

2021

INTERNATIONAL STANDARD ON  
AUDITING (IRELAND) 240  
(Revised October 2021)

The Auditor's Responsibilities Relating  
to Fraud in an Audit of Financial  
Statements



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## Mission

To contribute to Ireland having a strong regulatory environment in which to do business by supervising and promoting high quality financial reporting, auditing and effective regulation of the accounting profession in the public interest.

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**INTERNATIONAL STANDARD ON AUDITING (IRELAND) 240**  
**(REVISED OCTOBER 2021)**

**THE AUDITOR'S RESPONSIBILITIES RELATING TO**  
**FRAUD IN AN AUDIT OF FINANCIAL STATEMENTS**

(Effective for audits of financial statements for periods commencing on or after 15 December 2021)

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International Standard on Auditing (Ireland) (ISA (Ireland)) 240 (Revised October 2021), *The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements* should be read in conjunction with ISA (Ireland) 200 (Updated December 2018), *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (Ireland)*.

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## Introduction

### Scope of this ISA (Ireland)

1. This International Standard on Auditing (Ireland) (ISA (Ireland)) deals with the auditor's responsibilities relating to fraud in an audit of financial statements. Specifically, it expands on how ISA (Ireland) 315 (Revised October 2020)<sup>1</sup> and ISA (Ireland) 330 (Revised August 2018)<sup>2</sup> are to be applied in relation to risks of material misstatement due to fraud.

### Characteristics of Fraud

2. 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 and involves deception or is unintentional.
3. Although fraud is a broad legal concept, for the purposes of the ISAs (Ireland), the auditor is concerned with fraud or suspected fraud that causes a material misstatement in the financial statements. Two types of intentional misstatements are relevant to the auditor – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets. Judgements about whether an identified misstatement is material involve both qualitative and quantitative considerations. For example, an identified fraud or suspected fraud 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 (e.g. where it gives rise to concerns about the integrity of management responsible for the entity's system of internal control or the controls relevant to the preparation of the financial statements). Although the auditor may suspect or, in rare cases, identify the occurrence of fraud, the auditor does not make legal determinations of whether fraud has actually occurred. (Ref: Para. A1–A6)

### Responsibility for the Prevention and Detection of Fraud

4. The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. 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 detection and punishment. This involves a commitment to creating a culture of honesty and ethical behavior which can be reinforced by an active oversight by those charged with governance. Oversight by those charged with governance includes considering 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 influence the perceptions of analysts as to the entity's performance and profitability.

### *Responsibilities of the Auditor*

5. An auditor conducting an audit in accordance with ISAs (Ireland) is responsible for

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<sup>1</sup> ISA (Ireland) 315 (Revised October 2020), *Identifying and Assessing the Risks of Material Misstatement*.

<sup>2</sup> ISA (Ireland) 330 (Revised August 2018), *The Auditor's Responses to Assessed Risks*.

obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. Owing to the inherent limitations of an audit, 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 (Ireland).<sup>3</sup>

6. As described in ISA (Ireland) 200 (Updated December 2018),<sup>4</sup> the potential effects of inherent limitations are particularly significant in the case of misstatement resulting from fraud. The risk of not detecting a material misstatement resulting from fraud may be higher than the risk of not detecting one resulting from error. This is where fraud may have involved 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 is affected by 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. 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.
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.
  - 7-1. While, as described above, 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 responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement due to fraud. Reasonable assurance is a high, but not absolute, level of assurance<sup>4a</sup>.
8. When obtaining reasonable assurance, the auditor is responsible for maintaining professional skepticism throughout the audit, considering the potential for management override of controls and recognizing the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud. The requirements in this ISA (Ireland) are designed to assist the auditor in identifying and assessing the risks of material misstatement due to fraud and in designing procedures to detect such misstatement.
  - 8a. The auditor may have additional responsibilities under law, regulation or relevant ethical requirements regarding an entity's non-compliance with laws and regulations,

<sup>3</sup> ISA (Ireland) 200 (Updated December 2018), *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (Ireland)*, paragraphs A51–A53.

<sup>4</sup> ISA (Ireland) 200 (Updated December 2018), paragraph A51.

<sup>4a</sup> ISA (Ireland) 200 (Updated December 2018), paragraph 5.

including fraud, which may differ from or go beyond this and other ISAs (Ireland), such as: (Ref: Para. A5a)

- (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;
- (b) Communicating identified or suspected non-compliance with laws and regulations to other auditors (e.g. in an audit of group financial statements); and
- (c) Documentation requirements regarding identified or suspected non-compliance with laws and regulations.

Complying with any additional responsibilities may provide further information that is relevant to the auditor's work in accordance with this and other ISAs (Ireland) (e.g., regarding the integrity of management or, where appropriate, those charged with governance).

### Effective Date

9. This ISA (Ireland) is effective for audits of financial statements for periods commencing on or after 15 December 2021, early adoption is permitted.

### Objectives

10. The objectives of the auditor are:
  - (a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement due to fraud, including:
    - (i) Identifying and assessing the risks of material misstatement of the financial statements due to fraud;
    - (ii) Obtaining sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and
  - (b) To respond appropriately to fraud or suspected fraud identified during the audit.

### Definitions

11. For purposes of the ISAs (Ireland), the following terms have the meanings attributed below:
  - (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.
  - (b) Fraud risk factors – Events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud.



## Requirements

### Professional Skepticism

12. In accordance with ISA (Ireland) 200 (Updated December 2018),<sup>5</sup> the auditor shall maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance. (Ref: Para. A7–A8)
- 12-1. The auditor shall undertake risk assessment procedures and design and perform further audit procedures in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory. (Ref: Para. A7-1)
13. 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 record or 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. A9)
- 13-1. The auditor shall remain alert for conditions that indicate a record or document may not be authentic. (Ref. Para A9-1)
14. Where responses to inquiries of management, those charged with governance or others within the entity are inconsistent, or appear implausible, the auditor shall investigate the reasons.

### Related Parties

- 14-1. In obtaining audit evidence regarding the risks of material misstatement due to fraud the auditor shall comply also with the relevant requirements in ISA (Ireland) 550<sup>5a</sup>.

### Discussion among the Engagement Team

15. ISA (Ireland) 315 (Revised October 2020) requires a discussion among the engagement team members and a determination by the engagement partner of which matters are to be communicated to those team members not involved in the discussion.<sup>6</sup> This discussion shall place particular emphasis on how and where the entity's financial statements (including the disclosures) 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. A10–A11)
- 15-1. The discussion shall include an exchange of ideas among engagement team members about fraud risk factors, including incentives for management or others within the entity to commit fraud, how management could perpetrate and conceal fraudulent financial reporting, and how assets of the entity could be misappropriated.
- 15-2. For a group audit, the discussion among the group engagement team shall include matters to discuss with the component auditor of a significant component about the

<sup>5</sup> ISA (Ireland) 200 (Updated December 2018), paragraph 15.

<sup>5a</sup> ISA (Ireland) 550, *Related Parties*

<sup>6</sup> ISA (Ireland) 315 (Revised October 2020), paragraphs 17-18.

susceptibility of the component to material misstatement of the financial information of that component due to fraud<sup>6a</sup>.

- 15-3. If allegations of fraud come to the auditor's attention, the discussion shall include how to investigate and respond to those allegations.
- 15-4. The engagement partner shall determine whether further discussion(s) among members of the engagement team be held at later stages in the audit to consider fraud risk factors that have been identified during the course of the audit and the implications for the audit. (Ref: Para. A11-1)

### **Risk Assessment Procedures and Related Activities**

16. When performing risk assessment procedures and related activities required by ISA (Ireland) 315 (Revised October 2020), to obtain an understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control, the auditor shall perform the procedures in paragraphs 17–24-1 below to obtain information for use in identifying the risks of material misstatement due to fraud. This shall include obtaining an understanding of the fraud risk factors relevant to the entity that affect the susceptibility of assertions to material misstatement due to fraud.

#### *Management and Others within the Entity*

17. The auditor shall obtain an understanding of, and make inquiries of management regarding:
- (a) Management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments; (Ref: Para. A12–A13)
  - (b) Management's process for identifying and responding to the risks of fraud in the entity, including any specific risks of fraud that management has identified or that have been brought to its attention, or classes of transactions, account balances, or disclosures for which a risk of fraud is likely to exist; (Ref: Para. A14)
  - (c) Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity; and
  - (d) Management's communication, if any, to employees regarding its views on business practices and ethical behavior.
18. The auditor shall make inquiries of management, and others within the entity as appropriate, to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity. (Ref: Para. A15–A17-1)
- 18-1. In making the determination in paragraph 18, the auditor shall also make inquiries of management, or others within the entity as appropriate, who deal with allegations, if any, of fraud raised by employees or other parties. (Ref. Para A16-1)
19. For those entities that have an internal audit function, the auditor shall make inquiries of appropriate individuals within the function to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain

<sup>6a</sup> ISA (Ireland) 600 (Revised November 2020), *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*, paragraph 30(b).

its views about the risks of fraud. (Ref: Para. A18)

#### *Those Charged with Governance*

20. Unless all of those charged with governance are involved in managing the entity,<sup>7</sup> the auditor shall obtain an understanding of how 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 mitigate these risks. (Ref: Para. A19–A21)
21. Unless all of those charged with governance are involved in managing the entity, the auditor shall make inquiries of those charged with governance to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity. These inquiries are made in part to determine whether the responses of those charged with governance corroborate or contradict the responses to the inquiries of management.
- 21-1. When obtaining an understanding and making inquiries of those charged with governance in accordance with paragraphs 20 and 21, the auditor shall discuss with those charged with governance the risks of fraud in the entity, including those that are specific to the entity's business sector. (Ref: Para. A20-1)
- 21-2. If the responses to inquiries of those charged with governance, or others within the entity, are inconsistent with the responses to the inquiries of management, the auditor shall determine the implications for the audit in accordance with ISA (Ireland) 500 (Updated December 2018)<sup>7a</sup>.

#### *Unusual or Unexpected Relationships Identified*

22. The auditor shall evaluate whether unusual or unexpected relationships that have been identified in performing analytical procedures required by ISA (Ireland) 315 (Revised October 2020)<sup>7b</sup>, including those related to revenue accounts, may indicate risks of material misstatement due to fraud. (Ref: Para. A21-1)

#### *Other Information*

23. The auditor shall consider whether other information obtained by the auditor indicates risks of material misstatement due to fraud. (Ref: Para. A22)

#### *Evaluation of Fraud Risk Factors*

24. The auditor shall evaluate whether the information obtained from the other risk assessment procedures and related activities performed indicates that one or more fraud risk factors are present. While 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. (Ref: Para. A23–A27)
- 24-1. The auditor shall determine whether the engagement team requires specialized skills or knowledge to perform the risk assessment procedures, to identify and assess the

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<sup>7</sup> ISA (Ireland) 260 (Revised November 2020), *Communication with Those Charged with Governance*, paragraph 13.

<sup>7a</sup> ISA (Ireland) 500 (Updated December 2018), *Audit Evidence*, paragraph 11.

<sup>7b</sup> ISA (Ireland) 315 (Revised October 2020), paragraph 14(b).

risks of material misstatement due to fraud, to design and perform audit procedures to respond to those risks, or to evaluate the audit evidence obtained. (Ref. Para A27-1, A34)<sup>7c</sup>

### Identification and Assessment of the Risks of Material Misstatement Due to Fraud

25. In accordance with ISA (Ireland) 315 (Revised October 2020), the auditor shall identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures.<sup>8</sup>
26. 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, evaluate which types of revenue, revenue transactions or assertions give rise to such risks. Paragraph 47 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. (Ref: Para. A28–A30)
27. The auditor shall treat those assessed risks of material misstatement due to fraud as significant risks and accordingly, to the extent not already done so, the auditor shall identify the entity's controls, that address such risks, and evaluate their design and determine whether they have been implemented.<sup>9</sup> (Ref: Para. A31–A32)

### Responses to the Assessed Risks of Material Misstatement Due to Fraud

#### *Overall Responses*

28. In accordance with ISA (Ireland) 330 (Revised August 2018), the auditor shall determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level.<sup>10</sup> (Ref: Para. A33)
29. In determining overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level, the auditor shall:
  - (a) Assign and supervise personnel taking account of the knowledge, skill and ability of the individuals to be given significant engagement responsibilities and the auditor's assessment of the risks of material misstatement due to fraud for the engagement; (Ref: Para. A34–A35)
  - (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 or key performance indicators; and
  - (c) Incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures. (Ref: Para. A36)

<sup>7c</sup> See also ISA (Ireland) 220 (Revised November 2020), paragraph 14.

<sup>8</sup> ISA (Ireland) 315 (Revised October 2020), paragraph 28.

<sup>9</sup> ISA (Ireland) 315 (Revised October 2020), paragraph 26(a)(i) and 26(d).

<sup>10</sup> ISA (Ireland) 330 (Revised August 2018), paragraph 5.

*Audit Procedures Responsive to Assessed Risks of Material Misstatement Due to Fraud at the Assertion Level*

30. In accordance with ISA (Ireland) 330 (Revised August 2018), the auditor shall design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement due to fraud at the assertion level.<sup>11</sup> (Ref: Para. A37–A40)

*Audit Procedures Responsive to Risks Related to Management Override of Controls*

31. 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.
32. Irrespective of the auditor's assessment of the risks of management override of controls, the auditor shall design and perform audit procedures to:
- (a) Test the appropriateness of manual or automated journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements, including consolidation adjustments in the preparation of group financial statements.<sup>11a</sup> In designing and performing audit procedures for such tests, the auditor shall:
    - (i) Make inquiries of individuals with different levels of responsibility involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;
    - (ii) Select journal entries and other adjustments made at the end of a reporting period and post-closing entries; and
    - (iii) Consider the need to test journal entries and other adjustments throughout the period. (Ref: Para. A41–A44)
  - (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:
    - (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
    - (ii) Perform a retrospective review of management judgments and assumptions related to significant accounting estimates reflected in the financial statements of the prior year. (Ref: Para. A45–A47)

<sup>11</sup> ISA (Ireland) 330 (Revised August 2018), paragraph 6.

<sup>11a</sup> ISA (Ireland) 600 (Revised November 2020), paragraph 34.

- (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 other information 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. A48)

32-1. In obtaining and evaluating audit evidence regarding possible management bias in making accounting estimates, the auditor shall also comply with the relevant requirements in ISA (Ireland) 540 (Revised December 2018)<sup>11b</sup>.

- 33. 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 32).

**Evaluation of Audit Evidence** (Ref: Para. A49)

33-1. If the auditor identifies a misstatement due to fraud or suspected fraud, the auditor shall determine whether specialized skills or knowledge are needed to investigate further for the purposes of the audit. (Ref: Para A48-1)

- 34. 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 previously unrecognized risk of material misstatement due to fraud. (Ref: Para. A50)

- 35. If the auditor identifies a misstatement, the auditor shall obtain an understanding of how the misstatement arose and evaluate whether such a misstatement is indicative of fraud. If there is such an indication, the auditor shall evaluate the implications of the misstatement in relation to other aspects of the audit, particularly the reliability of management representations, recognizing that an instance of fraud is unlikely to be an isolated occurrence. (Ref: Para. A51)

- 36. If the auditor identifies a misstatement, whether material or not, and the auditor has reason to believe that it is or may be the result of fraud and that management (in particular, senior management) is involved, the auditor shall reevaluate the assessment of the risks of material misstatement due to fraud and its resulting impact on the nature, timing and extent of audit procedures to respond to the assessed risks. The auditor shall also consider whether circumstances or conditions indicate possible collusion involving employees, management or third parties when reconsidering the reliability of evidence previously obtained. (Ref: Para. A52)

36-1. In applying ISA (Ireland) 330 (Revised August 2018)<sup>11c</sup>, based on the audit procedures performed and audit evidence obtained, the auditor shall evaluate before the conclusion of the audit whether:

- (a) The assessments of the risks of material misstatement at the assertion level

<sup>11b</sup> ISA (Ireland) 540 (Revised December 2018), *Auditing Accounting Estimates and Related Disclosures*, paragraphs 23(b), 24(b), 25(b), 32, 32D-1, 33(a), 39(d).

<sup>11c</sup> ISA (Ireland) 330 (Revised August 2018), paragraphs 25-26.

due to fraud remain appropriate; and

- (b) Sufficient appropriate audit evidence has been obtained regarding the assessed risks of material misstatement due to fraud,

and shall conclude whether, the financial statements are materially misstated as a result of fraud.

In making this evaluation the auditor shall take into account all relevant audit evidence obtained, whether corroborative or contradictory.

37. 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 evaluate the implications for the audit. (Ref: Para. A53)

### **Auditor Unable to Continue the Engagement**

38. 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:

- (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 persons who made the audit appointment or, in some cases, to regulatory authorities;
- (b) Consider whether it is appropriate to withdraw from the engagement, where withdrawal is possible under applicable law or regulation; and
- (c) If the auditor withdraws:
  - (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
  - (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. A54–A57)

### **Written Representations**

39. The auditor shall obtain written representations from management and, where appropriate, those charged with governance that:
- (a) They acknowledge their responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud and that they believe they have appropriately fulfilled those responsibilities;
  - (b) 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;
  - (c) They have disclosed to the auditor their knowledge of fraud or suspected fraud affecting the entity involving:
    - (i) Management;
    - (ii) Employees who have significant roles in internal control; or

- (iii) Others where the fraud could have a material effect on the financial statements; and
- (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. A58–A59)

### **The Auditor's Report**

39-1. As required by ISA (Ireland) 700 (Revised November 2020), the auditor's report for audits of public interest entities and listed entities shall explain to what extent the audit was considered capable of detecting irregularities, including fraud<sup>11d</sup>. This explanation shall be specific to the circumstances of the audited entity and take account of how the auditor planned and performed procedures to address the identification and assessment of the risks of material misstatement.

### **Communications to Management and with Those Charged with Governance**

- 40. 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. A59a–A60)
- 41. Unless all of those charged with governance are involved in managing the entity, if the auditor has identified or suspects fraud involving:
  - (a) management;
  - (b) employees who have significant roles in internal control; or
  - (c) others where the fraud results in a material misstatement in the financial statements,

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. A59a, A61–A63)

41R-1. For audits of financial statements of public interest entities, when an auditor suspects or has reasonable grounds to suspect that irregularities, including fraud with regard to the financial statements of the entity, may occur or have occurred, the auditor shall, unless prohibited by law or regulation, inform the entity and invite it to investigate the matter and take appropriate measures to deal with such irregularities and to prevent any recurrence of such irregularities in the future. (Ref: Para. A59a-1, A63, A63-1)

- 42. 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. In doing so, the auditor shall consider the matters, if any, to communicate regarding management's process for identifying and

<sup>11d</sup> ISA (Ireland) 700 (Revised November 2020), *Forming an Opinion and Reporting on Financial Statements*, paragraph 29-1.



responding to the risks of fraud in the entity and the auditor's assessment of the risks of material misstatement due to fraud. (Ref: Para. A59a, A64)

### Reporting Fraud to an Appropriate Authority Outside the Entity

43. If the auditor has identified or suspects a fraud, the auditor shall determine whether law, regulation or relevant ethical requirements: (Ref: Para. A65–A67)
- (a) Require the auditor to report to an appropriate authority outside the entity.
  - (b) Establish responsibilities under which reporting to an appropriate authority outside the entity may be appropriate in the circumstances.

43R-1. For audits of financial statements of public interest entities, where the entity does not investigate the matter referred to in paragraph 41R-1, the auditor shall inform the authorities responsible for investigating such irregularities. (Ref: Para. A66-1–A66-2)

### Documentation

44. The auditor shall include the following in the audit documentation<sup>12</sup> of the identification and the assessment of the risks of material misstatement required by ISA (Ireland) 315 (Revised October 2020):<sup>13</sup>
- (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;
  - (b) The fraud risk factors and the identified and assessed risks of material misstatement due to fraud at the financial statement level and at the assertion level; and
  - (c) Identified controls in the control activities component that address assessed risks of material misstatement due to fraud.
45. 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 (Ireland) 330 (Revised August 2018):<sup>14</sup>
- (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
  - (b) The results of the audit procedures, including those designed to address the risk of management override of controls.

45-1. As required by ISA (Ireland) 230<sup>14a</sup>, if the auditor identified information that is inconsistent with the auditor's final conclusion regarding a significant matter, the auditor shall document how the auditor addressed the inconsistency.

46. The auditor shall include in the audit documentation communications about fraud made

<sup>12</sup> ISA (Ireland) 230 (Updated December 2018), *Audit Documentation*, paragraphs 8–11, and paragraph A6.

<sup>13</sup> ISA (Ireland) 315 (Revised November 2020), paragraph 38.

<sup>14</sup> ISA (Ireland) 330 (Revised August 2018), paragraph 28.

<sup>14a</sup> ISA (Ireland) 230 (Updated December 2018), paragraph 11.

to management, those charged with governance, regulators and others.

47. 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.

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## **Application and Other Explanatory Material**

### **Characteristics of Fraud (Ref: Para. 3)**

- 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:
- 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.
  - 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.
  - Individuals may be able to rationalize committing a fraudulent act. Some individuals possess an attitude, 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.
- 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.
- A3. Fraudulent financial reporting may be accomplished by the following:
- Manipulation, falsification (including forgery), or alteration of accounting records or supporting documentation from which the financial statements are prepared.
  - Misrepresentation in, or intentional omission from, the financial statements of events, transactions or other significant information.

- Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure.
- 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:
- Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.
  - Inappropriately adjusting assumptions and changing judgments used to estimate account balances.
  - Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period.
  - Omitting, obscuring or misstating disclosures required by the applicable financial reporting framework, or disclosures that are necessary to achieve fair presentation.
  - Concealing facts that could affect the amounts recorded in the financial statements.
  - Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.
  - Altering records and terms related to significant and unusual transactions.
  - Altering reports that would highlight inappropriate activity or transactions.
  - Exploiting inadequate IT process controls over IT applications, including controls over and review of IT application event logs (for example, where users can access a common database using generic access identification, or modify access identification, to conceal activity)<sup>14b</sup>.
  - 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).
- 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:
- Embezzling receipts (for example, misappropriating collections on accounts receivable or diverting receipts in respect of written-off accounts to personal bank accounts).
  - 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).

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<sup>14b</sup> ISA (Ireland) 315 (Revised October 2020), Appendix 5, provides further matters that the auditor may consider in understanding the entity's use in of IT in its system of internal control.

- 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).
- 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).

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.

## **Responsibility for the Prevention and Detection of Fraud**

*Responsibilities of the Auditor* (Ref: Para. 8a)

A5a. Law, regulation or relevant ethical requirements may require the auditor to perform additional procedures and take further actions. For example, the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (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 to other auditors within a group, including a group engagement partner, component auditors or other auditors performing work at components of a group for purposes other than the audit of the group financial statements.<sup>15</sup>

A5a-1 In Ireland, auditors are subject to ethical requirements from two sources: IAASA's Ethical Standard concerning the integrity, objectivity and independence of the auditor, and the ethical pronouncements established by the auditor's relevant professional body.

A5a-2 The objectives of the auditor under ISA (Ireland) 250 Section A include to respond appropriately to identified or suspected non-compliance with laws and regulations identified during the audit<sup>15a</sup>. That standard establishes requirements for responding to such identified or suspected non-compliance, including determining whether law, regulation or relevant ethical requirements require the auditor to report to an appropriate authority outside the entity<sup>15b</sup>. ISA (Ireland) 250 Section B addresses the auditor's statutory right and duty to report to regulators of public interest entities and regulators of other entities in the financial sector. It identifies that speed of reporting is essential where the circumstances cause the auditor no longer to have confidence in the integrity of those charged with governance, for example where the auditor believes that a fraud or other irregularity may have been committed by, or with the knowledge of, those charged with governance, or have evidence of the intention of

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<sup>15</sup> See Sections 225.21–225.22 of the IESBA Code.

In Ireland, the auditor has regard to any specific requirements of the auditor's relevant professional body.

<sup>15a</sup> ISA (Ireland) 250 (Revised November 2020), *Section A - Consideration of Laws and Regulations in an Audit of Financial Statements*, paragraph 11(c).

<sup>15b</sup> ISA (Ireland) 250 (Revised November 2020), *Section A*, paragraph 29(a).

those charged with governance to commit or condone a suspected fraud or other irregularity<sup>15c</sup>.

*Considerations Specific to Public Sector Entities*

- A6. 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.

**Professional Skepticism** (Ref: Para. 12–14)

- A7. 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 the reliability and completeness 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.

A7-1. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. Obtaining audit evidence in an unbiased manner may involve obtaining evidence from multiple sources within and outside the entity. However, the auditor is not required to perform an exhaustive search to identify all possible sources of audit evidence.

A7-2. When concluding whether sufficient appropriate audit evidence has been obtained and forming an opinion, ISA (Ireland) 330 (Revised August 2018) requires the auditor to consider all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the financial statements<sup>15d</sup>. Professional skepticism assists the auditor in remaining unbiased and alert to both corroborative and contradictory audit evidence.

- A8. 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, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism or allow the auditor to be satisfied with anything less than sufficient and appropriate audit evidence when obtaining reasonable assurance. 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.

- A9. An audit performed in accordance with ISAs (Ireland) rarely involves the authentication of manual or electronic documents, nor is the auditor trained as or expected to be an expert in such authentication.<sup>16</sup> Nevertheless, the auditor is required to consider the reliability of information to be used as audit evidence<sup>16a</sup>. When the auditor identifies

<sup>15c</sup> ISA (Ireland) 250 (Revised November 2020), *Section B - The Auditors Statutory Right and Duty to Report to Regulators of Public Interest Entities and Regulators of Other Entities in the Financial Sector*, paragraph A34.

<sup>15d</sup> ISA (Ireland) 330 (Revised August 2018), paragraph 26.

<sup>16</sup> ISA (Ireland) 200 (Updated December 2018), paragraph A47.

<sup>16a</sup> ISA (Ireland) 500 (Updated December 2018), paragraphs 7-9.

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:

- Confirming directly with the third party.
- Using the work of an expert to assess the document's authenticity.

A9-1. Tampering includes the deliberate and unauthorized modification of information (e.g. through destruction, manipulation or editing). Documents that are fraudulent or have been tampered with can be difficult to detect. Conditions that indicate a document is not authentic or has been tampered with may include:

- Unexplained alterations to documents received from external sources.
- Serial numbers used out of sequence or duplicated.
- Addresses and company emblems not as expected.
- Document style different to others of the same type from the same source (for example, changes in fonts and formatting).
- Information that would be expected to be included is absent.
- Invoice references that differ from others.
- Unusual terms of trade, such as unusual prices, interest rates, guarantees and repayment terms (for example, purchase costs that appear unreasonable for the goods or services being charged for).
- Information that appears implausible or inconsistent with the auditor's understanding and knowledge.
- A change from authorized signatory.
- 'Copy' documents presented rather than originals.
- Electronic documents with a last edited date that is after the date they were represented as finalized.

**Discussion among the Engagement Team** (Ref: Para. 15)

A10. Discussing the susceptibility of the entity's financial statements to material misstatement due to fraud with the engagement team:

- Provides an opportunity for more experienced engagement team members to share their insights about how and where the 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.

A10-1. Members of the engagement team involved in the discussion may include specialists participating in the audit who have relevant knowledge and experience.

A11. The discussion may include such matters as:

- Whether there are incentives to manage earnings or key performance indicators derived from the financial statements in order to deceive financial statement users by influencing their perceptions as to the entity's performance and profitability.
- 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 for fraud to be perpetrated, and indicate a culture or environment that enables management or others to rationalize committing fraud.
- Whether there are economic, industry and operating conditions that give rise to fraud risk factors for particular classes of transactions, account balances and disclosures. (Examples of economic, industry and operating conditions that may give rise to fraud risk factors are included in the examples of incentives/pressures and opportunities in Appendix 1.)
- A consideration of any material frauds of which team members have experience in companies in the same industry and whether there are similar risks.
- A consideration of management's involvement in overseeing employees with access to cash or other assets susceptible to misappropriation.
- 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.
- An emphasis on the importance of maintaining a proper state of mind throughout the audit regarding the potential for material misstatement due to fraud.
- A consideration of the types of circumstances that, if encountered, might indicate the possibility of fraud.
- A consideration of how an element of unpredictability will be incorporated into the nature, timing and extent of the audit procedures to be performed.
- 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.
- A consideration of any allegations of fraud that have come to the auditor's attention.
- A consideration of the risk of management override of controls.
- A consideration of the extent of segregation of duties and whether and how that may be overridden.
- A consideration of how those charged with governance and management promote a culture of honesty and integrity; what policies they have to facilitate

and encourage reporting of wrongdoing; and how they respond to any such reports.

- A consideration of audit team experience, or other knowledge, of the competencies and attitudes of employees in areas where there are risks of material misstatement.

A11-1 Circumstances where it may be beneficial to have further discussion(s) among the engagement team at later stages in the audit may include, for example, when the auditor's evaluation of audit evidence has provided further insight about the risks of material misstatement due to fraud (see paragraph A49) or members of the audit team have identified:

- Fraud risk factors that were not covered in the original discussion.
- Actual or suspected fraud.

## **Risk Assessment Procedures and Related Activities**

### *Inquiries of Management*

#### Management's Assessment of the Risk of Material Misstatement Due to Fraud

(Ref: Para. 17(a))

A12. Management<sup>16b</sup> accepts responsibility for the entity's 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 of such risk and controls 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.

A12-1. Although the control environment may provide an appropriate foundation for the system of internal control and may help reduce the risk of fraud, an appropriate control environment is not necessarily an effective deterrent to fraud<sup>16c</sup>.

#### Considerations specific to smaller entities

A13. In some entities, particularly smaller entities, the focus of management's assessment may be on the risks of employee fraud or misappropriation of assets.

#### Management's Process for Identifying and Responding to the Risks of Fraud

(Ref: Para. 17(b))

A14. In the case of entities with multiple locations management's processes may include different levels of monitoring of operating locations, or business segments. Management may also have identified particular operating locations or business

<sup>16b</sup> In Ireland, those charged with governance are responsible for the preparation of the financial statements.

<sup>16c</sup> ISA (Ireland) 315 (Revised October 2020), paragraph A107.



segments for which a risk of fraud may be more likely to exist.

*Inquiry of Management and Others within the Entity* (Ref: Para. 18)

- A15. 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 convey information to the auditor that may not otherwise be communicated.
- A16. Examples of others within the entity to whom the auditor may direct inquiries about the existence or suspicion of fraud include:
- Operating personnel not directly involved in the financial reporting process.
  - Employees with different levels of authority.
  - Employees involved in initiating, processing or recording complex or unusual transactions and those who supervise or monitor such employees.
  - Employees involved in initiating, processing or recording high volumes of payments and settlements and those who supervise or monitor such employees.
  - Employees responsible for the maintenance of IT systems or monitoring system logs for unusual or unauthorized activity.
  - In-house legal counsel.
  - Chief ethics officer or equivalent person.
  - The person or persons charged with dealing with allegations of fraud.

A16-1. Entities may have whistleblowing policies to provide for employees, or other parties, disclosing concerns about actual or suspected wrongdoing, including fraud. For entities that do not have such policies the auditor may direct inquiries to the person within the entity who would deal with allegations of fraud.

A17. 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 other information.

A17-1. When seeking other information that relates to management's responses to inquiries, the auditor does so in a manner that is not biased towards excluding audit evidence that may be contradictory.

*Inquiries of the Internal Audit Function* (Ref: Para. 19)

A18. ISA (Ireland) 315 (Revised October 2020) and ISA (Ireland) 610 establish requirements and provide guidance relevant to audits of those entities that have an internal audit function.<sup>17</sup> In carrying out the requirements of those ISAs (Ireland) in the context of fraud, the auditor may inquire about specific activities of the function including, for example:

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<sup>17</sup> ISA (Ireland) 315 (Revised October 2020), paragraphs 14(a) and 24(a)(ii), and ISA (Ireland) 610 , *Using the Work of Internal Auditors*.

- The procedures performed, if any, by the internal audit function during the year to detect fraud.
- Whether management has satisfactorily responded to any findings resulting from those procedures.

*Obtaining an Understanding of Oversight Exercised by Those Charged with Governance*

(Ref: Para. 20)

- A19. Those charged with governance of an entity oversee the entity's systems for monitoring risk, financial control and compliance with the law. 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 the 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 country, 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.<sup>18</sup>
- A20. 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 minutes from such meetings or making inquiries of those charged with governance.

A20-1. A discussion between the auditor and those charged with governance about the risks of fraud in the entity, including those specific to the entity's business sector, assists the auditor in identifying and assessing the risks of material misstatement of the financial statements due to fraud. The discussion may also enhance the understanding of those charged with governance of fraud risks specific to the entity and assist them in exercising oversight of management's process for identifying and responding to the risks of fraud in the entity. Business sector specific risks may arise from economic, industry and operating conditions that give rise to fraud risk factors for particular classes of transactions, account balances and disclosures. Examples of economic, industry and operating conditions that may give rise to fraud risk factors are included in the examples of incentives/pressures and opportunities in Appendix 1.

*Considerations Specific to Smaller Entities*

- A21. 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.

*Unusual or Unexpected Relationships Identified* (Ref: Para.22)

- A21-1. Analytical procedures can be performed using a number of tools or techniques, which may be automated. Applying automated analytical procedures to the data may be referred to as data analytics<sup>18a</sup>.

<sup>18</sup> ISA (Ireland) 260 (Revised November 2020), paragraphs A1–A8, discuss with whom the auditor communicates when the entity's governance structure is not well defined.

<sup>18a</sup> For an example, see ISA (Ireland) 315 (Revised October 2020), paragraph A31.

*Consideration of Other Information* (Ref: Para. 23)

A22. In addition to information obtained from applying analytical procedures, other information obtained about the entity and its environment, the applicable financial reporting framework and the entity's system of internal control may be helpful in identifying the risks of material misstatement due to fraud. The discussion among team members may provide information that is helpful in identifying such risks. In addition, information obtained from the auditor's client acceptance and retention processes, and experience gained on other engagements performed for the entity, for example engagements to review interim financial information, may be relevant in the identification of the risks of material misstatement due to fraud.

*Evaluation of Fraud Risk Factors* (Ref: Para. 24)

A23. The fact that fraud is usually concealed can make it very difficult to detect. Nevertheless, 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:

- The need to meet expectations of third parties to obtain additional equity or other financing may create pressure to commit fraud<sup>18b</sup>;
- The granting of significant bonuses if hard to reach or unrealistic profit targets are met may create an incentive to commit fraud; and
- A control environment that is not effective may create an opportunity to commit fraud.

A24. 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 of whether a fraud risk factor is present and whether it is to be considered in assessing the risks of material misstatement of the financial statements due to fraud requires the exercise of professional judgment.

A25. Examples of fraud risk factors related to fraudulent financial reporting 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 may relate to incentives, pressures or opportunities that arise from conditions that create susceptibility to misstatement, before consideration of controls. Fraud risk factors, which include intentional management bias, are, insofar as they affect inherent risk, inherent risk factors.<sup>19</sup> Fraud risk factors may also relate to 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

<sup>18b</sup> For an example, see ISA (Ireland) 315 (Revised October 2020), paragraph A197.

<sup>19</sup> ISA (Ireland) 315 (Revised October 2020), paragraph 12(f); Appendix 2.

fraudulent actions. 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>20</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.

A26. The size, complexity, and ownership characteristics of the entity have a significant influence on the consideration of relevant fraud risk factors. For example, 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.
- Appropriate segregation of responsibilities to reduce the opportunities for a person to both perpetrate and conceal fraud.
- Effective IT processes that manage access to the IT environment, manage program changes or changes to the IT environment and manage IT operations (for example, to ensure that access and changes to the data is by persons with appropriate authority).

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.

#### Considerations Specific to Smaller Entities

A27. 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 a lack of segregation of duties or 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.

#### *Specialized Skills or Knowledge* (Ref: Para. 24-1)

A27-1. Matters that may affect the auditor's determination of whether the engagement team requires specialized skills or knowledge, include, for example:

- The complexity of transactions.
- The complexity of data flows.

<sup>20</sup> ISA (Ireland) 315 (Revised October 2020), paragraph 21.

- The use of complex models.
- The complexity of contractual terms.
- The complexity of related party relationships.
- The use of complex financial instruments or other complex financing arrangements.
- The use of special-purpose entities.
- Matters involving a high degree of judgment.
- The complexity and extent of the entity's use of information technology.
- The estimation of non-financial information.
- Possible need for forensic skills as part of the risk assessment process, and to follow up on identified or suspected fraud.

### **Identification and Assessment of the Risks of Material Misstatement Due to Fraud**

#### *Risks of Fraud in Revenue Recognition (Ref: Para. 26)*

- A28. 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 shifting revenues to a later period.
- A29. 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 cash sales.
- A30. The presumption that there are risks of fraud in revenue recognition may be rebutted. For example, the auditor may conclude that there is no risk of material misstatement due to fraud relating to revenue recognition in the case where there is a single type of simple revenue transaction, for example, leasehold revenue from a single unit rental property.

#### *Identifying and Assessing the Risks of Material Misstatement Due to Fraud and Understanding the Entity's Related Controls (Ref: Para. 27)*

- A31. 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 assume.<sup>21</sup> In determining which controls to implement to prevent and detect fraud, management considers the risks that the financial statements may be materially misstated as a result of fraud. As part of this consideration, management may conclude that it is not cost effective to implement and maintain a particular control in relation to the reduction in the risks of material misstatement due to fraud to be achieved.
- A32. It is therefore important for the auditor to obtain an understanding of the controls that

<sup>21</sup> ISA (Ireland) 315 (Revised October 2020), Appendix 3, paragraph 24.

management has designed, implemented and maintained to prevent and detect fraud. In identifying the controls that address the risks of material misstatement due to fraud, the auditor may learn, for example, that management has consciously chosen to accept the risks associated with a lack of segregation of duties and, if so, the auditor takes account of that management position when identifying and assessing risks of material misstatement. Information from identifying these controls, and evaluating their design and determining whether they have been implemented, may also be useful in identifying fraud risks factors that may affect the auditor's assessment of the risks that the financial statements may contain material misstatement due to fraud.

## **Responses to the Assessed Risks of Material Misstatement Due to Fraud**

### *Overall Responses (Ref: Para. 28)*

A33. 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:

- Increased sensitivity in the selection of the nature and extent of documentation to be examined in support of material transactions.
- Increased recognition of the need to corroborate management explanations or representations concerning material matters.

When seeking other information that relates to management's explanations or representations, the auditor does so in a manner that is not biased towards excluding audit evidence that may be contradictory.

It also involves more general considerations apart from the specific procedures otherwise planned; these considerations include the matters listed in paragraph 29, which are discussed below.

### *Assignment and Supervision of Personnel (Ref: Para. 29(a))*

A34. The auditor may respond to identified risks of material misstatement due to fraud by, for example, assigning additional individuals with specialized skill and knowledge, such as forensic and IT experts, or by assigning more experienced individuals to the engagement.

A35. 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.

### *Unpredictability in the Selection of Audit Procedures (Ref: Para. 29(c))*

A36. 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:

- Performing substantive procedures on selected account balances and assertions not otherwise tested due to their materiality or risk.
- Adjusting the timing of audit procedures from that otherwise expected.
- Using different sampling methods.

- Performing audit procedures at different locations or at locations on an unannounced basis.

*Audit Procedures Responsive to Assessed Risks of Material Misstatement Due to Fraud at the Assertion Level* (Ref: Para. 30)

A37. 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:

- 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 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 automated tools and techniques to gather more evidence about data contained in significant accounts or electronic transaction files.

Documents may provide audit evidence of the ownership of physical assets but may not provide reliable evidence about the existence of such assets, or their condition, without observation or inspection.

- The auditor may design procedures to obtain additional 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 or request information regarding outstanding amounts, but also to confirm or request information regarding 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.
- As required by ISA (Ireland) 330, the auditor considers whether external confirmation procedures are to be performed as substantive audit procedures<sup>21a</sup>. The auditor may determine that external confirmation procedures performed for one purpose provide an opportunity to obtain audit evidence about other matters. For example, confirmation requests for bank balances often include requests for information relevant to other financial statement assertions. Such considerations may influence the auditor's decision about whether to perform external confirmation procedures. In Ireland, depending on the auditor's risk assessment, the auditor considers whether confirmation is needed in relation to additional information such as trade finance transactions and balances or information about guarantees and other third party securities, in addition to the

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<sup>21a</sup> ISA (Ireland) 330 (Revised August 2018), paragraph 19.

confirmation of balances and other banking arrangements usually provided in such a request.<sup>21b</sup>

- 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 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.
- 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, automated tools and 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. They may also be used to identify unusual entries or outliers that do not follow the auditor's expectations.

As described in ISA (Ireland) 530<sup>21c</sup> it is important that samples intended to be representative of the population, or a segment of the population, are selected appropriately and not in a way that would exclude particular elements of the population or segment from the possibility of being tested.

- A38. 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.
- A39. 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 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 (see also paragraphs A46-A47).
- A40. Examples of possible audit procedures to address the assessed risks of material

<sup>21b</sup> ISA (Ireland) 330 (Revised August 2018), paragraph A50.

<sup>21c</sup> ISA (Ireland) 530, *Audit Sampling*, paragraphs 5(a) and (f), 8, A5 and A12.



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.

*Audit Procedures Responsive to Risks Related to Management Override of Controls*

Journal Entries and Other Adjustments (Ref: Para. 32(a))

A41. 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.

A42. Further, the auditor's consideration of the risks of material misstatement associated with inappropriate override of controls over journal entries<sup>22</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.

A42-1. As described in ISA (Ireland) 315 (Revised August 2020)<sup>22a</sup> controls that address risks of material misstatement at the assertion level that are expected to be identified for all audits are controls over journal entries, because the manner in which an entity incorporates information from transaction processing into the general ledger ordinarily involves the use of journal entries, whether standard or non-standard, or automated or manual.

A43. 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:

- *The identification and assessment of the risks of material misstatement due to fraud* – the presence of fraud risk factors and other information 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.
- *Controls that have been implemented over journal entries and other adjustments* – 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 and concluded that they can be relied on.
- *The entity's financial reporting process and the nature of evidence that can be obtained* – for many entities routine processing of transactions involves a

<sup>22</sup> ISA (Ireland) 315 (Revised August 2020), paragraph 26(a)(ii)

<sup>22a</sup> ISA (Ireland) 315 (Revised August 2020), paragraph A160

combination of manual and automated controls. Similarly, the processing of journal entries and other adjustments may involve both manual and automated controls. Where information technology is used in the financial reporting process, journal entries and other adjustments may exist only in electronic form.

- *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.
- *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.
- *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.

A43-1. In manual general ledger systems, non-standard journal entries may be identified through inspection of ledgers, journals, and supporting documentation. When automated procedures are used to maintain the general ledger and prepare financial statements, such entries may exist only in electronic form and may therefore be more easily identified through the use of automated techniques.

A44. 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 32(a)(ii) requires the auditor to select the journal entries and other adjustments made at that time and as post-closing entries. 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 32(a)(iii) requires the auditor to consider whether there is also a need to test journal entries and other adjustments throughout the period. Where there are high numbers of journals, automated tools and techniques may enable more extensive testing through further analysis based on particular characteristics.

*Accounting Estimates* (Ref: Para. 32(b))

A45. The preparation of the financial statements requires management<sup>16b</sup> 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.

- A46. The purpose of performing a retrospective review in accordance with paragraph 32(b)(ii), 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 professional judgments made in the prior year that were appropriate based on the information available at the time they were made.
- A47. A retrospective review is also required by ISA (Ireland) 540 (Revised December 2018).<sup>23</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 misstatements 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 (Ireland) may be carried out in conjunction with the review required by ISA (Ireland) 540 (Revised December 2018).

*Business Rationale for Significant Transactions* (Ref: Para. 32(c))

- A48. 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:
- The form of such transactions appears overly complex (for example, the transaction involves multiple entities within a consolidated group or multiple unrelated third parties).
  - 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.
  - Management is placing more emphasis on the need for a particular accounting treatment than on the underlying economics of the transaction.
  - 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.
  - 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.

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<sup>23</sup> ISA (Ireland) 540 (Revised December 2018), *Auditing Accounting Estimates and Related Disclosures*, paragraph 14.

Automated tools and techniques may assist the auditor in identifying transactions outside the normal course of business.

**Evaluation of Audit Evidence** (Ref: Para. 33-1–37)

A48-1. The determination of whether specialized skills or knowledge are needed to investigate a misstatement due to fraud or suspected fraud further for the purposes of the audit involves consideration of the particular circumstances. In some circumstances the auditor may consider it appropriate to use the specialist skills and knowledge of a forensic accountant. If management or those charged with governance undertake their own investigation, or employ an expert to investigate on their behalf, the audit engagement team may need specialized skills or knowledge to evaluate the findings of that investigation for the purposes of the audit.

A49. ISA (Ireland) 330 (Revised August 2018) 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>24</sup> This evaluation is primarily a qualitative matter based on the auditor's judgment. Such an evaluation may provide further insight 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.

*Analytical Procedures Performed Near the End of the Audit in Forming an Overall Conclusion* (Ref: Para. 34)

A50. 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;
- unusual transactions;
- income that is inconsistent with trends in cash flow from operations;
- uncharacteristically low amounts of revenue at the start of the subsequent period;  
or
- uncharacteristically high levels of refunds or credit notes.

Automated tools and techniques may assist identifying trends and relationships that may indicate a risk of material misstatement.

*Consideration of Identified Misstatements* (Ref: Para. 35–37)

A51. 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.

A52. The implications of identified fraud depend on the circumstances. For example, an

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<sup>24</sup> ISA (Ireland) 330 (Revised August 2018), paragraph 25.

otherwise insignificant fraud may be significant if it involves senior management. In such circumstances, the reliability of 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 documentation. There may also be a possibility of collusion involving employees, management or third parties.

- A53. ISA (Ireland) 450 (Updated July 2017)<sup>25</sup> and ISA (Ireland) 700 (Revised November 2020)<sup>26</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.

**Auditor Unable to Continue the Engagement** (Ref: Para. 38)

- A54. Examples of exceptional circumstances that may arise and that may bring into question the auditor's ability to continue performing the audit include:

- 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;
- 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
- The auditor has significant concern about the competence or integrity of management or those charged with governance.

- A55. 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.

A55-1. As explained in ISA (Ireland) 250 Section A, withdrawal from the engagement by the auditor is a step of last resort. It is normally preferable for the auditor to remain in office to fulfil the auditor's statutory duties, particularly where minority interests are involved. However, there are circumstances where there may be no alternative to withdrawal, for example, where the directors of a company refuse to issue its financial statements or the auditor wishes to inform the shareholders or creditors of the company of the auditor's concerns and there is no immediate occasion to do so.

A55-2. If the auditor determines that continued holding of office is untenable or the auditor is removed from office by the entity, the auditor will be mindful of the auditor's reporting duties.<sup>26a</sup>

- A56. 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

<sup>25</sup> ISA (Ireland) 450 (Updated July 2017), *Evaluation of Misstatements Identified during the Audit*.

<sup>26</sup> ISA (Ireland) 700 (Revised November 2020), *Forming an Opinion and Reporting on Financial Statements*.

<sup>26a</sup> In Ireland, under part 6 of the Companies Act 2014.

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>27</sup>

#### *Considerations Specific to Public Sector Entities*

A57. 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.

#### **Written Representations** (Ref: Para. 39)

A58. ISA (Ireland) 580 (Updated December 2018)<sup>28</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.

A59. Because of the nature of fraud and the difficulties that may be 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:

- (a) The results of management’s assessment of the risk that the financial statements may be materially misstated as a result of fraud; and
- (b) Their knowledge of actual, suspected or alleged fraud affecting the entity.

#### **Communications to Management and with Those Charged with Governance**

(Ref: Para. 40–42)

A59a. 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.

A59a-1. In Ireland, laws or regulations may prohibit alerting (“tipping off”) the entity when, for example, the auditor is required to report the non-compliance to an appropriate

<sup>27</sup> The IESBA *Code of Ethics for Professional Accountants* provides guidance on communications with an auditor replacing the existing auditor.

In Ireland, the relevant ethical guidance on proposed communications with a successor auditor is provided by the ethical pronouncements relating to the work of auditors issued by the auditor’s relevant professional body.

<sup>28</sup> ISA (Ireland) 580 (Updated December 2018), *Written Representations*.

authority pursuant to anti-money laundering legislation.

*Communication to Management* (Ref: Para. 40)

- A60. 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 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.

*Communication with Those Charged with Governance* (Ref: Para. 41)

- A61. The auditor's communication with those charged with governance may be made orally or in writing (see also paragraph A63-1 regarding public interest entities). ISA (Ireland) 260 (Revised November 2020) identifies factors the auditor considers in determining whether to communicate orally or in writing.<sup>29</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.
- A62. 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.
- A63. In the exceptional circumstances where the auditor has doubts about the integrity or honesty of management or those charged with governance, the auditor may consider it appropriate to obtain legal advice to assist in determining the appropriate course of action.

*Communication with Those Charged with Governance of Public Interest Entities*  
(Ref: Para. 41R-1)

- A63-1. For audits of financial statements of public interest entities, ISA (Ireland) 260 (Revised November 2020)<sup>29a</sup> requires the auditor to communicate in the additional report to the audit committee any significant matters involving actual or suspected non-compliance with laws and regulations which were identified in the course of the audit. This would include fraud or suspected fraud when such communication is not prohibited by laws or regulations (see paragraph A59a-1). The additional report to the audit committee is required to be in writing<sup>29b</sup>.

*Other Matters Related to Fraud* (Ref: Para. 42)

- A64. Other matters related to fraud to be discussed with those charged with governance of

<sup>29</sup> ISA (Ireland) 260 (Revised November 2020), paragraphs A38 and A47-1.

<sup>29a</sup> ISA (Ireland) 260 (Revised November 2020), paragraph 16-2(k).

<sup>29b</sup> ISA (Ireland) 260 (Revised November 2020), paragraph 20R-1(a).

the entity may include, for example:

- 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.
- A failure by management to appropriately address identified significant deficiencies in internal control, or to appropriately respond to an identified fraud.
- The auditor’s evaluation of the entity’s control environment, including questions regarding the competence and integrity of management.
- 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.
- Concerns about the adequacy and completeness of the authorization of transactions that appear to be outside the normal course of business.

**Reporting Fraud to an Appropriate Authority outside the Entity** (Ref: Para. 43)

- A65. ISA (Ireland) 250 Section A (Revised November 2020)<sup>30</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.
- A66. The determination required by paragraph 43 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.

*Reporting to Authorities of Public Interest Entities* (Ref: Para. 43R-1)

- A66-1. The disclosure in good faith to the authorities responsible for investigating such irregularities, by the auditor, of any irregularities referred to in paragraph 43R-1 does not constitute a breach of any contractual or legal restriction on disclosure of information in accordance with the Audit Regulation.<sup>30a</sup>
- A66-2. The auditor considers whether to take further action when the entity investigates the matter referred to in paragraph 41R-1 but where the measures taken by management or those charged with governance, in the auditor’s professional judgement, were not appropriate to deal with the actual or potential risks of fraud identified or would fail to prevent future occurrences of fraud.

<sup>30</sup> ISA (Ireland) 250 (Revised November 2020), *Section A - Consideration of Laws and Regulations in an Audit of Financial Statements*, paragraphs A28–A34.

<sup>30a</sup> Article 7 of Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014.



*Considerations Specific to Public Sector Entities*

- A67. 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.

**Appendix 1**

(Ref: Para. A25)

**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>1</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 evaluate.
- Significant, unusual, or highly complex transactions, especially those close to period end that pose difficult "substance over form" questions.

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<sup>1</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.

- Significant operations located or conducted across international borders in jurisdictions where differing business environments and cultures exist.
- 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 management understanding of the flow of data from initiation of the accounting records through to recording in the general ledger.
- 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.

**Appendix 2**

(Ref: Para. A40)

**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.
- Using automated tools and 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. Automated tools and 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 automated tools and 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 obtain information that may corroborate or contradict 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.

**Appendix 3**

(Ref: Para. A49)

**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' or contractors' access to systems and records inconsistent with that necessary to perform their authorized duties.
- Evidence of unauthorized third party access to the IT environment.
- 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.
- The entity's performance is out of line with industry trends and competitors.



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