

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

Board members are asked to take the following into account:

- Sections with no shading were discussed during the June 2022 Board meeting (paragraphs 1–16B and 27–48)
- Green shaded sections were discussed during the September 2022 Board meeting (paragraphs 17–26)
- Gray shaded sections will NOT be discussed during the December 2022 Board meeting

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<b>Introduction</b>	
<b>Scope of this ISA</b>	
<p>1. This International Standard on Auditing (ISA) deals with the auditor’s responsibilities relating to fraud in an audit of financial statements. Such responsibilities include <u>identifying and assessing</u> <del>designing and implementing responses to the identified and assessed</del> risks of material misstatement in the financial statements due to fraud <u>and designing and implementing responses to address the assessed risks of material misstatement due to fraud</u>. The requirements and guidance in this ISA refer to, or expand on, the application of other relevant ISAs, in particular ISA 200,<sup>1</sup> ISA 315 (Revised 2019)<sup>2</sup> and ISA 330.<sup>3</sup></p>	

<sup>1</sup> ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

<sup>2</sup> ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement* ~~through Understanding the Entity and Its Environment~~

<sup>3</sup> ISA 330, *The Auditor’s Responses to Assessed Risks*

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<p><b>Responsibilities of the Auditor, Management and Those Charged with Governance</b></p>	<p><b>Responsibilities of the Auditor, Management and Those Charged with Governance</b></p>
<p><i>Responsibilities of the Auditor</i></p> <p>1A. An auditor conducting an audit in accordance with ISAs is responsible for: <a href="#">(Ref: Para. A1A)</a></p> <p><del>(a) Planning and performing the audit to obtain</del>ing reasonable assurance that the financial statements taken as a whole are free from material misstatement <del>due to, whether caused by</del> fraud <del>or error</del>.</p> <p><del>— The auditor is also responsible for</del> Communicating and reporting about matters related to fraud as required by this ISA.</p> <p><del>(a)(b)</del> <a href="#">(Ref: Para. A1A)</a></p>	<p><i>Responsibilities of the Auditor</i> <a href="#">(Ref: Para. 1A)</a></p> <p>Considerations Specific to Public Sector Entities</p> <p>A1A. The public sector auditor’s responsibilities relating to fraud may be a result of law, regulation or other authority applicable to public sector entities or separately covered by the auditor’s mandate. Consequently, the public sector auditor’s responsibilities may not be limited to consideration of risks of material misstatement of the financial statements, but may also include a broader responsibility to consider risks of fraud.</p>
<p>1B. <b>[Moved to paragraph 4E]</b></p>	
<p><i>Responsibilities of Management and Those Charged with Governance</i></p> <p>1C. The primary responsibility for the prevention and detection of fraud rests with both management and those charged with governance of the entity, <del>unless all of those charged with governance are involved in managing the entity in which case management is responsible for the prevention and detection of</del> fraud. It is important that management, with the oversight of those charged with governance, place a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place, and fraud deterrence, which could persuade individuals not to commit fraud because of the likelihood of</p>	<p><del><i>Responsibilities of Management and Those Charged with Governance</i></del> <a href="#">(Ref: Para. 1C)</a></p> <p>A1B. <b>[Moved to paragraph A12F]</b></p>

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<p>detection and punishment. This involves a commitment to creating <u>and maintaining</u> culture of honesty, <del>integrity</del> and ethical behavior which can be reinforced by <del>an</del> active oversight by those charged with governance. <del>(Ref: Para. A1B)</del></p>	
Key Concepts in this ISA	Key Concepts in this ISA (Ref: Para. 4B, <u>4CA</u> , <u>4D</u> , <u>6</u> , <u>8</u> and 9)
<p><i>Characteristics of Fraud</i></p> <p>4A. Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.</p>	<p><i>Characteristics of Fraud</i> (Ref: Para. 4B)</p>
<p>4B. Two types of intentional misstatements are relevant to the auditor – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets. (Ref: Para. A1–A5)</p>	<p>A1. Fraud, whether fraudulent financial reporting or misappropriation of assets, involves incentive or pressure to commit fraud, a perceived opportunity to do so and some rationalization of the act. For example:</p> <ul style="list-style-type: none"> <li>• Incentive or pressure to commit fraudulent financial reporting may exist when management is under pressure, from sources outside or inside the entity, to achieve an expected (and perhaps unrealistic) earnings target or financial outcome – particularly since the consequences to management for failing to meet financial goals can be significant. Similarly, individuals may have an incentive to misappropriate assets, for example, because the individuals are living beyond their means.</li> <li>• A perceived opportunity to commit fraud may exist when an individual believes internal control can be overridden, for example, because the individual is in a position of trust or has knowledge of specific deficiencies in internal control.</li> <li>• Individuals may <del>be able to</del> rationalize committing a fraudulent act <u>as they may</u>. <del>Some individuals</del> possess an attitude,</li> </ul>

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	<p>character or set of ethical values that allow them knowingly and intentionally to commit a dishonest act. However, even otherwise honest individuals can commit fraud in an environment that imposes sufficient pressure on them.</p> <p>A2. Fraudulent financial reporting involves intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users. It can be caused by the efforts of management to manage earnings in order to deceive financial statement users by influencing their perceptions as to the entity's performance and profitability. Such earnings management may start out with small actions or inappropriate adjustment of assumptions and changes in judgments by management. Pressures and incentives may lead these actions to increase to the extent that they result in fraudulent financial reporting. Such a situation could occur when, due to pressures to meet market expectations or a desire to maximize compensation based on performance, management intentionally takes positions that lead to fraudulent financial reporting by materially misstating the financial statements. In some entities, management may be motivated to reduce earnings by a material amount to minimize tax or to inflate earnings to secure bank financing.</p> <p>A3. Fraudulent financial reporting may be accomplished by the following:</p> <ul style="list-style-type: none"> <li>• Manipulation, falsification (including forgery), or alteration of accounting records or supporting documentation from which the financial statements are prepared.</li> <li>• Misrepresentation in, or intentional omission from, the financial statements of events, transactions or other significant information.</li> </ul>

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	<ul style="list-style-type: none"> <li>● Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure.</li> </ul> <p>A4. Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as intentionally:</p> <ul style="list-style-type: none"> <li>● Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.</li> <li>● Inappropriately adjusting assumptions and changing judgments used to estimate account balances.</li> <li>● Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period.</li> <li>● Omitting, obscuring or misstating disclosures required by the applicable financial reporting framework, or disclosures that are necessary to achieve fair presentation.</li> <li>● Concealing facts that could affect the amounts recorded in the financial statements.</li> <li>● Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.</li> <li>● Altering records and terms related to significant and unusual transactions.</li> <li>● Altering reports that would highlight inappropriate activity or transactions.</li> </ul>

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	<ul style="list-style-type: none"> <li>● <del>Taking advantage of</del>Exploiting inadequate IT process controls over IT applications, including controls over and review of IT application event logs (for example, <u>modifying the application logic or</u> where users can access a common database using generic access identification, or modify access identification, to conceal activity).</li> <li>● <del>Exploiting inadequate automated controls over IT applications such as automated calculations or input, processing and output controls, (for example, where users access source code to make program changes).</del></li> </ul> <p>A5. Misappropriation of assets involves the theft of an entity’s assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more able to disguise or conceal misappropriations in ways that are difficult to detect. Misappropriation of assets can be accomplished in a variety of ways including:</p> <ul style="list-style-type: none"> <li>● Embezzling receipts (for example, misappropriating collections on accounts receivable or diverting receipts in respect of written-off accounts to personal bank accounts).</li> <li>● Stealing physical assets or intellectual property (for example, stealing inventory for personal use or for sale, stealing scrap for resale, colluding with a competitor by disclosing technological data in return for payment).</li> <li>● Causing an entity to pay for goods and services not received (for example, payments to fictitious vendors, kickbacks paid by vendors to the entity’s purchasing agents in return for inflating prices, payments to fictitious employees).</li> </ul>

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	<ul style="list-style-type: none"> <li>Using an entity's assets for personal use (for example, using the entity's assets as collateral for a personal loan or a loan to a related party).</li> </ul> <p>Misappropriation of assets is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorization</p>
<p><u>Fraud or Suspected Fraud</u></p> <p>4C. Although fraud is a broad legal concept, for the purposes of the ISAs, the auditor is concerned with <del>fraud or suspected fraud that could cause a material misstatement of</del> the financial statements <del>due to fraud. The term "fraud" is intended to include both actual fraud and suspected fraud, unless otherwise indicated.</del> <del>While</del>Although the auditor may suspect or, <del>in rare cases,</del> identify the occurrence of fraud, the auditor does not make legal determinations of whether fraud has actually occurred.</p>	<p><u>Fraud or Suspected Fraud (Ref: Para. 4CA)</u></p>
<p><u>4CA. The auditor may identify fraud or suspected fraud when performing:</u> (Ref: Para. A5Aa)</p> <p>(a) <u>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 that provide an appropriate basis for the identification of risks of material misstatement due to fraud, and</u></p> <p>(b) <u>Further audit procedures in response to the assessed risks of material misstatement due to fraud.</u></p>	<p><u>A5Aa. Audit evidence obtained when performing risk assessment procedures and further audit procedures may indicate the existence of fraud or suspected fraud. For example:</u></p> <ul style="list-style-type: none"> <li><u>When performing risk assessment procedures, the auditor identified unusual or unexpected relationships relating to the inventory balance that was indicative of fraud that may result in a misstatement due to the intentional misappropriation of assets.</u></li> <li><u>When performing further audit procedures to obtain audit evidence to respond to the assessed risks of material misstatement due to fraud, audit evidence was obtained that identified misappropriation of inventory by employees (e.g., by</u></li> </ul>

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	<p><u>using automated tools or techniques, such as surveillance cameras-).</u></p>
<p><u>Nature of the Circumstances Giving Rise to the Fraud and the Identified Misstatements</u></p> <p>4D. <u>The auditor’s determination of whether a fraud is material or not is a matter that involves the exercise of professional judgment. Judgments about whether <del>an identified fraud could cause a material misstatement is material</del> involves consideration of the nature of the circumstances <u>giving rise to that gave rise to the identified misstatement the fraud and the identified misstatements. Judgments about materiality involve both</u> <del>These considerations may be</del> qualitative <u>and</u> quantitative considerations. (Ref: Para. A5Ab) <del>For example, a fraud perpetrated by a key member of management may be considered material even if the potential misstatement is less than materiality determined in quantitative terms for the financial statements as a whole. This may in turn give rise to concerns about the integrity of management responsible for the entity’s system of internal control.</del> <u>[Moved the last 2 sentences to paragraph A5Ab-(a)]</u></u></p>	<p><u>Nature of the Circumstances Giving Rise to the Fraud and the Identified Misstatements (Ref: Para. 4D)</u></p> <p><u>A5Ab. The qualitative considerations of the auditor may vary for identified misstatements that are less than materiality determined in quantitative terms for the financial statements as a whole, for example the auditor may consider:</u></p> <p>(a) <u>Who has instigated or perpetrated the fraud – <del>For example,</del> a fraud perpetrated by a key member of management may be considered material <del>even if the potential misstatement is less than materiality determined in quantitative terms for the financial statements as a whole.</del> This may in turn give rise to concerns about the integrity of management responsible for the entity’s system of internal control. <b>[Previously paragraph 4D]</b></u></p> <p>(b) <u>Why the fraud was perpetrated – <del>misstatements that are not material, either individually or in the aggregate, may have been made intentionally to “manage” key performance indicators that need to be met in order for the entity to conduct its business according to specific laws or regulations. In such instances the auditor’s responsibilities in accordance with ISA 250 (Revised)<sup>4</sup> also apply.</del></u></p>
<p><i>Inherent Limitations</i></p> <p>4E. While the risk of not detecting a material misstatement resulting from fraud may be higher than the risk of not detecting one resulting from error, that does not diminish the auditor’s</p>	<p><i>Inherent Limitations (Ref: Para. 6)</i></p>

<sup>4</sup> ISA 250 (Revised), Consideration of Laws and Regulations in an Audit of Financial Statements

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<p>responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements <u>as a whole</u> are free from material misstatement due to fraud. Reasonable assurance is a high, but not absolute, level of assurance.<sup>5</sup> [Previously paragraph 1B]</p>	
<p>5. <del>Because of</del><sup>Owing to</sup> the <u>significance of these</u> inherent limitations <del>of an audit as it relates to fraud</del>, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the ISAs.<sup>6</sup> <del>However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less than persuasive audit evidence.</del><sup>7</sup></p>	
<p>6. <del>As described in ISA 200,<sup>8</sup> the potential effects of inherent limitations are particularly significant in the case of misstatement resulting from fraud. The auditor's risk of not detecting a material misstatement resulting from fraud may be higher than the risk of not detecting one resulting from error.</del> While the auditor may be able to identify potential opportunities for fraud to be perpetrated, it may be difficult for the auditor to determine whether misstatements in judgment areas such as accounting estimates are caused by fraud or error. (Ref: Para. A5A)</p>	<p>A5A. The risk of not detecting a material misstatement resulting from fraud exists because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. Such attempts at concealment may be even more difficult to detect when accompanied by collusion. Collusion may cause the auditor to believe that audit evidence is persuasive when it is, in fact, false. The auditor's ability to detect a fraud depends on factors such as the skillfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved.</p>

<sup>5</sup> ~~ISA 200, paragraph 5~~

<sup>6</sup> ~~ISA 200, paragraphs A53-A54~~

<sup>7</sup> ~~ISA 200, paragraphs A53-A54~~

<sup>8</sup> ~~ISA 200, paragraph A53~~

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<p>7. Furthermore, the risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud, because management is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information or override controls designed to prevent similar frauds by other employees.</p>	
<p><i>Professional Skepticism</i></p> <p>8. <del>When obtaining reasonable assurance, the auditor is responsible for maintaining professional skepticism throughout the as required by ISA 200<sup>9</sup>, considering the potential for management override of controls and recognizing</del> In accordance with ISA 200,<sup>10</sup> the auditor is required to maintain professional skepticism when planning and performing the audit, including to recognize the fact that audit procedures that are effective for detecting error may not be effective for detecting fraud. <del>Professional skepticism is affected by the auditor's consideration of fraud risk factors, and</del> The importance of maintaining professional skepticism increases when there is a greater susceptibility to misstatement due to management bias or a risks of material misstatement due to fraud. (Ref: Para. A5B-A5C) [Combined with paragraph 8A]</p>	<p><i>Professional Skepticism (Ref: Para. 8)</i></p> <p>A5B. ISQM 1<sup>11</sup> requires the firm to design, implement and operate a system of quality management for audits of financial statements. The firm's commitment to an effective system of quality management underpins the requirement for the auditor to exercise professional skepticism when performing the audit engagement. This commitment is recognized and reinforced in the governance and leadership component, including a:</p> <p>(a) Commitment to quality by the leadership of the firm, such as the tone at the top by leadership that supports and encourages the auditor to focus on the auditor's responsibilities relating to fraud in an audit of financial statements.</p> <p>(b) Recognition that the resource needs are planned for and resources obtained, allocated or assigned in a manner that is consistent with the firm's commitment to quality, such as resources with the appropriate specialized knowledge and skills</p>

<sup>9</sup> ISA 200, paragraph 15

<sup>10</sup> ISA 200, paragraph 15

<sup>11</sup> International Standard on Quality Management (ISQM) 1, *Quality Management for Firms that Perform Audit or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*

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	<p><u>that may be needed when performing audit procedures related to fraud in an audit of financial statements.</u></p> <p><u>A5C. As explained in ISA 220 (Revised),<sup>12</sup> conditions inherent in some audit engagements can create pressures on the engagement team that may impede the appropriate exercise of professional skepticism when designing and performing audit procedures and evaluating audit evidence. For example, a lack of cooperation or undue pressures imposed by management, may negatively affect the engagement team’s ability to resolve complex or contentious issues and may indicate the presence of fraud risk factors.</u></p>
<p>8A. <b>[Moved and combined with paragraph 8]</b></p>	
<p><u>8AB. The auditor also remains alert to the possibility that other audit procedures applied for the purpose of forming an opinion on the financial statements may bring instances of fraud or suspected fraud to the auditor’s attention. Maintaining professional skepticism throughout the audit, as required by ISA 200, is important in this context.</u></p>	
<p><i>Inherent Risk Factors and Fraud Risk Factors</i></p> <p>8B. In applying ISA 315 (Revised 2019)<sup>13</sup> when identifying and assessing the risks of material misstatement due to both fraud and error, the auditor obtains an understanding of how inherent risk factors affect the susceptibility of assertions to misstatement, which includes the susceptibility to misstatement</p>	

<sup>12</sup> [ISA 220 \(Revised\), Quality Management for an Audit of Financial Statements, paragraph A34](#)

<sup>13</sup> ISA 315 (Revised 2019), paragraph 12(f) and 19(c)

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<p>due to management bias or other fraud risk factors insofar as they affect inherent risk.</p>	
<p>8C. Events or conditions may exist in the entity's system of internal control that provide an opportunity to commit fraud and may be an indicator that fraud risk factors are present.</p>	
<p><i>Non-Compliance with Laws and Regulations</i></p> <p>9. <u>If the auditor identifies fraud or suspected fraud,</u> <del>t</del>The auditor may have additional responsibilities under law, regulation or relevant ethical requirements regarding an entity's non-compliance with laws and regulations, including fraud, which may differ from or go beyond this and other ISAs, such as: (Ref: Para. A6)</p> <ul style="list-style-type: none"> <li>(a) Responding to identified or suspected non-compliance with laws and regulations, including requirements in relation to specific communications with management and those charged with governance, assessing the appropriateness of their response to non-compliance and determining whether further action is needed;</li> <li>(b) Communicating identified or suspected non-compliance with laws and regulations to other auditors (e.g., in an audit of group financial statements); and</li> <li>(c) Documentation requirements regarding identified or suspected non-compliance with laws and regulations.</li> </ul> <p>ISA 250 (Revised) <u>deals with the auditor's responsibility to consider laws and regulations in an audit of financial</u></p>	<p><i>Non-Compliance with Laws and Regulations</i> (Ref: Para. 9)</p> <p>A6. Law, regulation or relevant ethical requirements may require the auditor to perform additional procedures and take further actions. For example, the International Ethics Standards Board for Accountants' <i>International Code of Ethics for Professional Accountants (including International Independence Standards)</i> (IESBA Code) requires the auditor to take steps to respond to identified or suspected non-compliance with laws and regulations and determine whether further action is needed. Such steps may include the communication of identified or suspected non-compliance with laws and regulations between auditors within the engagement team, or other auditors performing work at entities or business units of a group for purposes other than the audit of the group financial statements.<sup>14</sup></p>

<sup>14</sup> See, for example, paragraphs R360.16–360.18 A1 of the IESBA Code.

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<p><del>statements expands on the auditor's responsibility to consider laws and regulations, C</del>omplying with <del>th</del>ese responsibility<del>ies</del> and any additional responsibilities relating to relevant ethical requirements may provide further information that is relevant to the auditor's work in accordance with this and other ISAs (e.g., regarding the integrity of management or, where appropriate, those charged with governance).</p>	
<b>Relationship with Other ISAs</b>	<b>Relationship with Other ISAs (Ref: Para. 9A)</b>
<p><del>Relationship with Other ISAs</del></p> <p>9A. <del>Some</del>Other ISAs that address specific topics, such as ISA 550<sup>15</sup> <del>may</del> also have requirements and guidance that are applicable to the auditor's work on the identification and assessment of the risks of material misstatement due to fraud and responses to address such assessed <u>risks of material misstatement due to fraud</u><del>risks</del>. In such instances, the other ISAs expand upon how this ISA is applied. <u>(Ref: Para. A7A)</u></p>	<p>A7A. <u>Appendix 5 identifies specific requirements that refer to fraud or suspected fraud in other ISAs.</u></p>
<b>Effective Date</b>	
<p>10. This ISA is effective for audits of financial statements for periods beginning on or after December 15, 2009.</p>	
<b>Objectives</b>	
<p>11. The objectives of the auditor are:</p>	

<sup>15</sup> ISA 550, *Related Parties*

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<p>(a) To identify and assess the risks of material misstatement of the financial statements due to fraud;</p> <p>(b) To obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and</p> <p>(c) To respond appropriately to fraud or suspected fraud identified during the audit.</p>	
<b>Definitions</b>	
<p>12. For purposes of the ISAs, the following terms have the meanings attributed below:</p> <p>(a) Fraud – An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.</p> <p>(b) Fraud risk factors – Events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud</p>	
<b>Requirements</b>	
<b>Professional Skepticism</b>	<b>Professional Skepticism (Ref: Para. 13–15)</b>
<p>13. In accordance with ISA 200<sup>16</sup>, the auditor shall maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist,</p>	<p>A8. Maintaining professional skepticism requires an ongoing questioning of whether the information and audit evidence obtained suggests that a material misstatement due to fraud may exist. It includes considering</p>

<sup>16</sup> ISA 200, paragraph 15

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<p>notwithstanding the auditor’s past experience of the honesty and integrity of the entity’s management and those charged with governance. (Ref: Para. A8–A9)</p>	<p>the reliability of the information to be used as audit evidence and identified controls in the control activities component, if any, over its preparation and maintenance. Due to the characteristics of fraud, the auditor’s professional skepticism is particularly important when considering the risks of material misstatement due to fraud.</p> <p>A9. Although the auditor cannot be expected to disregard past experience of the honesty and integrity of the entity’s management and those charged with governance, the auditor’s professional skepticism is particularly important in considering the risks of material misstatement due to fraud because there may have been changes in circumstances.</p>
<p>14. Unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine. If conditions identified during the audit cause the auditor to believe that a document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, the auditor shall investigate further. (Ref: Para. A10)</p>	<p>A10. An audit performed in accordance with ISAs rarely involves the authentication of documents, nor is the auditor trained as or expected to be an expert in such authentication.<sup>17</sup> However, when the auditor identifies conditions that cause the auditor to believe that a document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, possible procedures to investigate further may include:</p> <ul style="list-style-type: none"> <li>• Confirming directly with the third party.</li> <li>• Using the work of an expert to assess the document’s authenticity.</li> </ul>
<p>15. Where responses to inquiries of management or those charged with governance are inconsistent, the auditor shall investigate the inconsistencies.</p>	

<sup>17</sup> ISA 200, paragraph A49

Engagement Resources	Engagement Resources (Ref: Para. 16A)
<p>16A. In applying ISA 220 (Revised),<sup>18</sup> the <del>engagement partner</del> auditor shall determine <del>whether members of the engagement team require specialized skills or knowledge that members of the engagement team collectively have the appropriate competence and capabilities, including appropriate specialized skills or knowledge</del> to perform risk assessment procedures, identify and assess the risks of material misstatement due to fraud, design and perform further audit procedures to respond to those risks, or evaluate the audit evidence obtained. (Ref: Para. A12A–A12E)</p>	<p>A12A. <u>The nature, timing and extent of the involvement of individuals with specialized skills or knowledge may vary throughout the audit.</u> Matters that, <u>individually or collectively,</u> may affect the <del>engagement audit partner</del>’s determination of whether <del>the engagement team requires</del> specialized skills or knowledge, <u>including forensic skills, are needed,</u> include, for example:</p> <ul style="list-style-type: none"> <li>• The complexity of transactions that may present an opportunity for management to manipulate earnings that could be driven by management incentives linked to the entity’s performance, or pressures to meet investors’ expectations.</li> <li>• The complexity of contractual terms that may present an opportunity for management (or a third party) to make false representations that are intended to induce a third party (or management) to agree to the terms of the contract.</li> <li>• The complexity of the flow of data through the entity’s information system that may present an opportunity to conceal facts that could affect the amounts recorded in the accounting records.</li> <li>• The use of complex models that may present an opportunity for management to make adjustments to the output of the model that are not in accordance with the requirements of the applicable financial reporting framework.</li> <li>• The use of complex financial instruments or other complex financing arrangements that may present an opportunity to inadequately disclose the risks and nature of complex structured products.</li> </ul>

<sup>18</sup> ISA 220 (Revised), paragraphs ~~25–28~~6–29

	<ul style="list-style-type: none"><li>• The complexity of the entity's organizational structure and related party relationships that may present an opportunity for management to misrepresent the financial position or financial performance of the entity.</li><li>• <del>Special purpose entities that may be present an opportunity for management to enter into complex transactions or issue complex derivative financial instruments casting doubt on the quality of the entity's earnings or the business purpose for the transactions.</del></li><li>• <del>Operating in complex industries that may present an opportunity for management to engage in fraudulent financial reporting, or emerging markets that may be susceptible to risks from bribery and corruption.</del></li><li>• <u>The matter involved is in a field other than accounting or auditing.<sup>19</sup></u></li><li>• <del>Conditions indicating that a document may be fraudulent or tampered with, raising doubts about the authenticity of the audit evidence.</del></li></ul> <p>A12B. <del>The nature, timing and extent of the involvement of individuals with specialized skills or knowledge may vary throughout the audit. For many audits, the engagement audit partner or</del> <u>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 does not require specialized skills or knowledge to perform the audit engagement.</u></p>
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<sup>19</sup> ISA 620, Using the Work of an Auditor's Expert

~~A12C. The auditor may not possess the specialized skills or knowledge necessary when the matter involved is in a field other than accounting or auditing and may need to use an auditor's expert.<sup>20</sup>~~

A12D. Forensic skills, in the context of an audit of financial statements, may combine accounting, auditing and investigative skills. Such skills are applied in an investigation and evaluation of an entity's accounting records to derive evidence that can be used in a court of law or legal proceeding—with regard to fraudulent financial reporting or misappropriation of assets, or for use when performing audit procedures. Forensic skills (or knowledge) may include specialized skills or knowledge~~competence and experience~~, for example, in:

- Identifying and evaluating fraud risk factors.
- Identifying and assessing the risks of material misstatement due to fraud.
- Evaluating the effectiveness of controls implemented by management to prevent and detect fraud.
- Analyzing the authenticity of audit evidence.
- Gathering, analyzing and evaluating information or data to identify links, patterns, or trends that may be indicative of fraud.
- Applying knowledge in fraud schemes, and techniques for interviews, information gathering and data analytics, in the detection of fraud.

A12E. In determining whether the engagement team has the appropriate competence and capabilities, the engagement partner may take into consideration matters such as expertise in IT systems or IT applications used by the entity or automated tools or techniques that are to be used by the engagement team in planning and performing

<sup>20</sup>—ISA 620, *Using the Work of an Auditor's Expert*

	<p><u>the audit (e.g., such as the testing of journal entries and other adjustments or accounting estimates).</u></p>
<p><b><u>Ongoing Nature of Communications with Management and Those Charged with Governance</u></b></p>	<p><b><u>Ongoing Nature of Communications with Management and Those Charged with Governance (Ref: Para. 16B)</u></b></p>
<p><u>16B.</u> The auditor shall communicate with management and those charged with governance matters related to fraud at appropriate times throughout the audit. (Ref: Para. A12F–A12G) <u>Previously paragraph 40A]</u></p>	<p><u>A12F.</u> Robust two-way communication between management or those charged with governance, and the auditor assists in identifying and assessing the risks of material misstatement due to fraud. The appropriate timing of the communications may vary depending on the significance and nature of the fraud-related matter, and the expected action(s) to be taken by management or those charged with governance. For example:</p> <ul style="list-style-type: none"> <li>• <u>Specific discussions</u> <u>Obtaining the views with of</u> those charged with governance about: <ul style="list-style-type: none"> <li>○ <u>The entity's approach to fraud risk management.</u></li> <li>○ <u>The entity's fraud risks factors.</u></li> <li>○ <u>Possible areas susceptible to misstatement due to management bias of</u></li> <li>○ <u>Whether they are aware of control deficiencies related to the prevention or detection of fraud, in accordance with paragraph 22A of this ISA, may form part of the auditor's communications for planning purposes early in the audit engagement.</u></li> <li>○ <u>Their oversight responsibilities of management by those charged with governance includes considering including</u> the potential for override of controls or other inappropriate influence over the financial reporting process, such as efforts by management to manage earnings in order to</li> </ul> </li> </ul>

	<p>influence the perceptions of analysts as to the entity's performance and profitability. [Previously paragraph A1B]</p> <p><u>Obtaining these views may form part of the auditor's communications for planning purposes early in the audit engagement.</u></p> <ul style="list-style-type: none"><li>• Specific discussions with those charged with governance about the auditor's evaluation of the components of the entity's system of internal control and the auditor's assessment of the risks of material misstatement due to fraud may form part of the auditor's communications on findings from the audit at the conclusion of the audit.</li><li>• <u>Communicating Significant</u><del>significant</del> deficiencies in controls in place to prevent and detect fraud <del>may be communicated</del> with the appropriate level(s) of management and those charged with governance <u>on a timely basis as soon as practicable to</u><del>may</del> assist them in taking <u>necessary and</u> timely remedial actions<del>s</del> to <del>minimize-reduce</del> the risks of material misstatement due to fraud <u>to an acceptably low level</u>. Such significant deficiencies may be communicated orally in the first instance with management and those charged with governance, prior to communicating these in writing as required by ISA 265.<sup>21</sup> [Previously paragraph A60A]</li></ul> <p><i>Assigning Appropriate Member(s) within the Engagement Team When Communicating with Management and Those Charged with Governance</i></p> <p><u>A12G. Paragraphs 25-28 of</u> ISA 220 (Revised)<sup>22</sup> deals with the engagement partner's overall responsibility with respect to engagement resources <u>and engagement performance</u>. <del>This overall responsibility includes determining that members of the engagement</del></p>
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<sup>21</sup> ISA 265, Communicating Deficiencies in Internal Control to Those Charged with Governance and Management, paragraphs 9, 10(a), ~~9~~ and A14

<sup>22</sup> ISA 220 (Revised), Quality Management for an Audit of Financial Statements, paragraphs 25-28, and paragraphs 29-34

	<p><del>team collectively have the appropriate competence and capabilities, determining that there are sufficient and appropriate resources assigned or made available on a timely basis, and taking appropriate action when insufficient or inappropriate resources are provided by the firm, among other matters.</del> Assigning members of the engagement team with the appropriate competence and capabilities and providing appropriate levels of direction, <u>and</u> supervision and review <u>of their work is also</u><del>are equally</del> important when performing the required communications in accordance with this ISA. This includes involving appropriately skilled or suitably experienced members of the engagement team when communicating with <u>management and</u> those charged with governance. <b>[Moved, and combined from paragraphs A60B and A60C]</b></p>
<p><b>Risk Assessment Procedures and Related Activities</b></p>	<p><b>Risk Assessment Procedures and Related Activities</b></p>
<p>-17. In applying ISA 315 (Revised 2019),<sup>23</sup> the auditor shall perform the procedures in paragraphs 24–24G to obtain audit evidence that provides an appropriate basis for: (Ref: Para. A12K–A12L)</p> <p>(a) The identification and assessment of risks of material misstatement due to fraud, at the financial statement and assertion levels, <del>taking into account including obtaining an understanding of</del> fraud risk factors; and</p> <p>(<del>c</del>b) The design of further audit procedures in accordance with ISA 330.</p>	<p>A12K. ISA 315 (Revised 2019) contains requirements and guidance regarding the auditor’s responsibility to obtain an understanding of the entity and its environment, the applicable financial reporting framework, and the entity’s system of internal control, and the identification and assessment of the risks of material misstatement whether due to fraud or error. The requirements and guidance in this ISA refer to, or expand on, what is required by ISA 315 (Revised 2019).</p> <p>A12L. As explained in ISA 315 (Revised 2019),<sup>24</sup> obtaining an understanding of the entity and its environment, the applicable financial reporting framework and the entity’s system of internal control is a dynamic and iterative process of gathering, updating and analyzing information and continues throughout the audit. Therefore, the auditor’s expectations</p>

<sup>23</sup> [ISA 315 \(Revised 2019\), paragraph 13](#)

<sup>24</sup> ISA 315 (revised 2019) paragraph A48

	<p>with respect to risks of material misstatements due to fraud may change as new information is obtained.</p> <p><del>A12M. The auditor may perform the procedures in paragraphs 24–24G simultaneously with the procedures in ISA 315 (Revised 2019) to obtain audit evidence for use in identifying and assessing the risks of material misstatement due to fraud or error. [Previously paragraph A12G]</del></p>
<p><i>Information from Other Sources</i></p> <p>24. In applying ISA 315 (Revised 2019),<sup>25</sup> the auditor shall consider whether information from other sources obtained by the auditor indicates that one or more fraud risk factors are present.<sup>26</sup> (Ref: Para. A23–A23A)</p>	<p><i>Information from Other Sources</i> (Ref: Para. 24)</p> <p><del>A22E. ISA 315 (Revised 2019)<sup>27</sup> requires the auditor to consider information from the auditor’s procedures regarding acceptance or continuance of the client relationship or the audit engagement and, when applicable, other engagements performed by the engagement partner for the entity.</del></p> <p>A23. Information obtained from other sources may be relevant to the identification of fraud risk factors by providing information and insights about:</p> <ul style="list-style-type: none"> <li>• The <del>nature of the</del> entity and the industry in which the entity operates, <u>and its related business risks that may create pressures on the organization to meet targeted financial results.</u></li> <li>• Management’s commitment to integrity and ethical values, <u>including management’s commitment to remedy known significant deficiencies in internal control on a timely basis.</u></li> <li>• Complexity in the application of the applicable financial reporting framework due to the nature and circumstances of the entity <u>that</u></li> </ul>

<sup>25</sup> ISA 315 (Revised 2019), paragraphs 15–16

<sup>26</sup> ~~ISA 720 (Revised), The Auditor’s Responsibilities Relating to Other Information~~

<sup>27</sup> ~~ISA 315 (Revised 2019), paragraph 15–16~~

	<p><u>may create opportunities for management to perpetrate and conceal fraudulent financial activity.</u></p> <p>A23A. Law, regulation, or relevant ethical requirements may require the successor auditor to request the predecessor auditor to provide known information regarding any facts or circumstances that, in the predecessor auditor’s judgment, the successor auditor needs to be aware of before deciding whether to accept the engagement. In some circumstances, the proposed successor auditor may request the predecessor auditor to provide information regarding identified or suspected fraud. [Previously paragraph A23C]</p> <p><del>A23B. Examples of information from other sources that may be relevant to the identification of fraud risk factors:</del></p> <ul style="list-style-type: none"> <li><del>• Information obtained during the acceptance and continuance process such as information that the organizational structure is overly complex with numerous legal entities or managerial lines of authority.</del></li> <li><del>• Information obtained from other engagements performed by the engagement partner, such as a separate engagement to address regulatory reporting requirements.</del></li> <li><del>• Information from the auditor’s previous experience with the entity, such as management’s failure to remedy known significant deficiencies in internal control on a timely basis.</del></li> </ul> <p>A23C. [Moved to paragraph A23A]</p>
<p><i>Engagement Team Discussion</i></p> <p>24A. ISA 315 (Revised 2019) requires a discussion among the engagement team members and a determination by the engagement partner of which matters are to be communicated</p>	<p><i>Engagement Team Discussion</i></p> <p>A23CaB. Discussing the susceptibility of the entity’s financial statements to material misstatement due to fraud with the engagement team:</p> <ul style="list-style-type: none"> <li>• Provides an opportunity for more experienced engagement team members to share their insights about how and where the</li> </ul>

to those team members not involved in the discussion.<sup>28</sup> This discussion shall place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud might occur. The discussion shall occur setting aside beliefs that the engagement team members may have that management and those charged with governance are honest and have integrity. (Ref: Para. A23CaB–A23Cb)

financial statements may be susceptible to material misstatement due to fraud.

- Enables the auditor to consider an appropriate response to such susceptibility and to determine which members of the engagement team will conduct certain audit procedures.
- Permits the auditor to determine how the results of audit procedures will be shared among the engagement team and how to deal with any allegations of fraud that may come to the auditor's attention.

A23Cb. The discussion may include such matters as:

- An exchange of ideas among engagement team members about how and where they believe the entity's financial statements (including the individual statements and the disclosures) may be susceptible to material misstatement due to fraud, how management could perpetrate and conceal fraudulent financial activity, and how assets of the entity could be misappropriated.
- A consideration of circumstances that might be indicative of earnings management and the practices that might be followed by management to manage earnings that could lead to fraudulent financial reporting.
- A consideration of the risk that management may attempt to present disclosures in a manner that may obscure a proper understanding of the matters disclosed (for example, by including too much immaterial information or by using unclear or ambiguous language).
- A consideration of the known external and internal factors affecting the entity that may create an incentive or pressure for management or others to commit fraud, provide the opportunity

<sup>28</sup> ISA 315 (Revised 2019), paragraphs 17-18

	<p>for fraud to be perpetrated, and indicate a culture or environment that enables management or others to rationalize committing fraud.</p> <ul style="list-style-type: none"><li>• A consideration of management's involvement in overseeing employees with access to cash or other assets susceptible to misappropriation.</li><li>• A consideration of any unusual or unexplained changes in behavior or lifestyle of management or employees which have come to the attention of the engagement team.</li><li>• An emphasis on the importance of maintaining a proper state of mind throughout the audit regarding the potential for material misstatement due to fraud.</li><li>• A consideration of the types of circumstances that, if encountered, might indicate the possibility of fraud.</li><li>• A consideration of how an element of unpredictability will be incorporated into the nature, timing and extent of the audit procedures to be performed.</li><li>• A consideration of the audit procedures that might be selected to respond to the susceptibility of the entity's financial statement to material misstatement due to fraud and whether certain types of audit procedures are more effective than others.</li><li>• A consideration of any allegations of fraud that have come to the auditor's attention.</li><li>• A consideration of the risk of management override of controls.</li></ul>
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<p><b>Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework and the Entity's System of Internal Control</b></p>	<p><b>Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework and the Entity's System of Internal Control</b></p>
<p><i>Understanding the Entity and Its Environment, and the Applicable Financial Reporting Framework</i></p> <p>24B. In applying ISA 315 (Revised 2019),<sup>29</sup> the auditor shall obtain an understanding of: (Ref: Para. A23Da–<del>A23G</del>)</p> <p>(a) <u>Matters related to the entity and its environment that may lead to an increased susceptibility to misstatement due to management bias or other fraud risk factors, including with respect to:</u></p> <p>(i) <u>The entity's organizational structure and ownership, governance, objectives and strategy and geographic dispersion; (Ref: Para. A23Db–A23F)</u></p> <p>(ii) <u>The industry; and (Ref: Para. A23G)</u></p> <p>(ii) <u>The performance measures used, internally and externally, that may create incentives or pressures to achieve financial performance targets; and (Ref: Para. A23H–A23J)</u></p> <p>(b) Matters related to the applicable financial reporting framework and the entity's accounting policies that may lead to an increased susceptibility to misstatement due to management bias or other fraud risk factors. (Ref: Para. A23K)</p>	<p><i>Understanding the Entity and Its Environment</i></p> <p><u>A23Da. ISA 315 (Revised 2019)<sup>30</sup> establishes requirements and provides guidance for the auditor to obtain an understanding of the entity and its environment. Such understanding assists the auditor in identifying fraud risk factors.</u></p> <p>The Entity's Organizational Structure, Ownership, and Governance, and Its Business Model (Ref: Para. 24B)</p> <p>A23D<u>b</u>. Understanding the entity's organizational structure and ownership assists the auditor in identifying fraud risk factors. An overly complex organizational structure involving unusual legal entities <u>across multiple jurisdictions</u> may indicate a fraud risk factor is present. For example, where there are complex intercompany transactions, this increases the risk that schemes may be in place to manipulate balances or create fictitious transactions.</p> <p>A23D<u>ca</u>. Understanding the nature of the entity's governance arrangements, and <u>key roles and</u> accountability for <u>internal controls related to fraud control</u> within the entity, assists the auditor in identifying fraud risk factors. For example, poor governance or accountability arrangements may weaken oversight and increase the opportunity for fraud (<u>see also paragraphs A24A-A24K</u>). In a larger or more complex entity, the entity may have assigned <u>the overall</u> responsibility for <u>overseeing the processes for identifying and responding to fraud in the entity control</u> to a senior member of management <u>or to someone with, as part of their</u></p>

<sup>29</sup> ISA 315 (Revised 2019), paragraphs 19–27

<sup>30</sup> ISA 315 (Revised 2019), paragraphs 19(a)(i) and (ii) and A56-A69

~~normal duties or as a position with~~ designated responsibility ~~for overseeing an entity's broader counter fraud strategy.~~

A23E. Understanding the entity's objectives and strategy assists the auditor in identifying fraud risk factors. Objectives and strategy impact expectations, internally and externally and may create pressures on the entity to achieve financial performance targets. For example, when the entity has a very aggressive growth strategy, this may create pressures on personnel within the entity to commit fraud to meet the goals set.

A23F. Understanding the entity's geographic dispersion assists the auditor in identifying fraud risk factors. For example, the entity may have operations in locations that may be susceptible to inappropriate activity or transactions and are high on a corruption perception index.

Industry, ~~Regulatory and Other External Factors~~ (Ref: Para. 24B)

A23G. Understanding the industry in which the entity operates assists the auditor in identifying fraud risk factors. The auditor may obtain an understanding whether the entity is active in:

- An industry where there are greater incentives to commit fraud. For example, in the construction industry the revenue recognition policies may be complex and subject to judgment which may create an incentive to commit fraud.
- An industry that is under pressure (e.g., high degree of competition or market saturation, accompanied by declining margins in that sector). Such characteristics may create an incentive to commit fraud as it may be harder to achieve the financial performance targets.

~~Performance Measures Used, Internally and Externally, to Assess the Entity's Financial Performance~~ (Ref: Para. 24B)

	<p>A23H. Performance measures, whether internal or external, may create pressures on the entity. These pressures, in turn, may motivate management to take action to inappropriately improve the business performance or to misstate the financial statements. Internal performance measures may include employee performance measures and incentive compensation policies. External performance measures may include expectations from shareholders, analysts or other users. Accordingly, an understanding of the entity's performance measures assists the auditor in considering whether pressures to achieve performance targets may result in incentives or pressures for management that increase the risks of material misstatement due to fraud.</p> <p>A23I. The auditor may consider listening to the entity's earnings calls with analysts or by reading analysts' research reports. This may provide the auditor with information about whether analysts have unduly aggressive or unrealistic expectations about an entity's financial performance. Auditors may also learn about management's attitudes regarding those expectations based on how management interacts with analysts. Aggressive expectations by analysts that are met by commitments by management to meet those expectations may be indicative of pressures and rationalizations for management to manipulate key performance metrics. Based on this information the auditor may conclude that the financial statement accounts included in the calculation of key performance metrics may <del>have</del> <del>be</del> <del>at</del> an increased risk of material misstatement due to fraud.</p> <p>A23J. Other matters that the auditor may consider include:</p> <ul style="list-style-type: none"><li>• Management's compensation package. When a significant portion of management's compensation package is contingent on achieving aggressive financial targets, management may have an incentive to manipulate financial results.</li></ul>
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- Short-selling reports, negative media attention, negative analyst reports. When management is under pressure or intense scrutiny to respond to these matters, management may have an incentive to manipulate financial results.

*The Applicable Financial Reporting Framework and the Entity's Accounting Policies* Ref: Para. 24B(b))

A23K. Matters related to the applicable financial reporting framework that the auditor may consider when obtaining an understanding of where there may be an increased susceptibility to misstatement due to management bias or other fraud risk factors, include:

- Areas in the applicable financial reporting framework that require:
  - The use of complex processes or techniques.
  - Management to make significant judgements such as accounting estimates with high estimation uncertainty.
  - Expertise in a field other than accounting or auditing, such as actuarial calculations, valuations, or engineering data. Particularly where management can influence and direct work performed and conclusions reached by the expert.
- Changes in the applicable financial reporting framework. For example, management may intentionally misapply new accounting requirements relating to amounts, classification, manner of presentation, or disclosures.
- The selection of and application of accounting policies by management. For example, management's choice of accounting policy is not consistent with similar entities in the same industry ~~management's interpretation of accounting requirements differs from similar entities in the same industry.~~

	<ul style="list-style-type: none"> <li>The amount selected by management for recognition or disclosure in the financial statements of an accounting estimate. For example, management may consistently trend toward one end of a range of possible outcomes that provide a more favorable financial reporting outcome for management.</li> </ul>
<p><i>Understanding the Components of the Entity's System of Internal Control</i></p> <p>Control Environment</p> <p>24C. In applying ISA 315 (Revised 2019),<sup>31</sup> the auditor shall:</p> <p>(a) Obtain an understanding of: <u>how management has created and maintained a culture of honesty and ethical behavior, including h</u></p> <p><del>(i)</del> How management communicates <del>with</del> its employees its views on business practices and ethical behavior; (Ref: Para. A24A–A24C)</p> <p><del>(b)</del> <del>(ii)</del> When those charged with governance are separate from management, obtain an understanding of:</p> <p><del>(i)</del> <b>[Moved to paragraph 24C(c)]</b></p> <p><del>(ii)</del> <del>h</del><u>When those charged with governance are separate from management, h</u>ow those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the controls that management has established to <del>address</del><u>mitigate</u> these risks. (Ref: Para. A24D–A24H)</p>	<p><i>Understanding the Components of the Entity's System of Internal Control</i></p> <p>Control Environment</p> <p>Entity's culture and management's commitment to integrity and ethical values (Ref: Para. 24C(a)(i))</p> <p>A24A. Understanding <u>aspect of</u> the entity's control environment that address the entity's culture and understanding management's commitment to integrity and ethical values assists the auditor in determining management's attitude <u>and tone at the top with regards</u> to the prevention and detection of fraud.</p> <p>A24B. In considering the extent to which management demonstrates a commitment to ethical behavior, the auditor may obtain an understanding through inquiries of management and employees, and through considering information from external sources, about:</p> <ul style="list-style-type: none"> <li>Management's commitment to integrity and ethical values through their actions. Commitment from management and 'tone at the top' are important as employees may be more likely to behave ethically when management is committed to integrity and ethical behaviors. <b>[Moved bullet up – was fourth bullet]</b></li> <li><del>The entity related controls that support integrity and ethical values.</del>The entity's <del>formal</del> communications with respect to integrity and ethical values. <del>These communications may reduce the risk of fraudulent behavior which may also impact the assessed level of fraud risk evaluated within the entity's risk</del></li> </ul>

<sup>31</sup> [ISA 315 \(Revised 2019\), paragraph 21](#)

<p>(c) <del>Make inquiries of m</del>Management regarding management's communications to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity. [Previously paragraph 24C(b)(i)]</p> <p>(d) When those charged with governance are separate from management, make inquiries of those charged with governance <del>about</del> (Ref: Para. A24I–A24L)</p> <p>(i) <del>Determine w</del>Whether they have knowledge of any actual, suspected or alleged fraud affecting the entity;</p> <p>(ii) <del>Obtain t</del>Their views <u>about whether and how</u> that the financial statements may be materially misstated due to fraud;</p> <p>(iii) <del>Obtain t</del>Their views on possible areas that are susceptible to misstatement due to management bias or management fraud; and</p> <p>(iv) <del>Determine w</del>Whether they are aware of deficiencies in the system of internal control related to the prevention and detection of fraud, and the remediation efforts to address such deficiencies.</p>	<p><del>assessment process.</del> For example, the entity may have a mission statement, a code of ethics or a fraud policy. In larger or more complex entities, management may also have set up a process that requires employees to annually confirm that they have complied with the entity's code of ethics.</p> <ul style="list-style-type: none"> <li><del>• The mechanism for employees of the entity to make anonymous or confidential communications about identified or suspected fraud. For example, communications to appropriate persons within the entity as part of a whistle-blower program or ethics hotline (also see paragraph A24C).</del></li> <li>• Whether the entity has developed fraud awareness training. For example, the entity may require employees to undertake ethics and code of conduct training as part of an ongoing or induction programme. In a larger or more complex entity, specific training may be required for those with a role in the prevention and detection of fraud (e.g., the internal audit function)</li> <li>• Management's response to fraudulent activity. For example, where minor unethical practices are overlooked (e.g., petty theft, expenses frauds), this may indicate that more significant frauds committed by key employees may be treated in a similar lenient fashion.</li> </ul> <p>A24C. Depending on the nature and circumstances of the entity, the entity may have a formal whistleblower program, in such circumstances, obtaining an understanding of the program may assist the auditor in identifying risks of material misstatement due to fraud. The auditor may:</p> <ul style="list-style-type: none"> <li>• Obtain an understanding of the whistleblower program reporting mechanisms (e.g., telephone hotline, online forms, in-person reporting, etc.), who is responsible for the program, including</li> </ul>
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	<p>who receives the notifications, and how the entity addresses the matters raised.</p> <ul style="list-style-type: none"><li>• Follow up on matters that are under investigation by the entity as these matters may be indicative of suspected fraud with financial reporting implications which the auditor will need to respond to during the audit</li></ul> <p>In a larger or more complex entity, the lack of a whistleblower program, or an ineffective one, may be indicative of weaknesses in the entity's control environment.</p> <p>Oversight exercised by those charged with governance (Ref: Para. 24C(<del>ba</del>)(<del>iii</del>))</p> <p>A24D. <del>Those charged with governance of an entity oversee the entity's systems for monitoring risk, financial control and compliance with laws and regulations.</del> In many countries, corporate governance practices are well developed and those charged with governance play an active role in oversight of the entity's assessment of risks, including risks of fraud and the controls that address such risks. Since the responsibilities of those charged with governance and management may vary by entity and by jurisdiction, it is important that the auditor understands their respective responsibilities to enable the auditor to obtain an understanding of the oversight exercised by the appropriate individuals <u>with respect to the prevention and detection in fraud.</u><sup>32</sup></p> <p>A24E. An understanding of the oversight exercised by those charged with governance may provide insights regarding the susceptibility of the entity to management fraud, the adequacy of controls that address risks of fraud, and the competency and integrity of management. The auditor may obtain this understanding in a number of ways, such as by attending meetings where such discussions take place, reading the</p>
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<sup>32</sup> ISA 260 (Revised), paragraphs A1–A8; discuss with whom the auditor communicates when the entity's governance structure is not well defined.

minutes from such meetings or making inquiries of those charged with governance.

A24F. The effectiveness of oversight by those charged with governance is influenced by their objectivity and familiarity with the controls management has put in place to prevent and detect fraud. For example, the oversight by those charged with governance of the effectiveness of controls to prevent and detect fraud is an important aspect of their oversight role and the objectivity of such evaluation is influenced by their independence from management.

A24G. [Moved to paragraph A24L]

Considerations specific to smaller or less complex entities

A24H. In some cases, all of those charged with governance are involved in managing the entity. This may be the case in a small entity where a single owner manages the entity and no one else has a governance role. In these cases, there is ordinarily no action on the part of the auditor because there is no oversight separate from management.

Inquiries of Those Charged with Governance (Ref: Para. 24C(~~db~~))

A24I. The auditor may also inquire of those charged with governance about how the entity ~~assesses the risk of~~ fraud ~~risk assessment~~, the entity's controls to prevent and detect fraud, the entity's culture and management's commitment to integrity and ethical values.

A24J. Specific inquiries on ~~possible~~—areas that are susceptible to misstatement due to management bias or management fraud (~~i.e., fraud risk factors~~) may relate to both inherent risk and control risk. Specific inquiries may include management judgment when accounting for significant accounting estimates or unusual or complex transactions, including those in controversial or emerging areas, which may be susceptible to fraudulent financial reporting.

	<p>A24K. Inquiries on whether those charged with governance are aware of any control deficiencies may inform the auditor’s evaluation of the components of the entity’s system of internal control. Such inquiries may highlight conditions within the entity’s system of internal control that provide opportunity to commit fraud or that may affect management’s attitude or ability to rationalize fraudulent actions. For example, incentives or pressures on management that may result in intentional or unintentional management bias, which may help the auditor’s understanding of the entity’s risk assessment process and understanding of business risks. Such information may affect the auditor’s consideration of the effect on the reasonableness of significant assumptions made by, and the expectations of, management.</p> <p>A24L. When those charged with governance’s ability to objectively assess the actions of management is insufficient or impaired, the auditor may consider performing additional or alternative risk assessment procedures or further audit procedures, seeking legal advice, or considering whether to continue the audit engagement. [Previously paragraph A24G]</p>
<p>The Entity’s Risk Assessment Process</p> <p>24D. In applying ISA 315 (Revised 2019),<sup>33</sup> the auditor shall:</p> <ul style="list-style-type: none"> <li>(a) Obtain an understanding of <u>how</u> the entity’s risk assessment process <del>for</del>: (Ref: Para. A25A–A25J<del>a</del>)</li> <li>(i) Identify <del>esying</del> fraud risks related to the misappropriation of assets and fraudulent financial reporting, including any classes of transactions, account balances, or disclosures for which risks of fraud exist;</li> </ul>	<p>The Entity’s Risk Assessment Process</p> <p>The entity’s process for identifying, assessing, and addressing fraud risks (Ref: Para. A24D(a))</p> <p><del>A25A. The auditor’s understanding of how the entity identifies fraud risks, and how it assesses and addresses those risks, assists the auditor in understanding whether fraud risks identified by the entity are appropriate to the nature and complexity of the entity, and assists the auditor in identifying fraud risk factors and risks of material misstatement due to fraud.</del></p>

<sup>33</sup> [ISA 315 \(Revised 2019\), paragraph 22](#)

<p>(ii) Assess<del>ing</del> the significance of the identified fraud risks, including the likelihood of their occurrence; and</p> <p>(iii) Address<del>ing</del> the assessed fraud risks;</p> <p>(b) Make inquiries of management and of other appropriate individuals within the entity <del>about</del>: (Ref: Para. A25K–A25N)</p> <p>(i) <del>Determine w</del>Whether they have knowledge of any actual, suspected or alleged fraud affecting the entity; and</p> <p>(ii) <del>Obtain t</del>Their views that the financial statements may be materially misstated due to fraud.</p> <p><u>(iii) The entity's process to prevent and detect fraud.</u></p>	<p><u>A25A. Management may place a strong emphasis on fraud prevention by implementing a fraud risk management program as part of the entity's risk assessment process. The design of the fraud risk management program may be impacted by the nature and complexity of the entity and may include the following five key elements:</u></p> <ul style="list-style-type: none"><li>• <u>Establishing fraud risk governance policies.</u></li><li>• <u>Performing a fraud risk assessment.</u></li><li>• <u>Designing and deploying fraud preventive and detective control activities.</u></li><li>• <u>Conducting investigations.</u></li><li>• <u>Monitoring and evaluating the total fraud risk management program.</u></li></ul> <p>Identifying fraud risks <u>(Ref: Para. A24D(a)(i))</u></p> <p>A25B. As part of the entity's risk assessment process, management may consider the various ways that misappropriation of assets and fraudulent financial reporting could occur. A fraud risk identification process may include an assessment of the incentives, pressures, and opportunities to commit fraud. <del>For example, incentive programs and the performance measures on which they are based can be used to identify where fraud might occur.</del> A fraud risk identification process may also consider the potential override of controls by management as well as areas where there are control deficiencies, including a lack of segregation of duties.</p> <p>A25C. Where legal or regulatory requirements apply, management may consider risks relating to misappropriation of assets or fraudulent financial reporting in relation to the entity's compliance with laws or regulation. For example, a fraud risk may include the preparation of inaccurate regulatory reporting statements in order to improve the</p>
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	<p>appearance of an entity's performance in order to avoid inspection by regulatory authorities or penalties.</p> <p>Assessing the significance of the identified fraud risks and addressing the assessed fraud risks <del>(Ref: Para. A24D(a)(ii)–(iii))</del></p> <p>A25D. There are a number of approaches management may use to assess fraud risks and the approach will vary depending on the nature and circumstances of the entity. The fraud risk assessment may be reported in different forms, such as a complex matrix of risk ratings or simple narrative.</p> <p>A25E. When determining the likelihood of fraud, management may consider both probability and frequency (the number of fraud incidents that can be expected). <del>There are also</del> other factors that management may consider in determining likelihood <del>may include, such as</del> the volume of transactions, or the potential nature or quantitative benefit to the individual.</p> <p>A25F. Management may address the likelihood of a fraud risk by taking action within the other components of the entity's system of internal control or by making changes to certain aspects of the entity or its environment. To <del>address</del>mitigate fraud risks, an entity may choose to cease doing business in certain locations, reallocate authority among key personnel, or make changes to aspects of the entity's business model. <del>For example, management may determine that the risk of fraudulent financial reporting may be reduced by using a shared service center for central management of IT processes in a group because a shared service center may be less vulnerable to management override by local personnel.</del></p> <p>A25G. Controls that prevent or detect fraud are generally classified as either preventive (designed to avoid a fraudulent event or transaction <del>from at the time of initial</del> occurrence) or detective (designed to discover a fraudulent event or transaction after the initial processing has</p>
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occurred). Addressing fraud risks may involve a combination of manual and automated fraud prevention and detection controls that enable the entity to monitor for indicators of fraud within the scope of its risk tolerance.

A25Ga. Examples of preventive and detective controls include:

Preventative controls

- Clearly defined and documented decision makers using delegations, authorizations and other instructions.
- Physical access controls, including those that address security of assets against unauthorized access, acquisition, use or disposal.
- Entry level checks, probationary periods, suitability assessments or security vetting to assess the integrity of new employees, contractors or third parties.
- Sensitive or confidential information cannot leave the entity's IT environment without authority or detection.

Detective controls

- Exception reports to identify activities that are unusual or not in the ordinary course of business and should be further investigated.
- Mechanisms for employees of the entity and third parties to make anonymous or confidential communications to appropriate persons within the entity about identified or suspected fraud.
- Fraud detection software programs incorporated into the IT infrastructure that automatically analyses transaction data to detect what is different from what is standard, normal, or expected and may therefore indicate fraud.

	<ul style="list-style-type: none"><li><del>• Ongoing training activity to support employees in detecting fraud, such as identifying red and understanding the entity's policies and procedures if they identify or suspect fraud.</del></li></ul> <p><del>A25Gb. In some entities, there may also be controls in place to respond to fraud after it has occurred. These controls may be implemented to reduce the consequences or address additional consequences, such as setting up separation or termination controls, installing external electronic surveillance or creating a debt recovery process.</del></p> <p>A25H. [Moved to paragraph A25J]</p> <p>A25I. If the auditor identifies risks of material misstatement due to fraud that management failed to identify, the auditor is required to determine whether any such risks are of a kind that the auditor expects would have been identified by the entity's risk assessment process and, if so, obtain an understanding of why the entity's risk assessment process failed to identify such risks of material misstatement.<sup>34</sup> The auditor is also required to consider the implications for the auditor's evaluation.<sup>35</sup></p> <p>Scalability</p> <p>A25J. For some entities whose nature and circumstances are more complex, such as those operating in the insurance or banking industries, there may be more complex preventative and detective controls in place. <del>These controls, which</del> may also affect the <u>extent to which</u> specialized skills <del>that</del> are needed to assist the auditor in obtaining an understanding of the entity's risk assessment process. [Previously paragraph A25H]</p> <p><del>A25Ia. As explained in ISA 315 (Revised 2019)<sup>36</sup> in some smaller or less complex entities, and particularly owner manager entities, an</del></p>
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<sup>34</sup> [ISA 315 \(Revised 2019\), paragraph 23\(a\)](#)

<sup>35</sup> [ISA 315 \(Revised 2019\), paragraph 23\(b\)](#)

~~appropriate risk assessment may be performed through the direct involvement of management or the owner-manager. The evidence of this risk assessment occurring in such entities may not be formally documented, but it may be evident from the auditor's inquiries that management are in fact performing risk assessment procedures.~~

Inquiries of Management and Others within the Entity (Ref: Para. 24D(b))

A25K. Management accepts responsibility for the entity's system of internal control and for the preparation of the entity's financial statements. Accordingly, it is appropriate for the auditor to make inquiries of management regarding management's own assessment of the risk of fraud and the controls in place to prevent and detect it. The nature, extent and frequency of management's assessment may vary from entity to entity. In some entities, management may make detailed assessments on an annual basis or as part of continuous monitoring. In other entities, management's assessment may be less structured and less frequent. The nature, extent and frequency of management's assessment are relevant to the auditor's understanding of the entity's control environment. For example, the fact that management has not made an assessment of the risk of fraud may in some circumstances be indicative of the lack of importance that management places on internal control. [Previously paragraph A25J]

A25L. ~~The auditor's~~ inquiries of management may provide useful information concerning the risks of material misstatements in the financial statements resulting from employee fraud. However, such inquiries are unlikely to provide useful information regarding the risks of material misstatement in the financial statements resulting from management fraud. ~~Making~~ inquiries of others within the entity may provide individuals with ~~an opportunity to provide additional insight into fraud prevention controls, tone at the top, and culture of the organization~~ convey information to the auditor that may not otherwise be communicated. [Previously paragraph A25K]

	<p>A25M. Examples of others within the entity to whom the auditor may direct inquiries about the existence or suspicion of fraud include:</p> <ul style="list-style-type: none"> <li>• Operating personnel not directly involved in the financial reporting process.</li> <li>• Employees with different levels of authority.</li> <li>• Employees involved in initiating, processing or recording complex or unusual transactions and those who supervise or monitor such employees.</li> <li>• In-house legal counsel.</li> <li>• Chief ethics officer or equivalent person.</li> <li>• The person or persons charged with dealing with allegations of fraud. [Previously paragraph A25L]</li> </ul> <p>A25N. Management is often in the best position to perpetrate fraud. Accordingly, when evaluating management’s responses to inquiries with an attitude of professional skepticism, the auditor may judge it necessary to corroborate responses to inquiries with information from other sources. [Previously paragraph A25M]</p>
<p>The Entity’s Process to Monitor the System of Internal Control</p> <p>24E. In applying ISA 315 (Revised 2019),<sup>37</sup> the auditor shall:</p> <p>(a) Understand those aspects of the entity’s process that address the ongoing and separate evaluations for monitoring the effectiveness of controls to prevent and detect fraud, and the identification and remediation of control deficiencies <del>identified</del> (Ref: Para. A26A–A26B)</p> <p>(b) Make inquiries of appropriate individuals within the internal audit function (if the function exists) <del>about to determine</del></p>	<p>The Entity’s Process to Monitor the System of Internal Control (Ref: Para. A24E(a))</p> <p><del>Scalability</del></p> <p>A26A. <del>In smaller or less complex entities, and in particular owner-manager entities, the auditor’s understanding of the entity’s process to monitor the system of internal control is often focused on how management or the owner-manager is directly involved in operations, as there may not be any other monitoring activities.</del> Information from identifying and evaluating controls that management has designed and implemented</p>

<sup>37</sup> [ISA 315 \(Revised 2019\), paragraph 24](#)

whether they have knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud. (Ref: Para. A26C–A26D)

to prevent and detect fraud, may also be useful in identifying fraud risk factors that may affect the auditor's assessment of the risks ~~that the financial statements may contain of~~ material misstatement due to fraud. [Previously paragraph A33]

Ongoing and separate evaluations for monitoring the effectiveness of controls to prevent and detect fraud (Ref: Para. A24E(a))

A26B. Matters that may be relevant for the auditor to consider when understanding those aspects of the entity's process that addresses the ongoing and separate evaluations for monitoring the effectiveness of controls to prevent and detect fraud, and the identification and remediation of such control deficiencies identified, may include:

- Whether management has identified particular operating locations, or business segments for which the risk of fraud may be more likely to exist and whether management has introduced different approaches to monitoring for these operating locations or business segments.
- How the entity may monitor fraud mitigation processes in each component of internal control, including the operating effectiveness of anti-fraud controls, and the remediation of control deficiencies as necessary.

Inquiries of internal audit (Ref: Para. 24E(b))

A26C. The internal audit function of an entity may perform assurance and advisory activities designed to evaluate and improve the effectiveness of the entity's governance, risk management and internal control processes. In that capacity the internal audit function may identify frauds or be involved throughout a fraud investigation process. Inquiries of appropriate individuals with the internal audit function may therefore provide the auditor with useful information about instances of actual, suspected or alleged fraud and the risk of fraud.

	<p>A26D. ISA 315 (Revised 2019) and ISA 610 (Revised 2013) establish requirements and provide guidance relevant to audits of those entities that have an internal audit function.<sup>38</sup> In carrying out the requirements of those ISAs in the context of fraud, the auditor may, for example, inquire about:</p> <ul style="list-style-type: none"><li>• The entity's fraud risk assessment.</li><li>• The entity's controls to prevent and detect fraud.</li><li>• The entity's culture and management's commitment to integrity and ethical values.</li><li>• Whether the internal audit function is aware of any instances of management override of controls.</li><li>• The procedures performed, if any, by the internal audit function during the year to detect fraud and whether management and those charged with governance have satisfactorily responded to any findings resulting from those procedures.</li><li>• The procedures performed, if any, by the internal audit function in investigating frauds and suspected violations of the company's code of ethics and values and whether management and those charged with governance have satisfactorily responded to any findings resulting from those procedures.</li><li>• If any, the fraud related reports or communications prepared by the internal audit function and whether management and those charged with governance have satisfactorily responded to any findings resulting from those reports.</li><li>• Control deficiencies identified by the internal audit function that are relevant to the prevention and detection of fraud and whether management and those charged with governance have</li></ul>
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<sup>38</sup> ISA 315 (Revised 2019), paragraphs 14(a) and 24(a)(ii), and ISA 610 (Revised 2013), *Using the Work of Internal Auditors*

	satisfactorily responded to any findings resulting from those deficiencies.
<p>Control Activities</p> <p>24F. In applying ISA 315 (Revised 2019),<sup>39</sup> the auditor shall <u>obtain an understanding of controls that prevent and detect fraud over journal entries</u><del>identify controls to prevent and detect fraud over journal entries</del>, including <u>controls over journal entries authorized by management and non-standard journal entries</u><del>non-standard journal entries used to record non-recurring, unusual transactions or adjustments</del>.</p>	<p>Control Activities</p> <p>[To develop application material about:</p> <ul style="list-style-type: none"> <li>• Journal entry fraud (using accounting journal entries to fraudulently adjust financial statements).</li> <li>• Inappropriate or unusual journal entries.]</li> </ul>
<p><i>Control Deficiencies Within the Entity's System of Internal Control</i></p> <p>24G. In applying ISA 315 (Revised 2019),<sup>40</sup> based on the auditor's evaluation of each of the components of the entity's system of internal control, the auditor shall determine <u>deficiencies in internal control identified that are relevant to the prevention and detection of fraud</u><del>whether one or more control deficiencies in controls for the prevention and detection of fraud have been identified</del>. (Ref: Para. A27A)</p>	<p>Control Deficiencies Within the Entity's System of Internal Control (Ref: Para. 24G)</p> <p>A27A. In performing the evaluations of each of the components of the entity's system of internal control, the auditor may determine that certain of the entity's controls in a component are not appropriate to the nature and circumstances of the entity. Such a determination may be an indicator that assists the auditor in identifying <u>deficiencies in internal control that are relevant to the prevention and detection of fraud</u><del>control deficiencies in controls for the prevent and detection of fraud</del>. If the auditor has identified one or more control deficiencies to prevent and detect fraud, the auditor may consider the effect of those control deficiencies on the design of further audit procedures in accordance with ISA 330. [Previously paragraph A28A]</p> <p><del>A28B. If the auditor has identified one or more control deficiencies to prevent and detect fraud, ISA 265<sup>41</sup> requires the auditor to determine whether, individually or in combination, the deficiencies constitute a significant</del></p>

<sup>39</sup> [ISA 315 \(Revised 2019\), paragraph 26](#)

<sup>40</sup> [ISA 315 \(Revised 2019\), paragraph 27](#)

	<p><del>deficiency. The auditor uses professional judgment in determining whether a deficiency represents a significant control deficiency.<sup>42</sup></del></p>
<p><b>Identifying and Assessing the Risks of Material Misstatement due to Fraud</b></p>	<p><b>Identifying and Assessing the Risks of Material Misstatement due to Fraud</b></p>
<p><i>Evaluation of Fraud Risk Factors</i></p> <p>25. The auditor shall evaluate whether the information obtained from the risk assessment procedures and related activities indicates that one or more fraud risk factors are present. (Ref: Para. A28A–A28E)</p>	<p><i>Evaluation of Fraud Risk Factors</i> (Ref: Para. 25)</p> <p>A28A. <del>The auditor may identify events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud (fraud risk factors). For example, fraud risk factors include:</del></p> <ul style="list-style-type: none"> <li>• The need to meet expectations of third parties to obtain additional equity financing may create pressure to commit fraud;</li> <li>• The granting of significant bonuses if unrealistic profit targets are met may create an incentive to commit fraud; and</li> <li>• A control environment that is not effective may create an opportunity to commit fraud.</li> </ul> <p><del>Fraud risk factors may not necessarily indicate the existence of fraud, they have often been present in circumstances where frauds have occurred and therefore may indicate risks of material misstatement due to fraud. [Previously paragraph A24]</del></p> <p>A28B. Fraud risk factors cannot easily be ranked in order of importance. The significance of fraud risk factors varies widely. Some of these factors will be present in entities where the specific conditions do not present risks of material misstatement. Accordingly, the determination as to whether a fraud risk factor indicates there is a risk of material misstatement due to fraud is a matter of professional judgment. [Previously paragraph A25]</p> <p>A28C. Examples of fraud risk factors related to fraudulent financial reporting</p>

and misappropriation of assets are presented in Appendix 1. These illustrative risk factors are classified based on the three conditions that are generally present when fraud exists:

- An incentive or pressure to commit fraud;
- A perceived opportunity to commit fraud; and
- An ability to rationalize the fraudulent action.

Fraud risk factors reflective of an attitude that permits rationalization of the fraudulent action may not be susceptible to observation by the auditor. Nevertheless, the auditor may become aware of the existence of such information through, for example, the required understanding of the entity's control environment.<sup>43</sup> Although the fraud risk factors described in Appendix 1 cover a broad range of situations that may be faced by auditors, they are only examples and other risk factors may exist. [Previously paragraph A26]

A28D. The size, complexity, and ownership characteristics of the entity have a significant influence on the consideration of relevant fraud risk factors. For example, depending on the nature and circumstances of the entity in the case of a large entity, there may be factors that generally constrain improper conduct by management, such as:

- Effective oversight by those charged with governance.
- An effective internal audit function.
- The existence and enforcement of a written code of conduct.

Furthermore, fraud risk factors considered at a business segment operating level may provide different insights when compared with those obtained when considered at an entity-wide level. [Previously paragraph A27]

<sup>43</sup> ISA 315 (Revised 2019), paragraph 21

	<p><u>Scalability Considerations Specific to Smaller Entities</u></p> <p>A28E. In the case of a small entity, some or all of these considerations may be inapplicable or less relevant. For example, a smaller entity may not have a written code of conduct but, instead, may have developed a culture that emphasizes the importance of integrity and ethical behavior through oral communication and by management example. Domination of management by a single individual in a small entity does not generally, in and of itself, indicate a failure by management to display and communicate an appropriate attitude regarding internal control and the financial reporting process. In some entities, the need for management authorization can compensate for otherwise deficient controls and reduce the risk of employee fraud. However, domination of management by a single individual can be a potential deficiency in internal control since there is an opportunity for management override of controls. [Previously paragraph A28]</p>
<p><i>Identifying the Risks of Material Misstatement Due to Fraud</i></p> <p>26. In applying ISA 315 (Revised 2019),<sup>44</sup> the auditor shall:</p> <p>(a) Identify and assess the risks of material misstatement due to fraud and determine whether they exist at the financial statement level, or the assertion level for classes of transactions, account balances and disclosures. (Ref: Para. A28G–A28L)</p> <p>(b) Treat those assessed risks of material misstatement due to fraud as significant risks as significant risks <u>and accordingly, to the extent not already done so, the auditor shall obtain an understanding of the design and implementation of the entity’s related controls, including control activities, relevant to such risks.</u> (Ref: Para. A28L–</p>	<p><i>Identifying the Risks of Material Misstatement Due to Fraud</i> (Ref: Para. 26(a))</p> <p>A28G. Determining whether the risks of material misstatement due to fraud exist at the financial statement level or the assertion level for classes of transactions, account balances and disclosures may assist the auditor in determining appropriate responses to address the assessed risks of material misstatement due to fraud. The following are examples of relevant assertions and the related classes of transactions, account balances or disclosures that may be particularly susceptible to material misstatement due to fraud:</p> <ul style="list-style-type: none"> <li>• Accuracy, valuation or classification of revenue from contracts with customers – revenue from contracts with customers may be susceptible to inappropriate estimates of the amount of consideration to which an entity expects to be entitled in</li> </ul>

<sup>44</sup> ISA 315 (Revised 2019), paragraph 28

<p>A28N).</p>	<p>exchange for transferring promised goods or services to a customer.</p> <ul style="list-style-type: none"><li>• Existence of cash balances – cash balances may be susceptible to the creation of falsified or altered external confirmations or bank statements.</li><li>• Valuation of account balances involving significant accounting estimates – account balances involving significant accounting estimates such as goodwill and other intangible assets, expected credit losses, insurance contract liabilities, employee retirement benefits liabilities, environmental liabilities or environmental remediation provisions may be susceptible to high estimation uncertainty, significant subjectivity and management bias in making judgments about future events or conditions.</li><li>• Presentation of profit before tax from continuing operations – profit before tax from continuing operations may be susceptible to misrepresentation (i.e., earnings management) for example, to minimize tax and other statutory obligations or secure financing.</li><li>• Presentation of disclosures – disclosures may be susceptible to the omission, incomplete or inaccurate presentation, for example, disclosures relating to contingent liabilities, off-balance sheet arrangements, financial guarantees, debt covenant requirements, or management defined performance measures (i.e., non-GAAP performance measures). [Previously paragraph A28A]</li></ul> <p>A28H. ISA 315 (Revised 2019) requires the auditor to identify the entity's controls that address significant risks and evaluate their design and determine whether they have been implemented.<sup>45</sup> [Previously</p>
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<sup>45</sup> ISA 315 (Revised 2019), paragraphs 26(a)(i) and 26(d)

paragraph A28B]

A28I. In accordance with ISA 200,<sup>46</sup> the auditor exercises professional judgment when determining whether the presence of fraud risk factors, individually or in combination, indicates that there are risks of material misstatement due to fraud.

[To develop application material with examples to explain “how” the fraud risk factors affect the auditor’s assessment of control risk.]

A28J. As described in paragraph 4CA, the auditor may identify fraud or suspected fraud when performing risk assessment procedures. Depending on the nature and circumstances, the auditor may determine that the audit evidence obtained from the risk assessment procedures no longer provides an appropriate basis for the identification and assessment of the risks of material misstatement due to fraud. In such circumstances, in accordance with ISA 315 (Revised)<sup>47</sup>, the auditor is required to perform additional risk assessment procedures until audit evidence has been obtained to provide such a basis.

A28K. Where fraud or suspected fraud has been identified when performing risk assessment procedures, the auditor is required to perform additional audit procedures in accordance with paragraph 34A.

Considerations Specific to Public Sector Entities

A28L. For public sector entities, misappropriation of assets (i.e., misappropriation of funds) may be a common type of fraud. For example, fraud risk factors from the authority of an individual with a significant role, to commit the public sector entity to sensitive expenditure, including travel, accommodation, or entertainment, and that sensitive expenditure provides personal benefits to the individual.

<sup>46</sup> ISA 200, paragraph 15

<sup>47</sup> ISA 315 (Revised 2019), paragraph 35

	<p>[Previously paragraph A28E]</p> <p><u>Obtaining An Understanding of the Entity’s Controls, Relevant to Assessed Risks of Material Misstatement Due to Fraud (Ref: Para. 26(b))</u></p> <p><u>A28M. ISA 330<sup>48</sup> includes specific requirements for significant risks. As assessed risks of material misstatement due to fraud are significant risks, the auditor is required to address these requirements, and specific requirements for significant risks in other ISAs.</u></p> <p>A28N. Management may make judgments on the nature and extent of the controls it chooses to implement, and the nature and extent of the risks it chooses to <del>accept</del><u>assume</u> given the nature and circumstances of the entity. In determining which controls to implement to prevent and detect fraud, management considers the risks that the financial statements may be materially misstated due to fraud. [Previously paragraph A32]</p>
<p>Presumption of <del>the Fraud</del><u>Risks of Material Misstatement due to Fraud</u> in Revenue Recognition</p> <p>27. When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, <del>determine</del> <u>evaluate</u>—which types of revenue, revenue transactions or relevant assertions give rise to such risks. <u>In making this determination, the auditor shall take by taking</u> into account the fraud risk factors, <u>if any, relevant to revenue recognition that are present in accordance with paragraph 25.</u> (Ref: Para. A29–A31A)</p>	<p>Presumption of <del>the Fraud</del><u>Risks of Material Misstatement due to Fraud</u> in Revenue Recognition (Ref: Para. 27)</p> <p>A29. Material misstatement due to fraudulent financial reporting relating to revenue recognition often results from an overstatement of revenues through, for example, premature revenue recognition or recording fictitious revenues. It may result also from an understatement of revenues through, for example, improperly deferring revenues to a later period.</p> <p><u>A29A. Because revenue is such that it is highly susceptible to fraudulent financial reporting, fraud may exist in revenue recognition, notwithstanding the simplicity of the revenue transactions or straightforwardness of the applicable recognition criteria.</u></p>

<sup>48</sup> ISA 330, paragraphs 15 and 21

	<p>A30. The risks of fraud in revenue recognition may be greater in some entities than others. For example, there may be pressures or incentives on management to commit fraudulent financial reporting through inappropriate revenue recognition in the case of listed entities when, for example, performance is measured in terms of year over year revenue growth or profit. Similarly, for example, there may be greater risks of fraud in revenue recognition in the case of entities that generate a substantial portion of revenues through <u>cash sales or in cases entities have complex revenue recognition arrangements (e.g., online advertising, online gaming, in-app purchasing, software arrangements and licenses of intellectual property or percentage of completion)</u>.</p> <p>A30A. Understanding the entity's business and its environment, the applicable financial reporting framework and the entity's system of internal control helps the auditor understand the nature of the revenue transactions, the applicable revenue recognition criteria and the appropriate industry practice related to revenue. This understanding may assist the auditor identify <u>events/circumstances</u> or conditions relating to the types of revenue, revenue transactions, or <u>relevant</u> assertions, that could give rise to fraud risk <u>factors</u>, for example:</p> <ul style="list-style-type: none"><li>• When there are changes in the financial reporting framework <u>relating to</u> revenue recognition, which may present an opportunity for management to commit fraudulent financial reporting or bring to light the lack of (or significant deficiency in) controls for managing changes in the financial reporting framework.</li><li>• When an entity's accounting principles for revenue recognition are more aggressive than, or inconsistent with, its industry peers.</li><li>• When the entity operates in emerging industries.</li></ul>
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- When revenue recognition involves significant accounting estimates.
- When revenue recognition is based on complex contractual arrangements with a high degree of estimation uncertainty, for example, construction-type or production-type contracts and multiple-element arrangements.
- When there is contradictory evidence when performing risk assessment procedures.
- When the entity has a history of significant adjustments for the improper recognition of revenue (e.g., premature recognition of revenue).
- When circumstances indicate the recording of fictitious revenues.
- When circumstances indicate the omission of required disclosures or presentation of incomplete or inaccurate disclosures regarding revenue, for example, to manipulate the entity's financial performance due to pressures to meet investor / market expectations, or due to the incentive for management to maximize compensation linked to the entity's financial performance.

A30B. When there are fraud risk factors present related to revenue recognition, it is ordinarily inappropriate to rebut the presumption of fraud risk in revenue recognition.

A31. The presumption that there are risks of fraud in revenue recognition may be rebutted. The auditor may conclude that there ~~are~~is no ~~risks~~s of material misstatement due to fraud relating to revenue recognition in the case where the nature of the revenue transaction is simple and the applicable recognition criteria is straightforward and non-complex, for example:

	<ul style="list-style-type: none"> <li>• <del>Leasing-Leasehold revenue from</del> a single unit of rental property, or multiple rental properties with <del>a single tenanted leases</del>.</li> <li>• Rendering one type of service for a fixed fee.</li> <li>• Reselling one type of purchased good for a fixed price.</li> <li>• <u>Simple or straightforward ancillary revenue sources</u>, which are determined by fixed rates or externally published rates (e.g., interest or dividend revenue from investments with level 1 inputs).</li> </ul> <p>A31A. Paragraph 48 specifies the documentation required where the auditor concludes that the presumption is not applicable in the circumstances of the engagement and, accordingly, has not identified revenue recognition as a risk of material misstatement due to fraud.</p>
<p>Unusual or Unexpected Relationships Identified</p> <p>27A. The auditor shall evaluate whether unusual or unexpected relationships that have been identified in performing analytical procedures, including those related to revenue accounts, may indicate risks of material misstatement due to fraud.</p>	
<p>28. <b>[Moved to paragraph 26(b)]</b></p>	<p>A32. <b>[Moved to paragraph A28N]</b></p> <p>A33. <b>[Moved to paragraph A26A]</b></p>
<p>Inconsistent responses</p> <p>28B. In applying proposed ISA 500 (Revised),<sup>49</sup> if the responses to inquiries of individuals within the internal audit function, those charged with governance, or others within the entity, are inconsistent with the responses to the inquiries of management, the auditor shall:</p>	

<sup>49</sup> [Proposed ISA 500 \(Revised\), Audit Evidence, paragraph 13A](#)

<p>(a) Determine what modifications or additions to audit procedures are necessary to understand and address the inconsistency; and</p> <p>(b) Consider the effect, if any, on other aspects of the audit. [Previously paragraph 22B]</p>	
<p><b>Responses to the Assessed Risks of Material Misstatement Due to Fraud</b></p>	<p><b>Responses to the Assessed Risks of Material Misstatement Due to Fraud</b></p>
<p><i>Overall Responses</i></p> <p>29. In accordance with ISA 330,<sup>50</sup> the auditor shall determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level.<sup>54</sup> (Ref: Para. <u>A33A – A34</u>)</p>	<p><u><i>Audit Evidence Obtained Based on the Overall Responses and the Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Assertion Level</i></u> (Ref: Para. 29 and 31)</p> <p><u>A33A. Based on the audit procedures performed in response to the assessed risks of material misstatement due to fraud at the financial statement level and assertion levels, the auditor may:</u></p> <p><u>(a) Obtain audit evidence that</u></p> <p><u>(i) Reduces the risks of material misstatement due to fraud to an acceptably low level;</u></p> <p><u>(ii) Indicates the existence of fraud or suspected fraud; or</u></p> <p><u>(iii) A misstatement due to fraud has been identified.</u></p> <p><u>(b) Be unable to obtain sufficient appropriate audit evidence to conclude</u></p> <p><u>(i) The risks of material misstatement due to fraud have been reduced to an acceptably low level; or</u></p> <p><u>(ii) There is a misstatement due to fraud that may cause the financial statements to be materially misstated.</u></p>

<sup>50</sup> ISA 330, paragraph 5

<sup>54</sup> ISA 330, paragraph 5

	<p><u>A33B. When the auditor has performed further audit procedures and</u></p> <p><u>(a) There is an indication as to the existence of fraud or suspected fraud, the auditor is required to perform additional audit procedures in accordance with paragraph 34A.</u></p> <p><u>(b) A misstatement due to fraud has been identified, the auditor is required to determine if such misstatement is material to the financial statements in accordance with paragraphs 34E-34H.</u></p> <p><u><del>(c)</del> Is unable to obtain sufficient appropriate audit evidence, the auditor determines the implications for the audit in accordance with paragraph 34X.</u></p>
<p>30. In determining overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level, the auditor shall:</p> <p>(a) Assign and supervise personnel taking account of the knowledge, skill and ability of the individuals to be given</p>	<p><i>Overall Responses</i> (Ref: Para. 29)</p> <p>A34. Determining overall responses to address the assessed risks of material misstatement due to fraud generally includes the consideration of how the overall conduct of the audit can reflect increased professional skepticism, for example, through:</p> <ul style="list-style-type: none"> <li>Increased sensitivity in the selection of the nature and extent of documentation to be examined in support of material transactions.</li> <li>Increased recognition of the need to corroborate management explanations or representations concerning material matters.</li> </ul> <p>It also involves more general considerations apart from the specific procedures otherwise planned; these considerations include the matters listed in paragraph 30, which are discussed below.</p> <p><i>Assignment and Supervision of Personnel</i> (Ref: Para. 30(a))</p> <p>A35. The auditor may respond to identified risks of material misstatement due to fraud by, for example, assigning additional individuals with</p>

<p>significant engagement responsibilities and the auditor's assessment of the risks of material misstatement due to fraud for the engagement; (Ref: Para. A35–A36)</p> <p>(b) Evaluate whether the selection and application of accounting policies by the entity, particularly those related to subjective measurements and complex transactions, may be indicative of fraudulent financial reporting resulting from management's effort to manage earnings; and</p> <p>(c) Incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures. (Ref: Para. A37)</p>	<p>specialized skill and knowledge, such as forensic and IT experts, or by assigning more experienced individuals to the engagement.</p> <p>A36. The extent of supervision reflects the auditor's assessment of risks of material misstatement due to fraud and the competencies of the engagement team members performing the work.</p> <p><i>Unpredictability in the Selection of Audit Procedures</i> (Ref: Para. 30(c))</p> <p>A37. Incorporating an element of unpredictability in the selection of the nature, timing and extent of audit procedures to be performed is important as individuals within the entity who are familiar with the audit procedures normally performed on engagements may be more able to conceal fraudulent financial reporting. This can be achieved by, for example:</p> <ul style="list-style-type: none"> <li>• Performing substantive procedures on selected account balances and assertions not otherwise tested due to their materiality or risk.</li> <li>• Adjusting the timing of audit procedures from that otherwise expected.</li> <li>• Using different sampling methods.</li> <li>• Performing audit procedures at different locations or at locations on an unannounced basis.</li> </ul>
<p><i>Audit Procedures Responsive to <u>the</u> Assessed Risks of Material Misstatement Due to Fraud at the Assertion Level</i></p> <p>31. In accordance with ISA 330,<sup>52</sup> the auditor shall design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks of material</p>	<p><i>Audit Procedures Responsive to <u>the</u> Assessed Risks of Material Misstatement Due to Fraud at the Assertion Level</i> (Ref: Para. 31)</p> <p>A38. The auditor's responses to address the assessed risks of material misstatement due to fraud at the assertion level may include changing the nature, timing and extent of audit procedures in the following ways:</p>

<sup>52</sup> [ISA 330, paragraph 6](#)

misstatement due to fraud at the assertion level.<sup>53</sup> (Ref: Para. [A33A–A33B](#), A38–A41)

- The nature of audit procedures to be performed may need to be changed to obtain audit evidence that is more reliable and relevant or to obtain additional corroborative information. This may affect both the type of audit procedures to be performed and their combination. For example:
  - Physical observation or inspection of certain assets may become more important or the auditor may choose to use computer-assisted audit techniques to gather more evidence about data contained in significant accounts or electronic transaction files.
  - The auditor may design procedures to obtain additional corroborative information. For example, if the auditor identifies that management is under pressure to meet earnings expectations, there may be a related risk that management is inflating sales by entering into sales agreements that include terms that preclude revenue recognition or by invoicing sales before delivery. In these circumstances, the auditor may, for example, design external confirmations not only to confirm outstanding amounts, but also to confirm the details of the sales agreements, including date, any rights of return and delivery terms. In addition, the auditor might find it effective to supplement such external confirmations with inquiries of non-financial personnel in the entity regarding any changes in sales agreements and delivery terms.
- The timing of substantive procedures may need to be modified. The auditor may conclude that performing substantive testing at or near the period end better addresses an assessed risk of material misstatement due to fraud. The auditor may conclude that, given the assessed risks of intentional misstatement or

<sup>53</sup>—ISA 330, paragraph 6

	<p>manipulation, audit procedures to extend audit conclusions from an interim date to the period end would not be effective. In contrast, because an intentional misstatement – for example, a misstatement involving improper revenue recognition – may have been initiated in an interim period, the auditor may elect to apply substantive procedures to transactions occurring earlier in or throughout the reporting period.</p> <ul style="list-style-type: none"><li>• The extent of the procedures applied reflects the assessment of the risks of material misstatement due to fraud. For example, increasing sample sizes or performing analytical procedures at a more detailed level may be appropriate. Also, computer-assisted audit techniques may enable more extensive testing of electronic transactions and account files. Such techniques can be used to select sample transactions from key electronic files, to sort transactions with specific characteristics, or to test an entire population instead of a sample.</li></ul> <p>A39. If the auditor identifies a risk of material misstatement due to fraud that affects inventory quantities, examining the entity’s inventory records may help to identify locations or items that require specific attention during or after the physical inventory count. Such a review may lead to a decision to observe inventory counts at certain locations on an unannounced basis or to conduct inventory counts at all locations on the same date.</p> <p>A40. The auditor may identify a risk of material misstatement due to fraud affecting a number of accounts and assertions. These may include asset valuation, estimates relating to specific transactions (such as acquisitions, restructurings, or disposals of a segment of the business), and other significant accrued liabilities (such as pension and other post-employment benefit obligations, or environmental remediation liabilities). The risk may also relate to significant changes in assumptions relating to recurring estimates. Information gathered through obtaining an understanding of the entity and its environment may assist the auditor in evaluating the</p>
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	<p>reasonableness of such management estimates and underlying judgments and assumptions. A retrospective review of similar management judgments and assumptions applied in prior periods may also provide insight about the reasonableness of judgments and assumptions supporting management estimates.</p> <p>A41. Examples of possible audit procedures to address the assessed risks of material misstatement due to fraud, including those that illustrate the incorporation of an element of unpredictability, are presented in Appendix 2. The appendix includes examples of responses to the auditor’s assessment of the risks of material misstatement resulting from both fraudulent financial reporting, including fraudulent financial reporting resulting from revenue recognition, and misappropriation of assets.</p>
<p><i>Audit Procedures Responsive to Risks Related to Management Override of Controls</i></p> <p>32. Management is in a unique position to perpetrate fraud because of management’s ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Although the level of risk of management override of controls will vary from entity to entity, the risk is nevertheless present in all entities. Due to the unpredictable way in which such override could occur, it is a risk of material misstatement due to fraud and thus a significant risk.</p>	<p><i>Audit Procedures Responsive to Risks Related to Management Override of Controls</i></p>
<p>33. Irrespective of the auditor’s assessment of the risks of management override of controls, the auditor shall design and perform audit procedures to:</p> <p>(a) Test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. In designing and</p>	<p>Journal Entries and Other Adjustments (Ref: Para. 33(a))</p> <p>Why the testing of journal entries and other adjustments is performed</p> <p>A42. Testing the appropriateness of journal entries and other adjustments (e.g., entries made directly to the financial statements such as consolidating adjustments and reclassifications, and eliminating</p>

<p>performing audit procedures for such tests, the auditor shall:</p> <ul style="list-style-type: none"> <li>(i) Make inquiries of individuals involved in the financial reporting process about their knowledge of inappropriate or unusual activity relating to the processing of journal entries and other adjustments;</li> <li>(ii) Obtain audit evidence about the completeness of the population of journal entries and other adjustments;</li> <li>(iii) Select journal entries and other adjustments made at the end of a reporting period; and</li> <li>(iv) Consider the need to test journal entries and other adjustments throughout the period. (Ref: Para. A42–A45A)</li> </ul> <p>(b) Review accounting estimates for biases and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud. In performing this review, the auditor shall:</p> <ul style="list-style-type: none"> <li>(i) Evaluate whether the judgments and decisions made by management in making the accounting estimates included in the financial statements, even if they are individually reasonable, indicate a possible bias on the part of the entity’s management that may represent a risk of material misstatement due to fraud. If so, the auditor shall reevaluate the accounting estimates taken as a whole; and</li> <li>(ii) Perform a retrospective review of management judgments and assumptions related to significant</li> </ul>	<p>adjustments for intra-group transactions and unrealized profits, and intra-group account balances at group level) may assist the auditor in identifying fraudulent journal entries and other adjustments. Material misstatement of financial statements due to fraud often involve the manipulation of the financial reporting process by recording inappropriate or unauthorized journal entries. This may occur throughout the year or at period end, or by management making adjustments to amounts reported in the financial statements that are not reflected in journal entries, such as through consolidating adjustments and reclassifications.</p> <p>A43. Further, the auditor’s consideration of the risks of material misstatement associated with inappropriate override of controls over journal entries<sup>54</sup> is important since automated processes and controls may reduce the risk of inadvertent error but do not overcome the risk that individuals may inappropriately override such automated processes, for example, by changing the amounts being automatically passed to the general ledger or to the financial reporting system. Furthermore, where IT is used to transfer information automatically, there may be little or no visible evidence of such intervention in the information systems.</p> <p>Determining the nature, timing and extent of testing journal entries and other adjustments</p> <p>A43A. Understanding of the entity and its environment, the applicable financial reporting framework and the entity’s system of internal control may help the auditor determine the nature, timing and extent of testing journal entries and other adjustments.</p> <p>A44. When identifying and selecting journal entries and other adjustments for testing and determining the appropriate method of examining the</p>
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<sup>54</sup> ISA 315 (Revised 2019), paragraph 26(a)(ii)

<p>accounting estimates reflected in the financial statements of the prior year. (Ref: Para. A46–A48)</p> <p>(c) For significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual given the auditor’s understanding of the entity and its environment and information from other sources obtained during the audit, the auditor shall evaluate whether the business rationale (or the lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets. (Ref: Para. A49)</p>	<p>underlying support for the items selected, the following matters are of relevance:</p> <ul style="list-style-type: none"><li>• When identifying and selecting journal entries and other adjustments for testing and determining the appropriate method of examining the underlying support for the items selected, the following matters are of relevance: Understanding of 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) – for many entities routine processing of transactions involves a combination of manual and automated controls. Similarly, the processing of journal entries and other adjustments may involve both manual and automated controls across one or multiple IT systems. Where information technology is used in the financial reporting process, journal entries and other adjustments may exist only in electronic form.</li><li>• Understanding of 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) – effective controls over the preparation and posting of journal entries and other adjustments may reduce the extent of substantive testing necessary, provided that the auditor has tested the operating effectiveness of the controls.</li><li>• The identification and assessment of the risks of material misstatement due to fraud – the presence of fraud risk factors and information from other sources obtained during the auditor’s identification and assessment of the risks of material misstatement due to fraud may assist the auditor to identify specific classes of journal entries and other adjustments for testing.</li></ul>
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	<ul style="list-style-type: none"><li>• The characteristics of fraudulent journal entries or other adjustments – inappropriate journal entries or other adjustments often have unique identifying characteristics. Such characteristics may include entries (a) made to unrelated, unusual, or seldom-used accounts, (b) made by individuals who typically do not make journal entries, (c) recorded at the end of the period or as post-closing entries that have little or no explanation or description, (d) made either before or during the preparation of the financial statements that do not have account numbers, or (e) containing round numbers or consistent ending numbers.</li><li>• The nature and complexity of the accounts – inappropriate journal entries or adjustments may be applied to accounts that (a) contain transactions that are complex or unusual in nature, (b) contain significant estimates and period-end adjustments, (c) have been prone to misstatements in the past, (d) have not been reconciled on a timely basis or contain unreconciled differences, (e) contain inter-company transactions, or (f) are otherwise associated with an identified risk of material misstatement due to fraud. In audits of entities that have several locations or components, consideration is given to the need to select journal entries from multiple locations.</li><li>• Journal entries or other adjustments processed outside the normal course of business – non standard journal entries may not be subject to the same nature and extent of controls as those journal entries used on a recurring basis to record transactions such as monthly sales, purchases and cash disbursements.</li></ul> <p>A45. The auditor uses professional judgment in determining the nature, timing and extent of testing of journal entries and other adjustments. However, because fraudulent journal entries and other adjustments are often made at the end of a reporting period, paragraph 33(a)(iii) requires the auditor to select the journal entries and other adjustments</p>
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made at that time. Further, because material misstatements in financial statements due to fraud can occur throughout the period and may involve extensive efforts to conceal how the fraud is accomplished, paragraph 33(a)(iv) requires the auditor to consider whether there is also a need to test journal entries and other adjustments throughout the period.

Considering the use of automated tools and techniques when testing journal entries and other adjustments

A45A. Considering the use of automated tools and techniques by the auditor when testing journal entries and other adjustments (e.g., determining the completeness of the population, and identifying and selecting items to test) may be impacted by the entity's use of technology in processing of journal entries and other adjustments.

Accounting Estimates (Ref: Para. 33(b))

A46. The preparation of the financial statements requires management to make a number of judgments or assumptions that affect significant accounting estimates and to monitor the reasonableness of such estimates on an ongoing basis. Fraudulent financial reporting is often accomplished through intentional misstatement of accounting estimates. This may be achieved by, for example, understating or overstating all provisions or reserves in the same fashion so as to be designed either to smooth earnings over two or more accounting periods, or to achieve a designated earnings level in order to deceive financial statement users by influencing their perceptions as to the entity's performance and profitability.

A47. The purpose of performing a retrospective review of management judgments and assumptions related to significant accounting estimates reflected in the financial statements of the prior year is to determine whether there is an indication of a possible bias on the part of management. It is not intended to call into question the auditor's

	<p>professional judgments made in the prior year that were based on information available at the time.</p> <p>A48. A retrospective review is also required by ISA 540 (Revised)<sup>55</sup>. That review is conducted as a risk assessment procedure to obtain information regarding the effectiveness of management's previous accounting estimates, audit evidence about the outcome, or where applicable, their subsequent re-estimation to assist in identifying and assessing the risks of material misstatement in the current period, and audit evidence of matters, such as estimation uncertainty, that may be required to be disclosed in the financial statements. As a practical matter, the auditor's review of management judgments and assumptions for biases that could represent a risk of material misstatement due to fraud in accordance with this ISA may be carried out in conjunction with the review required by ISA 540 (Revised).</p> <p>Business Rationale for Significant Transactions (Ref: Para. 33(c))</p> <p>A49. Indicators that may suggest that significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual, may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets include:</p> <ul style="list-style-type: none"><li>• The form of such transactions appears overly complex (for example, the transaction involves multiple entities within a consolidated group or multiple unrelated third parties).</li><li>• Management has not discussed the nature of and accounting for such transactions with those charged with governance of the entity, and there is inadequate documentation.</li></ul>
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<sup>55</sup> [ISA 540 \(Revised\), Auditing Accounting Estimates and Related Disclosures](#)

	<ul style="list-style-type: none"> <li>• Management is placing more emphasis on the need for a particular accounting treatment than on the underlying economics of the transaction.</li> <li>• Transactions that involve non-consolidated related parties, including special purpose entities, have not been properly reviewed or approved by those charged with governance of the entity.</li> <li>• The transactions involve previously unidentified related parties or parties that do not have the substance or the financial strength to support the transaction without assistance from the entity under audit.</li> </ul>
<p>34. The auditor shall determine whether, in order to respond to the identified risks of management override of controls, the auditor needs to perform other audit procedures in addition to those specifically referred to above (that is, where there are specific additional risks of management override that are not covered as part of the procedures performed to address the requirements in paragraph 33).</p>	
<p><b><del>Audit Procedures Responsive to Fraud or Suspected Fraud Identified By the Auditor During the Audit</del></b></p>	<p><b><del>Audit Procedures Responsive to Fraud or Suspected Fraud Identified By the Auditor During the Audit</del></b></p>
<p>[To be developed]</p>	<p>[To be developed]</p>
<p><b><u>Material Misstatements Due to Fraud</u></b></p>	<p><b><u>Material Misstatements Due to Fraud (Ref: Para. 34E–34H)</u></b></p>
<p><u>34E. In applying ISA 450,<sup>56</sup> the auditor shall determine whether identified misstatements due to fraud are material by considering both qualitative and quantitative factors. (Ref: Para. A49J–A49K) <del>If the auditor identifies a misstatement, the auditor shall evaluate</del></u></p>	<p><u>A49J. Examples of qualitative factors include whether a misstatement:</u></p> <ul style="list-style-type: none"> <li>• <u>Involves those charged with governance, management, related parties or third parties.</u></li> </ul>

<sup>56</sup> ISA 450, Evaluation of Misstatements Identified During the Audit

<p><del>whether such a misstatement is indicative of fraud.</del> [Previously paragraph 36]</p>	<ul style="list-style-type: none"> <li>• <u>Affects compliance with regulatory requirements.</u></li> <li>• <u>Affects compliance with debt covenants or other contractual requirements.</u></li> </ul> <p><u>A49K. Examples of quantitative factors include whether a misstatement:</u></p> <ul style="list-style-type: none"> <li>• <u>Affects key performance indicators such as earnings per share, net income and working capital.</u></li> <li>— <u>Affects multiple reporting periods such as when a misstatement has an immaterial effect on the current period's financial statements but is likely to have a material effect on future periods' financial statements.</u></li> <li>•</li> </ul>
<p><u>34F. If the auditor has reason to believe that an identified misstatement, whether material or not, is due to fraud, the auditor shall determine if there is such an indication, the auditor shall evaluate</u> the implications of the misstatement in relation to other aspects of the audit, particularly the reliability of management representations, <del>recognizing that an instance of fraud is unlikely to be an isolated occurrence.</del> (Ref: Para. A49L) [Previously paragraph 36]</p>	<p><u>A49L. The auditor's determination of whether a misstatement is due to fraud or error and whether the misstatement is material (or not material) affects the implications of the misstatement in relation to other aspects of the audit.</u> Since fraud involves incentive or pressure to commit fraud, a perceived opportunity to do so or some rationalization of the act, an instance of fraud is unlikely to be an isolated occurrence. Accordingly, misstatements, such as numerous misstatements at a specific location even though the cumulative effect is not material, may be indicative of a risk of material misstatement due to fraud. [Previously paragraph A52]</p>
<p><u>34G. If the auditor identifies a misstatement, whether material or not, and has reason to believe <del>that it is or may be the result of fraud and</del> that management (in particular, senior management) is involved, the auditor shall:</u></p> <p>(a) <del>Reevaluate</del> <u>revise</u> the <u>identification and</u> assessment of the risks of material misstatement due to fraud and its resulting impact on the nature, timing and extent of audit procedures</p>	<p><u>A49M. The implications of <del>identified</del> fraud <u>on the reliability of the audit evidence obtained</u> depend on the circumstances.</u> For example, an otherwise insignificant fraud may be significant if it involves senior management. In such circumstances, the reliability of <u>audit</u> evidence previously obtained may be called into question, since there may be doubts about the completeness and truthfulness of representations made and about the genuineness of accounting records and</p>

<p>to respond to the assessed risks <u>of material misstatement due to fraud; and</u></p> <p><del>(b) The auditor shall also c</del>Consider whether circumstances or conditions <u>relating to the misstatement</u> indicate possible collusion involving <del>employees,</del> management, <del>employees</del> or third parties when reconsidering the reliability of <u>audit</u> evidence previously obtained. (Ref: Para. <u>A49M</u>) [Previously paragraph 37]</p>	<p>documentation. There may also be a possibility of collusion involving management, employees or third parties. [Previously paragraph A53]</p>
<p><u>34H.</u> If the auditor confirms that, or is unable to conclude whether, the financial statements are materially misstated as a result of fraud the auditor shall:</p> <p><del>(a) evaluate</del><u>Determine</u> the implications for the audit.</p> <p><del>(b) Discuss the matter and the approach for further investigation with an appropriate level of management that is at least one level above those involved, and with senior management and those charged with governance.</del></p> <p><del>(c) If appropriate, obtain advice from legal counsel.</del> (Ref: Para. <del>A54</del><u>A49N</u>) [Previously paragraph 38]</p>	<p><u>A49N.</u> ISA 450<sup>57</sup> and ISA 700 (Revised)<sup>58</sup> establish requirements and provide guidance on the evaluation and disposition of misstatements and the effect on the auditor's opinion in the auditor's report. [Previously Paragraph A54]</p>
<p><b>Evaluation of Audit Evidence</b> (Ref: Para. A50)</p>	<p><b>Evaluation of Audit Evidence</b> (Ref: Para. 35–38)</p>
<p>35. The auditor shall evaluate whether analytical procedures that are performed near the end of the audit, when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity, indicate a</p>	<p>A50. ISA 330 requires the auditor, based on the audit procedures performed and the audit evidence obtained, to evaluate whether the assessments of the risks of material misstatement at the assertion level remain appropriate.<sup>59</sup> This evaluation is primarily a qualitative matter based on the auditor's judgment. Such an evaluation may provide further insight</p>

<sup>57</sup>—ISA 450, *Evaluation of Misstatements Identified during the Audit*

<sup>58</sup> ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

<sup>59</sup> ISA 330, paragraph 25

<p>previously unrecognized risk of material misstatement due to fraud. (Ref: Para. 51)</p>	<p>about the risks of material misstatement due to fraud and whether there is a need to perform additional or different audit procedures. Appendix 3 contains examples of circumstances that may indicate the possibility of fraud.</p> <p><i>Analytical Procedures Performed Near the End of the Audit in Forming an Overall Conclusion</i> (Ref: Para. 35)</p> <p>A51. Determining which particular trends and relationships may indicate a risk of material misstatement due to fraud requires professional judgment. Unusual relationships involving year-end revenue and income are particularly relevant. These might include, for example: uncharacteristically large amounts of income being reported in the last few weeks of the reporting period or unusual transactions; or income that is inconsistent with trends in cash flow from operations.</p>
<p>36. [Moved first sentence to paragraph 34E and second sentence to paragraph 34F]</p>	<p><i>Consideration of Identified Misstatements</i> (Ref: Para. 36-38)</p> <p>A52. [Moved to paragraph A49L]</p>
<p>37. [Moved to paragraph 34G]</p>	<p>A53. [Moved to paragraph A49M]</p>
<p>38. [Moved to paragraph 34H]</p>	<p>A54. [Moved to paragraph A49N]</p>
<p><b>Auditor Unable to Continue the Engagement</b></p>	<p><b>Auditor Unable to Continue the Engagement</b> (Ref: Para. 39)</p>
<p>39. If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:</p> <p>(a) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or</p>	<p>A55. Examples of exceptional circumstances that may arise and that may bring into question the auditor's ability to continue performing the audit include:</p> <ul style="list-style-type: none"> <li>The entity does not take the appropriate action regarding fraud that the auditor considers necessary in the circumstances, even where the fraud is not material to the financial statements;</li> </ul>

<p>persons who made the audit appointment or, in some cases, to regulatory authorities;</p> <p>(b) Consider whether it is appropriate to withdraw from the engagement, where withdrawal is possible under applicable law or regulation; and</p> <p>(c) If the auditor withdraws:</p> <p>(i) Discuss with the appropriate level of management and those charged with governance the auditor's withdrawal from the engagement and the reasons for the withdrawal; and</p> <p>(ii) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal. (Ref: Para. A55–A58)</p>	<ul style="list-style-type: none"> <li>• The auditor's consideration of the risks of material misstatement due to fraud and the results of audit tests indicate a significant risk of material and pervasive fraud; or</li> <li>• The auditor has significant concern about the competence or integrity of management or those charged with governance.</li> </ul> <p>A56. Because of the variety of the circumstances that may arise, it is not possible to describe definitively when withdrawal from an engagement is appropriate. Factors that affect the auditor's conclusion include the implications of the involvement of a member of management or of those charged with governance (which may affect the reliability of management representations) and the effects on the auditor of a continuing association with the entity.</p> <p>A57. The auditor has professional and legal responsibilities in such circumstances and these responsibilities may vary by country. In some countries, for example, the auditor may be entitled to, or required to, make a statement or report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities. Given the exceptional nature of the circumstances and the need to consider the legal requirements, the auditor may consider it appropriate to seek legal advice when deciding whether to withdraw from an engagement and in determining an appropriate course of action, including the possibility of reporting to shareholders, regulators or others.<sup>60</sup></p> <p><i>Considerations Specific to Public Sector Entities</i></p> <p>A58. In many cases in the public sector, the option of withdrawing from the engagement may not be available to the auditor due to the nature of the mandate or public interest considerations.</p>
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<sup>60</sup> The IESBA Code provides guidance on communications with an auditor replacing the existing auditor.

<u>Implications for the Auditor's Report</u>	<u>Implications for the Auditor's Report (Ref: Para. 39A–39F)</u>
<p><b>The drafting in this section is indicative and is provided to the Board to support the discussion as set out in Agenda Item 5, Section II. In due course, the Task Force will also develop more application material.</b></p>	
<p><u>Communicating Key Audit Matters Related to Fraud Risks</u></p> <p><u>39A. In the Key Audit Matters, including Fraud Risk section of the auditor's report, the auditor shall describe each fraud related key audit matter, using an appropriate subheading that clearly describes that the matter relates to a risk of material misstatement due to fraud.</u></p>	
<p><u>Determining Fraud Related Key Audit Matters</u></p> <p><u>39B. In applying ISA 701,<sup>61</sup> the auditor shall determine which of the risks of material misstatement due to fraud were of most significance in the current period and therefore are fraud related key audit matters. (Ref: Para. A58A–A58B)</u></p>	<p><u>Determining Fraud Related Key Audit Matters</u></p> <p><u>A58A. As described in ISA 701<sup>62</sup> the auditor's decision-making process in determining key audit matters is based on the auditor's professional judgment about which matters were of most significance in the audit of the financial statements of the current period. Significance can be considered in the context of quantitative and qualitative factors, such as relative magnitude, the nature and effect on the subject matter and the expressed interests of intended users or recipients.</u></p> <p><u>A58B. Considerations that may be relevant to determining which of the risks of material misstatement due to fraud were of most significance in the current period and therefore are fraud related key audit matters include:</u></p> <ul style="list-style-type: none"> <li><u>• The nature of the underlying accounting policy, relating to the risks of material misstatement due to fraud or the complexity or subjectivity involved in management's selection of an appropriate policy compared to other entities within its industry.</u></li> </ul>

<sup>61</sup> ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, paragraph 9(a)

<sup>62</sup> ISA 701 paragraph 10

	<ul style="list-style-type: none"> <li>• <u>The nature and materiality, quantitatively or qualitatively, of corrected and accumulated uncorrected misstatements due to fraud related to the risks of material misstatement due to fraud, if any.</u></li> <li>• <u>The nature and extent of audit effort needed to address the risks of material misstatement due to fraud, including the extent of specialized skills or knowledge needed to apply audit procedures to address the risks of material misstatement due to fraud or evaluate the results of those procedures, if any.</u></li> <li>• <u>Whether the risks of material misstatement due to fraud involved a number of separate, but related, auditing considerations. For example, long-term contracts may involve significant auditor attention with respect to revenue recognition, litigation or other contingencies, and may have an effect on other accounting estimates.</u></li> </ul>
<p><u><i>Description of Individual Fraud Related Key Audit Matters</i></u></p> <p><u>39C. The description of each fraud related key audit matter shall include a reference to the related disclosure(s), if any, in the financial statements and shall address:</u></p> <p><u>(a) Why the risk of material misstatement due to fraud was considered to be of most significance and therefore determined to be a fraud related key audit matter; and</u></p> <p><u>(b) How the risk of material misstatement due to fraud was addressed in the audit.</u></p>	<p><u><i>Description of Individual Fraud Related Key Audit Matters</i></u></p>
<p><u>39D. If the auditor identifies a significant deficiency in internal control that is relevant to the prevention and detection of fraud for a fraud related key audit matter, the description of the fraud related key audit matter shall include: (Ref: Para. A58C–A58D)</u></p>	<p><u>A58C. Deficiencies may exist in a class of transaction, account balances or disclosures for which the auditor has not identified a risk of material misstatement due to fraud. In such circumstances, the auditor may also describe a significant deficiency in internal control that is relevant to the prevention and detection of fraud for which the auditor has not identified</u></p>

<p><u>(a) If the financial statements provide disclosures to enable the intended users to understand the effect of the significant deficiency(s): (Ref: Para. A58E)</u></p> <p><u>(i) That the auditor has identified a significant deficiency(s) in internal control relevant to the prevention and detection of fraud based on the auditor's understanding of the entity's system of internal control, and the auditor has communicated the significant deficiency(s) in internal control to those charged with governance; and</u></p> <p><u>(ii) Where the matter has been described in the financial statements and management's plans to remediate the significant deficiency(s), if applicable.</u></p> <p><u>(b) If the financial statements do not provide disclosures to enable the intended users to understand the effect of the significant deficiency(s):</u></p> <p><u>(i) That the auditor has identified a significant deficiency in internal control relevant to the prevention and detection of fraud based on the auditor's understanding of the entity's system of internal control, and the auditor has communicated the significant deficiency(s) in internal control to those charged with governance;</u></p> <p><u>(ii) A description of the nature of the significant deficiency; and</u></p> <p><u>(iii) Information relating to management's plans to remediate the significant deficiency(s), if applicable.</u></p>	<p><u>a risk of material misstatement due to fraud. For example, the lack of a whistleblower program may be indicative of weaknesses in the entity's control environment, but it may not directly relate to a risk of material misstatement due to fraud and is therefore not determined to be a fraud related key audit matter. The auditor is required to communicate such matters to those charged with governance in accordance with ISA 265.<sup>63</sup></u></p> <p><u>A58D. The following examples illustrate the presentation in the auditor's report of a significant deficiency in internal control that is relevant to the prevention and detection of fraud that was identified and relates to a fraud related key audit matter when:</u></p> <ul style="list-style-type: none"><li><u>The financial statements provide disclosures on the matter:</u> <u><i>We have identified a significant deficiency in internal control relevant to the prevention and detection of fraud based on our understanding of the Company's system of internal control. We have communicated the significant deficiency in internal control to those charged with governance. The matter has been described in Note X to the financial statements, including management's plans to remediate the significant deficiency.</i></u></li><li><u>The financial statements do not provide disclosures on the matter.</u> <u><i>We have identified a significant deficiency in internal control relevant to the prevention and detection of fraud based on our understanding of the Company's system of internal control. We have communicated the significant deficiency in internal control to those charged with governance. The communication noted [describe the nature of the significant deficiency, and where applicable management's plans to remediate the significant deficiency].</i></u></li></ul>
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<sup>63</sup> ISA 265, paragraph A7

<p><u><i>Circumstances in Which a Risk of Material Misstatement Due to Fraud Determined to Be a Fraud Related Key Audit Matter Is Not Communicated in the Auditor's Report</i></u></p> <p>39E. <u>The auditor shall describe each fraud related key audit matter in the auditor's report unless:</u></p> <p>(a) <u>Law or regulation precludes public disclosure about the risks of material misstatement due to fraud; or</u></p> <p>(b) <u>In extremely rare circumstances, the auditor determines that the risks of material misstatement due to fraud should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication. This shall not apply if the entity has publicly disclosed information about the fraud risk.</u></p>	<p><u><i>Circumstances in Which a Risk of Material Misstatement Due to Fraud Determined to Be a Fraud Related Key Audit Matter Is Not Communicated in the Auditor's Report</i></u></p>
<p>39F. <u>If the auditor determines, depending on the facts and circumstances of the entity and the audit, that there are no fraud related key audit matters to communicate, the auditor shall include a statement to this effect in a separate section of the auditor's report under the heading "Key Audit Matters, including Fraud Risks." (Ref: Para. A58E–A58G)</u></p>	<p>A58E. <u>The requirement in paragraph 39F applies in two circumstances:</u></p> <p>(a) <u>The auditor determines in accordance with paragraph 39B that there are no fraud related key audit matters (see paragraph A58H).</u></p> <p>(b) <u>The auditor determines in accordance with paragraph 39E that a fraud related key audit matter will not be communicated in the auditor's report and no other matters have been determined to be fraud related key audit matters.</u></p> <p>A58F. <u>The following illustrates the presentation in the auditor's report if the auditor has determined there are no key audit matters to communicate:</u></p> <p><u><i>We have determined that there are no fraud related key audit matters to communicate in our report.</i></u></p> <p>A58G. <u>The determination of fraud related key audit matters involves making a judgment about the relative importance of matters that required</u></p>

	<p><u>significant auditor attention. Therefore, it may be rare that the auditor of a complete set of general purpose financial statements of a listed entity would not determine at least one fraud related key audit matter from the risks of material misstatement due to fraud. However, in certain limited circumstances, the auditor may determine that there are no risks of material misstatement due to fraud that are fraud related key audit matters in accordance with paragraph 39B.</u></p>
<p><b>Written Representations</b></p>	<p><b>Written Representations (Ref: Para. 40)</b></p>
<p>40. The auditor shall obtain written representations from management and, where appropriate, those charged with governance that:</p> <ul style="list-style-type: none"> <li>(d) They acknowledge their responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud;</li> <li>(e) They have disclosed to the auditor the results of management’s assessment of the risk that the financial statements may be materially misstated as a result of fraud;</li> <li>(f) They have disclosed to the auditor their knowledge of fraud, or suspected fraud, affecting the entity involving: <ul style="list-style-type: none"> <li>(i) Management;</li> <li>(ii) Employees who have significant roles in internal control; or</li> <li>(iii) Others where the fraud could have a material effect on the financial statements; and</li> </ul> </li> </ul>	<p>A59. ISA 580<sup>64</sup> establishes requirements and provides guidance on obtaining appropriate representations from management and, where appropriate, those charged with governance in the audit. In addition to acknowledging that they have fulfilled their responsibility for the preparation of the financial statements, it is important that, irrespective of the size of the entity, management and, where appropriate, those charged with governance acknowledge their responsibility for internal control designed, implemented and maintained to prevent and detect fraud.</p> <p>A60. Because of the nature of fraud and the difficulties encountered by auditors in detecting material misstatements in the financial statements resulting from fraud, it is important that the auditor obtain a written representation from management and, where appropriate, those charged with governance confirming that they have disclosed to the auditor:</p> <ul style="list-style-type: none"> <li>(g) The results of management’s assessment of the risk that the financial statements may be materially misstated as a result of fraud; and</li> </ul>

<sup>64</sup> ISA 580, *Written Representations*

<p>(d) They have disclosed to the auditor their knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others. (Ref: Para. A59–A60)</p>	<p>(b) Their knowledge of actual, suspected or alleged fraud affecting the entity.</p>
<p><b>Communications with Management and Those Charged with Governance</b></p>	<p><b>Communications with Management and Those Charged with Governance</b> (Ref: Para. 41–43)</p>
<p>40A. [Moved to paragraph 16B]</p>	<p>A60A. [Moved to paragraph A12F] A60B. [Moved to paragraph A12G] A60C. [Moved to paragraph A12G]</p>
<p><i>Communication of Identified Deficiencies in Internal Control</i> [To be developed and to be determined which requirements from extant ISA 240 will be placed under this section]</p>	
<p>41. If the auditor has identified a fraud or has obtained information that indicates that a fraud may exist, the auditor shall communicate these matters, unless prohibited by law or regulation, on a timely basis with the appropriate level of management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities. (Ref: Para. A61–A62)</p>	<p>A61. In some jurisdictions, law or regulation may restrict the auditor's communication of certain matters with management and those charged with governance. Law or regulation may specifically prohibit a communication, or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act, including alerting the entity, for example, when the auditor is required to report the fraud to an appropriate authority pursuant to anti-money laundering legislation. In these circumstances, the issues considered by the auditor may be complex and the auditor may consider it appropriate to obtain legal advice.</p> <p><i>Communication to Management</i> (Ref: Para. 41)</p> <p>A62. When the auditor has obtained evidence that fraud exists or may exist, it is important that the matter be brought to the attention of the appropriate level of management as soon as practicable. This is so</p>

	<p>even if the matter might be considered inconsequential (for example, a minor defalcation by an employee at a low level in the entity's organization). The determination of which level of management is the appropriate one is a matter of professional judgment and is affected by such factors as the likelihood of collusion and the nature and magnitude of the suspected fraud. Ordinarily, the appropriate level of management is at least one level above the persons who appear to be involved with the suspected fraud.</p>
<p>42. Unless all of those charged with governance are involved in managing the entity, if the auditor has identified or suspects fraud involving:</p> <ul style="list-style-type: none"> <li>(h) management;</li> <li>(i) employees who have significant roles in internal control; or</li> <li>(j) others where the fraud results in a material misstatement in the financial statements,</li> </ul> <p>the auditor shall communicate these matters with those charged with governance on a timely basis. If the auditor suspects fraud involving management, the auditor shall communicate these suspicions with those charged with governance and discuss with them the nature, timing and extent of audit procedures necessary to complete the audit. Such communications with those charged with governance are required unless the communication is prohibited by law or regulation. (Ref: Para. A61, A63–A65)</p>	<p><i>Communication with Those Charged with Governance</i> (Ref: Para. 42)</p> <p>A63. The auditor's communication with those charged with governance may be made orally or in writing. ISA 260 (Revised)<sup>65</sup> identifies factors the auditor considers in determining whether to communicate orally or in writing.<sup>66</sup> Due to the nature and sensitivity of fraud involving senior management, or fraud that results in a material misstatement in the financial statements, the auditor reports such matters on a timely basis and may consider it necessary to also report such matters in writing.</p> <p>A64. In some cases, the auditor may consider it appropriate to communicate with those charged with governance when the auditor becomes aware of fraud involving employees other than management that does not result in a material misstatement. Similarly, those charged with governance may wish to be informed of such circumstances. The communication process is assisted if the auditor and those charged with governance agree at an early stage in the audit about the nature and extent of the auditor's communications in this regard.</p> <p>A65. In the exceptional circumstances where the auditor has doubts about the integrity or honesty of management or those charged with</p>

<sup>65</sup> [ISA 260 \(Revised\), \*Communication with Those Charged with Governance\*](#)

<sup>66</sup> ISA 260 (Revised), paragraph A38

	<p>governance, the auditor may consider it appropriate to obtain legal advice to assist in determining the appropriate course of action.</p>
<p>43. The auditor shall communicate, unless prohibited by law or regulation, with those charged with governance any other matters related to fraud that are, in the auditor’s judgment, relevant to their responsibilities. (Ref: Para. A61, A66)</p>	<p><i>Other Matters Related to Fraud</i> (Ref: Para. 43)</p> <p>A66. Other matters related to fraud to be discussed with those charged with governance of the entity may include, for example:</p> <ul style="list-style-type: none"> <li>● Concerns about the nature, extent and frequency of management’s assessments of the controls in place to prevent and detect fraud and of the risk that the financial statements may be misstated.</li> <li>● A failure by management to appropriately address identified significant deficiencies in internal control, or to appropriately respond to an identified fraud.</li> <li>● The auditor’s evaluation of the entity’s control environment, including questions regarding the competence and integrity of management.</li> <li>● Actions by management that may be indicative of fraudulent financial reporting, such as management’s selection and application of accounting policies that may be indicative of management’s effort to manage earnings in order to deceive financial statement users by influencing their perceptions as to the entity’s performance and profitability.</li> <li>● Concerns about the adequacy and completeness of the authorization of transactions that appear to be outside the normal course of business.</li> </ul>

Communications to Regulatory and Enforcement Authorities	Communications to Regulatory and Enforcement Authorities (Ref: Para. 44)
<p>44. If the auditor has identified or suspects a fraud, the auditor shall determine whether law, regulation or relevant ethical requirements: (Ref: Para. A67–A69)</p> <p>(a) Require the auditor to report to an appropriate authority outside the entity.</p> <p>(b) Establish responsibilities under which reporting to an appropriate authority outside the entity may be appropriate in the circumstances.</p>	<p>A67. ISA 250 (Revised)<sup>67</sup> provides further guidance with respect to the auditor’s determination of whether reporting identified or suspected non-compliance with laws or regulations to an appropriate authority outside the entity is required or appropriate in the circumstances, including consideration of the auditor’s duty of confidentiality.</p> <p>A68. The determination required by paragraph 44 may involve complex considerations and professional judgments. Accordingly, the auditor may consider consulting internally (e.g., within the firm or a network firm) or on a confidential basis with a regulator or professional body (unless doing so is prohibited by law or regulation or would breach the duty of confidentiality). The auditor may also consider obtaining legal advice to understand the auditor’s options and the professional or legal implications of taking any particular course of action.</p> <p><i>Considerations Specific to Public Sector Entities</i></p> <p>A69. In the public sector, requirements for reporting fraud, whether or not discovered through the audit process, may be subject to specific provisions of the audit mandate or related law, regulation or other authority.</p>
Documentation	Documentation
<p>45. The auditor shall include the following in the audit documentation<sup>68</sup> of the identification and the assessment of the</p>	

<sup>67</sup> ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*, paragraphs A28–A34

<sup>68</sup> ISA 230, *Audit Documentation*, paragraphs 8–11, and paragraph A6

<p>risks of material misstatement required by ISA 315 (Revised 2019).<sup>69</sup></p> <ul style="list-style-type: none"> <li>(a) The significant decisions reached during the discussion among the engagement team regarding the susceptibility of the entity's financial statements to material misstatement due to fraud;</li> <li>(b) The identified and assessed risks of material misstatement due to fraud at the financial statement level and at the assertion level; and</li> <li>(c) Identified controls in the control activities component that address assessed risks of material misstatement due to fraud.</li> </ul>	
<p>46. The auditor shall include the following in the audit documentation of the auditor's responses to the assessed risks of material misstatement required by ISA 330:<sup>70</sup></p> <ul style="list-style-type: none"> <li>(a) The overall responses to the assessed risks of material misstatement due to fraud at the financial statement level and the nature, timing and extent of audit procedures, and the linkage of those procedures with the assessed risks of material misstatement due to fraud at the assertion level; and</li> <li>(b) The results of the audit procedures, including those designed to address the risk of management override of controls.</li> </ul>	
<p>47. The auditor shall include in the audit documentation communications about fraud made to management, those charged with governance, regulators and others.</p>	

<sup>69</sup> ISA 315 (Revised 2019), paragraph 38

<sup>70</sup> ISA 330, paragraph 28

<p>48. If the auditor has concluded that the presumption that there is a risk of material misstatement due to fraud related to revenue recognition is not applicable in the circumstances of the engagement, the auditor shall include in the audit documentation the reasons for that conclusion.</p>	
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## Appendix 1

(Ref: Para. A26)

### Examples of Fraud Risk Factors

The fraud risk factors identified in this Appendix are examples of such factors that may be faced by auditors in a broad range of situations. Separately presented are examples relating to the two types of fraud relevant to the auditor's consideration – that is, fraudulent financial reporting and misappropriation of assets. For each of these types of fraud, the risk factors are further classified based on the three conditions generally present when material misstatements due to fraud occur: (a) incentives/pressures, (b) opportunities, and (c) attitudes/rationalizations. Although the risk factors cover a broad range of situations, they are only examples and, accordingly, the auditor may identify additional or different risk factors. Not all of these examples are relevant in all circumstances, and some may be of greater or lesser significance in entities of different size or with different ownership characteristics or circumstances. Also, the order of the examples of risk factors provided is not intended to reflect their relative importance or frequency of occurrence.

Fraud risk factors may relate to incentives or pressures, or opportunities, that arise from conditions that create susceptibility to misstatement before consideration of controls (i.e., the inherent risk). Such factors are inherent risk factors, insofar as they affect inherent risk, and may be due to management bias. Fraud risk factors related to opportunities may also arise from other identified inherent risk factors (for example, complexity or uncertainty may create opportunities that result in susceptibility to misstatement due to fraud). Fraud risk factors related to opportunities may also relate to conditions within the entity's system of internal control, such as limitations or deficiencies in the entity's internal control that create such opportunities. Fraud risk factors related to attitudes or rationalizations may arise, in particular, from limitations or deficiencies in the entity's control environment.

### Risk Factors Relating to Misstatements Arising from Fraudulent Financial Reporting

The following are examples of risk factors relating to misstatements arising from fraudulent financial reporting.

#### *Incentives/Pressures*

Financial stability or profitability is threatened by economic, industry, or entity operating conditions, such as (or as indicated by):

- High degree of competition or market saturation, accompanied by declining margins.
- High vulnerability to rapid changes, such as changes in technology, product obsolescence, or interest rates.
- Significant declines in customer demand and increasing business failures in either the industry or overall economy.
- Operating losses making the threat of bankruptcy, foreclosure, or hostile takeover imminent.
- Recurring negative cash flows from operations or an inability to generate cash flows from operations while reporting earnings and earnings growth.
- Rapid growth or unusual profitability especially compared to that of other companies in the same industry.

- New accounting, statutory, or regulatory requirements.

Excessive pressure exists for management to meet the requirements or expectations of third parties due to the following:

- Profitability or trend level expectations of investment analysts, institutional investors, significant creditors, or other external parties (particularly expectations that are unduly aggressive or unrealistic), including expectations created by management in, for example, overly optimistic press releases or annual report messages.
- Need to obtain additional debt or equity financing to stay competitive – including financing of major research and development or capital expenditures.
- Marginal ability to meet exchange listing requirements or debt repayment or other debt covenant requirements.
- Perceived or real adverse effects of reporting poor financial results on significant pending transactions, such as business combinations or contract awards.

Information available indicates that the personal financial situation of management or those charged with governance is threatened by the entity's financial performance arising from the following:

- Significant financial interests in the entity.
- Significant portions of their compensation (for example, bonuses, stock options, and earn-out arrangements) being contingent upon achieving aggressive targets for stock price, operating results, financial position, or cash flow.<sup>71</sup>
- Personal guarantees of debts of the entity.

There is excessive pressure on management or operating personnel to meet financial targets established by those charged with governance, including sales or profitability incentive goals.

### *Opportunities*

The nature of the industry or the entity's operations provides opportunities to engage in fraudulent financial reporting that can arise from the following:

- Significant related-party transactions not in the ordinary course of business or with related entities not audited or audited by another firm.
- A strong financial presence or ability to dominate a certain industry sector that allows the entity to dictate terms or conditions to suppliers or customers that may result in inappropriate or non-arm's-length transactions.
- Assets, liabilities, revenues, or expenses based on significant estimates that involve subjective judgments or uncertainties that are difficult to corroborate.
- Significant, unusual, or highly complex transactions, especially those close to period end that pose difficult "substance over form" questions.
- Significant operations located or conducted across international borders in jurisdictions where differing business environments and cultures exist.

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<sup>71</sup> Management incentive plans may be contingent upon achieving targets relating only to certain accounts or selected activities of the entity, even though the related accounts or activities may not be material to the entity as a whole.

- Use of business intermediaries for which there appears to be no clear business justification.
- Significant bank accounts or subsidiary or branch operations in tax-haven jurisdictions for which there appears to be no clear business justification.

The monitoring of management is not effective as a result of the following:

- Domination of management by a single person or small group (in a non owner-managed business) without compensating controls.
- Oversight by those charged with governance over the financial reporting process and internal control is not effective.

There is a complex or unstable organizational structure, as evidenced by the following:

- Difficulty in determining the organization or individuals that have controlling interest in the entity.
- Overly complex organizational structure involving unusual legal entities or managerial lines of authority.
- High turnover of senior management, legal counsel, or those charged with governance.

Deficiencies in internal control as a result of the following:

- Inadequate process to monitor the entity's system of internal control, including automated controls and controls over interim financial reporting (where external reporting is required).
- High turnover rates or employment of staff in accounting, information technology, or the internal audit function that are not effective.
- Accounting and information systems that are not effective, including situations involving significant deficiencies in internal control.

#### *Attitudes/Rationalizations*

- Communication, implementation, support, or enforcement of the entity's values or ethical standards by management, or the communication of inappropriate values or ethical standards, that are not effective.
- Nonfinancial management's excessive participation in or preoccupation with the selection of accounting policies or the determination of significant estimates.
- Known history of violations of securities laws or other laws and regulations, or claims against the entity, its senior management, or those charged with governance alleging fraud or violations of laws and regulations.
- Excessive interest by management in maintaining or increasing the entity's stock price or earnings trend.
- The practice by management of committing to analysts, creditors, and other third parties to achieve aggressive or unrealistic forecasts.
- Management failing to remedy known significant deficiencies in internal control on a timely basis.
- An interest by management in employing inappropriate means to minimize reported earnings for tax-motivated reasons.
- Low morale among senior management.
- The owner-manager makes no distinction between personal and business transactions.

- Dispute between shareholders in a closely held entity.
- Recurring attempts by management to justify marginal or inappropriate accounting on the basis of materiality.
- The relationship between management and the current or predecessor auditor is strained, as exhibited by the following:
  - Frequent disputes with the current or predecessor auditor on accounting, auditing, or reporting matters.
  - Unreasonable demands on the auditor, such as unrealistic time constraints regarding the completion of the audit or the issuance of the auditor's report.
  - Restrictions on the auditor that inappropriately limit access to people or information or the ability to communicate effectively with those charged with governance.
  - Domineering management behavior in dealing with the auditor, especially involving attempts to influence the scope of the auditor's work or the selection or continuance of personnel assigned to or consulted on the audit engagement.

### **Risk Factors Arising from Misstatements Arising from Misappropriation of Assets**

Risk factors that relate to misstatements arising from misappropriation of assets are also classified according to the three conditions generally present when fraud exists: incentives/pressures, opportunities, and attitudes/rationalization. Some of the risk factors related to misstatements arising from fraudulent financial reporting also may be present when misstatements arising from misappropriation of assets occur. For example, ineffective monitoring of management and other deficiencies in internal control may be present when misstatements due to either fraudulent financial reporting or misappropriation of assets exist. The following are examples of risk factors related to misstatements arising from misappropriation of assets.

#### *Incentives/Pressures*

Personal financial obligations may create pressure on management or employees with access to cash or other assets susceptible to theft to misappropriate those assets.

Adverse relationships between the entity and employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets. For example, adverse relationships may be created by the following:

- Known or anticipated future employee layoffs.
- Recent or anticipated changes to employee compensation or benefit plans.
- Promotions, compensation, or other rewards inconsistent with expectations.

#### *Opportunities*

Certain characteristics or circumstances may increase the susceptibility of assets to misappropriation. For example, opportunities to misappropriate assets increase when there are the following:

- Large amounts of cash on hand or processed.
- Inventory items that are small in size, of high value, or in high demand.
- Easily convertible assets, such as bearer bonds, diamonds, or computer chips.

- Fixed assets which are small in size, marketable, or lacking observable identification of ownership.

Inadequate controls over assets may increase the susceptibility of misappropriation of those assets. For example, misappropriation of assets may occur because there is the following:

- Inadequate segregation of duties or independent checks.
- Inadequate oversight of senior management expenditures, such as travel and other reimbursements.
- Inadequate management oversight of employees responsible for assets, for example, inadequate supervision or monitoring of remote locations.
- Inadequate job applicant screening of employees with access to assets.
- Inadequate record keeping with respect to assets.
- Inadequate system of authorization and approval of transactions (for example, in purchasing).
- Inadequate physical safeguards over cash, investments, inventory, or fixed assets.
- Lack of complete and timely reconciliations of assets.
- Lack of timely and appropriate documentation of transactions, for example, credits for merchandise returns.
- Lack of mandatory vacations for employees performing key control functions.
- Inadequate management understanding of information technology, which enables information technology employees to perpetrate a misappropriation.
- Inadequate access controls over automated records, including controls over and review of computer systems event logs.

#### *Attitudes/Rationalizations*

- Disregard for the need for monitoring or reducing risks related to misappropriations of assets.
- Disregard for controls over misappropriation of assets by overriding existing controls or by failing to take appropriate remedial action on known deficiencies in internal control.
- Behavior indicating displeasure or dissatisfaction with the entity or its treatment of the employee.
- Changes in behavior or lifestyle that may indicate assets have been misappropriated.
- Tolerance of petty theft.

## **Examples of Possible Audit Procedures to Address the Assessed Risks of Material Misstatement Due to Fraud**

The following are examples of possible audit procedures to address the assessed risks of material misstatement due to fraud resulting from both fraudulent financial reporting and misappropriation of assets. Although these procedures cover a broad range of situations, they are only examples and, accordingly they may not be the most appropriate nor necessary in each circumstance. Also the order of the procedures provided is not intended to reflect their relative importance.

### **Consideration at the Assertion Level**

Specific responses to the auditor's assessment of the risks of material misstatement due to fraud will vary depending upon the types or combinations of fraud risk factors or conditions identified, and the classes of transactions, account balances, disclosures and assertions they may affect.

The following are specific examples of responses:

- Visiting locations or performing certain tests on a surprise or unannounced basis. For example, observing inventory at locations where auditor attendance has not been previously announced or counting cash at a particular date on a surprise basis.
- Requesting that inventories be counted at the end of the reporting period or on a date closer to period end to minimize the risk of manipulation of balances in the period between the date of completion of the count and the end of the reporting period.
- Altering the audit approach in the current year. For example, contacting major customers and suppliers orally in addition to sending written confirmation, sending confirmation requests to a specific party within an organization, or seeking more or different information.
- Performing a detailed review of the entity's quarter-end or year-end adjusting entries and investigating any that appear unusual as to nature or amount.
- For significant and unusual transactions, particularly those occurring at or near year-end, investigating the possibility of related parties and the sources of financial resources supporting the transactions.
- Performing substantive analytical procedures using disaggregated data. For example, comparing sales and cost of sales by location, line of business or month to expectations developed by the auditor.
- Conducting interviews of personnel involved in areas where a risk of material misstatement due to fraud has been identified, to obtain their insights about the risk and whether, or how, controls address the risk.
- When other independent auditors are auditing the financial statements of one or more subsidiaries, divisions or branches, discussing with them the extent of work necessary to be performed to address the assessed risk of material misstatement due to fraud resulting from transactions and activities among these components.

- If the work of an expert becomes particularly significant with respect to a financial statement item for which the assessed risk of material misstatement due to fraud is high, performing additional procedures relating to some or all of the expert's assumptions, methods or findings to determine that the findings are not unreasonable, or engaging another expert for that purpose.
- Performing audit procedures to analyze selected opening balance sheet accounts of previously audited financial statements to assess how certain issues involving accounting estimates and judgments, for example, an allowance for sales returns, were resolved with the benefit of hindsight.
- Performing procedures on account or other reconciliations prepared by the entity, including considering reconciliations performed at interim periods.
- Performing computer-assisted techniques, such as data mining to test for anomalies in a population.
- Testing the integrity of computer-produced records and transactions.
- Seeking additional audit evidence from sources outside of the entity being audited.

### **Specific Responses—Misstatement Resulting from Fraudulent Financial Reporting**

Examples of responses to the auditor's assessment of the risks of material misstatement due to fraudulent financial reporting are as follows:

#### *Revenue Recognition*

- Performing substantive analytical procedures relating to revenue using disaggregated data, for example, comparing revenue reported by month and by product line or business segment during the current reporting period with comparable prior periods. Computer-assisted audit techniques may be useful in identifying unusual or unexpected revenue relationships or transactions.
- Confirming with customers certain relevant contract terms and the absence of side agreements, because the appropriate accounting often is influenced by such terms or agreements and basis for rebates or the period to which they relate are often poorly documented. For example, acceptance criteria, delivery and payment terms, the absence of future or continuing vendor obligations, the right to return the product, guaranteed resale amounts, and cancellation or refund provisions often are relevant in such circumstances.
- Inquiring of the entity's sales and marketing personnel or in-house legal counsel regarding sales or shipments near the end of the period and their knowledge of any unusual terms or conditions associated with these transactions.
- Being physically present at one or more locations at period end to observe goods being shipped or being readied for shipment (or returns awaiting processing) and performing other appropriate sales and inventory cutoff procedures.
- For those situations for which revenue transactions are electronically initiated, processed, and recorded, testing controls to determine whether they provide assurance that recorded revenue transactions occurred and are properly recorded.

#### *Inventory Quantities*

- Examining the entity's inventory records to identify locations or items that require specific attention during or after the physical inventory count.

- Observing inventory counts at certain locations on an unannounced basis or conducting inventory counts at all locations on the same date.
- Conducting inventory counts at or near the end of the reporting period to minimize the risk of inappropriate manipulation during the period between the count and the end of the reporting period.
- Performing additional procedures during the observation of the count, for example, more rigorously examining the contents of boxed items, the manner in which the goods are stacked (for example, hollow squares) or labeled, and the quality (that is, purity, grade, or concentration) of liquid substances such as perfumes or specialty chemicals. Using the work of an expert may be helpful in this regard.
- Comparing the quantities for the current period with prior periods by class or category of inventory, location or other criteria, or comparison of quantities counted with perpetual records.
- Using computer-assisted audit techniques to further test the compilation of the physical inventory counts – for example, sorting by tag number to test tag controls or by item serial number to test the possibility of item omission or duplication.

#### *Management Estimates*

- Using an expert to develop an independent estimate for comparison to management's estimate.
- Extending inquiries to individuals outside of management and the accounting department to corroborate management's ability and intent to carry out plans that are relevant to developing the estimate.

#### **Specific Responses—Misstatements Due to Misappropriation of Assets**

Differing circumstances would necessarily dictate different responses. Ordinarily, the audit response to an assessed risk of material misstatement due to fraud relating to misappropriation of assets will be directed toward certain account balances and classes of transactions. Although some of the audit responses noted in the two categories above may apply in such circumstances, the scope of the work is to be linked to the specific information about the misappropriation risk that has been identified.

Examples of responses to the auditor's assessment of the risk of material misstatements due to misappropriation of assets are as follows:

- Counting cash or securities at or near year-end.
- Confirming directly with customers the account activity (including credit memo and sales return activity as well as dates payments were made) for the period under audit.
- Analyzing recoveries of written-off accounts.
- Analyzing inventory shortages by location or product type.
- Comparing key inventory ratios to industry norm.
- Reviewing supporting documentation for reductions to the perpetual inventory records.
- Performing a computerized match of the vendor list with a list of employees to identify matches of addresses or phone numbers.
- Performing a computerized search of payroll records to identify duplicate addresses, employee identification or taxing authority numbers or bank accounts.

- Reviewing personnel files for those that contain little or no evidence of activity, for example, lack of performance evaluations.
- Analyzing sales discounts and returns for unusual patterns or trends.
- Confirming specific terms of contracts with third parties.
- Obtaining evidence that contracts are being carried out in accordance with their terms.
- Reviewing the propriety of large and unusual expenses.
- Reviewing the authorization and carrying value of senior management and related party loans.
- Reviewing the level and propriety of expense reports submitted by senior management.

## **Examples of Circumstances that Indicate the Possibility of Fraud**

The following are examples of circumstances that may indicate the possibility that the financial statements may contain a material misstatement resulting from fraud.

### *Discrepancies in the accounting records, including:*

- Transactions that are not recorded in a complete or timely manner or are improperly recorded as to amount, accounting period, classification, or entity policy.
- Unsupported or unauthorized balances or transactions.
- Last-minute adjustments that significantly affect financial results.
- Evidence of employees' access to systems and records inconsistent with that necessary to perform their authorized duties.
- Tips or complaints to the auditor about alleged fraud.

### *Conflicting or missing evidence, including:*

- Missing documents.
- Documents that appear to have been altered.
- Unavailability of other than photocopied or electronically transmitted documents when documents in original form are expected to exist.
- Significant unexplained items on reconciliations.
- Unusual balance sheet changes, or changes in trends or important financial statement ratios or relationships – for example, receivables growing faster than revenues.
- Inconsistent, vague, or implausible responses from management or employees arising from inquiries or analytical procedures.
- Unusual discrepancies between the entity's records and confirmation replies.
- Large numbers of credit entries and other adjustments made to accounts receivable records.
- Unexplained or inadequately explained differences between the accounts receivable sub-ledger and the control account, or between the customer statements and the accounts receivable sub-ledger.
- Missing or non-existent cancelled checks in circumstances where cancelled checks are ordinarily returned to the entity with the bank statement.
- Missing inventory or physical assets of significant magnitude.
- Unavailable or missing electronic evidence, inconsistent with the entity's record retention practices or policies.
- Fewer responses to confirmations than anticipated or a greater number of responses than anticipated.
- Inability to produce evidence of key systems development and program change testing and implementation activities for current-year system changes and deployments.

*Problematic or unusual relationships between the auditor and management, including:*

- Denial of access to records, facilities, certain employees, customers, vendors, or others from whom audit evidence might be sought.
- Undue time pressures imposed by management to resolve complex or contentious issues.
- Complaints by management about the conduct of the audit or management intimidation of engagement team members, particularly in connection with the auditor's critical assessment of audit evidence or in the resolution of potential disagreements with management.
- Unusual delays by the entity in providing requested information.
- Unwillingness to facilitate auditor access to key electronic files for testing through the use of computer-assisted audit techniques.
- Denial of access to key IT operations staff and facilities, including security, operations, and systems development personnel.
- An unwillingness to add or revise disclosures in the financial statements to make them more complete and understandable.
- An unwillingness to address identified deficiencies in internal control on a timely basis.

*Other*

- Unwillingness by management to permit the auditor to meet privately with those charged with governance.
- Accounting policies that appear to be at variance with industry norms.
- Frequent changes in accounting estimates that do not appear to result from changed circumstances.
- Tolerance of violations of the entity's code of conduct.

**Appendix 4**

(Ref. Para. XX)

**Considerations When Identifying and Selecting Journal Entries and Other  
Adjustments for Testing**

[PLACEHOLDER]

## **Appendix 5**

(Ref: Para. 9A)

### **Specific Requirements in Other ISAs that Refer to Fraud or Suspected Fraud**

This appendix identifies other ISAs with specific requirements that refer to fraud or suspected fraud. The list is not a substitute for considering the requirements and related application and other explanatory material in ISAs.

- ISA 210, *Agreeing the Terms of Audit Engagements* – paragraph 6(b)(ii)
- ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement* – pParagraph 13(a)
- ISA 402, *Audit Considerations Relating to an Entity Using a Service Organization*, paragraph 19
- ISA 505, *External Confirmations* – paragraphs 8(b) and 11
- ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures* – paragraph 32
- ISA 550, *Related Parties* – paragraphs 12, 19, 22(e) and 23(a)(i)
- ISA 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* – paragraphs 32(a), 38(d), 45(h), 55, 57(d) and 59(g)(i)
- ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements* – paragraphs 11, 34(a), 38(a)(i), 38(c) and 39(b)(i)