

Fraud in an Audit of Financial Statements – Explanation of Significant Changes

This paper explains the significant changes and the rationale for the changes that have been made by the Fraud Task Force (the Task Force) to proposed ISA 240 (Revised)¹ since the June 2022 and September 2022 meetings, as reflected in the marked draft in **Agenda Item 5-B**.

Reference	Significant Changes and the Rationale for Those Changes
Introduction	
Paragraph 1	<ul style="list-style-type: none"> The Task Force enhanced the description of the auditor’s responsibilities in response to the Board’s feedback that the paragraph previously did not adequately describe the scope of proposed ISA 240 (Revised).
Paragraph 1A	<ul style="list-style-type: none"> The Task Force decided to clearly distinguish each of the auditor’s responsibilities by including such responsibilities as separate sub-paragraphs.
Paragraph 1B	<ul style="list-style-type: none"> The Task Force determined to keep all paragraphs related to the inherent limitations together in the <i>Key Concepts in this ISA</i> section, accordingly paragraph 1B was moved to paragraph 4E. This was done so that the inherent limitations do not detract from the responsibilities of the auditor. The Task Force believes that the entire <i>Introduction</i> section, which includes the inherent limitations of an audit, should be read in order to have the appropriate context in which to apply the requirements.
Paragraph 1C	<ul style="list-style-type: none"> The Task Force reverted to the extant wording based on Board feedback that the sentence structure was overly complex and appeared to diminish the responsibilities of management and those charged with governance. The removal of the word “integrity” was done to align with the phrase used in paragraph 21(b)(i) of ISA 315 (Revised 2019).²

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*

Reference	Significant Changes and the Rationale for Those Changes
	<p><i>Application Material</i></p> <ul style="list-style-type: none"> Paragraph A1B: The Board noted the importance of the responsibilities and oversight of those charged with governance and requested the Task Force to revert the proposed edits i.e., include the application material in paragraph 1C. However, the Task Force believes that the material is better placed as application material to paragraph 16B which requires communications with those charged with governance at appropriate times during the audit. The material in paragraph A1B was repurposed as an example of how those charged with governance view their oversight responsibilities. The Task Force noted in the CUSP Drafting Principles and Guidelines that the introductory material should be kept to a minimum with consideration of whether material can be “subsumed in application and other explanatory material relating to a requirement.”³
Paragraph 4B	<p><i>Application Material</i></p> <ul style="list-style-type: none"> Paragraph A4: In response to feedback raised relating to the appropriateness of the example addressing automated controls, the Task Force determined to remove the last bullet and clarified the penultimate bullet by providing another example of controls over IT applications.
Paragraph 4C	<ul style="list-style-type: none"> The Task Force reverted to extant wording given the concerns raised over the unintended consequences of clarifying that fraud encompasses both “actual and suspected fraud.” The Task Force removed the phrase “in rare cases” as it does not believe such clarification is needed and may inadvertently undermine the auditor’s responsibility to “obtain reasonable assurance that the financial statements ... are free from material misstatement due to fraud.” The auditor’s responsibility is the same whether such fraud is suspected or has occurred. Agenda Item 5, Section I explains the approach to addressing fraud or suspected fraud identified by the auditor.
Paragraph 4CA	<ul style="list-style-type: none"> The Task Force believes it is important to include in the <i>Key Concepts in this ISA</i> section that the auditor may identify fraud or suspected fraud when performing risk assessment procedures or further audit procedures. Agenda Item 5, Section I explains the approach to addressing fraud or suspected fraud identified by the auditor.

³ Complexity, Understandability, Scalability and Proportionality (CUSP) Drafting Principles and Guidelines, paragraph 6.3.4

Reference	Significant Changes and the Rationale for Those Changes
	<p><i>Application Material</i></p> <ul style="list-style-type: none"> Paragraph A5Aa: The Task Force provided examples of the audit evidence that may be obtained when performing such audit procedures that may indicate the existence of fraud or suspected fraud. Also, Agenda Item 5, Section I explains the approach to addressing fraud or suspected fraud identified by the auditor.
Paragraph 4D	<ul style="list-style-type: none"> The Task Force made changes to the requirement to clarify that the “circumstances giving rise to the fraud” are those whose nature the auditor needs to understand for the purpose of applying qualitative or quantitative considerations. The Task Force also aligned the wording with that used in paragraph 6(a) of ISA 450.⁴ <p><i>Application Material</i></p> <ul style="list-style-type: none"> Paragraph A5Ab: The Task Force added examples of what the auditor may consider as qualitative considerations when making the determination of whether a fraud is material or not. The examples, one of which leveraged extant wording in paragraph 4D, illustrate that such considerations may involve who instigated or perpetrated the fraud and why the fraud was perpetrated.
Paragraph 4E	<ul style="list-style-type: none"> See paragraph 1B.
Paragraph 5	<ul style="list-style-type: none"> The Task Force made changes to more closely align with the wording in paragraphs A53–A54 of ISA 200,⁵ including highlighting that the inherent limitations should not be the reason for the auditor obtaining less than persuasive audit evidence. The Task Force believes that this additional language provides further context as to the auditor’s responsibilities related to fraud in an audit of the financial statements.
Paragraph 6	<ul style="list-style-type: none"> The first sentence of paragraph 6 is essentially captured in paragraph 5 where there is a reference to “significance” of the inherent limitations. The footnote in paragraph 5 also cross references to paragraph A53 of ISA 200. The second sentence of paragraph 6 has been subsumed into paragraph 4E.

⁴ ISA 450, *Evaluation of Misstatements Identified During the Audit*

⁵ ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

Reference	Significant Changes and the Rationale for Those Changes
<p>Paragraph 8</p>	<ul style="list-style-type: none"> • The Task Force combined paragraphs 8 and 8A and made changes to the requirement to more closely align with paragraph 15 of ISA 200, which requires that “the auditor shall plan and perform an audit with professional skepticism”. <p><i>Application Material</i></p> <ul style="list-style-type: none"> • Paragraph A5B: The Task Force believes that a strong system of quality management enables the auditor to successfully perform their responsibilities with respect to fraud in an audit. The Task Force added new application material that serves as a reminder on how a firm’s effective system of quality management underpins the requirement for the auditor to maintain professional skepticism when performing the audit engagement. • Paragraph A5C: The Task Force recognizes that introductory material is focused on the auditor maintaining professional skepticism when planning and performing the audit, therefore the new application material is intended to provide an example of impediments to the exercise of professional skepticism at the engagement level with a reference to paragraph A34 of ISA 220 (Revised).⁶
<p>Paragraph 8AB</p>	<ul style="list-style-type: none"> • The Task Force notes that fraud or suspected fraud may be identified when performing procedures other than those in accordance with proposed ISA 240 (Revised). A paragraph was added, leveraging wording from paragraph 16 of ISA 250 (Revised),⁷ to remind the auditor to remain alert and maintain professional skepticism throughout the audit.
<p>Paragraph 9</p>	<ul style="list-style-type: none"> • The Task Force proposes wording edits to align the auditor’s responsibilities with those in paragraph 1 of ISA 250 (Revised).
<p>Engagement Resources</p>	
<p>Paragraph 16A</p>	<ul style="list-style-type: none"> • In its June 2022 meeting, the Board noted that the wording used in paragraph 16A was not aligned with ISA 220 (Revised). In response, the Task Force aligned the requirement more closely to the wording in ISA 220 (Revised).

⁶ ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*

⁷ ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*

Reference	Significant Changes and the Rationale for Those Changes
	<p><i>Application Material</i></p> <ul style="list-style-type: none"> • Paragraph A12B: The Task Force clarified the purpose of this paragraph. This paragraph signals that for many audits, the engagement partner may determine that members of engagement team (and external experts and internal auditors who provide direct assistance to the engagement team) collectively have the appropriate specialized skills or knowledge to perform the audit engagement and that no experts need to be involved. • Paragraph A12C: The Task Force noted that paragraph A12A also highlights matters that, individually or collectively, may affect the auditor’s determination of whether specialized skills or knowledge. Therefore, the Task Force merged paragraph A12C into paragraph A12A. • Paragraph A12E: The Task Force added application material with an example of the matters that the engagement partner takes into consideration in determining whether the engagement team has the appropriate competence and capabilities.
Ongoing Nature of Communications with Management and Those Charged with Governance	
Paragraph 16B	<p><i>Application Material</i></p> <ul style="list-style-type: none"> • Paragraph A12G: Based on suggestions from the Board, the Task Force moved the <i>Communications with Management and Those Charged with Governance</i> section to follow the <i>Engagement Resources</i> section. As part of this relocation, paragraphs A60B and A60C were moved. The Task Force merged these paragraphs and deleted the second sentence of paragraph A60B as it was repeating ISA 220 (Revised).
Risk Assessment Procedures and Related Activities	
Paragraph 17(a)	<ul style="list-style-type: none"> • Given comments from the Board, the Task Force deleted “including obtaining an understanding of fraud risk factors” in paragraph 17(a). Board members noted that this part of the sentence was implicit and that it didn’t work with the lead in. The Task Force was of the view that it is important to have a link to fraud risk factors so added “taking into account fraud risk factors” instead.

Reference	Significant Changes and the Rationale for Those Changes
	<p><i>Application Material</i></p> <ul style="list-style-type: none"> Paragraph A12M: The Task Force deleted this paragraph as it could signal that the auditor may perform two separate risk assessments: one based on the requirements in ISA 315 (Revised 2019) and one based on the requirements in proposed ISA 240 (Revised).
Paragraph 24	<p><i>Application Material</i></p> <ul style="list-style-type: none"> Paragraph A22E: The Task Force deleted this paragraph as it was repeating ISA 315 (Revised 2019) and did not highlight any fraud specific matters. Paragraphs A23 and A23B: Based on comments from the Board, the Task Force deleted paragraph A23B as some of the bullet points were repeating ISA 315 (Revised 2019). Some of the examples in paragraph A23B were used to enhance paragraph A23.
<p>Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework and the Entity’s System of Internal Control</p>	
Paragraph 24B	<ul style="list-style-type: none"> Paragraph 24B(a): In its September 2022 meeting, the Board noted that the application material to this paragraph missed a connection to the requirement. In response, the Task Force added more details to the requirements. In doing so, the Task Force highlighted the specific matters that were addressed in the application material. In doing so, the Task Force were cognizant of the Board’s comments in June 2022 that the requirement should not repeat ISA 315 (Revised 2019). <p><i>Application Material</i></p> <ul style="list-style-type: none"> Paragraph A23Da: The Task Force added this paragraph to explain that the auditor’s understanding of the entity and its environment assists the auditor in identifying fraud risk factors.
Paragraph 24C	<ul style="list-style-type: none"> Paragraph 24C(a): Extant ISA 240⁸ includes a requirement for the auditor to <u>inquire</u> of management regarding management’s communications, if any, to employees regarding its views on business practices and ethical

⁸ ISA 240, *The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements*

Reference	Significant Changes and the Rationale for Those Changes
	<p>behaviors. It was noted that the requirement as presented to the Board in September 2022, required the auditor to obtain an <u>understanding</u> about management’s communications, if any, to employees regarding its views on business practices and ethical behaviors. The Task Force noted that ISA 315 (Revised 2019) does not have such a requirement and in response, the Task Force linked the requirement to paragraph 21 of ISA 315 (Revised 2019).</p> <ul style="list-style-type: none"> • Paragraph 24C(b)(i)/ 24C(c): Extant ISA 240 includes as a requirement for the auditor to <u>inquire</u> of management regarding management’s communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity. It was noted that the requirement as presented to the Board in September 2022, required the auditor to obtain an <u>understanding</u> of management’s communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity. The Task Force noted that ISA 315 (Revised 2019) does not have such a requirement and in response, the Task Force aligned the wording with what was included in extant ISA 240 (Revised) and therefore had to move the requirement from paragraph 24C(b)(i) to paragraph 24C(c). • Paragraph 24C(c): Based on the CUSP Drafting Principles and Guidelines, the Task Force noted that the possible work effort and possible documentation implication of the verb “determine” may be more extensive than for other work effort verbs on the spectrum.⁹ For example, the CUSP Drafting Principles and Guidelines note that when the verb “determine” is used, the auditor is required to identify and analyze the relevant issues or matters, to come to a specific conclusion. The Task Force was of the view that inquiries alone were not sufficient to achieve the necessary work effort to meet the “determine” threshold (and associated documentation) as contemplated by the CUSP Drafting Principles and Guidelines. The Task Force therefore changed to construct of the paragraph. <p><i>Application Material</i></p> <ul style="list-style-type: none"> • Paragraph A24B: The Task Force deleted the third bullet as it was deemed duplicative of paragraph A24C.
Paragraph 24D	<ul style="list-style-type: none"> • Paragraph 24D(b): Based on the CUSP Drafting Principles and Guidelines, the Task Force noted that the possible work effort and possible documentation implication of the verb “determine” may be more extensive than

⁹ CUSP Drafting Principles and Guidelines, Appendix 2

Reference	Significant Changes and the Rationale for Those Changes
	<p>for other work effort verbs on the spectrum.¹⁰ The Task Force was of the view that inquiries alone were not sufficient to achieve the necessary work effort to meet the “determine” threshold (and associated documentation) as contemplated by the CUSP Drafting Principles and Guidelines. The Task Force therefore changed to construct of the paragraph.</p> <ul style="list-style-type: none"> • Paragraph 24D(b)(iii): The Task Force added a requirement for the auditor to make inquiries of management and appropriate individuals within the entity about the entity’s process to prevent and detect fraud. The Task Force was of the view that such a requirement would be useful as it is important for the auditor to have an understanding about whether management has such a process in place. <p><i>Application Material</i></p> <ul style="list-style-type: none"> • Paragraph A25A: The Task Force deleted paragraph A25A as it was deemed to repeat the requirement and therefore state the obvious. The Task Force instead added application material that describes an example of a fraud risk assessment program. The example is based on what is included in the Committee of Sponsoring Organizations of the Treadway Commission’s Fraud Risk Management Guide. • Paragraph A25F: The Board noted that the use of a shared service center for the central management of IT processes in a group would not reduce the risk of fraudulent financial reporting in the group, but would rather create the same risk at the shared service center. Therefore, the Task Force deleted the example. • Paragraph A25Ga: Deleted the last bullet as the Task Force was of the view that it was sufficiently covered by the other bullets (i.e., how employees can make communications if they suspect fraud). • Paragraph A25Gb: The Board noted that the paragraph was not clear and that it was sufficiently covered by other paragraphs in this section. Therefore, the Task Force deleted the paragraph. • Paragraph A25la: This paragraph is based on ISA 315 (Revised 2019), paragraph A113. It was noted that the paragraph works well in ISA 315 (Revised 2019), but not in proposed ISA 240 (Revised) as inquiries alone are insufficient when fraud factors are identified. It was also noted that this paragraph is repeating ISA 315 (Revised 2019). Therefore, the Task Force determined to delete this paragraph.

¹⁰ CUSP Drafting Principles and Guidelines, Appendix 2

Reference	Significant Changes and the Rationale for Those Changes
<p>Paragraph 24E</p>	<ul style="list-style-type: none"> • Paragraph 24E(b): Based on the CUSP Drafting Principles and Guidelines, the Task Force noted that the possible work effort and possible documentation implication of the verb “determine” may be more extensive than for other work effort verbs on the spectrum.¹¹ Therefore, the Task Force was of the view that inquiries alone were not sufficient to determine whether appropriate individuals within the internal audit function have knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud. The Task Force has therefore replaced “to determine.” <p><i>Application Material</i></p> <ul style="list-style-type: none"> • Paragraph A26A: It was noted that the scalability considerations for the auditor’s understanding of the entity’s process to monitor the system of internal control are sufficiently addressed in ISA 315 (Revised 2019). Therefore, the Task Force deleted the first sentence of the paragraph.
<p>Paragraph 24F</p>	<ul style="list-style-type: none"> • The Task Force aligned the requirement closer to ISA 315 (Revised 2019) (paragraph 26(a) of ISA 315 (Revised 2019) requires the auditor to obtain an understanding of controls over journal entries). Also, to make the requirement fraud specific, the Task Force replaced the reference to “non-standard journal entries used to record non-recurring, unusual transactions or adjustments” (which is similar to the wording used in ISA 315 (Revised 2019)) with “controls over journal entries authorized by management and non-standard journal entries.”
<p>Paragraph 24G</p>	<ul style="list-style-type: none"> • Based on comments from the Board, the Task Force enhanced the requirement. <p><i>Application Material</i></p> <ul style="list-style-type: none"> • Paragraph A28B: The Board noted that this paragraph was repeating ISA 265.¹² In response, the Task Force deleted the paragraph.
<p>Identifying and Assessing the Risks of Material Misstatement due to Fraud</p>	
<p>Paragraph 25</p>	<p><i>Application Material</i></p>

¹¹ CUSP Drafting Principles and Guidelines, Appendix 2

¹² ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*

Reference	Significant Changes and the Rationale for Those Changes
	<ul style="list-style-type: none"> Paragraph A28A: The Task Force deleted the lead in sentence as fraud risk factors is a defined term and there is no need to repeat the definition in this paragraph. The Task Force was also of the view that the hanging paragraph could be best placed as application material against the definition.
<p>Paragraph 26</p>	<ul style="list-style-type: none"> Based on a suggestion from the Board, the Task Force added “design and implementation of the” before entity’s related controls. <p><i>Application Material</i></p> <ul style="list-style-type: none"> Paragraph A28I The Task Force added this paragraph as it wanted to highlight that the auditor uses professional judgement when determining whether the presence of fraud risk factors, individually or in combination, indicates that there are risks of material misstatement due to fraud. Paragraphs A28J and A28K: Agenda item 5, Section I explain the addition of the application material. Paragraph A28M: The Task Force added application material to clarify that the linkage between proposed ISA 240 (Revised) and ISA 330¹³ as it relates to significant risks.
<p>Paragraph 27</p>	<ul style="list-style-type: none"> Based on the CUSP Drafting Principles and Guidelines, the Task Force changed the work efforts verb from “evaluate” to “determine”. In the CUSP Drafting Principles and Guidelines it is noted that the meaning of determine is similar to the meaning of evaluate, but that the preparation of the relevant information or analysis is the responsibility of the auditor.¹⁴ As it is the auditor’s responsibility to determine which types of revenue, revenue transactions or relevant assertions give rise to risks of material misstatement due to fraud, the Task Force is of the view that “determine” is the right word. To clarify the intended work effort, the Task Force added a second sentence to the requirement. <p><i>Application Material</i></p> <ul style="list-style-type: none"> Paragraph A29A: Based on comments from the Board, the Task Force added application material highlighting that the risks of material misstatement due to fraud (fraud risk) in revenue recognition can also exist in simple

¹³ ISA 330, *The Auditor’s Responses to Assessed Risks*

¹⁴ CUSP Drafting Principles and Guidelines, Appendix 2

Reference	Significant Changes and the Rationale for Those Changes
	<p>types of revenue. The purpose is to have auditors of less complex entities think about possible fraud risk, before deciding whether to rebut the presumption of fraud risk in revenue recognition.</p> <ul style="list-style-type: none"> Paragraph A30B: Based on comments from the Board, the Task Force added application material to clarify that it is ordinarily inappropriate to rebut the presumption of fraud risk in revenue recognition when there is a fraud factor risk present. The Task Force used the word ‘ordinarily’ as it was of the view that the application material should send a strong message.
Responses to the Assessed Risks of Material Misstatement Due to Fraud	
Paragraph 29	<p><i>Application Material</i></p> <ul style="list-style-type: none"> Paragraphs A33A and A33B: Agenda item 5, Section I explains the addition of the application material.
Material Misstatements Due to Fraud	
Paragraph 34E	<ul style="list-style-type: none"> The Task Force moved paragraphs relating to material misstatements due to fraud under a single heading for clarity. The requirement and related application material have been drafted in response to proposed action #B19 in paragraph 25 of the project proposal. The requirement builds on the characteristics outlined in paragraph 4D of the <i>Introduction</i> section that discusses the nature of the circumstances giving rise to the fraud and the identified misstatements. The Task Force also considered the first sentence of extant paragraph 36 of ISA 240 when drafting the new requirement. For clarity and to strengthen the links between the ISAs, the Task Force references ISA 450 which deals with the auditor’s responsibility to evaluate the effect of identified misstatements in the audit and of uncorrected misstatements. In addition, the Task Force changed the work effort verb from “evaluate” in extant ISA 240 to “determine” to align with the CUSP Drafting Principles and Guidelines.¹⁵

¹⁵ CUSP Drafting Principles and Guidelines, Appendix 2

Reference	Significant Changes and the Rationale for Those Changes
	<p>NOTE: The requirement has been drafted based on the premise that the auditor has identified, as a result of additional audit procedures performed, a misstatement due to fraud (see Agenda Item 5, Section I for an overview of the additional audit procedures).</p> <p><i>Application Material</i></p> <ul style="list-style-type: none"> • Paragraph A49J: The Task Force added examples of qualitative factors for the auditor’s consideration of an identified misstatement. • Paragraph A49K: The Task Force added examples of quantitative factors for the auditor’s consideration of an identified misstatement.
Paragraph 34F	<ul style="list-style-type: none"> • The Task Force leveraged the second sentence of extant paragraph 36 of ISA 240 in developing the requirement. In addition, the work effort verb was changed from “evaluate” in extant ISA 240 to “determine” to align with the CUSP Drafting Principles and Guidelines.¹⁶ The Task Force deleted the phrase “recognizing that an instance of fraud is unlikely to be an isolated occurrence,” as it believes such material is not essential or critical to the understanding of the requirement. <p><i>Application Material</i></p> <ul style="list-style-type: none"> • Paragraph A49L: The lead in was amended to align with the requirement.
Paragraph 34G	<ul style="list-style-type: none"> • Paragraph 34G(a): The Task Force changed the work effort verb from “reevaluate” to “revise”. The Task Force clarified that the auditor is required to revise both the identification and assessment of the risks of material misstatement due to fraud, and not just the assessment of the risks of material misstatement due to fraud per extant paragraph 37 of ISA 240. • Paragraph 34G(b): The Task Force made changes to limit the circumstances and conditions that the auditor is required to consider to those that relate to the misstatement.

¹⁶ CUSP Drafting Principles and Guidelines, Appendix 2

Reference	Significant Changes and the Rationale for Those Changes
<p>Paragraph 34H</p>	<ul style="list-style-type: none"> • Paragraph 34H(a): The Task Force changed the work effort verb from “evaluate” to “determine” to align with the CUSP Drafting Principles and Guidelines.¹⁷ • Paragraph 34H(b) and 34H(c): The Task Force expanded the requirement from extant paragraph 38 of ISA 240 which was previously limited to evaluating the implications of the audit. The Task Force believes that it is appropriate to provide the auditor with specific actions to address should the auditor confirm that, or is unable to conclude whether, the financial statements are materially misstated due to fraud.
<p>Implications for the Auditor’s Report</p>	
<p>Paragraph 39A–39F</p>	<ul style="list-style-type: none"> • Agenda item 5, Section II explains the additions to these paragraphs. <p><i>Application Material</i></p> <ul style="list-style-type: none"> • Agenda item 5, Section II explains the additions to these paragraphs.

¹⁷ CUSP Drafting Principles and Guidelines, Appendix 2