made by others in different jurisdictions relating to the use of specialized skills.</li> </ul>	<p>Paragraphs 16A and A12A–A12C</p>
<ul style="list-style-type: none"> <li>• Consider a new requirement and enhanced application material for those circumstances when it is appropriate for the auditor to “consider the need for specialized skills, including forensic skills” to assist with audit procedures, such as:                             <ul style="list-style-type: none"> <li>○ When performing risk identification and assessment. In doing so, consider how this links to the revised requirements in ISA 220 (Revised)<sup>15</sup> for adequate resources for the engagement.</li> <li>○ When there is identified or suspected fraud.</li> </ul> </li> </ul>	<p>Paragraphs 16A and A12A–A12D</p>
<ul style="list-style-type: none"> <li>• Consider how scalability of a new requirement can be achieved by taking into the account the nature and circumstances of auditors to have access to such specialized skills, in particular, auditors of less complex entities (LCEs).</li> </ul>	<p>Paragraphs 16A and A12A–A12D</p>
<ul style="list-style-type: none"> <li>• Consider how to describe “forensic skills,” in light of comments that this term is not commonly understood (i.e., clarify what may qualify as forensic skills).</li> </ul>	<p>Paragraph A12D</p>

**Task Force’s Views and Recommendations**

*Considering Changes Made by Others in Different Jurisdictions*

33. In addressing specialized skills (including forensic skills) in proposed ISA 240 (Revised), the Task Force:

- (a) Referred to and leveraged similar requirements and related application material to “determine the need for specialized skills” in ISA 540 (Revised),<sup>16</sup> and ISA (UK) 240 (Revised May 2021);<sup>17</sup> and

<sup>15</sup> ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*

<sup>16</sup> ISA 540 (Revised), paragraphs 15 and A61–A63

<sup>17</sup> ISA (UK) 240 (Revised May 2021), paragraphs 24-1, A27-1, 33-1 and A48-1

- (b) Took into account current requirements and application material relating to specialized skills in extant ISA 240<sup>18</sup> and those relating more broadly to engagement resources in other standards (i.e., ISQM 1,<sup>19</sup> ISA 220 (Revised)<sup>20</sup> and ISA 300).<sup>21</sup>

*Considering A New Requirement and Enhancing Application Material*

34. The Task Force included a new requirement in paragraph 16A of proposed ISA 240 (Revised) and enhanced the application material. The requirement supplements the foundational requirements in ISA 220 (Revised) to determine sufficient and appropriate resources (i.e., human, technological and intellectual) for the audit engagement and that such resources collectively have the appropriate competence and capabilities.

*Considering the Scalability, Including the Proportionality of the Requirement*

35. "Determining" the need for specialized skills would allow the application of judgment by the auditor in light of the varying circumstances of an audit. Following the CUSP Drafting Principles and Guidelines, the work effort implications of the verb "determine" requires the auditor to identify and analyze the relevant issues or matters of the audit to come to a specific conclusion on whether specialized skills or knowledge are needed. This approach is responsive to calls from auditors of LCEs for the scalability of any proposed requirement.
36. In support of the new requirement, the Task Force described how examples of matters that may affect the auditor's determination of the need for specialized skills or knowledge are linked to the incentives, pressures, or opportunities that create susceptibilities to misstatement due to fraud (see paragraph A12A of proposed ISA 240 (Revised)). Specific guidance is also provided that for many audits, the auditor may determine that specialized skills are not needed (see paragraph A12B of proposed ISA 240 (Revised)).

*Describing Forensic Skills*

37. The Task Force described the term "forensic skills," including a range of competencies and experience that it may include in the context of an audit. This is intended to clarify what may qualify as forensic skills in light of respondents' comments on the Discussion Paper, [Fraud and Going Concern in an Audit of Financial Statements](#), that this term is not commonly understood. In developing this application material, the Task Force leveraged how the term "forensic audit (or investigation)" was described in the Discussion Paper (see paragraph A12D of proposed ISA 240 (Revised)).

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<sup>18</sup> ISA 240, paragraphs 30(a) and A35–A36

<sup>19</sup> International Standard on Quality Management (ISQM) 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*, paragraphs 31(d), 32 and A79

<sup>20</sup> ISA 220 (Revised), paragraphs 25–28 and 35

<sup>21</sup> ISA 300, *Planning an Audit of Financial Statements*, paragraph 8(e)

**Matters for IAASB Consideration**

3. The Board is asked for its views on the changes made to proposed ISA 240 (Revised) as set out in paragraph 16A of **Agenda Item 7-A** (and related application material) and specifically:
  - (a) Whether the requirement to “determine” the need for specialized skills and related application material is sufficiently scalable and proportionate.
  - (b) Whether the term “forensic skills” is appropriately described.
4. In relation to the need for specialized skills, the Board is asked whether there are any other related matters the Task Force should consider as it develops proposed ISA 240 (Revised).

**Section IV – Identifying and Assessing the Risks of Material Misstatement Due to Fraud**

**Fraud Project Proposal – Key Issues**

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

- (b) *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**

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

<b>B4: Requirements and Application Material – Identifying and Assessing Risks of Material Misstatement</b>	<b>Proposed ISA 240 (Revised)</b>
<p><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></p> <ul style="list-style-type: none"> <li>• Clarifying that risk assessment procedures in ISA 240 are not separate from those in ISA 315 (Revised 2019).</li> <li>• Developing explicit fraud considerations in risk assessment procedures</li> <li>• Enhancing the requirements to consider information obtained from acceptance and continuance when obtaining an understanding of the entity and its environment, etc.</li> </ul>	<p>Paragraphs 17–28A</p> <p>Paragraphs 17–22, 22B</p> <p>Paragraph 24</p>

<ul style="list-style-type: none"> <li>• 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"> <li>○ The entity’s corporate culture.</li> <li>○ Entity’s key performance indicators (KPIs).</li> <li>○ Employee performance measures and incentive compensation policies.</li> <li>○ The entity’s risk assessment process.</li> <li>○ Specific control activities to prevent and detect fraud.</li> <li>○ Other information, e.g., matters the auditor is aware of based on the performance of procedures in accordance with ISA 720 (Revised)<sup>22</sup> or the auditor’s knowledge obtained throughout the audit.</li> </ul> </li> </ul>	<p>Paragraph 24B</p>
<ul style="list-style-type: none"> <li>• 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.</li> </ul>	<p>Paragraphs 25–26 and 27A–28A</p>
<ul style="list-style-type: none"> <li>• 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.</li> </ul>	<p>Pending</p>
<ul style="list-style-type: none"> <li>• Considering examples in ISA 240 to illustrate the scalability of the requirements, for example by providing examples that are more relevant to LCEs.</li> </ul>	<p>Pending</p>

**Task Force’s Views and Recommendations**

- 40. Based on the project proposal, previous Task Force discussions and input received from the Board in March 2022, the Task Force started enhancing the sections of proposed ISA 240 (Revised) that relate to the identification and assessment of risks of material misstatement due to fraud.
- 41. Certain of the proposed actions in Section VII (Communication with Those Charged with Governance) also impact the identification and assessment of the risks of material misstatement due to fraud.

*Clarifying That Risk Assessment Procedures in ISA 240 Are Not Separate from Those in ISA 315 (Revised 2019).*

- 42. To clarify that the risk assessment procedures in ISA 240 are not separate from those in ISA 315 (Revised 2019) the Task Force made several changes to proposed ISA 240 (Revised). The Task Force:

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<sup>22</sup> ISA 720 (Revised), *The Auditor’s Responsibilities Relating to Other Information*

- (a) Aligned the wording, structure and headings of proposed ISA 240 (Revised) with ISA 315 (Revised 2019).
- (b) Clarified the linkage between proposed ISA 240 (Revised) and ISA 315 (Revised 2019). In accordance with the CUSP guidelines, the phrase “In applying ISA 315 (Revised 2019)” was used when the auditor is required to do something in addition to the requirements in ISA 315 (Revised 2019). This construct was also used in ISA 600 (Revised).
- (c) Added application material in proposed ISA 240 (Revised) (paragraph A12E) that clarifies that the risk assessment procedures in proposed ISA 240 (Revised) refer to, and expand on, what is included in ISA 315 (Revised 2019). The Task Force also added application material (paragraph A12F), which states that the auditor may perform the risk assessment procedures and the identification and assessment of the risks of material misstatement as included in proposed ISA 240 (Revised) simultaneously with the procedures in ISA 315 (Revised 2019).
- (d) Added in the Introduction a paragraph that explains the linkage to ISA 315 (Revised 2019). Also, see paragraph 28 above.

*Developing Explicit Fraud Considerations in Risk Assessment Procedures*

43. The Task Force made several changes to the risk assessment procedures in proposed ISA 240 (Revised) to make them more specific to fraud. For example, the Task Force:
- (a) Aligned the construct of the paragraphs related to the inquiries of management and others within the entity, appropriate individuals within the internal audit function and TCWG (paragraphs 17A, 20 and 22 of proposed ISA 240 (Revised))
  - (b) Drafted a new requirement (paragraph 22B) for the auditor to determine the implications when the inquiries with individuals within the internal audit function, TCWG, or others within the entity are inconsistent with those of management. The requirement is partly based on paragraph 22 of extant ISA 240. Staff supporting the Task Force liaised with Staff supporting the Audit Evidence Task Force about the wording used (i.e., inconsistent).

*Enhancing the Requirements to Consider Information Obtained from Acceptance and Continuance When Obtaining an Understanding of the Entity and Its Environment*

44. Paragraph 15 of ISA 315 (Revised) requires the auditor to consider information from the acceptance and continuance procedures and, when applicable, other engagements performed by the engagement partner. The Task Force discussed which matters could be added in paragraph 24 of proposed ISA 240 (Revised) in addition to the matters already included in ISA 315 (Revised 2019). The Task Force concluded that this primarily relates to other information obtained from the auditor's procedures performed in accordance with ISA 720 (Revised). The application material includes possible other relevant sources of information (see paragraph A23A of proposed ISA 240 (Revised)).

*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*

45. Extant ISA 240 did not include a section on understanding the entity and its environment, the applicable financial reporting framework and the entity's system of internal control. Therefore, the project proposal included the proposed action to describe the auditor's responsibilities in that regard.

## Requirement

46. Based the proposals presented to the Board in March 2022 and discussions within the Task Force, the Task Force drafted paragraph 24B of proposed ISA 240 (Revised). The Task Force had extensive discussion on (i) how to structure the requirement and (ii) the fraud lens that should be used by the auditor when performing the risk assessment procedures specific to fraud.
47. In its decision how to structure the standard, the Task Force considered similar paragraphs in ISA 540 (Revised) (paragraph 13) and ISA 600 (Revised) (paragraph 30). In its discussions to date, the Task Force preferred using a structure similar to ISA 540 (Revised). The headings provide a clear link to ISA 315 (Revised 2019) and make the requirements easier to read. The Task Force recognizes that both paragraphs are relatively long and complicated and may consider other alternatives based on the views of the Board.
48. With respect to using the “fraud lens,” the Task Force took into account the proposed actions as set out in the project proposal but recognized that the wording in the proposed actions is not always aligned with the wording in ISA 315 (Revised 2019). The Task Force also recognized that some of the matters in the requirement are not fraud specific but were needed to provide a hook for the application material. For example, paragraph 24B(b) requires the auditor to obtain an understanding of the industry and does not include anything fraud specific. However, it is used as the hook for the application material that describes fraud specific matters about the industry.
49. Some of the matters included in paragraph 24B are based on matters that were previously included in paragraph 18 of extant ISA 240. The Task Force was of the view that by performing risk assessment procedures to obtain an understanding of the entity and its environment, the applicable financial reporting framework and the entity’s system of internal control, the auditor is making inquiries of management with respect to the matters previously included in paragraph 18.

## Application Material

50. The application material for the following sections is drafted:
  - (a) *The Entity and Its Environment*. The application material in this section is partly based on matters included in the [Canadian Public Accountability Board's \(CPAB\) Fraud thematic review](#) and discussions within the Task Force and among Staff.
  - (b) *The Applicable Financial Reporting Framework*. The application material in this section is partly based on application material included in ISA 540 (Revised) as accounting estimates are one of the areas where fraudulent financial reporting may occur.
51. The Task Force is working on the application material on the entity’s system of internal control. Placeholders describing what the application material may say, have been included.

## *Emphasizing in ISA 240 How Fraud Risk Factors Influence the Identified Risks of Material Misstatement Due to Fraud*

52. The Task Force started its discussion on how proposed ISA 240 (Revised) can emphasize how the fraud risk factors influence the identified risks of material misstatement due to fraud but recognizes that more work needs to be done in this area.
53. In addition to aligning the section on the identification and assessment of the risks of material misstatement to ISA 315 (Revised 2019), the Task Force drafted application material (paragraph

A28A of proposed ISA 240 (Revised)) that highlights classes of transactions, account balances or disclosures that may be particularly susceptible to material misstatement due to fraud. The Task Force noted that this relates to one of the proposed actions in the project proposal addressing the presumption of fraud in revenue recognition (also see [Section V](#) below, paragraphs 57 and 59). However, the Task Force was of the view that such application material is better placed to support the requirement for the auditor to identify the risks of material misstatement due to fraud (paragraph 26 of proposed ISA 240 (Revised)), than the requirement addressing the presumption of fraud risk in revenue recognition (paragraph 27 of proposed ISA 240 (Revised)).

*Next Steps*

54. Given the significance of the proposed actions in the project proposal, the Task Force has not yet addressed all proposed actions. The following proposed action will be addressed by the Task Force, and discussed at the December 2022 Board meeting:
  - (a) 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;
  - (b) 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; and
  - (c) Considering examples in ISA 240 to illustrate the scalability of the requirements, for example by providing examples that are more relevant to LCEs.
55. In addition, the Task Force will further develop application material on the entity's system of internal control as described in paragraph 51 above.

**Matters for IAASB Consideration**

5. The Board is asked for its views on the changes made to proposed ISA 240 (Revised) as set out in paragraphs 17–22, 22B, 24, 24B–26 and 27A–28A of **Agenda Item 7-A** (and related application material) and specifically for its views on:
  - (a) Whether further changes are needed to clarify that the risk assessment procedures in proposed ISA 240 (Revised) are not separate from those in ISA 315 (Revised 2019);
  - (b) The structure of paragraph 24B of proposed ISA 240 (Revised); and
  - (c) Whether other matters specific to the risk of fraud should be included in paragraph 24B of proposed ISA 240 (Revised) or the related application material.
6. In relation to identifying and assessing the risks of material misstatement, the Board is asked whether there are any other related matters the Task Force should consider as it develops proposed ISA 240 (Revised).

## Section V – Presumption of Fraud Risk in Revenue Recognition

### Fraud Project Proposal – Key Issues

56. The project proposal included the following key issues (see paragraph 19) where the related proposed actions impacted the presumption of fraud risk in revenue recognition:

<p>(f) <i>Specific fraud-related audit procedures</i></p> <p>...</p> <p>(ii) Presumption of fraud risk in revenue recognition – it is not clear when it may, or may not, be appropriate to rebut the presumption of fraud risk in revenue recognition, which has resulted in inconsistent application.</p> <p>(iii) Presumption of fraud risk in other account balances – stakeholders have questioned whether the presumption of fraud risk should be extended to include other account balances, such as goodwill.</p>
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### Fraud Project Proposal – Proposed Actions

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

<b>B15: Requirements and Application Material – Presumption of Fraud Risk in Revenue Recognition</b>	<b>Proposed ISA 240 (Revised)</b>
<p><i>Revise requirements and enhance application material in ISA 240 to clarify how performing a robust risk assessment is critical in determining whether or not the presumption of fraud risk in revenue recognition is applicable, including:</i></p> <ul style="list-style-type: none"> <li>• Revising the requirement in ISA 240 to shift the focus from the auditor developing a rebuttal to emphasizing the importance of performing robust risk identification and assessment.</li> <li>• Enhancing the application material in ISA 240 to:                             <ul style="list-style-type: none"> <li>○ Highlight other account balances that may be particularly susceptible to material misstatement due to fraud (such as goodwill).</li> <li>○ Clarify when it is inappropriate to rebut the presumption of risks of fraud in revenue recognition (shifting away from clarifying when it may be appropriate to rebut the presumption of risk of fraud in revenue recognition).</li> <li>○ Describe public sector considerations.</li> </ul> </li> </ul>	<p>Paragraph 27</p> <p>Paragraph A28A</p> <p>Paragraphs A30A–A31A</p> <p>Paragraph A28B</p>

## Task Force's Views and Recommendations

### *Shifting the Focus from Developing a Rebuttal to Performing Robust Risk Identification and Assessment*

58. To demonstrate a shift from the auditor developing a rebuttal to emphasizing the importance of performing robust risk identification and assessment with the “fraud lens,” in paragraph 27 of proposed ISA 240 (Revised) “taking into account the fraud risk factors” was added. The focus on the fraud risk factors is intended to assist the auditor when evaluating which types of revenue, revenue transactions or assertions give rise to fraud risks. The Task Force intends to explore the possibility of examples to illustrate how to action the requirement.

### *Enhancing Application Material*

#### Highlighting Other Account Balances That May Be Particularly Susceptible to Material Misstatement Due to Fraud

59. The Task Force was of the view that this is better addressed within the section on “Identifying the Risks of Material Misstatement due to Fraud” in proposed ISA 240 (Revised) (see paragraph A28A of proposed ISA 240 (Revised) and paragraph 53 above).

#### Inappropriate to Rebut the Presumption of Fraud Risk in Revenue Recognition

60. The Task Force was of the view that the application material may be more useful if presented to address those “circumstances or conditions relating to the types of revenue, revenue transactions, or assertions, that could give rise to fraud risk” (see paragraph A30A of proposed ISA 240 (Revised)).

### **Matters for IAASB Consideration**

7. The Board is asked for its views on the changes to proposed ISA 240 (Revised) as set out in paragraph 27 of **Agenda Item 7-A** (and related application material) and specifically:
- (a) Whether the enhancements shift the auditor’s focus away from developing a rebuttal.
  - (b) Whether the application material in paragraph A28A of proposed ISA 240 (Revised) provides sufficient guidance for other account balances that may be particularly susceptible to material misstatement due to fraud.
8. In relation to the presumption of fraud risk in revenue recognition, the Board is asked whether there are any other related matters the Task Force should consider as it develops proposed ISA 240 (Revised).

## Section VI – Journal Entries

### Fraud Project Proposal – Key Issues

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

- (f) *Specific fraud-related audit procedures*
- (i) Journal entries – uncertainty about how to select which journal entries to test that has resulted in inconsistent application.

### Fraud Project Proposal – Proposed Actions

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

<b>B.14: Requirements and Application Material – Journal Entries</b>	<b>Proposed ISA 240 (Revised)</b>
<p><i>Clarify the requirements and application material in ISA 240 on the approach to testing journal entries, including:</i></p> <ul style="list-style-type: none"> <li>• Considering enhancing requirements in ISA 240 to:                             <ul style="list-style-type: none"> <li>○ Clarify that the auditor’s risk assessment procedures performed as part of ISA 315 (Revised 2019) for controls over journal entries are also relevant to the auditor’s decisions on journal entry testing in ISA 240.</li> <li>○ Take account of the impact of technology when testing journal entries.</li> <li>○ Address the extent of testing of journal entries to respond to identified risks.</li> </ul> </li> <li>• Enhancing application material to:                             <ul style="list-style-type: none"> <li>○ Clarify what the auditor’s objectives are when testing journal entries, and explain how auditors may determine the nature, timing and extent of the auditor’s procedures for journal entry testing.</li> <li>○ Consider the impact of any proposed changes being made to ISA 500<sup>23</sup> (e.g., obtaining audit evidence about the completeness of the information used to test journal entries).</li> </ul> </li> </ul>	<p>Paragraphs A43A–A44</p> <p>Paragraph A45A</p> <p>Paragraphs 33(a)(iii)-(iv) and A45</p> <p>Paragraphs A42–A45</p> <p>Paragraph 33(a)(ii)</p>

<sup>23</sup> ISA 500, *Audit Evidence*

### Task Force's Views and Recommendations

63. In addressing journal entries in proposed ISA 240 (Revised), the Task Force took into consideration the current requirements and application material in extant ISA 240<sup>24</sup> and other standards (i.e., ISA 315 (Revised 2019)<sup>25</sup> and ISA 330).<sup>26</sup>

#### *Considering Enhancing Requirements to Clarify that the Auditor's Risk Assessment Procedures in ISA 315 (Revised 2019) for Controls Over Journal Entries Are Also Relevant to the Auditor's Decisions on Journal Entry Testing*

64. The Task Force noted that the relevant requirements and related application in ISA 315 (Revised 2019) relevant to journal entries and other adjustments deal with identifying controls over journal entries and other adjustments, evaluating the design of the controls, and determining the implementation of the relevant controls. These form part of the overarching requirements and related application material in ISA 315 (Revised 2019) to identify and assess the risks of material misstatement, whether due to fraud or error. In contrast, the relevant requirements and related application material in proposed ISA 240 (Revised) deal with "testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements."
65. The enhancements in proposed ISA 240 (Revised) are intended to provide the auditor with a robust framework for testing journal entries and other adjustments that enables auditors to better identify fraudulent journal entries and other adjustments. In doing so, the Task Force highlighted in paragraphs A43A–A44 the importance of the broader understanding required in ISA 315 (Revised 2019) in determining the nature, timing and extent of the test and not limiting it to the auditor's understanding of:
- (a) The entity's information system and communication relevant to the preparation of the financial statements, obtained in accordance with paragraph 25 of ISA 315 (Revised 2019); and
  - (b) Controls over journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments, obtained in accordance with paragraph 26(a)(ii) of ISA 315 (Revised 2019).

#### *Considering Enhancing Requirements to Take Account of the Impact of Technology When Testing Journal Entries*

66. The Task Force discussed enhancing the requirements in proposed ISA 240 (Revised) to "consider the use of automated tools and techniques when testing journal entries."
67. In its deliberations, the Task Force noted that the auditor's considerations for using automated tools and techniques in designing and performing audit procedures are only addressed within the application material of proposed ISA 500 (Revised) and other ISAs. The Task Force recognized the importance of remaining consistent with the overall approach on how technology is addressed within the suite of ISAs. The Task Force therefore recommends addressing the use of automated tools and

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<sup>24</sup> ISA 240, paragraphs 33(a) and A42–A45

<sup>25</sup> ISA 315 (Revised 2019), paragraphs 25, 26(a)(ii), A131–A146, A160–A161 and A175–A181

<sup>26</sup> ISA 330, paragraphs 20 and A52

techniques when testing journal entries and other adjustments within the application material of proposed ISA 240 (Revised) (see paragraph A45A for drafting).

*Considering Enhancing Requirements to Address the Extent of Testing of Journal Entries to Respond to Identified Risks*

68. In its deliberations, the Task Force noted that extant ISA 240 already requires the auditor to select items to test made at the end of the reporting period, and to consider the need to test items throughout the period. Following the CUSP Drafting Principles and Guidelines, the work effort implications of the verb “consider” requires a more active reflection by the auditor about whether there is a need to test journal entries throughout the period under the circumstances. The Task Force was of the view that the extant requirements addressing the extent of the testing appropriately consider scalability, including proportionality. Therefore, the Task Force recommends no further enhancements in the requirements and related application material (see relevant requirements renumbered as paragraphs 33(a)(iii)-(iv) and A45).

*Enhancing Application Material to Clarify the Auditor’s Objectives*

69. The Task Force enhanced the application material in paragraphs A42–A45 to clarify what the auditor’s objectives are when testing journal entries, and explain how auditors may determine the nature, timing and extent of the testing.

*Considering the Impact of Any Proposed Changes Being Made in Proposed ISA 500 (Revised)*

70. The Task Force (in consultation with the Staff of the Audit Evidence Task Force) considered how the relevant changes in proposed ISA 500 (Revised) impact the changes in proposed ISA 240 (Revised) relating to:
- (a) Whether the words “test the appropriateness of journal entries...” in the lead-in to paragraph 33(a) in proposed ISA 240 (Revised) reflects the appropriate work effort in responding to the risks related to management override of controls arising from journal entries and other adjustments. Staff of the Audit Evidence Working Group noted that the word “test” is a defined term in the IAASB Glossary of Terms (i.e., the application of procedures to some or all items in a population), which in the Task Force’s view appropriately reflects the work effort needed to address the fraud risks arising from journal entries.
  - (b) Whether a requirement addressing the completeness of the population of journal entries and other adjustments is needed in proposed ISA 240 (Revised), in view of the overarching requirements in proposed ISA 500 (Revised)<sup>27</sup> to evaluate the relevance and reliability of information intended to be used as audit evidence. The Audit Evidence Task Force is proposing a conditional requirement (paragraph 9A in proposed ISA 500 (Revised)) for the auditor to obtain audit evidence about the accuracy and completeness of the information, as necessary in the circumstances, if the auditor determines that accuracy and completeness are applicable in the circumstances. Given that the audit procedures in paragraph 33(a) of proposed ISA 240 (Revised) are intended to be designed and performed irrespective of the auditor’s assessment of the risks of management override of controls, the Task Force was of the view that “obtaining

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<sup>27</sup> Proposed ISA 500 (Revised), paragraphs 9–9A

audit evidence about the completeness of the population of journal entries and adjustments” should always be required (see paragraph 33(a)(ii) of proposed ISA 240 (Required)).

- (c) Whether a requirement to “consider the use of automated tools and techniques when testing journal entries and other adjustments” in proposed ISA 240 (Revised) is consistent with the overall approach on technology in designing and performing audit procedures to obtain sufficient appropriate audit evidence in proposed ISA 500 (Revised). Staff of the Audit Evidence Task Force confirmed that the approach taken by the Task Force is consistent with the overall approach on technology in proposed ISA 500 (Revised). See paragraphs 66–67 above for the Task Force’s views and recommendations on this topic.

*Next Steps*

- 71. While the Task Force has discussed journal entry testing in some detail, it is aware that as other changes are made to proposed ISA 240 (Revised) further enhancements may be apparent.

**Matters for IAASB Consideration**

- 9. The Board is asked for its views on the changes made to proposed ISA 240 (Revised) as set out in paragraph 33(a) of **Agenda Item 7-A** (and related application material) and specifically:
  - (a) Whether the enhancements provide the auditor with a robust framework in determining the nature, timing and extent of testing journal entries and other adjustments.
  - (b) Whether the proposed changes appropriately consider scalability and proportionality.
  - (c) Whether there is anything more that can be done to modernize the testing of journal entries and other adjustments.
- 10. In relation to journal entries, the Board is asked whether there are any other related matters the Task Force should consider as it develops proposed ISA 240 (Revised).

**Section VII – Communication with Those Charged with Governance**

**Fraud Project Proposal – Key Issues**

- 72. The project proposal included the following key issues (see paragraph 19) where the related proposed actions impacted the communication with TCWG:

- (h) *Transparency on the auditor’s fraud-related procedures*
  - (i) The required communications with TCWG on fraud considerations may not be sufficiently robust in the current environment, including that such communications relating to fraud matters are not presently explicitly required throughout the audit.

**Fraud Project Proposal – Proposed Actions**

- 73. The project proposal (see paragraph 25) included the following proposed actions related to communication with TCWG:

D.27: Requirements and Application Material – Transparency in the Required Communications with TCWG	Proposed ISA 240 (Revised)
<ul style="list-style-type: none"> <li>• <i>Enhance requirements and application material in ISA 240 to strengthen required communications with TCWG, including:</i> <ul style="list-style-type: none"> <li>○ Enhancing the requirements in ISA 240 for specific discussions with TCWG about the entity’s risks of material misstatement due to fraud and to encourage more appropriate two-way communication. Enhancements could include, for example, explicit discussions about: <ul style="list-style-type: none"> <li>- Susceptibilities to misstatement due to management bias, and corroborating inquiries of management with TCWG.</li> <li>- The auditor’s evaluation of the entity’s components of internal control (when performing risk assessment procedures in accordance with ISA 315 (Revised 2019)).</li> </ul> </li> <li>○ Enhancing the requirements in ISA 240 for the auditor to assess whether the remediation measures taken by management and TCWG for identified or suspected fraud are appropriate.</li> <li>○ Enhancing the requirements in ISA 240 to emphasize the ongoing nature of communications with TCWG about fraud throughout the audit.</li> <li>○ Clarifying in the application material of ISA 240 that effective participation by TCWG is influenced by their independence from management and their ability to objectively evaluate the actions of management.</li> </ul> </li> </ul>	<p>Paragraphs 22A and A22B–A22D</p> <p>[To be developed as part of the proposed action “when fraud is identified or suspected”]</p> <p>Paragraphs 40A and A60A–A60C</p> <p>Paragraphs A21A–A21B</p>

**Task Force’s Views and Recommendations**

74. In addressing communications with TCWG in proposed ISA 240 (Revised), the Task Force took into consideration the current requirements and application material in extant ISA 240<sup>28</sup> and other ISAs (i.e., ISA 260 (Revised)).<sup>29</sup>

*Specific Discussions with Those Charged with Governance*

75. The Task Force added a new requirement for specific discussions with TCWG about fraud-related matters in the audit (see paragraph 22A of proposed ISA 240 (Revised)). This requirement is intended to encourage more appropriate two-way communications between TCWG and the auditor. It clarifies that such specific discussions with TCWG are performed when obtaining an understanding and

<sup>28</sup> ISA 240, paragraphs 21–22, 42–43, A20–A22 and A61–A65

<sup>29</sup> ISA 260 (Revised), *Communication with Those Charged with Governance*, paragraphs 11-17, 21, A1–A32 and A49–A50

making inquiries in accordance with paragraphs 21–22 of proposed ISA 240 (Revised), respectively. To help auditors apply this new requirement, the Task Force developed application material in paragraphs A22B–A22D that explain the importance of effective two-way communication with TCWG and provide examples illustrating matters that could be discussed with TCWG.

*Ongoing Nature of Communications with Those Charged with Governance*

76. The Task Force added a new requirement (paragraph 40A of proposed ISA 240 (Revised)) emphasizing the ongoing nature of communications about fraud-related matters with management and TCWG. To help auditors apply this new requirement, the Task Force developed application material in paragraphs A60A–A60C that:
- (a) Provides examples of fraud-related matters that may be communicated by auditor at appropriate times throughout the audit (e.g., as part of the planning stage, conclusion stage, or as soon as practicable).
  - (b) Highlights the importance of assigning the appropriate member(s) of the engagement team when communicating with management and TCWG.

**Matters for IAASB Consideration**

11. The Board is asked for its views on the changes made to proposed ISA 240 (Revised) as set out in paragraphs 22A and 40A of **Agenda Item 7-A** (and related application material) and specifically:
- (a) Whether the enhancements in the requirements and the related application material adequately address the appropriate two-way communication and the ongoing nature of communications with TCWG.
  - (b) Whether the location of the requirement emphasizing the ongoing nature of communications with management and TCWG in paragraph 40A is appropriate.
12. In relation to communications with TCWG, the Board is asked whether there are any other related matters the Task Force should consider as it develops proposed ISA 240 (Revised).

**Section VIII – Transparency in the Auditor’s Report**

77. In the March 2022 Board meeting the Board discussed several options on transparency in the auditor’s report that the Task Force could use for its discussions with users of the financial statements. The Board agreed that the options presented, represent the views of respondents to the Discussion Paper and should be presented to users of the financial statements.
78. Based on the discussion and input received from the Board, the Task Force further developed the options and included examples for each of the options. The options have been incorporated into a paper that will be sent to users of the financial statements before the interviews take place. Further details will be provided during the opening remarks in the June 2022 Board meeting.
79. The Task Force and Staff will conduct the outreach with users of the financial statements in June and early July 2022 and will report back to the Board in September 2022.

## **Way Forward**

80. Following the June 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.
81. 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.
82. The Task Force will update the Board about the specific outreach activities with users of the financial statements about transparency in reporting on fraud in September 2022.
83. The Task Force will liaise with other IAASB task forces, working groups and consultation groups as needed, and as outlined in the project proposal in particular the LCE Task Force, and the Technology Consultation Group. The Task Force will also liaise with the IESBA to identify any ethics considerations or matters of relevance in terms of fraud.
84. In December 2022, the Task Force will bring a substantially full draft of the standard to the Board.

## Appendix 1

### Task Force Members and Activities Since the March 2022 IAASB Meeting

#### Task Force Members

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

#### Task Force Activities Since the March 2022 IAASB Meeting

2. The Task Force held four video conference meetings (i.e., March 29, April 19–20 and May 24) and one hybrid meeting on May 16-17. Owing to the nature of the activities being undertaken, substantial work was also progressed via electronic circulation of materials between members of the Task Force and IAASB staff.
3. The Task Force Chair, Staff or members of the Task Force participated in the following outreach events:
  - Meeting with representatives of the Chinese Institute of Certified Public Accountants in April 2022 by videoconference;
  - Meeting with representatives of the CPAB in May 2022 by videoconference; and
  - Meeting with representatives of the Auditing Standards Board of the American Institute of Certified Public Accountants in May 2022 by videoconference.

## Extract from the Draft March 2022 IAASB Meeting Minutes

### Fraud (Agenda Item 4)

#### Decisions

##### *Identifying and Assessing the Risks of Material Misstatement Due to Fraud*

1. The Board supported:
  - a. Restructuring ISA 240 to follow a similar flow as ISA 315 (Revised 2019).
  - b. Maintaining Appendix 1 on fraud risk factors in ISA 240.

##### *Communication with TCWG*

2. The Board supported the proposed changes to enhance two-way communication with TCWG about fraud throughout the audit and emphasized the ongoing nature of such communications. With respect to the latter, the Board preferred a new requirement over enhancing application material.

##### *Transparency in Reporting on Fraud*

3. The Board agreed that the alternatives presented represent the views of respondents to the [Discussion Paper](#), *Fraud and Going Concern in an Audit of Financial Statements*, that should be presented to users of the financial statements as part of the Fraud Task Force's planned targeted outreach.

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

4. The Board supported the publication of the proposed non-authoritative guidance and agreed that the non-authoritative guidance be designated as a "Task Force Publication" to be developed and cleared through a Channel 3 process as contemplated in the [Framework for Activities](#). The Board noted that the guidance may not be sufficiently detailed for some stakeholders but recognized that it would still be useful for others.

#### Directions

##### *Identifying and Assessing the Risks of Material Misstatement Due to Fraud*

5. The Board asked the Fraud Task Force to consider:
  - Not duplicating nor repeating requirements from ISA 315 (Revised 2019) especially when enhancing or developing related application and other explanatory material in ISA 240.
  - Expanding, only where appropriate, on the requirements of ISA 315 (Revised 2019).
  - Emphasizing that the auditor should use management's fraud risk assessment as the basis for identifying, assessing and responding to fraud risks (i.e., similar to the approach taken in ISA 540 (Revised) and ISA 570 (Revised), and highlighting the responsibilities of other participants in the financial reporting ecosystem).

- Keeping the standard scalable for less complex entities (LCEs) given that the system of internal control is often different for LCEs compared to more complex entities.
- Modernizing Appendix 1 for the fraud risk factors in ISA 240, including those related to specific ISAs, for example, audit evidence in ISA 500, accounting estimates in ISA 540 (Revised) and related party transactions in ISA 550.
- Being more specific as to the sources of other information that should be considered with a “fraud lens”. For example, the results of procedures performed under ISA 720 (Revised) that are focused on whether there is material inconsistency between the other information and the financial statements.
- Whether all fraud risks should be presumed to be significant risks. However, it was acknowledged that this was beyond the scope of the project proposal.
- Including a stand-back requirement in ISA 240 similar to paragraph 35 of ISA 315 (Revised 2019).

#### *Communication with TCWG*

6. The Board asked the Fraud Task Force to consider:

- Not duplicating nor repeating requirements from ISA 260 (Revised).
- Making the proposed changes scalable given the different governance structures across entities (e.g., TCWG and management may be the same in some entities). However, it was noted that even in smaller entities, TCWG should be able to carry out meaningful and purposeful discussions about fraud-related matters with auditors in view of their oversight role.

#### *Transparency in Reporting on Fraud*

7. The Board asked the Fraud Task Force to consider:

- Exploring alternative 4 with respect to emphasizing using the existing requirements for the communications of key audit matters (KAMs) when there is a risk of material misstatement due to fraud. Board members noted that the concept of KAMs is valued and could be used to enhance transparency in the auditor’s report in relation to fraud.
- Maintaining the balance between what management and TCWG disclose about fraud-related matters in the financial statements and what the auditor discloses in the auditor’s report. In that regard, the Fraud Task Force was cautioned to avoid a situation where a requirement may place the auditor in a position to communicate sensitive information about the entity in the auditor’s report. It was also suggested to explore, if necessary, what management is required to report in the financial statements on fraud in different jurisdictions.
- Avoiding unnecessary expansion of the auditor’s report and boilerplate disclosures when reporting on fraud.
- Making the alternatives scalable (i.e., the solution should be flexible and should not be “one size fits all”).
- The appropriate scope (scalability and proportionality) of the alternative(s) (e.g., for listed entities only, or for all entities).

- Performing outreach with a wide array of stakeholders instead of outreach with users of financial statements only.

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

8. The Board asked the Fraud Task Force to consider:
- Including a reference to ISA 550 within the diagram of the draft non-authoritative guidance.
  - Describing the term “fraud lens.”
  - Looking at the manner in which the objectives of ISA 200 are characterized in the draft non-authoritative guidance.

*Other Matters*

9. The Board asked the Fraud Task Force to consider:
- Using the proposed Complexity, Understandability, Scalability and Proportionality (CUSP) Drafting Principles and Guidelines in revising ISA 240.
  - Aligning with the proposed changes in other projects under way (i.e., going concern and audit evidence).

**Other Substantial Matters**

*IAASB CAG Chair Remarks*

10. Mr. Dalkin noted that Representatives were broadly supportive of the proposed changes addressing risk identification and assessment, and communication with TCWG.
11. With respect to the alternatives for transparency in reporting on fraud, Mr. Dalkin noted that Representatives were of the view that the alternatives are appropriate to discuss with users of the financial statements. However, Representatives cautioned against boilerplate disclosures. Mr. Dalkin furthermore suggested including stakeholders from the public sector in the planned targeted outreach.

*PIOB Observer Remarks*

12. Ms. van Diggelen noted that the PIOB recognizes the importance of this project as it is critical for narrowing the expectation gap and improving auditor behavior. She highlighted the importance of thinking out of the box when developing the revisions to ISA 240. Ms. van Diggelen encouraged the Board to also take into account the current audit approaches being more and more substantive and to assess whether, from the perspective of the audit risk model, this has implications for the detection of the risks of material misstatement due to fraud on those audits, compared to audits using a control-based audit approach. She noted that the impact of current practice is important in view of the aim to drive improved behaviors.
13. Ms. van Diggelen further noted the importance of the proposed changes for clarifying and strengthening the auditor’s responsibilities on fraud and addressing the communication with TCWG and transparency in reporting on fraud.

14. With respect to transparency in reporting on fraud, Ms. van Diggelen noted the importance of obtaining input from users of the financial statements before deciding on the way forward. She added that enhanced transparency on fraud in the auditor's report may drive enhanced disclosures by management as well.

*Next Steps*

15. In June 2022, the Fraud Task Force will bring the topics discussed in the March 2022 IAASB meeting and selected new topics to the Board for discussion, potentially including proposed drafting for certain of these topics.

**Appendix 3**

**Approach for the Discussion of the Agenda Items**

Section in Agenda Item 7-A	Section in Agenda Item 7	Paragraph(s) in Agenda Item 7-A
Structure	Section I	NA
Introduction	Section II	1–9A, A1A–A7
Engagement resources	Section III	16A, A12A–A12D
Risk assessment procedures and related activities (including certain aspects of communications with those charged with governance)	Section IV and VII	17–24, A12E–A23A
Obtaining an understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control	Section IV	24B, A23D–A23L
Identifying and assessing the risks of material misstatement due to fraud, including the presumption of fraud risk in revenue recognition	Section IV and V	25–28A, A24–A33
Journal entries	Section VI	33(a), A42–45A
Communications with management and those charged with governance	Section VII	40A, A60A–A60C