

Fraud – Question 3

3. Does ED-240 appropriately build on the foundational requirements in ISA 315 (Revised 2019) and other ISAs to support a more robust risk identification and assessment as it relates to fraud in an audit of financial statements?

Q01 Agree**2. Investors and Analysts****Eumedion**

Agree (with no further comments)

3. Regulators and Audit Oversight Authorities**Securities and Exchange Commission of Brazil**

Agree (with no further comments)

4. Jurisdictional and National Auditing Standard Setters**Compagnie Nationale des Commissaires aux Comptes and Conseil Supérieur de l'Ordre des Experts-Comptables**

Agree (with no further comments)

Instituto Mexicano de Contadores Publicos

Agree (with no further comments)

5. Accounting Firms**Moore Global Network**

Agree (with no further comments)

Grand Thornton International

Agree (with no further comments)

Crowe Global

ED-240 does appropriately build on the foundational requirements of ISA 315 (Revised 2019) and other ISAs to support a more robust risk identification and assessment as it relates to fraud in an audit of financial statements. A revised ISA 240 to support a revised core risk standard is much needed.

6. Public Sector Organizations**Provincial Auditor Saskatchewan**

Yes, ED 240 appropriately builds on ISA 315 (Revised 2019) and other ISAs.

Office of the Auditor General of Canada

Agree (with no further comments)

Office of the Auditor General of Ontario

Yes, we agree that ED-240 appropriately leverages the requirements in ISA 315 and other relevant auditing standards.

7. Member Bodies and Other Professional Organizations

Malaysian Institute of Certified Public Accountants

Agree (with no further comments)

Virginia Society of Certified Public Accountants

Agree (with no further comments)

Pennsylvania Institute of Certified Public Accountants

Agree (with no further comments)

Institute of Chartered Accountants of Jamaica

Agree (with no further comments)

Institute of Chartered Accountants of Ghana

Agree (with no further comments)

Institute of Certified Public Accountants of Rwanda

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)

Moises Gonzalez Mercado

Agree (with no further comments)

2 Agree with comments

1. Monitoring Group

International Forum of Independent Audit Regulators

Consideration of effective control environment when evaluating fraud risk factors

Although paragraph A22 explains that fraud risk factors relate to incentives, pressures or opportunities that arise from events or conditions that create susceptibility to misstatement before consideration of controls, the below examples suggest that an effective control environment can mitigate the risk of fraud:

Paragraph A57 provides examples of factors that may constrain improper conduct by management including effective oversight by those charged with governance, an effective internal audit function and the existence and enforcement of a written code of conduct. It would be better to expand on what level of evidence is expected under ISA 315R to support the auditor's conclusion that the oversight is effective and use the existence and enforcement of written code with an example of procedures that could be performed.

Paragraph A58 refers to a smaller or less complex entity that may not have formalized controls, but has a developed culture that emphasized the importance of integrity and ethical behaviors, through oral communications and management example. It also indicates that management approval can compensate for otherwise deficient controls. It is not appropriate for the auditor to take into consideration mitigating factors that cannot be validated.

Further, paragraph 40 should specify that fraud risks factors should be identified before taking internal controls into consideration. There also needs to be greater clarity that while the auditor cannot take credit for an effective control environment, there may be other events or conditions that increase the risks of material misstatement due to fraud such as known control deficiencies.

Whistleblower program

Considering the high number of frauds uncovered due to a whistleblower complaint, a requirement should be included and referenced to paragraph A70, for the auditor to evaluate the entity's whistleblower program and matters identified through the program as part of the understanding of the entity's controls environment and assessment of fraud risk factors.

Management override of controls

Paragraph 42 should require the auditor to determine the account balances and/or classes of transactions where the risk of management override could be perpetrated. Also, the text "irrespective of the auditor's assessment of the risks of management override of controls" should be removed from paragraph 48 to be clear that an auditor cannot determine the risks of management override of controls as not a significant risk. Similarly, the text "Although the level of risks of management override of controls will vary from entity to entity" should be deleted from paragraph A113 as this could be subject to different interpretations.

Quantitative and qualitative considerations

The qualitative considerations included in paragraph A11 are useful. Additional qualitative considerations that should be added include the amount of the illegal advantage such as a large contract obtained for a small bribe and other key elements included in paragraph A157.

Paragraph A155 examples should include consideration of cumulative materiality based on the duration of the fraud and the amount of a misstatement on an aggregate basis.

Fraud inquiries

The importance of fraud inquiries with management, other appropriate individuals and those charged with governance would be elevated with the use of stronger language in the requirements within paragraphs 34 and 35. For example, the standard should highlight the importance of establishing robust two-way communication related to fraud which would be consistent with ISA 260, Communication with Those Charged with Governance. Examples should also be provided for ways to strengthen inquiries such as by holding interviews with the appropriate individuals and asking probing and clarifying questions.

Consideration of effective control environment when evaluating fraud risk factors.

Whistleblower program.

Management override of controls.

Quantitative and qualitative materiality considerations.

Fraud inquiries.

Presumption of the risks of material misstatement due to fraud in revenue recognition

The ED-ISA 240 project proposal in December 2021 originally noted that the intention was to focus on when it is inappropriate, rather than clarify when it is appropriate to rebut the presumption of the risks of material misstatement due to fraud in revenue recognition. The application and other explanatory material still focus on when it is appropriate to rebut the presumption of the risks of material misstatement due to fraud. The ED should be expanded to include examples for both situations and should cover all assertions.

The ED-ISA 240 does not sufficiently enhance or clarify that the threshold for rebuttal should be high and applied in limited circumstances but instead memorializes what is already seen in practice. Unless revenue includes cash sales or there are complex revenue arrangements, auditors often limit the fraud risk in revenue to inappropriate manual journal entries impacting revenue recognition and the cut-off assertion at year end.

We support the addition of examples provided such as paragraphs A108 and A109 which identify situations when the risks of material misstatement due to fraud in revenue recognition may be greater. However, additional examples should be added to these paragraphs and Appendix 3 such as existence of tolling arrangements, or unnecessarily complex entity structures where revenue transactions may be with undisclosed related parties (as discussed in A59).

The application guidance should be expanded to clarify that limiting the fraud risk to manual journal entries or the cut-off assertion would ordinarily not be appropriate and should tie to expanded examples.

The additional examples added to paragraph A111 lack sufficient detail and may lead an auditor to inappropriately conclude that fraud risks factors are not significant. For instance, the example of rendering one type of service for a fixed fee where fraud risks factors may not be significant may be too simplistic. It may not be appropriate to conclude there are no fraud risks factors if it's a service with a high volume of customers. It should also be clarified what is meant by simple or straightforward ancillary revenue sources as these could include revenue sources that have more complexity than the examples provided (interest or dividend revenue from investments with level 1 inputs) and could lead auditors to inappropriately rebut the risks of material misstatement due to fraud.

Further, the examples in A111 may inadvertently suggest that fraud risk factors relevant to financial reporting relate only to opportunities to commit fraud versus reminding the auditor that opportunities should be considered in combination with incentives/pressures and attitudes/rationalization. If the opportunity is low but the incentive and rationalization is high, there could be a fraud risk.

We recognize that paragraph A56 identifies 'an ability to rationalize the fraudulent action' as a fraud risk factor while stating that fraud risk factors reflective of an attitude that permits rationalization of the fraudulent action may not be susceptible to observation by the auditor. Rationalization should also be added to the definition of a fraud risk factor included in paragraph 18(b) and require an auditor to specifically take into account an attitude that permits rationalization of a fraudulent action when the auditor is aware that such an attitude exists. The requirement in paragraph 40, does not appear to require auditors to take into account rationalization as a fraud risk factor in identifying and assessing the risks of material misstatement due to fraud.

We recommend the documentation requirement expand on the analysis that should be undertaken in paragraph 41 to conclude no fraud risks factors are present over revenue recognition. Paragraph 70 (d) specifies the documentation requirement when the auditor concludes that the presumption is not applicable in the circumstances of the engagement and has not identified revenue recognition as a risk of material misstatement due to fraud but provides no further guidance on what factors should be considered to support their conclusion.

The entity's organizational structure and ownership, governance, objectives and strategy, and geographic dispersion

Paragraph A59 indicates that "An overly complex organizational structure involving unusual legal entities may indicate that a fraud risk factor is present." This should also include unnecessarily complex or unusual for the industry and organizational structures where an entity is organized in a manner that introduces layers of complexity. It is important that the business rationale is understood by the auditors as part of their fraud risk assessment. For example, entities entering into an arrangement with a third party to perform a specific service that the entity could provide on its own could be an indication of an unidentified related party relationship or potential side arrangements.

Presumption of the risks of material misstatement due to fraud in revenue recognition.

The entity's organizational structure and ownership, governance, objectives and strategy, and geographic dispersion.

In addition, IFIAR has recommendations in the following areas:

We support the changes to the auditor's risk identification and assessment process as it relates to fraud to make it more robust, including the evaluation of fraud risk factors, understanding the entity and its environment, understanding the components of internal control and control deficiencies within the entity's system of internal control to determine if there is an impact on the prevention or detection of fraud and more closely aligning the requirements to identify and assess the risks of material misstatement with the revised ISA 315, Identifying and Assessing the Risks of Material Misstatement (ISA 315R).

2. Investors and Analysts

Corporate Reporting Users' Forum

Agree, with comments below

We agree that ED-240 is consistent with ISA250.

We strongly agree with paragraph 29 requires engagement team to discuss to exchange ideas about the entity's culture, management's commitment to integrity and ethical values, and related oversight by those charged with governance. We believe that the entity's culture against fraud should play a crucial role and work more effectively than setting meticulous rules to prevent fraud in the entity. In that regard, the management and the TCWG should be responsible to promote such culture to permeate throughout the entity.

CFA Institute

Agree, with comments below

Risk identification and assessment are at the heart of auditor's responsibilities with respect to fraud in a financial statement audit. Investors conduct many of the same risk assessment procedures (albeit with less privileged information) described in ED-240, which are used to develop forecasts, credit ratings, and equity

risk premia that inform investment decisions. CFA Institute’s curriculum for its CFA® Program highlights many of the same “warning signs” or “red flags” identified in Appendix 1.

Investors take a risk-based approach to prioritize their resources, as fraud risk is only one consideration in an investment decision and different entities can present significantly different levels of risk. For example, investors would spend significant time assessing fraud risk factors when analyzing securities issued by small company with significant insider ownership and related party transactions based in a jurisdiction with weak laws and regulations, and far less vs. a large company with significant internal controls and a strong track record of transparency. Investors expect auditors to do the same.

We recommend the following to augment Appendix 1:

Order Risk Factors – Order the risk factors from greatest to least concern, consider a requirement that auditors must assess the presence of the risk factors of greatest concern.

We suggest, for example, that “known history of violations of securities laws or other laws and regulations, or claims against the entity, its senior management, or those charged with governance alleging fraud or violations of laws and regulations, including those dealing with corruption, bribery, and money laundering,” past restatements, turnover in the CFO and senior finance ranks, and significant related party transactions would be risk factors of greatest concern.

Pressure to meet expectations or key performance indicators in general strikes us as a lower concern because it is present in virtually every entity; we’re not aware of any entity in which management feels no pressure to meet expectations. Of course, that pressure can become excessive, thus elevating the risk factor.

Add Risk Factors – Add the following risk factors:

Complexity of business and transactions (“black box” risk).

Significant short interest and published short sellers’ reports.

Small size and/or newly established entity.

Significant adjustments to reported IFRS or GAAP figures.

Domicile or incorporation in jurisdiction with weak laws and regulations, protection of property rights.

Mergers and acquisitions.

We would also note that at the recent PCAOB SEIAG meeting on fraud highlighted above one panelist – a lawyer bringing cases against auditors – noted that risk identification is not the most challenging procedure for auditors, it is planning and executing procedures to address those risks where the audit falls short. We are not sure this is evident in the drafting of the proposal.

3. Regulators and Audit Oversight Authorities

Financial Reporting Council – United Kingdom

Agree, with comments below

Engagement team discussion

Number of discussions

The auditor’s risk identification and assessment process should be iterative and dynamic. The engagement team discussion is a key element of the risk identification and assessment, particularly in relation to fraud

risks. However, the presentation of the requirement, in both ISA 315 (Revised 2019) and ED 240 could give the impression that it is a single point in time event. To reinforce the iterative process and ensure appropriate attention to fraud risk factors that might come to light after the initial discussion, we recommend that the engagement partner should be required to determine whether further discussion(s) among members of the engagement team be held at later stages in the audit to consider fraud risk factors that have been identified during the course of the audit and the implications for the audit. Such a requirement could be included in the engagement performance section. A38 would better support such a requirement rather than paragraph 24 to which it is currently linked.

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

Fraud risk factors that were not covered in the original discussion.

Actual or suspected fraud.

Considerations in group audits

Paragraph A8 identifies that audit procedures performed to comply with other ISAs may also bring instances of fraud or suspected fraud to the auditor's attention including, for example, those performed in accordance with ISA 600 (Revised). There is a footnote link to the requirement in ISA 600 (Revised) that specifies the matters to be communicated in relation to Identified significant risks of material misstatement of the group financial statements, including those due to fraud or error. We believe those risks should be covered as part of the engagement team discussion but ED 240 is silent in that context. Accordingly, we recommend that, for a group audit, the discussion among the group engagement team should be required to include matters to discuss with the component auditor of a significant component about risks of material misstatement due to fraud that are relevant to that component. A cross reference to paragraph A92 of ISA 600 would be helpful as that identifies fraud related considerations that could be covered in the discussion by the group engagement partner and other key engagement team members.

Discussion with those charged with governance

We recommend that as part of obtaining an understanding and making inquiries of those charged with governance, the auditor is required to discuss with those charged with governance the risks of fraud in the entity, including those that are specific to the entity's business sector. A discussion between the auditor and those charged with governance about the risks of fraud in the entity, including those specific to the entity's business sector, assists the auditor in identifying and assessing the risks of material misstatement of the financial statements due to fraud. The discussion may also enhance the understanding of those charged with governance of fraud risks specific to the entity and assist them in exercising oversight of management's process for identifying and responding to the risks of fraud in the entity.

Committee of European Auditing Oversight Bodies

We urge the IAASB to consider removing the first line in paragraph A110: 'If fraud risk factors related to revenue recognition are present, determining whether such fraud risk factors indicate a risk of material misstatement due to fraud is a matter of professional judgment.' It could be interpreted that the presumed risk is dependent on the existence of one or more fraud risk factors. However, if an auditor does not identify any fraud risk factors regarding revenue, is the fraud risk of revenue automatically rebutted? It seems unnecessary to state this, especially as paragraph A111 contains examples where fraud risk factors may not be significant.

We also suggest stating in this paragraph that the bar to rebut the presumption (that there are risks of material misstatement due to fraud in revenue recognition) is a high one.

Understanding the entity and its environment

For improved clarity and consistency of approach, it is our view that paragraph 35(b) should require the auditor to make inquiries of individuals within the entity that have responsibility for dealing with fraud reports as well as 'other appropriate individuals'.

Significant Risks Related to Management Override of Controls (including journal entry testing)

The purpose of the statement in paragraph A113 that '... the level of risks of management override of controls will vary from entity to entity...' is unclear, particularly as paragraph 42 requires that the auditor shall always treat them as significant risks. Additionally, the IAASB should consider providing examples of the types of procedures that should be performed in response to such risks. In paragraph 42 the IAASB could also consider requiring the auditor to evaluate the risk of management override in the audit and to identify and evaluate where in the financial statements or specific assertions and classes of transactions the risk of management override may arise.

Engagement team discussion

The IAASB should consider including a provision to require communication by the group auditor with component auditors of material components regarding the risk of fraud at the component in a group audit.

Presumed fraud risk – revenue recognition

Based on the inspections findings recorded in the CEA OB database in recent years, some regulators have found that rebuttal of the presumption of the fraud risk regarding revenue recognition is common practice in their country. For example, one regulator has seen large financial institutions with many different revenue streams where the risk of fraud in revenue recognition has been rebutted and questions if that is appropriate.

The majority of findings by inspection teams in this area arose due to insufficient documentation of the reasons for the rebuttal. Therefore, we appreciate the fact that the rebuttal of the presumed fraud risk regarding revenue recognition is no longer included in the requirements (paragraph 41 of ED 240). While this is a step forward in our opinion, we still think that there is too much room given to auditors in the application material (paragraphs A110 and A111) as well as the documentation requirements (paragraph 70(d)) to rebut the presumed risk. We explain this in more detail below.

The examples of events or conditions given in the application material (paragraphs A109 and A111) are either very complex or very simple. Paragraph A109 relates to very complex and risky situations where it is evident that fraud risk factors can emerge, while A111 relates to very simple situations where it is evident that fraud risk is remote. However the most challenging situations for auditors are likely to arise when dealing with situations that are in between these two extremes. For instance, what would be the decision when, the audited entity has:

numerous different types of services, each of which is not very complex and not subject to significant estimates; or

numerous rental properties with numerous different tenants, but there is no complexity or estimates in the determination of revenues?

In the above situations, there is a risk that auditors will conclude that the presumption may be rebutted, considering there are no significant fraud risk factors. Consequently, we believe clarification is needed for the situations that are “in between”, which could complement paragraph A110.

Paragraph A111 contains examples of situations where fraud risk factors may not be significant. However, the final example (“simple or straightforward ancillary revenue sources, which are determined by fixed rates or externally published rates”) is very unclear and gives too much room for auditors to rebut the presumed risk. In our opinion this example should be removed as:

The term ‘simple and straightforward’ is open to interpretation and gives room for auditors to put a lot of revenue streams under this category to rebut the presumed fraud risk.

The inclusion of “interest or dividend revenue from investments with level 1 inputs” as an example could be arguable. Level 1 inputs are part of the measurement of the fair value of financial instruments; using them in examples of revenue is from that point not logical. Additionally, financial instruments with level 1 inputs have assumptions that could contain fraud risks factors such as: is there an active market? are the transactions orderly? are related parties involved in transactions?

Some regulators have noted the situation where the auditor does not consider the fraud risk, i.e. when auditing revenue, the auditor collects sales invoices and related proof of payment without performing any procedures validating that the revenues invoiced are accurately computed based on for instance the agreement. Based on that, the auditor considers that an invoice paid is the best audit evidence to support the accuracy of the revenue. The same applies with suppliers (in that case as a potential third-party fraud). We believe ISA 240 should clarify that payment of an invoice alone is not necessarily sufficient to prove the accuracy of revenues or charges, that fraud risk and its impact on financial statements are to be considered by the auditor in those situations.

Integrated approach and consideration of all the ISAs

In the January 2021 letter, the CEAOB raised the need to facilitate the integrated application of all the ISAs. In this regard, the CEAOB welcomes the improved alignment with ISA 315 which can, in our view, lead to a more robust risk identification and assessment in relation to fraud.

Our understanding is that paragraph 40 requires a gross approach (the auditor must identify and assess the risks of material misstatement due to fraud before taking internal controls in consideration). Furthermore, paragraph A22 explains that fraud risk factors may relate to incentives, pressures or opportunities that arise from events or conditions that create susceptibility to misstatements before consideration of controls. Paragraph A56 states that one condition that is generally present when fraud exists is the perceived

opportunity to commit fraud. However, as this is usually due to inadequate internal controls, the IAASB should consider clarifying this point in the context of the requirements in paragraph 40. The risk is that auditors tend to conclude that significant fraud risk factors (before consideration of controls) are mitigated by the strong internal controls implemented by the entity (often without testing their operating effectiveness), leading them to reduce the significance of the fraud risk factors and thus the identification and assessment of the risk of material misstatement due to fraud. For this reason, the IAASB should clarify that:

the identification of fraud risks should not be limited or mitigated by internal controls in place in an entity;
weaknesses in internal controls should be considered when analysing opportunities for fraud; and

testing the operating effectiveness of controls in accordance with ISA 330 is a mandatory response when, in the auditor's assessment, the risks of material misstatements due to fraud have been reduced due to the internal controls implemented by the audited entity.

Irish Auditing & Accounting Supervisory Authority

Our understanding is that paragraph 40 requires a gross approach, i.e. the auditor must identify and assess the risks of material misstatement due to fraud before taking internal controls in consideration. Paragraph A22 explains that fraud risk factors may relate to incentives, pressures or opportunities that arise from events or conditions that create susceptibility to misstatements before consideration of controls. Paragraph A56 states that a condition that is generally present when fraud exists is the perceived opportunity to commit fraud. However, as this is usually due to inadequate internal controls, the IAASB should consider clarifying this point in the context of the requirements in paragraph 40. There is a risk that auditors may tend to conclude that significant fraud risk factors (before consideration of controls) are mitigated by strong internal controls implemented by the entity (without testing their operating effectiveness), leading them to reduce the significance of the fraud risk factors and thus the identification and assessment of the risk of material misstatement due to fraud. The IAASB should clarify that:

the identification of fraud risks should not be limited or mitigated by the internal controls in place in an entity; weaknesses in internal controls should be considered when analysing opportunities for fraud; and

testing the operating effectiveness of controls in accordance with ISA 330 is a mandatory response when, in the auditor's assessment, the risks of material misstatements due to fraud have been reduced due to the internal controls implemented by the audited entity.

Understanding the entity and its environment

For improved clarity and consistency of approach, paragraph 35(b) should require the auditor to make inquiries of individuals within the entity that have responsibility for dealing with fraud reports as well as 'other appropriate individuals'.

Engagement team discussion

The IAASB should consider including a provision to require communication by the group auditor with component auditors of material components regarding the risk of fraud at the component in a group audit.

Presumed fraud risk – revenue recognition

The rebuttal of the presumed fraud risk regarding revenue recognition is no longer included in the requirements (paragraph 41 of ED 240). While this is a step forward in our opinion, we still think that there is too much room given to auditors in the application material (paragraphs A110 and A111) as well as the documentation requirements (paragraph 70(d)) to rebut the presumed risk.

The examples of events or conditions in the application material (paragraphs A109 and A111) are either very complex or very simple. Paragraph A109 relates to very complex and risky situations where it is evident that fraud risk factors can emerge, while A111 relates to very simple situations where it is evident that fraud risk is remote. However the most challenging situations for auditors are likely to arise when dealing with situations that are in between these two extremes. For instance, what would be the decision when, the audited entity has: numerous different types of services, each of which is not very complex and not subject to significant estimates; or numerous rental properties with numerous different tenants, but there is no complexity or estimates in the determination of revenues?

In these situations, there is a risk that auditors will conclude that the presumption may be rebutted, considering there are no significant fraud risk factors. Consequently, clarification would be helpful for the situations that are “in between”, which could complement paragraph A110.

Paragraph A111 contains examples of situations where fraud risk factors may not be significant. However, in the final example the term ‘simple and straightforward’ is open to interpretation and there is a risk that auditors may classify a lot of revenue streams under this category to rebut the presumed fraud risk.

Some regulators have noted the situation where the auditor does not consider the fraud risk, i.e. when auditing revenue, the auditor collects sales invoices and related proof of payment without performing any procedures validating that the revenues invoiced are accurately computed based on for instance the agreement. Based on that, the auditor considers that an invoice paid is the best audit evidence to support the accuracy of the revenue. The same applies with suppliers (in that case as a potential third-party fraud). We believe ED 240 should clarify that payment of an invoice alone is not necessarily sufficient to prove the accuracy of revenues or charges, that fraud risk and its impact on financial statements are to be considered by the auditor in those situations.

The IAASB should consider rewording paragraph 70(d) regarding the documentation required when the presumption related to revenue recognition is “not applicable in the circumstances of the engagement”. This may be seen as an encouragement to auditors to rebut the presumption of fraud risks for all revenue streams in an audit. We suggest that it should be replaced by a requirement to document the analysis to be performed in paragraph 41 (determine which types of revenue exist, revenue transactions and relevant assertions that give rise to fraud risks, including any revenue types where the presumption has been rebutted and the reasons for that conclusion).

Paragraph 70(d) should also stress the need for the documentation to be sufficient to enable another practitioner to understand the rationale for the rebuttal as well as requiring documentation to show that, where applicable, all the entity’s revenue streams have been considered. Additionally, the IAASB should consider including application material to provide guidance for auditors on the documentation that would be appropriate in such cases e.g. engagement team discussions,

discussions with technical experts, experience in previous audits and no changes to the revenue streams, internal controls or key client personnel in this area.

Agree, with comments below

In our February 2021 letter, relating to the IAASB’s discussion paper on this topic, IAASA raised the need to facilitate the integrated application of all the ISAs. In this regard, IAASA welcomes the improved alignment with ISA 315 which will, in our view, lead to a more robust risk identification and assessment in relation to fraud.

Significant risks related to management override of controls (including journal entry testing)

The IAASB should consider providing examples of the types of procedures that should be performed in response to such risks related to management override of controls. In paragraph 42, the IAASB could also consider requiring the auditor to evaluate the risk of management override and to identify and evaluate where in the financial statements or specific assertions and classes of transactions the risk of management override may arise.

Canadian Public Accountability Board

Fraud inquiries

We believe that fraud inquiries of management, the audit committee and others at the entity including internal auditors, legal counsel, etc. should not be carried out by email or audio call. As highlighted in our May 2022 Fraud Thematic Review, in the audits we inspected in 2021, 25 per cent had fraud inquiries carried out by email or audio call (nine and 16 per cent respectively). The reliability of information obtained through fraud inquiries is enhanced significantly when those inquiries are made in person and include senior members of the engagement team. This allows auditors to observe the body language of interviewees, which is important because interviewees with knowledge of fraudulent schemes may exhibit signs of discomfort during interviews. In-person interviews also allow auditors to have a less scripted, and therefore less predictable, two-way dialogue with interviewees as auditors obtain answers to follow-up questions in real time. We recommend strengthening the requirements related to fraud inquiries within paragraphs 34 and 35 by providing examples of how this can be achieved by the auditor, such as by holding interviews with the appropriate individuals and asking probing and clarifying questions.

Presumption of the risks of material misstatement due to fraud in revenue recognition

In many audits, we observed that unless revenue includes cash sales or there are complex revenue arrangements, auditors often limit the fraud risk in revenue to inappropriate manual journal entries impacting revenue recognition and the cut-off assertion at year end. The application guidance should be expanded to clarify that limiting the fraud risk to manual journal entries or the cut-off assertion is ordinarily not appropriate.

Unnecessarily complex entity structure and related party transactions

As noted in examples provided, we observed various situations where unnecessarily complex entity structures were not identified as potential fraud risk factors and situations where the business rationale of unusual transactions was not understood by the auditors as part of their fraud risk assessment. For example, entities entering into an arrangement with a third party to perform a specific service that the entity could provide on its own could be an indication of an unidentified related party relationship or potential side arrangements. Assessment of related party transactions should be specifically highlighted in the standard and additional examples should be added to paragraphs A59, A109 and Appendix 3 to highlight such potential fraud risk factors.

Whistleblower program

A study by the Association of Certified Fraud Examiners (ACFE) found that 42 per cent of frauds reported by entities from around the world were detected through tips, with more than half of those tips coming from employees. Considering this, a requirement should be included and referenced to paragraph A70, for the auditor to evaluate the entity's whistleblower program and matters identified through the program as part of the understanding of the entity's controls environment and assessment of fraud risk factors. If a listed entity does not have a whistleblower program the auditor should be satisfied that it is appropriate for the nature of circumstances of the entity, and if not, consider whether the lack of a whistleblower program is a deficiency in the entity's control environment that should be communicated to those charged with governance.

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.

The exposure draft would be strengthened with the addition of more requirements, clarity and examples to promote consistent application by auditors. Specifically:

Add a stand-back requirement to the fraud standard.

Emphasize the importance of conducting fraud inquiries and use of stronger language around purpose and objective of those inquiries.

Include more robust examples of when it is not appropriate to rebut the presumption of the risks of material misstatement due to fraud in revenue recognition.

Emphasize unnecessarily complex entity structure and related party transactions.

Add a requirement to evaluate an entity's whistleblower programs.

Demonstrate strong links between unpredictability in the selection of audit procedures to fraud risk factors identified.

Botswana Accountancy Oversight Authority

Agree, with comments below

ED 240 provides appropriate linkage to other ISAs which makes it easier to apply along with other standards thus supporting a more robust risk identification and assessment.

Independent Regulatory Board for Auditors – South Africa

It is possible that the unintended consequence of the enhancement to ISA 701 paragraph A21 may cause the presumed risk of fraud in revenue recognition to become a “standard KAM” going forward. This is because auditing revenue always requires significant auditor attention. Therefore, it is recommended that the IAASB consider providing application material that helps the auditor to distinguish between “normal” significant auditor attention and potential additional significant auditor attention because of the associated fraud risk that will require a fraud-related KAM to be reported by the auditor.

It is unlikely that identification and communication of a significant deficiency in the system of internal controls related to fraud prevention and detection will meet the “significant auditor attention” threshold because the effectiveness of the controls are not necessarily tested as part of the audit if a fully substantive audit approach is followed. The unintended consequence is that significant deficiencies in internal controls will not be publicly disclosed.

Agree, with comments below

We agree that the risk identification and assessment procedures in ED-240, when compared to extant ISA 240 has been significantly enhanced to align with the ISA 315 (Revised 2019) and therefore that it is more robust. However, we are concerned that:

Striking the right balance between incorporating principles from ISA 315 (Revised 2019) and other ISAs and tailoring those principles to be relevant to the auditor's responsibilities related to fraud in order to promote understandability remains a challenge.

Examples of paragraphs that may not be sufficiently tailored include:

Paragraphs 28 and A47 do not explain how the auditor, through performing the retrospective review would distinguish between intentional versus unintentional bias (to distinguish between fraud versus error).

Paragraph 30 doesn't explain why or if inconsistent information is always indicative of fraud.

Paragraphs 37 and A95 – A97 do not link this risk assessment procedure with the auditor's ability to identify and assess the presumed risk of management override of controls.

Paragraphs 33(b) and A67 do not explain how the auditor would distinguish between deliberate versus erroneous misapplication of accounting policies.

As the intention is to build on the foundational elements of ISA 315 (Revised 2019) to enhance fraud risk identification, we propose that the IAASB incorporate into ED-240 considerations relevant to fraud to explain how the foundational risk assessment requirements of ISA 315 (Revised 2019) are to be applied in the context of fraud.

The current approach to building on the foundational requirements from other standards appears to be inconsistent and could benefit from applying uniform approach.

We have observed inconsistencies in the approach to incorporating principles from other ISAs and tailoring those principles to be relevant to the auditor's responsibilities related to fraud. The consequence is requirements that are scattered across various ISAs, raising doubts about completeness of the principal requirements, and a disconnect between principles addressed in the different phases of the audit i.e., risk identification and assessment versus response. For example:

ED-240 does not sufficiently emphasise the importance of understanding the business model for the purpose of determining susceptibility of the financial statements to material misstatement due to fraud. ISA 315 (Revised 2019) paragraph A61 explains why the auditor obtains an understanding of the entity's business model. In the context of fraud risk identification, understanding the business at a strategic level, including the business risks it faces is important because it provides the auditor with insight into management's intentions, i.e. the motivation behind their business decisions. Given intention is the key differentiator between material misstatement due to fraud versus error, this is considered a key omission in ED-240, needing to be addressed.

ED-240 emphasises responding to management override of controls without elaborating on the risk assessment and related activities that inform this response. The detailed guidance related to understanding and articulating the risk of material misstatement due to management override of controls resides in ISA 315 (Revised 2019) (for example paragraph A195). Thus, when reading ED-240, there is a disconnect between the auditor's fraud risk assessment and response.

ED-240 omits the requirements with respect to understanding accounting estimates, including the controls around estimates as it relates to risk of material misstatement of estimates due to fraud. We noted the requirements to perform a retrospective review of the outcome of previous accounting estimates in ED-240 paragraph 28, and the evaluation of management's judgments and decisions in making the accounting estimates included in the financial statements in ED-240 paragraph 51 and 52. We however observe the absence of requirements with respect to understanding the estimates, including the controls around estimates as it relates to risk of material misstatement of estimates due to fraud. i.e., the link between ISA 315 (Revised 2019) and ISA 540 (Revised) and the context that explains the purpose of the assessment is included in these ISAs.

ED-240 emphasises risk assessment and related procedures for the audit of estimates but does not follow a similar approach for related parties. Specifically, although Appendix 5 references the paragraphs in ISA 550

with specific requirements that refer to fraud or suspected fraud, the risk identification and assessment principles in ISA 550 have not been incorporated into ED-240, unlike the principles from ISA 540 (Revised).

Other comments related to building on the foundational requirements in ISA 315 (Revised 2019) for the IAASB's consideration include:

A proposal to enhance paragraph 29 of ED-240 to require a discussion about the presumed risks of fraud in revenue recognition and management override of controls. This can be achieved through adding a new paragraph 29(c).

Clarification of the requirement related to other sources. ED-240 paragraph 27 will be easier to understand and apply with a fraud lens if the other sources is identified (or less laborious), so it eliminates the need to go into ISA 315 (Revised 2019) to understand the intention of ED-240 paragraph 27. We propose adapting the application material for this purpose, for example:

“Information obtained from other sources in accordance with paragraphs 15–16 of ISA 315 (Revised 2019), may include information from the auditor’s procedures regarding acceptance or continuance, other engagements performed for the entity by the engagement partner or from previous audits and may be relevant to the identification of fraud risk factors by providing information and insights about...”

Clarifying the IAASB's intentions related to the auditor's responsibilities to perform a retrospective review for “significant accounting estimates” versus “accounting estimates”. ISA 540 (Revised), paragraph A57, states that a retrospective review of management judgments and assumptions related to “significant accounting estimates” is required by ISA 240. Paragraph 33 of the extant ISA 240 requires retrospective reviews to be performed for “significant accounting estimates”. The term “significant” has been removed in ED-240, paragraphs 28, A47, and A136 and ISA 540 (Revised), paragraph A57. By removing the word “significant” from ED-240 and ISA 540 (Revised), auditors would now be required to consider all estimates regardless of their nature, size, or inherent risk. Accordingly, we recommend that the IAASB reconsider this matter.

4. Jurisdictional and National Auditing Standard Setters

Japanese Institute of Certified Public Accountants

Agree, with comments below

We believe that ED-240 appropriately builds on the foundational requirements of ISA 315 (Revised 2019) and other ISAs to support a more robust risk identification and assessment as it relates to fraud in an audit of financial statement.

However, we propose the IAASB consider the following points.

Although we understand that the extant ISA 240 contains a similar statement, paragraph A47 is a general statement of retrospective review of accounting estimates. We suggest modifying the application material to be more fraud specific, for example, by adding the following underlined word to the paragraph A47.

“A47. The purpose of performing a retrospective review of management’s judgments and assumptions related to accounting estimates reflected in the financial statements of the previous period is to evaluate whether there is an indication of a possible intentional bias on the part of management. It is not intended to call into question the auditor’s judgments about previous period accounting estimates that were appropriate based on information available at the time they were made.”

Paragraph A54 gives an example that an unexpected relationship may be identified when the market values of government bonds depreciate as a result of central banks increasing interest rates to counter inflation.

However, the fair value of government bonds is often observable, and the risk of material misstatement due to fraud is generally not considered to be high. Therefore, we do not believe that this is an appropriate example of an unexpected relationship. We suggest revising the example to a more general one, such as the relationship between sales and operating expenses.

The first sentence of paragraph A69 states "... and through considering information from external sources", but there appears to be no reference to external sources in the examples provided. We also do not believe that information sources are limited to external sources. Therefore, we suggest removing "from external sources" in the first sentence.

The examples in paragraph A104 include a reference to "employee retirement benefits liabilities". However, we notice that identifying risk of material misstatement due to fraud for employee retirement benefits liabilities is limited in practice. We suggest, for example, changing to another example such as valuation of equity method investment or securities, or removing it due to the large number of examples in this ED as a whole.

American Institute of Certified Public Accountants

Interplay with ISA 315 (Revised 2019)

As noted below in our responses to questions 3 and 9, we are concerned that the linkages between ED-240 and ISA 315 (Revised 2019) might inadvertently lead auditors to duplicate risk assessment procedures and related documentation. We encourage the IAASB to further clarify in ED-240 which fraud-related risk assessment procedures are truly incremental compared to those that are repeated from other ISAs and emphasize that incremental fraud risk assessment procedures should be integrated into the auditor's overall risk assessment procedures. Additionally, we recommend the IAASB update the Nonauthoritative Guidance on Fraud in an Audit of Financial Statements "The Fraud Lens — Interactions Between ISA 240 and Other ISAs" issued in May 2022 to better explain the linkages between ED-240 and other ISAs (in particular, ISA 315 (Revised 2019)). One way in which to help practitioners understand and apply the "fraud lens" when performing risk assessment procedures may be to illustrate the linkages similar to the flowchart in ISA 540 (Revised) Implementation Tool. Please see the appendix "Linkages Between ISA Risk Assessment Requirements and ED-240" at the end of this comment letter as a possible way to illustrate such links.

Agree, with comments below

We are supportive of how ED-240 builds on ISA 315 (Revised 2019) with incremental requirements to add a fraud lens to risk assessment. However, as stated in Part A of this letter, we continue to have concerns that some auditors may look at these requirements as a separate risk assessment with separate documentation needed. We encourage the IAASB to further clarify in ED-240 which fraud-related risk assessment procedures are truly incremental compared to those that are repeated from other ISAs and emphasize that incremental fraud risk assessment procedures should not be treated as a separate exercise. Rather, they should be integrated into the auditor's overall risk assessment procedures.

Whistleblower Program

We also encourage the IAASB to consider requiring the auditor to obtain an understanding of an entity's whistleblower program, if one exists, because of the important role a whistleblower program plays in identifying fraud; and to strengthen the auditor's procedures relating to the use of internal audit. Accordingly, our suggestions for paragraphs 34, 35, and 36 in this section are of most importance when considering our comments.

Significant Transactions Outside the Normal Course of Business or that Otherwise Appear Unusual

Paragraph 53 of ED-240 includes a requirement that is based on the auditor's understanding of the entity and its environment and information from other sources obtained during the audit. Specifically, paragraph 53 states

“ For significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual given the auditor's understanding of the entity and its environment and information from other sources obtained during the audit, the auditor shall evaluate whether the business rationale (or the lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets.”

This requirement is located under the section “Responses to the Assessed Risks of Material Misstatement Due to Fraud” (see paragraph 53 of ED-240).

To enable the auditor to make such an evaluation, we recommend the IAASB include specific requirements for the auditor to obtain this understanding as part of the auditor's risk assessment procedures. This will provide the auditor with a basis to help the auditor make the evaluation in paragraph 53. For example, we recommend the IAASB include the following additional requirements:

Paragraph 34(c) of ED-240 addresses requirements for the auditor to obtain an understanding of the control environment component. In doing so, we believe the auditor should be required to make inquiries of management about whether the entity has entered into any significant transactions outside the normal course of business or that otherwise appear unusual and, if so, the nature, terms, and business purpose (or the lack thereof) of those transactions and whether such transactions involved related parties. This can be placed under paragraph 34(c).

Paragraph 34(d) of ED-240 requires the auditor to make inquiries of those charged with governance about various matters relating to the control environment. We recommend the IAASB include a new inquiry to those charged with governance about whether the entity has entered into any significant transactions outside the normal course of business or that otherwise appear unusual. This can be placed under paragraph 34(d).

Paragraph 36(b) of ED-240 addresses requirements for the auditor to obtain an understanding of the entity's process to monitor the system of internal control component. In doing so, we believe the auditor should be required to make inquiries of appropriate individuals within the internal audit function (if the function exists) to obtain their views about the risks of fraud and to determine whether they are aware that the entity has entered into any significant transactions outside the normal course of business or that otherwise appear unusual. This can be placed under paragraph 36(b). (Also see our other proposed edits to paragraph 36(b) to further strengthen the auditor's procedures relating to the use of internal audit that is located later in this section.)

Understanding the Components of the Entity's System of Internal Control

Control Environment

Paragraph 34 and Related Application material

Insights from ASB Outreach Related to Whistleblower Hotlines

The ASB outreach highlighted the importance of whistleblower hotlines in identifying fraud. Further, the findings from the report “Occupational Fraud 2024: A Report to the Nations” issued by the Association of Certified Fraud Examiners (ACFE) highlighted the continued prevalence of the whistleblower tips and complaints as the most common way fraud is detected, accounting for 43% of cases being uncovered. With this in mind, we believe that, for those entities that have a formal whistleblower program, ED-240 should require the auditor to obtain an understanding of the whistleblower program.

See proposed new requirements in paragraph 34(a-1) and (d)(iii) and proposed new application material in paragraph A70 below.

We also recommend that paragraph 34(b)-(d) be clarified to apply when those charged with governance are separate from management.

See proposed changes to paragraph 34(b)-(d) below.

Understanding the Components of the Entity's System of Internal Control

Control Environment

Paragraph 34

34. In applying ISA 315 (Revised 2019), the auditor shall:

(a) Obtain an understanding of how management's oversight responsibilities are carried out, such as the entity's culture and management's commitment to integrity and ethical values, including how management communicates with its employees its views on business practices and ethical behavior with respect to the prevention and detection of fraud. (Ref: Para. A68–A70)

(a-1) If the entity has a whistleblower program, obtain an understanding of the whistleblower program, including how the program receives and handles matters submitted, including matters relating to fraud the nature of the matters submitted, including matters related to fraud for the period under audit and through the date of the auditor's report how management and those charged with governance address allegations of fraud made through the whistleblower program

(b) When those charged with governance are separate from management, obtain Obtain an understanding of how those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the controls that management has established to address these risks. (Ref: Para. A71–A74)

(c) When those charged with governance are separate from management, Mmake inquiries of management regarding management's communications with those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity.

(d) When those charged with governance are separate from management, mMake inquiries of those charged with governance about: (Ref: Para. A75–A78)

(i) Whether they have knowledge of any fraud or suspected fraud, including allegations of fraud, affecting the entity;

(ii) Their views about whether and how the financial statements may be materially misstated due to fraud, including their views on possible areas that are susceptible to misstatement due to management bias or management fraud; and

(iii) Whether they have received any tips or complaints regarding the entity's financial reporting process used to prepare the entity's financial statements, including those received through a whistleblower program, if such program exist, and if so, how they have responded to such tips and complaints; and

(ivii) Whether they are aware of deficiencies in the system of internal control related to the prevention and detection of fraud, and the remediation efforts to address such deficiencies.

Paragraph A70

A70. Depending on the nature and circumstances of the entity, the entity may have a formal whistleblower program; In such circumstances, obtaining an understanding of the program may assist the auditor in identifying risks of material misstatement due to fraud and may be achieved by: . The auditor may:

Obtaining an understanding of the whistleblower program's process for handling tips or complaints, including how often tips or complaints are reported to entity management and those charged with governance, reporting mechanisms (e.g., telephone hotline, online forms, or in-person reporting), who is responsible and whether those charged with governance have oversight for the program, including who receives the notifications (that is, which members of management and those charged with governance receive such information), and how the entity addresses the matters raised. The auditor may also want to consider whether there is a pattern of the tips and complaints received. In a larger or more complex entity, the lack of a whistleblower program, or an ineffective one, may be indicative of deficiencies in the entity's control environment.

Inspecting whistleblower files for any tips or complaints that may allege fraud that are not under investigation by the entity, or for information that may raise questions about management's commitment to creating and maintaining a culture of honesty and ethical behavior.

Following up on matters that are under investigation by the entity as these matters may be indicative of suspected fraud with financial reporting implications that require a response by the auditor.

The whistleblower program may identify matters such as those related to noncompliance with laws and regulations that are not fraud related. ISA 250 (Revised), Consideration Of Laws And Regulations In An Audit Of Financial Statements, deals with the auditor's responsibility to consider laws and regulations in an audit of financial statements.

The Entity's Risk Assessment Process

Paragraph 35 and Related Application Material

Paragraph 35(a)

We recommend the IAASB include "and monitors" in paragraph 35(a)(i) referencing the requirement for the auditor to obtain an understanding for how management monitors the entity's fraud risks. Obtaining an understanding of how management monitors fraud risks sheds light on the prioritization of fraud within the organization, which may directly affect the auditor's assessment of risk of material misstatement due to fraud.

35. In applying ISA 315 (Revised 2019), the auditor shall:

- (a) Obtain an understanding of how the entity's risk assessment process: (Ref: Para. A79–A88)
 - (i) Identifies and monitors fraud risks related to the misappropriation of assets and fraudulent financial reporting, including any classes of transactions, account balances, or disclosures for which risks of fraud exist;
 - (ii) Assesses the significance of the identified fraud risks, including the likelihood of their occurrence; and
 - (iii) Addresses the assessed fraud risks

Paragraph 35(b)

Insights from ASB Outreach Related to Inquiries of Individuals Outside of the Financial Reporting Process

The ASB outreach underscores the significance of engaging with individuals across the entire organization, rather than limiting inquiries to employees with accounting or financial reporting roles and responsibilities. This approach may allow the auditor to identify additional risks of material misstatement due to fraud. Accordingly, we believe the requirement in paragraph 35(b) should be expanded to specifically include such inquiries and

to specifically ask about instances of management override of controls. Further, we are supportive of the guidance contained in paragraphs A89 and A90 that addresses the timing of such communications and highlights performing inquiries of others within the entity. We offer additional suggested content to capture key takeaways from our outreach in paragraphs 35(b), A89 (see Question 10), A90 and new paragraph A90A (see proposed changes that follow.)

We recommend the following changes to paragraph 35(b) as noted previously to capture insights from the ASB's outreach.

(b) Make inquiries of management and of other appropriate individuals within the entity, including personnel not directly involved in the financial reporting process, about: (Ref: Para. A89–A91)

(i) Whether they have knowledge of any fraud or suspected fraud, including allegations of fraud, affecting the entity; and

(ii) Their views on whether the financial statements may be materially misstated due to fraud.

Whether they are aware of any instances of management override of controls.

Paragraph A90

We believe language should be added to paragraph A90 to underscore the significance of engaging with individuals across the entire organization, rather than limiting interactions solely to management.

A90. Inquiries of management may provide useful information concerning the risks of material misstatements resulting from employee fraud. However, such inquiries are unlikely to provide useful information regarding the risks of material misstatement resulting from management fraud. Inquiries of others within the entity, in addition to management, may provide additional insight into fraud prevention controls, tone at the top, and culture of the organization. Such inquiries may be useful in providing the auditor with a perspective that is different from that of individuals in the financial reporting process. The responses to these other inquiries might serve to corroborate responses received from management or, alternatively, might provide information regarding the possibility of management override of controls. The auditor may also obtain information about how effectively management has communicated standards of ethical behavior throughout the organization.

New Paragraph A90A

We also encourage the IAASB to include the following application material related to fraud inquiries. The ASB's outreach (see part A of this letter) highlights that conducting fraud inquiries in person significantly enhances their effectiveness. This approach provides auditors with the valuable ability to observe body language, which can reveal crucial insights. Furthermore, receiving written responses in advance empowers management to compile all relevant information while also allowing auditors the opportunity to prepare targeted follow-up questions. Therefore, we believe incorporating this into application material will increase the likelihood of auditors implementing these good practices.

A90A. Inquiries of management and others within the entity are generally most effective when they involve an in-person discussion. The auditor may also determine it useful to provide the interviewee with specific questions and obtain written responses in advance to facilitate the discussion.

The Entity's Process to Monitor the System of Internal Control

Paragraphs 36 and Related Application Material

Paragraph 36

As noted in our comments relating to paragraph 34 of ED-240, the findings from the report “Occupational Fraud 2024: A Report to the Nations” issued by the ACFE highlighted the continued prevalence of the whistleblower tips and complaints as the most common way fraud is detected, accounting for 43% of cases uncovered. This was followed closely by internal audit processes as the second most common detection method. With this in mind, we believe that certain application material in paragraph A94 should be elevated to the requirement in paragraph 36 to strengthen the auditor’s procedures relating to the use of internal audit. We suggest the following changes to paragraphs 36(b) and A94.

36. In applying ISA 315(Revised 2019), the auditor shall:

(a)...

(b) Make inquiries of appropriate individuals within the internal audit function (if the function exists) about whether they have knowledge of any fraud or suspected fraud, including allegations of fraud, affecting the entity and to obtain their views about the risks of fraud, and to determine whether:

(i) they have performed any procedures to identify, detect, or investigate fraud during the year;

(ii) they believe management has satisfactorily responded to any findings resulting from these procedures; and

(iii) they are aware of any instances of management override of controls. (Ref: Para. A93-A94)

Paragraph A94

A94. ISA 315 (Revised 2019) and ISA 610 (Revised 2013) establish requirements and provide guidance relevant to audits of those entities that have an internal audit function.

Examples:

In applying ISA 315 (Revised 2019) and ISA 610 (Revised 2013) in the context of fraud, the auditor may, for example, inquire about:

The entity’s fraud risk assessment.

The entity’s controls to prevent or detect fraud.

The entity’s culture and management’s commitment to integrity and ethical values.

Whether the internal audit function is aware of any instances of management override of controls.

The procedures performed, if any, by the internal audit function during the year to detect fraud and whether management and those charged with governance have satisfactorily responded to any findings resulting from those procedures.

The procedures performed, if any, by the internal audit function in investigating frauds and suspected violations of the entity’s code of ethics and values, and whether management and those charged with governance have satisfactorily responded to any findings resulting from those procedures.

While we find the suggestions related to paragraphs 34, 35, and 36 to be of most importance for this question as stated previously, we also encourage the IAASB to make the following revisions:

Risk Assessment Procedures and Related Activities

Engagement Team Discussion

Paragraph 29 and Related Application Material

Paragraph 29

We recommend including additional requirements relating to the exchange of ideas as part of the engagement team discussion. Some of these items relate to content from extant ISA 240 application material. While some of this content may have been retained in ED-240, it has been moved so that it is no longer included within the context of the engagement team discussion. We believe it is important to require these topics be discussed as part of the brainstorming session to encompass a dialogue focused on entity-specific red flags and to emphasize the importance of maintaining professional skepticism. This could improve the engagement team's ability to identify fraud risk factors and better identify risks of material misstatement due to fraud. We believe making this revision could improve the auditor's consideration of fraud, ultimately strengthening the overall audit process.

29. In applying ISA 315 (Revised 2019), when holding the engagement team discussion, the engagement partner and other key engagement team members shall place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud may occur. In doing so, the engagement team discussion shall include: (Ref: Para. A48–A49 and A53)

(a) An exchange of ideas or brainstorming among the engagement team members about:

The entity's culture, management's commitment to integrity and ethical values and related oversight by those charged with governance; (Ref: Para. A50)

Fraud risk factors, including: (Ref: Para. A51–A52)

Incentives or pressures on management, those charged with governance, or employees to commit fraud;

How one or more individuals among management, those charged with governance, or employees could perpetrate and conceal fraudulent financial reporting, including consideration of circumstances that might be indicative of manipulation of earnings or of other financial measures and the practices that might be followed by management to manipulate earnings or other financial measures that could lead to fraudulent financial reporting); and

The risk of management override of controls; and

How assets of the entity could be misappropriated by management, those charged with governance, employees or third parties.

(b) The importance of maintaining professional skepticism throughout the audit regarding the potential for material misstatement due to fraud [moved here from the first bullet of paragraph A53 of ED-240]

(c) How the auditor might respond to the susceptibility of the entity's financial statements to material misstatement due to fraud [moved here from the last bullet of paragraph A53 of ED-240]

(dc) A consideration of any fraud or suspected fraud, including allegations of fraud, that may impact the overall strategy and audit plan, including fraud that has occurred at the entity during the current or prior yearsperiods.

29A. Communication among the engagement team members about the risks of material misstatement due to fraud should continue throughout the audit, particularly upon discovery of new information during the audit.

Insights from ASB Outreach Related to Engagement Team Discussion

Outreach performed by the ASB (see part A of this letter) highlights the importance of the engagement team discussion. We believe that elevating the proposed items in paragraphs 29 and 29A (as noted previously) will enhance the engagement team discussions and help the engagement team to better focus on fraud.

Requiring the engagement partner or other key engagement team members to reinforce the importance of exercising professional skepticism during the engagement team discussion is a best practice.

Further, we are supportive of the guidance in paragraphs A49, A51, A52 and A53 as these matters were acknowledged in the ASB outreach. In particular,

Paragraph A49 - the outreach highlighted the need to use individuals with proper skills on the audit and therefore we support the guidance in paragraph A49 relating to using individuals with specialized skills to be included in the engagement team discussion.

Paragraph A51 – the outreach indicated that the use of audit data analytics may be helpful as it relates to fraud. Therefore, in principle we support the guidance in paragraph A51, but suggest that the IAASB consider technology-related content within ED-240 more holistically (see proposed edits to paragraph A51 that follow).

Paragraph A52 – the outreach indicated that being aware of management's major life events may indicate a red flag. While we believe that the auditor's awareness of unusual or unexplained changes in management's lifestyle is important to include in the engagement team discussion, we also believe it should be limited to when those matters come to the auditor's attention – that is, the auditor is not responsible for investigating management's lifestyle. Accordingly, we support the guidance in paragraph A52 for the engagement team discussion to exchange ideas about any unusual or unexplained changes in behavior or lifestyle of management or employees that have come to the attention of the engagement team.

Paragraph A53 - the ASB outreach showed that there is a need for further examples to help auditors think about how to be unpredictable in the audit and therefore we support the guidance in paragraph A53 relating to including unpredictability in the audit and recommend including a reference to Appendix 2, which includes examples that include unpredictability (see proposed edits to paragraph A53 that follow).

Paragraph A51

As stated previously in Part A of this letter, we recommend the IAASB keep the ISAs principles-based and create a separate technology addendum as part of the IAASB's Technology Position Initiative. However, if the IAASB decides to continue including technology-related application material within ED-240, we encourage the IAASB in paragraph A51 to further highlight the use of automated tools and techniques to identify fraud risk factors and how the results should be discussed during the engagement team discussion. We also believe paragraph A51 should note that the benchmarking may also indicate unusual relationships within the entity's current period data and that adverse ratios or trends may also be compared to the entity's past performance.

A51. ...

Automated tools and techniques – these may be used to support the discussion about the susceptibility of the entity's financial statements to material misstatement due to fraud, and in the identification of fraud risk factors, including techniques that further the understanding of incentives and pressures, such as industry or sector financial ratio benchmarking, which may indicate unusual relationships within the entity's current period data (e.g, financial and operating data) and adverse ratios or trends compared to competitors or the entity's past performance.

Paragraph A53

The ASB outreach showed that there is a need for further examples to help auditors think about how to be unpredictable in the audit. We recommend including a reference to Appendix 2 in paragraph A53 to point the auditor to examples of audit procedures that incorporate an element of unpredictability. Further, as stated

previously, we recommend moving the first bullet from application material to the requirement in paragraphs 29(b) and (c).

A53. The engagement partner and other key engagement team members participating in the engagement team discussion may also, as applicable, use this as an opportunity to:

Emphasize the importance of maintaining a questioning mind throughout the audit regarding the potential for material misstatement due to fraud. [moved to paragraph 29(b) of ED-240]

Remind engagement team members of their role in serving the public interest by performing quality audit engagements and the importance of engagement team members remaining objective in order to better facilitate the critical assessment of audit evidence obtained from persons within or outside the financial reporting or accounting functions, or outside the entity.

When discussing how the auditor might respond to the susceptibility of the entity's financial statements to material misstatement due to fraud as required by paragraph 29(c), consider the audit procedures that may be selected to respond appropriately to the susceptibility of the entity's financial statements to material misstatement due to fraud, including whether certain types of audit procedures may be more effective than others and how to incorporate an element of unpredictability into the nature, timing and extent of audit procedures to be performed. Appendix 2, Examples of Possible Audit Procedures to Address the Risks of Material Misstatement Due to Fraud, contains some examples of procedures that include an element of unpredictability.

Inquiries of Management and Inconsistent Responses

Paragraph 30 and New Paragraph A53A

Paragraph 30

We believe the requirement in paragraph 30 should be expanded to also include responses that are otherwise unsatisfactory, and not just inconsistent, and that new application material (new paragraph A53A) should explain what is meant by unsatisfactory responses. Inclusion of this language is important because inconsistent responses to inquiries may not be the sole indicators of fraud. It is essential to recognize that other unsatisfactory responses, such as vagueness and implausibility, could also signal management's attempt to conceal fraud. Omitting this language may result in auditors accepting unsatisfactory responses merely because they were not directly contradictory.

Inquiries of Management and Inconsistent Responses

30. In applying ISA 500, if the responses to management, those charged with governance, individuals within the internal audit function, or others within the entity, are inconsistent with each other or otherwise unsatisfactory, the auditor shall: (Ref: Para. A53A)

Determine what modifications or additions to audit procedures are necessary to understand and address the matterinconsistency; and

Consider the effect, if any, on other aspects of the audit.

Paragraph A53A

A53A. Unsatisfactory responses to inquiries may include vagueness and implausibility.

Analytical Procedures Performed and Unusual or Unexpected Relationships Identified

New Paragraphs A54A-1 to A54A-3 Related to Paragraph 31

New Paragraphs A54A-1 to A54A-3

We strongly encourage the IAASB to include the following application material relating to analytical procedures to follow paragraph A54 (linked to paragraph 31) to further explain how data analysis techniques may be used when performing analytical procedures.

A54A-1. Analytical procedures may include data analysis techniques ranging from a high-level review of data patterns, relationships, and trends to highly sophisticated, technology-assisted analysis of detailed transactions using electronic tools, such as data mining, business intelligence, and file query tools. The degree of reliance that can be placed on such techniques is a function primarily of the source (for example, financial, nonfinancial), completeness and reliability of the data, the level of disaggregation, and the nature of the analysis.

A54A-2. Analytical procedures relating to revenue that are performed with the objective of identifying unusual or unexpected relationships that may indicate a material misstatement due to fraudulent financial reporting may include

- a. a comparison of sales volume, as determined from recorded revenue amounts, with production capacity. An excess of sales volume over production capacity may be indicative of recording fictitious sales.
- b. a trend analysis of revenues by month and sales returns by month, during and shortly after the reporting period. This may indicate the existence of undisclosed side agreements with customers involving the return of goods, which, if known, would preclude revenue recognition.
- c. a trend analysis of sales by month compared with units shipped. This may identify a material misstatement of recorded revenues.

A54A-3. Analytical procedures performed during planning may be helpful in identifying the risks of material misstatement due to fraud. However, if such analytical procedures use data aggregated at a high level, generally the results of those analytical procedures provide only a broad initial indication about whether a material misstatement of the financial statements may exist. Accordingly, the results of analytical procedures performed during planning may be considered along with other information gathered by the auditor in identifying the risks of material misstatement due to fraud.

Insights from ASB Outreach Related to the Use of Data Analysis Techniques

As discussed with paragraph A51, the ASB outreach indicated that the use of audit data analytics may be helpful as it relates to fraud and therefore, we believe that further guidance in the application material would be helpful (as suggested previously by including new paragraphs A54A-1 to A54A-3).

Evaluation of Fraud Risk Factors

Application Material Related to Paragraph 32

Paragraph A56

We encourage the IAASB to clarify that the inability to observe one or more of the conditions listed in paragraph A56 as conditions that are generally present when fraud exists does not necessarily mean that no risk of material misstatement due to fraud exists. Such clarification may enhance the auditor's professional skepticism and is an important reminder.

A56. Examples of fraud risk factors related to fraudulent financial reporting and misappropriation of assets are presented in Appendix 1. These illustrative fraud risk factors are classified based on the three conditions that are generally present, individually or in combination, when fraud exists:

An incentive or pressure to commit fraud;

A perceived opportunity to commit fraud; and

An ability to rationalize the fraudulent action.

The inability to observe one or more of these conditions does not necessarily mean that no risk of material misstatement due to fraud exists.

Fraud risk factors reflective of an attitude...

Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework and the Entity's System of Internal Control

Understanding the Entity and its Environment, and the Applicable Financial Reporting Framework

Application Material Related to Paragraph 33

Paragraph A63

We recommend the following revisions be made to the application material in paragraph A63 to expand upon why it is important for the auditor to understand the industry in which the entity operates. Further, the examples in the bullet speak about creating “opportunities” to commit fraud and not “incentives” and therefore the first bullet should be changed to align with the example.

Industry (Ref: Para. 33(a)(ii))

A63. Understanding the industry in which the entity operates assists the auditor in identifying fraud risk factors. The entity may operate in an industry that may be susceptible to fraud, or other illegal or unethical acts that may be carried out to facilitate or conceal fraud. For example, the The auditor may obtain an understanding about whether the entity operates is active in:

An industry where there are greater opportunitiesincentives to commit fraud. (e.g., in the construction industry the revenue recognition policies may be complex and subject to significant judgment which may create an opportunity to commit fraud).

An industry that is under pressure (e.g., a high degree of competition or market saturation, accompanied by declining margins in that sector). Such characteristics may create an incentive to commit fraud as it may be harder to achieve the financial performance targets.

Control Activities

Paragraph 38 and Related Application Material

Paragraph 38

We recommend the following revisions be made to paragraph 38 to further clarify that identified risks of material misstatement due to fraud are treated as significant risks and therefore the auditor is required to evaluate its design and determine whether the controls have been implemented (D&I) in accordance with ISA 315 (Revised). There is often confusion relating to when the auditor is required to perform D&I and these proposed revisions will help to clarify this point for auditors.

38. In applying ISA 315 (Revised), the auditor's understanding of the entity's control activities component shall include identifying controls that address risks of material misstatement due to fraud at the assertion level,FN including controls over journal entries, designed to prevent or detect fraud.; evaluating whether the controls are designed effectively; and determining whether the controls have been implemented.

FN As noted in paragraphs 40(b) and 42 of ED-240, risks of material misstatement due to fraud are treated as significant risks.

Paragraph A98

We encourage the IAASB to retain the following application material from extant ISA 240 and place it in paragraph A98. Incorporating this language provides further clarity about why management may conclude not to implement and maintain certain controls and highlights the importance for the auditor to obtain an understanding of management's controls relating to fraud.

A98. Management may make judgments on the nature and extent of the controls it chooses to implement and the nature and extent of the risks it chooses to accept given the nature and circumstances of the entity. In determining which controls to implement to prevent or detect fraud, management considers the risks that the financial statements may be materially misstated due to fraud. As part of this consideration, management may conclude that it is not cost effective to implement and maintain a particular control in relation to the reduction in the risks of material misstatement due to fraud to be achieved. For example, the auditor may learn that management has consciously chosen to accept the risks associated with a lack of segregation of duties.

Paragraph A106

We also encourage the IAASB to remove the reference to public sector entities in paragraph A106. Because this guidance is equally true for all entities, removing the reference to public sector entities helps to avoid the misconception that misappropriation of assets is specific to public sector entities. If paragraph A106 is retained for public sector entities, we request the IAASB further expand upon why this is of particular relevance to those entities.

Considerations Specific to Public Sector Entities

A106. For public sector entities, misappropriation of assets (i.e., misappropriation of funds) may be a common type of fraud...

Presumption of the Risks of Material Misstatement Due to Fraud in Revenue

Paragraph 41 and Related Application Material

We believe paragraph 41 is not appropriate for many public sector entities, as generally these entities' transactions consist primarily of expenditures rather than earned revenues. We suggest that the IAASB add an additional application material paragraph under the heading "Considerations Specific to Public Sector Entities" as follows:

A112A. In the public sector, there may be fewer incentives or pressures to engage in fraudulent financial reporting by intentionally overstating or understating revenue. In public sector entities, there may be more fraud risks related to expenditures, especially when such expenditures are subject to statutory limits.

Other Paragraphs

Please see our response to question 10 for comments that are more editorial in nature related to paragraphs A71 (par. 34), A75 (par. 34), A89 (par. 35), 39, and 40.

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

Agree, with comments below

We agree that ED-240 appropriately builds on the foundational requirements in ISA 315, supporting a more robust risk assessment process related to fraud in the audit of financial statements. The requirements and application material in ED-240 require the auditor to think more critically about fraud.

Some of our stakeholders have questioned whether mitigating controls can be taken into account in assessing fraud risks. Our understanding is that, consistent with ISA 315 (Revised 2019), the auditor considers inherent risk and control risk separately, however we recommend that the IAASB clarify this further in the final standard.

Australian Auditing and Assurance Standards Board

Agree, with comments below

The AUASB is strongly supportive of the strengthening of requirements and application material as it relates to risk assessment procedures and related activities. The AUASB is particularly supportive of the following new/enhanced requirements:

Paragraph 33 of ED-240 focusing on aspects of the auditor's understanding of the entity and its environment.

Paragraphs 34-38 of ED-240 focusing on aspects of the auditors understanding of the components of the entity's system of internal control.

Paragraph 39 of ED-240 for the auditor to determine whether there are deficiencies in internal control identified relevant to the prevention or detection of fraud.

Paragraph 16 of ED-240 making the engagement team discussions more robust.

The AUASB makes the following recommendations for the IAASB:

The rebuttal of the presumption of the significant risk of fraud in revenue recognition should be at the assertion level rather than the account level. The associated inherent risk assessment is performed at the assertion level.

Further consideration should be given to whether the pressures or incentives for management to commit fraudulent financial reporting and to manipulate the revenue growth or profit, may be less significant for smaller unlisted entities, where owners are also managers. The risks may lie more in the presentation of liabilities, affecting banking facilities and covenants.

Consider including examples specific to public sector entities. For example:

The presumed fraud risk for revenue may be more easily rebutted for appropriation funding; and

Highlighting the possible greater risk in the public sector procurement / contract management concerning undisclosed conflicts of interest.

Clarity and consistency across ED-240 paragraphs 42 and 48. ED-240 paragraph 42 requires that management override is always treated as a significant risk, while paragraph 48 seems to indicate that this is not always the case 'irrespective of the auditor's assessment of the risks of management override...'.

Saudi Organization for Chartered and Professional Accountants

Agree, with comments below

SOCPA believes that the proposed revisions in ED-ISA 240 have consistently built on the foundational requirements in ISA 315 (Revised 2019), and enhanced the understanding of underlying risk assessment concepts in relation to fraud through introducing extensive illustrative examples.

Austrian Chamber of Tax Advisors and Public Accountants

Agree, with comments below

Certain audit procedures are elaborated in parts of the standard, suggesting that their main or predominant purpose may be the detection of fraud. This is however not appropriate as such procedures also serve numerous other important aspects of performing an audit. We therefore consider it more appropriate to include the details and scoping of such procedures in ISA 500 where all other audit procedures are discussed. This holds particularly true of the journal entry test and the analysis thereof which is a procedure mandated in ISA 240 but should be performed in any case, irrespective of any concerns regarding fraud and can therefore not be differentiated from other audit procedures included in ISA 500.

The same holds true with respect to accounting estimates and significant transactions outside the normal course of business which may have completely different reasonings and backgrounds e.g. agreements among shareholders, regulatory requirements or tax matters which have no connexion whatsoever to suspected or actual fraud.

Hong Kong Institute of Certified Public Accountants

Agree, with comments below

Our stakeholders suggested the IAASB to consider using “may” instead of “ordinarily” in ED-240.A110 when highlighting the appropriateness of rebutting the presumption of risks of material misstatement due to fraud in revenue recognition based on the auditor’s professional judgment on the significance of the fraud risk factors. The use of “ordinarily” in the given context introduces challenges when applying professional judgment as it implies that in most cases or under normal circumstances, the presence of fraud risk factors related to revenue recognition would indicate a risk of material misstatement due to fraud, regardless of the significance of fraud risk factors as stated in ED-240.A110 and hence, the presumption should not be rebutted. By using “may” in ED240.A110, it allows the auditor to evaluate the significance of the fraud risk factors to determine if the presumption can be rebutted.

In addition, ED-240.41 requires the auditor, taking into account related fraud risk factors, to determine which types of revenue, revenue transactions or relevant assertions give rise to the risks of material misstatements due to fraud. We are not aware of guidance or linkage provided in ED-240 on how the fraud risk factors are being evaluated to reach the conclusion that they are not significant and hence the presumption of fraud risk may be appropriate to be rebutted. We would recommend that the IAASB develop implementation guidance such as non-authoritative material in respect of ED-240.41 to ensure consistent application of the requirements.

We also note that ED-240 provides more examples in ED-240.A111 compared to the extant ISA 240. While the examples aim to be broadly relevant, practitioners have conveyed that they are relatively straightforward, implying that the presumption could be easily rebuttable and they may not fully reflect certain practical situations encountered in audits. Practitioners have requested further illustrative examples reflecting the circumstances of entities with revenue, such as from telecommunication subscriptions, gambling machines that heavily rely on highly automated systems to process large volumes of data and low-value transactions, with sophisticated controls effectively operated, thereby minimizing opportunities for intervention. Appropriately reflecting such circumstances would enhance the practicality and relevance of the standard’s application.

Besides, we note that ED-240.29 focuses on discussion of material misstatements of the financial statements due to fraud, while the subparagraph (b) requires the engagement team to discuss consideration of any fraud

or suspected fraud which seems to extend to all types of fraud and not just those might lead to material misstatements. Therefore, we would recommend that the IAASB remove “any” from the subparagraph (b) of ED-240.29 to achieve consistency in ED-240.29 and to limit the extent to only material misstatements of the financial statements due to fraud.

Auditing and Assurance Standards Board Canada

Agree, with comments below

We agree that the proposals build on the foundational requirements in ISA 315 (Revised 2019) and other ISAs to support a more robust risk identification and assessment. We did receive suggestions for clarification in the application material that will help improve the practitioner’s understanding of the requirements, which we have included below.

Relationship between inherent risk factors and fraud risk factors

The relationship between inherent risk and fraud risk factors is not clear. Through our outreach, we received questions on whether fraud risk factors are a subset of inherent risk factors specific to fraud or if they are separate factors not related to inherent risk factors in ISA 315 (Revised 2019). For example, paragraphs A57 and A58 suggest an effective control can be taken into consideration in the evaluation of fraud risk factors, however, this contradicts the principle that inherent risks are considered before controls.

Paragraph A57 provides factors that could constrain management that would be considered a control (e.g., existence and enforcement of a written code of conduct).

Paragraph A58 suggests the existence of management authorization can serve as a compensating control, reducing the risk of fraud.

Furthermore, in paragraph A58, the scalability example “a smaller or less complex entity may not have a written code of conduct but, instead, may have developed a culture that emphasizes the importance of integrity and ethical behavior through oral communication and by management example” cannot be evaluated by the auditor as there will be no evidence to support that management emphasizes integrity and ethical behavior through examples.

Suggest:

Clarifying in paragraph A22 that fraud risk factors are a subset of inherent risk factors:

A22. Fraud risk factors may relate to incentives, pressures or opportunities that arise from events or conditions that create susceptibility to misstatement, before consideration of controls. Fraud risk factors, which include intentional management bias, are, insofar as they affect inherent risk, a subset of inherent risk factors. Fraud risk factors may also relate to events or conditions that may exist in the entity’s system of internal control that provide an opportunity to commit fraud and may be an indicator that other fraud risk factors are present.

Moving paragraphs A57- A58 near paragraphs A104-A105 as these paragraphs relate to the requirement in paragraph 40(a) where the auditor is identifying and assessing the risks of material misstatement due to fraud by taking into account both inherent and control risk and the fraud risk factors.

Clarifying in paragraph A58 how the auditor can verify a culture where management emphasizes the importance of integrity and ethical behavior through management example.

The evaluation of the significance of fraud risk factors

Paragraph 32 requires the auditor to “evaluate whether...one or more fraud risk factors are present.” The application material in paragraph A55 and Appendix 1 mentions the significance of fraud risk factors. While ED-240 acknowledges that significance may vary depending on the size of the entity and the complexity of the ownership structure, concerns were raised about how the auditor determines the “significance” of the fraud risk factors and how that connects with the requirements in paragraphs 32, 40 and 41.

Suggest:

Adding new application material to help auditors in their determination of the significance of fraud risk factors when identifying and assessing risks of material misstatement due to fraud.

Presumption of risk of material misstatement due to fraud in revenue recognition

(Our concerns and suggestions below also relate to our scalability response to Question 8).

Through our outreach, we heard concerns from practitioners from small-medium sized practices about the application of the presumption of risks of material misstatement due to fraud in revenue recognition.

For many smaller entities, and especially for not-for-profit entities, the presumed risk of material misstatement due to fraud in revenue recognition may not be as relevant as in other entities. In these cases, the risk lies elsewhere in the financial statements. However, we are of the view that ED-240 does not limit the risks of material misstatement due to fraud to revenue. We recognize that while the presumption of the risks of material misstatement due to fraud starts with revenue in the standard, auditors can think about where the risk exists for their engagement and document their considerations.

Under extant ISA 240, we understand there were challenges in supporting and documenting the risks of material misstatement due to fraud in revenue. Our outreach on ED-240 found that the new application material helps consider which types of revenue, revenue transactions or relevant assertions give rise to risks of material misstatement due to fraud. However, we identified further areas that can be clarified, including:

The extent of documentation required where there are fraud risk factors in certain types of revenue, revenue transactions or relevant assertions but not in other areas of revenue. Paragraph 41 requires an auditor to take into account related fraud risk factors when determining which types of revenue, revenue transactions and relevant assertions give rise to risks of material misstatement due to fraud. Paragraph 70(d) sets out the documentation requirement “If the auditor has concluded that the presumption that a risk of material misstatement due to fraud related to revenue recognition is not applicable in the circumstances of the engagement, the reasons for that conclusion.” It is unclear what documentation is required where an auditor has identified risk(s) of material misstatement due to fraud in particular types of revenue, revenue transactions or relevant assertions, and the auditor has not identified fraud risk factors in the other areas of revenue. This has led some engagement teams to focus their efforts on developing extensive documentation rather than addressing higher-risk areas.

When it would be inappropriate to rebut the risk of material misstatement due to fraud in revenue recognition. We heard concerns that practitioners may reference paragraph A111, when rebutting the presumption of risk of material misstatement due to fraud in revenue recognition by concluding the fraud risk factors are not significant, and therefore that there are no risks of material misstatement due to fraud relating to revenue recognition. Currently, there is no guidance on the “significance” of fraud risk factors, potentially leading auditors to prematurely conclude without thorough consideration. The project proposal also included a specific action to clarify when it is inappropriate to rebut the presumption of risks of fraud in revenue recognition.

Suggest:

Adding application material to paragraph 70(d) to clarify the documentation required where risk(s) of material misstatement due to fraud are identified in particular types of revenue, revenue transactions or relevant assertions, but not in other revenue areas.

We support retaining the proposed application material in paragraphs A107-A112; however, we suggest adding further application material to clarify other circumstances, including:

considerations for the auditor to help determine when fraud risk factors are not significant when rebutting the risk of material misstatement due to fraud in revenue recognition; and

when it would be inappropriate to rebut the presumption of risks of fraud in revenue recognition.

Whistleblower program

We support the proposed application material in paragraph A70 for the auditor to consider understanding and inspecting a formal whistleblower program depending on the nature and circumstances of the entity.

During our outreach, we received mixed feedback on whether the application material should be elevated to a conditional requirement or remain as application material. While whistleblower programs serve as a valuable resource for identifying fraud, these formal programs do not exist in all entities. Where they do exist, there is a range from informalized internal practices to formalized external reporting to a third-party (e.g. ombudsmen). If the application material is elevated to a requirement, we are concerned that entities without a formal whistleblower program could be interpreted as a control deficiency, which in our view is not appropriate for all entities.

While we acknowledge the concerns raised, we believe paragraph A70 includes an extensive list of considerations that can be appropriately applied based on the nature and circumstances of the entity using the practitioners' professional judgment.

Fraud-related inquiries

We heard some concerns about how fraud-related inquiries may be performed in practice today, including that in some circumstances they may be performed through email, with questions circulated in advance and responses jointly prepared by the interviewees. To the extent this practice is occurring, we have concerns that it would undermine the intent of this requirement.

Suggest:

Adding an example in the application material that a list of inquiries sent in advance to the entity may risk those within the entity collaborating on their responses. The application material could also suggest that fraud-related inquiries be conducted verbally by senior members of the engagement team.

Other suggestions:

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

Fraud risk factors definition

Paragraph 18(b) does not include attitude in the definition of fraud risk factors but is included in paragraph A22.

Suggest:

Including "attitude" in the definition of fraud risk factors in paragraph 18(b)

18. For purposes of the ISAs, the following terms have the meanings attributed below:

(b) Fraud risk factors – Events or conditions that indicate an incentive, or pressure or attitude to commit fraud or provide an opportunity to commit fraud. (Ref: Para. A22–A23)

Complexity, Understandability, Scalability, and Proportionality (CUSP) Drafting Principles and Guidelines

While paragraph 26 mirrors paragraph 31 of ISA 315 (Revised 2019), the drafting is not consistent with the CUSP Drafting Principles and Guidelines which state not to use “take into account” and use “consider” instead. ISA 315 (Revised 2019) was approved before the CUSP Drafting Principles and Guidelines were finalized. Therefore, we suggest the principles be used going forward and consequential amendments could be made to ISA 315 (Revised 2019) to match the language used. This comment also applies to paragraphs 23, 40(a), 41, and A33.

Suggest:

Updating paragraph 26 to be consistent with the CUSP Drafting Principles and Guidelines.

26. In applying ISA 315 (Revised 2019), 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 considering fraud risk factors;

First-time implementation guidance

There is concern from practitioners of smaller or less complex entities that the requirements in ED-240 related to ISA 315 (Revised 2019) are expected to be performed separately from the risk identification and assessment under ISA 315 (Revised 2019).

Suggest:

Highlight in first-time implementation guidance that the requirements linked to other standards can be performed simultaneously.

Nordic Federation of Public Accountants

Agree, with comments below

Below are some detailed comments to this section.

Paragraphs 27/A45–A46. A46 refers to ISA 510 and requests to predecessor auditor of identified or suspected fraud. Taking on an engagement with identified or suspected fraud has some further consequences beyond the identification of potential fraud factors. There should be some reference to ISQM 1 Acceptance and Continuance.

Paragraphs 29/A52. Inherent risks in internal control such as known weaknesses in access control, cyber security, frequent restructuring processes, moving of employees/functions are also quite relevant. We encourage the IAASB to consider whether these might be helpful examples to include either here or in non-authoritative guidance.

Almost all of paragraphs 30–42 begin with “In applying ISA 315 (Revised)”. This should, if needed at all, be shortened to one paragraph or considered to be included in ISA 315 (Revised). It should also be considered if application material is needed for every paragraph, at least where the application material repeats application material already available in the ISA it is referring to.

A56/Appendix 1: A56 clearly states that the three conditions that generally are present when fraud is committed, can exist individually or in combination. Appendix 1 should repeat this and not just state "...classified based on the three conditions generally present...." since this can easily be interpreted as if all three conditions need to be present.

Appendix 1 under section "Risk factors relating to misstatements arising from misappropriation of assets" the first sentence also includes: "...according to the three conditions generally present when fraud exists:". Same comment as above, this should be reformulated to clarify that all three conditions don't have to be present (or not identified by the auditor even if they are present).

A108 reads "there may be greater risks of material misstatement due to fraud in revenue recognition in the case of entities that generate a substantial portion of revenues through cash sales that present an opportunity for theft". This is more a potential example of misrepresentation of assets than revenue recognition as the sale has occurred. If the example is intended to address cash sales as a potential higher risk to be booked in the wrong period, then that needs to be clarified. Otherwise, we suggest removing this example.

Examples in A109 related to fraud risk factors in revenue refer primarily to risk factors in publicly traded entities. For audits of LCE fraud risk factors may be different. Examples for these should be included as well.

A111 It is a bit difficult to understand these examples. More information is needed so it is obvious for the reader which attributes/inherent factors each of these examples include that makes it possible to conclude that they will not be significant.

Instituto de Auditoria Independente do Brasil

As currently drafted, the statement in paragraph A173 that "revenue recognition or management override of controls may be regularly determined as key audit matters related to fraud" seems to act as positive encouragement to do so in all cases.

Agree, with comments below

Although we recognize that ED-240 expands on ISA 315 and ISA 330, we believe that is still a lot of repetition of the other standards, especially in the application material. Thus, we would recommend further revision to eliminate duplication.

Additionally, we also believe ambiguity exists since many of the risk assessment requirements from ISA 315 (Revised 2019) are included in ED-240 with certain paragraphs retaining very similar language between the two standards and other paragraphs having differences. Recommending the IAASB be clearer in their intention, ensuring that the requirements have a clear "fraud lens".

Royal Dutch Institute of Chartered Accountants

Agree, with comments below

Positive remarks:

We support the IAASB's efforts to develop ISA 240 in such a manner that it expands on ISA 315. In our view, the extension of ISA 315 through ISA 240 signifies the importance of sufficient cross-references between the two. We observe a number of cross-references from ISA 240 to ISA 315, but we also note that ISA 315 does not refer auditors to ISA 240 when preparing the ISA 315 risk identification and assessment. In our view fraud considerations must be considered when performing a risk assessment,. Therefore we urge the Board to develop suitable corresponding amendments to ISA 315 so that auditors can understand and build on the

connection between the two. In this context, we suggest to include this ISA within the Standards on Risk Assessment and Response to Assessed Risks, to better reflect the course of conducting an audit.

We appreciate that ED-240 is aligned with ISA 315, for instance in the sequence of paragraphs. Furthermore, par. 27 deals with 'Information from other sources' (different from the confusing extant term 'other information' as in ISA 720) after the general paragraph on risk identification and assessment procedures.

Also, par. 28 requires the auditor to perform a retrospective review of management judgements and assumptions related to the outcome of previous accounting estimates.

In addition, the engagement partner and key engagement team members play an active role for in the engagement team discussion (par. 29), emphasizing how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud may occur. Par. A48 of the ED-240 is linked to ISA 220.

Furthermore par. 27 (revenue recognition) in extant ISA 240 has been rewritten and improved in par. 41 in ED-240.

Constructive critical remarks:

Regarding par. 32 (evaluating fraud risk factors), especially the concept of identifying risks (due to fraud) out of (fraud) risk factors proves to be difficult to operationalize.

Par. 24 of the ED-240 mentions the requirement to consider fraud risk factors, fraud or suspected fraud, and control deficiencies. The process from identifying fraud risk factors to identifying fraud risks remains unclear.

We suggest IAASB clarify this matter.

As we understand the subsequent requirements after par. 32, fraud risks are supposed to have been identified by the auditor from the former par. 23 to 31. In addition, we wonder why this requirement in par. 32 is limited to audit evidence obtained from the risk assessment procedures.

We suggest IAASB to include more detailed explanatory paragraphs or other material on these topics and specifically how to identify and assess fraud risks and evaluate fraud risk factors, individually and in combination. We suggest to include application material on how the fraud brainstorm and discussion can be conducted. For example applying the ISA 315 concept of using probability and magnitude to evaluate fraud risk factors and explain what exactly should be documented (such as considerations as to why a fraud risk factor does not indicate the existence of a fraud risk).

As of par. 33, and further, the auditor obtains an understanding of the entity's system of internal control. In doing so, the procedures derived from ISA 315 are (through the fraud lens) focused on fraud risks identified by the client's system of internal control. During these procedures, the auditor may identify fraud risk factors related to the client's system of internal control, in paragraphs as of 33 up to and including 40.

We suggest the IAASB rephrase par. A57 in such a way that there may be factors that may reinforce improper conduct by management:

Ineffective oversight by TCWG;

An ineffective internal audit function;

The lack of a written code of conduct.

The rationale for this change is the following. In practice, we see auditors declining to identify and assess (inherent/fraud) risk factors or risks because of the image of the client's system of internal control, that is, after considerations of controls.

5. Accounting Firms

RSM International

Agree, with comments below

We believe the wording in paragraph A99 of ED-240 is not consistent with the guidance included in the IAASB's First Time Implementation Guide for ISA 315 (Revised 2019), Identifying and Assessing the Risks of Material Misstatement. Paragraph A99 of ED-240 states that the understanding of the controls over journal entries in accordance with paragraph 26(a)(ii) of ISA 315 (Revised 2019) is intended to focus on controls addressing risks of material misstatement at the assertion level whether due to fraud or error. However, paragraph 63 of the implementation guide indicates the focus of paragraph 26(a)(ii) of ISA 315 (Revised 2019) is on controls that could be susceptible to unauthorized or inappropriate intervention or manipulation. Whilst the guidance in paragraph 26(a)(ii) of ISA 315 (Revised) may not be clear (and may not be within the scope of this standard), paragraph A99 of ED-240 seems to further complicate the intended meaning of the requirement in paragraph 26(a)(ii) of ISA 315 (Revised 2019).

We, therefore, suggest the following revision to paragraph A99 of ED-240 to be more specific and consistent with language:

A99. ISA 315 (Revised 2019) requires the auditor to obtain an understanding of controls over journal entries as well as to evaluate their design and determine their implementation as part of understanding the entity's system of internal control. This understanding focuses on the controls over journal entries that address risks of material misstatement at the assertion level, and that could be susceptible to unauthorized or inappropriate intervention or manipulation whether due to fraud or error. Paragraphs 49–50 of this ISA require the auditor to test the appropriateness of journal entries and is specifically focused on the risks of material misstatement due to fraud (see Appendix 4 for additional considerations when testing journal entries).

MNP

Agree, with comments below

We agree that ED-240 appropriately builds on the foundational requirements of ISA 315 to support a more robust risk identification and assessment as it relates to fraud. We did find that paragraphs 33-39 are rather repetitive with ISA 315 paragraphs 19-27. In our view, the additions of 33-39 would not change the way the auditor identifies and assesses the risks of material misstatement due to fraud if they appropriately followed the requirements of ISA 315 as those requirements relate to identifying and assessing the risks of material misstatement, whether due to error or fraud. We understand the IAASB's intention of applying the requirements of ISA 315 with a fraud lens, however these additional requirements contribute to increasing the length of what are already long and comprehensive auditing standards.

We found that the ED does not address to interplay between inherent risk factors and fraud risk factors. When determining the risks of material misstatement we take into account inherent risk factors, which are considered "before consideration of controls". An aspect of fraud risk factors, per the ED, is the opportunity to commit fraud. Oftentimes, our fraud risk assessments around opportunity require us to consider the control environment, as strong internal controls that detect and prevent fraud generally reduce the opportunity for

fraud to be committed. This creates a contradiction in how to assess inherent risks (due to error) and fraud risks and we encourage the IAASB to provide additional guidance on this in ISA 240.

PriceWaterhouseCoopers

However, the proposed approach to using the KAM section is not without potential unintended consequences that should be carefully considered. For example, we urge the IAASB to consider whether the standard should make clear that the presumed risks of fraud (management override of controls and revenue recognition) would only be expected to be reported when there are engagement specific circumstances that can be described. As currently drafted, the statement in paragraph A173 that “revenue recognition or management override of controls may be regularly determined as key audit matters related to fraud” seems to act as positive encouragement to do so in all cases. It would be unhelpful to repeat experience in jurisdictions, such as the UK and Netherlands, where boilerplate KAMs were reported on these matters, with users subsequently indicating they were of no value. Many firms in those jurisdictions therefore removed these “presumed KAMs”. While the intent of paragraph A173 was to encourage auditors to make such presumed KAMs more entity specific, we instead suggest the IAASB acknowledge that the auditor should apply judgement as to whether a meaningful KAM can be described related to these matters and therefore warrant inclusion.

Agree, with comments below

We support the Board’s decision to align the structure of the requirements in ED-240 to mirror ISA 315 (Revised 2019). We also agree with the objective of supporting a more robust risk identification and assessment as it relates to fraud in an audit of financial statements. Aligning ED-240 with ISA 315 (Revised 2019) may help to enhance the consistency and effectiveness of the auditor’s consideration of fraud as part of understanding the entity and its system of internal control, thereby promoting a more informed risk identification and assessment.

Paragraph 38 of the EM highlights the IAASB’s intention to maintain a balance between ISA 315 (Revised 2019) and ED-240, ensuring that the requirements in the latter have a clear “fraud lens”. We believe that this clarity has not been achieved for all proposed requirements. Paragraphs 37 and 38 of the ED are good examples of how the requirements clearly build on ISA 315 (Revised 2019) without duplicating the underlying ISA 315 requirements. We highlight the following examples where the incremental fraud considerations beyond the baseline ISA 315 (or other ISA) requirements are not clear. Where possible, we have provided a recommendation to address the matter:

The lead-in language to paragraph 26 and part (a) of the requirement unnecessarily duplicates ISA 315 (2019 Revised). It also creates inherent circularity, as the lead in states that the requirement is “in applying ISA 315 (Revised 2019) [paragraph 13]”. To illustrate, a full articulation of the requirement, inserting the underlying requirement from ISA 315 (Revised 2019), would be:

“In designing and performing risk assessment procedures to obtain audit evidence that provides an appropriate basis for the identification and assessment of risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels; and the design of further audit procedures in accordance with ISA 330, the auditor shall perform the procedures in paragraphs 27–39 to obtain audit evidence that provides an appropriate basis for the: (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 (b) design of further audit procedures in accordance with ISA 330”.

Paragraph 26(b) is similarly redundant, and we recommend is deleted, as it is directly repetitive of ISA 315 (Revised 2019) paragraph 13(b) with no fraud lens.

We suggest an appropriate construct for paragraph 26 could be as follows:

“In designing and performing procedures in accordance with ISA 315 (2019 Revised) [footnote paragraph 13], the auditor shall perform the procedures in paragraphs 27-39. In doing so, the auditor shall consider whether one or more fraud risk factors are present.”

The second element of the above suggested requirement also provides a better linkage to, and symmetry with, the subsequent requirement in paragraph 27 that requires the auditor to consider whether information from other sources obtained by the auditor indicates that one or more fraud risk factors are present.

Paragraph 28 duplicates existing requirements in ISA 540 (Revised). Paragraph 14 of ISA 540 (Revised) already states that the auditor’s review of the outcome of previous accounting estimates is to assist in identifying and assessing the risks of material misstatement and requires the auditor to take into account the characteristics of the accounting estimates in determining the nature and extent of that review. The second sentence of paragraph 28 is therefore redundant. It is unclear if the reference to management judgements and assumptions in the first sentence of paragraph 28 is intended to signal a different work effort to the requirement in ISA 540 (Revised). We do not believe so, but it may be interpreted that way. Paragraphs 51 and 52 are more appropriate in how they link to the underlying work effort in ISA 540 (Revised) and primarily relate to risk identification and assessment. We therefore suggest deleting paragraph 28, which is unclear, and elevating paragraphs 51 and 52 to replace paragraph 28. In doing so, the following amendments would be necessary to paragraphs 51 and 52:

51. “In applying ISA 540 (Revised) [requirement 14], the auditor’s retrospective review of the outcome of previous accounting estimates, or, where applicable, their subsequent re-estimation shall include evaluating whether management’s judgments and decisions in making the accounting estimates included in the financial statements, even if they are individually reasonable, are indicators of possible management bias that may represent a risk of material misstatement due to fraud.”

52. “In performing the evaluation in accordance with paragraph 51, the auditor shall:

- (a) Consider the audit evidence obtained from the retrospective review performed in accordance with paragraph 28; and
- (b) If indicators of possible management bias are identified, the auditor shall reevaluate the accounting estimates taken as a whole.”

We note that paragraph 52, as drafted in the ED and as recommended above, is largely duplicative of ISA 540 (Revised) paragraph 32. We understand the Board’s rationale for repeating this requirement, to draw more specific attention to the risk of fraud. However, we suggest that if the ISA 240 (Revised) requirements are clarified as shown, paragraph A57 of ISA 540 (Revised) can be deleted.

Paragraph 30 has no specific fraud lens and feels directly repetitive of the principle-based requirement in ISA 500 paragraph 11. If the Board determines it is important to retain a specific requirement in ISA 240 to focus on the possible impact of inconsistent responses from inquiries of various parties within the entity, we suggest amending the requirement as follows:

“In applying ISA 500, if the responses to inquiries of management, those charged with governance, individuals within the internal audit function, or others within the entity are inconsistent with each other, the auditor shall: consider whether such inconsistencies indicate that one or more fraud risk factors are present.

- (a) Determine what modifications or additions to audit procedures are necessary to understand and address the inconsistency; and

(b) Consider the effect, if any, on other aspects of the audit.”

Paragraph 33 refers to the auditor obtaining an “understanding of matters” related to the entity and its environment and the applicable financial reporting framework that may lead to an increased susceptibility to misstatement due to management bias or other fraud risk factors. We agree with the intent of the requirement, however, we believe the structure could be improved. It is the understanding obtained of the various aspects of the entity and its environment and reporting framework described in the sub-parts of the requirement that may result in the auditor identifying matters that they consider may lead to an increased susceptibility to misstatement due to management bias or other fraud risk factors. We suggest the following restructured lead-in sentence (not shown in mark-up due to the extent of redrafting):

“In applying ISA 315 (Revised 2019), the auditor shall consider whether there are matters that may lead to an increased susceptibility to misstatement due to management bias or other fraud risk factors, based on the auditor’s understanding of:

(i) The entity’s organizational structure and ownership, governance, objectives and strategy, and geographic dispersion

(ii).....”

Part (b) of the requirement could simply be moved to form part of the above numbered list.

We also suggest that paragraph 33(a)(i) should incorporate understanding how the extent to which the entity’s business model integrates the use of IT may create susceptibility to internal or external fraudulent activity.

There is a lack of clarity about the interrelationship of ISA 315 (Revised 2019) paragraph 21(a) and proposed paragraph 34(a). Similar to the comments above, ISA 315 already requires the auditor to obtain an understanding of how management’s oversight responsibilities are carried out, including the entity’s culture and management’s commitment to integrity and ethical values. The requirement is therefore not drafted in a clearly incremental manner. Although a longer condition, we suggest an appropriate construct as follows:

“In applying ISA 315 (Revised 2019) the auditor shall:

(a) When Obtaining an understanding the set of controls, processes and structures that address of how management’s oversight responsibilities are carried out with respect to the, such as the entity’s culture and management’s commitment to integrity and ethical values, understand including how management communicates with its employees its views on business practices and ethical behavior with respect to the prevention and detection of fraud.”

With respect to paragraph 37 regarding the understanding of how journal entries are initiated, processed, recorded, and corrected as necessary, we suggest clarifying in application material that the scope of the underlying linked requirement in ISA 315 (Revised 2019) is limited to understanding the entity’s information processing activities related to significant classes of transactions, account balances, and disclosures.

We note that the language used in paragraph 43, to describe designing and performing procedures in a manner that is not biased, does not align with similar concepts in ISA 315 (Revised 2019) or as proposed in paragraph 8 of ED-500. It is unclear if this is a deliberate change. However, as the foundational concept will exist primarily in ISA 500, we would expect ISA 240 (Revised) to adopt language consistent with the foundational standard.

Deloitte

Agree, with comments below

We agree that ED-240 appropriately builds on the foundational requirements in ISA 315 (Revised 2019) and other ISAs to support a more robust risk identification and assessment as it relates to fraud in an audit of financial statements. To improve the clarity of ED-240 further we recommend the following:

We believe that any paragraphs in ED-240 that reference the application of ISA 315 (Revised 2019) should only build upon the requirements in ISA 315 (Revised 2019), rather than duplicate them or include similar requirements worded in a different manner, as appears to be the case for several requirement paragraphs. It is not clear whether differences in language between ISA 315 (Revised 2019) and ED-240 are intended to reemphasize the ISA 315 (Revised 2019) requirements or for the auditor to perform additional procedures beyond those required to be performed in accordance with ISA 315 (Revised 2019). One such example is whether there is an expected difference in the nature and extent of procedures regarding controls that address a fraud risk, including controls over journal entries, as demonstrated by the difference in wording in the following paragraphs:

ED-240, paragraph 38: “In applying ISA 315 (Revised 2019), the auditor’s understanding of the entity’s control activities shall include identifying controls that address risks of material misstatement due to fraud at the assertion level, including controls over journal entries, designed to prevent or detect fraud.”

ISA 315 (Revised 2019), paragraph 26(a): “Identifying controls that address risks of material misstatement at the assertion level in the control activities component as follows:

- i. Controls that address a risk that is determined to be a significant risk;
- ii. Controls over journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments;”

In the above example, paragraph 26(a) of ISA 315 (Revised 2019) requires the auditor to understand the entity’s controls over journal entries that address a risk of material misstatement at the assertion level, which would include due to fraud or error. Therefore, it is unclear whether the language used in paragraph 38 of ED-240 implies a different requirement or the same requirement using different language. As a result, we are concerned that there will be confusion and inconsistent application of the IAASB’s intended expectations. Accordingly, we recommend the IAASB reconsider any ISA 315 (Revised 2019) paragraphs that are referenced in ED-240 and only include additional paragraphs if ED-240 is clearly indicating additional requirements or include application material related to fraud when the language in ISA 315 (Revised 2019) does not sufficiently address the fraud element of the requirement.

Extant ISA 240, paragraph 33, focused on the retrospective review of significant accounting estimates as an audit procedure responsive to the significant fraud risk of management override of controls (it does not address retrospective review as a risk assessment procedure). ED-240 includes retrospective reviews as both a risk assessment procedure (paragraph 28) and an audit procedure responsive to the significant fraud risk of management override of controls (paragraphs 51 and 52).

We believe the responsive procedure to the risk of management override in paragraph 51 is not an application of the risk assessment procedure from ISA 540 (Revised), but rather a separate audit procedure that may take into consideration information learned from the risk assessment procedure. As paragraph 51 is a further audit procedure that is substantive in nature, we believe the procedure should apply to those accounting estimates that have been determined to be significant accounting estimates to the financial statements. As such, we recommend providing clarity as follows:

Paragraph 28: “In applying ISA 540 (Revised), the auditor shall perform a retrospective review of management judgments and assumptions related to the outcome of previous accounting estimates, or where applicable, their subsequent re-estimation to assist in identifying and assessing the risks of material misstatement due to fraud in the current period. In doing so, the auditor shall take into account the characteristics of the accounting estimates in determining the nature and extent of that review, including if, at an individual accounting estimate level, a review is necessary.”

Paragraph 51: “In applying ISA 540 (Revised) tThe auditor shall evaluate whether management’s judgments and decisions in making the significant accounting estimates included in the financial statements, even if they are individually reasonable, are indicators of possible management bias that may represent a risk of material misstatement due to fraud.”

We recommend that a paragraph similar to ISA 540.A58 be added as application material to paragraph 28 to further explain how the characteristics of the estimate are considered in determining the extent of review, if any, that is necessary.

We recommend clarifying in ED-240, paragraph 29, that the list of examples is not exhaustive to emphasize that there may be other salient ideas for engagement teams to discuss.

We recommend that the IAASB reword the example in paragraph A62 since, while there may exist in certain geographies cultural norms of using bribery to conduct business, this is different from a cultural norm of using bribery to conceal fraud.

Cultural norms in which using bribery is an accepted practice of doing business, which could lead to bribery being used to facilitate or to conceal fraud is deeply ingrained as an accepted practice of doing business.

We recommend moving certain language from paragraph 34(a) to the application material, as indicated below, given that some of the language in paragraph 34(a) mirrors the application material within ISA 315 (Revised 2019) and is further elaborated upon already within the ED-240 application material (paragraphs A68 and A69).

Paragraph 34(a) “Obtain an understanding of how management’s oversight responsibilities are carried out, such as the entity’s culture and management’s commitment to integrity and ethical values, including how management communicates with its employees its views on business practices and ethical behavior with respect to the prevention and detection of fraud.”

Paragraph A68 “Understanding aspects of the entity’s control environment that address the entity’s culture and understanding management’s commitment to integrity and ethical values, including how management communicates with its employees its views on business practices and ethical behavior with respect to the prevention and detection of fraud, assists the auditor in determining management’s attitude and tone at the top with regards to the prevention and detection of fraud.”

We recommend including “to monitor the system of internal control” in paragraph 36(a) since currently only the heading of this section in ED-240 includes such reference:

“Obtain an understanding of aspects of the entity’s process to monitor the system of internal control that address the ongoing and separate evaluations for monitoring the effectiveness of controls to prevent or detect fraud, and the identification and remediation of related control deficiencies.”

We recommend including a statement within paragraph A104 of ED-240 that the list of examples is not exhaustive. We also recommend that the IAASB make the following changes to the examples:

Paragraph A104 - 4th bullet: As profit before tax is a calculation of the financial statement line items that precede it, the example of the presentation of profit before tax from continuing operations may not be a meaningful example of earnings management. Accordingly, we recommend replacing this example with the below example:

“Classification — certain income or expenses may be susceptible to misclassification within the statement of comprehensive income, for example, to manipulate key performance measures.”

Paragraph A104 - 5th bullet: Since performance measures such as non-GAAP performance measures are not always subject to an auditor’s opinion, we propose the below edits to the following example:

“Presentation of disclosures — disclosures may be susceptible to omission, or incomplete or inaccurate presentation, for example, disclosures relating to contingent liabilities, off-balance sheet arrangements, financial guarantees, or debt covenant requirements, or management defined performance measures (i.e., performance measures that depart from those set forth in the financial reporting framework).”

Paragraph A110 of ED-240 references paragraphs A55–A57 in relation to the significance of fraud risk factors and, specifically, paragraph A56 states that the fraud risk factors in Appendix 1 are categorized by incentives or pressures, opportunities, and rationalizations (i.e., the fraud triangle). Paragraph A111 provides examples whereby fraud risk factors are not significant, but the examples provided do not address the fraud triangle. We recommend enhancing the examples in paragraph A111 to provide a better linkage between fraud risk factors, especially their significance (or lack thereof), and for the instances provided describing why the risk of fraud in revenue recognition is being rebutted. We believe this may result in better fraud risk identification and assessment.

For example, in the first example in paragraph A111, rather than the text “Leasehold revenue from a single unit of rental property, or multiple rental properties with a single tenant”, we recommend replacing that text with the following built out example:

“Related to leasehold revenue from a single unit of rental property, or multiple rental properties, with a single tenant, the auditor, based on other risk assessment procedures performed, determined that revenue is not a key performance indicator for the lessor such that there are no significant incentives or pressures related to revenue and the lease accounting is outsourced to an independent asset management company such that there are no significant opportunities for management to manipulate revenue.”

We recommend the IAASB apply similar changes to all the examples in paragraph A111. Further, we recommend including a statement within the lead in to the examples in A111 to indicate the list of examples is not exhaustive.

In addition, we recommend the IAASB update the wording in paragraph A110 as follows to read in a manner that does not indicate the auditor should essentially never rebut the presumed risk of fraud in revenue recognition:

“If fraud risk factors related to revenue recognition are present, determining whether such fraud risk factors indicate a risk of material misstatement due to fraud is a matter of professional judgment. The significance of fraud risk factors (see paragraphs A55–A57) related to revenue recognition, individually or in combination, ordinarily makes may make it inappropriate for the auditor to rebut the presumption that there are risks of material misstatement due to fraud in revenue recognition.”

Paragraph A56: “Fraud risk factors reflective of an attitude that permits rationalization of the fraudulent action may not be susceptible to observation by the auditor. Also, the fact that fraud is usually concealed can make

it very difficult to detect. Nevertheless, the auditor may become aware of the existence of such information through, for example, the required understanding of the entity's control environment.

CohnReznick

Agree, with comments below

We recommend that the IAASB consider our suggested clarifications and refinements set out below:

New language to prompt engagement teams' discussions and consideration as to how assets may be misappropriated, and how financial statements may be misstated as a result. For example, there is value in brainstorming about whether/how management may record a material related expense, including those relating to the misappropriation of assets as "general and administrative" with no appropriate disclosure, intentionally (fraud) or, out of lack of knowledge of the appropriate disclosure (error).

ED-240.29

An exchange of ideas about:

ii. Fraud risk factors, including: (Ref: Para. A51–A52)

(c) How (1) assets of the entity could be misappropriated by management, those charged with governance, employees or third parties, and (2) how such misappropriation may cause the financial statements to be misstated due to error or fraud.

Additional wording to proposed ED 240.29 to clarify that auditors should also consider fraud or suspected fraud that may occur after/subsequent to the period under audit in determining the overall audit strategy and audit plan.

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 year, prior years, or subsequent periods.

Ernst & Young Global

Controls over journal entries: We are unclear as to whether the requirement for the auditor to identify "controls that address the risks of material misstatement due to fraud at the assertion level, including controls over journal entries, designed to prevent or detect fraud" is intended to be consistent with the related requirement in ISA 315 (Revised 2019), or whether the IAASB intends for ED-240 to require the auditor to understand controls beyond those already required to be understood by ISA 315 (Revised 2019).

Risk of management override of controls: We believe that ED-240 should be explicit that the risk of management override of controls is required to be identified as a risk of material misstatement due to fraud at the financial statement level for all audits, and thus a significant risk.

Agree, with comments below

Although we support the approach taken in ED-240 to build on the foundational requirements in ISA 315 (Revised 2019) and other ISAs to support a more robust risk identification and assessment as it relates to fraud, we have several concerns about the clarity of the requirements and their consistency with ISA 315 (Revised 2019).

Distinction of incremental requirements

While we agree that ED-240 enhances the linkage to the requirements in ISA 315 (Revised 2019), in our view, greater clarity is needed to distinguish the incremental requirements in ED-240 necessary to apply a fraud lens to the risk assessment process from the requirements of ISA 315 (Revised 2019) that when executed as intended would not require any additional work effort to identify and assess risks of material misstatement due to fraud.

We think it is necessary to clearly state in ED-240 that the risk assessment required by this standard is not a separate or distinct risk assessment. Rather, certain requirements should be understood as an elaboration of how auditors are to consider fraud risk when applying the requirements of ISA 315 (Revised 2019) while other requirements in ED-240 require incremental work effort (with clear identification of such requirements).

Order of risk assessment procedures

We believe the order of the risk assessment procedures and related activities as presented in ED-240 is confusing because the flow is not consistent with the expected order of the performance of the requirements. We suggest improving the ordering of the requirements as follows:

Moving paragraph 30 of ED-240 to the professional skepticism section of ED-240 (paragraphs 19-21) (refer to our response to Q2).

Moving paragraph 32 of ED-240 to evaluate whether one or more fraud risk factors are present after the Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework, and the Entity's System of Internal Control section. We believe that this requirement should be placed immediately before the requirement in paragraph 40 of ED-240 to identify and assess the risks of material misstatement due to fraud, taking into account fraud risk factors. The auditor is only able to make the evaluation of fraud risk factors after they have obtained the required understanding of the entity. Repositioning the paragraph as we suggest will also help auditors understand the purpose of the risk assessment procedures to identify fraud risk factors and assess whether they give rise to risks of material misstatement due to fraud.

Understanding the entity and its environment

We believe the requirement in paragraph 33 of ED-240 should better align with paragraph 19 of ISA 315 (Revised 2019). Certain matters are missing from ED-240 that are relevant to understanding whether there is an increased susceptibility to misstatement due to management bias or other fraud risk factors (and therefore relevant to identifying fraud risk factors). Specifically:

Paragraph 33(a)(i) of ED-240 should include an understanding of the entity's business model, instead of focusing only on the entity's objectives and strategies which support the business model, as currently drafted. In our view, understanding the entity at a strategic level and its business risks is very relevant to identifying fraud risk factors. In addition, we believe that understanding the entity's business model supports the auditor in understanding whether and where third-party relationships may exist (e.g., customers, suppliers, service providers), which is important to the auditor's consideration of third-party fraud as explained in our response to Q1.

Paragraph 33(a)(ii) of ED-240 should include an understanding of regulatory and other external factors. For example, climate regulations maybe important to many entities (and are not industry specific) and pressure to meet climate targets could be an incentive for fraud.

Control environment

We suggest the following revisions to paragraph 34 of ED-240 as we believe the intention of the requirement is for the auditor to understand how those charged with governance oversee the entity's risk assessment process related to fraud risks.

34. In applying ISA 315 (Revised 2019), the auditor shall: ...

Obtain an understanding of how those charged with governance exercise oversight of management's processes for identifying fraud risks and responding to the risks of fraud in the entity and the controls that management has established to address these risks, assessing the significance of identified fraud risks and addressing the assessed fraud risks. (Ref: Para. A71–A74) ...

We also suggest that the IAASB revise the supporting application material in paragraphs A71–A73 and A75 of ED-240 to clarify that the auditor is not understanding or evaluating individual controls as part of this understanding of the oversight of those charged with governance. Refer to our response to Q10 for our suggested revisions to these paragraphs.

The guidance in paragraph A70 of ED-240 discusses following up on matters identified by inspecting whistleblower files “that are under investigation by the entity as these matters may be indicative of suspected fraud with financial reporting implications that require a response by the auditor.” We believe this guidance needs to make an explicit linkage to the requirement in paragraph 55 of ED-240.

We question why paragraph A78 was added to ED-240. In our view, it is not clear why it is necessary to have application material related to those charged with governance's objectivity being insufficient or impaired in ED-240 without an apparent fraud lens. In our view, it would be beneficial to explain the relationship of this application material to ISA 315 (Revised 2019) and the auditor's overall evaluation of the control environment, as well as provide fraud-related considerations, which may include increased opportunity for management override of controls.

The entity's risk assessment process

Although we agree with the requirement in paragraph 35 of ED-240, we believe that the related application material is inconsistent with the requirement (and with the application material in ISA 315 (Revised 2019)) as it inaccurately:

Implies that there is a separate “fraud risk management program” that would exist in all entities

Implies the “entity's fraud risk identification process” is always a separate process from the entity's overall risk assessment process

Implies that the understanding of the entity's risk assessment process needs to include understanding individual controls

Paragraph A79 of ED-240 introduces a discussion of an entity's “fraud risk management program.” We believe that this type of program would only be expected to be implemented in larger, more complex entities and that this application material is not scalable or relevant to less complex entities. We do not believe this is meaningful guidance to have as the first application material paragraph explaining the auditor's understanding of how an entity's risk assessment process addresses fraud risks. We suggest that paragraph A79 of ED-240 be moved to the first paragraph in the scalability section (before paragraph A88) to illustrate a consideration for larger entities.

The heading preceding paragraph A79 of ED-240 (“The entity's process for identifying, assessing, and addressing fraud risks”) implies that entities are expected to have a separate risk assessment process for

fraud risks, which is inconsistent with the requirement in paragraph 35 of ED-240 that requires an understanding of how the entity's risk assessment process (i.e., the component of the system of internal control) identifies, assesses and addresses fraud risks. Similarly, paragraph A80 of ED-240 refers to the "entity's fraud risk identification process." We believe this is misleading as it also implies there is always a separate process from the entity's risk assessment process. We believe that the wording in the application material should be consistent with the requirement as follows:

A80. The entity's fraud risk identification risk assessment process may include an assessment of the incentives, pressures, and opportunities to commit fraud, or how the entity may be susceptible to third-party fraud. An entity's risk assessment fraud risk identification process may also consider the potential override of controls by management as well as areas where there are control deficiencies, including a lack of segregation of duties.

A82. There are several approaches management may use to assess fraud risks and the approach may vary depending on the nature and circumstances of the entity. The fraud risk assessment entity may be reported in assess fraud risks using different forms, such as a complex matrix of risk ratings or a simple narrative.

If needed, guidance could be added in the scalability section that some entities may have separate or distinct risk assessment processes for fraud risks.

We also do not believe it is correct to include a discussion of preventive and detective controls in the application material paragraphs describing the auditor's required understanding of the entity's risk assessment process. In our view, understanding individual controls should be performed in the control activities component as part of the requirement to understand controls that address risks of material misstatement due to fraud. We believe the application material in paragraphs A82–A86 of ED-240 should focus on the auditor obtaining a higher-level understanding of how the entity's risk assessment process addresses fraud risks, such as through fraud risk management programs (which should not be expected to be implemented formally in all entities), and controls that operate above the transaction level (e.g., whistleblower hotlines, internal audit departments). As such, we recommend moving any guidance or examples of transaction-level controls to address risks of material misstatement due to fraud to support paragraph 38 of ED-240, such as:

Paragraph A85 of ED-240: The examples in this paragraph are a mixture of indirect and direct controls. Controls over authorizations of transactions, exception reports and general IT controls are the types of controls that should be identified and addressed in the control activities component.

Paragraph A87 of ED-240: We do not believe it is appropriate to include guidance on the extent to which specialized skills are needed to assist the auditor in obtaining an understanding of controls in the guidance discussing the entity's process to address fraud risks.

Paragraph A89 of ED-240: We do not believe it is appropriate to include inquiries about transaction-level controls as part of inquiries related to the entity's risk assessment process.

For consistency with the requirement in paragraph 35 of ED-240, and because we believe understanding the entity's process to address fraud risks is relevant for smaller and less complex entities, we suggest the following revisions:

A88. ...When there are no formalized processes or documented policies or procedures, the auditor is still required to obtain an understanding of how management, or where appropriate, those charged with governance identify fraud risks related to the misappropriation of assets and fraudulent financial reporting, and assesses the significance of the identified fraud risks, and addresses the assessed risks.

Related to our comments expressed above about the inappropriate expectation of a separate fraud risk assessment process in all entities and for the auditor to understand individual controls as part of the risk assessment process, we believe that the application material in paragraph A89 of ED-240 also needs to be revised. We encourage the IAASB to challenge the relevance of the guidance in paragraph A89 (and whether it is better placed to support the requirement in paragraph 34(c)), but at a minimum to make the following revisions:

A89. Management accepts responsibility for the entity's system of internal control and for the preparation of the entity's financial statements. Accordingly, it is appropriate for the auditor to make inquiries of management regarding management's own process for identifying and responding to the risks of fraud in the entity assessment of the risk of fraud and the controls in place to prevent or detect it. The nature, extent and frequency of management's risk assessment process assessment may vary from entity to entity. In some entities, management's process may occur make detailed assessments on an annual basis or as part of ongoing monitoring. In other entities, management's process assessment may be less structured and less frequent. The nature, extent and frequency of management's assessment risk assessment process is relevant to the auditor's understanding of the entity's control environment. For example, the fact that management does not have a risk assessment process or when the entity's risk assessment process does not address the identified fraud risks has not made an assessment of the risk of fraud may in some circumstances be indicative of the lack of importance that management places on internal control.

The entity's process to monitor the system of internal control

We suggest the following revisions to paragraph 36(a) of ED-240 to make it clear that this requirement is part of understanding the entity's overall monitoring process and to better align this requirement with ISA 315 (Revised 2019):

36. In applying ISA 315 (Revised 2019), the auditor shall:

(a) Obtain an understanding of those aspects of the entity's process for monitoring the system of internal control that address the ongoing and separate evaluations for monitoring the effectiveness of controls to prevent or detect fraud, and the identification and remediation of related control deficiencies identified. (Ref: Para. A92)

We suggest the following revisions to paragraph A92 of ED-240 as the term "fraud mitigation process" is not clear:

A92. Matters that may be relevant for the auditor to consider ... may include:

How the entity monitors controls that address fraud risks fraud mitigation processes in each component of the entity's system of internal control, including the operating effectiveness of anti-fraud controls, and the remediation of control deficiencies as necessary.

The information system and communication

Paragraph 37 of ED-240 that requires an understanding of how journal entries are initiated, processed, recorded and corrected aligns with the understanding required by paragraph 25(a)(i) of ISA 315 (Revised 2019). However, in our view, it is not complete because it does not include understanding the process for making journal entries as part of the financial reporting process to prepare the entity's financial statements (paragraph 25(a)(iii) of ISA 315 (Revised 2019)). We suggest that paragraph 37 be expanded accordingly.

As the auditor is obtaining their understanding of how, where and when journal entries are made, it is important that they obtain an understanding of the types of journal entries (whether standard or non-standard)

incorporated in the general ledger, and, in turn, reported in the financial statements, as well as other adjustments made directly to the financial statements. We also suggest that the linkage to ISA 315 (Revised 2019) paragraph 25(a)(i) and 25(a)(iii) is strengthened in paragraph A95 of ED-240 to consider the types of journal entries posted as part of transaction processing as well as the entity's financial reporting process.

Given the importance of the understanding obtained from paragraph 37 and paragraph A95 of ED-240 to the auditor's design and performance of audit procedures to test journal entries and other adjustments, we believe that paragraph 50(b)-(d) should also reference paragraph A95 of ED-240.

Please refer to additional comments as it relates to the auditor's design and performance of audit procedures to test journal entries and other adjustments in our response to Q10.

Control activities component

We are unclear, based on the drafting of the requirement, whether paragraph 38 of ED-240 is intended to be consistent with the related requirements in ISA 315.26(a)(i) and 315.26(a)(ii), or whether the IAASB intends for paragraph 38 of ED-240 to require the auditor to understand controls beyond those already required to be understood by ISA 315 (Revised 2019). Based on the supporting application material, it appears the IAASB intends for there to be alignment with the controls in scope under the existing ISA 315 (Revised 2019) requirements.

In addition, we believe there is an opportunity to clarify the scope of controls over journal entries required to be understood for both the purposes of ED-240 and the related ISA 315 (Revised 2019) requirements by linking the requirement in paragraph 38 of ED-240 to the required understanding in paragraph 37 of ED-240. We believe this is a better approach because, in our experience, the controls over journal entries are generally designed to prevent or detect risks of material misstatement whether due to fraud or error, and there may not be controls specifically designed by management to prevent or detect fraud. In our view, the auditor only needs to be satisfied that the controls identified over journal entries are sufficient to address both fraud and error (i.e., the evaluation of the design of the controls should include evaluating whether there are controls in this population of journal entries that, as designed, would address risks of material misstatement due to fraud).

We also suggest:

Clearly stating in paragraph 38 that the auditor is required to evaluate whether these controls are designed effectively and have been implemented by combining the requirements in paragraphs 38 and 40(b).

Adding application material to explain that although paragraph 26 of ISA 315 (Revised 2019) only addresses controls at the assertion level, ED-240 also requires the auditor to understand controls that address the risks of material misstatement due to fraud at the financial statement level because these risks need to be treated as significant risks.

The following represents our suggested revisions to paragraph 38 and paragraph 40:

38. In applying ISA 315 (Revised 2019) , the auditor's understanding of the entity's control activities shall include: (Ref: Para. A98–A101)

Identifying controls that address risks of material misstatement due to fraud at the financial statement level or assertion level (which are significant risks),

including Based on the auditor's understanding obtained in paragraph 37, identifying controls over journal entries designed to prevent or detect fraud, and

Evaluating whether the controls are designed effectively; and determining whether the controls have been implemented.

40. In applying ISA 315 (Revised 2019), the auditor shall:

(a) ...

(b) Treat those assessed risks of material misstatement due to fraud as significant risks. Accordingly, to the extent not already done so, the auditor shall identify controls that address such risks, evaluate whether they have been designed effectively and determine whether they have been implemented.

We also do not believe the application material in paragraphs A98–A101 adequately supports the requirements in paragraph 38 of ED-240. For example:

Paragraphs A99 and A100 of ED-240 only mention controls over journal entries and do not adequately explain the relationship between the requirement in ISA 315 (Revised 2019) paragraph 26 and ED-240 paragraph 38 because they do not provide any guidance more broadly related to the requirement to identify controls that address risks of material misstatement due to fraud.

Paragraph A101 of ED-240 provides examples of general IT controls that may address the risks arising from the use of IT. It would be helpful to link this guidance to the requirement in ISA 315 (Revised 2019) paragraph 26(b).

We also suggest that the IAASB include a consequential amendment in ISA 315 (Revised 2019) to explain the connection to ED-240 paragraph 38. Further, as mentioned above, we suggest that the IAASB consider repurposing and relocating certain of the application material included in The Entity's Risk Assessment Process section of ED-240 that would be applicable to identifying controls in the control activities component, including general IT controls, and evaluating their design and implementation.

Procedures related to third-party fraud

We suggest the IAASB consider enhancing guidance about risk assessment procedures that can address identifying fraud risks related to third parties as follows:

The application material to paragraphs 33 and 37 of ED-240 could emphasize that as part of obtaining an understanding of the entity and its environment and the system of internal control pursuant to ISA 315 (Revised 2019), the auditor considers whether and where third-party relationships exist (e.g., customers, suppliers, service providers). This explanation would provide better context for addressing how third-party relationships may give rise to fraud risk factors in the required engagement team discussion, as expected by paragraph A52.

We note that paragraph A80 of ED-240 acknowledges that the entity's fraud risk identification process may include how the entity may be susceptible to third-party fraud. However, we believe additional guidance is necessary as it relates to the auditor's responsibility to obtain an understanding of how the entity's risk assessment process identifies and addresses risks related to third-party relationships. For example, as it relates to external parties unknown to the entity, we believe the auditor could consider how management is governing their exposure to third-party fraud from unknown external parties (e.g., cyber risk management program).

Significant risks related to management override of controls

Paragraph 42 of ED-240 is focused on the auditor treating any identified risks related to management override as significant risks; it does not directly require the auditor to identify a risk of management override of controls.

We believe that paragraph 42 should be explicit that the risk of management override of controls is required to be identified as a risk of material misstatement due to fraud at the financial statement level for all audits, and thus a significant risk. Given that the responsive audit procedures to this risk are required on every audit (i.e., paragraphs 48-53 of ED-240), ED-240 appears to require this risk be identified without the possibility of rebuttal. We believe the standard can be strengthened, as follows:

We propose changing the header to paragraph 42 of ED-240 to read “Risk of Material Misstatement Due to Fraud at the Financial Statement Level Related to Management Override of Controls”.

We propose revising paragraph 42 of ED-240 as follows:

42. Due to the unpredictable way in which management is able to override controls and irrespective of the auditor’s assessment of the risks of management override of controls, the auditor shall identify management override of controls as a risk of material misstatement due to fraud at the financial statement level on all audits. Treat those risks as risks of material misstatement due to fraud and thus treat this risk as a significant risks. (Ref: Para. A113)

Auditors should also consider whether any risks of management override exist at the assertion level (e.g., a risk specific to a particular account). Auditors find it challenging in practice to distinguish between a specific risk of management override of controls, which would necessitate a specifically designed response, and the risk of management override at the financial statement level that requires completion of the responsive procedures outlined in paragraphs 48-53 of ED-240. We therefore propose the following additions to paragraph A113 of ED-240:

A113. When considering the significant risk related to management override of controls, the auditor acknowledges the following:

Management is in a unique position to perpetrate fraud because of management’s ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Although the level of risks of management override of controls will vary from entity to entity, the risk is nevertheless present in all entities. See also paragraphs 48–53.

While the risk of material misstatement due to fraud at the financial statement level related to management override of controls exists on every audit and requires the responsive procedures outlined in paragraphs 48-53, the auditor may, in the performance of the identification and assessment of risks of material misstatement due to fraud pursuant to paragraph 40, identify specific risks of material misstatement due to fraud related to management override of controls. For example, the auditor may identify a risk of management override as it relates to a specific class of transactions, account balance or disclosure. When a specific risk of material misstatement due to fraud related to management override of controls is identified, the auditor designs and performs further audit procedures that are responsive to the identified specific risk in accordance with paragraph 47.

We propose changing the header to paragraph 48 of ED-240 to read “Audit Procedures Responsive to the Risk of Material Misstatement Due to Fraud at the Financial Statement Level Related to Management Override of Controls”. We also propose revising the requirement in paragraph 48 of ED-240 as follows:

48. Irrespective of the auditor’s assessment of the risks of management override of controls, the auditor shall design and perform the audit procedures to respond to the risk of material misstatement due to fraud at the financial statement level related to management override of controls in accordance with paragraphs 49–53, and determine whether other audit procedures are needed in addition to those in paragraphs 49–53, in order to respond to the identified risks of management override of controls.

Responses to the assessed risks of material misstatement due to fraud

In determining overall responses to address the assessed risks of material misstatement due to fraud, extant ISA 240 paragraph 30 requires the auditor to specifically consider assignment and supervision of personnel and incorporate an element of unpredictability in the selection of audit procedures (in addition to the evaluation of the selection and application of accounting policies by the entity, which is included in ED-240 paragraph 46). We believe that the structure of extant ISA 240, which connects these specific procedures to the auditor's overall response, is beneficial to auditors. We do not believe it was the IAASB's intention to remove these requirements in ED-240 from the context of required overall responses.

Therefore, we believe ED-240 paragraphs 45 and 46 (and the related application material) that address overall responses need to be expanded in some manner to acknowledge that certain requirements that precede these paragraphs are also overall responses to address the risks of material misstatement due to fraud at the financial statement level. These include the requirements in paragraph 22 that addresses determining whether the engagement team has appropriate specialized skills or knowledge, paragraph 23 that addresses determining appropriate direction, supervision and review and paragraph 44 that addresses incorporating unpredictability in audit procedures. We also believe that the application material in paragraphs A114–116 of ED-240 should be revised to more closely align with the guidance in paragraphs A34–A37 of extant ISA 240 to provide more robust guidance for how an auditor can comply with the requirement in paragraph 45 of ED-240 to determine overall responses (which should include consideration of the requirements in paragraphs 22, 23 and 44). Finally, we suggest that the IAASB add application material to make it clear that the reference in paragraph 45 of ED-240 to the “assessed risks of material misstatement due to fraud at the financial statement level” includes the risk of management override of controls at the financial statement level (at a minimum) and then any other financial statement level risks of fraud that the auditor has identified.

KPMG International

Agree, with comments below

We are supportive of the changes made to ED-240 to more closely align the standard with ISA 315R, including in terms of its structure and flow and the layered approach in which ED-240 builds appropriately on the foundational requirements set out in ISA 315R, in order to support a more robust risk identification and assessment in relation to fraud in an audit of financial statements.

In particular, we welcome the enhancements to drive better application of a “fraud lens” when performing the procedures required by ISA 315R, including clearer linkage to each of the aspects of understanding the entity and its environment and the applicable financial reporting framework, and understanding the components of the entity's system of internal control, as well as more explicitly requiring the auditor to take into account fraud risk factors when identifying and assessing the risks of material misstatement due to fraud at the financial statement and assertion levels.

However, whilst we recognise these improvements over the extant standard, we highlight the following concerns, in particular, in relation to aspects of the alignment of ED-240 with ISA 315R and the application of certain concepts from ISA 315R, and our recommendations to address these:

Lack of Clarity Regarding Application of the Concept of the Spectrum of Inherent Risk in Identifying and Assessing Fraud Risks

We consider that, as drafted, there is a lack of clarity within ED-240 regarding how the concept of the spectrum of inherent risk is to be applied when assessing fraud risks. Risks of material misstatement due to fraud are required to be treated as significant risks, in both the extant standard and in ED-240 (e.g., at paragraph 40(b)).

Furthermore, paragraph 40(b) requires the auditor, to the extent that the auditor has not already done so, to “identify controls that address such risks, evaluate whether they have been designed effectively and determine whether they have been implemented” in line with the fact that risks of material misstatement due to fraud are determined to be significant risks. However, elsewhere in ED-240, where the concept of fraud risk factors is discussed and the standard has been amended to align more closely to ISA 315R in terms of the assessment of inherent risk, there is reference to the auditor assessing fraud risks, which, if performed in accordance with the requirements of ISA 315R.31, including applying the concept of the spectrum of inherent risk, indicates that the auditor determines where on the spectrum of inherent risk the risk of material misstatement due to fraud lies, taking into account the fraud risk factors similar to consideration of the effects of inherent risk factors. This could result in an auditor, in assessing the likelihood of a material misstatement due to fraud arising, determining this not to be at the upper end of the spectrum of inherent risk. For example, paragraph 35(a)(ii) states that “in applying ISA 315R, the auditor shall obtain an understanding of how the entity’s risk assessment process assesses the significance of identified fraud risks, including the likelihood [but not magnitude] of their occurrence”. Additionally, paragraphs 26(a) and 40(a) requires the auditor to take into account fraud risk factors when identifying and assessing the risks of material misstatement due to fraud. Furthermore, paragraph A117 refers to the requirement for the auditor to obtain more persuasive evidence the higher the auditor’s assessment of risk.

As a result of the above, to avoid inconsistency in interpretation and application of these requirements, we recommend that ED-240 better clarify how the proposed changes to align more closely to ISA 315R are to be applied. We suggest that ED-240 explicitly clarify why risks of material misstatement due to fraud are required to be treated as significant risks, for example, because the intent of such classification is to trigger certain required responses in accordance with ISA 330 and other ISAs. We also recommend that ED-240 explicitly clarify how the assessment of inherent risk for risks of material misstatement due to fraud, required by ISA 315R.31, is intended to be made. We believe that ED-240 should explicitly state whether the intent behind treating all risks of material misstatement due to fraud as significant risks, as required by ED-240.40(b), is that the likelihood and magnitude of misstatements is automatically presumed to be at the upper end of the spectrum. Alternatively, if an assessment of the likelihood and magnitude of misstatements is expected to be made to assess inherent risk, we recommend that ED-240 explicitly acknowledge that certain risks of material misstatement due to fraud are more likely to occur and/or may be of a greater magnitude than others and, whilst the auditor is required to treat a risk of material misstatement due to fraud as a significant risk, they are still expected to determine where on the spectrum of inherent risk the fraud risk lies and the reasons for doing so (for example, to enable the auditor to design and perform audit procedures that differ in terms of their nature, timing and extent in order to be responsive to the assessed risks of material misstatement at the assertion level, and to obtain more persuasive audit evidence the higher the auditor’s assessment of risk).

Evaluation of Fraud Risk Factors

In connection with the above, we highlight that there is potential for inconsistency in practice in terms of application of the fraud risk factors. Whilst we believe the enhancements to material in this regard, including the introduction of additional examples, will be helpful to auditors, we consider that there is a lack of clarity regarding this concept, and how to apply it, as we describe below:

We believe that it could be clearer as to how fraud risk factors relate to inherent risk factors as described in ISA 315R. We note that the application material at paragraph A22 states that “fraud risk factors, which include intentional management bias, are, insofar as they affect inherent risk, inherent risk factors”. However, we believe that this does not appropriately describe the interrelationship between these two concepts. We consider that the presence of certain inherent risk factors, e.g., in relation to complexity (e.g., revenue

recognition that involves the use of complex estimates) or subjectivity (e.g., assets, liabilities or expenses that are recorded based on significant estimates, which involve subjective judgements), may give rise to fraud risk factors, primarily in relation to opportunity, which, either individually or in combination with other fraud risk factors, may give rise to risks of material misstatement due to fraud. Furthermore, certain fraud risk factors, e.g., incentives or pressures to commit fraud, may create susceptibility to misstatement, before consideration of controls, i.e., influence the inherent risk of fraud at the assertion level, but not the risk of error. Accordingly, we recommend that the IAASB clarify this interrelationship and the intended interaction between the linked but distinct concepts of inherent risk factors and fraud risk factors, with examples to illustrate;

In connection with the above, we also recommend that the reference at paragraph A22 to “fraud risk factors, which include intentional management bias” be amended to refer to susceptibility to management bias. Additionally, we recommend that the IAASB clarify that when susceptibility to management bias is present, this may affect the assessed risks of material misstatement due to error resulting from the possibility of unintentional management bias, and may affect the assessed risks of material misstatement due to fraud resulting from the possibility of intentional management bias;

We also note that ED-240 uses the terms “circumstances”, “conditions”, “events and conditions”, “fraud risk factors” and “information” somewhat inconsistently and also interchangeably. We suggest that the IAASB check these references throughout ED-240 to ensure that they are using the appropriate terminology in each instance and are not co-mingling concepts and definitions;

We highlight that the definition of fraud risk factors makes reference to incentive or pressure, and opportunity, but not to attitude/rationalization. However, related application material and appendix 1 provide examples of fraud risk factors that relate to the condition of attitude/rationalisation. We appreciate that aspects of attitude/rationalization may be challenging for the auditor to identify and that it is only through performing other audit procedures that they may identify these. However, we recommend that the definition include reference to attitude/rationalisation, for completeness, and that the application material explain the challenges in this area, with a focus on remaining alert to these, linked also to the material discussing the inherent limitations of an audit;

We also note that the application material, including examples of fraud risk factors, is not always consistent with the appendices. We suggest that the application material provide higher-level information and examples, and refer out to the appendices for further details and more examples;

We highlight the certain fraud risk factors are applicable to particular aspects of the financial statements and the entity’s financial reporting processes, e.g., in respect of related party transactions, intercompany transactions in a group audit, management override of controls, and accounting estimates. We recommend that the application material discuss such fraud risk factors more specifically, together with examples of more targeted procedures to identify/consider these;

Similarly, there may be more pervasive fraud risk factors related to the entity’s internal control environment, culture and tone at the top etc. We recommend that ED-240 make clearer reference to these, to guide the auditor to focus and respond to related risks more effectively.

Understanding

We consider the requirement at paragraph 35, which overlays the requirements at ISA 315R.22 regarding the entity’s risk assessment process and related application material, is not sufficiently specific in terms of identifying risks of material misstatement due to fraud as a result of business risks relevant to financial reporting objectives. Accordingly, we recommend that ED-240 focus more clearly on fraud matters related to

“business risks relevant to financial reporting objectives”, as described in ISA 315R.22, with related application material to provide clearer guidance to auditors, focused on factors such as the industry within which the entity operates, and which cross-refers to material to address fraud risks arising from related party transactions and significant and unusual transactions. We also recommend that such material cross-refer to the guidance regarding material third-party fraud, as we discuss in our response to Question 1;

In addition to the above, we recommend that the examples, at paragraph A90, of others within the entity to whom the auditor may direct inquiries about the existence or suspicion of fraud include specific reference to individuals from the internal audit function, if applicable;

Paragraph 42 requires the auditor to “irrespective of the auditor’s assessment of the risks of management override of controls, to treat those risks as risks of material misstatement due to fraud and thus [as] significant risks”. Furthermore, paragraph 48 requires the auditor to design and perform audit procedures [in respect of journal entries and other adjustments, accounting estimates, and significant transactions outside the normal course of business or that otherwise appear unusual] and determine whether other audit procedures are necessary in addition, to respond to the identified risks of management override of controls. Accordingly, we recommend that the “Understanding” section of the standard focus more specifically on matters related to risks of management override of controls, in order to assist the auditor in identifying these risks more specifically, considering the fraud risk factors applicable and how management may override controls and perpetrate fraud. This would better support the auditor in fulfilling the requirement at paragraph 48 in a more targeted manner, in particular, in determining whether additional audit procedures are necessary.

Other

Paragraph 30 refers to steps the auditor is required to take if responses to inquiries of management, TCWG, individuals within the internal audit function, or others within the entity are inconsistent with each other. We recommend that this requirement be broadened to also refer to when these responses are inconsistent with other audit evidence obtained, with related application material included to discuss the implications.

We also set out certain recommendations to improve alignment of ED-240 to ISA 315R in Appendix 1 to this response.

6. Public Sector Organizations

Government Accountability Office – United States

Further, ED-240 paragraph A106 could be interpreted to mean that misappropriation of assets is not a common type of fraud for private sector entities. We believe that additional language would clarify the application material and make it specific for public sector entities. First, we believe that this paragraph should note that there is generally less incentive or motivation to commit fraudulent financial reporting in the public sector. Second, we believe that there should be an explanation that misappropriation of assets may be more prevalent in the public sector due to the actions of third parties that commit fraud to take advantage of various public sector grant programs and activities. We suggest revising this paragraph as follows:

A106. In public sector entities, there are generally fewer incentives or motivations to commit fraudulent financial reporting. Misappropriation of assets (e.g., misappropriation of funds) may be a more common type of fraud risk factor. Further, there may be greater risks of material misstatement due to fraud committed by third parties in the public sector, as there may be more numerous opportunities to defraud the public sector through grant programs, contracts, and social welfare or benefit programs.

Specifically, we believe requirements and application material should be clarified to better expand upon ISA 315 and other ISAs. We believe paragraph 41 is not appropriate for many public sector entities, as generally these entities' transactions consist primarily of expenditures rather than earned revenues. Since the second sentence of extant ISA 240 paragraph 27 was moved to exposure draft 240 (ED-240) application material paragraph A112, there is now a disconnect between the language in ED-240 paragraph 41 and paragraph

We support a robust risk identification and assessment related to fraud in an audit of financial statements. We believe that some clarification of the requirements and application material is necessary to better build on ISA 315 and other ISAs. Specifically, we believe that the description of fraud risk factors in paragraph 29(a)(ii) should be part of the application material for the definition of fraud risk factors in paragraph A22. This presentation would provide more detail when fraud risk factors are defined and provide for consistent examples throughout ED-

240. In addition, we believe paragraph 30 does not provide sufficient fraud focus to differentiate it from the requirements from ISA 500 paragraph 11. Further, paragraph 42 is phrased in a manner that contradicts the concept of performing an assessment of the risk of material misstatement due to fraud by designating as "significant risks" the risks of management override of controls. We believe that the paragraph should be rephrased and moved to be part of paragraph 40 as follows:

(c) Treat the risks of management override of controls as significant risks of material misstatement due to fraud, due to the unpredictable way in which management is able to override controls.

We believe paragraph 41 is not appropriate for many public sector entities, as generally these entities' transactions consist primarily of expenditures rather than earned revenues. Since the second sentence of extant ISA 240 paragraph 27 was moved to application material paragraph A112 of ED-240, there is now a disconnect between the language in ED-240 paragraph 41 and ED-240 paragraph 70(d). We suggest that the IAASB consider restoring the text of paragraph A112 to paragraph 41. Also, we suggest that the IAASB add an additional application material paragraph under the heading "Considerations Specific to Public Sector Entities" as follows:

A112A. In public sector entities, there may be fewer incentives or pressures to engage in fraudulent financial reporting by intentionally overstating or understating revenue. In public sector entities, there may be more fraud risk factors related to expenditures, especially when such expenditures are subject to statutory limits.

ED-240 paragraphs 33 through 40 are intended to build on ISA 315, but after we compared the paragraphs with the referenced paragraphs in ISA 315, we do not believe that the paragraphs do this. We believe that ED-240 creates inconsistencies between the standards. For example, in ED-240 paragraph 33, we do not believe that the understanding of the entity and its environment builds upon ISA 315 but instead creates confusion with what should be applied.

ISA 315 paragraph 19 has additional considerations that are not included in ED-240. Given the potential for third-party fraud and the potential to obtain an unfair or inappropriate advantage in a regulatory environment, we believe that the auditor should also consider external and regulatory factors, as required by ISA 315 paragraph 19(a)(ii). We further suggest more clearly identifying what is specifically additive for fraud rather than restating ISA 315.

For ED-240 paragraph 34(b), we suggest splitting the requirement into sub-sections, thus more clearly identifying the requirements for the auditor and how they expand upon the more limited requirements in ISA 315. As currently written, it is possible to interpret the compound clauses in multiple ways.

7. Member Bodies and Other Professional Organizations

Korean Institute of Certified Public Accountants

Agree, with comments below

The KICPA agrees that the ED-240 appropriately builds on the foundational requirements in ISA 315 (Revised 2019) and other ISAs to support a more robust risk identification and assessment as it relates to fraud in an audit of financial statements.

However, the presumption that fraud risk factors related to revenue recognition are present may not apply in some cases. Therefore, we propose revising the part of Paragraph A110 of the ED that ‘the significance of fraud risk factors related to revenue recognition ordinarily makes it inappropriate for the auditor to rebut the presumption that there are risks of material misstatement due to fraud in revenue recognition’ to ‘the significance of fraud risk factors related to revenue recognition makes it uncommon for the auditor to rebut the presumption that there are risks of material misstatement due to fraud in revenue recognition’.

Federation of Accounting Professions of Thailand

Agree, with comments below

Due to various incidents that may occur, it would be very useful to add more examples on A54 (related to paragraph 31), such as a significant increase in employee expenses despite the number of employees remaining constant and without any additional benefits being provided, or the increase in certain expenses that have risen significantly without correlation to business growth.

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

Agree, with comments below

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

In our view ED-240 does appropriately build on the foundational requirements of ISA 315 (Revised), however we did hear some concerns during our outreach. More specifically, our stakeholders stressed that ED-240 is repetitive in certain instances as well as becoming quite circular causing challenges recognising when a practitioner is for example following ISA 315 (Revised) and when following ISA 240. This is a comment we hear more frequently during outreach sessions over the revisions of recent standards when it comes to revisions building on foundational requirements in ISA 315 (Revised). For example, the requirements found in paragraphs 26 and 33 are almost identical to ISA 315 paragraphs 13 and 19 respectively. We therefore suggest that the board revisits the requirements stemming from ISA 315 (Revised) ensuring that any duplication is avoided.

Analytical procedures performed and unusual or unexpected relationships identified

Our stakeholders also raised concerns that having only one paragraph (paragraph 31) on analytics is not enough. The requirement that analytics are used to find fraud factors risks limiting the auditor’s ability to find fraud or the risk of fraud using other means.

Presumption of the risks of material misstatement due to fraud in revenue recognition

As our thought leadership report Closing the expectation gap the way forward for fraud and going concern: A multistakeholder approach noted, some audit practitioners have questioned whether the presumption of risks of fraud in revenue recognition continues to be appropriate. Some suggested that, frequently, this presumption leads auditors to spend an undue amount of time designing and performing fraud-related procedures in areas where, for many entities, the risks are not high because of the nature of the business. Further, they flagged

that as a result, they may not devote sufficient resources to other riskier areas. In contrast, regulatory representatives appeared to be concerned that auditors are rebutting this presumption too often without good cause.

In our view, while we find that the presumption of risk of material misstatement due to fraud in revenue recognition remains relevant it may be worth exploring whether other areas are more applicable particularly when it comes to audits of SMEs. For example, targeting reduced tax liability is common in owner managed businesses and hence expenses could be more susceptible to fraud.

Journal entry testing

With respect to paragraph 50, in our view, the relevant application material paragraphs A128-A135 and the Appendix 4 of the ED-240 are helpful, however, we also suggest that the use of technology in journal entry testing is also reflected. This could be in the form of examples either in the application material or in a separate guidance.

Institute of Singapore Chartered Accountants

Agree, with comments below

Overall enhancements to risk identification and assessment

It appears that the requirements may be scaling towards an active attempt to detect fraud in the process of the audit. We believe that this should not be the focus of an audit.

The standard could make clear that the rigour and extent of risk assessment procedures performed in relation to fraud should be commensurate to the propensity of fraud occurring based on the auditor's understanding of the business and operating environment of the entity (i.e. more rigorous risk assessment procedures would be needed if the auditor picks up irregularities when understanding the business or operating environment of the entity). This would help avoid a situation where it is perceived that the auditor is required to carry out extensive procedures to detect fraud regardless of risk levels.

Areas where more guidance is needed

We appreciate the application material added under Appendix 4 in relation to considerations over journal entries. It would be useful for the guidance to clarify how test of controls over journal entries would affect the nature and extent of substantive procedures in this area, considering that the criteria for selection of journal entries to test is based on criteria that denote higher risk.

Guidance on other considerations over unusual large transactions and key management estimates, which are areas susceptible to fraud, would also be helpful.

Role of culture

A strong ethical corporate culture can serve as an effective fraud deterrent. Notwithstanding that assessing culture could be challenging due to a certain degree of subjectivity involved, we are supportive of the enhancements in ED-240 that incorporate aspects of corporate culture that are observable in the auditor's risk assessment.

Malta Institute of Accountants

Agree, with comments below

We agree that ED-240 builds on the foundational requirements in ISA 315 (Revised 2019) and other ISAs to support a more robust risk identification and assessment as it relates to fraud in an audit of financial statements.

We have the following suggestions:

Extant ISA 240 requires retrospective review of "significant accounting estimates". This is in line with ISA 540 (Revised). In ED-240, "significant" has been removed, and paragraphs 28, A47, and A136 make reference to "accounting estimates". We suggest the term "significant" is added back in order to not unintentionally expand the auditor role to include all accounting estimates, even if insignificant.

Para A111 of ED-240 sets out circumstances where it may be appropriate to rebut the risk of material misstatement due to fraud in revenue recognition. Examples are included in A111 where fraud risk factors may not be significant. We would suggest that the examples are enhanced to explicitly link up with the fraud risk factors set out in A56 and Appendix 1 (incentive / opportunity / rationalization), particularly their lack of significance, in order to better guide auditors in their fraud risk identification and assessment.

Botswana Institute of Chartered Accountants

Agree, with comments below

Yes, ED-240 does build on the foundational requirements in ISA 315 (Revised 2019) and other ISAs to support a more robust risk identification and assessment as it relates to fraud in an audit of financial statements especially in integrated relationship between ISA 240 and ISA 315 (Revised 2019) through restructuring extant of ISA 240. A new application material of Paragraphs A38 and A49 of ED-240 regarding when it may be beneficial to hold additional engagement team discussions, and involve experts during engagement team discussions, respectively will also further assist in ensuring that adequate risk identifications and assessment are carried out from the planning to the completion stages of all audits of financial statements.

ASEAN Federation of Accountants

Agree, with comments below

We recommend that revisions be built on the foundational requirements in ISA 315 (Revised) and provide specific fraud related considerations in executing those required risk assessment procedures. The enhanced requirements for the engagement team discussion may facilitate more meaningful discussions regarding fraud risk factors, which, in combination with the changes proposed for other risk assessment procedures, may lead to a more informed identification and assessment of the risks of material misstatement due to fraud.

Guidance on other considerations over unusually large transactions and key management estimates, which are areas susceptible to fraud, would also be helpful. More guidance on how analytical procedures could be more effectively carried out to comply with the requirement would be helpful. There should be a strong linkage between understanding the entity and its environment, and such analytical procedures.

A strong ethical corporate culture can serve as an effective fraud deterrent. Considering that assessing culture could be challenging due to a certain degree of subjectivity involved, we are supportive of the enhancements in ED-240 that incorporate aspects of corporate culture that are observable in the auditor's risk assessment.

CPA Ontario Small and Medium Practices Advisory Committee

Agree, with comments below

Yes, ED-240 builds on the foundational requirements of ISA 315 (Revised 2019) and other International Standards on Auditing (ISAs) to support a more robust risk identification and assessment concerning fraud in an audit of financial statements. This integration and enhancement are outlined in both the Explanatory Memorandum (EM) and the Exposure Draft (ED) text, focusing on ensuring that the standards effectively address the evolving complexities of fraud risk in financial audits.

ED-240 is designed to complement and extend the principles set out in ISA 315 (Revised 2019), which deals with the auditor's responsibilities to identify and assess risks of material misstatement. It enhances these by specifically focusing on fraud-related considerations, ensuring that auditors apply a fraud lens to the risk assessment processes mandated by ISA 315.

The EM highlights how ED-240 requires auditors to give special attention to fraud risk factors when performing risk assessment procedures. This includes understanding the entity's environment and internal controls, which are crucial for identifying potential opportunities for fraud.

The ED provides specific requirements and extensive guidance on how auditors should approach fraud risk assessment. This includes considering how fraud might occur, involving the understanding of possible schemes and scenarios in which fraud could be perpetrated.

Overall, ED-240 effectively clarifies how auditors should integrate fraud considerations into their risk assessment processes by building on the requirements of ISA 315 and other relevant ISAs. This approach aims to enhance the detection and prevention of fraud through more diligent and targeted audit planning and execution.

Institute of Certified Public Accountants of Uganda

Agree, with comments below

We believe that to a large extent, the ED-240 appropriately builds on the foundational requirements in ISA 315 (Revised 2019) and other ISAs to support a more robust risk identification and assessment as it relates to fraud in an audit of financial statements.

However, we recommend the following:

The application material in A22 be amended to cover not just events and conditions that may exist to create fraud but also the attitude of rationalization as a fraud risk factor.

Paragraph A69 be amended to illustrate acceptable external sources of information from which auditors may obtain information about the issues listed in the paragraph.

Asociacion Interamericana de Contabilidad

Agree, with comments below

We consider that ED 240 is adequately based on the requirements of ISA 315 while maintaining a balance with its provisions and with other ISAs, aimed at carrying out the process of identifying and assessing risks in a sound manner in an audit of financial statements.

Yes, ED-240 appropriately builds on the foundational requirements of ISA 315 (revised 2019) and other International Standards on Auditing (ISAs) to support a more robust identification and assessment of risks related to fraud in a financial statement audit. In doing so, it expands and specifies the need for a risk-based approach that is central to ISA 315, emphasizing the identification and assessment of material fraud risks. ED-240 introduces detailed guidance and clarifies expectations on how auditors should apply professional skepticism and consider both intentional and unintentional misstatements. In addition, it strengthens aspects

of risk assessment by requiring auditors to consider how and why fraud might occur, which improves the quality and depth of their approach to fraud detection.

Pan-African Federation of Accountants

Agree, with comments below

ED 240 is appropriately built on the foundational requirements in ISA 315 (Revised 2019) as it followed a similar structure to ISA 315 (Revised 2019) and incorporates the recent changes which made fraud risk identification and assessment more robust, including requirements describing the auditor's explicit or specific fraud considerations when obtaining an understanding of the Entity and its environment, applicable financial reporting framework; and the components of the entity's system of internal control, including the control environment, the entity's risk assessment process, the entity's process to monitor the system of internal control, the information system and communication, and control activities.

We note that ISA 315 (Revised) paragraph A61 explains why the auditor obtains an understanding of the entity's business model. In the context of fraud risk identification, understanding the business at a strategic level, including the business risks it faces is exceptionally important because it provides the auditor with insight into management's intentions, i.e. the motivation behind their business decisions. Given intention is the key differentiator between material misstatement due to fraud and error, this is considered a key omission ED-240. We therefore propose for this to be incorporated into ED-240 paragraph 33(a), with complementary application material.

Malaysian Institute of Accountants - Auditing and Assurance Standards Board

Agree, with comments below

Changes that build on the foundational requirements in ISA 315 (Revised) and provide specific fraud related considerations in executing those risk assessment procedures requirements can be supported.

The enhanced requirements for the engagement team discussion may facilitate more meaningful discussions regarding fraud risk factors, which, in combination with the changes proposed for other risk assessment procedures, may lead to a more informed identification and assessment of the risks of material misstatement due to fraud.

Further clarity may be useful in some of the requirements that seem to be a duplicate of the baseline ISA 315 (or other ISA) requirements without a clear "fraud lens". For example, Paragraph 26(b) which is directly repetitive of ISA 315 (Revised 2019) paragraph 13(b) with no additional fraud lens and Paragraph 30 which seems repetitive of ISA 500 paragraph 11. We suggest that the IAASB consider amending the below paragraphs as follows:

"In designing and performing procedures in accordance with ISA 315 (Revised 2019), the auditor shall perform the procedures in paragraphs 27-39. In doing so, the auditor shall consider whether one or more fraud risk factors are present."

"In applying ISA 500, if the responses to inquiries of management, those charged with governance, individuals within the internal audit function, or others within the entity are inconsistent with each other, the auditor consider whether such inconsistencies indicate that one or more fraud risk factors are present and shall:

Determine what modifications or additions to audit procedures are necessary to understand and address the inconsistency; and consider the effect, if any, on other aspects of the audit."

8. Academics

Accounting and Finance Association of Australia and New Zealand

Agree, with comments below

We agree that ED-240 supports a more robust risk identification and assessment as it relates to fraud in an audit of financial statements, but reiterate concerns, as expressed in our response to Question 2, that ED-240 may not be reinforcing the appropriate exercise of professional scepticism such that the proposed enhancements may not realise their potential.

While ED-240 supports a more robust risk assessment, we believe that there are opportunities for the IAASB to reinforce the enhanced requirements with revisions to the proposed application and explanatory material.

Extending application material beyond the traditional fraud triangle

We are concerned that the application material related to paragraph 32 (and in particular Appendix 1) overly emphasises the fraud triangle in evaluating fraud risk factors and may inadvertently (and inappropriately) constrain the auditor's assessment of the risk of material misstatement due to fraud.

Fraud is a multifaceted phenomenon that may not fit any single framework (Dorminey et al. 2012; Free and Murphy 2015; Lokanan 2015). Furthermore, the fraud triangle individualises the perpetrators and is less effective when collusion and management override are involved. This limits the understanding of management fraud (Dorminey et al. 2012; Lokanan 2015; Free 2015; Free and Murphy 2015; Trompeter et al. 2013).

In extending the fraud triangle, Free et al. (2007) emphasised an element of culture alongside charismatic leadership and subverted management controls as part of an organisational fraud triangle. Ramamoorti (2008) proposed the A-B-C Model to illustrate how pervasive collusion and organisational culture is to fraud perpetration within an organisation. Indeed, Free and Murphy (2015) reported that an organisation can have numerous subcultures, potentially leading to multiple 'tones at the top'. Therefore, expanding the fraud triangle to include group dynamics might be necessary when applying it to fraudulent financial reporting (Trompeter et al. 2013). Wilks and Zimbelman (2004) highlight that auditors may be more focused on opportunity and incentive when evaluating fraud risk factors, and enhanced conceptualisations of the fraud triangle (e.g., fraud diamond) (e.g., Boyle et al. 2015) highlight other fraud risk indicators that the auditor should consider (e.g., capability).

In addition, previous research has also found that the presence of only one element of the fraud triangle may be sufficient for fraud to occur. For example, if the fraudsters do not view their act as wrong, rationalization plays no part (Trompeter et al. 2013). The presence of opportunity, particularly in situations where the internal control system is weak, or the fraudster holds positions of power that allow them to override internal controls may be sufficient (Ameer and Othman 2022; Clarke 2012; Holtfreter 2013; Othman and Ameer 2022; Schuchter and Levi 2015). Internal controls might appear to be designed to prevent fraud, but it is the opportunity that prompted the fraud commission (Villaescusa and Amat 2022). Such preventative controls are less effective in situations involving collusion and management override (Trompeter et al. 2013).

We therefore encourage the IAASB to reflect on opportunities to more effectively present application and explanatory material that extends the evaluation of fraud risk factors beyond the traditional fraud triangle.

Fraud Prediction Models

We also believe that ED-240 could recognise the potential contribution of existing and evolving fraud prediction models in assessing risk of material misstatement due to fraud. For example, Beneish (1997) M-Score and Dechow et al. (2011) F-Score models present opportunities to complement traditional approaches. While the use of fraud prediction models can be costly in terms of false positives (i.e., flagged clients for which

material misstatement due to fraud is not present) (see Beneish and Vorst 2022 for an analysis and discussion), we note that when used in conjunction with other techniques, these models have the potential to contribute to a more complete assessment of the risk of material misstatement due to fraud. Models continue to be developed (e.g., Craja et al. 2020; Bao et al. 2020; Brown et al. 2020) and we encourage the IAASB to reflect on opportunities to extend application and explanatory material to include the use of fraud prediction models in obtaining evidence that provides an appropriate basis for the identification of potential risks of material misstatement due to fraud (paragraph 26).

Engagement Team Discussion

We believe that changes reflected in ED-240 make the engagement team discussion more robust. Research highlights the benefits of the required engagement team discussion (e.g., Carpenter 2007; Hoffman and Zimbelman 2009; Trotman et al. 2009; Chen et al. 2015; Chen et al. 2022), and we commend the IAASB on new application material highlighting potential benefits of additional engagement team discussions.

We do note, however, that research highlights several ways in which the effectiveness of the engagement team discussion

can be improved. To illustrate, engagement team discussions are likely to be more effective when conducted face-to-face (Carpenter 2007), with the provision of strategic reasoning questions (Hoffman and Zimbelman 2009) and brainstorming guidelines (Trotman et al. 2009), but in an electronic environment effectiveness is facilitated by less structure (Chen et al. 2022) and with limited interaction (Chen et al. 2015). In addition, research speaks of the importance of partner communication and style in realising the benefits for engagement team discussions (Carpenter and Reimers 2013; Harding and Trotman 2017; Gissel and Johnstone 2017; Dennis and Johnstone 2018). We encourage the IAASB to expand on paragraph A51 in ED-240 to more broadly consider approaches that may usefully facilitate the exchange of ideas in the engagement team discussion.

Whistleblowing

We commend the IAASB on the introduction of application material on whistleblower programs which we believe will make the risk assessment process more robust. Kuang et al. 2021 examine auditor responses to whistleblowing in the US and find that auditors respond to risks in whistleblowing allegations. Positively, they also find that auditors are able to separate the noise in frivolous versus substantiated whistleblowing reports. These findings suggest the consideration of whistleblowing tips can help support the effective identification of risk of material misstatement due to fraud.

The conduct of analytical procedures

We concur with changing the work effort verb from 'evaluate' to 'determine' to reflect the increasing work effort required to incorporate an increasingly broad range of information that can be captured and analysed (e.g., Brazel et al. 2009; Chiu et al. 2023). We do, however, caution that the work effort implications of needing to come to a specific conclusion when the verb 'determine' is used may encourage an implemental rather than deliberative mindset, and this may negatively impact an auditor's responses to the assessed risk of material misstatement due to fraud, and the effectiveness of the auditor in identifying fraud (Bauer et al. 2020). In this regard, it is important that the auditor effectively responds to the assessed risk of material misstatement. Concerningly, research highlights that auditors do not effectively respond to elevated fraud risk (e.g., Zimbelman 1997; Asare and Wright 2004; Asare et al. 2015; Aghazadeh and Joe 2022). In the absence of a specific question on responses to the assessed risk of material misstatement, we provide our comments in this regard under Question 10.

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9. Individuals and Others

Ataf Noor Ali Chartered Accountants

R3: Yes.

Our reasons for the agreement is follows

3.1 Explicit requirement now includes exchange of ideas regarding entity's culture, management culture, management's commitment to integrity, oversight of TCWG and other risk factors.

3.11 What is missing?>> Obtain information on many of above may not be available or in case of first audit engagement. Review past audit working papers, and points forwarded to the current year In case of a recurring audit engagement.

3.2 Additional audit team discussion and involving experts.

3.3 Analytical procedures at planning and completion stage.

3.4 Fraud risk in revenue recognition.

3 Neither agree nor disagree

1. Monitoring Group

International Organization of Securities Commission

We support the Board's approach to build on the foundational requirements in ISA 315 (Revised in 2019), Identifying and assessing the risks of material misstatement, and other ISAs to support a more robust risk identification and assessment as it relates to fraud in an audit of financial statements. However, it is unclear how the Board determined which key concepts from ISA 315 (Revised 2019) to incorporate into ED-240. For example, in some cases certain requirements from ISA 315 (Revised 2019) have been included in ED-240 without, or with limited, modification (i.e., without applying a meaningfully tailored "fraud lens") to what is already required in ISA 315 (Revised 2019). Some of the application material paragraphs in ED-240 contain procedures with a meaningfully tailored "fraud lens" that we believe could result in more robust risk identification and assessment of fraud risks if applied consistently and we encourage the Board to consider including these explicit fraud considerations in the requirements in ED-240 instead of having the more general requirements that are mostly consistent with the requirements ISA 315 (Revised 2019). Specifically, paragraphs A66, A67, A69, A70, A79, A94, and A97 contain certain procedures that could meaningfully apply a "fraud lens" to the ISA 315 (Revised 2019) requirements that we believe could result in more robust risk identification and assessment of fraud risks.

In other instances, certain requirements from ISA 315 (Revised 2019), once a "fraud lens" has been applied to it, have not been included in ED-240 where the inclusion of such requirements could result in a more robust risk identification and assessment of fraud risks. For example, in addition to evaluating the entity's process to investigate and remediate the fraud or suspected fraud once identified as described in paragraphs 55(b) and (c), we believe it is also important for the auditor to obtain an understanding of the entity's process to report, investigate and remediate fraud or suspected fraud as part of obtaining an understanding of the components of the entity's system of internal control to identify and assess fraud risks. Another example would be the inclusion of additional tailored requirements related to technology in the information systems and communication section.

In order to emphasize the auditors' professional skepticism requirements, we believe it is important to emphasize that auditors should not have a “checklist mentality” to risk identification and assessment procedures. Similar to ISA 500, paragraph A6, we also believe it is important to remind auditors in ED 240 that inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement.

In addition to the aforementioned, we believe there are certain other requirements related to risk identification and assessment in ED-240 that should be strengthened:

Iterative nature of fraud risk identification and assessment

We believe the Board should strengthen the proposed requirements to emphasize that the auditor's risk assessment and use of the “fraud lens” is an iterative process that continues until the issuance of the audit report. Specifically, we recommend that the Board consider the following to further emphasize the iterative nature of fraud risk identification and assessment:

Including a paragraph, similar to ISA 315 (Revised 2019) paragraph 7, that requires an iterative and dynamic risk identification and assessment process in ED-240.

Specifically stating that inquiries of those charged with governance, management, internal audit, and other appropriate individuals within the entity (ED-240 paragraphs 34(c)–34(d), 35(b), and 36(b)) should be required throughout the audit not just during the planning phase.

Revise the reference to “engagement team discussions” throughout the standard to emphasize that such discussions should occur more than once.

Fraud inquiries

In addition to emphasizing the importance of the iterative nature of fraud inquiries, we believe the Board should strengthen the fraud inquiry requirements in the following ways:

Move all required fraud inquiries to its own subsection within the “Risk assessment and related activities” section as opposed to embedding these inquiries within the “Understanding the components of the Entity's System of Internal Control” subsection as we believe such inquiries could provide meaningful information related to all components of the entity's system of internal control. The inclusion of these requirements under certain specific components may have the unintended consequence of limiting inquiries to obtaining an understanding of those specific components only.

Expand all the required inquiries to also include inquiries related to the concepts of incentive/pressure, opportunities, and attitudes/rationalization to commit fraud in order to help the auditor identify and evaluate fraud risk factors as required in ED-240 paragraph 32.

We believe the auditor should also perform the inquiries required in ED-240 paragraph 34(c) with those charged with governance to assess whether management and those charged with governance have consistent understandings of management's processes to identify, respond and communicate risks of fraud in the entity, including the use of materiality thresholds.

We believe the auditor should also perform the inquiries required in ED-240 paragraph 34(d) with management because we believe it could be a relevant source of information to use in the auditor's risk identification and assessment process.

Include a specific documentation requirement in paragraph 70 related to the inquiries performed, who was involved, and the results of the discussions.

4. Jurisdictional and National Auditing Standard Setters

Wirtschaftsprüferkammer

In addition, it is proposed in paragraphs 41 and 42 of ED-240 to require management override of controls to be assessed as a risk of material misstatement due to fraud and presume that there are risks of material misstatement due to fraud in revenue recognition. It is therefore to be expected that this will presumably entail reporting on both fraud-related risk areas within the key audit matters in most cases. In this connection, we also fear the risk of boilerplating (i.e. using standard text) if there are no specific circumstances.

In our view, the proposed requirements in paragraph 40 (b) are not fully consistent with the spectrum of inherent risks in ISA 315. Therefore, the requirements in paragraph 40b should be more closely aligned with or explained in relation to the spectrum of inherent risks in ISA 315.

Paragraphs 41 and 42 of ED-240 require to assess management override of controls as a risk of material misstatement due to fraud and to presume that there are risks of material misstatement due to fraud in revenue recognition. It is therefore to be expected that this will presumably entail reporting on both fraud-related risk areas within the key audit matters in most cases. In this connection, we also fear the risk of boilerplating (i.e. using standard text) if there are no specific circumstances. As a consequence, this could hinder the acknowledgment and understanding of genuinely significant fraud risks if they were to arise.

Institut der Wirtschaftsprüfer in Deutschland

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: issues we have identified in which the draft is not aligned with other ISAs – in particular, ISA 315 (Revised 2019). Among other matters, of particular importance is the inconsistency in treating all risks of material misstatement due to fraud as significant risks (as newly defined in ISA 315 (Revised 2019) as being at the upper end of the spectrum of the assessed risks of material misstatement), but yet require more persuasive evidence the higher the assessed risks of material misstatement due to fraud. Similar considerations apply to management override of controls. Another important concern in this respect is the misalignment between fraud risk factors and inherent risk factors. We have also noted that reference is often made to management bias, when in fact only intentional management bias would be fraudulent and therefore covered by ISA 240. (Primarily responses to Questions 3 and 9, but throughout the responses)

Neither agree/disagree, but see comments below

Overall, there is a close relationship between the draft and ISA 315 (Revised 2019) and the draft does build on the foundational requirements in that standard. However, there are a number of issues with the structure and content of the draft that cause it to be inconsistent with ISA 315 (Revised 2019) and therefore confusing. Our response to this question focusses on the matters with which we disagree, rather than on those with which we agree.

Inherent risk factors vs. fraud risk factors

We believe that the introduction of inherent risk factors through the revision of ISA 315 as set forth in paragraphs 12(f) and 31(a) and further described in paragraphs A7 and A8 and Appendix 2 of ISA 315 (Revised 2019) significantly improves the ability of auditors to assess inherent risks in the financial statements. However, these relatively high-level inherent risk factors (which, based on their description in paragraph A7 of ISA 315 (Revised 2019) appear to be seven in number) do not appear to be properly aligned with the concept of fraud risk factors in extant ISA 240 or in the draft: there appear to be over 80 fraud risk factors in

Appendix 1 of the draft. The disparity in numbers suggests that the comparative granularity of fraud risk factors vs. inherent risk factors means that one is dealing with completely different concepts. We believe that these concepts need to be reconciled conceptually and in terminology in some way. Since ISA 315 (Revised 2019) encompasses the latest IAASB thinking on the issue of inherent risk factors, we believe that the concept of fraud risk factors in ISA 240 needs to be adjusted to match the concept used in ISA 315 (Revised 2019). Appendix 2 of ISA 315 (Revised 2019) does provide greater granularity to the inherent risk factors in No. 5 of that Appendix by referring to “events or conditions that may give rise to the existence of risks of material misstatement”. Using this paradigm from ISA 315 (Revised 2019), we have concluded that the fraud risk factors in extant ISA 240 and the draft actually represent “events or conditions that may give rise to potential fraud risks”. Applying the same paradigm, the three conditions generally present when material misstatements due to fraud occur as set forth in Appendix 1 of the draft (incentives or pressures, opportunities, and attitudes/rationalizations) are in fact the “fraud risk factors” akin to the seven inherent risk factors, recognizing that these fraud risk factors cover matters both related to inherent and control risk. The new definition of fraud risk factors would then read “incentives or pressures to commit fraud, opportunities to commit fraud, or attitudes or rationalizations facilitating fraud.” and the examples in Appendix 2 would relate to events or conditions that may give rise to potential fraud risks. These changes would also imply that the final bullet of No. 2 in Appendix 2 of ISA 315 (Revised 2019) would need to be amended to refer to these three fraud risk factors insofar as they affect inherent risk.

Treating fraud risk factors and “events or conditions that may give rise to potential fraud risks” in this way would also help alleviate the issue arising from Appendix 1 in the draft together with the new requirement in paragraph 27 of the draft, that many “fraud risk factors” in Appendix 1 are actually isolated examples of “events or conditions that may give rise to potential fraud risks” and become actual “fraud risks” only when combined with other such events or conditions that cause one of the three “conditions” (see above – that is those that we suggest be termed “fraud risk factors”) to be present. For example, a high degree of competition or market saturation, accompanied by declining margins, alone may not be considered a fraud risk factor if there is no perceived opportunity for fraud or adverse attitudes that exist due to other events or conditions that may give rise to potential fraud risks.

We believe that aligning the concepts in ISA 315 (Revised 2019) and ISA 240 of inherent risk factors, fraud risk factors, events or conditions that may give rise to the existence of risks of material misstatement, and events or conditions that may give rise to potential fraud risks, will further aid understanding and therefore improve auditor application of ISA 240.

Treatment of all assessed risks of material misstatement due to fraud as significant risks

We do not believe that treating all assessed risks of material misstatement due to fraud as significant risks as required by paragraph 40(b) of the draft is appropriate or proportionate because it undermines the new definition of significant risks in ISA 315 (Revised 2019) and undermines the purpose of a risk assessment, which is to conclude on the likelihood of occurrence and potential magnitude of a material misstatement for the purposes of designing and performing further procedures to respond to the assessed risk. Prior to the revision of ISA 315 in 2019, significant risks were described differently – that is, there were described as those risks of material misstatement requiring “special audit consideration”, with certain considerations that were applied when judging whether risks are significant risks, including whether those risks are due to fraud. Consequently, it made sense to treat risks of material misstatement due to fraud as significant risks under old ISA 315.

Due to the changes resulting from ISA 315 (Revised 2019), including the new definition of significant risk (“an identified risk of material misstatement ... for which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur”), treating all risks of material misstatement due to fraud as significant risks no longer makes sense. The mere existence (that is, a reasonable possibility of a potential material misstatement occurring, which is a low threshold) of a risk of material misstatement due to fraud does not imply that such a risk would be assessed at the upper end of the spectrum of inherent risk in terms of likelihood and magnitude of misstatement. The auditor’s risk assessment may result in the conclusion that the risk of material misstatement for a particular assertion is acceptably low, in which case quite rightly, no response would be required by ISA 330 (see second last sentence of paragraph A4 in ISA 330). Requiring the treatment of such risks of material misstatement due to fraud as significant risks would therefore result in unwarranted work effort for risks of material misstatement due to fraud that are acceptably low without an appreciable increase in quality of the audit. Furthermore, paragraph 7(b) of ISA 330 requires an auditor, in designing further audit procedures to be performed, to obtain more persuasive audit evidence the higher the auditor’s assessment of risk. This is recognized in paragraph A117, but this paragraph does not recognize the implication thereof. The implication of this requirement together with treating every risk of material misstatement due to fraud as a significant risk (at the upper end of the spectrum of risk) would be that for any risk of material misstatement due to fraud, auditors would need to obtain the most persuasive evidence practicable, even if the assessed risk of material misstatement due to fraud is much lower (albeit, if not acceptably low) than for other risks of material misstatement, which would lead to a misallocation of auditor work effort in audits to risks of fraud that are less important.

In our view, rather than treating all risks of material misstatement due to fraud as significant risks, we suggest that the IAASB consider those requirements in the ISAs that address significant risks generally and determine which of those requirements ought to apply to risks of material misstatements due to fraud generally (such as perhaps identifying controls and evaluating their design effectiveness and implementation) and then include those requirements in ISA 240. This would result in a more targeted treatment of fraud in the ISAs.

Treatment of all risks of management override of controls as significant risks

The arguments above on the treatment of risks of material misstatements due to fraud given the new definition of significant risks also appear to apply to management override of controls, in particular, since not all risks of material misstatement due to management override of controls will be assessed as being greater than acceptably low and, as posited above, auditors would need to obtain the most persuasive evidence practicable since under the definition it would be assumed that such risks are at the upper end of the spectrum of risk. Management may override controls for legitimate operational reasons, for example, in unusual situations when there is imminent danger that significant assets may be lost or significant contractual obligations may not be fulfilled. What matters in these cases is that such instances of override are properly documented so that management can justify its departure from entity policies and procedures. Furthermore, the requirements for dealing with management override of controls appear to be largely set forth in paragraphs 49 to 53. It seems to us that the IAASB should rethink its treatment of the risk of management override of controls rather than just carrying forward previous requirements, such as the requirement in paragraph 48 that the requirements apply regardless of the assessed risk, that may not make sense given the new definitions (in particular of significant risk) and requirements in ISA 315 (Revised 2019).

Additional incongruencies with ISA 315 (Revised 2019)

There are a number of additional issues with the structure and content of the draft that cause it to be inconsistent or duplicative with ISA 315 (Revised 2019) and therefore confusing. These include:

Fraud risk factors are already described in ISA 315 (Revised 2019), in particular in Appendix 2 No. 1 last bullet and in the last row of the table in No. 5, Appendix 4 No. 5, Appendix 5 Nos. 18 and 19. These could be extended as necessary to cover fraud more fully.

The requirement for information from other sources in ISA 315 (Revised 2019) paragraphs 15 and 16 relates to the overarching requirements for risk assessment procedures in ISA 315 (Revised 2019) paragraph 13. The footnote reference for paragraph 27 of the draft to ISA 315 (Revised 2019) decouples the requirement for information from other sources from the overarching requirement in paragraph 13 of ISA 315. Hence the reference in the footnote to paragraph 29 needs to be augmented to include paragraph 13. As an editorial, we note that since the other sources are not obtained by the auditor, the sentence should read "... the auditor shall consider whether information obtained by the auditor from other sources indicates...",

In the draft, there does not appear to be a counterpart related to fraud to ISA 315 (Revised 2019) paragraph 19(c). In addition, the requirements in the draft paragraph 28, "the auditor shall perform a retrospective review of management judgements and assumptions...to assist in identifying and assessing the risks of material misstatement due to fraud in the current period", and 31, "the auditor shall determine whether unusual or unexpected relationships that have been identified ... may indicate risks of material misstatement", are decoupled from the risk assessment procedures under "obtaining an understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control". Requirements for retrospective review of estimates in paragraph 28 and analytical review in paragraph 31 of the draft should primarily inform the auditor's understanding of inherent risk factors required by ISA 315 (Revised 2019) paragraph 19(c). In this respect, see also Appendix 2 to ISA 315 (Revised 2019) relating to subjectivity and management bias, No. 2 third bullet and No. 4, which link back to ISA 315 (Revised 2019) paragraph 19(c). Consequently, these two requirements in the draft belong to obtaining an understanding of the entity and its environment (part of the "what") rather than being overarching requirements (part of the "how") for risk assessment procedures as in the corresponding ISA 315 (Revised 2019) paragraph 13 to 18 and related activities. Therefore, paragraph 33 needs to be augmented to include obtaining an understanding of how fraud risk factors affect the susceptibility of assertions to misstatements due to fraud, and the requirements in paragraphs 28 and 31 need to be incorporated into this augmented part of paragraph 33.

In line with our comments on the relationship between fraud risk factors and inherent risk factors above, the requirement in paragraph 32 of the draft to evaluate whether the audit evidence obtained from the risk assessment procedures and related activities indicates that one or more fraud risk factors are present ought to be incorporated into the requirement in paragraph 40(a) in applying ISA 315 (Revised 2019) paragraph 31(a) so that the auditor takes into account the degree to which inherent risk factors affect the susceptibility of relevant assertions to misstatement due to fraud, rather than being as a separate requirement in paragraph 32.

Some parts of the sections on understanding the components of the entity's system of internal control in paragraphs 34 to 38 of the draft are largely duplicative of the corresponding paragraphs 21 to 26 in ISA 315 (Revised 2019). Consideration could be given to limiting these paragraphs to "add-ons" through ISA 240.

There does not appear to be a differentiation of inherent risk compared to control risk in the draft in relation to fraud beyond the application material to the definition in paragraph A22 and the discussion in the second paragraph of Appendix 1. It is therefore unclear what is required in relation to fraud when assessing control risk in accordance with ISA 315 (Revised 2019) paragraph 34, although matters related to fraud could clearly

have an impact on the assessment even if they are not related to the override of controls. We suggest that either the draft or ISA 315 (Revised 2019) be augmented to address the considerations in relation to fraud when assessing control risk.

In some of the cases noted above, consequential and conforming amendments to ISA 315 would be more straightforward than attempting to include “add-ons” in ISA 240. This would not preclude ISA 240 from referencing ISA 315 (Revised 2019) when appropriate. Such amendments to ISA 315 would also be more practical: firms implementing risk assessment procedures would less often have to look outside of ISA 315 (Revised 2019) to determine auditor responsibilities.

Issues with the engagement team discussion

We noted the following issues in the requirement in paragraph 29 of the draft:

The first sentence of the requirement closes with “including how fraud may occur”. However, this requirement relates to the susceptibility of the financial statements due to fraud, not to fraud generally. For this reason, the words should be changed to read: “including how material misstatements due to fraud may occur”, or “including how such fraud may occur”, given the previous reference to material misstatements due to fraud.

Reference is made in (a)(ii)a. to the discussion including fraud risk factors that include incentives and pressures on management, those charged with governance or employees to commit fraud. First, we note that since the auditor is concerned only with material misappropriation of assets and fraudulent financial reporting, the generic reference to fraud generally and any kind of fraud in terms of size (this would include petty fraud by lower-level entity employees) is too broad for the purposes of the team discussion for an audit of the financial statements, where the objective is to detect material misstatements in the financial statements. The team discussion should therefore be limited to material misappropriation of assets or fraudulent financial reporting: the wording should be adjusted accordingly. Second, we note that the engagement team may need to also discuss the opportunities these parties may have to misappropriate material assets or engage in material fraudulent financial reporting. We therefore suggest that the incentives and pressures on management etc. be augmented by opportunities.

For both (a)(ii)b. and c., like in the previous bullet point, fraudulent financial reporting and misappropriation of assets, respectively, should be augmented with the adjective “material”.

In relation to (b), we refer to our response to Question 1, in which we explain why alleged and suspected fraud should not be conflated, we suggest that allegations of fraud that are not yet suspected fraud are not capable of affecting the overall audit strategy or audit plan, even if alleged fraud needs to be followed up to determine if it is suspected fraud. For this reason, we suggest deleting the reference to alleged fraud.

Paragraph A48 refers to ISA 220 (Revised) paragraph 14 making the engagement partner responsible for creating an environment that emphasizes open and robust communication. However, ISA 220 (Revised) paragraph 14 actually does not require this: it requires the engagement partner to take responsibility for clear and effective actions being taken that establish and communicate the expected behavior of engagement team members, including emphasizing the importance of open and robust communication. We suggest that paragraph A48 be amended to reflect what ISA 200 (Revised) actually requires.

Treatment of management bias

Since management bias can be unintentional or intentional, but only intentional management bias relates to fraud, the treatment of management bias in the standard should be limited to intentional management bias. For this reason, and in line with paragraphs A22 and A35 of the draft, the words “management bias” in

paragraph 33(a) and (b) of the draft should be preceded by “intentional” to clarify that unintentional management bias (errors) are not being dealt with in these requirements. This also applies to paragraph 34(d)(iii) and paragraph A47, as well as to paragraphs A76, A91, A104 third bullet, and A108.

References to fraud generally

Given the very broad definition of fraud, which includes deception to obtain unjust advantage or some types of illegal advantage (e.g., unjust enrichment) that may not be directly related to misappropriation of assets or fraudulent financial reporting, we are not convinced that understanding the components of internal control for the purposes of a financial statement audit should cover such matters. Furthermore, the references to fraud generally serve to further cause inappropriate expectations or confusion among some readers about what the purpose of an audit of financial statements is. For these reasons, the general references to fraud in paragraphs 34(b), (c), and (d), 36(a) and (b), 38 and 39 should refer to misappropriation of assets and fraudulent financial reporting or material misstatements due to fraud, as appropriate, rather than to fraud generally.

In this vein, we note that paragraph 35(a)(i) correctly refers to misappropriation of assets and fraudulent financial reporting, but then refers to “identified” and “assessed” fraud risks in (a)(ii) and (iii). To clarify that the fraud risks in (a)(i) are meant, we suggest that the word “the” prior to “identified” and “assessed” be changed to “these”.

Control deficiencies

In line with ISA 265 and ISA 315 (Revised 2019), since auditors do not seek control deficiencies to express an opinion on internal control, ISA 265 refers to the auditor determining whether control deficiencies have been identified rather than determining whether there are control deficiencies identified. For this reason, the words in paragraph 55(d) should be changed to “determine whether control deficiencies have been identified”.

Prior-period estimates

Reference to “the prior period” in paragraph A47 ignores other potentially relevant assessments (e.g. in earlier periods) and is inconsistent with paragraph 28 and ISA 540 paragraph A56.

Information from other sources

The second bullet in paragraph A45 addresses both management’s commitment to integrity and ethical values and its commitment to remedy known significant deficiencies in internal control. These two matters are unrelated and therefore warrant separate bullets because by addressing them in one bullet, it suggests that there is a connection between ethical values and the commitment to remedy significant deficiencies. In addition, significant deficiencies in internal control are defined in ISA 265 as those that are of sufficient importance to merit the attention of those charged with governance. Nevertheless, in some cases, the cost of remedying significant deficiencies in internal control may exceed the benefit (e.g., the cost of establishing and maintaining effective controls over certain types of third-party fraud (e.g., immaterial theft by customers) may exceed the benefit of reducing losses due to fraud and such losses may therefore be regarded as “cost of doing business” in some industry sectors).

Improper conduct by management

The third bullet point of paragraph A57 claims that the existence and enforcement of a written code of conduct would generally constrain improper conduct by management. Enforcement of such a code would require more than just oversight by those charged with governance as set forth in the first bullet – it would require enforcement by those charged with governance. Consequently, the third bullet should be augmented at the end with “by those charged with governance”.

Inquiries of those charged with governance

Paragraph A78 refers to the auditor considering whether to continue the engagement. In line with other ISAs on this matter and because withdrawal is not possible in some jurisdictions, reference should be made to considering whether to withdraw from the engagement, where withdrawal is not prohibited by law or regulation.

Assessing fraud risks

Paragraph A84 addresses how management may address the likelihood of a fraud risk. However, management may also seek to address the potential impact of a fraud risk, including its velocity (that is, how quickly it might occur). We suggest that the paragraph be augmented to deal with how management may address the impact of a fraud risk.

The example box under paragraph A85 includes a last bullet under preventive controls that does not represent a control – it represents the result of a preventive control. We suggest that the bullet point be redrafted to represent a preventive control.

Identifying and assessing the risks of material misstatement

The first bullet in the example under paragraph A104 refers to estimation of revenue, and in particular inappropriate estimates of the amounts of consideration. However, inappropriate estimates of revenue also occur when estimates of the timing of consideration are subject to uncertainty. We therefore suggest inserting “or timing” between “amount” and consideration.

Fraud in revenue recognition

The IAASB rejected the use of the term “rebuttable presumption” in its redrafting ISA 240 as part of the clarity project because “rebuttable presumption” is actually an American legal term that was adopted by the PCAOB and the IAASB chose to avoid using American legal terms in international standards. Nevertheless, extant ISA 240 includes one case of referring to “rebutting a presumption” in paragraph A31. However, this is not standard English because the word “rebut” can also mean that one has made a claim of refutation without having actually refuted the matter. A refutation of the presumption is what is actually desired in this case. We therefore suggest that to avoid misunderstanding, paragraphs A110 and A111 should be changed in line with paragraph A112 (using “applicable”) to read as follows:

A110. ...The significance of fraud risk factors related to revenue recognition, individually or in combination, ordinarily justifies the applicability of the presumption that there are risks of material misstatement due to fraud in revenue recognition.

A111. There may be circumstances where it is justifiable that presumption that there are risks of material misstatement due to fraud in revenue recognition is not applicable. The auditor may conclude that there are no risks of material misstatement due to fraud relating to revenue recognition in the case where fraud risk factors are not present or not significant

7. Member Bodies and Other Professional Organizations

Federación Argentina de Consejos Profesionales de Cs. Económicas

Answer 3: We consider that ED 240 is adequately based on the requirements of ISA 315, maintaining a balance with its provisions and also with other ISAs, aimed at carrying out the risk identification and evaluation process in a solid manner, in an audit of financial statements.

European Federation of Accountants and Auditors for SMEs

While in general we support ED-240 building on the foundational requirements in ISA 315 and other ISAs, we believe the presumed risk of fraud in revenue recognition is less relevant for SMEs as it is in larger entities. A more calibrated consideration of where fraud risk appears could have been used to develop some of the foundational thinking for the standard. We wonder whether recognizing sales or costs in an incorrect accounting period, manipulating stock, or manipulating bad debt provisions would be more prevalent risks than revenue recognition, especially for SMEs.

We welcome the application guidance for smaller and less complex entities but believe more guidance is required to illustrate what would be appropriate and how scalability would work practically. For instance, A55 of ED-240 states “In the case of a smaller or less complex entity, some or all of these considerations may be inapplicable or less relevant.” While some examples are provided, there is insufficient illustration of the expected process and what elements of the considerations can be scaled back to make them more applicable to SMEs.

Institute of Chartered Accountants of Scotland

We believe there is scope for considerable refinement to ensure that ED-240 does appropriately build on the foundational requirements in ISA 315 (revised 2019) and other ISAs to support a more robust risk identification and assessment as it relates to fraud in an audit of financial statements.

ED-240 contains various examples of the inclusion of very similar content to that found in ISA 315 with little substantive additional reference to specific fraud matters. We would encourage the IAASB to review such matters e.g. the only apparent difference between paragraph 26 of ED-240 and paragraph 13 of ISA 315 is the need for the auditor to take account of fraud risk factors when identifying and assessing risks of material misstatement. There are a series of similar examples of this repetitive approach. We would encourage the IAASB to focus on providing enhanced clarity to clearly differentiate what are the incremental requirements in ED-240 i.e. those assessed specifically through a fraud lens related to the risk assessment process versus those requirements required by ISA 315 (Revised 2019) that when executed as intended would not require any additional work effort to identify and assess risks of material misstatement due to fraud.

We also believe that the requirement in paragraph 33 of ED-240 could be enhanced by better aligning with paragraph 19 of ISA 315 (Revised). In particular, as per paragraph 19 of ISA 315, paragraph 33(a)(i) of ED-240 should include the need for the auditor to have an understanding of the entity’s business model. We believe that such an approach would assist the auditor’s understanding of whether, and where, third-party relationships may exist, and therefore, their consideration of third-party fraud.

We also believe that the requirement in paragraph 33 of ED-240 could be enhanced by better aligning with paragraph 19 of ISA 315 (Revised). In particular, as per paragraph 19 of ISA 315, paragraph 33(a)(i) of ED-240 should include the need for the auditor to have an understanding of the entity’s business model. We believe that such an approach would assist the auditor’s understanding of whether, and where, third-party relationships may exist, and therefore, their consideration of third-party fraud.

9. Individuals and Others

Albert Bosch

The link to ISA 315 is clear and this link prevents inconsistencies between ISA 240 and ISA 315.

However, fraud has a very different characteristic than any other aspect of an audit. The financial statements are essentially nothing more than a collection of assertions made by management, such as the assertion that goodwill is worth \$ 2.5 million, that there inventory worth \$ 1.8 million and that this inventory is salable, and

that there are \$ 3.0 million in bank loans. These are all assertions that normally speaking are verifiable. They can be proven. The financial statements also contain the implicit assertion that no fraud has been committed (or that there are no misstatements due to fraud). Such an assertion is never verifiable, but at most falsifiable (similar to Karl Popper's theory about scientific theories).

An auditor can in theory identify infinitely many fraud risks. From obtaining an understanding of the client, fraud risk factors (FRF) can be identified. The evaluation of those FRF leads to the identification of fraud risks and the rejection of fraud risks (or not identifying certain fraud risks or not distilling a fraud risk from a FRF). The latter group is often larger than the first group. From the above-mentioned idea that the absence of a (misstatement as a result of) fraud can never be proven, it is necessary to support the auditor more and better in the process of rejecting or not identifying fraud risks. This is an important part of the risk analysis, but ED 240 does not sufficiently support the auditor in this (as ISA 315 does not support the auditor in this either).

Practical issues related to this are, for example:

Is audit evidence required in the planning phase to reject or to not identify a fraud risk?

Can an auditor in the planning phase reject a fraud risk based on the design and implementation of internal control?

Can positive information about the design and implementation of an effective control only be used together with other positive information to reject a fraud risk?

Reference is made to ED 240 paragraph 38 and corresponding application material. The current requirement is one dimensional. If ED 240 does not address this issue, ISA 240 will contain a major shortcoming and auditors and regulators will continue to struggle with (and disagree about) the fraud risk analysis.

4 Disagree

5. Accounting Firms

BDO International

Disagree, with comments below

The following are some areas that we believe need further guidance and clarification:

The concept of fraud risk factors is used in various requirement paragraphs of ED-240, including paragraphs 18(b), 26(a), 27, 29(a)(ii), 32, 33(b), etc. However, it is not clear whether the identification of fraud risk factors is required. For example, paragraph 26(a) states that fraud risk factors are 'tak[en] into account' whereas paragraph 27 indicates that the auditor 'shall consider' fraud risk factors, paragraph 29(b) that the engagement team discussion 'shall include' fraud risk factors, and paragraph 32 that the auditor 'shall evaluate' whether the audit evidence from the risk assessment procedures and related activities 'indicates' that one or more fraud risk factors are present. We suggest clarifying the wording in the different requirement paragraphs where fraud risk factors are referred to ensure consistency.

Further, it is not clear in paragraph 32 of ED-240 whether the intent is for the auditor to evaluate audit evidence obtained from risk assessment procedures and related activities for the existence of fraud risk factors overall or on an individual basis. We suggest adding further clarification in this area. Also, the title of paragraph 32 ('Evaluation of fraud risk factors') is confusing: this paragraph is about the evaluation of the audit evidence from the risk assessment procedures, not about the evaluation of the fraud risk factors.

Paragraph 240.A55 says that the determination (please note the different wording compared to 'evaluation', which is confusing) as to whether fraud risk factors indicate that there are risks of material misstatements due

to the existence of fraud, is a matter of professional judgment. We suggest adding some examples, perhaps in implementation or other non-authoritative guidance, which result in an auditor identifying a risk of material misstatement due to fraud as well as examples of when an auditor does not identify a risk of material misstatement due to fraud even though fraud risk factors are present.

Paragraph A111 states 'The auditor may conclude that there are no risks of material misstatement due to fraud relating to revenue recognition in the case where fraud risk factors are not significant.' The part 'where fraud risk factors are not significant' suggests an assessment of fraud risk factors which seem inconsistent with the requirement paragraphs as noted in the prior bullet points, where the words 'take into account', 'consider' etc. are used, to identify possible fraud risk factors. The requirement paragraphs do not mention the word 'significant' nor imply an assessment of fraud risk factors. We suggest adding further clarification in this area.

Paragraph A111 also includes examples when rebutting the risk of material misstatement due to fraud in revenue recognition may be considered appropriate. As these are relatively simple and non-complex situations, we suggest adding some examples of more complex situations where the rebuttal of fraud risk in revenue recognition may still be appropriate. For example:

Property taxation revenue in a local Government that is determined by applying a fixed rate to externally assessed property values to arrive at the budgeted revenue: This situation is more complex than the examples currently provided, but auditors could still conclude that the fraud risk factors are not significant. This is because as the revenue amount is fixed, there is no motivation (once the budget is approved, there is no reason to change the revenue total) or opportunity (any manipulation of the assessment values would be offset by a change to the rate) to overstate or understate the revenue that has been approved by those charged with governance.

The audited entity is a housing association with an x-number of comparable rental units (houses). The fraud risk in revenue recognition can be rebutted due to the simple and homogeneous nature of the transactions (fixed rental prices, quantity of rental units has not changed and there are no vacancies). There is no motivation or opportunity to fraudulently report rental income as prices and quantities are fixed.

Further, we suggest that paragraph 240.41 emphasizes that the presumed risk of fraud in revenue recognition primarily relates to fraudulent financial reporting rather than misappropriation of assets. We believe explicitly stating that the presumed fraud risk in revenue recognition is primarily related to fraudulent financial reporting will improve consistency and therefore quality in identifying and assessing risks of fraud in revenue.

The wording in paragraph 42 seems to imply that auditors are expected to identify multiple risks of material misstatement related to the management override of controls. We suggest some clarification on this requirement as there are likely some instances when there may only be a single risk related to management override of controls.

Paragraphs ED 240.33-39 relate to procedures from ISA 315 about obtaining an understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control. However, these requirements are based on ISA 315 which are now included in ED 240. We foresee the risk that some regulators may interpret these requirements as separate procedures to identify and document fraud risk factors whereas another interpretation is to evaluate the evidence obtained through a fraud lens (i.e., not separate procedures). Please provide some clarity on these requirements.

Crowe

Disagree, with comments below

Foundational requirements: We concur with the need for the auditor to perform a robust risk identification and assessment as it relates to fraud, as well as to maintain a “fraud lens” when conducting the audit. However, we are concerned about the extent of duplication of content from ISA 315 (Revised) within ED-240, and the implications for the auditor’s performance and documentation requirements. It is not clear if the fraud-related risk assessment procedures are incremental requirements or if they are meant to drive the auditor to perform the “foundational requirements” with the application of a “fraud lens”.

We believe that the intent of the IAASB was to present the “foundational requirements” with a fraud lens in ED-240. The proposal indicates that “The phrase “In applying ISA...” signals that a requirement is intended to be applied in addition to or alongside performing the relevant requirements of the foundational standard.” However, the presentation in ED-240 may appear to auditors as incremental (and separate) required risk assessment procedures, specific to fraud. As such, to comply with the requirements, auditors may, unnecessarily, duplicate certain risk assessment procedures and related documentation.

We believe the most effective risk assessment procedures should include a cohesive focus on risks due to fraud and error. As an alternative to “repeating” or linking the foundational requirements of ISA 315 (Revised) in ED-240, the IAASB might consider clarifying in ISA 315 (Revised) that the requirements are intended to address both “risk of errors and risk of fraud”.

Rebutting the presumption of fraud risk in revenue recognition: We agree that there can be value in providing guidance to auditors on how to assess the ability to rebut the presumption that there is a fraud risk related to revenue recognition. However, we don’t believe that the application guidance provided in A110 of ED-240 is clear in this regard, as this paragraph states that it would be inappropriate to overcome the presumed risk. The examples provided in A111, however, appear to imply that and provide examples on how the auditor can overcome the presumed risk, when the fraud risk factors are not significant. As a result, this may drive inconsistent interpretation and application of the standard in this regard. We recommend that the IAASB update A110 to remove the following sentence “The significance of fraud risk factors related to revenue recognition, individually or in combination, ordinarily makes it inappropriate for the auditor to rebut the presumption that there are risks of material misstatement due to fraud in revenue recognition”. Along with this, examples provided in A111 should illustrate how the auditor may conduct the assessment and include an explanation for the conclusions reached in the example.

SRA

Disagree, with comments below

We make a general remark. The exposure draft of ISA 240 incorporates the relevant elements of ISA 315 and makes them specific for identifying and assessing the risk of material misstatement due to fraud. However, ISA 315 also includes requirements for applying inherent risk factors aimed at identifying the risk of material misstatement due to fraud (the factor ‘susceptibility to misstatement due to management bias or other fraud risk factors’). ISA 315 refers to ISA 240.A24-A27 in this regard. This is confusing. In our view, it is recommended that either there is a strong and clear relationship between the requirements of ISA 315 and ISA 240, or that ISA 315 also includes the auditor’s responsibilities for identifying and assessing risks related to fraud. The latter would mean that, for example, a distinction could be made between identifying and assessing a risk of material misstatement resulting from fraud (to be included in ISA 315) and responding to an assessed risk of material misstatement resulting from fraud (‘response’, for example to be included in ISA 330 or a new specific ISA).

ED Paragraph 27. The term ‘information from other sources’ is, despite the reference to ISA 315, not entirely clear. In our opinion, the application material (paragraphs A45 and A46) gives examples that do not fully correspond to ISA 315 paragraphs 15 and 16. We propose to clarify the scope of this requirement in the application material.

ED Paragraphs 26, 32 and 40. With regard to identifying and assessing a risk of material misstatement due to fraud, in our view it is not sufficiently clear what the difference and relationship is between a fraud risk factor, fraud risk and a risk of material misstatement due to fraud. Furthermore, in our view it is not sufficiently clear how fraud risk factors should be used to identify and assess the inherent risk of material misstatement due to fraud (whereby internal control may not be taken into account). This mainly concerns the application of the fraud risk factor ‘opportunities’. In this regard we note that paragraph 18(b) is not addressed in the IAASB’s request for comment. However, we do have comments on it. In our opinion, the explanation in paragraph A23 is difficult to read, partly due to the use of ‘may’ and ‘opportunities that arise from events or conditions [...] before consideration of controls.’ Taking the lack of internal control into account as an ‘event’ or a ‘condition’ seems in itself contradictory to the principle that internal control may not be taken into account.

See also appendix 1, page 70. This appendix (on page 75) provides examples of ‘inadequate controls’ as a fraud risk factor. Almost all examples can be reformulated ‘positively’ by changing ‘inadequate’ to ‘adequate’ or omitting the words ‘lack of’. However, in that case, the ‘positive’ contributions of controls may not be taken into account.

We give as an example the use by an entity of a bank account for money transfers (payments and receipts). In these cases, there is normally an inherent risk of ‘misappropriation of assets’ (f.i. the fraudulent withdrawal of money from the bank account). The auditor must, if there are deficient controls around payment transactions, take this ‘condition’ into account when assessing the risk of a material misstatement resulting from fraud (despite the fact that the auditor may not, in principle, take controls into account when assessing an inherent risk). Suppose now that the auditor does not identify opportunities that arise from ‘events’ or ‘conditions’ that lead to a higher estimate of the inherent risk. However, because the auditor may not take into account the fact that the entity has set up internal control measures around payment transactions when assessing the inherent risk, the conclusion is - as we understand - that this inherent risk must always lead to the identification of a risk of a material misstatement resulting from fraud.

Our question based on this example is: how can the auditor - when acting according to the ISAs - arrive at the conclusion that he will not identify a fraud-related risk of a material misstatement, if there is an inherent risk of fraud but there are no opportunities that arise from events or conditions that lead to an increased risk of a material misstatement? In other words, is it conceivable that positively formulated factors are identified that contribute to reducing the inherent risk of material misstatement due to fraud?

Paragraph A55 is not very helpful in this respect. It states that fraud risk factors are present, but there are no ‘circumstances’ that lead to the identification of a risk of a material misstatement resulting from fraud. This is a ‘matter of professional judgment’ and can (therefore even) mean that deficiencies in internal control do not ultimately lead to the identification of one or more risks of a material misstatement resulting from fraud. This seems to contradict other explanations on this point in the exposure draft.

ED Paragraph 38 raises a number of questions, in particular because the definition of the term ‘journal entries’ (we will abbreviate this to JE hereinafter) is missing. The exposure draft contains the combination ‘JE and other adjustments’, as well as the terms ‘standard JE’, ‘non-standard JE’ and ‘specific classes of JE’. There seems to be a distinction between ‘routine processing of transactions’ and JE. However, routine processing of transactions is also done in principle by means of journal entries. In appendix 4, page 84 at the bottom,

some explanation seems to be given: ‘non-standard journal entries - where the journal entries are automated or manual and are used to record non-recurring, unusual transactions or adjustments’. However, this explanation does not apply as a definition.

In line with this, we note the following. If according to par 38(a) insight must be obtained into ‘Controls over journal entries, designed to prevent or detect fraud’, it is not clear whether this concerns controls that are related to JE that relate to identified risks of a material misstatement resulting from fraud, to all controls that are intended to detect or prevent fraud in general or to controls that specifically relate to the concept of JE (see above). See also paragraph A102, which discusses the GITC. The same questions apply here with regard to the scope of the insight to be obtained with regard to JE.

ED Paragraph 41. In our opinion, paragraph A111 weakens the requirement in paragraph 41 by using ‘If’ at the beginning of this paragraph and the relationship with ‘professional judgment.’ The last sentence of paragraph A111 seems to correct this, but ‘ordinarily’ again gives the auditor a lot of room to rebut the assumed risk. If the intention of the exposure draft is to increase the threshold for being able to rebut the assumed risk of a material misstatement resulting from fraud relating to revenue recognition, we advise tightening the formulated requirement on this point and adjusting the application material accordingly.

ED Paragraph 42. As regards paragraph 42 (concerning the risk of ‘management override of controls’), the relationship with paragraph A171 is in our view somewhat strange, because it states: The auditor may determine that certain risks of material misstatement due to fraud did not require significant auditor attention and, therefore, these risks would not be considered in the auditor’s determination of key audit matters in accordance with paragraph 62. Does this now mean that it is possible that the auditor does not pay ‘significant attention’ to the risk related to ‘management override of controls’?

Forvis Mazars

Disagree, with comments below

We do not believe that ED-240 builds on the foundational requirements in ISA 315 (Revised) as the existing requirements in ISA 315 largely appear to be repeated in the proposed standard. This continues a trend in recent years where concepts from ISA 315 (Revised) are repeated in other standards as and when they are updated. We believe that requirements for risk assessment should be contained within ISA 315 (via conforming amendments if necessary) rather than scattered through multiple individual standards, in this case repeating requirements with the addition of the word “fraud” where relevant to existing ISA 315 content.

This trend is leading to a circularity in the standards which can sometimes be confusing, an example of which relates to the difference between how inherent risk factors are dealt with in ISA 315 (five inherent risk factors to consider) and ED-240 (with around 80 examples of events or conditions that could give rise to fraud risk factors). The IAASB may wish to consider whether different terminology should be used in ED-240 such as “indicators of fraud” rather than fraud risk factors. Furthermore, despite the significant content on fraud risk factors, it is not clear how these may impact the fraud risk assessment itself.

The reference in ED-240 to considering and reporting on control deficiencies from a fraud perspective appears to imply that auditors should be testing the operating effectiveness of controls – it is not clear if this is the IAASB’s intention. More importantly, the proposals do not take account of the fact that there may be more important control deficiencies in other areas of the audit that do not need to be reported in the same way that control deficiencies over fraud are, raising the importance of fraud in every audit even where other risks and findings may be more relevant.

Analysis of how the IAASB considers that the following procedures would have led to the identification of fraud risks and/or discovery of previous frauds would be powerful when updating the standard:

ED240.26 - will this lead to step change in behaviour over and above ISA315.13?

New requirements in ED240.33 compared to ISA315.19

New requirement to consider whether deficiencies are relevant to fraud.

We note that requirements around analytical procedures (ED240.31 & ED240.54) and those relating to fraud in revenue (ED 240.41) include a change in work effort from “evaluate” to “determine”, but we do not believe that these changes will shift the dial in auditor behaviour or lead to a substantive change in the work performed or documented in these areas. These changes represent further examples of where changes to the standard may appear likely to have a more significant impact than they will have in reality.

We note that ED240.A111 appears to give more flexibility for auditors to rebut the presumption of fraud in revenue, referring to situations “where fraud risk factors are not significant” and we welcome this change in emphasis compared to the extant standard which may go some way to addressing our comments above. Further guidance would be helpful to assist auditors considering the rebuttal of the presumption of fraud in revenue recognition, using realistic examples of when the auditor may appropriately rebut the presumption and, equally importantly, when it may not be appropriate to rebut the presumption. For example, it may not be appropriate to rebut the presumption when: revenue is a key performance indicator when assessing the entity's financial performance the compensation of management and/or sales staff depends significantly on the revenue achieved there are changes in the accounting principles that provide an opportunity for management to commit reporting fraud or that reveal a lack of (or significant deficiency in) internal control for controlling these changes in the accounting principles the entity applies aggressive accounting policies for revenue recognition the entity applies revenue recognition accounting policies that are unusual for the industry the entity operates in an emerging market revenue is based on significant estimates, such as an overtime revenue recognition method based on an estimated input revenue recognition accounting principles can be interpreted in different ways revenues are based on complex contractual terms with a high degree of uncertainty, for example, contracts in construction, manufacturing and/or contracts with multiple parts (“multiple arrangements”) the entity has a known history of significant adjustments for improper revenue recognition (e.g., recognizing revenue too early) the company deals in high-value goods that are easily misappropriated a significant portion of revenue is realized through cash sales.

We believe that the application material relating to risk identification and assessment could be enhanced, for example:

ED240.29 - Indicators of potential challenges arising from poor standards of culture, integrity and ethical values and how they might give rise to fraud risks

Engagement team discussion – guidance on topics such as potential pitfalls for team discussions (e.g. lack of preparation, engagement team dynamics and attitude of team members) and the need for the engagement partner to create an open and frank discussion

ED240.61 - Risk factors around strategy may include business opportunities (e.g. the entity targeting an exclusive contract, gaining footprint in a new market, obtaining guarantees to become or remain the preferred supplier)

ED240.35b – Guidance on inquiries of management may be strengthened by providing examples of topics to discuss or questions that auditors may consider

ED240.31 – Guidance around performance of analytical procedures could be enhanced by providing examples of analytical procedures which may be more likely to identify potential fraud risks (e.g. use of longer-term trends, ratios, industry or competitor comparison and non-financial performance measures which may identify inconsistencies with financial information)

6. Public Sector Organizations

Riksrevisionen (Swedish National Audit Office)

Application material for risk assessment

Our concern is that the application material drives the auditor to do more work than necessary for the audit. Below are a few examples:

The application material for the understanding of the control environment suggest that the auditor should gather information about how the entity whistle blow system functions. This may be totally irrelevant if there are no risks and never have been any issues with fraud.

The team discussion is an important part of the risk assessment. The application material states that the team may involve experts with forensic skills. These could analyze data to identify any suspected fraud. First of all we do not think that the standard should refer to a specific expertise where there is no universal definition of what forensic is. This could also be interpreted differently as in many jurisdictions' forensics are only used in investigative work. Which is not something an auditor should do. We suggest that the standard uses a neutral terminology instead, just referring to experts with analytical skills. We also question whether the audit should "look for" suspected fraud.

Further on, the application material states that the team could base their risk assessment on asking "what if" questions. We think that this is a wider scope of assessing risks than what is stated in ISA 315 referring to assessing inherent risk, probability and consequence.

We do understand that the application material is not mandatory though it scopes the intention of the requirements. The application material "drives" the audit in certain directions. We believe that the application material is not in proportion to the application material and guidance for team discussion and risk assessment related to other risks. This may also come across as risk related to fraud are more important than any other risk.

Our conclusion is that the requirements combined with the application material related to risk assessment may lead the auditor to perform more procedure than necessary. There is also a fine line between gathering information and performing procedures to assess risk and doing "forensic investigations". We believe that the standards drive the auditor toward doing more investigative work which may touch upon crime investigations.

We suggest that the standard

clarifies that the procedures we perform in the risk assessment may vary between audited entities. We might need to do more in environments where we potentially have higher risk including fraud and less if not so.

tones down the forensic and investigative aspects.

Disagree, with comments below

See above under Auditor responsibilities

7. Member Bodies and Other Professional Organizations

Chartered Accountants Ireland

Disagree, with comments below

We have the following suggestions to improve the clarity of ED-240, in particular in relation to building on the foundational requirements in ISA 315 (Revised 2019):

ISA 315 (Revised 2019) is repeated in some instances (e.g. Paragraph 33 around obtaining an understanding of the entity and its environment including considering the entity's organizational structure and ownership, the industry, performance measures) this is already included in ISA 315 (Revised) and should not be repeated here as it implies additional work effort will be required. Additional items added to build on the foundational requirements of ISA 315 (Revised 2019) should rather be added in ISA 315 (Revised 2019) directly instead of setting out additional requirements here, as the requirements in ISA 315 also has a fraud lens and not just in relation to risks of material misstatement due to error. Another example in relation to this is in paragraph 34 where there is a reference to the requirement to understand the entity's information system and communication relevant to the preparation of the financial statements which shall include understanding how journal entries are initiated, processed recorded and corrected as necessary. ISA 315 (Revised 2019) already includes detailed consideration around information systems and communications.

Paragraph 13 refers to "the quality of judgments" which is a subjective term. We recommend that a definition is added or explained further in application material

Paragraph 33 of the current ISA 240 standard and ISA 540 (Revised), paragraph A57, currently states that a retrospective review of management judgments and assumptions related to "significant accounting estimates" is required. The term "significant" has been removed in ED-240, paragraphs 28, A47, and A136. By removing the word "significant" from ED-240 and ISA 540 (Revised), auditors would now be required to consider all estimates regardless of their nature, size, or inherent risk. Accordingly, we suggest that the IAASB add back the word "significant" to ISA 540 (Revised), paragraph A57, and ED-240, paragraphs 28, A47, and A136.

We note that it would be helpful for paragraph A104 to indicate that the list of examples is not exhaustive- for example:

"Relevant assertions and the related classes of transactions, account balances or disclosures that may be susceptible to material misstatement due to fraud include, but are not limited to:"

Examples throughout the application material in A104 and A109 could be enhanced by providing a better linkage to fraud risk factors to result in better fraud risk identification and assessment.

The wording in A110 noting that "The significance of fraud risk factors... related to revenue recognition, individually or in combination, ordinarily makes it inappropriate for the auditor to rebut the presumption that there are risks of material misstatement due to fraud in revenue recognition." is very strong in comparison to the extant standard where it notes "The presumption that there are risks of fraud in revenue recognition may be rebutted.". We do not agree with the update to the wording as it indicates that it would be inappropriate to rebut the presumption, however there are a number of scenarios in which it would be appropriate to rebut the presumption.

In relation to paragraph 41, the application material at A111 includes examples of when it is appropriate to rebut the presumption that there are risks of material misstatement due to fraud in revenue recognition, however these examples do not appear to mirror real-world scenarios and don't look to allow for scalability e.g. the example in relation to leasehold revenue from one single unit doesn't seem to allow for instances where there is more than one unit. We recommend additional guidance be added to the application material to allow auditors to make a judgement based on when it may not be appropriate to rebut the presumption that there are risks of material misstatement due to fraud in revenue recognition as opposed to only when they

can rebut. Further, A111 could be enhanced by providing a better linkage to fraud risk factors to result in better fraud risk identification and assessment.

CPA Australia

Disagree, with comments below

We have received feedback from our members and others that there are practical challenges in applying ISA 315 (Revised). Consequently, we are unsure if it is appropriate to base the requirements in ED-240 on ISA 315 (Revised) at this stage. Perhaps, a PIR should first be done on ISA 315 (Revised) prior to revising all the other standards and using ISA-315 as the main point of reference, including ISA 240.

We are also concerned that ED-240 over-emphasises the importance of fraud risk, treating it as fundamentally different from other audit risks. Fraud is not inherently exceptional compared to other risks, and there may be other more significant existential risks to entities. Therefore, fraud risk may be of lesser concern to managers or TCWG than other risks. While fraud risk is important for auditors, it should not overshadow other critical risks identified in a financial statement audit.

Similarly, revenue is singled out for fraud risk presumption, which we question. The risk of revenue overstatement may be significant for listed and larger entities where there are pressures or incentives on management to commit fraudulent financial reporting and to manipulate the revenue growth or profit. However, this risk is often insignificant for smaller entities, where owners are also managers. In SMEs, risks may lie more in the presentation of liabilities, affecting banking facilities and covenants.

Over-emphasising fraud risk could reduce audit quality and detract from addressing other important risks. We encourage the IAASB to adopt a more principle-based approach, allowing auditors to use professional judgment in risk identification and assessment. For example, the presumption of fraud risk in revenue recognition could be re-purposed as one of the many examples of risky areas depending on the circumstances of the audited entities.

The risk identification and assessment section lacks scalability and practical guidance for smaller entities. Although ED-240 paragraph A88 states that “When there are no formalized processes or documented policies or procedures, the auditor is still required to obtain an understanding of how management, or where appropriate, those charged with governance identify fraud risks related to the misappropriation of assets and fraudulent financial reporting and assesses the significance of the identified fraud risks.”, ED-240 is unclear on what constitutes appropriate and sufficient audit evidence that is required to conclude on the entity’s control environment. As such, additional guidance on scalability in practice would be beneficial.

We also disagree with involving forensic and other experts in team discussions for every audit engagement, as stated in paragraph A49. Forensic insights could be shared more effectively through firm-wide training on fraudsters' modus operandi. Additionally, when scalability is mentioned, it is unclear to which requirements it refers. For instance, paragraph A58's reference to scalability is ambiguous relative to the preceding paragraph A57. We also suggest moving the detailed content of paragraphs A51 to A53 to the appendix of the standard for clarity.

Accountancy Europe

Disagree, with comments below

Requirements in ISA 240 should promote an integrated risk-based approach with respect to fraud and, therefore, the requirements in ISA 315 (Revised 2019) should not be repeated unless there is a specific

procedure to be performed in addition to or alongside those required by ISA 315 (revised 2019). We see that this principle is not always followed in ED-ISA 240 (for example, in proposed paragraphs 26 and 33).

The implications of fraud committed by management are generally more severe and their detection is subject to greater inherent limitations compared to fraud committed by employees or third parties. Therefore, the risk of fraud involving the management of the entity requires a different audit approach and we believe that this difference is not properly addressed in ED-ISA 240.

In this regard, the auditor should consider management's tone at the top with regards to fraud, and where applicable, oversight of those charged with governance on the entity's fraud risk management. This should include understanding of the entity's whistleblower program if one exists and inquiries of key individuals responsible for the program, as part of auditor's risk assessment and identification.

Chamber of Auditors of the Czech Republic

Disagree, with comments below

We believe that the requirements of ISA 315 (Revised 2019) should not be repeated in ED-240, except when a specific procedure beyond those required by ISA 315 (Revised 2019) is required.

In paragraph 35b, we miss the inquiry about the entity's internal control system to make the paragraph consistent with paragraph A89.

Institute of Chartered Accountants in England and Wales

Disagree, with comments below

Many stakeholders we consulted were experienced partners from firms of all sizes. They suggested that fraud-related considerations, the content of which has been clarified by ED-240 Para. 29, are already firmly on the agenda during engagement teams discussions. They did not object to the clarification, however, and acknowledged that there was some inconsistency in relation to how far firms think they should go in this discussion. Paras. A50 – A53 certainly provide useful guidance on the shape these discussions might take. We agree with the proposed revision to mandate the inclusion of fraud-related matters as part of the engagement team discussion.

We are concerned however, that attempts to align standards with ISA 315 (Revised 2019) over the last few years have become too circular. Ideas and concepts emerging from this standard are being duplicated in the subsequent revisions of other standards with little focus or specificity in relation to the standard being revised.

This is true of ED-240. Some of the content appears to be pure repetition of ISA 315 with no fraud-specific considerations. This runs contrary to IAASB's endeavours to 'present the foundational requirements (of ISA 315) with a fraud lens in ED-240' (EM, Section 1-F, Para. 39(a)).

Examples we have identified include:

ED-240 Para. 26 is lifted almost entirely verbatim from ISA 315 Para. 13, with the only adjustment being that the auditor should take 'fraud risk factors' into account when identifying and assessing risks of material misstatement.

There is little substantive difference between ED-240 Para. 33 and ISA 315 Para. 19. Again, the only real difference is the addition of 'fraud risk factors' when gaining an understanding of the entity and its environment and the applicable financial reporting framework.

There is a lack of clarity regarding the interrelationship between ED-240 Para. 34(a) and ISA 315 Para. 21(a). ISA 315 already requires the auditor to obtain an understanding of how management's oversight responsibilities are carried out, including the entity's culture and management's commitment to integrity and ethical values. The proposed ED-240 requirement is not articulated in a clearly incremental manner.

The language used in ED-240 Para. 36(a) is almost identical to that of ISA 315 Para. 24(a), the only difference being that the reference to the effectiveness of controls in ED-240 specifically cites controls to prevent or detect fraud.

We note 13 repetitions of 'In applying ISA 315...' in ED-240. The EM elaborates on the use of the phrase, stating that it 'signals that a requirement is intended to be applied in addition to or alongside performing the relevant requirements of the foundational standard.' IAASB should exercise caution in making excessive circular references to another standard while adding nothing materially new.

We suggest that, rather than simply copying and pasting the corresponding requirement from ISA 315 and adding some fraud-specific terminology, IAASB should build on the foundational principles of the risk identification and assessment standard by focusing on what is truly distinct when fraud is concerned.

The language used in ED-240 Para. 43 (which describes designing and performing audit procedures in a manner that is not biased) does not align with similar concepts in ISA 315 or in proposed Para. 8 of ED-500. It is unclear whether this change is deliberate. However, as the foundational concept will exist primarily in ISA 500, we would expect the fraud standard to adopt language consistent with the foundational standard.

We also highlight a potential disconnect between how ISA 315 sets out the inherent risk factors, and how this is achieved in ED-240.

ISA 315 specifies five such risk factors that auditors should consider when identifying and assessing risk inherent in classes of transactions, account balances or disclosures: complexity, subjectivity, change, uncertainty, and susceptibility to misstatement due to management bias or other fraud risk factors (ISA 315 Para. 12(f)). In relation to these 'other fraud risk factors', the standard directs the auditor to paragraphs A24 – 27 of ISA 240 which in turn steers them towards Appendix 1 which remains almost unchanged in ED-240. These appendices provide over 80 examples of events or conditions that could give rise to fraud risk factors in the incentive-opportunity-rationalisation fraud risk triangle.

We appreciate the value of these fraud risk factor examples, but there is a gap to be bridged between ISA 315's five high-level inherent risk factors and how they connect with the appendix to ED-240. Both are described as fraud risk factors. IAASB might rename the fraud risk 'factors' in ED-240 as 'indicators' or similar, to distinguish them from ISA 315's inherent risk factors and avoid confusion.

ISA 315 (Revised 2019) also makes it clear that risk cannot be pigeonholed into discrete categories and should be assessed by reference to a spectrum of risk (ISA 315 Para. 5). ED-240's position, conversely, is that the identified and assessed risks of material misstatement due to fraud must be treated as significant risks (ED-240 Para. 40(b)). A problem arises where fraud risks only just exceed materiality. It is not clear whether they must be assessed as significant risks, regardless of the ISA 315 spectrum. The spectrum is not well-articulated in ED-240 and we encourage IAASB to consider what it can do to address this disconnect.

South African Institute of Chartered Accountants

A106. For public sector entities, misappropriation of assets (e.g., misappropriation of funds) may be a common type of fraud.

The above application material has the potential of giving undue perception that fraud arising from misappropriation of assets only exists in the public sector audit engagements. It is essential for a standard in dealing with fraud to drive the view that fraud can occur in any audit, whether private or public sector audits.

A152: This refers to single instances of fraud. Cases may arise where there are multiple instances of possible fraud which individually may not be material but could be indicative of the entity's culture, weak control environment and oversight - e.g. fraud in assets, Supply Chain Management, payroll reimbursements etc.

The IAASB should consider providing guidance or procedures relating to what auditors should do when they cannot conclude the audit procedures in response to fraud or suspected fraud due to ongoing investigations, especially when this results in the financial statements being delayed due to the audit being incomplete. This comment is particularly relevant to ED-240 paragraph 59, because it may not yet be possible at this stage to determine the implication for the audit report.

Delaying the financial statements because of uncertainties related to suspected fraud is not in the public interest, because it may take an extended period to investigate and resolve the suspected fraud, creating significant uncertainties in the market because no information can be shared with the public during this time.

Par A153: Deals with the extension of reporting deadlines. There is no guidance to indicate how the extension will be balanced with a legal requirement that the audit report must be signed off at a specific date.

Further guidance in the application material is required regarding the actions that the auditor may need to undertake if suspected fraud is identified. For example, the standard could specify that steps to be undertaken include the following: 1. Updating the fraud risk level 2. Adjusting the audit sample sizes.

Disagree, with comments below

ED-240 does not currently support more robust risk identification and assessment related to fraud in an audit of financial statements. This is because of the following:

At the client acceptance and continuation stage, the auditor tends not to consider fraud risk but only considers it when they have accepted the audit. Consideration could be given to include guidance in the application material to prompt the auditor to perform fraud risk identification and assessment during the client acceptance and continuance assessment stage.

We propose that the IAASB provide clearer and more explicit guidance on how the foundational risk assessment requirements of ISA 315 (Revised 2019) should be applied in the context of fraud when integrated into ED-240.

4.4 Further guidance needs to be included in the application material to clarify the following:

ISA 315 (Revised 2019) paragraph A61 explains why the auditor obtains an understanding of the entity's business model. In the context of fraud risk identification, understanding the business at a strategic level, including the business risks it faces is exceptionally important because it provides the auditor with insight into management's intentions, i.e. the motivation behind their business decisions. Given intention is the key differentiator between material misstatement due to fraud and error, this is considered a key omission ED-240.

Par. 39 is unclear in its present format as to which types of internal controls need to be tested for deficiencies in preventing and detecting fraud. The link to ISA 315 (Revised 2019) is insufficient.

4.5 With respect to accounting estimates, we noted the requirements to perform a retrospective review of the outcome of previous accounting estimates ED-240 paragraph 28, and the evaluation of management's

judgments and decisions in making the accounting estimates included in the financial statements in ED-240 paragraph 51 and 52.

4.6 In ED-240 Par. 28, A47 and A136, the term significant, has been removed, however ISA 315 (Revised 2019) and 540 (Revised) refer to significant accounting estimates. This omission means that auditors are required to consider all estimates regardless of their nature, size, or inherent risk.

4.5 There are no requirements in ED-240 with respect to understanding the estimates, including the controls around estimates as it relates to risk of material misstatement of estimates due to fraud. I.e., the link between ISA 315 (Revised) and ISA 540 (Revised) and the context that explains the purpose of the assessment is included in these ISAs. Therefore, we propose enhancing Par. 28 to emphasizing why understanding, review and specific responses to estimates is particularly important in the context of the auditor's responsibilities to fraud.

Center for Audit Quality

Disagree, with comments below

Potential implications of proposed changes that are intended to build on the foundational requirements of ISA 315 and other ISAs

The CAQ appreciates the IAASB's efforts to correlate the requirements in ED-240 related to the identification and assessment of risks of material misstatement due to fraud with ISA 315. We understand and appreciate that, in developing the proposed changes relating to risk identification and assessment in the proposed standard, the IAASB was mindful of maintaining the balance between ISA 315 and ED-240 and that in making the changes the IAASB endeavored to present the foundational requirements with a fraud lens in ED-240 and not to duplicate nor repeat requirements from ISA 315 or other ISAs. As described in the ED, we understand that the construct of ED-240 paragraphs 26 through 40 (the repetitive use of the phrase "in applying ISA...") is meant to signal that a requirement is intended to be applied "in addition to or alongside" performing the relevant requirements of the referenced foundational standard. However, as written, certain of the proposed requirements in the aforementioned paragraphs are not tailored in a way that clearly demonstrates how an auditor is expected to consider them with a fraud lens or distinguish them from the requirements in ISA 315. This could result in inconsistency in behaviors, procedures, and outcomes in the implementation of ED-240, and the proposed amendments could unintentionally create undue duplicative performance and/or documentation requirements.

Specifically, we are concerned that, with respect to proposed paragraphs 26, 28, 30, and 33 of ED-240, it is not clear what the auditor would do differently or in addition to what is required by ISA 315. As currently proposed, these paragraphs may create the impression that two separate sets of risk assessment procedures – one related to identifying risks of material misstatements due to error and another related to identifying risks of material misstatement due to fraud – must be performed in order to meet the requirements (i.e., could result in a "bolt on" approach). Not only do we believe that this is not the intention of the Board, but we also believe that a holistic approach to risk assessment that considers risks of material misstatement due to fraud and error is most effective.

Our preference would have been for the IAASB to amend ISA 315 to enhance the emphasis on fraud so as not to create the confusion we describe in the paragraph above by duplicating requirements in ED-240. If the Board determines it is appropriate to retain the structure proposed in ED-240, we believe it is necessary for the Board to consider whether, with respect to the aforementioned requirements, the proposed expanded considerations related to fraud could be tailored to more specifically demonstrate how an auditor is expected

to apply a fraud lens in these aspects of their risk assessment. To the extent the Board does not find this approach acceptable, we recommend that the Board consider issuing guidance focused on how an auditor's risk assessment procedures are expected to be performed holistically in a manner that encompasses both risks of fraud and error.

Retrospective review of the outcome of previous accounting estimates

Paragraph 32(b)(ii) of extant ISA 240, which relates to audit procedures responsive to risks related to management override of controls (i.e., substantive audit procedures), requires the auditor to perform a retrospective review of management judgments and assumptions related to significant accounting estimates reflected in the financial statements of the prior year (emphasis added). Additionally, paragraph A57 of extant ISA 540 (Revised) states that a retrospective review of management judgments and assumptions related to significant accounting estimates is required by ISA 240 [FN 37 excluded] (emphasis added).

Proposed paragraph 28 of ED-240, which relates to the auditor's risk assessment procedures, does not include the word "significant" in the requirements related to retrospective reviews. Additionally, as part of the proposed changes to conform ISA 540 (Revised) to the changes being made to ISA 240, the word "significant" has been removed from paragraph A57 of ISA 540 (Revised) and the reference to ISA 240 has been updated to reference paragraph 28 of that standard. We are supportive of these requirements, as we believe it is appropriate that the auditor's risk assessment procedures would not necessarily be limited to retrospective reviews of significant accounting estimates, but rather, as described in the last sentence of ED-240.28, that the auditor would "take into account the characteristics of the accounting estimates in determining the nature and extent of that [retrospective] review [of accounting estimates]."

Proposed paragraphs 51 and 52 of ED-240, which relate to the auditor's procedures in response to risks related to management override of controls (i.e., substantive audit procedures), discuss the requirements of the auditor to evaluate management's accounting estimates, but do not limit such requirements to significant estimates. Specifically, ED-240.51 states that "... the auditor shall evaluate whether management's judgments and decisions in making the accounting estimates included in the financial statements, even if they are individually reasonable, are indicators of possible management bias that may represent a risk of material misstatement due to fraud." As ED-240.51 and .52 relate to substantive audit procedures, we believe that it is appropriate for the requirements in these paragraphs to be limited to accounting estimates associated with a risk of material misstatement to the financial statements due to fraud. As such, we believe it is important that the word "significant" be included in ED-240.51. We are concerned that without such a clarification, there is a risk of inconsistent application and execution by auditors in this area.

To address this concern, we recommend that the Board consider making the following revision to paragraph 51 of ED-240

(additions are marked as underlined):

51. In applying ISA 540 (Revised), [FN 29 excluded] the auditor shall evaluate whether management's judgments and decisions in making the significant accounting estimates included in the financial statements, even if they are individually reasonable, are indicators of possible management bias that may represent a risk of material misstatement due to fraud. (Ref: Para. A136–A138)

Presumption of risks of material misstatement due to fraud in revenue recognition

While we are supportive of the IAASB's efforts to clarify when it may, or may not, be appropriate to rebut the presumption of fraud risk in revenue recognition, we have concerns that ED-240.41 and the related application material may create confusion and, ultimately, inconsistent interpretation and application of the standard.

Specifically, we are concerned that proposed paragraphs A110 and A111 do not clearly describe how an auditor would be expected to take into account related fraud risk factors when assessing risks of material misstatement due to fraud in revenue recognition, and that the connection between the two paragraphs is not clear.

The language in proposed paragraph A110 seems to imply that it would be rare for the presumption that there are risks of material misstatement due to fraud in revenue recognition to be overcome. However, proposed paragraph A111 states that “The auditor may conclude that there are no risks of material misstatement due to fraud relating to revenue recognition in the case where fraud risk factors are not significant,” and provides examples of revenue where fraud risk factors may not be significant. Certain of those examples are not necessarily uncommon, which would seem to imply that it would not be rare for the presumption to be overcome, which appears contradictory to proposed paragraph A110.

Additionally, both ED-240.A110 and ED-240.A111 discuss the “presence of fraud risk factors” as well as the “significance of fraud risk factors.” This could be interpreted to indicate that the auditor would be expected to first determine whether fraud risk factors are present, and then, if they are, to assess whether those fraud risk factors are significant, but it is unclear whether this is the expectation or how an auditor would go about doing so. While ED-240.A111 includes “examples of revenue where fraud risk factors may not be significant,” no additional context is provided to explain why the examples represent situations in which fraud risk factors are present but not significant (as opposed to fraud risk factors not being present at all), or what the drivers are that cause the fraud risk factors in these scenarios to be insignificant.

We recommend that the Board consider whether there are changes that could be made to ED-240.A110 and or ED-240.A111 to clarify or eliminate what appears to be contradictory concepts in the two paragraphs. Additionally, we recommend that the Board consider making updates to the examples in ED-240.A111 to include context that will allow the auditor to understand why and how the relevant conclusions outlined in the examples were reached based on the considerations described in ED-240.A110 and ED-240.A111.

International Federation of Accountants

Disagree, with comments below

We note the proposals build on the foundational requirements of ISA 315 (Revised 2019). There may be a challenge to build upon this as a base until a post-implementation review has been carried out as many practitioners have raised practical challenges in applying this standard. We also raise some specific challenges regarding the approach to risk identification and assessment taken in ED-240. For the audit of smaller entities, and especially NFP bodies, the presumed risk of fraud in revenue recognition may not be as relevant as it is in larger entities. A more measured consideration of where fraud risk appears could have been used to develop some of the foundational thinking for the standard. More specifically than general revenue recognition, recognizing sales or costs in an incorrect accounting period, manipulating stock or manipulating bad debt provisions would all appear to be more prevalent risks.

More generally, while the application guidance for smaller and less complex entities is appreciated, more guidance is required to illustrate what would be appropriate and how scalability would work practically. For instance, A58 of ED-240 states “In the case of a smaller or less complex entity, some or all of these considerations may be inapplicable or less relevant.” While some examples are then provided, overall, there is not enough illustration of the expected process and what elements of considerations can be cut back to make more applicable to SMEs. The majority of businesses subject to audit are not large companies, so the standard must be designed to cater to the majority of audits rather than focus on the largest or most complex entities.

The proposed approach may also be flawed for smaller entities in that it relies on inherent presumptions such as that there will be formal, written, risk assessment processes in place at all entities. This would not be the case for many smaller entities. As such, the proposals could do more to cater for the reality of situations auditors completing engagements may face.

Some specific revisions to parts of the application guidance in this section may also be appropriate. Paragraph A47 covering the retrospective review of the outcome of previous accounting estimates seems quite general and makes reference to indications of management bias. Management bias alone in this area would not necessarily be indicative of fraud, this would need to be intentional bias to give rise to an indicator of fraud. Paragraph A54 refers to unusual or unexpected relationships giving the example of the relationship between the value of government bonds and central bank interest rates. This may be a poor choice of example as the fair value of government bonds is often observable, which limits the utility of the illustration the example provides. A more common relationship, such as that between sales and operating expenses may be more appropriate to use. Paragraph A69 makes reference to 'external sources' but none of the examples presented appear to be ones where external sources would be especially relevant. Finally, paragraph A104 includes "employee retirement benefit liabilities," as an example of an area that may be susceptible to material misstatement due to fraud, but such a risk would often appear to be limited in reality, especially where valuation reports are required. This could be removed or replaced by an example such as valuation of investments or securities under the equity method investment.

Institute of Chartered Accountants of Sri Lanka

Disagree, with comments below

Please refer to the comments for 2 above.

California Society of Certified Public Accountants

Disagree, with comments below

As mentioned in question 1 above, there is ambiguity of misappropriation of assets.

9. Individuals and Others

Dr. Rasha Kassem

Disagree, with comments below

Enhanced guidance on fraud risk assessment is necessary for auditors, and I have outlined several suggestions below. Currently, the existing standard only takes into account two fraud risk factors: pressure or motives and opportunity, while neglecting other critical factors such as management integrity and perpetrators' capabilities. This limited scope may have a detrimental effect on the overall quality of fraud risk assessment conducted by auditors. Additionally, there is no guidance on how auditors can assess or respond to these fraud risk factors.

Based on my recent study, which involved interviews with external auditors, it became evident that motives and management integrity are crucial factors in financial fraud detection and prevention. However, these factors are often overlooked by auditors due to missing guidance in the audit standards on how to incorporate them into the audit plan. Additionally, the capabilities of potential perpetrators are equally important to opportunities and should not be disregarded in the audit standards. Therefore, to improve the effectiveness of fraud risk assessment, it is recommended that the guidance for auditors be expanded to include a more comprehensive set of fraud risk factors. This would encompass considerations of motives, management

integrity, and perpetrators' capabilities. By including these additional factors, auditors can enhance their ability to identify and mitigate fraud risks more effectively, ultimately improving the overall quality of audit procedures. I include a link to my publication FYI as it includes practical guidance that could be helpful in amending the standard: <https://tinyurl.com/bdcpmzjp>

Colin Semotiuk

Disagree, with comments below

ED-240 inappropriately moves ISA 240 from an appropriate risk identification and assessment for a financial statement audit to a robust risk identification and assessment of a fraud or forensic audit, a separate engagement when management or users suspect fraud. This is clearly demonstrated by the risk assessment procedures and related activities of ED-240 taking 5 pages of the ED with over 7500 words, (17 pages), of application guidance and Appendix 1: Examples of Fraud Factors which includes almost 100, (6 pages), of factors. How will auditors efficiently document that they have considered all these requirements and guidance? What happens when a fraud occurs, and all 90-100 factors/considerations in Appendix 1 were not documented in the audit file? What response does an auditor provide a judge as to why they didn't consider "use of business intermediaries for which there appears to be no clear business justification" as one of the opportunities for management to commit fraud, the consideration is clearly stated in ISA 240 (Revised)? We highlight that this is only the risk assessment requirements.

5 No response

3. Regulators and Audit Oversight Authorities

European Securities and Markets Authority

5. Accounting Firms

Baker Tilly International

No response

7. Member Bodies and Other Professional Organizations

Fraud Advisory Panel

No response