

## Fraud – Question 1

1. Does ED-240 clearly set out the auditor’s responsibilities relating to fraud in an audit of financial statements, including those relating to non-material fraud and third-party fraud?

### Q01 Agree

#### 3. Regulators and Audit Oversight Authorities

##### Securities and Exchange Commission of Brazil

Agree (with no further comments)

#### 5. Accounting Firms

##### RSM International

Agree (with no further comments)

#### 6. Public Sector Organizations

##### Provincial Auditor Saskatchewan

Yes, ED-240 clearly sets out the auditor’s responsibilities relating to fraud including those relating to non-material fraud and third-party fraud.

##### Office of the Auditor General of Canada

Agree (with no further comments)

##### Office of the Auditor General of Ontario

We agree that the auditor’s responsibilities relating to fraud are clearly stated in ED-240.

#### 7. Member Bodies and Other Professional Organizations

##### Malaysian Institute of Certified Public Accountants

Agree (with no further comments)

##### Federación Argentina de Consejos Profesionales de Cs. Económicas

Answer 1. We believe that ED 240 clearly establishes the auditor’s responsibilities related to fraud in an audit of financial statements, including those related to non-material fraud and third-party fraud.

##### Federation of Accounting Professions of Thailand

Agree (with no further comments)

##### Institute of Chartered Accountants of Ghana

Agree (with no further comments)

##### Instituto Nacional de Contadores Públicos de Colombia

Agree (with no further comments)

#### 8. Academics

##### University of KwaZulu-Natal

Agree (with no further comments)

## 9. Individuals and Others

John Keyser

Agree (with no further comments)

### 2 Agree with comments

#### 1. Monitoring Group

##### International Organization of Securities Commission

We appreciate the Board's initiative to develop the proposed revisions in ED-240 to clarify the role and responsibilities of the auditor for detection of fraud in the audit of financial statements, promote consistent behavior and facilitate effective responses to identified risks of material misstatement due to fraud by establishing more robust requirements and enhancing the application material, reinforce the importance of the appropriate exercise of professional skepticism throughout the audit, and enhance transparency of fraud-related procedures. Fraudulent financial reporting and the misappropriation of assets continue to be at the forefront of the public interest in audited financial statements, particularly in light of recent high-profile corporate failures. We are supportive of the scope of the project and focusing the discussion on what the auditor's responsibilities are, as we believe high-quality audits contribute to investor trust in capital markets, and the public interest is best served when participants in the financial reporting eco-system have confidence in audits of financial statements.

Extant ISA 240 states that the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management and the role of the auditor is to obtain reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. Therefore, there currently is a rightful expectation that auditors are responsible to detect and report on fraud that is material to the financial statements. The way fraud is perpetrated has significantly evolved since the extant standard became effective and likely will continue to evolve and increase in complexity due to the pace of change in technological advances and sophistication of schemes. Therefore, an auditor's attitude of professional skepticism will also need to evolve, as it will be critical to the auditor's ability to recognize and respond to circumstances that may exist that can result in the financial statements being materially misstated, whether caused by fraud or error. We are supportive of the Board's attention to these topics in ED-240.

Yes, we believe ED-240 clearly sets out the auditor's responsibilities relating to fraud in an audit of financial statements, including those relating to non-material fraud. In particular we are supportive of the Board's approach to the assessment of materiality, including emphasizing that judgments about materiality with regards to fraud include both qualitative and quantitative considerations and that fraud will be a significant qualitative factor when evaluating materiality, including when fraud gives rise to misstatements that might be quantitatively small.

Additionally, we are supportive of the Board's approach to emphasize the explicit roles and responsibilities of the engagement partner as it relates to fraud detection throughout all stages of the engagement. We believe the new and enhanced requirements and application material that should be directly undertaken by the engagement partner is critical to support a high-quality audit. We also appreciate the Board framing the discussion based on what an auditor's responsibilities are without the unnecessary discussion of what the auditor's role is not that has long dominated the profession's discussion of the topic.

Regarding the concept of third-party fraud, refer to our response to Question 10: Definitions below.

## 2. Investors and Analysts

### Eumedion

Agree, with comments below

We agree that ED-240 contains substantial improvements and indeed brings more clarity to the auditor's responsibilities.

There is one important topic where ED-240 falls short of Eumedion's expectations. The Explanatory Memorandum (EM) explains why the IAASB choose to address the themes of 'corruption, bribery, and money laundering' not in ED-240, but in standard 250: "In its deliberations, the IAASB agreed that the definition of fraud should not be expanded to include these terms considering how they may have varying definitions or interpretations across jurisdictions and how introducing these terms into the proposed standard may significantly increase the scope of an audit of financial statements."

Eumedion has attested before that corruption (in the context of this response synonymous to bribery) is more than just a crime, it undermines the business and investment climate of countries. It rewards and strengthens those individuals that unlawfully benefit and can even initiate the decline of states, or hinder the path towards a healthy society.

Corruption also meets the ED-240's proposed definition of 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". Investors are deceived by corruption: the reported revenues, or costs, or margins were not generated due the strength of the product offering, but through giving (or receiving) unjust or illegal advantages to key decision makers, while taking on board unreported financial and reputational risks of detection. The notion that including corruption 'may significantly increase the scope of an audit of financial statements' bears in our view no fundamental validity and is not a factor that the IAASB should shy away from.

We urge the IAASB to take notice of the Royal Netherlands Institute of Chartered Accountants (NBA) Draft Practice Note 1137 on corruption ('NBA's Draft Practice Note') (<https://www.nba.nl/siteassets/wet--en-regelgeving/consultaties-en-projecten/2023/nba-handreiking-1137/consultatieversie-hr-1137---20230814.pdf>). It defines corruption as fraud rather than merely an instance of non-compliance with laws and regulations. The NBA's Draft Practice Note also explicitly points out the gatekeeper role that external auditors have concerning corruption, including a hyperlink to a relevant disciplinary rulings against auditors.

The NBA's Draft Practice Note recognises the negative impact of corruption on society and emphasises that corruption is not only occurring in emerging economies but also in mature ones. Companies that knowingly undermine the healthy functioning of society through corruption can expect to lose access to capital from long-term institutional investors, regardless of the extent of the corruption.

Additionally, the financial liabilities and the reputational risks of corruption can be significant; so significant that they can endanger the continuity of a business. For long-term institutional investors, there is no financial gain from corruption, even if it remains unnoticed: the destructive nature of corruption also negatively impacts many other companies in which institutional investors invest. Eumedion views corruption as an aggravated form of fraud and a destructive form of short-termism by companies that is at odds with sustainable, long-term value creation. Eumedion therefore advocates a zero-tolerance approach by management and the supervisory board of companies towards corruption, regardless of its amounts, and we emphasize the importance of transparent reporting on this. The primary responsibility for external transparency lies with management. It is

their responsibility, in consultation with and under the supervision of the audit committee, to contextualise adequate reporting on corruption towards shareholders.

Eumedion believes that incidents and the actions of the management related to them should be reported diligently in the company's reports, and insight should be provided into the nature and quantity of suspicions and indications of corruption. Such information can be an essential indication that the management is (not) sufficiently alert to ensure that the anti-corruption policy is effective. Where management's reporting in this area falls short, we see a core task for the external auditor to clarify this in the auditor's report.

Corruption is often a hidden cost item; its discovery and possible reclassification should not necessarily lead to a different net result in the past financial year. Some external auditors might conclude that therefore only the plausible prospect of a fine or the loss of an ongoing contract may lead to a material deviation. From an investor's perspective, indications that the anti-corruption policy does not seem to have been effective are material in themselves, and the company, and if not the company, the external auditor should report on this.

Considering all these factors, Eumedion sees a justified need for the IAASB to increase the scope of 240 to include corruption. The indeed material step-up in the auditor's assessment of adequate transparency by corporates would in itself help safeguard adequate detection of corruption by corporates, adequate transparency on corruption incidents by corporates, and their own fair assessment of the effectiveness of their anti-corruption measures. The impact of such a decision by the IAASB will be positive and material and would not be limited to fewer investors depending on fraudulently achieved corporate results but is also in the interest of fair competition and the well-functioning of societies.

We suggest that Standard 240 also specifically addresses the situation where the external auditor is the first or the only potentially plausible party to identify the risk or suspicion of corruption. In such a situation, it is not unthinkable that the corruption could continue for a long time if the external auditor would not intervene. The external auditor might conclude that the chance of a material deviation is limited as long as the crime remains hidden, i.e. if the auditor were to remain silent. The IAASB should clarify that the responsibilities of the auditor to serve the public interests should in such cases prevail over the interest of management, the company, or those charged with governance.

We consider proposed A20 as rather incomplete: "While the auditor may identify or suspect corruption, bribery, or money laundering, as with fraud, the auditor does not make legal determinations on whether such acts have actually occurred.": it omits to require auditors to highlight in the auditor's report cases of suspected corruption, if management itself fails to adequately do so.

Please find Eumedion's unabbreviated comments on the NBA's Draft Practice Note in English here: <https://en.eumedion.nl/clientdata/217/media/clientimages/Comments-on-NBA-draft-Practice-Note-Auditor-and-Corruption.pdf?v=231011155942>

### **Corporate Reporting Users' Forum**

Agree, with comments below

We welcome the IAASB's publication of ED-240. For users to have confidence in financial statements, it is essential that companies have systems in place to prevent fraud and processes in place to properly detect fraud when it does occur. With the recent focus on fraud in corporate bankruptcies and scandals, we support the IAASB's decision to strengthen its response to fraud by undertaking a project to revise the current IAS 240. Our comments, including this question, are set forth below.

We believe ED-240 clearly sets out the auditor's responsibilities regarding fraud in audit of financial statements; while distinguishing from the inherent limitations of an audit, it articulates that these inherent limitations do not mitigate the auditor's responsibilities.

ED-240 also states the primary responsibility for the prevention and detection of fraud rests with both management and those charged with governance (TCWG) of the entity. At the same time, the auditor's responsibilities are equally emphasized, by referring to it before those of the management and the TCWG 16.

We believe the auditor's responsibilities clearly include confirming the financial statements are free from fraud which may lead to material misstatement. Paragraph 2(a) states that "the auditor's responsibilities relating to fraud when conducting an audit in accordance with this ISA, and other relevant ISAs, are to plan and perform the audit to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement due to fraud."

It is also clear that the auditor should communicate and report about matters related to fraud when he or she addresses the fraud or the suspected fraud as stated in Paragraph 2(b)

We also highly support Paragraph 6, which states that the auditor does not make legal determinations of whether fraud has actually occurred, because it limits the scope of the auditor's responsibilities. Meanwhile, we think ED-240 should articulate that the auditor is not responsible for preventing fraud nor detecting all cases of illegal conduct in accordance with the requirements of ISA250.

We also support Paragraph A11, which sets out "materiality" to include qualitative materiality. It is possible that frauds listed in that paragraph may become quantitatively material in the future.

Meanwhile, we think that the following definition of fraud in Paragraph 18 is too broad; 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.

ED-240 refers to the relationship between fraud and illegal conducts in Paragraph 14. Paragraphs A18 - A20 also state that auditors' responsibilities may cover corruption, bribery and money laundering as well as fraud. Paragraph A21 states fraud as defined in Paragraph 18(a) can include an intentional act by a third party. We understand all these paragraphs intend to clarify the relationship between fraud and these activities, but we are not fully convinced that they are very successful.

For example, we believe that some additional rationale may be needed to explain why ED-240 deals with corruption, bribery and money laundering in particular among others. If it is to prepare the possible legislation against them and the possible statutory disclosure of non-financial information and assurance in the OECD and other jurisdictions, we believe such background should be clearly explained in ED-240. We also believe the definition of the auditor's responsibility in ISA250 should be amended as necessary, in accordance with the revision of ISA240.

Note that one member of the CRUF believes that corruption meets the definition of fraud in Section 18. Incidentally, this member believes that corruption should be included in ISA 240 for the following reasons, for example,

"Investors are deceived by corruption: the reported revenues, or costs, or margins were not generated due to the strength of the product offering, but through giving (or receiving) unjust or illegal advantages to key decision makers, while taking on board unreported financial and reputational risks of detection."

“The financial liabilities and the reputational risks of corruption can be significant; so significant that they can endanger the continuity of a business. For long-term institutional investors, there is no financial gain from corruption, even if it remains unnoticed. The destructive nature of corruption also negatively impacts many other companies in which institutional investors invest.”

He believes that incidents and the actions of the management related to them should be reported diligently in the company’s reports, and insight should be provided into the nature and quantity of suspicions and indications of corruption. Such information can be an essential indication that the management is (not) sufficiently alert to ensure that the anti-corruption policy is effective.”

Thus, there is a possibility that users of financial statements may request an expansion of the scope of fraud that the accounting auditor should address. Users’ demands may sometimes exceed the scope and capability of the auditor, and resources and time that should be devoted to audit engagement may be excessively allocated to fraud, and the auditor’s efforts to perform the audit engagement may be neglected.

In summary, the definition of fraud in Paragraph 18 needs to be clarified to narrow the range of interpretation. As aforementioned, views of the CRUF participants are diverted as to whether the auditors are expected to expand or limit their audit scope to identify corruption in the context of assurance of non-existence of material misstatements.

We expect the IAASB to more clearly describe the scope of fraud that the auditor should address, including the background, in the revised ISA 240 or in the explanatory statement.

That said, these responses may not work in practice as expected, if the auditee entity does not understand that the auditor’s response to fraud or suspected fraud is included within the scope of the audit exercise in the contract, and recognize they are paying fees for that service. We encourage the auditor to let the auditees understand it in advance. We also encourage the IAASB or the IFAC to ask the supervising authority to educate them, while it may be beyond the scope of the ISAs.

We would like to confirm that the identified fraud or suspected fraud in this context means those identified in the process of audit, and that ED-240 is not intended to require the auditor to conduct proactive investigation to detect fraud. As we answered to Q1, ED-240 it may be better to include the paragraph clarifying that the auditor is not responsible for the prevention of fraud and not expected to detect all cases of illegal conduct .

We are concerned that some financial statement users still appear to expect the auditor to conduct inquiries on fraud by entities as if they were a prosecutor. There may also be some auditees, or preparers, who have excessive expectations on auditor’s inquiries on fraud. We believe the ED-240 should state the auditor’s role and responsibilities more clearly to fill the gap between the auditor’s actual jobs and responsibilities and expectations held by stakeholders including users and preparers of financial statements.

### **3. Regulators and Audit Oversight Authorities**

#### **Financial Reporting Council – United Kingdom**

Agree, with comments below

We are very supportive of the steps proposed to clarify the auditor’s responsibilities relating to fraud. Currently there is ongoing concern that auditors are not doing enough to detect material fraud and that this may, at least in part, be due to a lack of clarity as to their obligation to plan and perform the audit to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement due to fraud. We agree that while the risk of not detecting a material misstatement resulting from fraud may be higher than the risk of detecting one resulting from error, that does not diminish the auditor’s responsibility to plan

and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement due to fraud. It is helpful to have a statement of that in the ISA. The inherent limitations of an audit are not a justification for the auditor to be satisfied with less-than-persuasive audit evidence. The greater the risks of material misstatement the auditor believes exists, the more persuasive the audit evidence required by the auditor.

There is some overlap between the description of the responsibilities of the auditor as set out in paragraph 2 and the objectives of the auditor as set out in paragraph 17. It would be helpful if they were even more closely aligned, and the objectives supplemented to clarify and emphasise they include to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement due to fraud. This would be consistent with the overall objectives of the auditor set out in ISA 200 which include to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement whether due to fraud or error.

### **Irish Auditing & Accounting Supervisory Authority**

#### Application material

A further example of misappropriation of assets that could be provided in paragraph A6 is over or underpayment for goods and services.

The statement in paragraph A10 that allegations of fraud involving the entity are treated as suspected fraud by the auditor is of such importance that it should be moved the requirements section of the standard.

Paragraph A17 states that Appendix 5 to the standard “identifies other ISAs that address specific topics that reference fraud or suspected fraud”. For the avoidance of doubt, it should be clarified that this does not reduce the responsibility on the auditor to consider all relevant ISAs, whether or not they are listed in Appendix 5.

#### Definition of fraud

The IAASB should consider adding corruption, bribery and anti-money laundering to the definition of fraud in ED240. Additionally, the language in paragraph A19 should be amended to make it clear that corruption, bribery and money laundering are fraudulent acts.

Paragraph A11 states: ‘Even when an identified misstatement due to fraud is not quantitatively material, it may be qualitatively material depending on: (a) Who instigated or perpetrated the fraud – an otherwise insignificant fraud perpetrated by senior management is ordinarily considered qualitatively material irrespective of the amount involved. This may in turn give rise to concerns about the integrity of management responsible for the entity’s system of internal control.’ Material fraud often begins with quantitatively non-material fraud and we support the inclusion of ‘qualitative materiality’. We suggest:

‘Cumulative materiality’ such as the period of time covered by the fraud should also be considered. Misappropriation of assets that is not quantitatively material in the current financial year could be if the fraud has taken place over several years and is cumulatively larger than the quantitative materiality level.

The size of the illegal advantage should be taken into account, for example bribery for a small amount to obtain large contracts.

Moving the application material in paragraph A11 to the requirements section of the ISA. This will reduce room for interpretation and decrease the risk of inconsistent application by auditors.

Agree, with comments below

ED 240 is an improvement on the extant standard, including the structure, better alignment with other standards, the added objective regarding reporting, responsibilities of management and those charged with governance, what should be done when fraud occurs, emphasis on qualitative materiality and clarification that difficulty in detecting material misstatements in the financial statements resulting from fraud (rather than error) does not reduce the auditor's responsibilities. We also support the requirement to design and perform audit procedures in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory (paragraph 43).

#### Role of the Auditor

According to ISA 200, the overall objective of the auditor is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatements, whether due to fraud or error. It should be emphasised in ED 240 that these existing provisions drive the role of the auditor conducting an audit in accordance with the ISAs.

#### Botswana Accountancy Oversight Authority

Agree, with comments below

ED240 clearly sets out the auditor's responsibilities relating to fraud in an audit of financial statements now that the inherent limitations paragraph has been removed and disclosed separately. The separation of these paragraphs results on the focus being on what the Auditor's responsibilities are without being obscured by inherent limitations relating to fraud. The paragraph regarding the responsibilities of the auditor coming before the paragraph regarding the responsibilities of management and TCWG also highlights the Auditor's importance in the matter as this standard is specifically designed for Auditors.

#### Independent Regulatory Board for Auditors – South Africa

Enhancements to the introduction section of ED-240 to achieve a synonymous understanding of the auditor's responsibilities related to fraud, including the meaning of fraud to promote consistent behaviour in responding to fraud and to enhance auditor accountability.

Agree, with comments below

We support the following steps taken by the IAASB to address the key issues identified in the project proposal related to the roles and responsibilities of the auditor:

Decoupling the auditor's responsibilities from the inherent limitations

Not expanding the role and responsibilities of the auditor

However, we are concerned that the IAASB has not done enough to achieve its objectives of clarifying the auditor's (general) responsibilities relating to fraud in an audit of financial statements, and specifically non-material and third-party fraud. Our rationale for proposing further enhancements is that clarity about the auditor's responsibilities related to fraud, including the meaning of fraud, will contribute to the public interest objective of promoting consistent behaviour and facilitating effective responses to identified risks of material misstatement due to fraud in an audit of financial statements. We therefore propose:

Enhancements to the introduction section of ED-240, including:

Explaining the interrelated roles and responsibilities of management, those charged with governance and auditors related to fraud.

The separation of the responsibilities of the auditor and management and those charged with governance in ED-240, creates the perception that these responsibilities are mutually exclusive and independent of each other. This is contrary to the position that the effectiveness of fraud prevention and detection is contingent upon the synergistic efforts of both management and those charged with governance, and the auditor.

The IAASB's Discussion Paper on Fraud and Going Concern in an Audit of the Financial Statements emphasised that auditors have a key dependency on others in the financial reporting ecosystem. For example, management, for the prevention and detection of fraud, and those charged with governance to work with management, to oversee the establishment of appropriate anti-fraud controls and take the necessary steps when fraud is detected.

The Responsibilities of the Auditor, Management and Those Charged with Governance section of the introduction to ED-240 could acknowledge that there is a financial reporting ecosystem and could emphasise the synergy of these parties' responsibilities through explaining their interrelated roles and responsibilities.

Elevating the engagement partner's leadership responsibilities related to fraud.

ISA 220 (Revised), Quality Management for an Audit of Financial Statements, deals with the specific responsibilities of the auditor regarding quality management at the engagement level for an audit of financial statements, and the related responsibilities of the engagement partner. Paragraphs 13 - 15 of this ISA elaborates on the engagement partner's responsibility to create an environment for the audit engagement that emphasizes the firm's culture and expected behaviour of engagement team members, including emphasising:

That all engagement team members are responsible for contributing to the management and achievement of quality at the engagement level;

The importance of professional ethics, values, and attitudes to the members of the engagement team;

The importance of open and robust communication within the engagement team, and supporting the ability of engagement team members to raise concerns without fear of reprisal; and

The importance of each engagement team member exercising professional scepticism throughout the audit engagement.

The introduction section to ED-240 could benefit from emphasising, not only professional scepticism and professional judgement as it currently does in paragraphs 12 and 13, but the broader leadership responsibility of the engagement partner that encompasses creating an audit environment that is conducive to fraud risk identification to enforce accountability.

We therefore propose expanding on this current link from ISA 220 and incorporating this broader leadership responsibility into the Responsibilities of the Auditor, Management and Those Charged with Governance section of the introduction to ED-240.

Explaining the manner in which information that is indicative of fraud or suspected fraud comes to the auditor's attention throughout the audit

Paragraph A29 in ED-240 explains that there are various ways in which information that is indicative of fraud or suspected fraud can come to the auditor's attention for example, through management, employees, or internal auditors. Incorporating this into the introduction section of ED-240 has the following potential benefits:

It emphasises that the auditor is not solely responsible for the identification of fraud.

It enhances the understanding of the meaning of fraud in the context of a financial statement audit.

It sets the scene for a response section that is tailored to the specific circumstances of the fraud or suspected fraud. Refer to our response to Question 4.

We propose introducing a new subheading under the Key Concepts in this ISA section of the introduction to ED-240, namely Understanding fraud and how it can come to the auditor's attention and incorporating paragraph A29 under this heading.

Enhancements to the inherent limitations paragraph

We support the inclusion of the statement in ED-240 paragraph 9 that the inherent limitations do not diminish the auditor's responsibilities relating to fraud.

Additionally, we propose incorporating the fact that the auditor does not make legal determinations of whether fraud has actually occurred into the inherent limitations' subsection because it does influence the auditor's ability to assess the impact on the financial statements and take further steps in accordance with ED-240 in the midst of an open investigation. It also better aligns with ISA 200.A52.

Overall, we reflected on the length and complexity of the Inherent Limitations section and question whether: the inherent limitations are understandable (the repeated use of "not"), and

balanced in comparison with how the introduction addresses the auditor's responsibilities related to fraud.

We propose that it may benefit from redrafting for clarity and conciseness.

Non-material fraud

We agree conceptually that:

fraud can be non-material i.e., based on the quantitative assessment it can be immaterial to the financial statements.

the auditor's judgement about materiality must involve both quantitative and qualitative considerations.

However, ED-240 doesn't go far enough in defining non-material fraud and the auditor's responsibilities related to responding to non-material fraud. Therefore, we encourage the IAASB to do more to achieve its objective of promoting consistent behaviour and effective response in this regard. For example:

Given that suspected fraud is not always quantifiable, how do you determine if it is non-material suspected fraud?

What is the difference between non-material suspected fraud and suspected fraud that cannot (perhaps yet) be directly linked to the financial statements for example third-party fraud and fraudulent acts extending from suspicions of corruption, bribery or money laundering?

Can fraud perpetrated by management be non-material to the financial statements? We acknowledge the application material in A11 indicates that if fraud is perpetrated by management, a quantitatively immaterial fraud may be qualitatively material. Is the intention then to suggest that it can also still be non-material?

Considering fraud is by nature intentional, what is a reasonable explanation for why the fraud was perpetrated? What reason will lead the auditor to conclude that a quantitatively immaterial fraud is also qualitatively non-material? The example in paragraph A11(b) is unclear because it involves management which would support that the fraud is material regardless of the why.

Paragraph 8 is not explicit about fraud that is quantitatively material i.e. it doesn't specify that fraud that is quantitatively material to the financial statements is always material. Does the IAASB envision a scenario where

a quantitatively material fraud could be concluded to be non-material for qualitative reasons, for example if the nature of the misstatement due to fraud is misclassification or disclosure related only; or if the fraud was committed by a lower-level employee?

What is the auditor's responsibility in responding to non-material fraud for example, do the requirements in ED-240 only apply to material fraud or suspected fraud? Or what further steps, if any, is the auditor required to take in responding to non-material fraud post concluding that it is non-material.

There is a need to clarify the potential implication of the accumulation of non-material misstatements of the financial statements due to fraud. An accumulation of non-material frauds could be indicative of a more pervasive risk of material misstatement due to fraud, for example, entity-level control deficiencies. This is because there is no explicit linkage between ED-240 and ISA 450, Evaluation of Misstatements Identified During the Audit.

Based on the above, we propose that more guidance is needed to enable a better understanding of the concept of a non-material fraud. It would also be helpful to understand whether the auditor's evaluation of misstatements due to fraud is intended to be applied in the same way that it is applied in ISA 450.

#### Third-party fraud

We support the IAASB's objective not to expand the auditor's role and responsibilities related to third-party fraud that is not directly related to a risk of material misstatement due to fraud in the financial statements.

However, we are uncertain about what the auditor's responsibilities are related to third-party fraud.

We observed that the definition of non-compliance with laws and regulations (NOCLAR) in the Code is confined to acts perpetrated by a client, those charged with governance of a client, management of a client, or other individuals working for or under the direction of a client. Similarly, from a local legislative perspective, we observed that reportable irregularities, which per definition includes unlawful acts or omissions that are fraudulent, are also confined to those matters committed by any person responsible for the management of the entity. The definition of fraud, including third-party fraud as detailed in paragraph A21 of ED-240, is therefore much broader.

We propose to incorporate into the definition of fraud, the link to the risk of material misstatements of the financial statements, to help clarify the parameters of the auditor's responsibilities related to fraud, including third party fraud. Specifically, we propose:

Adapting the definition of fraud in ED-240 paragraph 18(a) to read, "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 through misstatement of the financial statements."

Adapting paragraph A21 to read, "Fraud as defined in paragraph 18(a) can include an intentional act by a third party. Fraud or suspected fraud committed against the entity by customers, suppliers, service providers, or other external parties which may cause the financial statements to be misstated is generally described as third-party fraud."

Additionally, we encourage the IAASB to provide guidance related to practical impediments to the auditor's ability to fulfil its responsibilities related to third-party fraud, including for example:

The premise in ISA 500, Audit Evidence, that the reliability of audit evidence is increased when it is obtained from independent sources outside the entity. Therefore, the auditor won't necessarily have a reason to doubt or question the information provided to the entity by a third-party.

Constraints, such as limited access to third parties, which can impede the auditor's ability to investigate suspicions of fraud thoroughly, including instances of potentially falsified documents.

### European Securities and Markets Authority

#### Role and Responsibilities of the Auditor on matters relating to fraud

ESMA welcomes the IAASB's proposal to clarify the role and responsibilities of auditors relating to fraud in an audit of financial statements. ESMA considers that the proposals from the IAASB to decouple the concepts addressing the auditor's responsibilities from the inherent limitations of an audit significantly improve the clarity of the role, responsibilities and limitations of auditors' work in the context of fraud. ESMA considers that it is key that the auditor's responsibilities are clearly stated and understood by all parties to reduce expectation gaps between what the market may expect from auditors and auditors' actual role.

In this vein, ESMA is of the view that the description of auditors' responsibilities should not include any language that could be perceived by users of financial statements as disclaimers that discharge auditors from their duties. Therefore, ESMA agrees with the IAASB's proposal to include language clarifying that the limitations inherent to the audit work should not be understood as an exoneration of auditors' responsibilities (i.e., the auditor remains responsible for planning and performing the audit to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatements due to fraud).

Furthermore, ESMA supports the Board's approach on the assessment of materiality in the context of fraud. Notably, ESMA strongly believes that materiality of a misstatement due to fraud should be assessed both from a quantitative and qualitative perspective based on who instated or perpetrated the fraud and why the fraud was perpetrated. While ESMA agrees with the considerations included in paragraph A11 of ED-240, it also considers that other circumstances could be explicitly referred to in the application material. The IAASB could consider including the following examples to illustrate as to when qualitative factors may be relevant when assessing materiality: intentionally omitting qualitative (or narrative) information or intentionally providing unclear qualitative (or narrative) information in the financial statements to achieve a particular presentation of an entity's financial position, financial performance or cash flows (e.g., by obscuring material information with non-material information or by intentionally using vague, boilerplate or ambiguous language).

#### Transparency and communications with Management and TCWG

ESMA agrees with the extant ISA 240 when stating that (i) the primary responsibility for the prevention and detection of fraud rests with both TCWG of the entity and management and (ii) the role of the auditor is to obtain reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. While both roles should not be confused, ESMA believes that there is a valid expectation that auditors are also responsible to detect and to report on fraud and fraud risks that are material to financial statements. Therefore, we concur with the changes proposed to the audit report and, particularly, to the proposals regarding Key Audit Matters. ESMA is of the view that these changes will enhance the clarity of the auditor's responsibilities vis-à-vis fraud.

### 4. Jurisdictional and National Auditing Standard Setters

#### Japanese Institute of Certified Public Accountants

Agree, with comments below

We believe that ED-240 clearly sets out the auditor's responsibilities relating to fraud in an audit of financial statements, including those relating to non-material fraud and third-party fraud.

However, some of the examples in application material paragraphs A2 - A6 and the examples of fraud risk factors in Appendix 1 seem to overlap, so we suggest that the IAASB consider deleting the duplicative examples in the application material.

### **Wirtschaftsprüferkammer**

While we basically agree with the proposals regarding the auditor's responsibilities relating to fraud in an audit of financial statements, we would like to emphasize the importance of clearly articulating that the audit of the financial statements should not be mistaken for a forensic audit. While addressing fraud in a financial audit is crucial, it is imperative to maintain a distinction between the two kinds of engagements considering the different objectives and methodologies. The purpose of a financial audit primarily is about ensuring the accuracy and fairness of financial statements as well as compliance with accounting standards, and providing assurance to stakeholders. In contrast, forensic audits are specifically focused on investigating suspicions of fraud, misconduct, or legal irregularities, often involving specialized techniques and procedures.

Clarity in communication regarding the nature and scope of the audit is essential to avoid misconceptions among stakeholders. It is vital that the draft explicitly delineates the boundaries of the audit process and underscores that while it includes procedures to detect material misstatements due to fraud, its primary focus remains on the overall compliance with the financial reporting framework. This distinction not only safeguards the integrity and objectivity of the audit but also helps manage expectations among stakeholders regarding the outcomes and limitations of the engagement.

Such clarification and distinction will ultimately contribute to enhance the effectiveness and credibility of the financial audit and to avoid a further increase of the expectation gap.

### **American Institute of Certified Public Accountants**

Agree, with comments below

We believe ED-240 helps to clarify the auditor's responsibilities relating to fraud in an audit of financial statements while retaining the inherent limitations of the audit. However, we believe clarification is necessary related to the auditor's responsibilities for nonmaterial fraud as well as when fraud is clearly inconsequential as further explained in our response to question 5. We also provide several recommendations for further clarity as detailed below.

We recommend that the IAASB provide further guidance relating to paragraph 8 and how to apply ED-240 when an identified or potential misstatement due to fraud (a) has been determined to be quantitatively material; (b) has not been determined to be quantitatively material but may be qualitatively material (for example, the fraud involves senior management or is indicative of a pattern of fraud); or (c) has been determined to be neither quantitatively nor qualitatively material, and list the relevant requirements in ED-240 to help auditors navigate ED-240 in those situations.

We also believe that additional clarification in the following areas is needed to further enhance the auditor's understanding of their responsibilities:

Responsibilities of the Auditor, Management and Those Charged With Governance

Responsibilities of Management and Those Charged With Governance

Paragraph 3

We recommend retaining language from extant ISA 240 within the last sentence in paragraph 3. We believe this content is helpful for auditors because it provides a clearer and more detailed example of management overriding controls to manipulate earnings.

.03 ...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 manipulate earnings in order to influence the perceptions of financial statement users regarding the entity's performance and profitability.

Key Concepts in this ISA

Characteristics of Fraud

New Paragraph A1A Related to Paragraph 4

New Paragraph A1A

We recommend adding application material to paragraph 4 to describe the inherent limitations of determining intent. This additional content will provide clarity about the auditor's responsibilities related to intent and help minimize confusion about the auditor's responsibilities.

Characteristics of Fraud (Ref: Para. 4-5)

A1A. Intent is often difficult to determine, particularly in matters involving accounting estimates and the application of accounting principles. For example, unreasonable accounting estimates may be unintentional or may be the result of an intentional attempt to misstate the financial statements. Although an audit is not designed to determine intent, the auditor's objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.<sup>fn</sup>

<sup>fn</sup>ISA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing, paragraph 11.

Other Paragraphs

Please see our response to question 10 for comments that are more editorial in nature related to paragraphs A3 (par. 5), A5 (par. 5), and 6.

### **Compagnie Nationale des Commissaires aux Comptes and Conseil Supérieur de l'Ordre des Experts-Comptables**

Agree, with comments below

Based on the premise that the auditor's role is primarily to identify material misstatements in the financial statements whether due to fraud or error and not to detect fraud committed by third parties, particularly when such fraud does not raise a risk of material misstatement of the financial statements, we consider that the auditor's role should be limited to third-party frauds that raise a risk of material misstatements in the financial statements.

In addition, we believe that the term " third-party" needs to be clarified: does this term refer to all external parties, i.e. other than management, governance and employees? Or does it refer to third parties with which the entity has some sort of contractual agreements? At present the guidance around third parties (paragraph A21 below) refers to customers, suppliers, service providers, or other external parties. It should be clarified who those other external parties are. Are they "other similar external parties"? I.e. similar to customers,

suppliers, service providers, etc.? Or are they “all other external parties”? i.e. the rest of the world. Is a hacker or a shoplifter a third party in the meaning of the standard?

Moreover, paragraph A21 states that “Fraud as defined in paragraph 18(a) can include an intentional act by a third party. Fraud or suspected fraud committed against the entity by customers, suppliers, service providers, or other external parties is generally described as third-party fraud.”

The notion of “suspected third-party fraud” combined with the notion of “other external parties” further broadens the scope of the standard and increases the risk of widening the expectation gap.

### **New Zealand Auditing and Assurance Standards Board of the External Reporting Board**

Agree, with comments below

Generally the NZAuASB agrees that ED-240 clearly sets out the auditor’s responsibilities relating to fraud in an audit of financial statements. We agree with decoupling the descriptions of inherent limitations of the audit and the auditor’s responsibilities because the inherent limitations do not diminish the auditor’s responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement due to fraud. We are however concerned that there may be some “scope creep” with regard to third-party fraud.

#### **Third-party fraud**

The auditor’s responsibilities regarding third-party fraud are not clearly defined. While the definition of fraud in ED-240 includes reference to third-party fraud, the ED, as currently drafted, does not adequately convey that it is not the responsibility of the auditor to detect third-party fraud that is not directly related to a risk of material misstatement due to fraud in the financial statements.

#### **Non-compliance with laws and regulations**

We understand that fraud constitutes an instance of non-compliance with laws and regulations and that the auditor may have additional responsibilities as described in ISA 250. However, we find the example of a cybersecurity breach in paragraph A16 confusing and provides little value as currently drafted. Paragraph A16 already states that identification of fraud or suspected fraud perpetrated by a third party may also give rise to additional responsibilities for the auditor under law, regulation or relevant ethical requirements. We believe the example could benefit from addressing what action the auditor might need to take to address the risk of material misstatement of the financial statements due to fraud.

### **Australian Auditing and Assurance Standards Board**

Agree, with comments below

The AUASB is supportive of the auditor’s responsibilities relating to fraud as set out in ED-240. The auditor has the primary responsibility for audit quality. While fraud can be more difficult to detect, overall ED-240 appropriately outlines the auditor’s responsibilities in obtaining reasonable assurance that the financial report is not materially misstated, whether due to error or fraud.

We also agree that the primary responsibility for the prevention and detection of fraud rests with management and those charged with governance (TCWG). Australian practitioners have highlighted continuing concerns with expectation gaps and that some users of financial reports and others may have a perception that the auditor has sole or primary responsibility for preventing and detecting material fraud.

While recognising the challenges in addressing expectation gaps, there should be appropriate communication and education in national jurisdictions on the responsibilities of management and TCWG. Greater

transparency by the auditor should be complemented in due course by jurisdictional requirements for statements by TCWG as to how the risks of material fraud have been identified and addressed.

We also note that securities and audit regulators in Australia and elsewhere have worked to educate and remind management and TCWG on their roles and responsibilities in relation to financial reporting quality, as well as how they can support audit quality. Guidance issued by IOSCO for audit committees and others includes IOSCO Report on Good Practices for Audit Committees in Supporting Audit Quality (January 2019) and IOSCO Consultation on Goodwill (June 2023).

Other matters raised by Australian practitioners in connection with expectation gaps included:

ED-240 does not adequately convey in all instances that auditors are only responsible for financial statement fraud that could result in a material misstatement. For example, paragraph 2 on the auditor's responsibilities refers to the risk of material misstatement, whereas subparagraph 2(b) on reporting does not refer to the risk of material misstatement.

Paragraph A21 should state the auditor is not responsible for conducting an in-depth assessment of third-party fraud risk and that a more specific targeted engagement would be required to address those risks. Practitioners noted that the example of a cybersecurity breach in paragraph A16 may be contradictory to the intent of IAASB not to expand the auditor's role.

The use of the word 'possibility' through ED-240, for example in paragraphs 12 and 19, could be interpreted as potentially broadening the auditor's role and responsibilities. Paragraph 19 should be more closely aligned with ISA 200, which states, "The auditor shall plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated."

Reversing the order of the introductory paragraphs on the auditor's responsibilities and management's responsibilities.

Paragraph A12 on the factors that may make it more difficult to detect fraud compared to error (e.g. collusion) should be reinstated into the introductory paragraphs.

### **Saudi Organization for Chartered and Professional Accountants**

Agree, with comments below

SOCPA believes that the proposed revisions have introduced comprehensive explanations and illustrative examples (e.g. appendix 2) which can contribute to the clarity and understanding of the auditors' role and responsibilities for fraud in an audit of financial statements. However, we think that such added materials raise the risk of narrowing the expectation gap at the expense of audit quality as the auditor is still providing reasonable assurance which involve certain inherent limitations. In some parts of the proposed revisions in the ED-ISA 240, the language seems rhetorically expanding the responsibility of the auditor for fraud. Although the ED-ISA 240 emphasizes on the reasonable assurance concept and its related inherent limitations (e.g. paras 9, 10 & 11), other parts of the proposed revisions raises the expectations, which could paint a mind image that the auditor should detect and publicly report every material misstatements due to fraud.

Arranging the responsibility of auditors for fraud in an audit of financial statements first in the order before the responsibility of the management and those charged with governance does not seem to align with the consistent approach used in the ISAs. For instance, in ISA 250, the management's responsibility to ensure compliance of the entity's operations with the relevant laws and regulations comes first before the auditor's. Also, this approach can be seen in ISA 200 where the management's responsibility for preparing the financial statements according to the applicable financial reporting framework (e.g. the "premise") comes first in order

before the discussion of auditors' responsibilities. Therefore, we believe that this proposed shift to put auditors' responsibilities first in order since they are the main users of the standards may generate unintended consequences on the understanding of auditors' responsibilities for fraud in an audit of financial statements. It is more logical and consistent with the ISAs' approach to have management's responsibility for preventing and detecting fraud first in order before clarifying the auditor's responsibility. This is important because it specifically goes in line with the "premise" of auditing standards that the management is the one responsible for preparing the financial statements in accordance with the applicable financial reporting framework and in compliance with the relevant laws and regulations.

The responsibility for detecting and reporting fraud issues (illegal acts) exposes auditors to serious legal considerations, which have not been comprehensively clarified in the revisions in a way that can be practically implemented, for instance, the operational meaning of the "legal determinations" concept. Such proposed expansion of auditors' responsibility, which can be comprehended from the revisions' approach, may harm public's confidence in the audits as the public would increasingly perceive auditors who do not report misstatements due to fraud as failing to fulfil their responsibilities. This risk can be seriously heightened in the time of corporate failures. Therefore, we think that auditors' responsibility with regard to fraud detection and the legal considerations (including the idea of "legal determinations" while asking for more procedures relating to fraud risks) should be further illustrated taking into consideration the requirements of ISA 250. Accordingly, It can be difficult in practice to operationalize the idea that auditors are not responsible to detect (investigate) fraud issues, but at the same time they have a reasonability to assess the existence of fraud risks and report (in the audit report) such fraud matters, even if they do not find any material fraud issues. Thus, more specific examples and illustrations could help.

Although the proposed revisions provide beneficial clarifications regarding the risk assessment and audit procedures in relation to fraud risks which can enhance the understanding of the auditors' responsibilities for fraud, we believe that there is still a need for adequate illustrations clearly define the limits of the auditors' responsibilities. For instance, such heightened emphasis on the acknowledgement of fraud risks (including third party fraud; as described in A18-A20) stresses the significance for introducing more clarifications on "legal determinations" concept which auditors should be wary not to engage in. This is specifically important because when a fraud or suspected fraud matter is assessed, there would be always a discussion about the perpetrators of such acts as part of the risk assessment and the required responsive audit procedures. This may require auditors themselves to possess certain level of fraud investigation skills and knowledge considering the costs associated with the consultation process with legal and forensic investigation experts.

Although the proposed revisions in the ED-ISA 240 clarified the importance of considering the need to involve certain experts in order to help with assessing fraud related risks (e.g. A35), the emphasized idea to involve a forensic expert in the audit process as one of the procedures that auditor should consider to help understand and assess fraud related risks should be further illustrated with examples clarifying when to assess that there is a need whether from the beginning or throughout the audit engagement.

SOCPA agrees that the proposed revisions in the ED-ISA 240 provide comprehensive illustrations which help address different circumstances that auditors might face. However, taking into consideration our comment on the first question, the proposed revisions in ED-ISA 240 introduce heavy burden on auditors' professional judgement in order to fulfil their role and responsibilities regarding the fraud risks. This heavy reliance on auditors' judgement may become a concern to the public who may perceive the emphasis on auditors' proposed expanded role and responsibilities in relation to fraud (including the reporting of material fraud issues in the audit report) as a major element in evaluating the quality of auditors' work. This may require further awareness and supplemental guidance to help navigate auditors' responsibility, including their exercise of

professional judgment in the context of assessing and responding to fraud risks in an audit of financial statements.

### **Austrian Chamber of Tax Advisors and Public Accountants**

Agree, with comments below

In general, the proposed revision of ISA 240 is a positive step towards a better understanding of aspects, circumstances, and challenges of all sorts of fraud affecting the fair presentation of financial information and the role played by an auditor in this regard. However, other parties, particularly management and those charged with governance (TCWG), undoubtedly play a particularly more important role than the auditor in combating fraud.

We propose that the efforts of the IAASB should focus on responding to valid expectations of stakeholders and evolving business environment. Any suggested changes to auditing standards should be clear and proportionate, reflecting the fact that the primary responsibility for the prevention and detection of fraud rests with the management and TCWG of the entity. There is a certain level of inconsistency in stakeholders' understanding with regards to what the purpose of the financial statements audit is. We believe that the IAASB has a further role in actively informing stakeholders (i.e., through targeted outreach and including specific text in ISA 240), especially as to the inherent limitations the auditor faces.

This revision of ISA 240 along with more reporting requirements for the auditors bears some risks. This is because there is no regulatory requirement for the management to make a public statement regarding the effectiveness of internal controls over financial reporting, including with respect to fraud, and because TCWG are not responsible for reporting about its role of monitoring such internal controls.

One can see the consequence that the revised standard may widen the expectations gap by responding to potentially evolving market needs but may not contribute to an overall better financial reporting ecosystem that is free from material misstatement.

The clear presentation of the individual aspects of fraud and suspected fraud (including allegations of fraud) is a helpful point to understand the definition of fraud according to the ISA.

The revised section "Introduction" of ISA 240 creates high expectations regarding more detailed explanations of the auditor's responsibility including a more detailed explanation of inherent limitations. We suggest rewording the section "inherent limitations" to "inherent limitations of an audit" and provide more guidance about the auditor's responsibility and requirements. Regarding the wording in ISA 240.9 -11, we have the following comments:

Responsibility to obtain reasonable assurance is not diminished by a higher detection risk (9.) - The auditor's role is not to detect fraud but is instead directed to identifying risks of material misstatement of the financial statements arising from fraud. We recommend that this statement in an audit standard should either in a positive way address the efforts an auditor has to make (by reference to other sections in the standard) in order to achieve this goal or to remove this sentence because it may bear the risk of misunderstanding (higher detection risks are not a reason to reduce audit procedures but instead to plan and execute further audit procedures). It is stated that there is an unavoidable risk of undetected material misstatements, but still the auditor shall not be satisfied by "less than persuasive audit evidence" (10) - The message of this statement is unclear – together with Para. A 12 it leaves room for interpretation and gives no clear guidance.

Management Fraud is harder to detect. (11) - This point depends on the quality of the internal control environment established by the management and overseen by TCWG. We recommend connecting this point

to ISA 240.3 regarding the primary responsibility for the prevention and detection of fraud of the management and TCWG.

To improve the linkages between this standard and other ISA, we suggest including in Appendix 5 all relationships to other ISA as explained in the “non authority guidance fraud lens – interactions between ISA 240 and other ISAs” and add the ISA 220 regarding the aspect of consultation.

ISA 240.10 explains that the auditor should not be satisfied with audit evidence that is “less than persuasive” / A 12 however only explains why it is hard to detect false audit evidence but does not explain factors that make audit evidence “less than persuasive”. We want to highlight that this kind of statement in general is contradictory to the overall requirement of professional skepticism and gives no additional helpful guidance.

We suggest clarifying the links between third party fraud and the scope of audit as well as the links between non-compliance with laws and regulations and scope of audit.

For example, A52 sets out examples for third party fraud. This is a very broad subject that should be emphasized. Risk factors are hardly to be obvious, and it should be clarified that the auditor should base his risk assessment on the risk evaluation of the client, otherwise this cannot be covered sufficiently in an audit.

#### **Instituto Mexicano de Contadores Publicos**

Agree, with comments below

The auditor responsibilities are clearly identified in the standard and we agreed with them, however the standard does not include any responsibility over non-material error relating to fraud and we agree those non material risk are not deal into the standard.

#### **Instituto de Auditoria Independente do Brasil**

Agree, with comments below

Proposal to dissociate the description of inherent limitations relating to fraud in an audit x paragraphs describing the auditor’s responsibilities related to fraud:

having inherent limitations described together with the auditor’s responsibilities is important because those inherent limitations are fundamental for stakeholders in understanding the auditor’s responsibilities in relation to fraud. So, the proposal to dissociate” these concepts might lead to misunderstanding.

Application material within A12 of ED-240 provides important context for stakeholders to understand “why” the risk of undetected misstatements due to fraud are higher than those due to error. We believe that the content within A12 should be presented together with Para..

Responsibilities of Management and TCWG x Responsibilities of the auditor

the responsibilities of the auditor in ED-240 were described before those of management and TCWG, and those are more prominent. Given that the primary responsibility for the prevention and detection of fraud resides with management and TWCG as stated in Para 3 of ED-240, we believe this paragraph should be placed before those describing the auditor’s responsibilities.

Certain “protective” language in the extant was removed from ED-240, including (suggestion to include these protective language):

That it will be rare the auditor detects fraud (ED-240, paragraph 6)

That the auditor may accept records and documents as genuine (ED-240, paragraph 20)

That it is difficult for the auditor to determine whether misstatements in judgment areas such as accounting estimates are caused by fraud or error (ED-240, paragraph A12)

Paragraphs 19 and 21 use language that does not provide appropriate transparency of the auditor's responsibilities for fraud (e.g., shall remain alert throughout the audit).

#### Quantitatively material fraud

we suggest that the ED-240 also consider the matter of "intent" when dealing with qualitative considerations (i.e. determining whether the fraud or suspected fraud is qualitative material), including expanding the application material to provide guidance as to relevant considerations for the auditor when determining whether the "intent" is a present element. "Intent" also helps in the evaluation of whether a misstatement would be qualitative material (e.g. a misstatement may be quantitatively not material but may involve senior management and appear to be intentional – this may indicate a misstatement due to fraud that may be qualitative material).

Additionally, we also believe more clarity is warranted in paragraph A11, which considers when an identified misstatement due to fraud that is not quantitatively material may be qualitatively material.

#### Third-Party Fraud

as the identification and response to risks of material misstatement due to third-party fraud may be more challenging for auditors, we recommend that ED-240 provides more guidance with respect to considerations for auditors when identifying and assessing risks of material misstatement in relation to third-party fraud and how to respond to these risks. This may include factors to consider (including industry-specific and jurisdiction risks), potential effects arising from the broader geopolitical and economic environment, examples of "red flags", example of inquiries to perform to management and TCWG, areas of the financial statements that are more susceptible to third-party fraud, and when to consider having access to third-party's systems, records and personnel to perform audit procedures to address such risks.

Paragraph 92 of the Explanatory Memorandum (EM) that accompanies ED-240 states that the "IAASB did not support expanding the role of the auditor to detect third-party fraud that is not directly related to a risk of material misstatement due to fraud in the financial statements. However, the IAASB enhanced the application material in paragraph A16 of ED-240 by explaining the auditor's action if third party-party fraud or suspected fraud is identified by the auditor that may give rise to risks of material misstatement due to fraud." We do not believe that paragraph A16 as currently drafted, which also refers to, as an example, the effects of a cybersecurity breach, clearly explains this intent. Thus, we suggest including another example in this paragraph and leave cybersecurity issues to the technology workstream.

Additionally, paragraph A21 fails to limit the role of the auditor to third-party fraud that poses a risk of material misstatement due to fraud.

#### e. Non-material fraud

With respect to non-material fraud, we support paragraph 6 of ED-240, however we believe it is still unclear that the auditor does not have to apply the response requirements in respect of identified or suspected fraud that is clearly not material. A second sentence should be added to paragraph 6 to make this explicit.

In order to complement performance of quality audits and fully address elements of the expectations gap, we believe that solutions that deliver meaningful change demand a comprehensive approach involving active engagement from all

stakeholders. For example, changes could be considered by global regulators and standard setters, for certain entities, to enhance management's focus on establishing and monitoring processes and controls to identify, assess and respond to risks of fraud and more fulsome disclosure by entities, in providing transparency to users of financial statements, about such processes and controls. We encourage the IAASB to continue in active dialogue with other stakeholders in the reporting ecosystem to influence broader change.

### Royal Dutch Institute of Chartered Accountants

Agree, with comments below

Positive remarks:

We support the approach of emphasizing and clarifying the auditor's responsibilities.

ED-240 clarifies and enhances the auditor's responsibilities:

Starting with the auditor's responsibilities in par. 2, the concept of material fraud on qualitative considerations in par. 8, and the concept in par. 9, 10 and 11 that inherent limitations do not diminish the auditor's responsibility.

Furthermore, par. 14 (non-compliance with laws and regulations) sets out that fraud comes first, on which the auditor has to act in accordance with ED-240. Non-compliance may introduce additional responsibilities as explained in par. A15.

Constructive critical remarks:

The responsibilities and requirements imposed on the auditor will become effective in practice if audited entities and other parties in the financial reporting ecosystem also assume their roles and responsibilities.

Various forms of corruption or bribery can be regarded as fraud, for instance bribery, kickbacks and facilitating payments, depending on jurisdictional provisions. In par. A18, corruption or bribery seem to be considered as dealing with laws or regulations. In par. A19, forms of corruption and bribery are considered as forms of fraud. We suggest IAASB clarify in what cases corruption or bribery are to be considered as fraud in relation to the definition of fraud, and not only with examples in A19.

Regarding misappropriation of assets (par. 5, 18(a)), we suggest IAASB to explain whether this might include 'product fraud' and at what moment this becomes the auditor's responsibility to act. Although this aspect is not the primary goal of an audit, this may become relevant through indications of fraud or non-compliance. For example, the engineering of fraudulent software and items to commit 'diesel fraud' includes intent, concealment and illegitimate benefit and therefore may be categorized as product fraud, i.e. being fraudulent relating to products as to obtain inappropriate benefits. Furthermore, this was likely not what the shareholders of the perpetrating car manufacturers had in mind for their investment.

Regarding par. 10, what is meant by less than persuasive evidence ('However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less than persuasive audit evidence.')

The audit evidence ordinarily required is sufficient and appropriate. In light of inherent limitations should there be more sufficient appropriate audit evidence than is ordinarily required?

Regarding third-party fraud (par. 18), this may make the client complicit in money laundering by the third party. Many jurisdictions include provisions to combat money laundering (and financing terrorism). As such, this may affect the client's business and financial statements, even if the money laundering initiative came from a third party. However, this only affects the auditor's responsibility if the third party fraud results in a material

misstatement in the client's financial statements. We suggest the IAASB clarify to treat third party fraud in the same manner as other fraud and include more examples in the explanatory section.

Overall, we commend the IAASB for the efforts to revise ED-ISA240, given the public interest expectations as well as the experiences with extant ISA240. We strongly support the IAASB's efforts to better align ED-ISA240 with the revised risk model (per ISA315). We also appreciate the clarification of the auditor's responsibilities regarding fraud as well as the enhanced balance in how the standard describes the auditor's responsibilities in relation to management's responsibilities. In our view, these revisions represent a major step forward.

## 5. Accounting Firms

### BDO International

Agree, with comments below

We agree with the proposed changes and reallocation of the paragraphs with the intention of clarifying the responsibility of the auditor in regards the identification of fraud in an audit of financial statements (including non-material fraud or suspected fraud). We also agree with the intention of the IAASB that auditors apply a fraud lens during the audit. However, we recommend that the IAASB emphasize in communications about the revised standard that the changes within the revised standard do not have the intention of expanding the roles and responsibilities of the auditor with respect to fraud.

As it relates to the concept of qualitatively material fraud, although the requirements are the same as extant ISA 240, we also agree that paragraph A11 will help to reinforce to the auditors the importance of considering factors irrespective of the amount involved.

### PriceWaterhouseCoopers

Agree, with comments below

Overall comments

Existing ISA 240 (Revised) establishes appropriate responsibilities for the auditor with respect to considering risks of material misstatement due to fraud. However, we agree that, in key areas, these responsibilities can be further clarified and enhanced. Fraud continues to be a persistent topic of discussion in respect of the requirements of an audit, resulting from both potential misunderstanding of the responsibilities of an auditor with respect to fraud and the ability of an audit to detect fraud, as well as a desire from some stakeholders for auditors to provide greater transparency about their work in this key area. We recognise the public interest benefits of more transparency about the work of the auditor that is responsive to the risks of material misstatement due to fraud. As such, we are supportive of the overarching objectives of the IAASB's project to revise ISA 240, aimed at enhancing the clarity and robustness of the auditor's responsibilities regarding fraud in an audit of financial statements and the transparency thereof.

As a network, PwC is focused on enhancing the execution and transparency of our work regarding fraud. Appropriate auditing standards that are responsive to stakeholder needs, together with consistent application of them by auditors, are important elements to maintaining trust in the audit profession. We support many of the proposed changes and believe they will help reinforce appropriate procedures and auditor behaviours.

In expressing that support, we note that corporate reporting operates within a complex ecosystem, comprising various interconnected stakeholders, including preparers, those charged with governance, investors, regulators and other users. Auditors have an important role to play in addressing the expectations of these participants, and therefore strengthening the auditing standards is one element in achieving this. The auditor's

response to identified and suspected fraud can result in material impacts from fraud being pre-empted. However, to complement performance of quality audits and fully address elements of users' expectations, we believe that solutions that deliver meaningful change demand a comprehensive approach involving active engagement from all stakeholders. For example, changes could be considered by global regulators and standard setters, to enhance management's focus on establishing and monitoring processes and controls to identify, assess and respond to risks of fraud, given the different approaches that may exist from a legal or regulatory perspective in various jurisdictions and in relation to the nature of the entity (e.g., public interest entities vs. private companies). Furthermore, more fulsome disclosure by listed and other public interest entities about such processes and controls, which could include a statement by management on the effectiveness of internal controls over financial reporting, including controls related to fraud, would provide useful transparency to users of financial statements and be in the public interest. Similarly, for such entities, those charged with governance have an important role to play by explaining how they have considered and, where relevant, challenged management on the effectiveness of such processes and controls. We believe it is important that such responsibilities are established in law or regulation and that, similar to management, disclosure by those charged with governance of how they have discharged those responsibilities provides meaningful transparency for users. While outside the remit of the IAASB, these are areas – similar in nature to recognising the overall responsibility of management with respect to an assessment of an entity's ability to continue as a going concern – where respective responsibilities need to be transparent and balanced. We encourage the IAASB to continue in active dialogue with other stakeholders in the reporting ecosystem to influence broader change.

In this regard, we note the 'Introduction' section is intended to highlight management's and those charged with governance's responsibilities and other key concepts in the proposed standard. To avoid the risk that this section might be misinterpreted or be viewed as potentially undermining the requirements in the standard that set out the obligations of the auditor, due to the use of the shorthand references in certain paragraphs of ED-240 as to whether fraud or suspected fraud is or is not "material", we recommend paragraph 8 is clarified as shown below.

"The auditor's determination of whether a fraud or suspected fraud is material in the context of an audit of the financial statements, including whether it gives rise to a material misstatement of the financial statements, involves the exercise of professional judgment. This includes consideration of the nature of the circumstances, giving rise to the fraud or suspected fraud and the identified misstatement(s). Judgments about materiality involve both qualitative and quantitative considerations."

#### Third-party fraud

With respect to the proposed changes concerning the auditor's responsibilities regarding fraud, we believe further clarity is needed regarding the IAASB's intent with respect to fraud committed against the entity by third parties. Paragraph A16 of the application material in ED-240 acknowledges that the auditor may have "additional" responsibilities when fraud or suspected fraud perpetrated by a third-party is identified and that such responsibilities may arise under law, regulation or relevant ethical requirements. However, the guidance does not clearly explain whether the auditor is expected to conduct audit procedures or to investigate such instances of fraud or suspected fraud in conducting an audit in accordance with ISAs. Paragraph 92 of the Explanatory Memorandum (EM) that accompanies ED-240 states that the "IAASB did not support expanding the role of the auditor to detect third-party fraud that is not directly related to a risk of material

misstatement due to fraud in the financial statements. However, the IAASB enhanced the application material in paragraph A16 of ED-240 by explaining the auditor's action if third-party party fraud or suspected fraud is identified by the auditor that may give rise to risks of material misstatement due to fraud." We do not believe

that paragraph A16 as currently drafted, which also refers to, as an example, the effects of a cybersecurity breach, clearly explains this intent. Further clarification of the IAASB's intent may be helpful in paragraph A21.

While we agree that cybersecurity risks can affect financial reporting, and certain jurisdictions have increased their focus on company disclosures regarding cybersecurity risk management programs and disclosure of cybersecurity incidents, cybersecurity may not be the best example to use to illustrate the concept of third-party fraud. An example based on fraud by a supplier of goods or services to the entity may be more appropriate. However, the IAASB should consider whether a more fulsome discussion of cybersecurity is warranted by the Board in the context of its separate Technology workstream.

#### Non-material fraud

With respect to non-material fraud, we support paragraph 6 of ED-240 but believe it may remain unclear that the auditor does not have to apply the response requirements in relation to an identified or suspected fraud that is clearly not material, including matters that are clearly inconsequential – a phrase used in the IESBA NOCLAR provisions. We suggest a second sentence is added to paragraph 6 to make this explicit. For example:

“Although matters may be identified during an audit that may constitute fraud in a broad legal sense, the auditor is not required to respond to matters that clearly could not result in material misstatement of the financial statements.”

We also agree in principle with the statement in paragraph 7 that suspected fraud includes allegations of fraud that come to the auditor's attention during the course of the audit. However, we note that there is a lack of consistency in the standard regarding the use of the phrase “suspected fraud” and “suspected fraud, including allegations of fraud.” Given the clear statement in paragraph 7, the latter phrase is redundant and may cause confusion. We recommend the shorter phrase is used throughout the standard to avoid any ambiguity or misinterpretation.

#### SRA

Agree, with comments below

ED Paragraphs 8, 14 and 18. Fraud is an aspect of the broader concept of financial and economic crime, which also includes, for example, money laundering and corruption. We propose that the scope of the term ‘fraud’ in the light of ISA 240 be clarified in the definition.

ED Paragraph 10. It is not clear what is meant in paragraph 10 by ‘less than persuasive audit evidence’. Is it intended that more and/or other audit evidence should be obtained with regard to the risk of a material misstatement resulting from fraud than what is understood by ‘sufficient and appropriate audit evidence’?

#### Deloitte

Agree, with comments below

We generally agree that ED-240 sets out the auditor's responsibilities relating to fraud in an audit of financial statements; however, we believe the following recommendations (and related changes) to ED-240 would provide additional clarity.

#### Perceived Shift in Responsibilities Relating to Fraud Detection

We are concerned that the proposed changes to ED-240, when taken together, may be perceived as inappropriately shifting the onus of fraud prevention and detection solely onto the auditor, despite the primary responsibility resting with management and those charged with governance. To retain the appropriate

emphasis on the responsibilities of management and those charged with governance, and clearly define the auditor's role and circumscribe it to the auditor's core competencies, there are certain recommendations we have provided throughout this comment letter to better align the responsibility of the auditor to detect fraud, including the following:

We have concerns with the reordering of the ED-240 paragraphs relating to (1) the responsibilities of management and those charged with governance and (2) the responsibilities of the auditor. While we acknowledge that ED-240 still states that management and those charged with governance have the primary responsibility for the prevention and detection of fraud, the placement of this paragraph below the responsibilities of the auditor does not adequately demonstrate that management and those charged with governance are first and foremost responsible for preventing and detecting fraud. Accordingly, we recommend that the order of paragraphs 2 and 3 within ED-240 be reversed such that the paragraph describing the responsibilities of management and those charged with governance is first as paragraph 2.

Paragraph 2 of ED-240 omits the responsibility of the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement due to error (i.e., in addition to fraud). This omission places undue emphasis on the auditor's responsibility to detect fraud.

Paragraph 2: "The auditor's responsibilities relating to fraud when conducting an audit in accordance with this ISA, and other relevant ISAs, are to:

Plan and perform the audit to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement due to error or fraud. These responsibilities include identifying and assessing risks of material misstatement in the financial statements due to error or fraud and designing and implementing responses to address those assessed risks."

We believe that certain language that was removed from extant ISA 240 should be included in ED-240 to avoid overstating the role and ability of the auditor to detect fraud.

It is a bedrock principle in the preparation and auditing of financial statements that management and those charged with governance have primary responsibility in fraud detection. As recognized in the extant standard and ED-240, paragraph A12, the auditor is inherently limited in its ability to detect fraud because it may involve "sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations to the auditor." Therefore, we recommend the following edits in paragraph 6 of the ED to better reflect auditor's capabilities:

Paragraph 6: "Although fraud is a broad legal concept, for the purposes of the ISAs, the auditor is concerned with a material misstatement of the financial statements due to fraud. Although the auditor may suspect or, in rare cases, identify or suspect the occurrence of fraud as defined by this ISA, the auditor does not make legal determinations of whether fraud has actually occurred."

We believe that certain existing language (bolded and underlined below) should be carried forward, with some minor edits, to ED-240, as it serves a key function in delineating the auditor's responsibilities and inherent limitations in detecting fraud, the removal of which may signal an expansion in the auditor's role, which we note to be at odds with the IAASB's intent: See, for example, the IAASB's statement in the EM that removal of certain language in the extant standard "is not intended to increase the work effort as it pertains to considering the authenticity of records and documents obtained during the audit."

Paragraph 20: "Unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine. If conditions identified during the audit cause the auditor to believe that a record or

document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, the auditor shall investigate further. (Ref: Para. A26–A3228)”

Paragraph A12: “The risk of not detecting a material misstatement resulting from fraud exists because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. Such attempts at concealment may be even more difficult to detect when accompanied by collusion. Collusion may cause the auditor to believe that audit evidence is persuasive when it is, in fact, false. The auditor’s ability to detect a fraud depends on factors such as the skillfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved. While the auditor may be able to identify potential opportunities for fraud to be perpetrated, it will be more challenging for the auditor to definitively determine whether misstatements in judgment areas such as accounting estimates are caused by fraud or error.”

Paragraph A26: “The auditor is not required to perform procedures that are specifically designed to identify conditions that indicate that a record or document may not be authentic or that terms in a document have been modified. An audit performed in accordance with the ISAs rarely involves the authentication of documents, nor is the auditor trained as or expected to be an expert in such authentication. However, audit procedures performed in accordance with this or other ISAs, or information from other sources, may bring to the auditor’s attention, through the exercise of professional skepticism, conditions that cause the auditor to believe that a record or document may not be authentic or that terms in a document have been modified but not disclosed to the auditor. Paragraph 20 applies if the auditor identifies such conditions during the course of the audit.”

#### The Auditor’s Responsibility Relating to Fraud - Third-Party Fraud

While we acknowledge that the definition of fraud in ED-240 remains unchanged from extant ISA 240, we are concerned that ED-240, as revised, implies an expanded scope of auditor responsibility for third-party fraud without fully addressing the impacts of doing so across the financial reporting ecosystem. This expanded scope appears to contradict paragraph 92 of the EM, which indicates that the IAASB did not support expanding the role of the auditor to detect third-party fraud that is not directly related to a risk of material misstatement due to fraud in the financial statements. Consequently, we have the following concerns with respect to third-party fraud and the role of the auditor to detect third-party fraud:

Paragraph A21, which expands on the definition included in paragraph 18, fails to limit the role of the auditor with respect to third-party fraud that poses a risk of material misstatement due to fraud to the financial statements and, accordingly, could vastly broaden the role of the auditor as it exists today, which would have implications to the scope, timing, and cost of financial statement audits (and possibly integrated reporting in the future when other subject matters, such as sustainability, could be included in the scope of the auditor’s report). As such, we recommend the IAASB revise ED-240, paragraph A21, to better align with the intention to not expand the role of the auditor when considering the detection of fraud related to third parties.

ED-240, paragraph 29(a)(ii)(c) states that engagement teams, as part of their fraud risk factor discussion, should consider “how assets could be misappropriated by ... third parties”. We recommend that the IAASB either remove reference to third parties from this paragraph or provide more clarity around instances of third-party misappropriation of assets resulting in fraud risk factors and limit the brainstorming on third-party fraud to significant instances only. We believe that it should not be incumbent of the auditor to consider every potential instance of third-party misappropriation of assets (of which most instances would likely not rise to the level of a material misstatement).

We acknowledge and agree with the IAASB's aim to emphasize that fraud discussions should not take place only during the planning phase of an audit but, should rather continue throughout the audit process. However, the second example within paragraph A52 does not relate to an exchange of ideas around an entity's third-party relationships that give rise to a fraud risk factor, or a risk of third-party fraud. Instead, the example discusses an already identified instance of third-party fraud that would be responded to in a timelier and more direct manner than through an engagement team discussion on fraud risk factors. In addition, we believe this example does not appropriately state how an auditor should identify fraud risk factors for any potential material third-party fraud that is reasonably likely to occur. For example, the instance of fraud in this example details third parties using falsified documents in a loan application document but does not indicate how the auditor was reasonably able to design procedures to detect this. To the contrary, the example alludes to the fact that the auditors were made aware through means that were not their planned audit procedures. To address both observations, we recommend the IAASB consider including an alternative example such as the following:

“Based on the auditor's understanding of the entity's physical access controls, the auditor identified a fraud risk factor (i.e., opportunity to commit fraud) resulting from the entity's lack of sufficient security at locations with a material amount of small, lightweight, high-value assets.”

#### The Auditor's Responsibility Relating to Fraud - Other Matters

We recommend the IAASB remove the word “any” from ED-240, paragraph 29(b), as the current wording would require an audit engagement team discussion to encompass any conceivable fraud rather than only those that may pose risk(s) of material misstatement:

Paragraph 29(b): “A consideration of any fraud or suspected fraud, including allegations of fraud, that may impact the overall audit strategy and audit plan, including fraud that has occurred at the entity during the current or prior years.”

We also believe more clarity is warranted in paragraph A11, which considers when an identified misstatement due to fraud that is not quantitatively material may be qualitatively material:

Extant ISA 240 explicitly states that an otherwise insignificant fraud involving senior management is an example whereby the fraud may be deemed to be significant. ED-240, paragraph A11(a) includes solely this example but is worded in a manner that implies that any otherwise insignificant fraud involving anyone other than senior management would not be considered significant. We recommend the IAASB clarify this is just an instance of one example.

Paragraph A11(b) discusses that a quantitatively immaterial fraud may be qualitatively material depending on why the fraud was perpetrated. Although the bullet is included in application material, the context of how it is written implies this is a matter that would always be considered. We do not believe this should be a matter for auditors to always consider, as there are often times when the auditor may never know the reason, or all the reasons, as to why a fraud was perpetrated and the auditor should not be expected to conduct what could be an exhaustive and unwarranted exercise.

#### **Forvis Mazars**

We believe that we need to keep awareness of the inherent limitations of an audit when it comes to the identification of fraud, and welcome the IAASB's inclusion of the inherent limitations section (ED-240.9-11) in the proposed standard.

We are concerned, however, that the proposed changes to the standard put fraud “centre stage” in the audit, above other risks which may be more pertinent to individual engagements, and thereby risk increasing the expectation gap around the auditor's role and responsibilities in relation to fraud. For example, third-party

fraud is likely difficult or impossible to detect during an audit and the references to "non-material" fraud muddy the waters regarding the auditor's responsibilities (to obtain reasonable assurance about whether the financial statements are free from material misstatement due to fraud). Further clarity over such matters through description of the inherent limitations may be helpful.

One of the key challenges is drawing the line where auditor action is required in relation to potential fraud. The standard should make clear that it is key for auditors to respond to issues when they become aware of them rather than necessarily seek out every potential fraud. In a well-known case where car manufacturers fraudulently recorded diesel emissions data, it would not be reasonable to expect the auditor to have necessarily identified such matters, but it would be reasonable to expect the auditor to respond when they become aware of the issue to assess the impact on the financial statements audit.

The primary responsibility for the prevention and detection of fraud rests with management and, as such, management's responsibilities should be presented first in the responsibilities section of the standard to provide greater clarity to users and other stakeholders as to the respective responsibilities of management and the auditor.

It is not clear what the IAASB is expecting auditors to do regarding qualitatively material (but quantitatively immaterial) fraud committed by management; for example, what work effort is required to address risks of fraud related to directors' expenses? Surely the expectation is not that auditors would test every expense claim for each director, although it would be reasonable to expect auditors to evaluate the circumstances and respond appropriately if they became aware of any issue with director claims. Greater clarity around the expected work effort in this situation would be useful to avoid misunderstanding and manage expectations; for example ED-240.A11(a) refers to "insignificant" which is not the same as "not material" and also talks of frauds being material "irrespective of the amount" (ignoring the concept of clearly trivial) – from this paragraph it could be inferred that inflated travel expenses would be significant regardless of the amount – is that the IAASB's intention? It would be helpful to include practical, real life, examples in the application material of when a quantitatively immaterial fraud may be considered qualitatively material.

Agree, with comments below

There needs to be clarity over what auditors can and can't realistically be expected to achieve in relation to fraud during an audit carried out under international standards on auditing. We welcome the IAASB's efforts to clarify the responsibilities of the auditor in relation to fraud and believe most of the changes proposed are logical and uncontroversial, and generally codify good practices followed by most auditors and clarify existing requirements in a number of areas. As such it is unlikely that these changes will lead to a significant shift in the dial of behaviours and performance of auditors, although stakeholders may expect that the revisions are intended to lead to more change in how fraud is addressed than is likely. There is, therefore, a risk that the standard may raise expectations that the changes will lead to a more fundamental change in auditor behaviour than will be borne out in reality, widening the already considerable expectation gap that auditors are required to do more on fraud than they really do.

We note that the project objectives set out in the project proposal focus on "strengthening" the standard and to "enhance" the auditor's response to identified risk, with other references to verbs such as "clarify", "promote consistent behaviour", "reinforce the importance". As such, the proposed revision of the standard may not be as fundamental as some stakeholders may expect.

Stakeholders will likely expect that the revisions to ISA 240 would address previous failings to identify frauds in high profile cases, such as Patisserie Valerie and Wirecard. If the IAASB believes that these changes will make a fundamental difference, it should be able to demonstrate whether the revised auditing standards would

have led auditors to identify and address frauds in such cases. If this is not the case, the IAASB should carefully consider how it messages the likely impact of these changes to avoid expectations that all frauds will now be picked up during an audit, which we believe would be unreasonable. Perhaps greater emphasis on the inherent limitations may be warranted to manage such expectations.

### CohnReznick

It is well understood, including under extant ISA 240, that fraud detection and deterrence is a shared responsibility. That responsibility includes management, those charged with governance, and internal and external auditors. The IAASB's proposal expands on the description of the auditor's responsibility in ED-240 without a consideration of changes that may be needed to explain and expand on the description of the responsibilities of management, those charged with governance and others for fraud detection and deterrence. This is especially relevant considering increased fraud risks that may arise due to the transformative effects of technology. Therefore, we encourage the IAASB to collaborate with the International Accounting Standards Board (IASB), the International Ethics Standards Board for Accountants (IESBA) and others in the financial reporting ecosystem before finalizing any revisions to the description of responsibilities for the consideration of fraud in the auditor's report.

Agree, with comments below

We agree that ED-240 clearly sets out the auditor's responsibilities related to fraud in an audit. We have two specific comments:

We note the examples for fraudulent financial reporting in ED-240.A3 appeared to be earnings focused. To avoid focusing auditors only on earnings, we recommend that the IAASB consider adding additional application guidance calling attention to non-earnings misstatements such as those underlined below.

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 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 adjustment of assumptions, and changes in judgments by management or may be perpetuated partially or completely through large adjustments; or

misstate the financial statement other than through earnings, such as through (1) inappropriate classification on the balance sheet, income statement, and/or cash flow, and/or (2) inappropriate or omitted note disclosures.

Pressures and incentives may lead these actions to increase to the extent that they result in material fraudulent financial reporting.

Examples:

- Management intentionally takes positions that lead to fraudulent financial reporting by materially misstating the financial statements due to pressures to meet market expectations or a desire to maximize compensation based on performance.
- Management reduces earnings by a material amount to minimize tax.
- Management defers recognition of revenue by a material amount to improve its chances for obtaining government grants or charitable contributions.

- Management inflates earnings to secure bank financing.
- Management reclassifies balance sheet amounts to maintain bank financing bound by restrictive balance sheet covenants.
- Management omits disclosures related to a material uncertainty about an entity’s ability to continue as a going concern to better attract investors.

We are supportive of the additional application guidance in ED 240.A21 providing examples of what may be determined to be Third-Party Fraud. We believe this will help clarify matters for both preparers and auditors.

### Ernst & Young Global

As we included in our response to the IAASB’s Discussion Paper on Fraud and Going Concern in an Audit of Financial Statements (dated 1 February 2021), we continue to believe that additional actions could be taken by others to address the expectation gap, including enhancements to corporate reporting, with a focus on expanding transparency related to management’s responsibilities for prevention of fraud. We also see an opportunity for improvements in corporate governance for public interest entities, such as setting expectations for a system of strong internal control that specifically addresses fraud risk as well as management and director certifications on the content of financial statements and internal control over financial reporting. We strongly encourage the IAASB to continue to engage with stakeholders and organizations that address corporate reporting and corporate governance about further actions that can be taken to address management’s responsibilities for prevention of fraud.

Agree, with comments below

We believe that ED-240 clearly sets out the auditor’s responsibilities relating to fraud in an audit of financial statements and are supportive of the IAASB’s revisions to the Introduction section of ED-240, with the exception of third-party fraud for which we believe the auditor’s responsibilities are not as clear as they need to be for consistent understanding and implementation.

We acknowledge that paragraph A21 of ED-240 states that third-party fraud is included in the definition of fraud (and is therefore included in the terms “identified or suspected fraud” used throughout ED-240). However, we believe that paragraph A21 of ED-240 can be clarified, at a minimum, as follows:

A21. Fraud or suspected fraud committed against the entity by customers, suppliers, service providers, or other external parties is generally described as third-party fraud. Fraud as defined in paragraph 18(a) can include an intentional act by a third party, and accordingly, if an intentional act by a third party is identified or suspected by the auditor that could result in misappropriation of the entity’s assets or fraudulent financial reporting by the entity, the auditor performs the audit procedures in paragraphs 55 – 59. Fraud or suspected fraud committed against the entity by customers, suppliers, service providers, or other external parties is generally described as third-party fraud.

Additionally, we note that the definition of “third-party” in paragraph A21 of ED-240 extends to “customers, suppliers, service providers, or other external parties”. We also note that paragraph A52 of ED-240 makes mention of “third-party relationships”, which are not defined in ED-240 and which appear distinct from related party relationships (as addressed by ISA 550) and external parties that are unknown to the entity. We believe that paragraph A21 of ED-240 would further benefit from guidance that expands upon who perpetrators of third-party fraud may be, which would then allow for a focused identification of risks by the auditor. We suggest the IAASB consider the following distinctions in paragraph A21 of ED-240:

Related parties, where the most significant concerns are collusion with management, overly complex transactions, or bias in the structure of transactions, as explained in ISA 550.

Third-party relationships that include third-parties with which the entity has a relationship to support their business model such as customers, suppliers, service providers or other external parties known to the entity and with whom the entity has a business relationship. In addition to fraudulent activity that benefits the third party and creates a risk of material misstatement for the entity, the nature of these relationships may also introduce the risk of collusion with employees of the entity, as well as the risk of unauthorized access to the entity's IT systems and assets.

External parties unknown to the entity, which include nefarious actors that may attempt to gain unauthorized access to an entity's IT systems and/or assets, disrupt the entity's business operations and financial reporting processes, harm the entity's reputation or render the entity non-compliant with laws and regulations related to data privacy.

We believe that the above clarifications would provide the right context for explaining the auditor's responsibilities for each category, as well as how the nature of the auditor's response to third-party fraud differs from risks of fraud internal to the entity. The clear distinction between the types of third parties will allow for the auditor's consideration of fraud risks that could arise from transacting with those parties. Refer also to our additional comments related to enhancing risk assessment procedures that address fraud risks related to third parties in our response to Q3.

We also believe that thresholds or guidance should be established to aid auditors in determining when actions by third parties constitute fraud or suspected fraud for purposes of ED-240. Such clarity is essential for determining the applicability of the requirements set forth in paragraphs 55-59 of ED-240. Refer to our response to Q4 for our suggestions in this regard.

Third-party fraud: To assist auditors in understanding the treatment of third-party fraud in ED-240, we believe additional guidance is needed. We include suggestions in our letter that include ED-240 more clearly describing the potential perpetrators of third-party fraud, which would then facilitate a more focused identification of risks and enable auditors to design appropriate responses. We also believe that explicit thresholds and supporting guidance should be established to aid auditors in determining when actions by third parties constitute fraud or suspected fraud for purposes of ED-240. Such clarity is essential for the auditor determining the applicability of the requirements to respond to identified or suspected fraud.

#### **Crowe Global**

ED-240 does clearly set out the auditor's responsibilities relating to fraud in an audit of financial statements, including those relating to non-material fraud and third-party fraud. It is important for the successful application of the standard that financial statement users understand that the primary responsibility for the prevention and detection of fraud rests with both management and those charged with governance of the entity.

### **7. Member Bodies and Other Professional Organizations**

#### **Korean Institute of Certified Public Accountants**

Agree, with comments below

The KICPA is of view that ED-240 clearly defines the auditor's responsibilities relating to fraud. The KICPA strongly supports the proposed revision to enhance the clarity while maintaining the existing requirements regarding the auditor's responsibilities relating to fraud. However, the KICPA hopes that improvements are made in following areas to further enhance the clarity of the standards.

Need to clearly state that the detection of fraud is not the auditor’s responsibility.

There is a need to clearly state that ‘the auditor is not responsible for detecting fraud’ and to provide relevant guidelines, in order to address the expectation gap regarding the auditor’s responsibility relating to fraud and enhance the clarity about the auditor’s responsibility.

Many users of the auditor’s report believe that the auditor is responsible for detecting fraud and expect the audit of financial statements to provide assurance that no fraud has been detected. Although the proposed revision clarifies that the auditor’s responsibility is ‘to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement due to fraud’, it is still difficult for the user of the auditor’s report to distinguish ‘no material misstatement due to fraud’ from ‘no detected fraud’.

Paragraphs 6 and 7 of ED-240 indirectly indicate that the detection of fraud is not the auditor’s responsibility. However, inexplicit explanation alone doesn’t appear to be sufficient to resolve the expectation gap described above. There is a need to explicitly state that ‘the detection of fraud is not the auditor’s responsibility’ in the standards.

Specifically, following enhancements are considered to be required.

ISA 240 should include an explicit statement under Introduction Section that ‘the auditor is not responsible for detecting fraud or obtaining assurance that no fraud has occurred’. (Add an introductory paragraph in paragraph 6 or 7 of ED-240)

ISA 240 should describe in a great detail under Application Material or elsewhere, what are the differences in terms of objective, outcome and procedure between ‘obtaining assurance about whether the financial statements as a whole are free from material misstatement due to fraud’ and ‘detecting fraud or obtaining assurance that no fraud has occurred’.

ISA 240 should explain that there may be a need to perform ‘a procedure to directly detect fraud’ in the course of audit engagement and provide guidance on situations when such a procedure is required. For example, paragraph A35 can provide specific and diverse examples of situations when experts specialized in fraud detection including forensic skills should be relied on, along with description of forensic skills.

Need to revise the paragraph on the auditor’s responsibility relating to inherent limitations.

Paragraph A57 of ISA 200 clearly states that the inherent limitations of an audit are not a justification for the auditor to be satisfied with less than persuasive audit evidence. Therefore, there is no need to include a duplicate statement in paragraph 10 of the ED that ‘the inherent limitations of an audit are not a justification for the auditor to be satisfied with less than persuasive audit evidence’. In addition, the paragraph 9 of the ED states that ‘that does not diminish the auditor’s responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement due to fraud’. Considering that the auditor should obtain persuasive audit evidence to obtain reasonable assurance about whether the financial statements as a whole are free from material statement due to fraud, the statement that ‘not a justification for the auditor to be satisfied with less than persuasive audit evidence’ also means ‘that doesn’t diminish the auditor’s responsibility’. This also indicates that there is no need to repeat duplicate statements. Therefore, we propose removing the added statement in paragraph 9 of the ED that ‘that does not diminish the auditor’s responsibility’ and the statement in paragraph 10 of the ED that ‘not a justification for the auditor to be satisfied with less than persuasive audit evidence’.

Need to revise the requirements relating to forensic skills.

In addition to providing examples of situations when forensic skills are required as described in the above, part of the application material relating to forensic skills need to be revised.

Paragraph A35 of the ED outlines the examples of specialized skills or knowledge included in forensic skills. They include identifying and evaluating fraud risk factors, identifying and assessing the risks of material misstatement due to fraud, and evaluating the effectiveness of controls implemented to prevent or detect fraud, among others. They are described as the examples of the specialized areas of forensic skills, although these procedures are in fact general assurance skills and techniques used by the auditor of financial statements. This may create misunderstanding that some of the auditor's general assurance skills and techniques are forensic skills. It is desirable to add explanation to prevent such misunderstanding or remove the relevant items.

#### **Virginia Society of Certified Public Accountants**

Agree, with comments below

“Decoupling” key concepts highlighted in ED-240 certainly offers a clearer understanding of the auditor's responsibilities. Additionally, further clarification of the auditor's responsibilities concerning non-material fraud and suspected non-material fraud, with an extra emphasis on "qualitatively material" misstatements due to fraud, enhances the auditor's awareness beyond just materiality.

#### **Institute of Chartered Accountants of Jamaica**

Agree, with comments below

Generally, the exposure draft does not include thresholds for considering materiality in determining the audit response. There should be some consideration of materiality in determining the audit response along with consideration of other factors such as covenants and any related regulatory threshold.

#### **Botswana Institute of Chartered Accountants**

Agree, with comments below

The ED-240 clearly set out the above-mentioned responsibilities and the new application material in para A11 also does assist in clarifying that although an identified misstatement due to fraud may not be “quantitatively material”, it may nevertheless be “qualitatively material” depending on who instigated the fraud (e.g., management of the entity) and why the fraud was perpetrated (e.g., to manage key performance metrics).

#### **Institute of Certified Public Accountants of Rwanda**

Agree, with comments below

There is more clarity on the role and responsibilities of an auditor relating to fraud in an audit of financial statements – described before those of management and TCWG; now supported by a distinct paragraph explaining the inherent limitations – which clarifies that such limitations should not lessen whatsoever the auditor's responsibilities relating to fraud.

#### **South African Institute of Chartered Accountants**

Agree, with comments below

The IAASB's objective to ensure that the auditors consider the risk of material misstatement due to fraud as an integral part of the audit, was well articulated, as the auditor is required to plan procedures to obtain reasonable assurance that the financial statements are free from material misstatements due to fraud and to communicate these.

ISA 240(Revised) Par 2 (a) and (b) clearly explain the auditors' responsibility. Further to this the IAASB provided further clarity on ISA 240 (Revised) par 9 in ED 240. While the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one that relates to error, it does not diminish the responsibility of the auditor to plan and perform the audit to obtain reasonable assurance that the financial statements are free from material misstatements due to fraud.

We recommend that as part of ISA 700 (Revised), the IAASB should consider elevating the responsibilities of management and those charged with governance with regards to fraud in the audit of financial statements, on the audit report to enhance transparency

The auditor's responsibilities in respect of the following matters remain unclear:

We are concerned about the broad scope of the definition of third-party fraud. We support the IAASB's objective not to expand the role of the auditor to detect third-party fraud that is not directly related to a risk of material misstatement due to fraud in the financial statements. This is not apparent from the definition of fraud or the application material. We therefore propose:

Consider amending the definition of fraud as follows: 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 through misstatement of the financial statements.

The definition of third-party fraud in Par. A21 does not limit the role of the auditor to third-party fraud. Consider adding additional clarity in the application material how fraud or suspected fraud by a third party may cause the financial statements to be misstated.

#### **ASEAN Federation of Accountants**

We would like to suggest the IAASB could consider including the definition of suspected fraud in paragraph 18 to provide better clarity of the term.

Agree, with comments below

ED-240 discloses the responsibility of the auditor in relation to fraud ahead of management's and those charged with governance's responsibility. This may result in skewed reading of where the primary responsibility lies. Reference is made to ISA 250 (Revised), where the standard states first that the responsibility for the compliance with laws and regulations lies with management and those charged with governance (TCWG) before specifying the responsibilities of the auditor. This would present a more coherent flow of information by stating the primary responsibility prior to stating the scope of an auditor's responsibility

#### **CPA Ontario Small and Medium Practices Advisory Committee**

Agree, with comments below

ED-240 addresses the auditor's responsibilities regarding fraud detection in financial statement audits comprehensively. In terms of non-material fraud and third-party fraud, it extends these responsibilities by clarifying and enhancing the existing guidelines.

ED-240 emphasizes the auditor's duty to consider not only material but also non-material fraud. The standard highlights that misstatements that might not be quantitatively material could still be qualitatively significant, particularly if perpetrated intentionally by management. This is a crucial aspect, as it acknowledges the potential impact of smaller-scale frauds that could signal broader issues within the organization, thus requiring auditor attention irrespective of the quantitative materiality.

The revised standard clearly sets out the auditor's responsibilities concerning third-party fraud. This includes a requirement for engagement teams to discuss how assets might be misappropriated by external parties. Additionally, there is an expectation for auditors to consider how the entity's control environment might be susceptible to third-party fraud and to reflect this in their risk assessments and subsequent audit procedures.

ED-240 is designed to ensure that auditors are sufficiently equipped and obligated to identify and assess risks from all types of fraud, including those that might previously have been deemed less critical due to their size or source. This approach is intended to enhance the overall robustness of audits and the reliability of financial reporting, particularly in environments where smaller-scale or external frauds could have been overlooked.

#### **Institute of Chartered Accountants of Scotland**

Agree, with comments below

We generally believe that ED-240 clearly sets out the auditor's responsibilities relating to fraud in an audit of financial statements. We do, however, have concerns over the following aspects of the IAASB's proposals.

Placing the responsibilities of the auditor before those of management who have primary responsibility for the detection of fraud, could have the unintended consequence of exacerbating the current expectations gap.

In relation to third-party fraud, we are not convinced that as currently drafted the auditor's responsibilities are as clear as they should be to ensure consistent understanding and implementation in practice. We therefore believe further work is required by the IAASB to address and clarify these specific aspects of the proposed revised standard. In particular, paragraph A21 of ED-240 should be revised to reflect additional guidance on who perpetrators of third-party fraud might be, which would facilitate a more focused identification of risk by the auditor.

#### **Institute of Certified Public Accountants of Uganda**

Agree, with comments below

While we agree with the proposals in the ED-240, we are a bit apprehensive that the proposals create the perception that the auditor's major role is fraud detection. We believe that the wording of the standard should be amended to stress that the auditor's major responsibility remains the provision of an opinion on the financial statements while the prevention of fraud is the major responsibility of management.

Additional application material is needed to help auditors easily assess whether a misstatement due to fraud is material or not. Some such misstatements may be individually immaterial but become material when aggregated with other factors. Therefore, additional guidance is necessary concerning when such individual misstatements due to fraud may be considered material.

#### **Asociacion Interamericana de Contabilidad**

Agree, with comments below

Yes, we are persuaded that Exposure Draft (ED) 240, entitled "Fraud in an Audit of Financial Statements" of the International Auditing and Assurance Standards Board (IAASB); proposes clarifications and enhancements to current standards related to the auditor's responsibility for detecting fraud during the audit of financial statements; ED- 240 seeks to strengthen and clarify the auditor's responsibilities in relation to fraud, including both material and immaterial fraud and fraud committed by third parties. Highlighting the importance of a proactive and risk-aware approach to fraud in the audit of financial statements, as provided in Section 1-C - Auditor's Responsibilities by addressing the following points in detail: Auditor's Responsibilities

in Relation to Fraud, Auditor's Responsibilities in Relation to Non-Material Fraud and Suspected Non-Material Fraud.

Some key points related to the auditor's responsibilities for fraud, including non-material fraud and fraud by third parties:

ED-240 reaffirms the auditor's responsibility to identify and assess the risks of material fraud in the financial statements and to design and implement responses to those risks. Although the auditor is not responsible for preventing fraud, the auditor does have a responsibility to perform the audit to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether caused by fraud or error.

Although the auditor's primary focus is on material fraud, ED-240 recognizes that the discovery of non-material fraud may be indicative of deficiencies in internal control or a poor control environment. This could influence the auditor's assessment of the risks of material fraud and the auditor's response to those risks.

ED-240 discusses the need to consider the risk of fraud committed by third parties (not just employees or management). This includes consideration of external frauds that could affect financial reporting, such as supplier scams or manipulation of transactions by third parties.

The auditor should evaluate whether the responses designed and implemented are adequate to address the identified risks of material fraud, and this evaluation should include a consideration of how fraud could occur and whether it could have a material effect on the financial statements.

The auditor has a responsibility to communicate fraud-related matters to management and those charged with governance, especially those frauds that could have a significant effect on the organization's management or control, even if it is immaterial.

#### **Pan-African Federation of Accountants**

Agree, with comments below

The IAASB effectively emphasized that auditors must consider the risk of material misstatement due to fraud as integral to the audit, requiring procedures to ensure financial statements are free from material misstatements due to fraud and to communicate these findings. ED-240 clearly sets out the auditor's responsibilities regarding fraud in financial statements, including non-material and third-party fraud, however, noting that fraud may involve both management and those charged with governance our view is that the standard lacks clarity on auditor requirements in such cases. We propose therefore, that guidance or procedures be included for responding to these situations. In addition, we propose that the standard explicitly acknowledge the responsibilities of management and those charged with governance to implement controls to prevent and detect fraud. We believe that it is critical that the IAASB support bridging the expectation gap and prevent further widening it, consequently, we encourage the IAASB to undertake a review to articulate more clearly the auditor's responsibilities in relation to third-party fraud.

#### **Malaysian Institute of Accountants - Auditing and Assurance Standards Board**

Agree, with comments below

While the enhanced guidance describing third-party fraud is useful, there may be confusion regarding the auditor's responsibilities related to third-party fraud, i.e., whether it is sufficiently clear that the auditor is not expected to design and perform procedures specifically to detect third-party fraud that is not directly related to a risk of material misstatement due to fraud in the financial statements.

Paragraph A16 as currently drafted, which also refers to, as an example, the effects of a cybersecurity breach, does not seem to clearly explain the IAASB's intent included in Paragraph 92 of the Explanatory Memorandum that accompanies ED-240.

With respect to non-material fraud, it may be helpful to make it more explicit that the auditor does not have to apply the requirements in relation to identified or suspected fraud that is clearly not material as compared to, for example, the phrase "in relation to matters that are clearly inconsequential" used in the provisions of the IESBA Code in responding to non-compliance with laws and regulations (NOCLAR).

While we agree for the decoupling of the auditor's inherent limitations from the auditor's responsibilities relating to fraud, the primary responsibility for the prevention and detection of fraud still rests with management and those charged with governance ('TCWG'). The ED-240 discloses the responsibility of the auditor in relation to fraud ahead of management's and TCWG's responsibility. This may result in skewed reading of where the primary responsibility lies. We make reference to ISA 250 (Revised), where the standard states first the responsibility for the compliance of laws and regulations lies with management and TCWG before specifying the responsibilities of the auditor. This would present a more coherent flow of information by stating the primary responsibility prior to stating the scope of an auditor's responsibility.

The "Inherent Limitations" section in ED-240 is proposed to be presented separately from the "Responsibilities of the Auditor" section. Although this separation does not reduce the auditor's responsibilities regarding fraud, it is important to set the expectation that there is an unavoidable risk that material misstatements due to fraud may not be detected.

The phrase "suspected fraud, includes allegations of fraud" is mentioned throughout ED-240 in a few paragraphs. We would like to suggest that the IAASB use that phrase in paragraph 7 and for subsequent paragraphs, to consistently use the term "suspected fraud". Alternatively, the IAASB could consider including the definition of suspected fraud in paragraph 18 to provide better clarity of the term.

## 8. Academics

### Accounting and Finance Association of Australia and New Zealand

Agree, with comments below

We agree that ED-240 more effectively sets out auditors' responsibilities relating to fraud in an audit of financial statements and, in doing so, helps realise the benefits from improvements throughout the proposed new standard.

We strongly support the 'decoupling' of auditors' responsibilities from inherent limitations and the statement of auditors' responsibilities before referring to the responsibilities of management and those charged with governance. Research in psychology (e.g., Tversky and Kahneman 1981; Levin et al. 1985) and auditing (e.g., Johnson et al. 1991; Jamal et al. 1995; Andolia 2024; Vinson et al. 2024) highlights that the framing of a problem can influence the approach to that problem.

Extant ISA 240, by first stating management's responsibility and including a discussion of inherent limitations when discussing auditor's responsibilities, frames the problem such that there is a risk that the auditor may subconsciously perceive a lesser responsibility to detect material misstatements due to fraud. The revised structure of the introductory paragraphs in proposed ED-240 more clearly presents auditor's responsibilities for fraud in an audit of financial statements.

We further note, and commend, changes in the work effort verbs employed throughout the standard. Stepankova et al. (2022) highlights that different work effort verbs impact auditor judgments and research

highlights the increased work effort necessary when dealing with fraud in an audit of financial statements (e.g. Brazel et al. 2024). For example, replacing 'evaluate' with 'determine' (a verb implying greater work effort) more effectively reinforces auditors' responsibilities.

We note, however, that the increased work effort must be appropriately applied. Using the verb 'determine' may encourage a more implemental mindset that is associated with the application of less scepticism (Nolder and Kadous 2018) and a less effective response to the assessed risk of material misstatement (Bauer et al. 2020). We refer the IAASB to our responses in this regard to Questions 2 and 10.

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Bauer, T.D., Hillison, S.M., Peecher, M.E., and Pomeroy, B. 2020. Revising audit plans to address fraud risk: A case of 'Do as I advise, Not as I Do'? *Contemporary Accounting Research* Vol.37 No.4, pp.2558-2589.

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Levin, I.P., Johnson, R.D., Russo, C.P., Deldin, P.J. 1985. Framing effects in judgment tasks with varying amounts of information. *Organizational Behavior and Human Decision Processes* Vol.36 No.3, pp.362-377.

Nolder, C.J., and Kadous, K. 2018. Grounding the professional skepticism construct in mindset and attitude theory: A way forward. *Accounting, Organizations and Society* Vol.67, pp.1-14

Stepankova, S., Harding, N., Mayorga, D.M., and Trotman, K.T. 2022. Using more effective instructional verbs to elevate auditors' professional scepticism. *International Journal of Auditing* Vol.26 No.2, pp.240-251.

Tversky, A., and Kahneman, D. 1981. The framing of decisions and the psychology of choice. *Science* Vol.211 No.4481, pp.453-458.

Vinson, J.M., Pike, B.J., Chui, L., and Zhou, M. 2024. The influence of audit evidence framing on auditors' judgment. *Behavioral Research in Accounting* Vol.36 No.1, pp.105-120.

## 9. Individuals and Others

### Altaf Noor Ali Chartered Accountants

R1: Yes, subject to the following.

Definition of fraud>> We give credit to the Board for our heightened awareness on the term 'third-party' fraud. Would it be interesting to see fraud as an intentional act involving deception to gain an unjust or undue advantage for or against an entity by the internal and external stakeholders individually or in collusion? Internal stakeholders are TWCG and employees. External stakeholders may be customers, suppliers, service providers or even cyber-criminals.

Looking at stakeholders as internal or external helps simplify the possible definition of fraud. It seems more understandable than using the term 'third-party' that most of us take it for granted without pausing for what it means.

1.11 A related question is: when an error becomes a fraud or vice-versa for the auditor? Guidance cannot be found in the ED240 on the matter. Trust in the financial reporting means its free from material misstatements which may be unintentional (error) or intentional (fraud).

1.2 We also give credit to the Board on using a term like 'non-material' fraud. Non-material was normally assumed to mean immaterial in both qualitative and quantitative terms.

1.3 We agree that 'the IAASB did not support expanding the role of the auditor to detect third-party fraud that is not directly related to a risk of material misstatement due to fraud in the financial statements.'

Identifying third-party frauds is most difficult. We see the auditor as a watchdog and not a bloodhound. This consolation may not be satisfactory for some. At the end of an audit engagement, the question is: Have we discharged our duties as auditors reasonably? We believe that there remains an invisible area in an entity the auditor remains unaware about.

1.4 We agree to policy of the Board of leveraging enhancements in other jurisdiction.

1.5 We found the statement contrary to our understanding that 'the IAASB was not seeking to expand the role and responsibilities of auditor relating to the fraud in an audit of the financial statements'.

### **Albert Bosch**

Agree, with comments below

We agree with the point in ED 240 paragraph 6 that the auditor is responsible for finding material misstatements due to fraud (and error). We also agree that determining whether a misstatement due to fraud is material, is a matter of judgment (ED 240 paragraph 8). And that both quantitative and qualitative considerations should be involved.

However, in ED 240 paragraph 8 it is stated "The auditor's determination of whether a fraud or suspected fraud is material to the financial statements involves the exercise of professional judgment." The auditor does not assess fraud(s), but assesses the misstatement(s) in the financial statements due to fraud. The wording in ED 240 paragraph 8 would be better if it were as follows: "The auditor's determination of whether a misstatement due to fraud has a material impact on the financial statements involves the exercise of professional judgment."

The adjustment in the wording seems subtle, but in combination with the qualitative evaluation, in addition to the quantitative evaluation, it prevents the auditor from having to take into account 'qualitative fraud' up front in the planning phase of the audit and in the procedures in the audit plan. The auditor is not looking for fraud, but for misstatements due to fraud. See also our response to consultation question 10.

### **Moises Gonzalez Mercado**

Agree, with comments below

ED. Paragraphs 8. Judgments about materiality (fraud is material)

Judgments about fraud is material

### **3 Neither agree nor disagree**

#### **1. Monitoring Group**

#### **International Forum of Independent Audit Regulators**

Overall comments

In our response letter to the IAASB’s Discussion Paper on Fraud and Going Concern in an Audit of Financial Statements dated February 1, 2021 (“2021 Response Letter”) we encouraged the IAASB to examine the benefits of strengthening ISA 240 (Revised) and we welcome the positive steps that the IAASB has taken to improve the audit procedures related to fraud in an audit of financial statements.

## 2. Investors and Analysts

### CFA Institute

Neither agree/disagree, but see comments below

See our overall comments in Part A regarding the deletion of paragraph 3 of ED-240 that discusses management’s responsibilities.

We agree with the application material that describes how quantitatively immaterial fraud can be “qualitatively material” if it is perpetrated by senior management. Any fraud or suspected fraud involving senior management is material.

Auditor’s Responsibilities Relating to Fraud: We Recommend Going a Step Further and Removing Mention of Management’s “Primary” Responsibility Entirely.

While extant ISA-240 and ED-240 state that “the primary responsibility for the prevention and detection of fraud rests with both management and those charged with governance of the entity,” we observe that management is often directly involved in most if not all high-profile frauds.

Management has a responsibility to not commit fraud and to prevent and detect fraud committed by those they oversee. For frauds involving management, the responsibility rests with those charged with governance of the entity (particularly independent audit committee members) and external auditors. Investors cannot rely on management to police themselves. Independent board members and external auditors are investors’ checks on management and act as important gatekeepers in the financial reporting ecosystem.

We commend the IAASB for placing less emphasis on the responsibilities of management in ED-240 vs. extant ISA-240. We recommend the Board finishes the job and delete paragraph 3 of ED-240 entirely.

It’s not necessary to describe the responsibilities of management and those charged with governance in an auditing standard. The responsibilities of management and those charged with governance are well established elsewhere in statutes, court cases, and corporate governance codes. We don’t expect management teams and boards to consult auditing standards to understand their responsibilities. Describing those responsibilities here at worst dilutes auditors’ responsibilities and, at best, is stating the obvious.

## 3. Regulators and Audit Oversight Authorities

### Committee of European Auditing Oversight Bodies

Application material

A further example of misappropriation of assets that could be provided in paragraph A6 is over or underpayment for goods and services.

Definition of fraud

In our opinion the definition of fraud in ED 240 is too narrow. The IAASB should consider adding corruption, bribery and anti-money laundering. Additionally, the language in paragraph A19 should be amended to make it clear that corruption, bribery and money laundering are fraudulent acts.

ED 240 is an improvement on the extant standard, including the structure, better alignment with other standards, the added objective regarding reporting, the responsibilities of management and those charged with governance, what should be done when fraud occurs, emphasis on qualitative materiality and clarification that difficulty in detecting material misstatements in the financial statements resulting from fraud (rather than error) does not reduce the auditor's responsibilities. We also support the requirement to design and perform audit procedures in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory (paragraph 43).

#### Role of the Auditor

It is essential to be clear on the current scope of the auditor's duties in ISA 240. According to ISA 200, auditors should obtain reasonable assurance about whether the financial statements as a whole are free from material misstatements whether due to fraud or error. This means that, when auditors express an unmodified opinion, they have obtained sufficient and appropriate audit evidence to reduce audit risk to an acceptably low level thereby enabling them to draw reasonable conclusions that there are no such misstatements, including due to fraud. We believe it is important to emphasise in the standard that these existing provisions drive the role of the auditor conducting an audit in accordance with ISAs.

In addition, paragraph A11 states: 'Even when an identified misstatement due to fraud is not quantitatively material, it may be qualitatively material depending on: (a) Who instigated or perpetrated the fraud – an otherwise insignificant fraud perpetrated by senior management is ordinarily considered qualitatively material irrespective of the amount involved. This may in turn give rise to concerns about the integrity of management responsible for the entity's system of internal control.' We suggest:

Material fraud often begins with quantitatively non-material fraud and we support the inclusion of 'qualitative materiality'. A further example could be 'cumulative materiality' such as the period of time covered by the fraud. Misappropriation of assets that is not quantitatively material in the current financial year could be if the fraud has taken place over several years and cumulatively is larger than the quantitative materiality. Also the size of the illegal advantage should be taken into account, for example bribery for a small amount to obtain large contracts. We suggest inserting some of the key elements of paragraph A157 ('Misstatements, such as numerous misstatements at a business unit or geographical location even though the cumulative effect is not material, may also be indicative of a risk of material misstatement due to fraud') in paragraph A11; and

Moving the application material in paragraph A11 to the requirements section of the ISA. This will reduce room for interpretation and decrease the risk of inconsistent application by auditors.

Paragraph A17 states that Appendix 5 to the standard "identifies other ISAs that address specific topics that reference fraud or suspected fraud". For the avoidance of doubt, it should be clarified that this does not reduce the responsibility on the auditor to consider all relevant ISAs, whether or not they are listed in Appendix 5.

The statement in paragraph A10 that allegations of fraud involving the entity are treated as suspected fraud by the auditor is of such importance that it should be moved the requirements section of the standard.

#### Canadian Public Accountability Board

##### Overall comments

CPAB is supportive of the positive steps that the IAASB has taken to improve the audit procedures related to fraud in an audit of financial statements. We performed fraud thematic reviews in 2019 and 2021, the results of which, included in communications issued in 2020 and 2022, support our comments in this letter. We agree more robust requirements are needed to promote consistent behaviour and facilitate effective identification and assessment of risks of material misstatement due to fraud and to reinforce the importance of auditors

exercising professional skepticism in fraud-related audit procedures throughout the audit. In addition, we support the proposed changes to the communication of key audit matters related to fraud.

#### 4. Jurisdictional and National Auditing Standard Setters

##### Nordic Federation of Public Accountants

Neither agree/disagree, but see comments below

We have no strong views regarding the reordering and clarification of paragraphs in the introductory section of ED-240. On one hand we understand the rationale for focusing on the auditor's responsibilities in an audit standard. At the same time, we believe there is a need for caution when dealing with the auditor's responsibilities so that the balance and expectations on all parties in the financial reporting ecosystem are not worsened given the lack of cooperation in this fight against fraud.

In terms of the auditor's responsibilities related to non-material fraud, the EM refers to paragraphs 6, 8 and A11. We understand what the IAASB is trying to achieve although the message here is more implicit than clear. However, there is a bigger issue related to non-material fraud and that regards references throughout the ED to only fraud or suspected fraud without linking this to material misstatements of the financial statements. For example, it is unclear how non-material fraud relates to paragraph 55. But above all, the proposals to new wording in the auditor's report that refers to "matters related to fraud" are worrying because they risk being perceived as the auditor making disclosures that also covers non-material fraud which might cause new and unnecessary expectation gaps.

We support the inclusion of third-party fraud and the way the IAASB has proposed to address these matters, although recognizing that there might be some inherent limitations in how to obtain necessary information.

##### Institut der Wirtschaftsprüfer in Deutschland

In relation to paragraphs 61 to 64, we believe that the reference to fraud generally is too broad. As we set forth in our response to Question 1, the auditor's responsibility relates to detecting material misstatements in the financial statements due to misappropriation of assets or fraudulent financial reporting. For this reason, the references to fraud in the introductory sentence of paragraphs 61, 61(b), 61(c), 63, and 64 should be changed to refer to material misstatements in the financial statements due to misappropriation of assets or fraudulent financial reporting.

Neither agree/disagree, but see comments below

##### Management vs. auditor responsibilities relating to fraud

As a matter of principle, the auditor's responsibility in relation to fraud in an audit of financial statements cannot be greater than management's responsibility in relation to fraud. However, management does have responsibilities in relation to fraud that go beyond those of the auditor of the financial statements. While we agree with the explanation in paragraph 3 that management has a responsibility to prevent and detect fraud, and through detection and punishment, to deter fraud, paragraph 3 does not clearly distinguish management responsibilities in this respect from auditor responsibilities as part of the financial statement audit. In particular, we believe that the draft needs to clarify that, unlike auditors of the financial statements, management has a responsibility to prevent, detect and deter all kinds of fraud as set forth in the definition of fraud, not just those frauds in relation to material misstatements due to fraudulent financial reporting or the misappropriation of assets. In addition, the draft should explain that since management is also responsible for safeguarding the assets of the entity, management responsibilities also extend to preventing, detecting and deterring immaterial fraud, including such fraud perpetrated by third parties. Nevertheless, the draft should also explain that, in line

with management's responsibilities to safeguard entity assets, management is not responsible for preventing, detecting and deterring immaterial frauds to the extent that the cost of implementing and maintaining controls designed to prevent, detect or deter such frauds exceed the cost of those frauds (this does not imply that management does not have a responsibility to follow up on immaterial frauds, other than trivialities, perpetrated by specific identified individuals of which management becomes aware). These clarifications are not only important to distinguish between the responsibilities of management and of the auditor, but also to help inform auditor judgments about the appropriateness of management responses to immaterial alleged, suspected or actual fraud, including whether there are deficiencies in internal control that need to be remedied.

We agree with the statement of auditor responsibility in paragraph 2 (a), in which auditor responsibilities are related to the detection of material misstatements in the financial statements due to fraud. Auditors of the financial statements do not and cannot have a responsibility to detect immaterial misstatements in the financial statements due to fraud, which would cause audits to become horrendously expensive with little benefit to the users of the financial statements and may cause auditor responsibilities to exceed those of management in this respect (see paragraph immediately above). We also agree with the statement in paragraph 5 that two types of intentional misstatements are relevant to the auditor – those resulting from fraudulent financial reporting and those resulting from misappropriation of assets. Since these two types of fraud are central to understanding auditor responsibilities and these terms are used in a number of requirements (that is, in paragraphs 29, 35, 46 and 53), in line with the CUSP drafting conventions, these terms should be defined in the definitions section of the draft so as to clearly limit auditor responsibilities to these types of fraud.

#### Alleged fraud vs. suspected fraud

The second sentence in paragraph 7, and paragraph A10, of the draft include allegations of fraud as a part of suspected fraud, and paragraph A10 also refers to the conflation of alleged and suspected fraud in the requirements in paragraphs 55-59 of the draft. While we agree that auditors cannot ignore allegations of fraud per se, we have a number of concerns with equating alleged fraud with suspected fraud. Legally speaking, there is a considerable difference between suspected and alleged fraud. An allegation of fraud is just an allegation: without further consideration, it does not automatically mean that the alleged fraud is suspected fraud. Suspected fraud, on the other hand, refers to an irregularity that gives rise to administrative or legal proceedings to establish the presence of fraud. In other words, suspected fraud involves reasonable grounds for believing that fraud may have occurred without yet having been able to investigate whether fraud has actually occurred. Therefore, the key difference between alleged fraud and suspected fraud is that alleged fraud needs further consideration to determine whether there are reasonable grounds to suspect fraud, whereas suspected fraud, which involves reasonable grounds for believing that fraud may have occurred, requires additional investigation to determine whether fraud has occurred. Furthermore, suspected fraud may actually involve additional responsibilities of the auditor under law, regulation, or relevant ethical requirements, whereas alleged fraud does not. Consequently, treating alleged fraud like suspected fraud as in the draft is inappropriate because auditor responses to alleged fraud and suspected fraud need to be different – that is, auditor responsibilities for alleged vs. suspected fraud are different. We also address these matters in our response to Question 4 below.

In addition, depending upon the circumstances, auditors need to do more to investigate some cases of alleged fraud than others. For example, if the auditor is more familiar with the circumstances than the alleging party, particularly in the case of obviously spurious allegations or allegations of clearly immaterial frauds by lower-level employees, then the auditor may choose to not perform further procedures after having addressed the matter with a level of management that is at least one level above those involved, appropriately considered that allegation, and documented the auditor's consideration. In other cases, when the auditor is less familiar

with the circumstances, the auditor may need to perform additional procedures to determine whether the alleged fraud leads to reasonable grounds for believing that fraud may have occurred – that is, that suspected fraud exists. The draft needs to take a more differentiated approach to different kinds of allegations of fraud.

In other parts of the draft, the auditor's responsibilities for immaterial fraud are not clear (see our responses to Questions 4 and 10). This results in part from the issues arising from not having differentiated between alleged and suspected fraud as discussed above. In particular, the current wording implies investigation (rather than just consideration) of all allegations, regardless of their seriousness and how material they could reasonably be. As we point out in our response to

Question 10, further lack of clarity regarding auditor responsibility for immaterial fraud results from requirements and application material formulated in such a way as to cover all fraud or suspected fraud, rather than only those that might indicate a risks of material misstatement.

#### Inherent limitations

We agree with the content included in paragraphs 9 to 10 of the draft and the related application material in paragraph A12 on the inherent limitations of audits with respect to fraud, because the inherent limitations described are real hindrances to auditors detecting material misstatements due to fraud. By definition, inherent limitations are inherent – that is, they exist regardless of auditor performance within the confines of the existing powers of auditors and do not have an impact on the auditor's responsibility to obtain reasonable assurance about whether the financial statements as a whole are materially misstated due to fraud. Not including this treatment of inherent limitations would increase the information asymmetry between auditors and other readers of the standard and lead to unrealistic expectations among other stakeholders about the ability of auditors to detect fraud, which is not in the public interest. However, we do not believe that the description of the inherent limitations and their impact on the persuasiveness of evidence that auditors are able to obtain is fulsome enough to adequately reduce the information asymmetry between auditors and other readers of the draft regarding auditors' ability to detect fraud.

In particular, less knowledgeable readers will not understand the real limitations in the powers of auditors that impact their ability to detect fraud. For these reasons, we believe that the application material to paragraph 10 needs to be augmented to point out that:

Auditors generally do not have legal powers to search for, and seize, documents from within the entity, from other entities, or from individuals,

Auditors generally do not have the legal powers to interrogate individuals (and confine individuals for interrogation) from within the entity or from outside the entity, under oath or otherwise, and

Management has the documents and records under its control and can therefore choose to conceal documents and records from the auditor without the auditor becoming aware of such concealment.

While the last bullet point is covered in part by paragraphs 11 and A10 in the draft, these paragraphs do not emphasize the control that management exercises over documents and records and their concomitant ability to conceal such documents and records from the auditor. We also note that paragraph A113 addresses management's unique position to perpetrate fraud, but primarily in the context of their ability to override controls. However, a key reason for management being able to perpetrate fraud is not just their ability to override controls, but also the fact that they have executive control over books and records even without overriding controls, which is why we believe that concentrating on overriding controls alone is not sufficient to explain management's ability to perpetrate fraud and why we believe that the last bullet point above is so important.

The inherent limitations noted above exacerbate the difficulty with which auditors are able to detect material third-party frauds. In particular when management or employees collude with third parties to commit fraud against the entity (e.g., third parties colluding with management or employees to misappropriate assets of the entity through collusion, including kick-backs, such as through choosing certain suppliers even though their price is higher, or their quality is less than that of other suppliers for the same price), such fraud is exceedingly difficult to detect as part of the financial statement audit because management or employees may forge or conceal documents to cover up such fraud and, in some cases, there may not be any documents within the entity to indicate such fraud. Furthermore, auditors cannot be expected to be experts in considering the quality of all of the myriads of types of goods and services provided by suppliers to entities. Auditors also typically do not have access to third parties and their documents or records, since auditors generally do not have any legal or contractual relationship with such parties. Consequently, the application material in paragraph A10 also needs to be augmented to address the particular difficulties facing auditors when seeking to detect third-party fraud.

What the draft does not address is the impact of all of the inherent limitations noted above on what reasonable assurance and persuasive audit evidence means. In line with ISA 200, paragraph 9 of the draft states that reasonable assurance is a high, but not absolute, level of assurance, but the IAASB has always skirted the issue as to what that means in the context of inherent limitations (i.e., high in relation to what?) As pointed out in the FEE Paper “Selected Issues in Relation to Financial Statement Audits” from 2007, it cannot mean that reasonable assurance is a constant level of assurance just below absolute assurance (i.e., just below omniscience). This also calls into question the meaning of the statement in the last sentence of paragraph 10 of the draft as to not being satisfied with less than persuasive audit evidence. In this context, when is evidence “less than persuasive”? Certainly, given the inherent limitations noted above, the persuasiveness of evidence obtained regarding most potential material factual errors would invariably be greater than that obtained with respect to whether the financial statements are free of material misstatements due to the misappropriation of assets through third parties in collusion with management. Perhaps it is time that the IAASB deals with what reasonable assurance and the persuasiveness of audit evidence means in the context of the inherent limitations of audits to reduce information asymmetry between auditors and their stakeholders.

#### Non-compliance with laws and regulations

We take issue with the statement in the first sentence in paragraph 14 that, for the purposes of this and other relevant ISAs, fraud is an instance of non-compliance with laws and regulations, because the definition of fraud in paragraph 18(a) speaks of “to obtain unjust or illegal advantage”, which given the use of a standard inclusive “or” under the ISAs implies that some kinds of unjust advantage are illegal (e.g., unjust enrichment under the law in some common law and civil law

jurisdictions) and some kinds of unjust advantage are not. If all unjust advantage were illegal, the definition would need to speak only of illegal advantage and not separately address unjust advantage. Hence, either the definition or the statement in paragraph 14 needs revision. We presume that the IAASB is not seeking to change the definition of fraud, which implies that the statement in the first sentence of paragraph 14 is incorrect. We therefore suggest that the wording be changed to read “For the purposes of this and other relevant ISAs, fraud involving obtaining illegal advantage constitutes an instance of non-compliance with laws and regulations”.

Nevertheless, we believe there needs to be a clear statement in paragraph 14 that ISA 240 applies to the auditor’s responsibilities regarding fraud and not ISA 250 (Revised) in addition to ISA 240, because otherwise the first sentence could still be interpreted to mean that auditors would need to apply both standards at the same time, which would lead to duplication of work effort. We suggest that a sentence be added after the third

sentence of this paragraph as follows: “However, even though fraud involving obtaining illegal advantage constitutes an instance of non-compliance with laws and regulations, auditors are not required to apply ISA 250 (Revised) to identified or suspected fraud in addition to this ISA unless the additional responsibilities described in ISA 250 (Revised) are relevant in the circumstances.”

In this vein, the last sentence in the example in the box after paragraph A16 should be augmented to clarify that the additional responsibilities in relation to law and regulation would be covered by ISA 250 (Revised).

#### Other Matters

The third example in the example box under paragraph A3 of the draft suggests that management may inflate earnings to secure bank financing. In such circumstances, management often seeks to inflate net assets to secure such financing. For this reason, we suggest that the words “or net assets” be inserted after the word “earnings”.

We agree with the clear majority of the matters addressed in the draft. However, we do have a number of important concerns regarding the draft that we address in this response template. The main themes underlying our concerns relate to:

Providing, in the standard, a proper understanding of the responsibilities of management regarding fraud, which exceed that of auditors of the financial statements. Such a proper understanding of the responsibilities of management informs auditor judgments about the appropriateness of management responses to alleged, suspected or actual fraud. In particular, there needs to be a clear recognition that while management is responsible for preventing and detecting immaterial frauds due to its responsibility to safeguard entity assets, this latter responsibility also leads to cost-benefit considerations when management designs and maintains controls in this regard. (Response to Question 1)

Given the very broad definition of fraud, further clarification (through the definitions and hence in the requirements) that auditor responsibilities are limited to detecting two types of material fraud: misappropriation of assets and fraudulent financial reporting. There is also a tendency within the draft to use “fraud” and “fraud risks” generally when risks of material misstatement due to fraud is meant. (Response to Question 1)

Properly distinguishing between alleged fraud and suspected fraud, for which auditor responses and hence responsibilities must be different, while yet acknowledging that auditors cannot “ignore” alleged fraud. (Responses to Questions 1 and 4)

Without in any way seeking to limit auditor liability or work effort, proper recognition of the inherent limitations of audits, which by definition cannot be overcome (or they would not be inherent) so that lay readers of the standard are not subject to information asymmetry about what auditor powers in relation to the detection of fraud are, which is important to manage stakeholder expectations about fraud detection in audits of financial statements. (Response to Question 1)

A clearer delineation of when ISA 250 (Revised) applies in addition to ISA 240 so that it is clear that, unless the additional requirements of ISA 250 (Revised) apply in a particular instance, auditors are not required to apply ISA 250 (Revised) to all instances of alleged, suspected or actual frauds. (Response to Question 1)

We would like to thank you for the opportunity to respond to the IAASB’s Exposure Draft: Proposed International Standard on Auditing 240 (Revised), The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements and Proposed Conforming and Consequential Amendments (hereinafter generally referred to as “the draft”).

As we mentioned in our comment letter dated February 1, 2022 on the IAASB Discussion Paper: Fraud and Going Concern in an Audit of Financial Statements (hereinafter referred to as the “our comment letter on the Paper”), we very much support the initiative of the IAASB to explore the auditor’s responsibilities in an audit of financial statements for fraud, because major instances of fraud have resulted in the public, and therefore legislators and regulators, calling the efficacy of audits in relation to fraud into question. We also very much welcome that the IAASB has stayed within its remit – that is, to deal with fraud in the context of the overall objective of an auditor, which is to obtain reasonable assurance that the financial statements are free of material misstatement, the key constraints on the remit in this context being obtaining reasonable assurance, the limitation of the responsibilities of the auditor in relation to the audit of the financial statements and hence misstatements of these, and that the responsibility be limited to material misstatements. That being said, we also recognize that when auditors discover other matters in relation to fraud during their audit, auditors have a responsibility to communicate with the appropriate level of management, and, when the matter is of governance interest, to those charged with governance and to consider whether such matters have an impact on the audit. Of course, there may be legislation and regulation in various jurisdictions requiring further communication or other actions, but these are matters that cannot be dealt with in other than at a general level within an international standard.

## 5. Accounting Firms

### Crowe

Neither agree/disagree, but see comments below

We generally agree with the clarified auditor responsibilities relating to fraud in ED-240, including the way the proposal decouples those responsibilities from inherent limitations in an audit. (See commentary below related to non-material and third-party fraud.)

We believe that it is very important, however, to educate financial statement users that the primary responsibility for the prevention and detection of fraud rests with both management and those charged with governance of the entity, as stated in paragraph 3 of ED-240. We further believe that it is critical to educate users on the auditor’s responsibilities, as clarified, and what are reasonable expectations related to the auditor’s responsibilities including the inherent limitations described in paragraphs 9-11 of ED-240. Such communication and education are essential for users to understand the role of each party involved in the financial reporting process as it relates to fraud, and to prevent any widening of the “expectations gap” related to the auditor’s responsibilities related to fraud.

Non-material fraud: Related to non-material fraud, we agree that auditors have an important role related to fraud detection. Specifically, as stated in paragraph 6 of ED-240, the auditor is concerned with a material misstatement of the financial statements due to fraud. As such, auditors should design their audits to appropriately identify, assess, and respond to risks of material misstatement to the financial statements due to fraud. This is not the same as management’s responsibility when fraud or suspected fraud is identified, which is to determine if the matter is material to the financial statements. We also agree, as indicated in ED-240.8, that judgments about materiality involve both qualitative and quantitative considerations.

Consistent with these concepts, we advise the IAASB to consider the following changes to ED-240.8: “The auditor’s determination of whether a fraud or suspected fraud reflects a risk of material misstatement is material to the financial statements involves the exercise of professional judgment. This includes obtaining an understanding of the nature of the circumstances giving rise to the fraud or suspected fraud and any the identified misstatement(s).” We also recommend that IAASB revise the introduction to ED-240 paragraph 8

by changing “the Fraud” to “Fraud or Suspected Fraud” and “the Identified Misstatements” to “Identified Misstatements”.

As indicated in ED-240, the auditor should understand the nature of a fraud or suspected fraud. Based on the understanding obtained, which we believe should involve inquiries of management, the auditor should apply professional judgment to determine if there is a related risk of material misstatement to the financial statements due to fraud. See more on this topic in our response to Question 4 below.

Third-party fraud: Related to third-party fraud, the IAASB notes in the proposal that it did not support expanding the role of the auditor to detect third-party fraud that is not directly related to a risk of material misstatement due to fraud in the financial statements. However, this concept is not reflected within ED-240, as the content about third-party fraud within the standard is only definitional in nature. We recommend that the application guidance in A16 or A21, which provides examples of third-party fraud, clarify that the auditor’s response related to third-party fraud is driven by a risk of material misstatement in the financial statements

### Grand Thornton International

Neither agree/disagree, but see comments below

Overall, we believe ED-240 clearly defines the auditor’s responsibilities related to fraud in an audit of financial statements, however we have two areas of concern.

First, we believe that the proposed revisions in ED-240 to present the auditor’s responsibilities related to fraud before management’s and those charged with governance’s responsibilities may perpetuate the existing expectation gap related to the auditor’s responsibility to detect fraud. We suggest the IAASB:

Present management’s and those charged with governance’s responsibilities before the auditor’s responsibilities as management and those charged with governance are ultimately responsible for establishing processes and controls to prevent and detect fraud. Re-ordering these paragraphs as we suggest would be consistent with the presentation of management’s and the auditor’s responsibilities related to going concern in ISA 570 (Revised).

Similar to 570 (Revised), add an example of management’s responsibilities related to implementing controls to deter and detect fraud under the COSO Internal Control – Integrated Framework (2013) and COSO Fraud Risk Management Guide or ISO 31000 to the paragraph describing management’s responsibilities.

Second, we believe further clarification is needed regarding the auditor’s responsibilities related to third-party fraud. The requirements in ED-240 are in the context of fraud committed by management and others within the entity and there is no mention of third parties in the requirement paragraphs. Furthermore, the application material contains limited guidance related to fraud and suspected fraud involving third parties. It is unclear from ED-240 how the Board believes auditors should evaluate the risk of fraud involving third parties as it relates to the fraud triangle and how auditors would identify fraud involving third parties. The way in which ED-240 discusses third-party fraud is inconsistent with how auditors consider fraud today. This is problematic as it relates to the auditor’s responsibilities to evaluate fraud risk factors. Based on the application material in ED-240, paragraph A56, fraud risk factors exist when just one arm of the fraud triangle is present; we interpret this to mean that if there is pressure for one third party to commit fraud, all third parties are part of the fraud risk assessment and response, which we do not believe is appropriate. Further, it is not clear from ED-240 how the auditor would identify incentives or an ability to rationalize as it relates to third parties given the limited nature of interaction between auditors and third parties.

## 6. Public Sector Organizations

### Government Accountability Office – United States

We support the International Auditing and Assurance Standards Board's (IAASB) effort to clarify auditor's responsibilities relating to fraud in an audit of financial statements. We note that the inclusion of third-party fraud is not a new concept in ED-240 as it was part of the definition in extant International Standards on Auditing (ISA) 240, but it is not clear from the added application material what additional responsibilities the auditor may have. The example cited in paragraph A16 can be clarified to indicate that when an auditor is informed of a cybersecurity breach, the auditor will initially need to review the auditee's actions before determining what additional responsibilities the auditor has with regard to appropriate laws, regulations, and relevant ethical requirements.

Finally, we recommend changing the definition of fraud to remove the phrase "unjust or illegal." We believe the concept of justification is frequently used to support an individual's fraudulent actions as just. We suggest modifying the definition as follows:

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 a personal or professional advantage.

### Riksrevisionen (Swedish National Audit Office)

Fraud relevant for the auditor

The standard gives examples of types of fraud that may be relevant to an auditor and clearly points out that there must be an intention behind the act. All the guidance and the requirements insinuate that it refers to fraud committed by management or employees. In the definition of fraud (paragraph 18a), third parties are also included as possible perpetrators. The addendum on third parties does not fit logically with all other guidance on fraud relevant to the auditor. Additionally, it can be a problem for the public sector where our auditees pay out huge sums based on third-party data. Third party in collusion with employees/management is one thing but third party alone is not logical. They cannot intend to manipulate the financial reporting or misuse assets (as described in the standard). This extended approach could mean that, for example, the following risks could be classified as fraud risks:

- burglary with the aim of stealing valuable assets
- cybercrime where the intent is to steal funds
- incorrect information in the grant application or tax return.

We therefore believe that it must be assumed that it is management or employees who commit irregularities. In cases where the definition also includes third parties, the guidance should be expanded around third parties and clarify the difference between other risks and risk of fraud.

Neither agree/disagree, but see comments below

We agree with the statement in paragraph 2 which states the following:

"The auditor's responsibilities relating to fraud when conducting an audit in accordance with this ISA, and other relevant ISAs, are to: (Ref: Para. A1)

(a) Plan and perform the audit to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement due to fraud. These responsibilities include identifying and

assessing risks of material misstatement in the financial statements due to fraud and designing and implementing responses to address those assessed risks.”

Though we have identified requirements throughout the that are not totally aligned with paragraph 2. This could lead to uncertainty about the auditor responsibilities.

The reason for the uncertainty is that the requirements does not consequently use the term “material misstatement of fraud” in the requirements. Instead, it sometimes only refers to “fraud” or “misstatement of fraud”.

One example is the requirements relating to risk assessment. Paragraph 26 states the following:

“In applying ISA 315 (Revised 2019),<sup>14</sup> the auditor shall perform the procedures in paragraphs 27–39 to obtain audit evidence that provides an appropriate basis for the: (Ref: Para. A44) (a) Identification and assessment of risks of material misstatement due to fraud at the financial statement and assertion levels, taking into account fraud risk factors; and...”

Paragraph 26 is followed by requirements related to understanding the environment and the entity. These requirements are more broadly formulated. This leads to a wider scope than understanding the environment of the entity to assess the risk of material misstatement due to fraud. For example, paragraph 39 states that the auditor should conclude if there are any deficiencies in the internal control for detecting fraud. In paragraph 39 there are no references to material misstatements, just fraud which we interpret as any fraud. Such requirement would require an enormous effort for the auditor to be able to conclude on that. The question is whether this is relevant of the purpose of the audit.

Our suggestion is that paragraph 39 should refer to material misstatements due to fraud. We also suggest that IAASB goes through all the requirements and application material ensuring that the auditor focuses on the risk of material misstatement due to fraud and aligned with the auditor responsibilities as stated in paragraph 2.

Application material for auditor responsibility

## **7. Member Bodies and Other Professional Organizations**

### **European Federation of Accountants and Auditors for SMEs**

Neither agree/disagree, but see comments below

We recognize the challenges in setting out the auditor’s responsibilities relating to fraud and the context under which the proposals have been developed. It is critically important that the revisions emphasize the inherent limitations of the ability of the auditor to address challenges raised by fraud so that this is clear to and understood by all users. We believe the current text under inherent limitations could be revised to make this point clearer and, in so doing, help address the expectation gap that exists in this area.

The proposals appear to place greater emphasis on employee fraud than management fraud. In the context of SMEs this may be inappropriate since management fraud is often more likely to significantly impact the entity. We suggest the IAASB heighten the profile of management fraud to mitigate the risk of SMP auditors focusing more attention on employee fraud that poses less risk to their clients.

We are also concerned that the proposals may increase the work effort related to non-material fraud. The auditor has no formal responsibilities in this area, since their focus should be on significant risks, including those of material misstatement due to fraud. Any specific work completed on non-material fraud or suspected

fraud would divert resources from more important risks. Consequently, we urge the IAASB to revisit the references to fraud and suspected fraud throughout ED-240 and ensure they convey the appropriate focus.

### **Chartered Accountants Australia and New Zealand and the Association of Chartered Certified Accountants**

Neither agree/disagree, but see comments below

In our view, ED-240 clearly sets out the auditor's responsibilities relating to fraud in audit of financial statements – subject to the specific points we outline below.

#### **Inherent limitations**

We support reordering the introductory paragraphs so that the responsibilities of the auditor appear before the inherent limitations of the audit. This also aligns with the views we received in our thought leadership report Closing the expectation gap the way forward for fraud and going concern: A multistakeholder approach where some regulator representatives raised concerns about the introduction of ISA 240 and particularly paragraph 5, arguing that this underplays the responsibility that auditors have in detecting material fraud, as it states that fraud may go undetected. Conversely, practitioners pointed to the need to be very clear on the limitations of reasonable assurance engagements in order to avoid widening the expectation gap. As our report notes, in the UK similar comments were raised in the Brydon review and as a result the UK FRC has already moved ahead by making revisions to the equivalent paragraph in ISA (UK) 240.

In our view, reordering the paragraphs addresses the concern of the introductory paragraphs being 'defensive' in the outset without undermining the importance of inherent limitations and hence being responsive to the requirements of different stakeholders views in this area.

#### **The auditor's responsibilities relating to fraud**

We support the IAASB's decision to retain the acknowledgement that the primary responsibility for the prevention and detection of fraud rests with both management and TCWG of the entity (paragraph 3). However, we do not support moving this acknowledgement after describing the auditor's responsibilities (paragraph 2). In our view, the responsibilities of management and TCWG should remain before referring to the auditor's responsibilities as it is more logical for those who have primary responsibility to be referred to first as is the case in the extant standard.

#### **The auditor's responsibilities relating to non-material fraud and non-material suspected fraud**

We support the intent behind the introductory paragraph 8 aiming to clarify how the auditor goes about determining whether an identified misstatement due to fraud or suspected fraud is material to the financial statements. However, in our view more clarity is needed in paragraph A11 which introduces a 'qualitatively' material misstatement due to fraud, particularly when it comes to who instigated the fraud. What is material

or not is not clear enough based on the current drafting and would likely cause confusion, particularly when it comes to the work effort required. We therefore suggest that the IAASB provides more clarity in the form of examples in this area.

### **CPA Australia**

Neither agree/disagree, but see comments below

Overall, we are of the view that the Explanatory Memorandum (EM) and ED-240 only partially clarify the auditor's responsibilities regarding non-material fraud and third-party fraud. The expectations for inquiries and work effort related to these areas remain unclear.

#### Responsibilities relating to fraud.

While we agree that the inherent limitations of an audit in detecting fraud can be misleading and should be 'decoupled' from the paragraph that describes the responsibilities of the auditor, we disagree with the proposed sequence change in ED-240. The primary responsibility for preventing and detecting fraud within an organisation lies with management and those charged with governance (TCWG). The auditor's role is subservient to that of management and TCWG and as such, the auditor's responsibilities should be described after their responsibilities. Changing this sequence and 'decoupled' inherent limitations may create the false perception that the auditor's responsibilities regarding fraud have been expanded, thus potentially exacerbating the expectation gap.

The EM repeatedly states that the proposed revisions for non-material fraud and third-party fraud are not intended to expand the roles and responsibilities of the auditor relating to fraud in an audit of the financial statements (see EM paragraphs 17 and 92.) However, this is not the case. The proposed ED-240 appears to have extended the audit procedures to address non-material fraud and third-party fraud that is not directly related to a risk of material misstatement.

#### Non-material fraud

We reiterate our stance in our Submission on the IAASB Public Consultation on Fraud and Going Concern in an Audit of the Financial Statements Expectation Gap that audit procedures should not be extended to detecting non-material fraud per se, as it likely fails a cost-benefit test. Moreover, the IAASB needs to be clear in its future intent and whether it now considers that an audit should address all conceivable, potential, suspected and expected risks relating to fraud, whether material or not. Non-material fraud is difficult to identify without significantly increasing work effort and lowering materiality thresholds. The very nature of fraud, which can include concealment, collusion, and deception, can mean it seeks to evade discovery. However, we acknowledge that when non-material fraud is identified, it is relevant to the auditor as it potentially may indicate broader risks, such as undetected future fraud or systematic control weaknesses. The same can be said about all risks.

While ED-240 paragraph A11 helps explain the qualitative impact of fraud, it lacks guidance on the auditor's response when qualitatively immaterial fraud is found. We acknowledge that auditors need to apply their professional judgment when determining the work effort required. Nonetheless, clear guidance on the extent of work required, linked back to fraud risk, would be helpful. This includes actions to take when dealing with qualitatively immaterial suspected fraud or allegations of fraud.

#### Third-party fraud

The auditor's responsibilities regarding third-party fraud are not clearly defined. The broad definition of third-party fraud in ED-240 paragraph A21 could include many types of fraud that auditors cannot reasonably be expected to detect. EM paragraph 92 states that the IAASB does not intend to expand the auditor's role to detect fraud that is not directly related to material misstatements. This is not the case; it does expand the auditor's role. The example of a cybersecurity breach that is indirectly related to the risk of material misstatements in ED-240 paragraph A16 contradicts this intent.

To provide clarity, the IAASB should offer examples of third-party fraud directly and indirectly related to material misstatements. It is also unclear if additional work is required when fraud perpetrated by a third party is identified, apart from considerations under law, regulation, or ethical requirements. Additionally, it is unclear if the work effort for fraud or suspected fraud perpetrated by a third party would differ from that which is required for fraud or suspected fraud perpetrated within the organisation.

Whilst broad third-party fraud risks can reasonably be expected to be considered by the auditor at a high level, we do not consider that the auditor can conduct an in-depth assessment of third-party fraud risk. A more specific targeted engagement is required to address those risks.

#### Definitions

The definitions of fraud and fraud risk factors remain largely unchanged, with additional application paragraphs included for clarity. These paragraphs are helpful, except for paragraph A21, which includes a broad definition of third-party fraud. The broad scope of the definition that captures many third parties can be problematic without a clear scope of the role of auditors in relation to third-party fraud.

#### Institute of Chartered Accountants in England and Wales

Neither agree/disagree, but see comments below

ICAEW welcomes IAASB's efforts to provide clarity around the auditor's responsibilities relating to fraud in an audit of financial statements. However, the revisions do not adequately address the auditor's responsibilities relating to third-party fraud. Intentional acts by third parties have been clarified in ED-240 as falling under the umbrella of the definition of fraud (ED-240 Para. A21). IAASB has stated that it 'did not support expanding the role of the auditor to detect third-party fraud (...) not directly related to a risk of material misstatement due to fraud (...)' (EM, Section 1-J, Para. 92) while simultaneously stating in ED-240 Para. A16 that third-party fraud 'may also give rise to additional responsibilities for the auditor under law, regulation, or relevant ethical requirements (...)'. Clarity is needed regarding the circumstances which may trigger these additional responsibilities and the expected work effort in the event of a third-party fraud. Of particular concern are those instances of third-party fraud which do not directly impact the financial statements. The inexactitudes of the proposals might lead auditors and others to infer that their responsibilities extend to these situations.

We are also concerned by clarifications around the auditor's responsibilities for 'qualitatively' material fraud (ED-240 Para. 8). We agree that the materiality of a fraud depends on its circumstances as well as its quantum. We also appreciate that the application material (Paras. A11 and A155) expands on this (auditors should consider who perpetrated the fraud and why). Nevertheless, the determination of what is and what is not a material fraud can be a challenging subjective judgement and we suggest including more specific examples of a quantitatively immaterial fraud that is qualitatively material, over and above the high-level circumstances already proposed.

ED-240's emphasis on qualitative as well as quantitative fraud may lead to an expectation that auditors increase their work effort by, for example, reviewing every expense claim for every director and following up every error irrespective of quantitative materiality, which would be neither desirable nor feasible. An alternative interpretation is that the ED aims to clarify the auditor's response supposing they do identify non-material fraud. Clearer wording around this and the associated work effort would be helpful to avoid misunderstandings and inconsistent practices.

The proposals could also make a clearer distinction between financial reporting fraud and fraud through misappropriation of assets. The latter is fairly common for certain types of businesses such as retailers and ED-240 could have more focus on financial reporting fraud, which may be rarer but potentially more damaging to the business.

In its 2024 'Report to the Nations', the Association of Certified Fraud Examiners found that although financial reporting fraud is the least common form of fraud, when it occurs, it results in the highest median loss for companies. It is also harder to detect. Risk factors for financial reporting should have more prominence in the engagement team discussion and we urge IAASB to amend ED-240 Para. 29 to reflect this. In addition, the

auditor cannot be expected to consider every act of third-party misappropriation of assets, regardless of its materiality and impact on the audited entity. This should be made clear in ED-240 Para A21.

ICAEW supports IAASB's approach to the inherent limitations of an audit. In May 2021 the Financial Reporting Council (FRC) revised ISA (UK) 240 to address some of the concerns raised by Sir Donald Brydon in his 2019 review of the quality and effectiveness of audit, including providing increased clarity as to the auditor's obligations in respect of fraud. One of these revisions was to make clear that the auditor's responsibilities were not diminished by the inherent limitations and challenges of an audit in relation to fraud (ISA (UK) 240 Para. 7-1). IAASB has followed suit in its own revisions to ISA 240.

We agree with the proposal to place the description of the auditor's responsibilities (ED-240 Para. 2) before those of management and TCWG (ED-240 Para. 3), as well as before the inherent limitations caveat (ED-240 Paras. 9 – 11). ISA 240 is an auditing standard and the description of the auditor's responsibilities should go first.

The primary responsibility for the prevention and detection of fraud rests with management and TCWG, however, and there is an unavoidable risk that some material misstatements may not be detected even in a fully ISA-compliant audit. The proposals prudently continue to make this clear.

There is a danger, however, that the proposals could be perceived as raising the bar for auditors with no corresponding levelling-up for directors and TCWG. Although there is undoubtedly a public perception that auditors can and should be doing more to detect fraud to help prevent the unexpected failures of companies due to fraud, directors, governments, and audit regulators must also play their part and be held to account. In July 2022, ICAEW published a report *Sharpening the Focus on Corporate Fraud: An Audit Firm Perspective* in which we explain what more can be done, and what can be done differently, by all these groups, not just auditors, to better detect fraud, and thereby reduce the risk of disorderly corporate failure. Collective responsibility must be kept in mind when it comes to improving external reporting in relation to fraud.

#### Third-party fraud

One of the key issues identified in IAASB's project proposal was the extant standard's lack of clarity with respect to third party fraud (EM, Section 1-J, Para. 89(b)). We note that intentional acts by third parties are included in the definition of fraud in ED-240. ICAEW does not believe that this, together with the 'additional responsibilities' (ED-240 Para. A16) arising from third-party fraud, provides the intended clarification.

Many third-party frauds do not directly impact the financial statements and IAASB needs to address this in the application material. The standard should explain what can trigger the 'additional responsibilities' and be clearer about what the auditor's response, should they identify such fraud, may involve.

#### Center for Audit Quality

Neither agree/disagree, but see comments below

The CAQ appreciates the opportunity to share our views and provide input on the questions included in the International Auditing and Assurance Standards Board's (IAASB or the Board) Exposure Draft, Proposed International Standard on Auditing 240 (Revised): The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements, including Proposed Conforming and Consequential Amendments to Other ISAs (referenced herein as the Exposure Draft, ED-240, the proposed requirements, or the proposal).

The CAQ is supportive of the IAASB's efforts to clarify and enhance the auditor's responsibilities relating to fraud in an audit of financial statements, including highlighting the importance of professional skepticism in the audit, as a means of enhancing public trust in financial reporting. We appreciate that the IAASB has

incorporated into ED-240 the feedback from stakeholders on their previously issued discussion paper, *Fraud and Going Concern in an Audit of Financial Statements: Exploring the Differences Between Public Perceptions About the Role of the Auditor and the Auditor’s Responsibilities in a Financial Statement Audit* (September 2020). However, we have certain concerns with the proposed requirements, as described below.

#### Stakeholder perceptions/expectations regarding fraud in an audit of financial statements

Many of the revisions to extant requirements and linkages to ISA 315 (Revised) included in the proposal, including the proposed changes that highlight the importance of the auditor’s professional skepticism, would serve as good reminders to auditors as they assess and respond to the risk of material misstatement due to fraud in performing financial statement audits. Additionally, the procedures outlined in the proposed requirements are generally consistent with what many auditors do today when assessing and responding to risks of material misstatements due to fraud in applying extant ISA 240 and ISA 315 (Revised), as well as when fraud is identified or suspected (e.g., in the public company context, because of additional requirements embedded in Section 10A of the Securities Exchange Act of 1934). As such, we are generally supportive of the proposed amendments (subject to the concerns expressed herein), and we believe that the benefit of the standard will be to promote more consistency in the procedures performed by auditors to comply with their responsibilities in determining that the financial statements are free of material misstatement due to fraud. Additionally, given that the IAASB’s previously issued discussion paper on this topic was initially focused on the “expectation gap,” an appropriate balance must be struck to ensure that the final standard is not inadvertently expanding the expectation gap if it is interpreted as requiring a fundamental shift in auditor behavior.

As such, we believe it is important that the IAASB effectively manages expectations through communications and education regarding what the proposed changes are and what they can reasonably be expected to achieve. We recommend that the Board include such communications as part of implementation guidance once the standard is finalized, potentially in the form of publications, videos, webinars, etc. Education could also come in the form of additional guidance related to what is expected from each participant in the financial reporting ecosystem with respect to the prevention and detection of fraud, which may help further narrow the expectation gap. Such clarity as to what is expected of management and those charged with governance (TCWG) could help users of the financial statements understand how the responsibilities of management, auditors and others interrelate.

#### Potential unintended expansion (or perceived expansion) of the role and responsibilities of the auditor

Paragraph 17 of the Explanatory Memorandum that accompanies ED-240 indicates that the IAASB is not seeking to expand the role and responsibilities of the auditor relating to fraud in an audit of financial statements. We are supportive of this intention. We are concerned, however, that certain proposed wording changes and additions that may not be intended to be significant could unintentionally expand the role and responsibilities (or the perceived role and responsibilities) of the auditor. Specifically, we considered the following areas and examples and provide suggestions to address each:

#### Responsibility for the prevention and detection of fraud

As described in the explanatory memorandum, the IAASB has proposed changes in extant ISA 240 to describe the auditor’s responsibilities before those of management and TCWG as they believe that the focus of an auditing standard relating to fraud in an audit of financial statements should be on the role and responsibilities of the auditor. As the primary responsibility for the prevention and detection of fraud continues to rest with management and TCWG, we believe that it is important to avoid the perception or implication that the roles or responsibilities of these groups under ED-240 differ from those under extant ISA 240.

We recommend that the Board consider including a brief lead-in sentence in ED-240.02 to clarify this point. Specifically, we suggest the following revision to paragraph 2 of ED-240 (deletions are struck through, additions are marked as underlined):

While the primary responsibility rests with management and those charged with governance of the entity, Tthe auditor’s responsibilities relating to fraud when conducting an audit in accordance with this ISA, and other relevant ISAs, are to: (Ref. Para. A1)

(a) Plan and perform the audit to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement due to fraud. These responsibilities include identifying and assessing risks of material misstatement in the financial statements due to fraud and designing and implementing responses to address those assessed risks.

(b) Communicate and report about matters related to fraud.

Additionally, any efforts by the IAASB to communicate and educate stakeholders regarding what the proposed changes are and what they can reasonably be expected to achieve (as referenced above) could include reminding users about the responsibilities of management and TCWG for prevention and detection of fraud and to explain what the audit is and is not.

We also believe that all other participants in the financial reporting ecosystem, including internal and external auditors, audit committees, and management, should continue to educate the public and users of the financial statements as to their respective roles and responsibilities when it comes to deterring and detecting fraud. Such clarity as to what is expected of management could help users of the financial statements understand how the responsibilities of management, auditors and others interrelate. For example, more fulsome disclosure by entities about their processes and controls could be helpful to users of financial statement (e.g., a statement by management on the effectiveness of internal controls over financial reporting, including controls related to fraud, for certain entities).

Further, we would recommend that the Board consider whether any potential new or revised requirements in the ISAs would achieve the objectives in the exposure draft without complementary systemic changes. The enactment of the Sarbanes-Oxley Act (SOX) in the United States in 2002 and its cascading impact have helped to highlight the shared responsibility of fraud deterrence and detection among those charged with governance, management, and internal and external auditors. The Securities and Exchange Commission’s (SEC) guidance for management related to management’s report on internal controls, together with the 2013 Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control - Integrated Framework, provide management and boards of directors a means to identify and analyze risks, and to develop and manage appropriate responses to risks within acceptable levels and with a greater focus on anti-fraud measures. Additional regulatory actions, such as the establishment of the SEC’s Whistleblower Program, have placed greater attention on fraud detection to complement actions by auditors. We encourage the Board to work collaboratively with others in the financial reporting ecosystem to seek holistic solutions where possible. As the primary responsibility for fraud deterrence and detection rests with management and TCWG, we believe that any potential solution should align with, and consider the efforts by, the International Accounting Standards Board (IASB) and International Ethics Standards Board for Accountants (IESBA), among others.

#### Authenticity of records and documents

We acknowledge that, in accordance with ISA 500, Audit Evidence, auditors are required to consider the relevance and reliability of information to be used as audit evidence. However, we are concerned that the

proposed amendments in ED-240 related to the authenticity of records and documents could have unintended consequences related to the auditor's responsibilities, or the perceptions of those responsibilities, in this area. The proposed amendments could create confusion for auditors and could contribute to an expectation by financial statement users about what is required to be and/or has been performed by an auditor with respect to authenticating documents and records that does not align with the intended requirements of ED-240.

As described in paragraph 25 of the Explanatory Memorandum that accompanies ED-240, the IAASB is proposing to delete from ED-240.20 (extant ISA 240.14) the explanatory lead-in sentence, "Unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine." The Explanatory Memorandum goes on to explain that the deletion is being proposed because the same sentence is already included in ISA 200.A24 and that the proposed deletion is not intended to increase the work effort as it pertains to considering the authenticity of records and documents obtained during the audit. We are concerned that, as a result of the deletion of the lead-in sentence in ED-240.20, auditors may view ISA 240 and ISA 200 to be inconsistent with regards to the requirements of the auditor around the authenticity of records and documents, which could create confusion and inconsistency in performance by auditors.

Further, the language in extant ISA 240.A9, which states that "An audit performed in accordance with the ISAs rarely involves the authentication of documents, nor is the auditor trained as or expected to be an expert in such authentication," has also been excluded from ED-240. We believe that this language provides important context and we are concerned that its elimination could unintentionally imply to auditors and/or financial statement users that the expectations or requirements of auditors with respect to these considerations (i.e., frequency with which authentication procedures are being performed, expertise in authentication) have changed.

Additionally, ED-240.A26 provides examples of conditions that may cause the auditor to believe that a record or document is not authentic or that terms in a document have been modified but not disclosed to the auditor. We believe that in performing audit procedures, auditors (at least in some cases), may not become or be made aware of, or may not be able to discern, the existence of the example conditions listed in ED-240.A26. We are concerned that the extent and nature of the examples included in ED-240.A26 could imply an expansion of the role and responsibilities of the auditor related to validating the authenticity of records and documents in performing the audit.

We recommend that the Board consider retaining the aforementioned extant explanatory lead-in sentence in ED-240.20. To the extent the Board feels strongly that the language should not be repeated in ED-240, we encourage the Board to include a reference to ISA 200.24 within ED-240.20 in order to clarify that the auditor's responsibilities in this area are the same under the two standards. Additionally, we recommend that the Board consider retaining the language from extant ISA 240.A9, which could be included in ED-240.A26.

#### Other examples

The language in extant ISA 240.6, which states that "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," and the language in extant ISA 240.A23, which states that "Also, the fact that fraud is usually concealed can make it very difficult to detect," have also been excluded from ED-240. We believe that this language provides further important context regarding the auditor's ability to detect fraud, the elimination of which could result in unrealistic expectations by financial statement users. We recommend that the Board consider retaining the language from extant ISA 240.6, which could be included in ED-240.A12, as well as the language from extant ISA 240.A23, which could be included in ED-240.A56.

The application material and appendices include several lengthy lists of matters or examples related to fraud (e.g., ED-240.A52 and Appendices 1 through 3). We are concerned that this could have the effect of driving a checklist mentality, rather than a tailored discussion of fraud risk factors and risks of material misstatement that are specific to the company. While we appreciate the IAASB's efforts to provide auditors with examples to assist them in applying ED-240, we suggest that positioning them outside the standard could decrease the risk that they are treated as a checklist, while also providing the IAASB with more flexibility to update or expand upon them as new fraud schemes and fraud risk factors inevitably arise.

The auditor's responsibilities relating to non-material fraud

Similar to other revised ISAs, the IAASB has included "key concepts" in the Introduction section of the ISAs. As described in paragraph 6 of ED-240, the auditor is concerned with a material misstatement of the financial statements due to fraud. As described in the Explanatory Memorandum, the IAASB introduced a key concept in paragraph 8 of ED-240 which deals with circumstances giving rise to the fraud and the identified misstatements with the stated intention of "clarify[ing] how the auditor goes about determining whether an identified misstatement due to fraud or suspected fraud is material to the financial statements." Specifically, ED-240.8 describes that, "The auditor's determination of whether fraud or suspected fraud is material to the financial statements involves the exercise of professional judgment. This includes consideration of the nature of the circumstances giving rise to the fraud or suspected fraud and the identified misstatement(s). Judgments about materiality involve both qualitative and quantitative considerations."

It is important that the key concepts described in the Introduction section complement, but do not undermine, the requirements in the standard that set out obligations for auditors. We agree that the auditor's role and responsibilities relating to fraud in an audit of financial statements involve the exercise of professional judgment and we are supportive of reinforcing the concept that, in performing procedures in relation to fraud or suspected fraud, both qualitative and quantitative considerations are relevant. We believe the IAASB's intent with respect to paragraph 8 is to remind auditors that, as they perform procedures related to fraud or suspected fraud, in both the risk assessment (as described in ED-240.26 through .54) and audit evaluation (as described in ED-240.55 through .57) stages, it is important to incorporate qualitative and quantitative considerations. However, we are concerned that the language in paragraph 8 and the related heading, as proposed, do not clearly convey this concept, and could be misinterpreted.

Additionally, we are concerned that the proposed language in paragraph 8 may inappropriately characterize the auditor's role, as the determination of whether fraud or suspected fraud is material is primarily responsibility of management (and therefore could be better described in paragraph 3), whereas the role of the auditor is to determine whether a fraud or suspected fraud results in a material misstatement of the financial statements and determine the implications of the misstatement in relation to other aspects of the audit.

To address these concerns (assuming the IAASB's intent is as we have interpreted it), we recommend that the Board consider making the following revisions to paragraph 8 of ED-240 and the related heading (deletions are struck through, additions are marked as underlined):

Qualitative and Quantitative Considerations Related Circumstances Giving Rise to the Fraud and the Identified Misstatements

8. In performing procedures in relation to The auditor's determination of whether a fraud or suspected fraud in accordance with this ISA, is material to the financial statements involves the auditor exercises of professional judgment. This includes consideration of the nature of the circumstances giving rise to the fraud

or suspected fraud and the identified misstatement(s). Judgments about materiality involve both qualitative and quantitative considerations. (Ref: Para. A11)

We have also considered the implications of the related application material (ED-240, paragraph A11), which describes that, “Even when an identified misstatement due to fraud is not quantitatively material, it may be qualitatively material depending on: (a) Who instigated or perpetrated the fraud – an otherwise insignificant fraud perpetrated by senior management is ordinarily considered qualitatively material irrespective of the amount involved. This may in turn give rise to concerns about the integrity of management responsible for the entity’s system of internal control [; and] (b) Why the fraud was perpetrated – misstatements that are not material quantitatively, either individually or in the aggregate, may have been made intentionally by management to “manage” key performance indicators in order to, for example, meet market expectations, maximize compensation based on performance, or comply with the terms of debt covenants.”

To promote consistent application of ED-240, we believe it is important that the proposed standard include a description of which individuals within the company represent senior management so that the intent of 240.A11 is clear. We would expect senior management to include the principal executive and financial officers (e.g., those who may be required to sign the company’s financial statement certifications, as applicable), as well as any other members of senior management who play a significant role in the company’s financial reporting process.

Additionally, we have concerns with the circumstances described in proposed 240.A11 (a) and (b). With respect to ED-240.A11(a), the proposed language seems to imply that a quantitatively immaterial fraud perpetrated by someone other than senior management would be viewed as “insignificant,” which we do not necessarily believe to be the case, nor do we believe the Board intended to imply as much. With respect to ED-240.A11(b), we are concerned with the specific reference to “why the fraud was perpetrated.” In some cases, the auditor may obtain information related to a fraud or suspected fraud that informs their perspective on why the fraud may have been perpetrated. By contrast, there may be other situations in which the auditor is not privy to any information regarding the reasoning or motivations of the perpetrator. In most cases, it is unlikely that an auditor would be able to know definitively why a fraud was perpetrated, and we believe it is unreasonable that they should be expected to do so.

To address these concerns, we recommend that the Board consider making the following revisions to paragraph A11 of ED-240 (deletions are struck through, additions are marked as underlined):

A11. Even when an identified misstatement due to fraud is not quantitatively material, it may be qualitatively material depending on In assessing the materiality of fraud or suspected fraud, the auditor may consider:

Who instigated or perpetrated the fraud – an otherwise insignificant quantitatively immaterial fraud perpetrated by senior management<sup>x</sup> is ordinarily considered qualitatively material irrespective of the amount involved. When fraud is perpetrated by senior management, Tthis may in turn also give rise to concerns about the integrity of management responsible for the entity’s system of internal control.

Footnote X - The term senior management includes the principal executive and financial officers (e.g., those who may be required to sign the company’s financial statement certifications, as applicable), as well as any other members of senior management who play a significant role in the company’s financial reporting process.

(b) The nature of circumstances giving rise to the fraudWhy the fraud was perpetrated – misstatements that are not material quantitatively, either individually or in the aggregate, may have been made intentionally by management to “manage” key performance indicators in order to, for example, meet market expectations, maximize compensation based on performance, or comply with the terms of debt covenants.

### The auditor's responsibilities related to third-party fraud

Paragraph 92 of the Explanatory Memorandum that accompanies ED-240 states that the "IAASB did not support expanding the role of the auditor to detect third-party fraud that is not directly related to a risk of material misstatement due to fraud in the financial statements." (emphasis added) We agree with this decision.

We understand and acknowledge that extant ISA 240 defines fraud as "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" (emphasis added) and that the IAASB has not proposed changes to that definition in ED-240. Additionally, we acknowledge that ED-240.5 retains the concept from extant ISA 240.3 that two types of intentional misstatements are relevant to the auditor – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

We believe that the inclusion of the concept of third-party fraud in ED-240 can serve as a good reminder for auditors that individuals outside of the company could commit a fraud that falls into one of the categories of intentional misstatements that are relevant to the auditor. However, we are concerned that ED-240, as currently drafted (including the level of emphasis placed on the topic), reads in a manner that could be viewed as expanding the role of the auditor to detect any third-party fraud, or at least to detect third-party fraud that falls outside of the categories that are relevant to the auditor.

The proposed standard does not clearly convey how the responsibility of the auditor to detect third-party fraud aligns with the more broadly defined responsibility of the auditor to detect intentional material misstatements of the financial statements resulting from fraudulent financial reporting and misappropriation of assets (as described in ED-240.5). ED-240.18(a) includes a definition of fraud that does not limit the role of the auditor to third-party fraud that meets the aforementioned criteria (intentional material misstatements of the financial statements resulting from fraudulent financial reporting and misappropriation of assets), and ED-240.A21 makes reference to the definition in paragraph 18(a).

We recommend that the Board consider updating ED-240 to include explicit language stating that third-party fraud considerations therein are related to intentional misstatements of the financial statements resulting from fraudulent financial reporting and misappropriation of assets. We also recommend that ED-240 be updated to include specific examples of third-party fraud related to each of these categories. Without such clarification, we believe that the opportunities for inconsistent interpretation and application of the requirements of the auditor related to third-party fraud are significant.

Additionally, as described in the ED, the IAASB enhanced the application material in paragraph A16 of ED-240 by explaining the auditor's actions if third-party fraud or suspected fraud that may give rise to risks of material misstatement is identified by the auditor, including a brief example relating to third-party fraud which involved a cybersecurity breach. In recent years, there has been a rapid increase in cyber-attacks across every industry, and we understand and acknowledge that a cybersecurity breach by a third party could meet the definition of fraud in extant ISA 240 and ED-240 and could result in a material misstatement of the financial statements. However, given the complexities and potential nuances associated with this emerging area, we are concerned that the brief example in ED-240.A16 referencing a cybersecurity breach may introduce more confusion than clarity.

We recommend that the Board consider replacing the example in paragraph A16 with a simpler example of third-party fraud that does not relate to a cybersecurity breach. To the extent the Board believes it is important to provide clarity to and/or remind auditors about how cybersecurity risk should be considered in the identification of, and responses to, risks of material misstatement to the financial statements, we recommend

that the Board address the topic separately and comprehensively, potentially as part of the Board's separate technology project.

#### **4 Disagree**

#### **4. Jurisdictional and National Auditing Standard Setters**

##### **Hong Kong Institute of Certified Public Accountants**

Disagree, with comments below

Given that the primary responsibility for the prevention and detection of fraud rests with both management and those charged with governance ("TCWG") of the entity, the order of the paragraphs describing the responsibilities of management and TCWG (ED-240.3) should be before the auditor's responsibilities (ED-240.2), which reflects the usual flow of the fraud process and follows a more logical sequence. This is also consistent with the order of presentation of the information in the auditor's report according to ISA 700, Forming an Opinion and Reporting on Financial Statements.

Paragraph 3 of the extant ISA 240 states that the auditor may identify the occurrence of fraud in rare cases while ED-240.6 mentions that the auditor may identify or suspect fraud, without highlighting that such circumstances are only identified in rare cases. The explanatory memorandum ("EM") for ED-240 did not provide the background information for including the reference to "rare cases" in the extant ISA 240 nor explain the omission of the reference to circumstances of "rare cases" when elevating the guidance from extant ISA to ED-240. We believe that the inclusion of reference to "rare cases" serves to manage the expectation gap between the financial statements users and auditors regarding the auditor's responsibilities relating to fraud in an audit and so we suggest that it should be retained in ED-240.6.

Besides, we also note that the whole paragraph 6 of the extant ISA 240 which describes the inherent limitations is elevated into ED-240.A12 except for the sentence "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." No explanation for the omitted sentence is included in the EM. We are of the view that the omitted sentence should be reinstated to help provide the context under which the auditor is responsible for fraud when performing an audit of financial statements. If the sentence is excluded in the final ISA 240, we suggest that the IAASB provide an explanation in the Basis for Conclusion.

#### **51. Auditing and Assurance Standards Board Canada**

Through our outreach and detailed review of the proposed revisions, we have identified other editorial suggestions that can improve the clarity and understandability of ED-240.

Consistency of terms

Paragraph A11 is inconsistent with the reference "fraud or suspected fraud" found throughout the rest of the standard.

Suggest:

Including suspected fraud in paragraph A11 to maintain consistency throughout the rest of the standard.

A11. Even when an identified misstatement due to fraud is not quantitatively material, it may be qualitatively material depending on:

Who instigated or perpetrated the fraud or suspected fraud – an otherwise insignificant fraud or suspected fraud perpetrated by senior management is ordinarily considered qualitatively material irrespective of the amount involved. This may in turn give rise to concerns about the integrity of management responsible for the entity's system of internal control.

Why the fraud or suspected fraud was perpetrated – misstatements that are not material quantitatively, either individually or in the aggregate, may have been made intentionally by management to “manage” key performance indicators in order to, for example, meet market expectations, maximize compensation based on performance, or comply with the terms of debt covenants.

Disagree, with comments below

While we agree that ED-240 clearly sets out the auditor's responsibilities relating to material fraud in an audit of financial statements, the proposals are unclear about the auditor's responsibilities regarding non-material fraud.

Auditors' responsibilities regarding non-material fraud

(Our concerns and suggestions below also relate to our response to Question 4).

## 5. Accounting Firms

### MNP

Disagree, with comments below

Most of ED-240 clearly sets out the auditor's responsibilities relating to fraud in a financial statement audit, however, we find that paragraph 21 may require additional skills beyond those of a certified public accountant and potentially cause confusion to the practitioner. It is unclear whether paragraph 21 is intended to also include immaterial fraud or fraud unrelated to financial statements (e.g., clients conducting impersonation for other fraudulent purposes). We suggest that the revised standard use more specific language (e.g., “...remain alert throughout the audit for information that is indicative of material financial statement fraud”) in order to prevent this confusion.

### Non-Material Fraud

Application material paragraph A11 discusses how identified misstatements due to fraud may be qualitatively material depending on why the fraud was perpetrated. In many financial statement frauds, the auditor may never truly identify why the fraud was perpetrated or may not determine the “why” for many periods after the report date. Determining the “why” may exceed the auditor's ability and generally is not necessary when determining the impact of the fraud on the financial statements.

### Third-Party Fraud

While the explanatory memorandum was explicit that the IAASB did not support expanding the role of the auditor to detect third-party fraud that is not directly related to a risk of material misstatement due to fraud in the financial statements, some of the application material, including examples used, may be interpreted differently by regulators. The example used in A52 implies that any lack of management oversight over significant business processes outsourced to a third-party service provider gives rise to a fraud risk factor (i.e., opportunity). This is a simplistic example that is suggesting an absolute fact, which may not always be the case. Many small and medium sized businesses would not have strong oversight over third-party services but that doesn't necessarily mean there are fraud risks present. We encourage the board to consider softening the language and to include scalability considerations around these examples. The other challenge is that if

a risk of material misstatement related to fraud is identified related to a third-party, developing the appropriate response may be difficult as the auditor may have access limitations over performing procedures at the third-party. Examples including the auditor's responses in these scenarios would be beneficial to include. Additionally, we propose aligning ED 240 with ED 500 for enhanced cohesiveness. In instances where no identified or suspected third-party fraud is detected during the audit, the auditor may refer to guidance from ED 500 to evaluate the relevance and reliability of the audit evidence acquired from third parties.

### Moore Global Network

Disagree, with comments below

#### Non-material fraud

We believe the additional guidance given in Para A11 (a) for Para. 8 should be removed. Our concern is that the interpretation of this phrasing widens the scope beyond what would be considered reasonable for the auditor to consider “an otherwise insignificant fraud perpetrated by senior management is ordinarily considered qualitatively material irrespective of the amount involved”.

Para A11 (b) alone sufficiently demonstrates and contextualises the concept of non-quantitative, qualitatively material instances of fraud as it relates to a material misstatement of the financial statement due to fraud in an approachable way.

At a minimum, further clarity regarding qualitatively material fraud committed by senior management concerning the expected work effort, including practical, real-life examples of when a quantitatively immaterial fraud may be considered qualitatively material, would be necessary to avoid scope creep or misinterpretations.

#### Auditors Responsibility

Like in extant ISA 240, we believe that Management's Responsibility in paragraph 3 should come before the Auditor's Responsibility in paragraph 2, as the primary responsibility for the prevention and detection of fraud rests with both management and those charged with governance of the entity. The current structure could be interpreted as auditors having a greater responsibility than management & TCWG.

### Baker Tilly International

There are some countries where fraud is enabled (and there are examples of fraud being perpetrated using such loopholes) because data protection laws prevent the auditor approaching the likes of banks directly for evidence – it would be helpful if auditor's responsibilities disclosed this limitation where applicable.

Disagree, with comments below

Whenever fraud is discovered that was not detected by the auditor then the auditor is deemed to have failed – this is incorrect but is a view that is reinforced by the revised auditor's responsibilities relating to fraud

Once a fraud is discovered you can often spot what you could have done differently to identify the fraud – regulators need to find a way to share lessons learned with market participants including audit committees and auditors; there also needs to be a way to share when internal or independent auditors have identified/ stopped fraud, for the benefit of other participants and to inform a balanced stakeholder/ press/ public understanding of the benefits of audit/ internal audit

There will be frauds perpetrated and not identified by auditors after ISA 240 Revised becomes effective – what will the IAASB do then? Auditor's responsibilities relating to fraud are one piece of a larger puzzle, including responsibilities of those charged with governance, but while it is only auditor's responsibilities that get revised

then the public perception is unfairly reinforced that it is only auditors that need to learn lessons. Fraud is an issue that needs coordinated actions and awareness raising, not action in isolation targeting one piece of the puzzle.

### KPMG International

Disagree, with comments below

Whilst we believe that ED-240 provides greater clarity regarding some aspects of the auditor's responsibilities relating to fraud in an audit of financial statements, we do have certain concerns with how the auditor's responsibilities are set out in ED-240, which we describe further below, together with recommendations as to how the IAASB may address these.

#### Concept of an Audit and Role and Responsibilities of the Auditor are Fit for Purpose

We understand the IAASB's intentions in proposing changes to the auditor's responsibilities section of the standard to provide greater clarity regarding such responsibilities. We also acknowledge the IAASB's statement, at paragraph 17 of the Explanatory Memorandum accompanying ED-240 (the "EM"), that in making the changes to this section of the standard, the IAASB is not seeking to expand the role and responsibilities of the auditor relating to fraud in an audit of financial statements. We support this objective as we consider that the concept of an audit and the role and responsibilities of an auditor, including with respect to fraud matters, are appropriate and fit for purpose. Furthermore, we recognise, as the IAASB also states at paragraph 17 of the EM, that the descriptions of the inherent limitations of the audit and the auditor's responsibilities relating to fraud in audits, at paragraphs 9-11 and A12 of ED-240, are consistent with how these concepts are currently described in extant ISA 240.

#### De-Coupling of the Description of the Inherent Limitations of an Audit Relating to Fraud from the Auditor's Responsibilities

We are concerned by the proposal to decouple the description of the inherent limitations relating to fraud in an audit of financial statements from the paragraphs describing the auditor's responsibilities in relation to fraud. We believe that describing the inherent limitations together with the auditor's responsibilities, as set out in the extant standard, is helpful because such inherent limitations are fundamental to understanding the auditor's role and responsibilities in this area. In clarifying that "reasonable assurance" in respect of any aspect of an audit does not constitute absolute assurance, we consider it critical to emphasise the inherent limitations that are specific to fraud to enable all stakeholders to understand this fundamental context to an audit. However, rather than enhancing clarity, we believe that the proposal to decouple explanations of these key concepts in ED-240 may reduce understanding in this respect and potentially widen any "expectation gap".

We also have concerns about the statement, introduced at paragraph 9, that "whilst the risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error, that does not diminish the auditor's responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement due to fraud". We believe that this wording, together with the de-coupling noted above, may be misconstrued by some to disregard the inherent limitations described above. This could lead to a misinterpretation by some as meaning that the effects of the inherent limitations are such that for an audit to be properly designed and performed, the auditor is to design and perform audit procedures to overcome such inherent limitations in order to reduce the risk that the audit does not detect a material misstatement resulting from fraud to the same level as the risk of not detecting a material misstatement due to error. We consider that this would be impracticable within the context of performing an audit in accordance with the ISAs, i.e., a reasonable assurance engagement.

We recommend that the above statement be removed, and that the inherent limitations and the auditor's responsibilities are not decoupled, and instead continue to be presented in a similar manner to their current presentation in the extant standard, i.e., that the IAASB include the statement set out in ED-240 at paragraph 10, which states that "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", at paragraph 2(a) when describing the responsibilities of the auditor, or at least include an explicit cross-reference from paragraph 2(a) to paragraph 10. Additionally, we recommend that the statement at paragraph 8 of the extant ISA that "the requirements of 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" be retained at paragraph 2 of ED-240, to clarify that in complying with the requirements of ED-240 auditors will discharge their responsibilities in respect of fraud, despite the effects of the inherent limitations.

In connection with the above, we also highlight that material at paragraph 6 of the extant ISA, setting out reasons why the risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting a material misstatement resulting from error (such as the fact that this may involve sophisticated and carefully organised schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor, which may all be exacerbated by collusion) has been moved to the application material at A12 in ED-240. As above we recommend that the IAASB reinstate this material within paragraph 9 in the inherent limitations section in the introduction to the standard, as this provides important context as to both why the risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting a material misstatement resulting from error, and also why the auditor's (in)ability to detect a fraud is affected by factors such as the skillfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved.

#### Paragraph Order of Respective Responsibilities of Management and Those Charged with Governance, and the Auditor

In addition to the above, we are concerned, although to a lesser degree, with the change in paragraph order when describing the respective roles and responsibilities of the auditor, and management and those charged with governance. We understand the IAASB's rationale, as described at paragraph 16 of the EM, that the auditor's responsibilities should be placed first, as the focus of an auditing standard should be on the role and responsibilities of the auditor. However, given that management and those charged with governance have primary responsibility for the prevention and detection of fraud at an entity, as stated at paragraph 3 of ED-240, we would recommend placing this paragraph before the paragraph describing the auditor's responsibilities as it provides important introductory context, such as reference to the culture and "tone at the top" that is set by management, as well as active oversight by those charged with governance, to then help users of the auditor's report to understand the auditor's role. This would also be consistent with the approach taken in other International Auditing Standards, such as ISA 250 (Revised), Consideration of Laws and Regulations in an Audit of Financial Statements and ISA 570 (Revised), Going Concern and the approach taken in UK ISA 240.

#### Qualitatively Material Fraud

We are supportive of the inclusion of the requirement at paragraph 8 and the related application material at A11 of ED-240, together with the further guidance addressing fraud or suspected fraud that may be qualitatively material, and the factors that may drive this determination. However, we recommend that ED-240 also make reference to the matter of "intent" in connection with these qualitative considerations, in particular,

where fraud is suspected. In some circumstances, it may require significant professional judgement for an auditor to determine whether an action is or is not intentional (e.g., whether an expense claim outside of policy has been made with the intent to defraud, or is instead an unintentional error), and yet this is the factor on which the determination as to whether a misstatement is due to fraud versus error hinges. These qualitative considerations regarding intent are also linked to evaluating whether a misstatement is material, as a misstatement may be quantitatively not material, however, if it involves senior management and appears to be intentional, then the misstatement may be due to fraud and may be qualitatively material. We recommend that the application material provide more guidance as to relevant considerations for an auditor when determining whether intent is present, setting out factors to consider, including ethical/legal matters, and the need to exercise professional skepticism and professional judgement in the wider context of the audit, considering the fraud risk factors and other circumstances that may be indicative of fraud, in determining whether intent is present/likely to be present. Usually, the question of whether a fraud has been perpetrated is a legal one, at the heart of which lies the question of intent. Therefore, auditors would typically consider the need to consult with legal experts and also forensics experts when fraud, and, in particular, suspected fraud, is identified. We recognise that paragraph 6 of ED-240 states that “the auditor does not make legal determinations of whether fraud has actually occurred” when fraud is suspected, and instead is “concerned with a material misstatement of the financial statements due to fraud”, however, we highlight that the determination as to whether a misstatement is material or not involves consideration of qualitative factors, and that these are inextricably linked to whether or not there is intent.

Additionally, we recommend that ED-240 further discuss the implications for the auditor, and the auditor’s report, when the auditor is unable to determine whether or not an act was intentional. This may have implications for the auditor’s opinion in circumstances where they have identified a suspected fraud and are unable to conclude whether or not it is appropriate to issue an unmodified auditor’s opinion from a qualitative perspective, e.g., where the amount(s) involved are not material (individually or in aggregate) but the suspected fraud involves senior management. They may also have concerns about whether management are honest/have integrity, and the implications for the audit as a whole, as described at paragraph 59, may be of such significance that the auditor may need to perform the procedures set out at paragraph 60. Accordingly, we recommend that material addressing intent be cross-referenced to paragraphs 59 and 60, with application material that is also focused on suspected fraud.

In addition to the above, we note that a significant amount of auditor attention may be directed towards the particular matter giving rise to a suspected fraud, and the auditor may determine the matter to be a KAM. However, the auditor may consider it inappropriate to communicate information about the matter in the auditor’s report, given the uncertainty as to whether the suspected fraud is an actual fraud and the potentially serious adverse consequences to the entity that may arise in doing so. We note that ISA 701.14 refers to the auditor’s determination not to communicate a matter because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication but highlights that this would be in extremely rare circumstances. We recommend that ED-240 include linkage to ISA 701.14, and that related application material to ISA 701.14 be expanded to explicitly discuss the situation where there would be serious adverse consequences to communicating a KAM related to suspected fraud.

We also note that in such circumstances, where the auditor determines that it would not be appropriate to communicate a KAM, public interest concerns may be addressed by reporting the matter to an appropriate authority outside the entity. We therefore recommend that the additional content that we describe above also cross-refer to ED-240.69 and that additional application material to ED-240.69 be developed to explicitly address the situation where the auditor is unable to determine whether fraud has actually occurred, and determines, in accordance with ISA 701.14, that it is not appropriate to describe the matter within the auditor’s

report, and then determines whether law, regulation or ethical requirements require the auditor to report the matter to an appropriate authority outside the entity, either because this is required by laws, regulations or ethical requirements, or otherwise considers this to be an appropriate course of action, to discharge its obligations in the public interest. In connection with this, we recommend that such application material include similar

material to that included at ISA 250.A27-A33, which discusses the interaction of content in laws and regulations, including ethical requirements, regarding reporting to an appropriate authority outside the entity, with confidentiality requirements.

### Third-Party Fraud

The concept of third-party fraud is included at paragraph 18(a) of ED-240 and also in the extant standard and therefore we welcome the introduction of application material at paragraphs A18-A21 to raise awareness of this type of fraud and when/how it may occur. However, we recommend that the IAASB include further enhancements to highlight that the auditor would need to understand the entity's process to identify, assess and respond to risks of material misstatement due to third-party fraud in an audit. We also recommend that ED-240 provide more guidance to auditors regarding relevant considerations when identifying and assessing risks of material misstatement in respect of third-party fraud and how to respond to these, including:

factors that may be considered, such as industry-specific circumstances and events or conditions, e.g., collusion opportunities, which may increase the risk of third-party fraud that may be material to the financial statements, as well as jurisdictional-specific risks, e.g., if the entity operates in a jurisdiction that is "higher risk" in terms of fraud;

the potential effects of the broader geopolitical and economic environment, e.g., the risk of third-party fraud may increase during an economic downturn;

"red flags" that the auditor may identify during the course of the audit and should consider further, e.g., anomalies identified in performing analytical procedures, or a party that is a persistent late payer;

specific enquiries that the auditor may make of management and others as to how they assess the risk of third-party fraud, and procedures that the auditor may perform to understand any policies/processes the entity has put in place to address such risks. Additionally, we suggest that the application material explicitly clarify/emphasise that risks in relation to material third-party fraud be discussed with TCWG, where applicable, as part of the discussions required by ISA 260, Communication with Those Charged with Governance;

particular areas of the financial statements that may be more susceptible to third party fraud, e.g., where a third party has custody over assets such as inventory, and related auditor considerations/procedures such as whether the third party is subject to regulation, and whether management has insight into the third party's control environment, if relevant. We also refer to our comments in response to Question 3, regarding the auditor's understanding of the entity and its environment, including the entity's internal control, in which we recommend that ED-240 include more detailed application material focused on factors that the auditor should consider when understanding and evaluating the entity's risk assessment process, including considerations in respect of how the entity identifies and addresses business risks in relation to material third-party fraud;

in certain circumstances, the auditor may consider it necessary to perform procedures e.g., to inspect source documents to address risks of material third-party fraud, such as validating that the entity subject to audit retains title to assets that are held by a third party. Such guidance may emphasise the importance of exercising professional skepticism, and also matters such as the importance of including an element of unpredictability in the audit procedures.

We also suggest that the material addressing material third-party fraud be clearly cross-referenced to the inherent limitations of an audit, which we also recommend be expanded to explicitly acknowledge and explain, at paragraph 11, why the risk of the auditor not detecting a material misstatement resulting from third-party fraud may be greater than not detecting a material misstatement due to a fraud that is perpetrated within the entity itself.

## 7. Member Bodies and Other Professional Organizations

### Chartered Accountants Ireland

Disagree, with comments below

In relation to the re-ordering of the introduction, we have concerns that putting the responsibilities of the auditor ahead of the responsibilities of Management and Those Charged With Governance indicates that the primary responsibilities in relation to fraud lies with the auditor. While we note this is an ISA, we would recommend putting the responsibilities of Management and Those Charged with Governance ahead of the Responsibilities of the Auditor or alternatively having an Overall Responsibilities section setting out the respective responsibilities.

Further, we have concerns regarding the auditor's responsibilities in relation to third party fraud:

The ED is worded in a way that does not convey it is not the responsibility of the auditor to detect third-party fraud that is not directly related to a risk of material misstatement (ROMM) due to fraud- in particular we note that the definition of third-party fraud in A21 does not limit this to third-party fraud that poses a risk of material misstatement due to fraud. Per the Explanatory Memorandum, the IAASB are not looking to expand the role of the auditor in this area therefore we would recommend further wording is added to clarify the responsibility of the auditor in this area.

ED-240, paragraph 29(a)(ii)(c) states that engagement teams, as part of their fraud risk factor discussion, should consider "how assets could be misappropriated by ... third parties"- we would recommend removing the reference to third party as it is not the auditor's responsibility to consider every potential instance of third-party misappropriation of assets. If this is not removed, we recommend more clarity around instances of third-party misappropriation and linkage to fraud risks is included.

ED Paragraph 1 second sentence states "The requirements and guidance in this ISA refer to, or expand on, the application of other relevant ISAs, in particular ISA 200, ISA 220 (Revised), ISA 315 (Revised 2019), ISA 330 and ISA 701.". We recommend that this sentence should specify "in relation to material misstatement arising from fraud".

There are some differences between the extant standard in Ireland (and UK) to the proposed international standard, and we believe some of the language used in the UK and Irish versions should be reflected in the international standard:

ED Paragraph 4, the UK/Ireland version comments that fraud "involves deception", we believe the revised standard should include this phrase.

ED paragraph 6. "Although fraud is a broad legal concept, for the purposes of the ISAs, the auditor is concerned with a material misstatement of the financial statements due to fraud.". This is worded in the opposite way to the extant standard which notes "the auditor is concerned with fraud that causes a material misstatement". Is the intention of the IAASB to move away from a completeness approach with this wording, starting with the identified ROMMs and then considering fraud in those areas rather than starting with where fraud could occur and determining whether that would be material?

## Fraud Advisory Panel

As noted above, we consider it necessary to expand the definitions and explanations of fraud, including distinguishing between fraud perpetrated by staff and third parties from fraud perpetrated by management and those charged with governance.

Disagree, with comments below

We agree that the ED sets out the auditors' responsibilities relating to fraud in an audit of financial statements.

However, in respect of the responsibilities and throughout the standard, we consider it necessary to expand the definitions and explanations of fraud in ED paragraphs 6 and 7, and the definition at ED paragraph 18(a) to distinguish between:

The type of fraud - fraud caused by misappropriation, fraud caused by misrepresentation or fraud caused by corruption; and

The perpetrators of fraud - fraud perpetrated by staff or third parties, and fraud perpetrated by management or those charged with governance.

While we consider that the above distinctions are helpful in the body of the standard, we also consider that it would be helpful to set out common fraud schemes in an appendix.

### Types of fraud

We consider it necessary to clearly set out how misstatement of financial statements can occur in the financial statements due to fraud:

The fraudulent misappropriation of an entity's assets has not been detected.

The fraudulent misstatement of underlying accounting records or financial statements has not been detected.

An underlying contract has been won through fraudulent corruption, and the underlying transactions may be invalidated, incorrectly classified or the potential penalties associated with the criminal activity has not been provided for.

In respect of misappropriation, there is an apparent inverse correlation between the value of assets misappropriated and the likelihood that the misappropriation will not be detected – i.e. how many widgets would need to be stolen to have a material impact on the financial statements, and how likely that a theft of that size would go unnoticed? Furthermore, we note that management and those charged with governance are more likely to care about the theft of an entity's assets and put in controls and procedures to detect and mitigate the harm from misappropriation.

In respect of misstatements, we note that several recent high-profile corporate scandals have arisen due financial statement fraud, including Carillion, CHS and Patisserie Valerie. Several of the UK's SFO's deferred prosecution agreements are based on misstatements by corporates (G4S, Serco, Tesco) are based, in part, on misrepresentations made by the entities. Some of the largest corporate scandals (e.g. Lehman Brothers, Madoff, Satyam) can also be attributed – at least in part - to misstatements. We note that fraud by misstatements tends to be committed by those with the ability to circumvent or override an entity's controls and procedures and by those in a position to manipulate the information provided to auditors.

A definition of fraud by misstatement should also include definitions of ESG related fraud, such as the VW carbon emissions scandal.

We note that fraud by corruption is also referenced in ISA 250. However, for completeness, referencing this type of fraud in ISA 240 should also be helpful.

In our experience, in particular with smaller audit practices, auditors tend to focus disproportionately on fraud by misappropriation, rather than fraud by misstatements. In our view the distinction of the types of frauds in the definition of fraud and in the body of the standard, would assist in focusing the auditor on matters more likely to result in material errors in the financial statements.

#### Perpetrators of fraud

In general, management and those charged with governance will implement controls and procedures to detect and prevent significant fraud and fraud attempts by staff and third parties, and that the effectiveness of these controls and procedures can be tested by the auditors, with the support of management and those charged with governance.

However, where fraud is perpetrated by management or those charged with governance, it is more likely that these individuals can override controls and that they know the entities' systems and controls sufficiently that their activities may remain undetected by the entity.

It is more likely that frauds perpetrated by management and those charged with governance will be material (compared to those perpetrated by staff and third parties).

Accordingly, it is these types of fraud which should be considered as a priority by auditors in adhering to this revised standard.

#### Sources

We note the survey results in the 2024 ACFE Report to the Nations which show that, of the fraud investigations sampled:

89% of matters included asset misappropriation with a median loss of \$120,000

5% of matters included financial statement fraud with a median loss of \$766,000.

#### **Pennsylvania Institute of Certified Public Accountants**

Disagree, with comments below

The committee supports additional clarification of the auditor's requirements when an identified or potential misstatement due to fraud is quantitatively material, not quantitative material but qualitatively material, or neither quantitatively or qualitatively material.

#### **Institute of Singapore Chartered Accountants**

Disagree, with comments below

We are of the view that certain parts of ED-240 on the auditor's responsibilities relating to fraud are not sufficiently clear and may lead towards a widening of expectation gap over the auditor's responsibilities, as described below.

#### Decoupling inherent limitations from auditor's responsibilities

We disagree with the revision to decouple the inherent limitations from the auditor's responsibilities. Inherent limitations delineate the boundaries within which auditors operate. Such decoupling would potentially widen the expectation gap by not clearly communicating inherent limitations in an audit.

Users of financial statements may not be fully aware that the objective of a financial statements audit is to address the risk of material misstatement due to fraud, rather than actively seeking to detect fraud. Some may even perceive that the auditor is required to carry out forensic procedures as part of financial statement audits. Not all users understand that a forensic engagement is different from an audit due to the specialised skills and high costs involved.

Moreover, media coverage on the potential of technology and artificial intelligence may have raised expectations that auditors should be able to achieve 100% coverage and detect fraud.

These misconceptions make the communication of inherent limitations in an audit even more important. Instead of reducing such communication, we believe that there needs to be increased communication of such limitations to manage the expectations of users of financial statements. It is important, in our view, for all stakeholders to recognise that enhancements to the ISAs alone are not likely to have a substantial enough effect on the expectation gap between what users expect from the financial statements audit and the reality of what an audit is.

Hence, while we appreciate the expanded paragraphs on inherent limitations in paragraphs 9 to 11 which provide clarity on such limitations, we recommend retaining the description of inherent limitations within paragraph 2 on the responsibilities of the auditor. In addition, we suggest moving the application material in paragraph A12 to the “Inherent Limitations” section (in the body of the standard), as it highlights the factors that affect the auditor’s ability to detect fraud.

Describing responsibilities of management and those charged with governance before responsibilities of the auditor

Notwithstanding that this is an auditing standard, given that management and those charged with governance have primary responsibility for the prevention and detection of fraud, their responsibilities should be described first. Hence, our preference would be to retain the original sequence of the description of responsibilities. This would be consistent with the approach taken in other ISAs, such as ISA 250 (Revised), Consideration of Laws and Regulations in an Audit of Financial Statements and ISA 570 (Revised), Going Concern.

Third-party fraud

Paragraph A16 may be read to imply that the auditor is expected to design and perform procedures specifically to detect third-party fraud. If it is not the intention of IAASB to expand the role of the auditor in relation to third-party fraud, including third-party fraud that is not directly related to a risk of material misstatement due to fraud in the financial statements, this should be clarified in the standard. Conversely, if the auditor is required to consider the impact of third party fraud in the audit, more guidance or parameters should be provided for the auditor to determine when the actions by third parties would be considered fraud or suspected fraud for the requirements in paragraph 55 to apply.

In addition to paragraph A16, more guidance is needed on the assessment of how third-party fraud would affect the audit strategy:

How third-party fraud involving collusion with management (especially those with significant roles in internal controls) would affect the auditor’s assessment on whether to rely on internal controls. For example, if the third-party fraud is confined to the procurement function, would the auditor be able to rely on internal controls over other functions?

To what extent should the auditor consider whether the entity has implemented related controls to safeguard their assets

when third-party fraud has been committed before the auditor can rely on internal controls.

#### Application material

We appreciate the application material added, which we believe would help drive consistency in applying the requirements of the standard.

Guidance added under paragraph A11 on when an identified misstatement due to fraud may be “qualitatively material” is useful. We agree that fraud perpetrated by management should be viewed more critically. In this regard, more clarity on the potential implications of such “qualitatively material” misstatements due to fraud involving management on the audit opinion and key audit matter disclosures are needed.

One challenge that auditors face is that it may be difficult to determine whether an act is “intentional” for it to be considered as fraud in the first place. Hence, it would be useful for the application material to provide more guidance on considerations in determining whether “intent” is present, with linkage to fraud risk factors.

Another area where more guidance would be useful is under paragraph A146 on the areas that an auditor’s expert, such as a forensics expert, may assist the auditor with, such as in evaluating whether the entity’s investigation process is appropriate, and their remediation measures effective, as well as whether significant control deficiencies exist.

#### Accountancy Europe

Disagree, with comments below

#### Auditor’s Responsibility

All parties in the financial reporting ecosystem have a role to play in addressing fraud risks related to financial statements. The efforts of the IAASB should focus on responding to valid expectations of stakeholders and evolving business environment. Proposed changes to auditing standards should be clear and proportionate, reflecting the fact that the primary responsibility for the prevention and detection of fraud rests with the management and TCWG of the entity.

There is a certain level of inconsistency in stakeholders’ understanding with regards to the purpose of the financial statements audit. We believe that the IAASB has a further role in actively informing stakeholders (i.e., through targeted outreach and including more specific text in ISA 240), especially as to the full extent of the inherent limitations the auditor faces. In this regard, revising ISA 240 is a positive step to clarify auditor’s responsibilities although as noted in the explanatory memorandum, the proposals will not expand the role and responsibilities of the auditor relating to fraud.

#### Inherent Limitations

The ED-ISA 240 lacks application material regarding limitations of an audit that cannot be overcome. Such inherent limitations include:

Auditors generally do not have legal powers to search for and seize documents from within the entity, from other entities or individuals

Auditors generally do not have the legal powers to interrogate individuals within the entity or from outside the entity, under oath or otherwise.

Management has the documents and records under its control and can therefore choose to conceal documents and records from the auditor without the auditor becoming aware of such concealment

#### Third-party Fraud

The proposed definition of fraud should be clear with regards to third parties. In any case, it cannot go beyond third parties with which the audited entity has an engagement. It should also be clarified that the auditor's role is not to detect fraud committed by third parties but is instead directed to identifying risks of material misstatement of the financial statements arising from fraud. In this context, the example provided in paragraph A16 about a cybersecurity breach involving unauthorized access by a third party will not necessarily be relevant for a financial statements audit engagement.

In the context of third-party fraud, inherent limitations are far greater as the auditor typically does not have any legal or contractual relationship with the third party.

#### Non-material fraud

Fraud is a broad legal concept and auditors do not make legal determinations of whether fraud has occurred. Rather, the auditor's interest specifically relates to acts that result in a material misstatement of the financial statements and do not generally extend to acts of non-material fraud. The courts are the ultimate arbiters of whether fraud has been committed or not.

ED-ISA 240 could better explain the auditor's approach towards actual or suspected non-material fraud.

For example, paragraph A11(a) of the ED-ISA 240 refers to concepts like "insignificant fraud" (instead of non-material) and "qualitatively material fraud irrespective of the amount" and these concepts need to be clarified.

Regarding qualitatively material fraud committed by management, greater clarity around the expected work effort, including practical, real-life examples of when a quantitatively immaterial fraud may be considered qualitatively material, would be useful to avoid misinterpretations.

#### The expectation gap

As a general principle, Accountancy Europe strongly supports revising professional standards to enable effective improvements in audit quality and thus reducing the "expectation gap".

Stakeholders will most likely presume that the revision of ISA 240 has been a response to recent corporate failures. However, most of the proposals in the ED-240 simply provide clarification of existing requirements in a number of areas and reflect existing practices. Hence, those changes will not lead to fundamental changes in the auditor's engagement performance.

There are other actions outside the remit of IAASB that are needed to narrow the expectation gap. These may include education, sharing of lessons learned and performing root cause analysis for major fraud cases.

Finally, as noted in our publication (February 2021), auditors could be required to report publicly their conclusion on the management's statement on fraud risk management. We recognize that this is not within the IAASB's remit. Such an engagement could be done as part of the financial statements audit or in a separate assurance engagement and would necessitate auditors to consider the internal controls over financial reporting as a whole.

#### Malta Institute of Accountants

Disagree, with comments below

The definition of fraud in ED-240 includes reference to third party-fraud (A21). The current wording of draft ISA 240 may be understood in a way that expands the role of the auditor to detect any third-party fraud, even when it is not directly related to a risk of material misstatement due to fraud in the financial statements.

Para 92 of Section 1-J – Other Matters states that it is not the intention of IAASB to expand the role of the auditor to detect third-party fraud that is not directly related to a risk of material misstatement due to fraud in the financial statements. We would therefore suggest that ED-240 is revised to better align with the aforementioned intention and make it clear that the auditor's role is not being expanded when considering the detection of third-party fraud.

#### **Chamber of Auditors of the Czech Republic**

Disagree, with comments below

The definition of fraud should be clear as far as third parties are concerned. It should be clear that it is not the auditor's responsibility to detect fraud committed by third parties. It is the auditor's responsibility to identify risks of material misstatement of the financial statements caused by fraud.

#### **International Federation of Accountants**

Disagree, with comments below

We understand the challenges in setting out the auditor's responsibilities relating to fraud and the context under which some of the proposals have been shaped. It is critically important for the revisions to emphasize the inherent limitations of the ability of the auditor to address challenges raised by fraud, so that this is clear for all users. We believe that it would be helpful to include additional application material with paragraph 10 that adequately illustrates the real inherent limitations of an audit that cannot be overcome. Examples of such inherent limitations could include:

Auditors generally do not have legal powers to search for and seize documents from within the entity, from other entities, or from individuals.

Auditors generally do not have the legal powers to interrogate individuals within the entity or from outside the entity, under oath or otherwise.

Management has the documents and records under its control and can therefore choose to conceal documents and records from the auditor without the auditor becoming aware of such concealment.

Adding further clarity or illustration of the inherent limitations could be part of the solution for addressing the existing expectation gap in this area.

We are concerned that there is an overarching theme in ED-240 that seeks to emphasize that fraud is different from other risks, considerations and work completed for financial statements audits. The treatment of non-material fraud will be discussed further, below. Proposed treatment in the audit report serves as another example and will be discussed within our response to question 5. There is nothing inherently exceptional about the impact of fraud on financial statements compared to other risks, and in the majority of cases there will be bigger existential risks to entities. Consequently, fraud risk may legitimately be of lesser concern to managers or TCWG. While fraud risk is undoubtedly important for auditors, and the existing expectation gap may compound this importance, this should not be given undue attention in the context of other important risks in a financial statement audit. There is also a fear that extending the scope of focus on fraud could later be repeated for other areas that become important due to corporate failings or newsworthiness. This may lead to unnecessary work in relation to fraud and subsequently other areas in future. This will ultimately not be in the public interest as it could have the potential to divert time and resources from equally or more important risks, which could impact quality and it may also become a barrier to meaningful audit reporting. As such, overall, this creates a challenge to the auditor's responsibilities in relation to fraud.

While we note there is attention given to management fraud within ED-240, for example the risk of management override of controls in paragraph 42, there is a greater focus on employee fraud than management fraud within the proposals. This is arguably misplaced, especially in the context of SMEs where management fraud is more likely to have a significant impact on the entity. The profile of management fraud could be raised within the standard to prevent the risk of auditors, potentially more likely SMP auditors, focusing attention on employee fraud at the expense of management fraud which may pose bigger risks to their clients.

We note that the extant ISA 240 has been criticized, primarily from those in the regulatory community, for opening with a focus on what the auditor is unable to do rather than what the auditor's responsibilities are. As such, we understand the rationale for the auditor's responsibilities now appearing ahead of the responsibilities of management and those charged with governance (TCWG) in relation to fraud. However, the sensitivities around shifting these sections should be given due regard. This may result in an implication that the auditors' responsibilities are now more significant than those of management, which could widen the expectation gap in this area and would not be in the public interest. The IAASB should consider strength of opposition to this change from practitioners and PAOs and adjust accordingly.

Practitioners have also raised concerns around the potential for the proposals to increase work required related to non-material fraud. The auditor cannot have formal responsibilities in this area, as their focus should be on significant risks, including those of material misstatement due to fraud. We note the wording of proposed Paragraph 6 attempts to convey this, and there is emphasis on material misstatement due to fraud in other proposed paragraphs (e.g., para. 23) too. However, references to 'fraud' or 'suspected fraud' in other areas of the standard may create confusion regarding the efforts that they would need to expend on non-material fraud. Wording throughout the standard should clarify focus only on fraud or related issues that may result in a material impact on the financial statements. Any specific work completed on non-material fraud or suspected fraud would divert resources from more important risks. Consequently, it would be useful for the IAASB to revisit the references to fraud and suspected fraud throughout and ensure they convey appropriate focus. For example, in Paragraph 55, if fraud or suspected fraud is identified, the auditor needs to determine the effect on the audit engagement, but to do so the auditor "shall" do the four things identified in (a)-(d) of the paragraph. Where the fraud or suspected fraud is clearly trivial, carrying out these activities would result in inappropriate work for inconsequential added value to the engagement.

The considerations around third-party fraud and examples added in this respect have also raised concerns for some practitioners. We recognize that where an auditor has identified third-party fraud, or suspicion thereof, they would need to address this, and this would have also been the case under extant ISA 240. Consequently, the examples added may be useful for practitioners, but the increased references to this area may create unrealistic expectations of activity the auditor can undertake in reaction to suspicion of third-party fraud. Returning to the point of inherent limitations, in the context of third-party fraud, these are far greater because the auditor typically does not have any legal or contractual relationship with the third party, which compounds this issue. The practical reality is that it may be difficult to follow up any indications of third-party fraud where the third party holds the relevant information and records, so this could be better signposted in the standard or application guidance to keep expectations realistic and avoid widening of any expectation gap.

#### **Institute of Chartered Accountants of Sri Lanka**

Disagree, with comments below

Better clarity is required in identification of fraud especially in distinguishing between fraud and error when accounting for accounting estimates, as it is hard to determine whether an identified misstatement is intentional or unintentional.

It is important to enforce the primary responsibility for the prevention and detection of fraud by both management and TCWG of the entity. Without this being enforced, expanding or changing the auditors' responsibilities alone will not work in environments where the legal / regulatory frameworks are not robust.

### California Society of Certified Public Accountants

Disagree, with comments below

Please provide clarification on the scalability of the requirements for fraud and/or suspected fraud when the (suspected) fraud is non-material and third-party. For example, does this standard require auditors to perform audit procedures for misappropriation of assets that could be considered non-material?

## 9. Individuals and Others

### Dr. Rasha Kassem

Disagree, with comments below

The current standard expects auditors to plan and conduct audits to provide reasonable assurance regarding the absence of material misstatements in the financial statements resulting from fraud. However, I believe that this responsibility is not sufficiently clear due to the use of terms like "materiality" and "misstatement." "Misstatement" refers to manipulations or misrepresentations that can arise from either fraud or error.

To simplify matters, why can't auditors be held responsible for obtaining reasonable assurance that the financial statements, as a whole, are free from error and financial fraud? This would eliminate the ambiguity surrounding the concept of "misstatement." Some might say, misstatement does not refer to fraud and error, and that auditors do not have a responsibility for detecting either. Furthermore, materiality is often subjective and is sometimes used by auditors as a means to avoid reporting instances of fraud. It is crucial, regardless of materiality, that instances of financial fraud and error be reported to shareholders. In brief, I recommend removing the terms materiality and misstatements and simply requiring auditors to report financial fraud and error impacting the financial statements that can reasonably be identified during the normal course of external audits.

Additionally, the definition of fraud needs to be clearer and so are the types of fraud involved. For example, currently, auditors are still responsible only for two types of financial fraud, including financial reporting fraud and asset misappropriation as they can adversely impact the financial statements. However, other types of fraud, specifically corruption can have an impact on the financial statements too. In one of my publications, I have raised this issue and included various examples of how corruption can impact financial statements. I include the link to my publication FYI <https://tinyurl.com/rebta4ba>

### Colin Semotiuk

Not only does this demonstrate that ED-240 decouples ISA-240 from responsibilities of an auditor of financial statements to auditing fraud, it also increases risk to the assurance profession. Users of ISA auditor reports will incorrectly conclude that financial statement audit's include assurance that there is no fraud, which is incorrect, as well as not practical. Once a fraud occurs, these auditor's will then be seen as being primarily responsible for not detecting the fraud and increase exposure to lawsuits.

Disagree, with comments below

ED-240 incorrectly communicates the auditor's responsibilities relating to fraud in an audit of financial statements. This is clearly demonstrated by ED-240 describing the auditor's responsibilities relating to fraud before management and those charged with governance (TCWG). Financial statement auditor's have the least responsibility relating to fraud of the three (management, TCWG and financial statement auditor) and this should be clearly communicated through ED-240. The auditor's responsibility is to issue a financial statement audit opinion and ED-240 incorrectly moves the responsibility of a financial statement auditor from a financial statement audit to an audit to detect fraud.