

Agenda Item

C.2

Fraud in an Audit of Financial Statements—Issues

Please note: This is the Fraud Issues Paper presented to and discussed by the IAASB in December 2020 which is provided to the CAG Representatives in March 2021 for reference purposes.

Objectives of the Agenda Item:

The objectives of this Agenda Item are to:

- (a) Provide the Board with an update on information-gathering and brainstorming activities performed since the August 2020 meeting (**Section II** of this Agenda Item); and
- (b) Obtain the Board's direction on the Fraud Working Group's preliminary views on the issues and challenges identified to date with regard to specific requirements within ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* (**Section IV** of this Agenda Item).

Board Discussion:

The Working Group Chair and IAASB Staff will:

- (a) Provide an update to the Board on information-gathering and brainstorming activities performed since the August 2020 meeting.
- (b) Present the Fraud Working Group's preliminary views on specific issues and challenges identified in ISA 240 by stakeholders to date for IAASB discussion. The themes will be discussed as follows:
 - 1) #1, *Rebuttal of presumed risk of material misstatement due to fraud in revenue recognition.*
 - 2) #2, *Clarify the extent of journal entry testing required.*
 - 3) #3(a)-(b), *Supplemental audit requirements (additional to ISA 240) in other jurisdictions.*
 - 4) Themes #4-6.
 - 5) Themes #7-9.

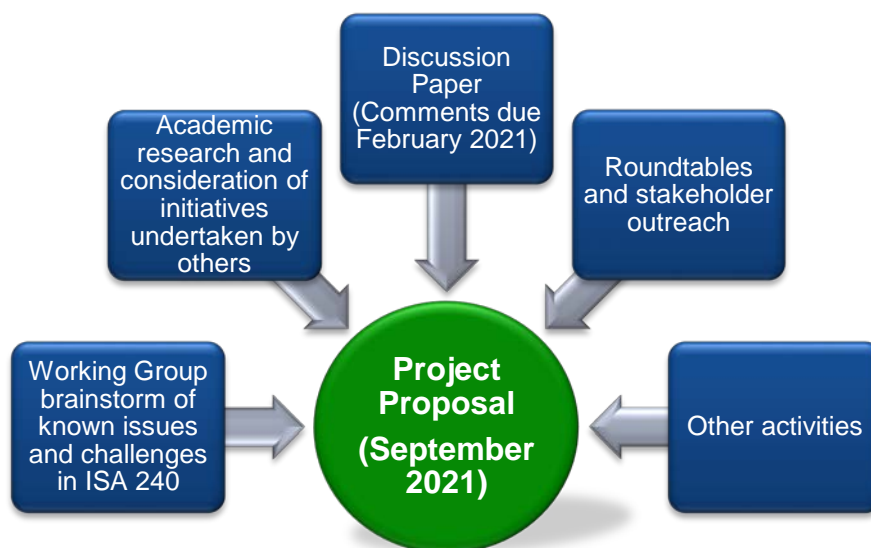
Lastly, the Working Group Chair will ask the Board whether there are any other matters the Fraud Working Group should consider as it continues with its information-gathering activities as they relate to ISA 240 and its requirements for the purposes of proposing a way forward in September 2021.

Appendix 3 sets out the names of the Fraud Working Group and its activities to date.

I. Introduction

1. Information gathering activities with regard to identified issues and challenges related to fraud are continuing. These information gathering activities are intended to assist the IAASB to better understand the root causes of the issues and challenges that have been identified so that any future activities by the IAASB are focused on the most appropriate actions to address them. These actions may include:

- (a) Standard-setting (i.e., either with regard to the requirements or application material).
 - (b) Development of non-authoritative materials.
 - (c) Other – which may include action by others in the financial reporting ecosystem. Although not in the remit of the IAASB's activities, it will be further considered whether the IAASB can encourage actions by others (for example through its global voice).
2. The diagram below depicts the various information-gathering activities being undertaken to ensure that the IAASB is as informed as it can be in considering recommendations of the Fraud Working Group, and when deciding on possible further actions in relation to fraud. The broad collection of information will assist with analyzing identified issues, determining recommendations and directing the development of a project proposal, that is targeted and appropriate, to be presented to the Board in September 2021.



Information Gathering Activities

3. At the August 2020 meeting, IAASB Staff presented [Agenda Item 1](#), which provided a summary of the completed and planned future information-gathering activities related to fraud in an audit of financial statements. Also, as part of Agenda Item 1, a draft Discussion Paper (DP), [Fraud and Going Concern in an Audit of Financial Statements: Exploring the Differences Between Public Perceptions About the Role of the Auditor and the Auditor's Responsibilities in a Financial Statement Audit](#) related to the expectation gap with regard to fraud and going concern was presented. The Board provided views regarding the form and content of the DP, and broadly supported the information-gathering activities undertaken and planned for the topic of fraud more broadly.
4. At the time of the August 2020 meeting, IAASB Staff had undertaken the following information-gathering activities. The Fraud Working Group will continue to monitor and engage regarding some of the specific developments mentioned below, as well as other or related developments that may arise:

- (a) **Project Inputs**—Feedback submitted on the topics of fraud and going concern through other completed or ongoing IAASB projects have been compiled, including to Auditing Accounting Estimates (ISA 540),¹ Auditor Reporting, ISA Implementation Monitoring,² ISA 315 (Revised 2019),³ Audits of Less Complex Entities, and the Strategy for 2020–2023 and Workplan for 2020–2021.
- (b) **Other Jurisdictional Inputs**—Considered results from reviews performed in other jurisdictions covering the topics of fraud and going concern in an audit of financial statements (e.g., the [Brydon](#) and [Kingman](#) reviews in the UK and the [2019 Fraud Thematic Review](#) in Canada).
- (c) **Academic Research**—An academic desktop review has been undertaken of relevant research related to the topics of fraud and going concern in an audit of financial statements. (See **Appendix 1**)
- (d) **NSS Outreach**—Liaised with representatives from the National Standard Setters (NSS) on the topic of fraud during the IAASB’s annual NSS meeting, discussing initiatives that are ongoing or recently completed in NSS jurisdictions.
- (e) **Targeted Outreach**—As a follow up from the NSS outreach, IAASB Staff met with representatives from Japan and the United Kingdom, respectively, to gather more information about (1) the separate fraud standard issued in Japan in 2013 and (2) the project underway in the UK to determine if changes are required to the fraud audit standard. Since that outreach discussion, the Financial Reporting Council in the UK published an Exposure Draft, [Proposed International Standard on Auditing \(UK\), 240 \(Revised 2021\), The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements](#) (UK ED) on a revised auditing standard for the auditor’s responsibilities relating to fraud.

II. Outreach Performed Since August 2020 Meeting

- 5. As a result of the information-gathering activities performed to date, IAASB Staff identified numerous themes that were divided into two categories: (1) broader themes where further outreach and consultation are considered necessary, and (2) themes related to specific requirements within ISA 240.
- 6. Themes where it was considered that further outreach and consultation on the topics would be helpful to better inform the IAASB about the issues and challenges that had been identified included:
 - (a) The ‘*expectation gap*’ with regard to fraud. This topic is the focus of the DP⁴ (see paragraphs 8–10 below). This topic was also the focus of the second roundtable (see paragraph 11).

¹ ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

² The IAASB’s ISA Implementation Monitoring Project was completed in July 2013 and was undertaken to determine whether further changes were needed to the ISAs arising from the IAASB’s Clarity project. Any [findings](#) as part of this review related to fraud have been included for consideration as part of the current initiative on fraud.

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

⁴ The DP and the roundtable also addressed the ‘*expectation gap*’ in relation to going concern to leverage the outreach and consultation with respect to obtaining more input with regard to the going concern information gathering activities.

- (b) The role of *technology* in relation to how fraud is perpetrated and how fraud audit procedures are performed. The first roundtable focused on this topic (see paragraph 11).
 - (c) The unique challenges faced by auditors of *less complex entities* (LCEs) in relation to fraud procedures. The third roundtable focused on this topic (see paragraph 11).
7. Themes related to specific requirements within ISA 240 are presented in **Section IV** of this Agenda Item in the context of an initial brainstorming session by the Fraud Working Group to form some preliminary views about how these could be addressed.

Discussion Paper

8. Subsequent to the August 2020 Board meeting, after considering comments received by the Board, the revised DP was published on September 15, 2020 with an original 120-day comment period (the due date for comments has recently been extended to February 1, 2021).⁵
9. The DP specifically focuses on the expectation gap, which in broad terms is the difference between public perceptions about the role of the auditor and the auditor's responsibilities under the standards relating to fraud and going concern in an audit of financial statements. Although there are different ways of describing the expectation gap, the Fraud Working Group is using the term to facilitate understanding more about the issues and challenges related to fraud, and has considered three components of the expectation gap: the "knowledge gap" (the difference between what the public thinks auditors do and what auditors actually do), the "performance gap" (where auditors do not do what auditing standards require), and the "evolution gap" (areas of the audit where there is a need for evolution).
10. The Fraud Working Group expects that the feedback received through the DP will further enhance the IAASB's understanding of identified issues and may draw attention to any further issues, as well as contribute to balancing views from an auditor perspective and from the perspective of other key players in the financial reporting ecosystem (including users of financial statements).

Virtual Roundtables

11. In addition to the DP, three virtual roundtables were held:
- (a) *Technology-Focused Fraud Roundtable*—Roundtable discussion on technological advancements in fraud perpetration and identification (held on September 2, 2020). This roundtable also explored forensic audits. Participants included forensic auditors, financial statement auditors, fraud audit methodology experts, third party audit solution companies, regulators, academics, and public sector representatives.
 - (b) *Expectation Gap and Auditor Reporting Roundtable*—Roundtable discussion on the differences between public perceptions about the role of the auditor and the auditor's obligations under the ISAs, including the topics set out in the DP. This roundtable also included a discussion on auditor reporting to understand whether the standards are consistently understood and implemented in a manner that achieves the IAASB's intended purpose in developing them (held on September 28, 2020). Participants included investors, analysts,

⁵ The original comments deadline of January 12, 2021 has recently been extended to February 1, 2021.

corporate governance experts, audit firms, academics, regulators, public sector representatives, and select others.

- (c) *Audit Procedures Related to Fraud and Going Concern in Audits of LCEs*—Roundtable discussion on the nature of fraud and going concern considerations in audits of LCEs and challenges that auditors face in applying audit requirements related to these topics (held on October 7, 2020). Participants included practitioners undertaking small- and medium-sized (SME) audits, audit methodology experts, third party audit solution companies, and representatives from professional accountancy bodies.
12. Summaries of the feedback from each of these roundtables, as well as the list of participants, are included in **Supplement 6-A, Summary of Key Takeaways from the IAASB Fraud and Going Concern Roundtables**.

Other Outreach Meetings

13. In addition to the roundtable events discussed above, the table below summarizes other outreach discussions held on the topic of fraud:

Outreach Group	Date Held	Details
Consultative Advisory Group (CAG)	September 9, 2020	See draft minutes from the CAG meeting included in Appendix 2 . ⁶
Canadian Public Accountability Board (CPAB)	October 2, 2020	CPAB is progressing work on the second phase of a fraud review project in Canada and provided some preliminary information regarding what they are hearing on this topic. For further details, refer to summary in Appendix 3 . A summary of the results of the first phase of their work, which included an evaluation of how auditors in Canada are complying with the fraud auditing standard, can be found here .
Forum of Firms (FoF)	October 6, 2020	IAASB Staff provided the FoF with an update regarding the information-gathering activities related to fraud and asked for broad feedback. The FoF was broadly supportive of the project and provided some additional feedback. For further details, refer to summary in Appendix 3 .
Center for Audit Quality (CAQ)	October 15, 2020	IAASB Staff provided the CAQ with high-level observations and take-aways from the three virtual IAASB roundtables discussed earlier in this document. For further details, refer to summary in Appendix 3 .
Accountancy Europe	October 29, 2020	Accountancy Europe provided the IAASB with an update on their project focused on fraud. IAASB Staff provided Accountancy Europe participants with high-level observations and take-aways

⁶ The CAG meeting minutes included in Appendix 2 are draft minutes, and therefore subject to change prior to final approval.

		from the three virtual IAASB roundtables discussed earlier in this document. For further details, refer to summary in Appendix 3 .
National Standard Setters (NSS)	November 3, 2020	IAASB Staff provided the NSS with high-level observations and take-aways from the three virtual IAASB roundtables discussed earlier in this document. For further details, refer to summary in Appendix 3 .

III. Financial Reporting Ecosystem

14. Based on the outreach efforts to date, the IAASB has consistently heard from stakeholders about the importance that all participants in the financial reporting ecosystem must play a role in helping narrow the expectation gap related to fraud. Although it has been acknowledged that standard-setting is an important part of this, there was encouragement for the IAASB to further consider what it could do to encourage others to act (it has been noted that because the IAASB has a ‘global voice’ it is well positioned to influence others).
15. The IAASB Chair, Staff and Working Group Chairs have also met with various investor groups, such as the CFA Institute and the South African Corporate Reporting Users’ Forum to obtain views on matters from investor groups, and to keep these groups updated on the IAASB’s efforts. The IAASB also plans to meet with the UK Corporate Reporting Users’ Forum in December 2020. As the information-gathering activities for fraud continue to progress, the IAASB Staff and others as relevant will continue to meet with investor groups and other key stakeholders to gather perspectives from all key participants in the financial reporting ecosystem.
16. Once comment letters to the DP are received in February 2021, the IAASB will assess and further consider how it can also interact with other stakeholders in the financial reporting ecosystem to encourage further action where needed on the issues raised that are outside the remit of the IAASB.

IV. Fraud Working Group Brainstorm Session on Issues and Challenges in ISA 240

17. From the information gathering activities to date, the matters identified relating to specific requirements within ISA 240 were discussed at a Fraud Working Group brainstorm session. Preliminary views that may be relevant in addressing the identified issues and challenges were deliberated (i.e., to identify recommendations regarding possible further actions), to prompt further discussion by the Board, as well as with IAASB stakeholders. as the Fraud Working Group progresses its work towards developing a project proposal. The Fraud Working Group also considered feedback obtained during the roundtables, outreach discussions, and findings from academic research while discussing each of the identified issues within ISA 240.
18. The Fraud Working Group discussed each requirement where issues and challenges have commonly been raised by the IAASB’s stakeholders. In doing so, consideration was given as to the most appropriate possible action by the IAASB (in the IAASB’s “toolkit”) to address the relevant issue or challenge. Identifying possible actions would help the Working Group determine those areas where standard-setting may be needed, and therefore help with the development of a project proposal in relation to fraud later in 2021. Accordingly, the Fraud Working Group formed a preliminary view on a direction forward with respect to each of the specific requirements where issues and challenges had

been identified. **The table below summarizes the issues and challenges identified and describes the preliminary views of the Fraud Working Group.**

19. The Fraud Working Group notes that these are preliminary views based on information-gathering and brainstorming activities performed to date. It is possible that additional matters relating to the auditor's responsibilities in relation to fraud more broadly or in relation to certain specific requirements within ISA 240 may be forthcoming from responses to the DP and ongoing outreach and monitoring of certain jurisdictional developments.⁷ Therefore, once the responses to the DP have been analyzed, the Fraud Working Group will reconsider if any of the preliminary views expressed below require modification or removal, or if new trends emerge that must be considered.
20. For purposes of indicating its preliminary views, the Fraud Working Group has categorized the possible actions to address the issues or challenges for specific requirements within ISA 240 as follows:
 - **Standard-setting (requirements)**—changes or enhancements to the requirements in the ISA.
 - **Application material**—additional application material developed to clarify or further explain application of the relevant requirement.
 - **Guidance**—Supporting materials developed outside of the ISAs, either in the form of non-authoritative materials developed by the IAASB or guidance developed by others (e.g., where it is outside the remit of the IAASB's work)
 - **Further outreach**—more information is required about the issues and challenges to better understand the root-cause so that an appropriate action can be determined.
 - **Actions for others**—although an issue or challenge has been identified, it does not relate to standard-setting and will need efforts from another participant in the financial reporting ecosystem to address it.

⁷ For example, the UK ED has not yet been discussed by the Fraud Working Group but will be considered as the project proposal for future IAASB action is developed.

#	Theme/Issue	Summary of Comments Received—Issues and Challenges	Possible Action(s)					Discussion Points from Fraud Working Group (WG) Meeting – Preliminary views regarding possible actions and related considerations
			Standard-Setting (requirements)	App. Material	Guidance	Further Outreach	Actions for Others	
1	Rebuttal of presumed risk of material misstatement due to fraud in revenue recognition⁸	<ul style="list-style-type: none"> The rebuttal of presumed risk of material misstatement due to fraud is often viewed as a high hurdle to meet. The work effort to support and document the rebuttal may not be well understood. Further clarification is needed around whether documentation for the rebuttal must address all assertions for all revenue streams. One commentor suggested removing the presumption of material misstatement due to fraud in revenue recognition. There is inconsistency in how firms apply the rebuttal. Some firms take the position that the presumption can never be rebutted, and others rebut the presumption without providing adequate rationale. A regulatory review in one jurisdiction found that about a quarter of audits inspected 	X	X	X			<ul style="list-style-type: none"> It would not be in the public interest to remove the presumed risk of material misstatement due to fraud in revenue recognition. While there are cases where it is appropriate to rebut the presumption, the fraud risk in revenue recognition is present in most entities. Therefore, auditors should start from the point of presumed risk and not inappropriately rebut such presumption. When rebuttal is appropriate, the rationale must be clear and adequately documented. Targeted changes to the requirements in the standard or the relevant application material may be made to enhance clarity about circumstances when rebuttal of the presumed risk of fraud in revenue recognition may be inappropriate or appropriate (including examples in this regard).

⁸ ISA 240, paragraphs 27 and A31

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		included a rebuttal of the risk of fraud in revenue recognition, which is higher than what was expected based on risk profiles of the audits. They also found that the rebuttal rate varied considerably across audit firms.						<ul style="list-style-type: none"> The relevant application material could be expanded to clarify the documentation required to support a rebuttal, in those circumstances when it was deemed appropriate. Non-authoritative guidance may also be issued to further assist auditors with application.
2	Clarify the appropriate nature and extent of journal entry testing required⁹	<ul style="list-style-type: none"> Comments indicate there is inconsistency in practice with regard to the nature and extent of journal entry testing performed. Clarity is needed around the nature and extent of journal entry testing required, including whether a risk-based approach is appropriate. Without proper focus on risk assessment, some teams may have large populations of journal entries that are flagged for testing (for example, identifying duplicate entries as a characteristic for testing without properly assessing upfront if duplicate entries truly 	X	X	X			<ul style="list-style-type: none"> Targeted changes to the requirements may be needed, and additional application material could further emphasize the risk assessment process, and how the results of the risk assessment should drive the journal entry testing approach (including appropriately focusing on those journal entries where fraud risks reside). The WG noted that some comments received reflect issues with implementation. The WG discussed that there may be inconsistency in the use of the term “journal entry” as the term may be used differently within entities or across audit

⁹ ISA 240, paragraphs 33(a), A42-A45

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		<p>present a fraud risk). This results in some teams choosing an arbitrary sub-selection of items for testing without valid rationale of why those were selected.</p> <ul style="list-style-type: none"> When many of the entity's journal entries have already been tested in a substantive audit approach, it is not clear how much additional testing is required. Entities' systems have evolved and have become much more sophisticated since the journal entry testing requirement first became effective in 2004. For example, some entities can post individual transactions to the general ledger by way of journal entries. Questions often arise on the nature of the journal entries to be tested (e.g., manual journal entries which may include year-end closing entries, reallocation entries, or other non-recurring or unusual entries) and on the work effort required to 						<p>teams. Although application material can be used to describe more precisely what the requirement is intended to cover, it may not necessarily go far enough. Therefore, non-authoritative guidance or other educational materials may be developed to assist with proper application. Specifically, guidance may clarify the various types of journal entries and where they fall within the financial reporting process (e.g. manual topside journal entries made to the financial statements as compared to recurring entries scheduled to post automatically in the general ledger), highlighting those types of journal entries at which this requirement is focused.</p> <ul style="list-style-type: none"> The WG discussed that journal entry testing is one area of the audit process where many firms are utilizing automated tools and techniques. Therefore, targeted changes may be required to modernize the standard to reflect the use of technology in this area.

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		test the completeness of those journal entries.						<ul style="list-style-type: none"> In addition, non-authoritative support materials may be useful in this area (for example, prepared in coordination with the IAASB Technology Working Group). <div> <p>Roundtable Feedback Considered</p> <p><i>(See Supplement 6-A for further details)</i></p> <ul style="list-style-type: none"> Auditors often use automated tools and techniques to test journal entries. New tools and technologies allow for more sophisticated visualization of entire populations of journal entries. With these new tools, auditors can more effectively profile the journal entries and target populations to test based on certain risk characteristics Verification of the completeness and accuracy of underlying data can be challenging. </div>

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3	Supplemental audit requirements (additional to ISA 240) in other jurisdictions	<ul style="list-style-type: none"> Based on feedback from national standard setters, the following jurisdictions are those that have additional requirements in their local equivalent fraud standards beyond what is currently required by ISA 240 (and beyond targeted changes for local laws and regulations): <ul style="list-style-type: none"> Japan United States¹⁰ For further details, see 3(a) and 3(b) below. 	For further details, see 3(a) and 3(b) below.					
3(a)	Supplemental audit requirements (additional to ISA 240) in other	The primary additional audit requirements in Japan's "Standard to Address Risks of Fraud in an Audit" (Japanese fraud standard) (which is only applicable for listed entities and certain unlisted entities) are ¹¹ :	X	X		X		<ul style="list-style-type: none"> The notion of requiring enhanced procedures only in certain circumstances (such as how the Japanese standard requires enhanced procedures when certain circumstances are identified that indicate the possibility of a material misstatement due to fraud) may be an

¹⁰ The UK is currently consulting on enhancements to its equivalent standard to ISA 240.

¹¹ The following are two of the basic concepts underlying the Japanese fraud standard: (1) the standard is not intended to change the purpose of the financial statement audit nor intended to expose fraud, and (2) the standard is not intended to uniformly require additional specified audit procedures to respond to risks of fraud in all financial statement audits. The Japanese fraud standard is based on the concept of a risk-based approach. Further details of the basic concepts underlying the Japanese fraud standard can be found [here](#).

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	jurisdictions (Japan)	<p>Emphasis on professional skepticism: the auditor is required to exercise increased professional skepticism in determining whether there is any suspicion of a material misstatement due to fraud and in performing the audit procedures to address such a suspicion.</p> <ul style="list-style-type: none"> • If the auditor identifies during the audit any circumstances that indicate the possibility of a material misstatement due to fraud, described as examples in Appendix 2 in Standard to Address Risks of Fraud, the auditor shall make inquiries of, and ask for explanations from, management and perform additional audit procedures in order to determine whether there is a suspicion of a material misstatement due to fraud. • A Suspicion of Material Misstatement Due to Fraud: When the auditor has determined that management's explanations, together with the audit evidence obtained relevant thereto, are not considered reasonable in relation to a certain circumstance that 						<p>appropriate way to respond to stakeholder feedback on the expectation gap related to fraud. For example, if it is determined that forensic-type procedures may be helpful at various stages of the audit or in certain circumstances, it may be appropriate to consider requiring forensic procedures in those certain circumstances. The WG will further consider the enhancement to the Japanese fraud standard to inform the direction forward (some of these matters have been noted in the DP, therefore stakeholder views on these matters may also further inform the Fraud Working group and the IAASB's future deliberations on these matters).</p>

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		<p>indicates the possibility of a material misstatement due to fraud, or if the auditor is unable to obtain sufficient appropriate audit evidence related to the assessed risk of fraud, even after performing additional audit procedures that the auditor determined necessary as a result of performing the audit procedure originally designed in response to the assessed risk of fraud, the auditor shall treat it as a suspicion of a material misstatement due to fraud. When the auditor has concluded not to treat a circumstance as a suspicion of a material misstatement due to fraud, the auditor shall include in the audit documentation the conclusion and the rationale for that conclusion.</p> <p>Requirements for auditors when an auditor concluded that a “suspicion of a material misstatement due to fraud” exists:</p> <ul style="list-style-type: none"> The auditor shall modify the audit plan to include audit procedures that are specifically responsive to the types of possible fraud 						

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		<p>(including sufficient investigation related to such suspicion, in order to obtain sufficient appropriate audit evidence)</p> <ul style="list-style-type: none"> The enhanced engagement quality control review is required, in regard to the auditor's responses to the "suspicion of a material misstatement due to fraud" The auditor shall not express an audit opinion until the Enhanced engagement quality control review (EQCR) is completed <p>In addition, the new fraud standard requires firms to establish policies and procedures that explicitly address the risks of fraud in the elements of the quality control system (i.e., leadership responsibilities for quality within the firm, acceptance and continuance of client relationships and audit engagements, human resources, engagement performance, and monitoring).</p>						

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3(b)	Supplemental audit requirements (additional to ISA 240) in other jurisdictions (US)	<p>The primary additional audit requirements in the US equivalent standard (AU-C Section 240, <i>Consideration of Fraud in a Financial Statement Audit</i>) are:</p> <ul style="list-style-type: none"> Some of the paragraphs included as application material in ISA 240 are elevated to requirements in the AU-C Section 240 standard, including: <ul style="list-style-type: none"> Fraud brainstorming considerations Inquiries of internal audit AU-C Section 240 requires the auditor to assess accumulated results of audit procedures when forming a conclusion (in addition to conclusion analytics). AU-C Section 240 requires additional inquiries and procedures over related parties and significant transactions. 				X		<ul style="list-style-type: none"> The WG noted that firms often require engagement teams to perform these procedures already. However, the WG will consider these additional requirements to determine whether changes to the standard are necessary.
4	Other audit procedures	<ul style="list-style-type: none"> Some commentators noted that auditors tend to design procedures over all assertions of 			X	X		<ul style="list-style-type: none"> The requirements to respond to management override and supporting application material

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	required in response to risk of management override of controls beyond journal entry testing (separately addressed in theme #2)¹²	<p>provisions, estimates and revenue streams as opposed to targeting where the risks really are.</p> <ul style="list-style-type: none"> Some commentators questioned whether the risk of management override of controls always needs to be a significant risk Some raised concerns that the extent of testing required is not clear and there is inconsistency across firms in the procedures performed around accounting estimates and significant transactions. Some firms rebut risk of management override inappropriately. 						<p>remain appropriate and are sufficiently clear. Non-authoritative guidance or other educational material may be developed to help provide clarification around the nature and extent of testing required in response to the risk of management override of controls.</p> <ul style="list-style-type: none"> There may however be a need to enhance the standard by including more on the identification of risks of material misstatement arising from management override of controls (paragraphs 26-28 of ISA 240 do not specifically address this), which should then flow better with the responses as they are currently required within the standard.

¹² ISA 240, paragraphs 32-34

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								<p>Roundtable Feedback Considered</p> <p>(See Supplement 6-A for further details)</p> <ul style="list-style-type: none"> Participants questioned whether the procedures in ISA 240 to respond to the risk of management override of controls are effective in all audits – for example, some procedures to test journal entries in audits of LCEs may not be as effective.
5	Clarity around procedures required when fraud is suspected or identified¹³	<ul style="list-style-type: none"> Some commentors asked for clarification with regard to the required procedures when fraud is identified or suspected, including how much needs to be done to confirm or refute that suspicion. One commentor asked for clarification on auditor considerations when withdrawing from the engagement. 				X		<ul style="list-style-type: none"> Withdrawing from the audit engagement is usually not in the public interest and the WG discussed how certain jurisdictions are driving legislation to prohibit withdrawal. Based on outreach performed with the NSS group (summarized in Appendix 3), the WG learned that various jurisdictions still have restrictions on when auditors can withdraw, but others have no restrictions or prohibitions.

¹³ ISA 240, paragraphs 36-39 and A52-A58

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			Standard-Setting (requirements)	App. Material	Guidance	Further Outreach	Actions for Others	
								<ul style="list-style-type: none"> The WG will assess responses from the DP to help inform whether changes are needed in relation to the audit requirements when fraud is identified or suspected.
6	Fraud brainstorming¹⁴	<ul style="list-style-type: none"> Comments received discussed the use of specialists, including forensic specialists, in the engagement team discussion performed as part of the risk assessment process. One external publication stated the need to be cautious of “groupthink” in engagement team discussions and that audit standard setters should draft the language in the standard in such a way that eliminates engagement team bias as much as possible. One external publication provides examples of topics that may be discussed during the engagement team meeting to ensure proper 		X	X			<ul style="list-style-type: none"> The WG will assess responses from the DP to help inform whether changes are necessary in relation to requiring the use of forensic specialists or other specialists in the risk assessment process. Additional application material, non-authoritative guidance or other educational materials may be developed to clarify examples of discussion topics that may be covered during the engagement team discussion (including the risk assessment procedures that inform such discussion) to properly focus on the risk of material misstatement due to fraud.

¹⁴ ISA 240, paragraphs 16, A11-A12

#	Theme/Issue	Summary of Comments Received—Issues and Challenges	Possible Action(s)					Discussion Points from Fraud Working Group (WG) Meeting – Preliminary views regarding possible actions and related considerations
			Standard-Setting (requirements)	App. Material	Guidance	Further Outreach	Actions for Others	
		focus on the risk of material misstatement due to fraud.						<p>Roundtable Feedback Considered</p> <p>(See Supplement 6-A for further details)</p> <ul style="list-style-type: none"> A more robust discussion about the fraud risk factors that are relevant to the nature and circumstances of the engagement is required.
7	Unpredictability procedures¹⁵	<ul style="list-style-type: none"> Some commentors stated it can be difficult to determine unpredictability procedures to perform, particularly in audits where most accounts are already selected for substantive testing One commentor stated it may be useful if regulators publish periodic reports that describe the types of unpredictability procedures that are performed in the audits they inspect. 		X	X		X	<ul style="list-style-type: none"> Application material may be enhanced, or non-authoritative guidance may be developed to provide further examples of the types of procedures that may be considered to incorporate unpredictability, beyond what is currently in the application material for ISA 240.

¹⁵ ISA 240, paragraphs 30(c) and A37

#	Theme/Issue	Summary of Comments Received—Issues and Challenges	Possible Action(s)					Discussion Points from Fraud Working Group (WG) Meeting – Preliminary views regarding possible actions and related considerations
			Standard-Setting (requirements)	App. Material	Guidance	Further Outreach	Actions for Others	
								<p>The WG agrees it may be helpful for regulators to publish educational material to highlight the types of unpredictability procedures they see in practice.</p> <div> <p>Roundtable Feedback Considered</p> <p><i>(See Supplement 6-A for further details)</i></p> <ul style="list-style-type: none"> The notion of unpredictability is important in audits of all entities but can be difficult in audits of smaller entities where procedures are already performed in most or all areas of the financial statements. </div>
8	Whistleblower hotline	<ul style="list-style-type: none"> Some commentators suggested adding a requirement that auditors evaluate management's risk management program for fraud risk (e.g. whistleblower hotlines) External research indicates most fraud is identified through tips or whistleblower complaints. 			X	X		<ul style="list-style-type: none"> The WG noted that it may be challenging to make updates to the standard given that there are different rules and regulations across jurisdictions as it relates to whistleblower complaints (e.g., access to information, privacy and confidentiality requirements). However, there also was a view expressed that the WG should revisit this matter to more fully consider possible options/alternatives.

#	Theme/Issue	Summary of Comments Received—Issues and Challenges	Possible Action(s)					Discussion Points from Fraud Working Group (WG) Meeting – Preliminary views regarding possible actions and related considerations
			Standard-Setting (requirements)	App. Material	Guidance	Further Outreach	Actions for Others	
								<ul style="list-style-type: none"> Non-authoritative guidance or other educational material may be developed to emphasize the consideration of a whistleblower hotline (or other method of collecting whistleblower tips or complaints) in an auditor's risk identification process. <p>The WG discussed that not all entities will have the resources available for a whistleblower hotline, although they may have other policies or procedures in place, such as designating who is notified of tips or complaints relating to (possible) fraud.</p> <div> <p>Roundtable Feedback Considered</p> <p><i>(See Supplement 6-A for further details)</i></p> <ul style="list-style-type: none"> Less complex entities often have less anti-fraud controls (e.g. whistleblower hotlines, internal audit function, etc.). High-profile fraud cases are often not identified by auditors, but by others (for example, short sellers or whistleblowers). </div>

9	Emphasize certain fraud risks more clearly in ISA 240¹⁶	<ul style="list-style-type: none"> One commentor indicated a need to emphasize certain fraud risks more clearly in ISA 240. 		X				<ul style="list-style-type: none"> The list of fraud risk factors in Appendix 1 to ISA 240 may need to be revisited to ensure the factors are relevant and up-to-date, and to determine if any additional factors should be added based on academic research findings, stakeholders outreach activities and materials that may have been developed at a global or jurisdictional level. <div data-bbox="1444 558 2060 1057"> <p><u>Roundtable Feedback Considered</u></p> <p><i>(See Supplement 6-A for further details)</i></p> <ul style="list-style-type: none"> Fraud risk factors in LCEs are often different to fraud risk factors in more complex entities Certain fraud risk factors are more prevalent in LCEs because pressures, opportunities and rationalizations are different <ul style="list-style-type: none"> For example, there are often less employees so less segregation of duties Certain fraud risk factors may be less prevalent <ul style="list-style-type: none"> For example, journal entries posted outside of normal business hours </div>
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¹⁶ ISA 240, Appendix 1, Examples of Fraud Risk Factors

V. Other Topics to Be Further Considered:

21. Other specific aspects of ISA 240 that have also been highlighted (e.g., at the roundtables or in other outreach) but that have not yet been explored as part of the identified issues and challenges in the table in Section IV, above, are listed below. These will be further considered and discussed once responses to the DP have been received. Some of these topics overlap with matters discussed in the DP, while others do not. These topics include but are not limited to:
- Possible addition of a ‘stand back’ requirement in ISA 240.
 - Possible requirements around forensic-type procedures in certain circumstances in relation to the auditor’s procedures with regard to fraud.
 - Enhancements to requirements with regard to the exercise of professional skepticism, and consideration of the notion of a ‘suspicious mindset’ in certain circumstances.
 - Enhanced procedures relating to non-material fraud.
 - More bespoke transparency in the auditor’s report related to the auditor’s responsibilities and findings with regard to fraud.
 - Consideration of any possible changes to ISA 250¹⁷ and ISA 260¹⁸ as it relates to the fraud workstream (i.e., there are aspects of fraud that relate to these standards).
 - Consideration of requirements about how management assess risks related to fraud and the controls they have in place to address those risks (i.e., management’s risk assessment process with a focus on fraud risks).
 - Enhanced linkage to other ISAs.
 - Changes and enhancements from the UK’s ED on ISA 240 (UK) to consider whether any changes in the ED would be appropriate to ISA 240 to address the challenges and issues that have been identified at a global level.

Matters for IAASB Consideration

1. The Board is asked for its direction on the preliminary views expressed for the themes detailed in the table in **Section IV** above relating to specific ISA 240 requirements.
2. The Board is asked whether there are any other matters the Fraud Working Group should consider as it continues with its information-gathering activities as they relate to ISA 240 and its requirements for purposes of proposing a way forward in September 2021.

Supplements to this Paper

Supplement	Description
6-A	<i>Summary of Key Takeaways from the IAASB Fraud and Going Concern Roundtables.</i>

¹⁷ ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*

¹⁸ ISA 260 (Revised), *Communication with Those Charged with Governance*

Appendix 1

Academic Research and Other Literature Review—Fraud

Introduction

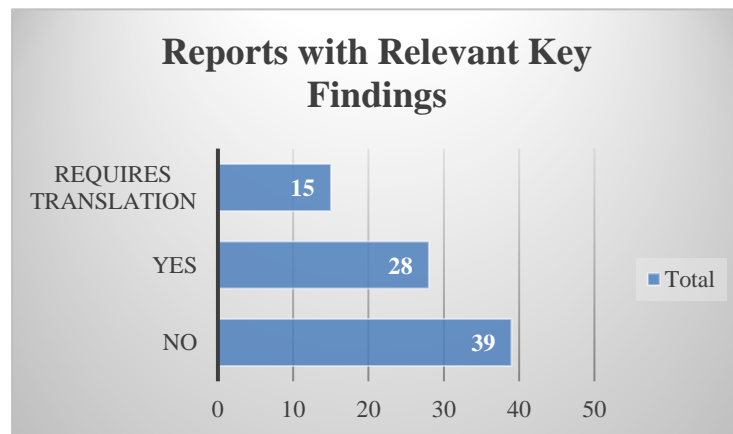
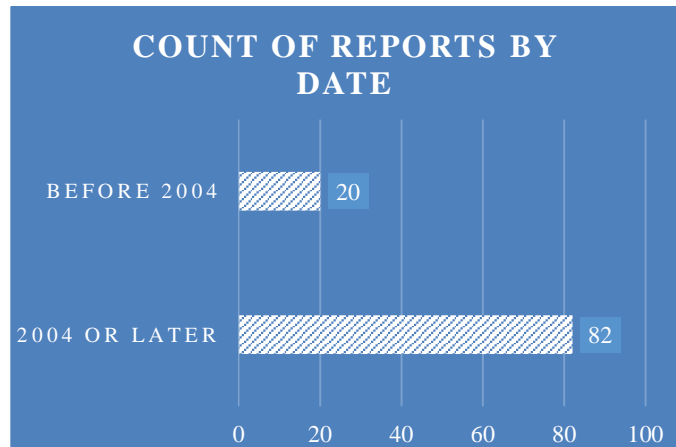
The purpose of this appendix is to present a summary of the academic research performed on this topic to date. This appendix:

- (a) Outlines the scope of the academic research and other literature review undertaken by IAASB Staff to date; and
- (b) Identifies key findings and aspects of the academic research and other literature review relevant for the fraud information gathering activities.

Scope of the Academic Research and Other Literature Review

The compilation of the initial list of research was outsourced to a team of researchers from the University of Dayton, School of Business Administration and Department of Accounting. This initial list was compiled by searching for published studies which either in their abstract, or in their title available on electronic databases accessed via the internet, included key words on a range of issues around fraud and/or International Standard on Auditing (ISA) 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*.

To this initial list of research, certain other published studies and literature were added based on feedback from Board members who represent the academic community (Professors Roger Simnett and Kai Uwe-Marten). From this list, 20 reports were scoped out because they predated the last major revision to ISA 240 in 2004.



Of the remaining 82 reports, 15 were in a non-English language and have not yet been analyzed as they require translation. 28 reports were determined to have findings that presented new information and were relevant to standard setting and the objectives of this fraud initiative.

The following pages summarize key findings included in the relevant reports, organized by theme.

Key Findings from Academic Research

Theme	Findings
Collusion	<p>According to a study presented in the 2020 ACFE Report to the Nations, 51% of frauds were committed by two or more fraudsters working in collusion. Losses tended to increase with multiple perpetrators—particularly when three or more individuals conspired to commit fraud. One reason collusive frauds might be more costly is that multiple fraudsters working together might be better able to undermine the systems of separated duties and independent verification that are at the heart of many anti-fraud controls.</p> <p>According to academic report "<i>The Role of Power in Financial Statement Fraud Schemes</i>", while the fraud triangle explains why a single individual becomes involved in financial statement fraud, the theory does not inform us as to how large groups of individuals become involved. The fraud triangle is limited in that it only provides a psychological glimpse of a single person's perceptions, and why he or she may choose to participate in fraudulent behavior through pressure, opportunity, and rationalization.</p> <p>This academic report presents the following propositions which link types of power to the components of the fraud triangle:</p> <p><u>Personal Power and its Relation to the Fraud Triangle:</u></p> <ol style="list-style-type: none"> 1. The more personal power that an individual has, the less likely he or she is to perceive external pressure to perpetrate a financial statement fraud. 2. The more personal power that an individual has, the more likely he or she is to perceive an opportunity to perpetrate a financial statement fraud. 3. The more personal power that an individual has, the more likely he or she will develop rationalizations for perpetrating a financial statement fraud. <p><u>Types of Social Power Most Effective to Drive Collusion in Each Component of Fraud Triangle</u></p> <ol style="list-style-type: none"> 4. Reward power (ability to convince potential co-conspirator that he or she will be rewarded for participation) and coercive power (ability to make the potential co-conspirator perceive punishment if they don't participate) are the most effective forms of social power that may be used to apply pressure on potential co-conspirators. 5. Expert power (ability of the conspirator to use influence through means of expertise or knowledge) and legitimate power (ability of Person A to convince Person B that A truly does have real power over them) are the most effective forms of social power that may be used to increase the perception of opportunity for potential co-conspirators. 6. Referent power (ability of the conspirator to relate to the target of influence (co-conspirators)), legitimate power, and expert

	power are the most effective forms of social power that may be used to help potential co-conspirators form satisfactory rationalizations regarding fraudulent behavior.
Corporate Culture	<p><u>Academic report "Corporate Culture and the Occurrence of Financial Statement Fraud: A Review of Literature"</u></p> <ul style="list-style-type: none"> > Culture refers to values that are shared by the people in a group and that tend to persist over time even when group membership changes. > The paper references a study that states employees take their cues from the top. The character of the CEO and other top officers is generally reflected in the character of the entire company.
Expectation gap	<p><u>Academic report "Understanding Auditors' Sense of Responsibility for Detecting Fraud Within Organizations"</u></p> <ul style="list-style-type: none"> > The primary objectives of this study were to evaluate auditors' perceived responsibility for fraud detection and how this perceived responsibility affects the auditors' fraud brainstorming procedures. The study included both internal and external auditors. <p>Key Findings were:</p> <ul style="list-style-type: none"> > Auditors who were held accountable (i.e. asked to provide their information and who were told their responses were subject to review) reported significantly more fraud detection responsibility than anonymous participants. This supports a theory that responsibility flows from accountability. > External auditors report significantly lower detection responsibility than internal auditors for misappropriation of assets and corruption. The detection responsibility reported for financial statement fraud was about equal for internal and external auditors. > There was a positive relationship between perceived detection responsibility and number of fraud-related audit procedures brainstormed. <p><i>"Our review of the extant literature related to policy and practice suggests an implicit assumption that accounting professionals internalize fraud detection responsibility standards as prescribed. However, this study's results indicate the need for policymakers and accounting professionals to evaluate this assumption and consider potential implications of a "responsibility gap" in future policymaking and training sessions. For example, our findings suggest that external auditors could benefit from additional guidance to help them interpret and operationalize authoritative fraud detection standards and supporting guidance."</i></p>
Financial analysis used to identify indication of fraud factors	<p>Academic research has found the following models and ratios to prove effective in identifying companies with financial statement fraud (though not with 100% accuracy):</p> <ul style="list-style-type: none"> > Beneish M-score (statistical model that uses financial ratios calculated with accounting data of a specific company in order to check if it is likely (high probability) that the reported earnings of the company have been manipulated) > Benford's Law (the comparison of the actual frequency of some digits in different positions in a data set to the expected frequency)

Fraud risk assessment	<p>Some academic reports provided findings related to which fraud risk factors were most tied to the occurrence of financial statement fraud. Some of the factors (among many others) described in the reports are:</p> <ul style="list-style-type: none"> > fast growth rate or unusual profitability, especially compared to that of other companies in the same industry; > recurrent negative cash flow from operating activities or inability to generate cash from operations, while at the same time reporting profit and profit growth; > substantial transactions with related parties or special purpose entities which are unusual for the company's business or with enterprises and organizations that are audited by another company; > substantial and unusual or complicated transactions, especially ones concluded towards the end of the reporting period and therefore posing complex questions as to the application of substance over form rule; > unusual increase in the number of days for turnover of accounts receivable from sales; > substantial volume of sales to entities whose substance and ownership are unknown; > unusual impetus in the sales of a small number of assets within the company or sales accounted for by the head office of the company
Internal Controls	<p>One study (<i>Internal Control Weaknesses and Financial Reporting Fraud</i>) finds a statistically and economically significant association between material weaknesses and the future revelation of fraud. This association is driven entirely by instances where the internal control issue reflects a general opportunity to commit fraud (as captured by entity-level material weaknesses) rather than account- or process-specific control deficiencies.</p>
Less Complex Entities	<p>One study (<i>Financial Reporting Fraud: Public and Private Companies</i>) reveals that public companies have stronger anti-fraud environments, are more likely to have frauds that involve timing differences, tend to experience larger frauds, have frauds that involve a larger number of perpetrators, and are less likely to have frauds that are discovered by accident. It states that overall, it appears that the stronger anti-fraud environment in public companies leads public company financial reporting fraud perpetrators to use less obvious fraud methods (i.e., timing differences) and to involve larger fraud teams to circumvent the controls. These public company frauds are larger than in private companies, and their larger size may make them more likely to be detected through formal means, rather than by accident.</p>

Professional Skepticism	<p>The report titled <i>Professional Skepticism: The Effects of a Partner's Influence and the Presence of Fraud on Auditors' Fraud Judgments and Actions</i> concludes that partner emphasis (i.e., a partner's emphasis on professional skepticism) significantly influences auditors' fraud risk assessments.</p> <p>The report titled "<i>The Effect of Fraud Risk Assessment Frequency and Fraud Inquiry Timing on Auditors' Skeptical Judgements and Actions</i>" studied the following:</p> <ol style="list-style-type: none"> 1 - Inward-directed skepticism - process by which auditors consider the fallibility of their own judgments. The study found that all participants exhibit heightened skepticism when re-evaluating fraud risk for a second time. 2 - Consideration of whether fraud inquiries of operational-level employees <u>prior to substantive procedures</u> could serve as a useful priming tool to improve skeptical evaluation of evidence and encourage adjustments to subsequent audit procedures. The study found that it does, but only if the auditors also exhibited higher levels of trait skepticism (an individual characteristic, acknowledging that some individuals may be inherently more or less skeptical than others).
Technology	<p>Technology developments include data mining, ERP (Enterprise Resource Planning software), business intelligence tools, and dedicated software like XBRL (Extensible Business Reporting Language).</p> <p>Data analytics may provide a more effective and efficient fraud examination. With the newest analytical techniques and modern ERP systems and databases, it is now possible to efficiently examine an entire database and identify those transactions that indicate further detailed testing.</p>
Third party fraud	<p>An article titled "Financial Statement Fraud by External Parties" reviews real fraud cases and presents the following list of lessons learned related to third party fraud:</p> <ol style="list-style-type: none"> 1 - Auditors may not be giving adequate attention to the serious risks that external parties pose for unauthorized acquisition, use or disposition of an organization's assets that have a material effect on its financial statements. 2 - Auditors should identify and evaluate country, business and entity risks. Red flags = countries known for corruption, lack of controls, impossibly consistent returns on investments, using small unknown audit firms 3 - Auditors should not ignore the prominence of the potential perpetrator. 4 - Auditors should recognize the limitations of the fraud triangle. Even if only one or two conditions of the fraud triangle are present, this may be enough to trigger an audit response. 5 - Auditors should focus on the opportunities for fraud created by control deficiencies. 6 - Auditors should brainstorm fraud potential and challenge quality of evidence from confirmations.

<p>Unpredictability procedures</p>	<p>The report titled "<i>Increase your fraud auditing effectiveness by being unpredictable</i>" gives examples of unpredictability procedures:</p> <ul style="list-style-type: none"> • Random sampling – the use of random numbers for sample selection means that every item has an equal chance of selection, thereby making it impossible for a fraudster to determine which items will be selected • Unannounced inventory observation – observation of inventory on an unannounced basis means inventory cannot be shifted to a location just to fool auditors. • Changing the timing of audit procedures – an auditor who normally confirms accounts receivable at fiscal year-end but shifts the date to two months prior to fiscal year-end, might catch a fraud that is normally concealed in receivables but is shifted to a different account at fiscal year-end because of anticipated year-end confirmation of receivables • Changing the audit technique from prior years – if the prior year technique was to test a sample of transactions which were posted to the account and that technique is switched to an analytical test which compares the account activity to production data, the latter might be more effective in spotting a fraud. • Test some low risk accounts – selection of low risk accounts which are ordinarily not tested might spot items which were buried there because of the perceived low risk of the account being tested. • Test some small accounts – a fraud could be spread over several small accounts which are perceived as unlikely to be tested because of their size. • Apply Benford's Law – Nigrini (1999) explains how large populations can be tested via Benford's law to see if suspicious items reside in the population according to a statistical law which evaluates the frequency of certain numbers occurring. This test is a standard feature in many generalized audit software packages such as ACLe (ACL Desktop/Network Edition, 2004). • Observe operations discretely – an auditor might make some interesting observations by sitting across the street from a business location and recording information such as customer traffic counts or vendor deliveries. • Sample "Whistleblower" files – audit time could be devoted to reviewing auditee files, paper or electronic, regarding whistleblower complaints received. • Use Generalized Audit Software – audit software, such as ACLTM (ACL Desktop/Network Edition, 2004), can be used to test large electronic files for items such as duplicate payments, duplicate invoices, or identical addresses for multiple employees or vendors. A fraudster might think these would be undetectable in files with hundreds of thousands of records.
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	<ul style="list-style-type: none"> • Apply detailed analytical analysis – use a graphical display of daily data such as number and dollar amount of transactions or number and dollar amount of journal entries for key cycles or processes. Abnormal amounts are much easier to spot in a graphical display and this procedure directly addresses the risk of management override. • Embed a software monitor in the auditee’s system – the auditor can design and embed (with the client’s permission) a software program that encrypts and record key data, such as daily shipments made, for the auditor’s later retrieval and analysis • Visit internet chat groups for the auditee’s stock – chat groups frequently include company employees who own stock. These individuals may talk about operational or other issues that an auditor should be aware of. • Obtain relevant external data – an auditor might visit auditee customers to discretely discuss or observe if factors such as “channel stuffing” or product quality appear to be an issue. • Examine auditee customer correspondence files – customer problems with service or products can be determined by looking at customer correspondence files.
Examples of types of fraud	<p>Some academic reports go through the most common types of fraud. For example, one study lists the following are the most common fraud cases:</p> <ol style="list-style-type: none"> (1) Falsification of primary and consolidated records (2) Falsification, intentional manipulation or altering of accounting entries used to prepare FS (3) Concealment of transactions, failure to record such transactions in primary documents and accounting records/financial statements (4) Unauthorized recording of transactions in primary documents and entry into accounting records and financial statements (entry of transactions that have not been actually performed) (5) Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation or disclosure (6) Deliberately incorrectly developed accounting policy (7) Intentional supply of incorrect information on transactions and/or corporate operational status (8) Deliberately inaccurate forecasts and estimates of financial indicators (9) Asset misappropriation (theft) and embezzlement

<p>Overall - Synthesis of fraud research</p>	<p>Key points from a report titled "<i>A Synthesis of Fraud-Related Research</i>"</p> <ol style="list-style-type: none"> 1 - Personality traits are a major fraud risk factor. Suggest auditors evaluate the ethics of management when assessing fraud risk. Also, another researcher (Hobson) concludes there is an association between vocal dissonance markers in earnings calls and financial misreporting (which may be useful in fraud inquiry/interview procedures). 2 - Block and Griffin (2002) and McBarnet (2006), using case studies, discuss the role of social networks and social systems that are necessary to carry out nefarious schemes. They highlight the roles of “enablers” of bad acts (fraud and financial crime) such as attorneys and accountants in promoting such activities. They state it may be helpful for the profession and the PCAOB, as well as academic researchers, to consider these findings and reflect on them in developing effective risk assessments. 3 - With globalization, registrants are increasingly doing business in lesser developed and developing countries where cultural norms and local corporate ethics do not always align with U.S. or Western concept of ethics. This can increase fraud risk. In that vein, Corporations that operate as multinational entities should establish general principles to help managers of adapt and work in conflicting cultural climates 4 - Weak corporate governance is associated with a greater likelihood of fraudulent reporting 5 - Research shows that fraudsters tend to be repeat offenders (CEOs previously charged with fraud are likely to be charged again). 6 - Whistleblower programs are an effective tool in the prevention and detection of fraud, though only if employees feel safe from retaliation 7 - The most common fraud technique was improper revenue recognition (61 percent of the 347 companies). Overstatement of assets was the second most common fraud technique (51 percent), followed by understatement of expenses/liabilities (31 percent) and misappropriation of assets (14 percent). 8 - Beasley et al.'s (2010) report on fraudulent financial reporting found that inventory was the most common asset account used to perpetrate a fraud, followed by accounts receivable and property, plant, and equipment. 9 - Brainstorming best practices - quality is higher when the brainstorming session occurs early in the audit process and when IT specialists attend (Brazel 2010) Also, having a partner or forensic specialist lead the session is best practice. 10 - Professional skepticism - Hammersley et al. (2010) provides evidence that reminding auditors about fraud brainstorming session before they evaluate evidence provides a means to reinforce fraud mindset 11 - One report (Bowlin 2011) supports a need for procedures over non-material fraud (i.e. focusing on lower-risk accounts since managers may commit fraud there knowing that auditors don't typically look there)
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Appendix 2

DRAFT CONSULTATIVE ADVISORY GROUP (CAG) MEETING MINUTES, SEPTEMBER 2020¹⁹

Fraud and Going Concern (Agenda Item F)

Fraud and Going Concern

- To *RECEIVE* an update on the information-gathering activities of the IAASB Staff with regard to fraud and going concern

Ms. Jackson introduced the topics. Ms. Donnelly provided an overview of the information gathering and targeted outreach activities completed to date by the IAASB staff and also provided an overview of the planned future activities with regards to these topics. Ms. Donnelly invited feedback from the Representatives on the information presented.

Representatives broadly expressed support for the IAASB's work on fraud and going concern and commented as follows:

- Mr. Dalkin noted that auditors might benefit from a stand-back that requires them to consider all facts collectively and 'see the big picture,' as opposed to only looking at the details. Mr. Dalkin added that if auditors had done this in some of the more high-profile frauds in recent years, they may have identified 'red flags.' Ms. Landell-Mills agreed, emphasizing the importance of auditors standing back and maintaining a questioning mindset in order to deliver an opinion as to a true and fair view, as opposed to solely delivering a compliance opinion. She added that a stand-back requirement already exists in the UK, and noted that they are now assessing if and how transparency can be enhanced with regards to the procedures the auditor performs in order to deliver a true and fair view, including stand back procedures.
- Ms. Landell-Mills highlighted concern with use of the phrase "Expectation Gap," noting that it presumes the fault lies with those who hold the expectations (i.e., users of financial statements). She added that the issue may lie with auditors too, for example, through a delivery gap, where auditors fail to deliver what is expected. Messrs. Munte, and Orth and Ms. Robert agreed that the use of the phrase "Expectation gap" could be misleading. However, Mr. Orth encouraged the IAASB staff to continue to explore these concepts in a structured approach. Ms. Jackson responded that we intend to take a structured approach and have incorporated this in the IAASB's Discussion Paper. Ms. Jackson added that the IAASB had used information gathering activities to frame and define the expectation gap in the IAASB Discussion Paper, which includes three components: the knowledge gap, the performance gap and the evolution gap. She further explained that the performance gap is where auditors do not do what is required by the standards; the knowledge gap is where there is a difference between what people believe auditors do and the reality of what the standards require; and the evolution gap is where there is a need for change based on evolving expectations.
- Ms. McGeachy emphasized the importance of coordination with the International Accounting Standards Board (IASB). She also expressed that the SMP Advisory Group would respond to the IAASB's Discussion Paper issued on these topics.
- Ms. Robert also agreed on the importance of coordination with the IASB, but highlighted that the ISAs

¹⁹ These draft CAG meeting minutes are subject to change prior to final approval.

also apply where IFRS is not used as the applicable financial reporting framework. She also emphasized the importance of considering the entire financial reporting ecosystem as there are other participants who may need to do more to narrow the gap, including management and those charged with governance. Ms. Donnelly responded that in the IAASB's Discussion Paper, the IAASB discusses the importance of the broader financial reporting ecosystem in helping narrow the expectation gap.

- Mr. Rees acknowledged support for continued coordination between the IAASB and the IASB on the topic of going concern and pointed out that going concern is not currently on the IASB's active agenda. Mr. Rees explained that over the past few months, IASB stakeholders have raised questions on going concern disclosures as well as what basis of preparation is required when a company is not a going concern. Mr. Rees explained that there are some who think there should be more specific disclosures in the International Financial Reporting Standards (IFRS) framework, which will be discussed at a national standard setters meeting later in September 2020. Mr. Rees explained that the IASB will perform its agenda consultation to gather views from stakeholders on whether their active agenda remains appropriate, which will help the IASB determine whether going concern should become more of an agenda priority.
- Ms. Wei noted that forming a diverse group of working group members from across the globe would be helpful to consider environment factors in capital markets globally.
- Mr. Munter encouraged the IAASB to steer the conversation on these topics to help users and auditors themselves understand the objectives and responsibilities of auditors. Mr. Munter noted that the IAASB should focus on what an audit is, as opposed to what it is not. Mr. Munter also expressed concern that as more activities are migrated to a remote approach in the current environment, there may be a negative impact on the auditor's assessment of corporate culture and tone at the top due to lack of face-to-face conversations and in-person interactions which may offer valuable information through tone and body language. Mr. Munter added that this is particularly important since high-profile frauds are often related to an auditor's failure to identify issues with corporate culture and tone at the top.
- Ms. Manabat questioned whether the IAASB could brief the CAG on the highlights of the fraud-focused technology roundtable that occurred on September 2, 2020. Ms. Donnelly responded that the IAASB will summarize the highlights in a future publication that will be shared with the CAG once complete.
- Mr. Yoshii highlighted that the knowledge gap may be narrowed through increased dissemination and transparency of information related to the audit.
- Mr. De Tullio questioned what the end goal of these initiatives are, i.e., whether the IAASB is aiming to revise the auditing standards or promote education for the readers of the financial statements. Ms. Bahlmann responded that the information-gathering activities will help inform the direction the IAASB's future activities, including whether standard setting is necessary or not. She added that at this point no decisions had yet been made.

PIOB OBSERVER'S REMARKS

- Mr. Kashiwagi expressed support for this initiative and expressed that it is very important and timely from a public interest perspective. Mr. Kashiwagi commented that the PIOB is very interested in the views that will be expressed in response to the discussion paper. He also noted his interest in whether

the IASB will add the going concern issue as a project on their agenda.

WAY FORWARD

Ms. Jackson thanked Representatives for their feedback. Ms. Donnelly explained that the IAASB will be provided with an update on the fraud initiative at the December 2020 meeting and the going concern initiative at the February 2021 meeting, and the CAG will receive an update on both fraud and going concern activities at the March 2021 meeting.

Appendix 3

Other Matters

Fraud Working Group

1. The work with respect to the fraud initiative was initially undertaken by IAASB Staff and Fiona Campbell, Chair of the Fraud Working Group.
2. The Fraud Working Group more formally commenced its activities in quarter 4 of 2020 and met twice by videoconference. Members of the Fraud Working Group are:
 - Fiona Campbell, IAASB Deputy Chair and Chair of the Working Group
 - Len Jui, IAASB member and incoming Deputy Chair of the IAASB
 - Julie Corden, IAASB member
 - Imran Vanker, IAASB member
 - Fabien Cerutti, IAASB Technical Advisor
3. Information about the Fraud Working Group members and the project can be found [here](#).

Summary of Other Outreach Meetings

The following provides a high-level summary of the topics discussed at the following outreach discussions related to fraud in an audit of financial statements:

Canadian Public Accountability Board (CPAB) – Meeting Held on October 2, 2020	
<u>CPAB Attendees:</u> <ul style="list-style-type: none"> • Carol Paradine, Chief Executive Officer • Jeremy Justin, Chief Risk Officer & VP Strategy • Stacy Hammett, Senior Director • Juzar Pirbhai – Director, Stakeholder Engagement • Angelo Giardina – Director, Thought Leadership 	<u>IAASB Attendees:</u> <ul style="list-style-type: none"> • Josephine Jackson, IAASB Member • Beverley Bahlmann, IAASB Deputy Director • Angela Donnelly, IAASB Staff Fellow
<u>Details of Discussion:</u> <ol style="list-style-type: none"> 1. CPAB is progressing work on the second phase of a fraud thematic review in their jurisdiction and provided some preliminary information regarding what they are hearing on this topic. The following provides a high-level overview of the discussions: <ol style="list-style-type: none"> (a) CPAB is focused on gathering information on fraud, going concern, professional skepticism, and emerging issues in the current environment. They have formed working groups (with representation from audit firms and standard setters) to hear perspectives and recommendations to improve audit agility and confidence in corporate reporting. (b) CPAB shared some of the topics they have heard from their stakeholders, which overlap with some of the matters included in the IAASB DP. (c) CPAB is in the early stages of this work and will set up further outreach calls with the IAASB in future to share knowledge as the work progresses. 	

2. A summary of the results of the first phase of their work, which included an evaluation of how auditors in Canada are complying with the Canadian fraud auditing standard, is linked [here](#).

Forum of Firms (FoF) - Meeting Held on October 6, 2020 (Agenda Item D – Fraud & Going Concern)

Attendees:

- Representatives from the [Forum of Firms](#)

IAASB Attendees:

- Josephine Jackson, IAASB Member
- Beverley Bahlmann, IAASB Deputy Director
- Angela Donnelly, IAASB Staff Fellow

Details of Discussion:

The IAASB Staff provided the FoF with an update regarding the information-gathering activities related to fraud. The FoF was broadly supportive of the project, noting the importance of work in this area. Participants emphasized the importance of the entire financial reporting ecosystem in addressing the expectation gap with regard to fraud. They emphasized that the issues and challenges will not be addressed by standard-setting alone, highlighting that the rest of the financial reporting ecosystem must also engage to bring about broad comprehensive change that is needed.

Center for Audit Quality (CAQ) - Meeting Held on October 15, 2020

Attendees:

- Julie Bell Lindsay, Executive Director
- Catherine Ide, Vice President of Professional Practice and Member Services
- Vanessa Teitelbaum, Senior Director of Professional Practice
- Dennis McGowan, Senior Director of Professional Practice
- Yuri Zwick, Professional Practice Fellow

IAASB Attendees:

- Tom Seidenstein, IAASB Chair
- Willie Botha, IAASB Technical Director
- Beverley Bahlmann, IAASB Deputy Director
- Natalie Klonaridis, IAASB Principal
- Angela Donnelly, IAASB Staff Fellow

Details of Discussion:

The IAASB Staff provided the CAQ with high-level observations from the three virtual IAASB roundtables held on the topics of fraud and going concern.

The CAQ informed the IAASB that they are in process of developing their response to the IAASB Discussion Paper. They discussed that many of the issues described in the Discussion Paper are consistent with issues they have heard through their outreach discussions in the United States.

Accountancy Europe - Meeting Held on October 29, 2020	
<u>Attendees:</u> <ul style="list-style-type: none"> • Hilde Blomme, Deputy CEO, Accountancy Europe • Harun Saki, Manager, Professional Expertise, Accountancy Europe • Johan Rippe, PwC Partner • Sebastien Lasou, PwC Partner • Andreas Wemelt, Deloitte • Andrew Hobbs, EY Partner • Peter Gath, EY Partner • Matt Laing, EY Manager • David Herbinet, Mazars Global Head of Audit • Marianne van Kimmenade, NBA 	<u>IAASB Attendees:</u> <ul style="list-style-type: none"> • Fiona Campbell, IAASB Deputy Chair • Beverley Bahlmann, IAASB Deputy Director • Angela Donnelly, IAASB Staff Fellow
<u>Details of Discussion:</u> <p>Accountancy Europe provided the IAASB with an update on their project related to fraud, which they noted is mainly focused on public interest entities. They provided a summary of some of the issues they have heard from their stakeholder outreach:</p> <ul style="list-style-type: none"> • It was highlighted that the auditor's procedures are meant to address 'error and fraud' but that many of the procedures undertaken focus on finding material misstatements arising from 'errors' with fraud as an afterthought. • In areas where many auditors are already going above what the standard requires with regard to fraud, it may be appropriate to elevate some of those best practices to requirements. • All participants in the financial reporting ecosystem have a role to play in narrowing the expectation gap. • It may be appropriate to require forensic specialists when certain circumstances arise or exist, but stakeholders are cautious about requiring forensic specialists in all audits. <p>The IAASB Staff provided Accountancy Europe participants with high-level observations from the three virtual IAASB roundtables held on the topics of fraud and going concern.</p>	

National Standard Setters - Meeting Held on November 3, 2020	
<u>Attendees:</u> <ul style="list-style-type: none"> • Representatives from national audit standard setters attending the IAASB-NSS meeting 	<u>IAASB Attendees:</u> <ul style="list-style-type: none"> • Tom Seidenstein, IAASB Chair • Willie Botha, IAASB Technical Director • Fiona Campbell, IAASB Deputy Chair • Beverley Bahlmann, IAASB Deputy Director • Angela Donnelly, IAASB Staff Fellow

Details of Discussion:

IAASB Staff provided the NSS with high-level observations and take-aways from the three virtual IAASB roundtables described earlier in this document.

The focus of the discussions was on three topics that were discussed at the Fraud Working Group brainstorm meeting where the Fraud Working Group felt more understanding was needed:

- (1) Whether withdrawal from an engagement is prohibited in their jurisdiction;
- (2) NSS views on whether more is needed with regard to non-material fraud; and
- (3) Whether the group had views on the concept of a suspicious mindset, and whether that differs from professional skepticism.

The NSS provided the following views:

- Different jurisdictions had different requirements for withdrawal from engagements – certain territories have restrictions on when this can be done, and others have no restrictions.
- Auditors should focus on qualitative aspects of materiality in addition to quantitative aspects of materiality but should not be expected to search for non-material fraud.
- Regardless of the term that is used (suspicious mindset or increased professional skepticism, for example), the profession should try to determine how to better apply professional skepticism and encourage skeptical behavior in the right circumstances.

The NSS also commented that they agree with feedback received that the entire financial reporting ecosystem must play their part to effectively narrow the expectation gap. They also supported continued dialogue between the IAASB and accounting standard setters.