# ISSAI 1240

INTOSAI



*Directriz de auditoría financiera*

# *Obligaciones del auditor en relación con el fraude en una auditoría de estados financieros*

**COMITÉ DE NORMAS PROFESIONALES DE LA INTOSAI**

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*La presente directriz de auditoría financiera se basa en la Norma Internacional de Auditoría (NIA) 240 "Obligaciones del auditor en relación con el fraude en una auditoría de estados financieros", formulada por el Consejo de Normas Internacionales de Auditoría y Aseguramiento (International Audit and Assurance Standards Board/IAASB) y publicada por la Federación Internacional de Contadores (International Federation of Accountants/IFAC). La NIA se ha incluido en la presente directriz con permiso de la IFAC.*

# Índice de la ISSAI 1240

*Nota de Práctica[1] para la Norma Internacional de Auditoría (NIA) 240*

# Obligaciones del auditor en relación con el fraude en una auditoría de estados financieros

## Fundamentos

Esta Nota de Práctica proporciona orientaciones adicionales sobre la NIA 240, “Obligaciones del auditor en relación con el fraude en una auditoría de estados financieros”, y debe leerse conjuntamente con ella. La NIA 240 entra en vigor para las auditorías de estados financieros correspondientes a los períodos que comiencen a partir de 15 de diciembre de 2009. Esta Nota de Práctica será efectiva en la misma fecha que la NIA.

### Introducción a la NIA

La NIA 240 establece las obligaciones del auditor en relación con el fraude en una auditoría de estados financieros, y en concreto detalla cómo deben aplicarse la NIA 315[2] y la NIA 330[3] para responder a los riesgos de incorrecciones materiales por causa de fraude.

### Contenido de la nota de práctica

P1. La Nota de Práctica proporciona orientaciones adicionales para los auditores del sector público en relación con los aspectos siguientes:

a) Consideraciones generales.
b) Definiciones.
c) Escepticismo profesional.
d) Debate en el seno del equipo auditor.
e) Procedimientos de evaluación de riesgos y actividades conexas.
f) Identificación y evaluación de riesgos de incorrecciones materiales por causa de fraude.
g) Respuestas a los riesgos evaluados de incorrecciones materiales por causa de fraude.
h) Valoración de la evidencia de auditoría.
i) Imposibilidad del auditor de proseguir con el encargo de auditoría.
j) Comunicaciones con la dirección y los encargados de la gobernanza.
k) Comunicaciones con órganos reguladores, judiciales y policiales.

## Aplicabilidad de la NIA en la auditoría del sector público

P2. La NIA 240 es aplicable a los auditores de las entidades del sector público en el desempeño de su función de auditores de los estados financieros.

1 Todas las Notas de Práctica habrán de leerse conjuntamente con la ISSAI 1000 ”Introducción general a las directrices de auditoría financiera de la INTOSAI.”
2 NIA 315, ”Identificación y evaluación de los riesgos de incorrecciones materiales mediante la comprensión de la entidad y su entorno.”
3 NIA 330, ”Respuesta del auditor ante los riesgos evaluados.”

## Orientaciones adicionales sobre cuestiones ligadas al sector público

P3. La NIA 240 contiene disposiciones de aplicación y otras disposiciones explicativas con consideraciones específicas a las entidades del sector público en los párrafos A6, A57 y A67.

## Consideraciones generales

P4. En una auditoría financiera en el sector público los objetivos van más allá de la emisión de una opinión sobre si los estados financieros han sido elaborados, en todos sus aspectos significativos, de acuerdo con el marco de información financiera aplicable (es decir, el alcance de las NIA). El mandato de auditoría derivado de leyes, reglamentos, órdenes ministeriales, exigencias de política pública o resoluciones del poder legislativo puede contener objetivos adicionales, entre ellos obligaciones de auditoría o de información, cuando los auditores del sector público hayan detectado falta de conformidad con las normas en cuestiones presupuestarias o de rendición de cuentas, o informen sobre la eficacia del control interno. Sin embargo, aun no existiendo objetivos adicionales, los ciudadanos pueden esperar de los auditores del sector público que notifiquen cualquier caso de falta de conformidad con las normas que hayan detectado durante la auditoría o informen sobre la eficacia del control interno. Los auditores del sector público han de tomar en consideración estas obligaciones suplementarias, y los riesgos de fraude conexos, al planificar y ejecutar la auditoría.

P5. Los párrafos 2 y 3 de la NIA abordan las características del fraude. Tres condiciones concurren normalmente cuando se produce un fraude y pueden encontrarse con frecuencia en el sector público bajo formas diversas, a saber:

- Incentivos o presiones (de forma real o percibida) a la dirección o a los empleados que proporcionen a estos un motivo para cometer el fraude. Los empleados del sector público se ven a menudo apremiados a prestar servicios de gran calidad con recursos escasos y a atenerse al presupuesto, particularmente cuando las circunstancias económicas son adversas y existe presión para mantener los gravámenes impuestos a los usuarios y los tipos impositivos, con lo cual existe un incentivo para sobrestimar ingresos y subestimar gastos. También puede haber incentivos para gastar el presupuesto disponible al término del ejercicio.
- Oportunidad (características o circunstancias de una entidad que permiten la perpetración del fraude). En el sector público pueden darse con más frecuencia dificultades para contratar a nuevos empleados o falta de personal con las necesarias cualificaciones. Estas situaciones suelen dar lugar a insuficiencias de control interno que crean oportunidades de fraude. El uso extendido de operaciones de efectivo de gran volumen y valor reducido en algunas entidades del sector público, como las que se registran en departamentos policiales o en clínicas, puede constituir un factor de riesgo añadido. Aunque el valor en juego sea reducido en términos monetarios, estas situaciones pueden llevar a un quebrantamiento de la confianza y de las expectativas de los ciudadanos, así como del control democrático.
- Racionalización o actitud (conducta, carácter o valores éticos que sirven a los individuos para justificar la comisión de un fraude). Los sueldos generalmente más bajos del sector público, en comparación con el sector privado, pueden hacer pensar a los empleados que gozan de justificación para hacer un uso indebido de los fondos. Al igual que se indicaba anteriormente, esta actitud puede llevar a un quebrantamiento de la confianza y de las expectativas de los ciudadanos, así como del control democrático.

## Definiciones

P6. Tal y como se declara en el artículo 1 de la parte de Generalidades de la Declaración de Lima de INTOSAI[4] ìLa institución del control es inmanente a la economía financiera pública. El control no representa una finalidad en sí mismo, sino una parte imprescindible de un mecanismo regulador que debe señalar, oportunamente, las desviaciones normativas y las infracciones de los principios de legalidad, rentabilidad, utilidad y racionalidad de las operaciones financieras, de tal modo que puedan adoptarse las medidas correctivas convenientes en cada caso, determinarse la responsabilidad del órgano culpable, exigirse la indemnización correspondiente o adoptarse las determinaciones que impidan o, por lo menos, dificulten, la repetición de tales infracciones en el futuroî. Los auditores del sector público se mantendrán en alerta durante toda la auditoría para detectar posibles casos de abuso. En este contexto, la Nota de Práctica añade una definición complementaria:

- Se entiende por abuso toda conducta deficiente o impropia en comparación con la que una persona prudente consideraría razonable y necesaria en una actividad comercial atendiendo a las circunstancias. El concepto también engloba los casos de utilización ilegítima de la autoridad o del cargo para favorecer intereses económicos personales o de familiares o socios comerciales. El abuso no implica necesariamente la existencia de fraude o la infracción de leyes y regulaciones, de estipulaciones contractuales o de condiciones de concesión de subvenciones, sino que representa una desviación del concepto de decoro que está relacionado con los principios generales de la buena gestión financiera del sector público y de conducta de los servidores públicos.

## Escepticismo profesional

P7. La obligación que tiene el auditor de mantener una actitud de escepticismo profesional durante la auditoría, contemplada en la NIA, se recoge en la ISSAI 1200.

P8. En el sector público el mantenimiento de una actitud de escepticismo profesional durante la auditoría puede verse amenazado, según se describe en los párrafos 12 a 14 de la NIA, por las siguientes causas:

- El carácter de las relaciones personales o profesionales como consecuencia del proceso o del entorno políticos.
- El carácter exclusivo del mandato recibido por el órgano fiscalizador del sector público que anula la competencia representada por otros auditores.
- La falta de un imperativo de rotación periódica de los auditores que se produce en algunos entornos.

De ello se deduce que los auditores del sector público adoptarán las medidas necesarias para contrarrestar estas amenazas, como pueden ser las salvaguardas contempladas en la ISSAI 1220.

P9. Cuando obtengan información acerca de la existencia de presuntos abusos, los auditores del sector público examinarán si éstos pueden llegar a afectar significativamente a los estados financieros. El examen debe realizarse con una doble perspectiva, cualitativa y cuantitativa. Los auditores del sector público no facilitan garantías razonables en cuanto a la detección del abuso pero sopesarán la necesidad de informar de esos casos si lo estiman conveniente.

4 ISSAI 1, ìLa Declaración de Limaî.

## Debate en el seno del equipo auditor

P10. El párrafo 15 de la NIA establece la necesidad de debate en el seno del equipo auditor y de que el responsable de la auditoría decida qué cuestiones deben comunicarse a los miembros del equipo auditor que no participan en el debate. En el sector público, el debate puede abarcar además los objetivos adicionales y los riesgos conexos de incorrecciones materiales que se describen en el párrafo P4. Los auditores del sector público pueden incluir también en el debate a auditores encargados de ejecutar auditorías de rendimiento, y de otro tipo, de la entidad.

## Procedimientos de evaluación de riesgos y actividades conexas

P11. Al remitirse a las exigencias contenidas en el subpárrafo 17 c) de la NIA, los auditores del sector público pueden informarse asimismo, si lo estiman conveniente, de la comunicación mantenida por la dirección con otros órganos públicos.

P12. Al remitirse a la exigencia de indagar acerca de los encargados de la gobernanza que se establece en el párrafo 21 de la NIA, los auditores del sector público podrán también incluir a los funcionarios de un ministerio, por ejemplo, o a consejeros o miembros de las comisiones parlamentarias pertinentes.

P13. Conforme al párrafo 22 de la NIA, el auditor evaluará si las relaciones inusuales o inesperadas que hayan sido detectadas al aplicar procedimientos analíticos, en relación por ejemplo con las cuentas de ingresos, apuntan a riesgos de incorrecciones materiales debido a la existencia de fraude. En el sector público, puede haber otros ámbitos, además de las cuentas de ingresos, con relevancia para los procedimientos analíticos según sea la naturaleza de las operaciones de la entidad. En muchas entidades del sector público, algunos ámbitos como los de adjudicación de contratos o concesión de subvenciones pueden tener más trascendencia en este aspecto que las cuentas de ingresos. Al aplicar procedimientos analíticos, los auditores del sector público tendrán presente los especiales problemas que plantean el criterio contable de caja y la posibilidad consiguiente de manipulación de la información financiera.

P14. Al evaluar los factores de riesgo de fraude que se señalan en el párrafo 24, los auditores del sector público tendrán presente, atendiendo a los ejemplos facilitados en el Apéndice 1 de la NIA, que dicho sector puede comportar factores de riesgo añadidos. En el Apéndice 1 de esta Nota de Práctica se facilitan ejemplos de dichos factores en el sector público.

## Identificación y evaluación de riesgos de incorrecciones materiales por causa de fraude

P15. En el sector público, el reconocimiento de ingresos no siempre es el ámbito en que presumiblemente hay más riesgos de fraude como se expone en el párrafo 26 de la NIA. Dicho reconocimiento puede revestir gran trascendencia para las autoridades tributarias u otros organismos que recaudan ingresos como las universidades públicas, los hospitales o los órganos reguladores, que recaudan derechos por los servicios prestados o reciben fondos de donantes. Ahora bien, en muchas entidades del sector público, la atención se centra principalmente en los gastos y en ámbitos como la adjudicación de contratos y el pago de subvenciones, por lo cual los auditores del sector público tendrán presente otros ámbitos, además del reconocimiento de ingresos, al establecer presunciones sobre los riesgos de fraude.

## Respuestas a los riesgos evaluados de incorrecciones materiales por causa de fraude

P16. Al concebir y aplicar procedimientos de auditoría adicionales, cuyo alcance, naturaleza, oportunidad respondan a los riesgos evaluados de incorrecciones materiales debido a la existencia de fraude en una cuenta o partida, según se señala en el párrafo 30 de la NIA e indican los ejemplos facilitados en el Apéndice 2 de la NIA, los auditores del sector público tendrán en cuenta que en dicho sector pueden ser pertinentes otros procedimientos de auditoría. En el Apéndice 2 de esta Nota de Práctica se facilitan ejemplos de dichos procedimientos adicionales.

P17. El subpárrafo 32 c) de la NIA 240 aborda la cuestión de operaciones importantes que no se corresponden con las operaciones y actividades corrientes de la entidad auditada, como las que se citan a continuación:

- Incentivos económicos al desarrollo.
- Disposiciones leoninas en acuerdos sindicales.
- Adquisición o venta de inmuebles.
- Intercambio de tierras.
- Concesión de derechos de servidumbre.
- Asociaciones público - privadas.
- Privatización de servicios públicos.
- Extinción anticipada de deudas.
- Concesión de garantías públicas para el rescate de entidades privadas en caso de dificultades financieras.

## Valoración de la evidencia de auditoría

P18. Según se dispone en el párrafo 35 de la NIA, cuando detecte una incorrección el auditor debe valorar si es indicativa de la existencia de fraude y, en ese caso, analizar sus posibles repercusiones. El Apéndice 3 de la NIA enumera una serie de circunstancias que indicarían la posible existencia de fraude, mientras que en el Apéndice 3 de esta Nota de Práctica se recogen ejemplos de otras circunstancias propias del sector público.

## Imposibilidad del auditor de proseguir con el encargo de auditoría

P19. Los auditores del sector público carecen por lo general de la facultad de abandonar un encargo de auditoría, tal y como se describe en el subpárrafo 38 c) de la NIA, por lo que deberán sopesar el efecto que puede tener en la opinión de auditoría y la necesidad de recurrir a otras formas de comunicación, como informar separadamente al poder legislativo o elaborar informes confidenciales o de divulgación restringida.

## Comunicaciones con la dirección y los encargados de la gobernanza

P20. Los auditores del sector público pueden tener la obligación, o tomar la decisión, de comunicar las cuestiones contempladas en el párrafo 41 de la NIA no sólo a los encargados de la gobernanza sino también a otras partes interesadas como el poder legislativo.

## Comunicaciones con órganos reguladores, judiciales y policiales

P21. La obligación de notificar el fraude en el sector público puede estar regulada de forma específica en el mandato de auditoría o en las leyes y los reglamentos aplicables, con arreglo al párrafo 43 de la NIA que trata de las comunicaciones con terceros ajenos a la entidad que pueden ser también los órganos reguladores, judiciales y policiales. En algunos entornos hay a veces la obligación de remitir los indicios de fraude a órganos de investigación e incluso de cooperar con ellos para determinar si efectivamente se ha producido fraude o abuso. En otros entornos, los auditores del sector público tienen que informar de las circunstancias que pueden ser indicativas de fraude a los órganos pertinentes de los poderes del Estado, como el ministerio fiscal, la policía y (si así lo establece la legislación) terceros afectados. Los auditores del sector público procurarán no interferir con otras investigaciones o actuaciones legales, habrán de estar familiarizados con la legislación y reglamentación aplicable a la notificación y documentación de indicios o sospechas de fraude y tendrán que sopesar la necesidad de recabar asesoramiento jurídico en la materia.

# Apéndice 1: Ejemplos de factores añadidos de riesgo de fraudes en el sector público

Los factores de riesgo de fraude que se enumeran en este Apéndice son ejemplo de las situaciones a las que pueden verse confrontados los auditores del sector público. Aunque abarcan gran número de situaciones, estos factores no dejan de ser ejemplos, por lo que los auditores pueden identificar otros diferentes, y no son pertinentes además en todas las circunstancias ni su trascendencia es la misma en todas las entidades del sector público, cuyas dimensiones, características o circunstancias varían. Tampoco el orden en que se citan estos ejemplos de factores de riesgo refleja su importancia relativa ni la frecuencia de su aparición.

## Factores de riesgo de incorrecciones derivadas de la presentación de información financiera fraudulenta

Los factores de riesgo de incorrecciones derivadas de la presentación de información financiera fraudulenta se clasifican en función de las tres condiciones que concurren generalmente cuando se produce el fraude: incentivos/presiones, oportunidad y actitudes/racionalización. A continuación se exponen diversos ejemplos.

### Incentivos/Presiones

Circunstancias de inestabilidad financiera o amenazas planteadas por la situación política, económica y presupuestaria o por las condiciones de funcionamiento de la entidad como las siguientes:
ï Deficiencias de los controles presupuestarios.
• Privatizaciones.
• Nuevos programas.
• Modificaciones importantes de los programas existentes.
• Nuevas fuentes de financiación.
• Nueva legislación o reglamentación o nuevas directivas.
• Decisiones políticas como la de reubicación de las operaciones.
• Programas sin fondos o recursos suficientes.
• Adquisición de bienes y servicios en determinados sectores, como el de defensa.
• Externalización de actividades públicas.
• Operaciones sujetas a investigación.
• Cambios políticos.
• Asociaciones público - privadas.

Excesiva presión impuesta a la dirección para cumplir las exigencias o expectativas de terceros o los encargados de la gobernanza como consecuencia de las circunstancias siguientes:
• Aumento de las expectativas de los ciudadanos.
• Expectativas superiores a las normales para ajustarse al presupuesto.
• Reducción de los presupuestos sin la correlativa reducción de las expectativas en torno a los servicios prestados.

## Oportunidad

Las características del sector público proporcionan la oportunidad de presentar información financiera fraudulenta como consecuencia de las circunstancias siguientes:

- Un ambiente cerrado con estrechos contactos y conexiones de carácter político.
- Estructuras jerárquicas y burocráticas y la consiguiente mentalidad de lealtad y obediencia creada por relaciones jerárquicas intensas y bien definidas.
- Transferencias tortuosas entre agencias que dificultan el seguimiento de la ìpista del dineroî y tienden a ocultar la efectiva utilización de los fondos.
- El abuso de poder por parte de los funcionarios de mayor rango.
- Acceso potencial a puestos de dirección del sector privado tras el abandono del cargo, debido por ejemplo a la adjudicación de contratos públicos.
- Tolerancia de errores en la información financiera.

El seguimiento llevado a cabo por la dirección no es eficaz como consecuencia de las circunstancias siguientes:

- Fuerte entramado de motivaciones, conexiones y lealtades políticas.
- Clima político inestable.

La estructura organizativa es compleja o inestable como se demuestra por la:

- Dispersión de las actividades públicas en numerosos puntos, por ejemplo ayuntamientos situados en zonas alejadas.

Los elementos de control interno resultan deficientes como consecuencia de las circunstancias siguientes:

- Dificultades para la contratación de nuevos empleados o falta de personal cualificado.
- Falta de aplicaciones y plataformas informáticas perfeccionadas para atender las necesidades específicas del sector público.
- Fragmentación y falta de integración de la infraestructura informática.

## Actitudes/Racionalización

- Los salarios generalmente inferiores del sector público con respecto al sector privado pueden llevar a los empleados a justificar la presentación de información financiera fraudulenta, sobre todo si existen incentivos tales como primas.
- Indiferencia a las repercusiones de los fallos de la administración que en el sector privado llevarían aparejadas sanciones económicas, despidos o penas de cárcel.

## Factores de riesgo de incorrecciones derivadas de malversación de activos

Algunos de los factores de riesgo de incorrecciones derivadas de la presentación de información financiera fraudulenta pueden también estar presentes cuando se producen incorrecciones por la malversación de activos. Por ejemplo, habrá a veces falta de eficacia en el seguimiento llevado a cabo por la dirección e insuficiencias de control interno al mismo tiempo que se producen incorrecciones derivadas de la presentación de información financiera fraudulenta o malversación de activos. A continuación se exponen ejemplos de dichos factores.
Incentivos/Presiones

Malas relaciones entre la entidad y los empleados con acceso al manejo de efectivo u otros activos susceptibles de apropiación que pueden llevar a los empleados a realizar la malversación. Es posible que esas malas relaciones se deban a las circunstancias siguientes:
- Estructuras rígidas de remuneración en el sector público que no satisfagan las expectativas.
- Recompensa de la antigüedad y no del rendimiento.

Elementos exclusivos del proceso de licitación y adjudicación de contratos del sector público como los que se enumeran a continuación:
- Contratos con repercusiones políticas sensibles.
- Riesgo de soborno y pago de comisiones debido a la competencia generada por el elevado volumen o valor de los contratos.
- Contratos con partes vinculadas.
- Naturaleza arriesgada de algunas actividades públicas, como las de los sectores del armamento, recursos naturales, etc.

Abuso de autoridad y de poder:
- La posibilidad de soborno cuando se trata de decisiones sobre temas sensibles como subvenciones, solicitudes de permiso de trabajo o residencia o solicitudes de obtención de la nacionalidad.

## Oportunidad

Algunas circunstancias pueden aumentar las posibilidades de que se produzca una malversación, como por ejemplo:
- Discrepancia entre el valor real y el valor registrado de los activos patrimoniales.
- Deficiencias del criterio contable de caja como por ejemplo:
  - Falta de anotación de determinados activos.
  - Falta de información adecuada sobre la titularidad de bienes inmuebles como edificios y terrenos.
  - Posibilidad de manipular el período de registro de las operaciones.
  - Transición no estructurada o sin control del principio de contabilidad de caja al de devengo.

## Actitudes/Racionalización

- Funcionarios públicos que no distinguen entre transacciones privadas y públicas y hacen por ejemplo un uso abusivo de las tarjetas de crédito oficiales.
- Funcionarios públicos que mantienen la creencia que su rango justifica un estilo de vida similar a los ejecutivos del sector privado, cuando su régimen de remuneración no es suficiente para sostenerlo.
- Tolerancia de conductas inadmisibles en situaciones en que resulte difícil despedir o sustituir empleados.

# Apéndice 2: Ejemplos adicionales de procedimientos de auditoría utilizables para contrarrestar los riesgos evaluados de incorrecciones materiales por causa de fraude en el sector público

## Respuestas concretas ñ Incorrecciones derivadas de la presentación de información financiera fraudulenta

Además de los ejemplos de respuestas recogidos en la NIA, se pueden citar otros aplicables al sector público como los siguientes:

## Planificación de la auditoría

Hacer frente a los riesgos enumerados en el Apéndice 1 de esta Nota de Práctica, dado su carácter genérico, puede implicar un proceso de planificación más intenso. Si bien los procedimientos pueden ser los mismos que en el sector privado, una evaluación más detenida de los riesgos requerirá quizá la práctica de pruebas más detalladas.

Dentro de este proceso de planificación más intenso, pueden considerarse los siguientes aspectos:
**Conflicto de Intereses**

- Creación, mantenimiento y consulta de una base de datos con información adicional referente por ejemplo a:
  - Fraudes notificados.
  - Noticias de medios de comunicación.
  - Medidas disciplinarias adoptadas contra empleados.
  - Denuncias.
  - Reacciones de los ciudadanos y de las partes interesadas.
  - El enlace con la información obtenida por los órganos reguladores, el ministerio público, las agencias encargadas de la investigación de delitos económicos graves u otras agencias de investigación que consideren pertinente los auditores del sector público.
  - Información procedente de agentes públicos, mecanismos de denuncia interna, etc.
  - Resultados de investigaciones judiciales o de auditorías de gestión (sobre todo en relación con la adjudicación de contratos públicos y la inversión en infraestructuras).

## Adjudicación de contratos públicos

La adjudicación de contratos públicos está sujeta por lo general a numerosas leyes y reglamentaciones, que a menudo regulan detalladamente procedimientos de contratación pública destinados a que todos los interesados reciban en todo momento la misma invitación y tengan las mismas oportunidades de participar en una licitación. Estos procedimientos suelen responder también a la necesidad de ofrecer un trato transparente y equitativo a todos los licitadores y, pese a que suelen ser los mismos que en el sector privado, requieren la realización de pruebas más detenidas al evaluar los riesgos.

Dentro de este proceso de planificación más intenso, pueden considerarse los siguientes aspectos:

## Sistema de licitación

- Interrogar a la dirección si se ha creado y existe en la práctica un sistema de licitación que abarque tanto la adquisición de bienes y de servicios como la enajenación y el arrendamiento de bienes públicos.
- Verificar en la documentación relativa al sistema de licitaciones si existen disposiciones que puedan comprometer su carácter equitativo, justo, transparente, competitivo y eficiente en relación con los costes.
- Comparar la documentación relativa al sistema de licitaciones con las leyes y reglamentaciones aplicables.
- Verificar en la documentación relativa al sistema de licitaciones si existen normas o criterios de referencias propios de un sistema de esas características.

## Conflicto de intereses

- Inspeccionar por medio de entrevistas con la dirección y de comprobación de la documentación relativa al sistema de licitaciones y las actas de las reuniones de la comisión de licitaciones si los responsables de la adjudicación de contratos públicos y otros intervinientes:
  - Admitieron y declararon todo posible conflicto de intereses.
  - Trataron de modo equitativo a todos los proveedores y posibles proveedores.
  - No utilizaron su posición con fines de lucro personal o para beneficiar ilícitamente a otras personas.
  - No comprometieron la credibilidad o integridad del sistema de licitaciones aceptando regalos, hospitalidad o cualquier otro tipo de dádiva.
  - Utilizaron los bienes públicos con escrupulosidad.
  - Ayudaron a las autoridades o a los encargados del sistema de contabilidad a combatir la corrupción y el fraude en el sistema de licitaciones.
- Indagar e inspeccionar si la entidad practicaba controles para informar de conflictos de intereses y si estos controles habían sido comunicados al personal.
- Comprobar la documentación de apoyo para determinar si en el período examinado había un sistema para garantizar el cumplimiento de normas deontológicas.

## Conducta irregular e infracciones

- Indagar por medio de entrevistas con la dirección si durante el período examinado se registraron alegaciones de conducta irregular o infracciones en relación con el sistema de licitaciones.
- Verificar si se notificó y abordó adecuadamente cualquier caso de conducta irregular o infracción en relación con el sistema de licitaciones detectado en otra parte del proceso de auditoría. Confirmar asimismo si han sido alertadas las autoridades competentes.
- Indagar por medio de entrevistas con la dirección si durante el período examinado se registraron casos de licitadores que cometieran acciones fraudulentas cuando competían para la adjudicación de un contrato. Si así sucedió, interrogar a la dirección si fueron rechazadas las ofertas de esos licitadores.
- Si la entidad auditada está aplicando un mecanismo de denuncia interna, investigar cómo se denuncian y abordan las infracciones en esa organización. Examinar y debatir con el servicio de auditoría los resultados del mecanismo de denuncia interna y determinar si se han adoptado medidas correctoras cuando ha habido infracciones.

- Indagar por medio de entrevistas con la dirección si durante el período examinado se recibieron quejas de los interesados en relación con el sistema de licitaciones o la información relativa al mismo. Si así sucedió, investigar si se adoptaron medidas al respecto.

## Pruebas de confirmación o sustantivas

- Inspeccionar los registros y la documentación para localizar:
    - Nombres y direcciones de vendedores inhabitúales.
    - Recepción de copias (facturas, órdenes de compras, etc.) en vez de originales.
    - Pedidos de material ya existente en cantidades suficientes.
    - Pedidos de materiales cuya eliminación está programada debido a su estado de obsolencia.
    - Pedidos de materiales cuya naturaleza no se ajusta al mandato y a las operaciones de la entidad.
    - Compras por un importe o por una cantidad justo inferiores al límite exigido para la aprobación por el nivel siguiente.
    - Fragmentación de las compras mediante pedidos u otros medios para eludir las políticas en vigor.
    - Pagos a los vendedores al margen del sistema normal de licitaciones.
    - Firmas de la dirección o de supervisores en documentos firmados normalmente por subordinados (evitando así los controles ordinarios).
    - Concesión a los proveedores de un volumen significativo de bienes o servicios de la entidad del sector público.
    - Precios superiores a los del mercado, especialmente en compras de grandes cantidades.
    - Esquemas de adjudicación de contratos que indican la existencia de rotación de las ofertas.
    - Combinación de escasa calidad con precios elevados / porcentaje elevado de productos con problemas.
    - Existencia de una única fuente de provisión de bienes y servicios en cantidades significativas.
    - Recurso excesivo a procedimientos excepcionales, de urgencia o abreviados para la adquisición de bienes y servicios públicos.

## Ajustes presupuestarios

- Cerciorarse de que el procedimiento presupuestario se adecua a las exigencias legales.
- Cerciorarse de que el presupuesto ha sido aprobado correctamente.
- Examinar el proceso de notificación mensual de las previsiones presupuestarias y la ejecución real:
    - Investigar toda posible excepción (gastos excesivos o insuficientes) y sus motivos, así como las medidas adoptadas.
    - Confirmar que las excepciones han sido autorizadas en caso necesario.
- Examinar todo ajuste presupuestario significativo o movimiento excesivo de fondos entre programas realizados en fechas próximas al término del ejercicio o posteriormente, así como sus motivos.
- Examinar los informes de resultados para determinar si se registraron infracciones significativos de objetivos fijados en el plan estratégico / gastos excesivos o insuficientes por importes considerables al término del ejercicio.

- Examinar todo ajuste presupuestario realizado en fechas próximas al término del ejercicio o posteriormente para determinar si fue oportunamente autorizado por el poder legislativo en caso necesario.

## Costes de personal

- Examinar los registros de gastos y dietas de viaje para determinar si hay indicios de:
  - Inclusión de gastos personales.
  - Solicitudes de reembolso de gastos de alojamiento, representación o comidas que no resulten conformes con lo establecido.
  - Autorización por persona distinta al supervisor ordinario.
  - Fechas, horas u otros elementos de las solicitudes de reembolso de gastos que resulten inhabitúales o irrazonables.
- Examinar las hojas de asistencia para determinar si hay indicios de:
  - Autorización por persona distinta al supervisor ordinario.
  - Extravío o alteración de las hojas de asistencia o cualquier otro hecho inhabitual en relación con ellas, especialmente si sucede de forma recurrente con los mismos empleados.
  - Número excesivo o inhabitual de horas extraordinarias.
  - Utilización de códigos horarios o de códigos de clasificación de empleados que resulten inhabitúales o inapropiados.
- Proceder a pruebas de confirmación de las nóminas para determinar si hay indicios de:
  - Número excesivo o inhabitual de horas extraordinarias.
  - Discrepancias inhabitúales entre los importes reales y los presupuestados o variaciones estacionales.
  - Ingresos bancarios en números de cuentas inhabitúales o en cuentas en lugares inhabitúales (por ejemplo la realización de más de un ingreso en un ejercicio en la misma cuenta puede ser reveladora de la existencia de empleados ficticios).
  - Comparación entre la remuneración por empleado o grupo de empleados al final del ejercicio con el nivel de remuneraciones normal para la categoría laboral correspondiente.
- Analizar los procedimientos de contratación y sus controles y proceder a la realización de pruebas con el fin de determinar si:
  - Los puestos publicados han sido debidamente autorizados.
  - Los puestos han sido publicados conforme a la reglamentación aplicable (requisitos de transparencia, competencia abierta y leal, etc.).
  - Se ha cumplido el procedimiento de contratación en sus distintas fases (entrevista, presentación de referencias y su control, fijación del nivel adecuado de remuneración, etc.).
  - Se ha prestado la necesaria atención a los indicios de amistades o enemistades personales.
  - Se ha dado el curso apropiado a las denuncias recibidas respecto de procedimientos de contratación.

# Apéndice 3: Ejemplos adicionales de circunstancias indicativas de la posibilidad de fraude en el sector público

A continuación se enumeran ejemplos de circunstancias que pueden indicar la existencia de incorrecciones en los estados financieros por causa de fraude.

## Discrepancias en los registros contables:

- Transferencias considerables de operaciones entre fondos y programas.

## Procedimientos presupuestarios anormales:

- Ajustes presupuestarios significativos.
- Solicitudes de financiación complementaria.
- Falta de autorización de los ajustes presupuestarios.
- Gastos excesivos o insuficientes por importes considerables.
- Los indicadores de resultados señalan incumplimientos importantes.

## Adjudicación de contratos públicos:

- Procesos judiciales.
- Ausencia de normativa sobre la adjudicación de contratos públicos.
- Modificaciones recientes a la normativa sobre adjudicación de contratos públicos.
- Normativa compleja o falta de claridad.
- Importes considerables en juego (como en el sector de defensa).
- Inspección por los órganos reguladores.
- Denuncias de posibles proveedores sobre prácticas irregulares en la organización de licitaciones.
- El nombramiento de antiguos funcionarios para puestos de responsabilidad en empresas que han recibido contratos públicos.

## Concesión de subvenciones y financiación por donantes:

- Incumplimiento de los requisitos exigidos para las subvenciones.
- Falta de claridad de los requisitos exigidos para las subvenciones.
- Recepción de las subvenciones por destinatarios no designados.
- Denuncias de destinatarios o grupos de interés designados.

## Activos:

- Uso no autorizado de activos.
- Material objeto de uso personal o no programado como teléfonos móviles, cámaras digitales, ordenadores, vehículos, herramientas, etc.
- Activos materiales que puedan ser objeto de uso personal o de un uso desviado, como edificios o terrenos desocupados, equipamiento obsoleto, activos abandonados, etc.
- Pérdida de material utilizado en procedimientos oficiales de carácter confidencial como pasaportes y documentos de identidad.

International Auditing and Assurance Standards Board

**ISA 240**

April 2009

*International Standard on Auditing*

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

International Federation of Accountants

International Auditing and Assurance Standards Board
International Federation of Accountants
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# INTERNATIONAL STANDARD ON AUDITING 240

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

(Effective for audits of financial statements for periods beginning on or after December 15, 2009)

## CONTENTS

**Application and Other Explanatory Material**



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International Standard on Auditing (ISA) 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" should be read in conjunction with ISA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing."

# Introduction

## Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor's responsibilities relating to fraud in an audit of financial statements. Specifically, it expands on how ISA 315[1] and ISA 330[2] 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 or unintentional.

3. Although fraud is a broad legal concept, for the purposes of the ISAs, the auditor is concerned with 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. 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.

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1 ISA 315, "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment."

2 ISA 330, "The Auditor's Responses to Assessed Risks."

*Responsibilities of the Auditor*

5. An auditor conducting an audit in accordance with ISAs is responsible for 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.[3]

6. As described in ISA 200,[4] 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 is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. Such attempts at concealment may be even more difficult to detect when accompanied by collusion. Collusion may cause the auditor to believe that audit evidence is persuasive when it is, in fact, false. The auditor's ability to detect a fraud depends on factors such as the skillfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved. While the auditor may be able to identify potential opportunities for fraud to be perpetrated, it is 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 control procedures designed to prevent similar frauds by other employees.

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 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.

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3 ISA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing," paragraph A51.

4 ISA 200, paragraph A51.

### Effective Date

9. This ISA is effective for audits of financial statements for periods beginning on or after December 15, 2009.

## Objectives

10. The objectives of the auditor are:

    (a) To identify and assess the risks of material misstatement of the financial statements due to fraud;

    (b) To obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and

    (c) To respond appropriately to fraud or suspected fraud identified during the audit.

## Definitions

11. For purposes of the ISAs, 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 200, 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)

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 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)

14. Where responses to inquiries of management or those charged with governance are inconsistent, the auditor shall investigate the inconsistencies.

## Discussion among the Engagement Team

15. ISA 315 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.[5] This discussion shall place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud might occur. The discussion shall occur setting aside beliefs that the engagement team members may have that management and those charged with governance are honest and have integrity. (Ref: Para. A10-A11)

## Risk Assessment Procedures and Related Activities

16. When performing risk assessment procedures and related activities to obtain an understanding of the entity and its environment, including the entity's internal control, required by ISA 315,[6] the auditor shall perform the procedures in paragraphs 17-24 to obtain information for use in identifying the risks of material misstatement due to fraud.

*Management and Others within the Entity*

17. The auditor shall 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)

19. For those entities that have an internal audit function, the auditor shall make inquiries of internal audit to determine whether it has knowledge of any actual,

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5 ISA 315, paragraph 10.

6 ISA 315, paragraphs 5-24.

suspected or alleged fraud affecting the entity, and to obtain 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,[7] 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 internal control 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 corroborate the responses to the inquiries of management.

*Unusual or Unexpected Relationships Identified*

22. The auditor shall evaluate whether unusual or unexpected relationships that have been identified in performing analytical procedures, including those related to revenue accounts, may indicate risks of material misstatement due to fraud.

*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)

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

25. In accordance with ISA 315, 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.[8]

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

[7] ISA 260, "Communication with Those Charged with Governance," paragraph 13.

[8] ISA 315, paragraph 25.

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 obtain an understanding of the entity's related controls, including control activities, relevant to such risks. (Ref: Para. A31-A32)

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

*Overall Responses*

28. In accordance with ISA 330, the auditor shall determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level.[9] (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; and

(c) Incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures. (Ref: Para. A36)

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

30. In accordance with ISA 330, 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.[10] (Ref: Para. A37-A40)

[9] ISA 330, paragraph 5.

[10] ISA 330, paragraph 6.

*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 journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. In designing and performing audit procedures for such tests, the auditor shall:

        (i) Make inquiries of individuals 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

        (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)

    (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)

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)

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 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)

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;

(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)

**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 on a timely basis to 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. 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 to those charged with governance on a timely basis. If the auditor suspects fraud involving management, the auditor shall communicate these suspicions to those charged with governance and discuss with them the nature, timing and extent of audit procedures necessary to complete the audit. (Ref: Para. A61-A63)

42. The auditor shall communicate with those charged with governance any other matters related to fraud that are, in the auditor's judgment, relevant to their responsibilities. (Ref: Para. A64)

**Communications to Regulatory and Enforcement Authorities**

43. If the auditor has identified or suspects a fraud, the auditor shall determine whether there is a responsibility to report the occurrence or suspicion to a party outside the entity. Although the auditor's professional duty to maintain the confidentiality of client information may preclude such reporting, the auditor's legal responsibilities may override the duty of confidentiality in some circumstances. (Ref: Para. A65-A67)

**Documentation**

44. The auditor shall include the following in the audit documentation[11] of the auditor's understanding of the entity and its environment and the assessment of the risks of material misstatement required by ISA 315:[12]

(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; and

(b) The identified and assessed risks of material misstatement due to fraud at the financial statement level and at the assertion level.

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 330:[13]

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[11] ISA 230, "Audit Documentation," paragraphs 8-11, and paragraph A6.

[12] ISA 315, paragraph 32.

[13] ISA 330, paragraph 28.

(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.

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

- 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.
- Concealing, or not disclosing, 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.

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).
- 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.

*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 of the information to be used as audit evidence and the controls over its preparation and maintenance where relevant. Due to the characteristics of fraud, the auditor's professional skepticism is particularly important when considering the risks of material misstatement due to fraud.

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, 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 rarely involves the authentication of documents, nor is the auditor trained as or expected to be an expert in such authentication.[14] However, when the auditor identifies conditions that cause the auditor to believe that a document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, possible procedures to investigate further may include:

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

**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.

A11. The discussion may include such matters as:

- An exchange of ideas among engagement team members about how and where they believe the entity's financial statements may be susceptible to material misstatement due to fraud, how management could perpetrate and conceal fraudulent financial reporting, and how assets of the entity could be misappropriated.
- A consideration of circumstances that might be indicative of earnings management and the practices that might be followed by management to manage earnings that could lead to fraudulent financial reporting.
- A consideration of the 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.
- A consideration of management's involvement in overseeing employees with access to cash or other assets susceptible to misappropriation.

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14 ISA 200, paragraph A47.

- 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.

**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 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.

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 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.
- In-house legal counsel.
- Chief ethics officer or equivalent person.
- The person or persons charged with dealing 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.

*Inquiry of Internal Audit* (Ref: Para. 19)

A18. ISA 315 and ISA 610 establish requirements and provide guidance in audits of those entities that have an internal audit function.[15] In carrying out the requirements of those ISAs in the context of fraud, the auditor may inquire about specific internal audit activities including, for example:

- The procedures performed, if any, by the internal auditors during the year to detect fraud.

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[15] ISA 315, paragraph 23, and ISA 610, "Using the Work of Internal Auditors."

- 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 of the relevant internal control. 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.[16]

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 internal control over 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.

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.

*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 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.

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16 ISA 260, paragraphs A1-A8, discuss with whom the auditor communicates when the entity's governance structure is not well defined.

*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 financing may create pressure to commit fraud;
- The granting of significant bonuses if 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.

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. 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.

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 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.

**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 a 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.[17] 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 management has designed, implemented and maintained to prevent and detect fraud. In doing so, the auditor may learn, for example, that management has consciously chosen to accept the risks associated with a lack of segregation of duties. Information from obtaining this understanding 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.

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.

[17] ISA 315, paragraph A48.

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 corroborative information. This may affect both the type of audit procedures to be performed and their combination. For example:
  - Physical observation or inspection of certain assets may become more important or the auditor may choose to use computer-assisted audit techniques to gather more evidence about data contained in significant accounts or electronic transaction files.
  - The auditor may design procedures to obtain additional corroborative information. For example, if the auditor identifies that management is under pressure to meet earnings expectations, there may be a related risk that management is inflating sales by entering into sales agreements that include terms that preclude revenue recognition or by invoicing sales before delivery. In these circumstances, the auditor may, for example, design external confirmations not only to confirm outstanding amounts, but also to confirm the details of the sales agreements, including date, any rights of return and delivery

terms. In addition, the auditor might find it effective to supplement such external confirmations with inquiries of non-financial personnel in the entity regarding any changes in sales agreements and delivery terms.

- The timing of substantive procedures may need to be modified. The auditor may conclude that performing substantive testing at or near the period end better addresses an assessed risk of material misstatement due to fraud. The auditor may conclude that, given the assessed risks of intentional misstatement or 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, computer-assisted audit techniques may enable more extensive testing of electronic transactions and account files. Such techniques can be used to select sample transactions from key electronic files, to sort transactions with specific characteristics, or to test an entire population instead of a sample.

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.

A40. Examples of possible audit procedures to address the assessed risks of material misstatement due to fraud, including those that illustrate the incorporation of an element of unpredictability, are presented in Appendix 2. The appendix includes examples of responses to the auditor's assessment of the risks of material misstatement resulting from both fraudulent financial reporting, including fraudulent financial reporting resulting from revenue recognition, and misappropriation of assets.

*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 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.

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 assessment of the risks of material misstatement due to fraud* – the presence of fraud risk factors and other information obtained during the auditor's 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.

- *The entity's financial reporting process and the nature of evidence that can be obtained* – for many entities routine processing of transactions involves a combination of manual and automated steps and procedures.

Similarly, the processing of journal entries and other adjustments may involve both manual and automated procedures and 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 level of internal control as those journal entries used on a recurring basis to record transactions such as monthly sales, purchases and cash disbursements.

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. 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.

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

A45. The preparation of the financial statements requires management to make a number of judgments or assumptions that affect significant accounting estimates and to monitor the reasonableness of such estimates on an ongoing basis. Fraudulent financial reporting is often accomplished through intentional misstatement of accounting estimates. This may be achieved by, for example, understating or overstating all provisions or reserves in the same fashion so as to be designed either to smooth earnings over two or more accounting periods, or to achieve a designated earnings level in order to deceive financial statement users by influencing their perceptions as to the entity's performance and profitability.

A46. The purpose of performing a retrospective review of management judgments and assumptions related to significant accounting estimates reflected in the financial statements of the prior year is to determine whether there is an indication of a possible bias on the part of management. It is not intended to call into question the auditor's professional judgments made in the prior year that were based on information available at the time.

A47. A retrospective review is also required by ISA 540.[18] That review is conducted as a risk assessment procedure to obtain information regarding the effectiveness of management's prior period estimation process, audit evidence about the outcome, or where applicable, the subsequent re-estimation of prior period accounting estimates that is pertinent to making current period accounting estimates, and audit evidence of matters, such as estimation uncertainty, that may be required to be disclosed in the financial statements. As a practical matter, the auditor's review of management judgments and assumptions for biases that could represent a risk of material misstatement due to fraud in accordance with this ISA may be carried out in conjunction with the review required by ISA 540.

*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.

[18] ISA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures," paragraph 9.

- 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.

**Evaluation of Audit Evidence** (Ref: Para. 34-37)

A49. ISA 330 requires the auditor, based on the audit procedures performed and the audit evidence obtained, to evaluate whether the assessments of the risks of material misstatement at the assertion level remain appropriate.[19] 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 or unusual transactions; or income that is inconsistent with trends in cash flow from operations.

*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 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.

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19 ISA 330, paragraph 25.

A53. ISA 450[20] and ISA 700[21] 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.

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 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.[22]

*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.

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20 ISA 450, "Evaluation of Misstatements Identified during the Audit."

21 ISA 700, "Forming an Opinion and Reporting on Financial Statements."

22 The IFAC *Code of Ethics for Professional Accountants* provides guidance on communications with an auditor replacing the existing auditor.

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

A58. ISA 580[23] 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 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**

*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. ISA 260 identifies factors the auditor considers in determining whether to communicate orally or in writing.[24] 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

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[23] ISA 580, "Written Representations."

[24] ISA 260, paragraph A38.

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.

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

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

**Communications to Regulatory and Enforcement Authorities** (Ref: Para. 43)

A65. The auditor's professional duty to maintain the confidentiality of client information may preclude reporting fraud to a party outside the client entity. However, the auditor's legal responsibilities vary by country and, in certain circumstances, the duty of confidentiality may be overridden by statute, the law or courts of law. In some countries, the auditor of a financial institution has a statutory duty to report the occurrence of fraud to supervisory authorities. Also, in some countries the auditor has a duty to report misstatements to authorities in those cases where management and those charged with governance fail to take corrective action.

A66. The auditor may consider it appropriate to obtain legal advice to determine the appropriate course of action in the circumstances, the purpose of which is to ascertain the steps necessary in considering the public interest aspects of identified fraud.

*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.

### 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.[25]
- 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.

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25 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.

- Assets, liabilities, revenues, or expenses based on significant estimates that involve subjective judgments or uncertainties that are difficult to corroborate.
- Significant, unusual, or highly complex transactions, especially those close to period end that pose difficult "substance over form" questions.
- Significant operations located or conducted across international borders in jurisdictions where differing business environments and cultures exist.
- 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.

Internal control components are deficient as a result of the following:

- Inadequate monitoring of controls, including automated controls and controls over interim financial reporting (where external reporting is required).
- High turnover rates or employment of accounting, internal audit, or information technology staff 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 internal control 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 re-imbursements.
- Inadequate management oversight of employees responsible for assets, for example, inadequate supervision or monitoring of remote locations.
- Inadequate job applicant screening of employees with access to assets.
- Inadequate record keeping with respect to assets.

- Inadequate system of authorization and approval of transactions (for example, in purchasing).
- Inadequate physical safeguards over cash, investments, inventory, or fixed assets.
- Lack of complete and timely reconciliations of assets.
- Lack of timely and appropriate documentation of transactions, for example, credits for merchandise returns.
- Lack of mandatory vacations for employees performing key control functions.
- Inadequate management understanding of information technology, which enables information technology employees to perpetrate a misappropriation.
- Inadequate access controls over automated records, including controls over and review of computer systems event logs.

*Attitudes/Rationalizations*

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

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

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

*Revenue Recognition*

- Performing substantive analytical procedures relating to revenue using disaggregated data, for example, comparing revenue reported by month and by product line or business segment during the current reporting period with comparable prior periods. Computer-assisted audit techniques may be useful in identifying unusual or unexpected revenue relationships or transactions.
- Confirming with customers certain relevant contract terms and the absence of side agreements, because the appropriate accounting often is influenced by such terms or agreements and basis for rebates or the period to which they relate are often poorly documented. For example, acceptance criteria, delivery and payment terms, the absence of future or continuing vendor obligations, the right to return the

product, guaranteed resale amounts, and cancellation or refund provisions often are relevant in such circumstances.

- Inquiring of the entity's sales and marketing personnel or in-house legal counsel regarding sales or shipments near the end of the period and their knowledge of any unusual terms or conditions associated with these transactions.
- Being physically present at one or more locations at period end to observe goods being shipped or being readied for shipment (or returns awaiting processing) and performing other appropriate sales and inventory cutoff procedures.
- For those situations for which revenue transactions are electronically initiated, processed, and recorded, testing controls to determine whether they provide assurance that recorded revenue transactions occurred and are properly recorded.

*Inventory Quantities*

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

*Management Estimates*

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

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

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

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

- Counting cash or securities at or near year-end.
- Confirming directly with customers the account activity (including credit memo and sales return activity as well as dates payments were made) for the period under audit.
- Analyzing recoveries of written-off accounts.
- Analyzing inventory shortages by location or product type.
- Comparing key inventory ratios to industry norm.
- Reviewing supporting documentation for reductions to the perpetual inventory records.
- Performing a computerized match of the vendor list with a list of employees to identify matches of addresses or phone numbers.
- Performing a computerized search of payroll records to identify duplicate addresses, employee identification or taxing authority numbers or bank accounts
- Reviewing personnel files for those that contain little or no evidence of activity, for example, lack of performance evaluations.
- Analyzing sales discounts and returns for unusual patterns or trends.
- Confirming specific terms of contracts with third parties.
- Obtaining evidence that contracts are being carried out in accordance with their terms.
- Reviewing the propriety of large and unusual expenses.
- Reviewing the authorization and carrying value of senior management and related party loans.
- Reviewing the level and propriety of expense reports submitted by senior management.

# 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' access to systems and records inconsistent with that necessary to perform their authorized duties.
- Tips or complaints to the auditor about alleged fraud.

Conflicting or missing evidence, including:

- Missing documents.
- Documents that appear to have been altered.
- Unavailability of other than photocopied or electronically transmitted documents when documents in original form are expected to exist.
- Significant unexplained items on reconciliations.
- Unusual balance sheet changes, or changes in trends or important financial statement ratios or relationships – for example, receivables growing faster than revenues.
- Inconsistent, vague, or implausible responses from management or employees arising from inquiries or analytical procedures.
- Unusual discrepancies between the entity's records and confirmation replies.
- Large numbers of credit entries and other adjustments made to accounts receivable records.
- Unexplained or inadequately explained differences between the accounts receivable sub-ledger and the control account, or between the customer statements and the accounts receivable sub-ledger.
- Missing or non-existent cancelled checks in circumstances where cancelled checks are ordinarily returned to the entity with the bank statement.