

Fraud – Question 10

10. Are there any other matters you would like to raise in relation to ED-240? If so, please clearly indicate the requirement(s) or application material, or the theme or topic, to which your comment(s) relate.

Q10 Yes

1. Monitoring Group

International Forum of Independent Audit Regulators

Conforming amendments

The following conforming amendments are necessary to ensure the understandability and clarity of the ISAs is not reduced. For example:

A conforming amendment is needed to eliminate a circular reference included within ISA 540 and ISA 240 relating to the retrospective review requirements previously in ISA 240.33(b)(ii). ISA 240.28 references that the requirement is in ISA 540 while ISA 540 paragraph A57 references the requirement is in ISA 240.

The addition of the specific references to the International Ethics Standards Board for Accountants (IESBA) Code in A43 related to integrity, standing one's ground when confronted by dilemmas and difficult situations or challenging others should also be included as a conforming amendment to ISA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Auditing Standards (ISA 200). Inclusion within ISA 200 would be more impactful because the role and mindset of professional accountants is critical to all aspects of the audit and should not just be limited to the engagement leader's interaction with management and those charged with governance related to fraud. We would also encourage the IAASB to link A43 with the stand-back requirement discussed above.

Additional responsibilities related to fraud should be made as conforming amendments to ISA 220 so that the engagement leader's responsibilities are clearly laid out in one standard.

The changes to ISA 240 specifying that "The auditor may accept records and documents as genuine unless the auditor has reason to believe the contrary" should also be made in ISA 200.A24 (i.e., delete this lead-in sentence in ISA 200).

Conforming amendments.

In addition, IFIAR has recommendations in the following areas:

Unpredictability in the selection of audit procedures.

International Organization of Securities Commission

Appendix – Editorial Comments

Paragraph 1 – "...in particular ISA 200, ISA 230 [text added], ISA 220 (Revised), ISA 315 (Revised 2019), ISA 330, ISA 500 [text added] and ISA 701." We suggest these edits as we believe it is also important to highlight those two standards.

Paragraph 2(a) – "Plan and perform the audit to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement due to fraud. These responsibilities include identifying and assessing risks of material misstatement in the financial statements due to fraud and designing

and implementing responses to address those assessed risks. This includes considering the potential for override of controls or other inappropriate influence over the financial reporting process, such as efforts by management to manipulate earnings. [text added]” We suggest this edit because we believe this consideration is applicable to both the auditor (paragraph 2) and those charged with governance (paragraph 3).

Paragraph 8 – “Circumstances Giving Rise to the Fraud and the Identified Misstatements [text deleted] Assessing materiality of fraud or suspected fraud [text added]” We suggest revising the header to paragraph 8 to better align with the topic addressed within the paragraph and corresponding application material.

Paragraph 10 – “However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less than persuasive or contradictory [text added] audit evidence.” Additionally, we do not believe that inherent limitations of an audit justify an auditor’s satisfaction with contradictory audit evidence.

Paragraphs 10-11 – We suggest moving these paragraphs to the application material, as we believe they are an application of the key concept discussed in paragraph 9.

Paragraph 13 – We suggest moving this paragraph to the application material, as we believe it is an application of the key concept discussed in paragraph 12.

Paragraph 15 – “Some ISAs that address specific topics also have requirements and guidance that are applicable to the auditor’s work on the identification and assessment of the risks of material misstatement due to fraud and responses to address such assessed risks of material misstatement due to fraud. In these instances, the other ISAs expand on how this ISA is applied. [text deleted]” We suggest this deletion as to not imply that ED-240 contains all requirements and guidance that are applicable to the auditor’s work on the identification and assessment of the risks of material misstatement due to fraud and responses to address such assessed risks of material misstatement due to fraud.

Paragraph 17(d) – “To report and communicate [text added] in accordance with this ISA.” We suggest this edit because proposed requirements in ED-240 include both reporting and communication requirements.

Paragraph 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.” We believe the Board should provide guidance on the term “other key engagement team members” in order to promote consistent application.

Paragraph 30 - “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 and/or are inconsistent with knowledge the auditor has from performing the audit more broadly [text added], the auditor shall...” We suggest this edit because we believe an auditor should also consider whether the responses of inquiries are inconsistent in the context of the broader audit.

Paragraph 32 – “The auditor shall evaluate whether the audit evidence obtained from the risk assessment procedures and related activities indicates that one or more fraud risk factors are present and assess the risk of material misstatement [text added].” We suggest this edit because we believe this requirement should go beyond the identification of a fraud risk factor.

Paragraph 35(a)(i) – “Identifies 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 [text deleted].” We suggest this edit to reduce redundancies.

Paragraph 57(c) – “Reconsider the reliability of management’s representations and audit evidence previously obtained, including [text added] when the circumstances or conditions giving rise to the misstatement indicate possible collusion involving employees, management or third parties.” We suggest this edit because we believe that even if there was not collusion, the auditor should reconsider the reliability of managements representations and audit evidence previously obtained.

Paragraphs 61 to 64 – We believe the section, “Implications for the Auditor’s Report” (paragraphs 61 to 64), should be moved to follow the sections on “Written Representation” (paragraph 65) “Communications with Management and Those Charged with Governance” (paragraphs 66 to 68) in order to follow the ordering of the procedures in an audit engagement.

Paragraph A7 – We believe the Board should also include an example of a risk assessment procedure performed, that is not directly a fraud risk assessment procedure, that indicated the existence of fraud or suspected fraud.

Paragraph A17 Example – As proposed, it is not clear that this is an example of fraud. We suggest the Board consider revisions to the example to make the linkage to fraud clearer.

Paragraphs A18 to A20 – We note that the use of the term “bribery” may create translation issues and suggest the French translation use only one term, “corruption,” to translate the phrase “corruption and bribery.”

Paragraph A41 – “Making the required inquiries of management and those charged with governance about matters referred to in paragraphs 34(c)–34(d) and 35(b) as early as possible in the audit engagement, for example, as part of the auditor’s communications regarding planning matters, and performing updated inquiries throughout the audit engagement, up to the auditor’s report date.” We suggest this edit to reinforce the iterative process of the auditor’s risk assessment.

Paragraph A67 – We are supportive of the examples provided to illustrate areas where there may be an increased susceptibility to misstatement due to management bias or other fraud risk factors, however we believe another example related to revenue recognition should be added.

Paragraph A148 – “New allegations of fraud were made by a disgruntled former employee. Management followed the policies and procedures in place at the entity and referred the matter to the legal and human resources departments. Since the entity’s policies and procedures were followed and prior allegations of a similar nature [text deleted] with similar facts and circumstances [text added] had been investigated and determined to be without merit, management determined that no further action was necessary.” We suggest this edit because we believe “similar nature’ may set too high of a bar.

Appendix 1 – “Lack of oversight by those charged with governance over how management utilized financial aid from governments and local authorities (e.g., bailouts during pandemics, wars, or impending industry collapse) is not effective [text deleted].” We suggest this edit to avoid potential misunderstanding caused by using both the phrases “lack of” and “is not effective.”

Definitions:

Fraud

Paragraph 18(a) defines fraud as, “An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.” While we acknowledge the definition of fraud has remained unchanged from extant ISA 240, we believe the definition should be grounded in the fact that it is the auditor’s responsibility to obtain reasonable assurance about whether the financial statements taken as a whole are free from material

misstatement due to fraud. In addition, we believe the Board should consider a new definition of fraud given the following challenges:

certain terms and concepts associated with fraud, such as bribery, corruption, and money laundering, are not directly addressed in the definition of fraud (Explanatory memorandum paragraph 89(a)).

lack of clarity in understanding the auditor's role with respect to third party fraud (Explanatory memorandum paragraph 89(b)).

the subjectiveness associated with determining whether an act resulted in an "unjust" advantage; and

the challenges associated with determining whether an act resulted in an "illegal" advantage when ED-240 paragraph 6 states "the auditor does not make legal determinations of whether fraud has actually occurred."

We suggest the Board consider the following definition: "An intentional misstatement in financial statements, including the omission of an amount or a disclosure." This proposed definition provides clarity that it relates to fraud impacting the financial statements, is neutral as to who perpetrates the fraud and what types of fraud it relates to, and it closely aligns with the Board's definition of error which is defined as "An unintentional misstatement in financial statements, including the omission of an amount or a disclosure."

Regarding third-party fraud, we believe the Board should further clarify the intended scope. Paragraph A22 explains that "fraud or suspected fraud committed against the entity by customers, suppliers, service providers, or other external parties is generally described as third-party fraud." However, we believe the Board should include more guidance and examples of when third-party fraud is, and is not, considered fraud for purposes of ED-240. Also, we believe the Board should include further guidance and examples on the auditor's work effort related to third-party fraud, including the extent of procedures to be performed, in order to promote consistent understanding and application of the requirements.

We also believe the Board should include guidance to provide clarity and promote consistent understanding of the applicability of the requirements in instances where there has been misappropriation of assets while the amounts have been appropriately accounted for and sufficiently disclosed in the financial statements.

Fraud Risk Factors

Paragraph 18(b) defines fraud risk factors as, "Events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud." However, ED-240 paragraphs A2, A51, A56, A65, A157, and Appendix 1, Examples of Fraud Risk Factors, discuss the concept of rationalization as a third concept that is generally present when material misstatements due to fraud occur. Therefore, we believe the Board should consider revising the definition of fraud risk factors, the corresponding application paragraph A22, and paragraph 29(a)(ii) to include the concept of rationalization.

Journal Entries

ED-240 paragraph 50(b) requires the auditor to "obtain audit evidence about the completeness of the population of all journal entries and other adjustments made in the preparation of the financial statements throughout the period." We support this requirement; however, we believe the Board should provide clarity in the form of guidance on how to apply the requirement in instances where the auditor has concluded certain populations [emphasis added] of journal entries do not present a risk of material misstatement and no further testing will be performed. For example, in a complex group audit situation where the group auditor concluded audit work will not be performed at certain components in accordance with ISA 600, Special considerations – audits of group financial statements (including the work of component auditors), paragraph 22 due to those components not presenting a risk of material misstatement, the group auditor may need to use component

auditors for the sole purpose of testing the completeness of journal entries and other adjustments at certain components in order to comply with ED-240 paragraph 50 (b), as proposed.

2. Investors and Analysts

CFA Institute

Some Public Interest Issues Including Those Discussed by PIOB Appear Unaddressed.

Over the life of the Board's project on fraud, the Public Interest Oversight Board (PIOB) has emphasized several areas of ISA-240 that should be strengthened to better meet the public's expectations, including:

"...to explore how the auditor should consider aspects such as external sources of information, culture, tone at the top, the role of the group auditor in respect of the risk of material misstatement at a component level, and the use of IT tools, and consider how these could impact the detection of fraud."

Transparency requirements and impact of fraud on auditor's report; and

Auditor's role with respect to authenticity of documentation.

The Board's public interest mapping document does not align with issues discussed by the PIOB, but it's our understanding based on our read of ED-240 that several of these issues, other than the transparency requirements addressed above, have not been addressed. For example:

The Importance of External Sources of Information and Whistleblower Programs. Paragraphs A65 and A66 state that the auditor "may consider" listening to the entity's earnings calls, reading analysts' research reports, management's compensation packages, short-selling reports, negative media attention, or negative analyst reports.

Similarly, paragraph A70 states that the auditor "may consider" obtaining an understanding of, inspecting, and following up on matters related to an entity's whistleblower program.

Given that whistleblower programs may be more effective than auditors at detecting fraud and that some high-profile frauds seem to have been detected by short sellers and financial journalists before auditors, we urge the Board to elevate these requirements from "may consider" to "must consider."

The Presumption of Document Authenticity has Been Deleted from ED-240 But, Confusingly, Retained in ISA 200. We're not sure how to interpret this decision and urge the Board to delete this presumption from ISA 200 to avoid conflicts between the two standards.

There are Changes the Board Should Make to its Communication Approach to Increase Investor and User Engagement.

The ED-240 consultation should be presented in a manner which better enables conversation and engagement with investors and enables them to respond effectively. We believe the IAASB needs to develop outreach materials and more concise summaries of its exposure drafts that focus more on what is changing for investors and what problems it is intending to solve.

One example from ED-240 is the discussion of changes to the auditor's report regarding matters related to fraud – the example of what the proposed KAMs section may look like is buried at the end of the consultation, on page 147 of 162 in the discussion of conforming amendments to ISA 700/701. Investors do not know what ISA 700/701 are, nor do they know to look at that section for what is the only change from ED-240 that will be observable to them.

To connect and engage with investors and other users of financial statements, the IAASB needs to write documents and outreach materials that start with what change investors/users will see in what they can observe. Only then can the IAASB deepen its engagement with investors regarding the changes in processes and procedures that they cannot observe. More concise summary documents in language which is not audit standard setting heavy which highlight the issues seeking to be resolved by the proposed standard and how the changes address such investor/user concerns would also facilitate broader engagement with investors and other users.

It would also be helpful if ED-240 included a redline version that tracked the changes from extant ISA-240.

Use of technology to improve fraud detection or reduce inherent limitations of the audit. As of 2024, a significant portion of entities' transactions with customers, employees, suppliers, and providers of finance are digital. It's also our impression that it is easier to audit a greater number of digital transactions at lower cost than it was to audit paper records, which were the norm when the first auditing standards were created that prominently featured the language regarding the "inherent limitations" of an audit.

We recommend the Board add a paragraph to ED-240 like the following:

"Technological developments including the digitalization of books and records and automated tools that can analyze large quantities of data reduce the inherent limitations of an audit and, in general, increase users' expectations of assurance."

We Urge the Board to Work Globally with Other Standard Setters to Achieve Convergence

Our views with respect to high-quality audits, generally, and audit procedures related to fraud, more specifically, are jurisdictionally agnostic. Our aforementioned comment letter in response to the UK Brydon Review highlights this. We note that the US Public Company Accounting Oversight Board (PCAOB) is currently working on a project related to fraud and had a meeting discussing the topic with the Standards and Emerging Issues Advisory Group in May 2024 where fraud was the primary topic.

Investors invest globally. It is crucial for audit standard setters, particularly the IAASB and PCAOB given their "tentpole" status as the primary audit standard setters globally, to work toward a high quality, investor focused, converged, global baseline for auditors' responsibilities related to fraud.

3. Regulators and Audit Oversight Authorities

Canadian Public Accountability Board

Unpredictability in the selection of audit procedures

Paragraph A114 discusses incorporating an element of unpredictability in the selection of the nature, timing and extent of audit procedures to be performed. In our inspections, we often observed auditors incorporating an element of unpredictability by sampling a seldom-used account, changing the sampling method, or altering the testing approach for certain financial statement account balances from previous audits, consistent with the examples included in paragraph A114. The effectiveness of these methods for identifying and addressing the risk of fraud will vary depending on fraud risk factors identified by the auditors. In many instances, these procedures do not have a clear or direct link to the risk of fraud. Selecting audit procedures that incorporate an element of unpredictability should consider the specific circumstances of the audit and risks of material misstatement due to fraud. Some additional examples of how to incorporate an element of unpredictability in the selection of audit procedures have been included in IFIAR's written response to the Exposure Draft.

Committee of European Auditing Oversight Bodies

Written representations

The statement in paragraph A180 of ED 240 that “although written representations are an important source of audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal” should be moved to the requirements section as it is integral to the auditor’s use of written representations. A corresponding amendment should also be made to ISA 580.

We urge the IAASB to also reword paragraph 70(d) regarding the documentation required when the presumption related to revenue recognition is “not applicable in the circumstances of the engagement”. It 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 this 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. This would go some way towards addressing the issues identified in the CEAOB inspections findings database. 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.

Use of specialists

While ED 240 includes additional material on the use of specialists, it should be made clear that the use of a specialist does not reduce the auditor’s responsibility for the audit. The auditor remains responsible for forming and expressing the audit opinion. In addition, it is important for auditors to be clear on the expertise that they expect from that specialist and the link with the audit engagement. Discussing the need for a specialist’s involvement with TCWG may prove beneficial.

Given the continuing evolving nature of technology and its importance in many audits, the language in paragraph A36 should be amended to state that the engagement partner would usually be expected to consider expertise in IT systems etc when determining if the engagement team have the necessary competence and capabilities.

Engagement quality review (EQR)

Additional quality control review procedures focused on the engagement team’s responsibilities relating to fraud should be considered for all engagements where an EQR is required. In particular, the engagement quality reviewer should be required to review the reasons used to conclude that the presumed fraud risk related to revenue recognition has been rebutted.

Coordination with IESBA

As with other standard-setting projects, we highlight the importance of appropriate coordination between the IAASB and the IESBA. Changes to the ISAs, if any, should be mirrored to ensure consistency with the provisions of the IESBA Code and coordinated with the IESBA.

Specific items for consideration by others

We encourage the IAASB to liaise with relevant other parties which are likely to take action on the following matters to ensure a convergence of efforts to address fraud issues:

Delivering educational actions, for instance explaining the role of auditors regarding fraud more clearly and precisely to stakeholders; and

Further developing the two-way communication culture in the audit profession with audit committees and TCWG, in order to facilitate efficiency of the dialogue on fraud risks.

European Securities and Markets Authority

ESMA agrees that the recent fraud cases demonstrate that the extant ISA 240 necessitated revisiting to accommodate developments in technology and the sophistication that some fraud schemes currently entail. In this respect, ESMA invites the IAASB to further investigate if the current proposals and examples are sufficient to tackle the challenges and opportunities that Artificial Intelligence (AI) may introduce to audit work related to fraud in financial statements. Given the fast development of AI, underestimating its effects on audit procedures and audit evidence relating to fraud at this moment may prompt another revision of the standard(s) in the near future.

Financial Reporting Council – United Kingdom

We suggest amending paragraph A50 to “The exchange of ideas may serve to inform the auditor’s initial perspective about the tone at the top. The conversation may include a discussion of the actions and behaviors of management and those charged with governance, including how they promote a culture of honesty and integrity; what policies they have to facilitate and encourage reporting of wrongdoing; how they respond to any such reports; and whether there are clear and consistent actions and communications about integrity and ethical behavior at all levels within the entity.

We suggest adding in paragraph A57 as a further example of a factor that may generally constrain improper conduct by management “Appropriate segregation of responsibilities to reduce the opportunities for a person to both perpetrate and conceal fraud.”

In the application material on the control environment (paragraphs A68 – AA70) it would be helpful to support professional skepticism by adding a statement that “Although the control environment may provide an appropriate foundation for the system of internal control and may help reduce the risk of fraud, an appropriate control environment is not necessarily an effective deterrent to fraud.”

We suggest adding in paragraph A90 as a further example of others within the entity to whom the auditor may direct inquiries about the existence or suspicion of fraud “Employees responsible for the maintenance of IT systems or monitoring system logs for unusual or unauthorized activity.”

In relation to paragraphs A159 and A160, it would be helpful to add that “withdrawal from the engagement by the auditor is a step of last resort. It is normally preferable for the auditor to remain in office to fulfil the auditor’s statutory duties, particularly where minority interests are involved. However, there may be circumstances where there may be no alternative to withdrawal where that is permitted.”

Conforming and consequential amendments to other ISAs

ISA 450

We disagree that the proposed new 5A should require in effect that for every identified misstatement the auditor shall “determine” whether the misstatement is indicative of fraud. Those risks imposing a

disproportionate work effort, especially when there is no regard to materiality. This is an instance where “evaluate” would be more appropriate.

Yes, with comments below

We agree with the new requirement in paragraph 43 that “The auditor shall design and perform audit procedures in response to the assessed risks of material misstatement due to fraud in a manner that is not biased towards obtaining audit evidence that may corroborate management’s assertions or towards excluding audit evidence that may contradict such assertions.” However, we believe it would be helpful for clarity if supporting application material were also added, matching that for the equivalent requirement in ISA 540, that “Obtaining audit evidence in an unbiased manner may involve obtaining evidence from multiple sources within and outside the entity. However, the auditor is not required to perform an exhaustive search to identify all possible sources of audit evidence.”

In paragraph 4, we recommend amending the second sentence to “... whether the underlying action that results in the misstatement of the financial statements is intentional and involves deception or unintentional.” The inclusion of the reference to “deception” better aligns the explanation with the definition of fraud that is given in paragraph 18(a).

Independent Regulatory Board for Auditors – South Africa

Encouraging the IAASB to reflect on whether the practical challenges surrounding the communication of fraud-related KAMs can be overcome to enable enhanced transparency.

Yes, with comments below

Enhancements related to communication requirements.

We propose that the IAASB consider elevating application paragraph A39 of ED-240 which emphasizes that the communication requirements incorporate robust two-way communication.

Additionally, we propose adapting the language from communication with management and those charged with governance to communication between management and those charged with governance to clearly indicate two-way communication.

Enhancements with respect to engagement resources, and specifically the use of forensic skills in the audit

We want to encourage the IAASB to elevate the consideration for the involvement of someone with forensic skills on the audit in ED-240

We are supportive of the application material in ED-240 paragraphs A33 – A36 but are of the view that the link to ISA 220 (Revised) in the requirements section in ED-240 paragraph 22 is redundant.

We recognize that ED-240 cannot prescribe that the auditor must involve someone with forensic skills. We are also not advocating for this, because we know it may not be feasible to involve someone with forensic skills for every audit due to cost and skills shortages.

Instead, we propose a requirement for the explicit consideration by the auditor to involve someone with forensic skills as part of the auditor’s responsibilities related to fraud, based on the nature and circumstances of the audit engagement. The application material could be used to highlight the nature and circumstances that may indicate a need for the involvement of someone with forensic skills on the audit, For example:

If information obtained at acceptance and continuance phase already identifies fraud or suspected fraud.

If risk assessment and related activities indicate anomalies in accounting estimates or analytical procedures performed by the auditor that are unexplained.

Multiple significant transactions outside the normal course of business that don't have a clear business purpose.

Management provides inconsistent responses, or their actions lead the auditor to doubt their integrity.

If significant deficiencies in the company's system of internal controls indicate pervasive susceptibility of the financial statements to material misstatement due to fraud.

Additionally, we encourage the IAASB to consider incorporating in the application material a paragraph that explains the interaction between the auditor's professional skepticism and engagement resources, specifically explaining that having the forensic skills on the engagement can enhance the auditor's ability to exercise professional skepticism related to fraud in the audit. For example, challenging the auditor's thinking on fraud-related matters and influencing their response in ways that they might not have considered, due to the auditor not possessing forensic skills.

Use of Technology

We recognize the enhancements that the IAASB has made to ED-240 related to how technology may be used by the company to perpetrate fraud or by auditors to perform fraud-related audit procedures.

We welcome these enhancements, but question their sufficiency, given the sophisticated nature of fraud and the vulnerability of companies to fraud because of the impact that advanced technologies, such as Artificial Intelligence and Robotic Processing Automation, have on their internal controls. This is not explicitly acknowledged and catered for in ED-240.

We propose that the IAASB enhance the prominence of the impact of rapid-changing technologies on the perpetration of fraud and how this may impact the auditor's responsibilities related to fraud. Specifically:

Explicit reference to these complexities in the introduction to the standard, relating to Understanding fraud and how it can come to the auditor's attention (refer to par 3.4.2).

Similarly, explicit reference to how this may contribute to the inherent limitations of the auditor to identify risks of material misstatement due to fraud.

A requirement for a determined effort by the auditor to understand what the company's vulnerabilities are in this respect as part of the risk assessment procedures and related activities (acknowledging that the impact and consequently the audit effort may differ substantially depending on the nature and circumstances of the company).

A requirement for the auditor to understand and evaluate management or those charged with governance risk management plans or procedures in response to these vulnerabilities as part of the auditor's evaluation of the components of the company's system of internal control.

The auditor must be required to consider how changes in technology impact the business and specifically the financial reporting process, whether the company is actively managing these vulnerabilities as part of their understanding of the components of the entity's system of internal controls and consequently the impact on the risk identification and assessment of risks of material misstatement due to fraud.

Clarifying terminology in ED-240 to support the understanding of the auditor's responsibilities related to fraud

We observed frequent use of the phrase "if the auditor identifies fraud..." throughout ED-240, possibly contributing to the public misconception that the auditor is solely responsible for identifying all fraud.

We propose that using more specific terminology, for example "if fraud or suspected fraud comes to the auditor's attention...", may contribute to alleviating this misconception.

Irish Auditing & Accounting Supervisory Authority

Engagement quality review (EQR)

Additional engagement quality review procedures focused on the engagement team's responsibilities relating to fraud should be considered for all engagements where an EQR is required. In particular, the engagement quality reviewer should be required to review the reasons used to conclude that the presumed fraud risk related to revenue recognition has been rebutted.

Given the continuing evolving nature of technology and its importance in many audits, the language in paragraph A36 should be amended to state that the engagement partner would usually be expected to consider expertise in IT systems etc. when determining if the engagement team have the necessary competence and capabilities.

Yes, with comments below

Coordination with IESBA

As with other standard-setting projects, we highlight the importance of appropriate coordination between the IAASB and the IESBA. Changes to the ISAs, if any, should be mirrored to ensure consistency with the provisions of the IESBA Code and coordinated with the IESBA.

Specific items for consideration by others

We encourage the IAASB to liaise with relevant other parties which are likely to take action on the following matters to ensure a convergence of efforts to address fraud issues:

Delivering educational actions, for instance explaining the role of auditors regarding fraud more clearly and precisely to stakeholders; and

Further developing the two-way communication culture in the audit profession with audit committees and TCWG, in order to facilitate efficiency of the dialogue on fraud risks.

Use of specialists

While ED 240 includes additional material on the use of specialists, it should be made clear that the use of a specialist does not reduce the auditor's responsibility for the audit. The auditor remains responsible for forming and expressing the audit opinion. In addition, it is important for auditors to be clear on the expertise that they expect from a specialist and the link with the audit engagement. Discussing the need for a specialist's involvement with TCWG may prove beneficial.

Written representations

The statement in paragraph A180 of ED 240 that "although written representations are an important source of audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal" should be moved to the requirements section as it is integral to the auditor's use of written representations. A corresponding amendment should also be made to ISA 580.

4. Jurisdictional and National Auditing Standard Setters

American Institute of Certified Public Accountants

Yes, with comments below

In addition to our responses to questions 1 through 9, we also suggest the following revisions to ED-240. The following comments are designated as “Recommended Change” for those more significant comments or “Suggested Edit” for those comments that are more editorial in nature.

Application Material Related to Paragraph 5

Suggested Edit: Paragraph A3

We encourage the IAASB to replace “manage earnings” with “manipulate earnings” within paragraph A3. We believe that the term “manipulate” has the connotation of “intent” while managing earnings is not necessarily fraudulent in nature. Therefore, we recommend the IAASB consider replacing “manage” with “manipulate” throughout ED-240.

A3. Fraudulent financial reporting involves intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users. It can be caused by the efforts of management to manipulate manage earnings to deceive financial statement users by influencing...

Suggested Edit: Paragraph A5

We also encourage the IAASB to make the following revision within paragraph A5 for consistency with ISA 315 (Revised 2019) when using “ineffective” as it relates to controls rather than “inadequate”:

A5. Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as intentionally:

Taking advantage of ineffectively designed inadequate information processing controls in information technology (IT) applications, including controls over and review of IT application event logs (e.g., modifying the application logic, or where users can access a common database using generic access identification, or modify access identification, to conceal activity).

Suggested Edit: Paragraph 6

We recommend the following revisions be made to paragraph 6 for consistency in how ED-240 refers to fraud and suspected fraud. The language “the occurrence of fraud” is not used elsewhere in ED-240 and creates confusion about whether it means something different from when the auditor identifies fraud or suspected fraud.

Fraud or Suspected Fraud

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

Definitions

Recommended Change: Paragraph 18 and Related Application Material

Paragraph 18

The definition of fraud risk factors in paragraph 18 of ED-240 omits the rationalization element of the fraud triangle. We strongly recommend including rationalization into the definition of fraud risk factors in paragraph 18 of ED-240 to emphasize each of the three components—opportunity, incentive, and rationalization—that may indicate a fraud risk factor exists.

Fraud risk factors – Events or conditions that indicate an incentive or pressure to commit fraud, or provide an opportunity to commit fraud, or indicate attitudes or rationalizations to justify a fraudulent action. (Ref: Para. A22–A23)

Recommended Change: Paragraph A18

We suggest adding the following language to the application material in paragraph A18 to explicitly state that not every instance of non-compliance with laws and regulations is considered fraud, to help mitigate the risk of the auditor misapplying ED-240 and ISA 250

A18. Depending on the nature and circumstances of the entity, certain laws, regulations or aspects of relevant ethical requirements dealing with corruption, bribery or money laundering may be relevant to the auditor's responsibilities to consider laws and regulations in an audit of financial statements in accordance with ISA 250 (Revised). As discussed in paragraph 14, fraud constitutes an instance of non-compliance with laws and regulations. It is important to note that not every instance of noncompliance with laws and regulations is considered fraud.

Recommended Change: Paragraph A21

We also recommend adding the following language to the application material in paragraph A21 to reinforce that the auditor is only concerned with third-party fraud that is directly related to a risk of material misstatement due to fraud in the

financial statements. This aligns with the content in paragraph 6 of ED-240 and is also discussed in paragraph 92 of the explanatory memorandum.

Third-Party Fraud (Ref: Para. 18(a))

A21. Fraud as defined in paragraph 18(a) can include an intentional act by a third party. Fraud or suspected fraud committed against the entity by customers, suppliers, service providers, or other external parties is generally described as third-party fraud. With regard to third-party fraud, the auditor is concerned with third-party fraud that is directly related to a risk of material misstatement due to fraud in the financial statements.

Recommended Change: Paragraph A22

We recommend adding “or an ability to rationalize the fraudulent action” to paragraph A22 to capture the conditions that are generally present when fraud exists.

Fraud Risk Factors (Ref: Para. 18(b) and 32)

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 or an ability to rationalize the fraudulent action. Fraud risk factors, which include intentional management bias, are, insofar as they affect inherent risk, 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.

Engagement Resources

Paragraph 22 and Related Application Material

Recommended Change: Paragraph 22

We recommend adding the following language to paragraph 22 to align with the wording in ISA 220 and provide context to what is meant by “collectively”.

22. In applying ISA 220 (Revised), the engagement partner shall determine that members of the engagement team and any auditor’s external experts and internal auditors who provide direct assistance who are not part of the engagement team collectively have the appropriate competence and capabilities, including sufficient time and appropriate specialized skills or knowledge to perform risk assessment procedures, identify and assess the risks of material misstatement due to fraud, design and perform further audit procedures to respond to those risks, or evaluate the audit evidence obtained. (Ref: Para. A33–A36)

Recommended Change: Paragraph A34

We recommend the following revisions to application paragraph A34 to better clarify that in certain cases the auditor may want to include an individual with forensic skills to assist in planning and performing audit procedures. We believe this wording more clearly describes the intent of when to use forensic skills in the audit. Further, we recommend the example relating to noncompliance with laws and regulations (NOCLAR) be removed from the second bullet. Examples in the application material to ED-240 should be specific to fraud so as not to conflate the auditor’s responsibilities under ED-240 and ISA 250. This is important because not every NOCLAR is fraud. Additionally, our proposed edits to the third and fifth bullets clarify that they are addressing fraudulent financial reporting.

A34. The nature, timing, and extent of the involvement of individuals with specialized skills or knowledge, such as forensic and other experts, or the involvement of more experienced individuals, may vary based on the nature and circumstances of the audit engagement.

Examples:

The entity is investigating fraud or suspected fraud that may have a material effect on the financial statements (e.g., when it involves senior management). In certain cases, the auditor may want to include an individual with forensic skills to may assist in planning and performing audit procedures as it relates to the specific audit area where the fraud or suspected fraud was identified.

The entity is undergoing an investigation by an authority outside the entity for fraud or suspected fraud, or for instances of non-compliance or suspected non-compliance with laws and regulations (e.g., materially misstated tax provision related to tax evasion and materially misstated revenues due to such revenues being generated from illegal activities facilitated through money laundering). Tax and anti-money laundering experts may assist with identifying those fraudulent aspects of the non-compliance or suspected non-compliance that may have a financial statement impact.

The complexity of the entity’s organizational structure and related party relationships, including the creation or existence of special purpose entities, may present an opportunity for management to fraudulently misrepresent the financial position or financial performance of the entity. For example, an expert in taxation law may assist in understanding the business purpose and activities or business units within complex organizations, including how its structure for tax purposes may be different from its operating structure.

The complexity of the industry or regulatory environment in a particular emerging market in which the entity operates may present an opportunity or pressure for management to engage in fraudulent financial reporting. For example, an individual specializing in fraud schemes in specific emerging markets may assist in identifying

fraud risk factors or where the financial statements may be susceptible to risks of material misstatement due to fraud.

The use of complex financial instruments or other complex financing arrangements may present an opportunity to inadequately disclose the risks and nature of complex structured products fraudulently misstate balance sheet amounts. For

example, a valuation expert may assist in understanding the product's structure, purpose, underlying assets, and market conditions, which may highlight fraud risk factors such as discrepancies between market conditions and the valuation of the structured product.

Suggested Edit: Paragraph A35

We recommend the following changes to paragraph A35 of ED-240 to clarify how forensic skills may be used on the audit and to avoid the implication that every audit should use a forensic specialist because we do not believe that is the intent of ED-240.

A35. Forensic skills, in the context of an audit of financial statements, may combine accounting, auditing and investigative skills. Such skills may be applied to evaluate the entities in an investigation and (including the entity's evaluation of an entity's its accounting records to determine whether obtain possible evidence of fraudulent financial reporting or misappropriation of assets has occurred), or in performing to perform audit procedures. The use of forensic skills may also assist the auditor in evaluating whether there is management override of controls or intentional management bias in financial reporting...

Suggested Edit: Paragraph A36

We recommend the following revision:

A36. In determining whether the engagement team has the appropriate competence and capabilities, the engagement partner may consider matters such as experience expertise in IT systems or IT applications used by the entity or automated tools or techniques that are to be used by the engagement team in planning and performing the audit (e.g., such as the testing of high volumes of journal entries and other adjustments, or complex accounting estimates when responding to the significant risk related to management override of controls).

Engagement Performance

Paragraph 23 and Related Application Material

Suggested Edit: Paragraph 23

We suggest adding the following language to paragraph 23(a) to provide a fraud lens regarding engagement performance:

23. In applying ISA 220 (Revised), the engagement partner shall determine that the nature, timing and extent of direction, supervision and review is responsive to the nature and circumstances of the audit engagement, taking into account the: (Ref: Para. A37)

Skills, knowledge, and experience of the individuals to be given significant engagement responsibilities related to fraud; and

Risks of material misstatement due to fraud identified and assessed in accordance with ISA 315 (Revised 2019).

Recommended Change: Paragraph A37

We also suggest adding the following language to paragraph A37:

A37. The engagement partner may plan for direction, supervision and review to respond to identified risks of material misstatement due to fraud by, for example:

Involving additional individuals with specialized skills or knowledge, such as forensic and other experts

Assigning more experienced individuals to the engagement team; or

Changing the composition of the engagement team so that more experienced members of the engagement team conduct certain audit procedures for those specific audit areas that require significant auditor attention (for example, due to the nature and sensitivity of fraud, particularly those involving senior management, assigning fraud inquiries to appropriately skilled or suitably experienced members of the engagement team).

According to the findings from outreach performed by the ASB (see part A of this letter), it is beneficial to have experienced engagement team members perform any inquiries related to fraud because they are more likely to detect red flags and ask appropriate follow-up questions.

Suggested Edit: Paragraph 24 and Related Application Material

Insights from ASB Outreach Related to Engagement Team Discussion

Outreach performed by the ASB (see part A of this letter) suggested ongoing engagement team discussions to remind auditors throughout the audit to maintain professional skepticism and continuously assess risks of material misstatement due to fraud. Accordingly, we are supportive of the guidance in paragraph A38 that discusses the frequency of the engagement team discussions.

Paragraph A38

We recommend the following revision:

A38. Depending on the nature and circumstances of the audit engagement, the engagement partner's approach to direction, supervision and review may include increasing the extent and frequency of the engagement team discussions. It may be beneficial to hold additional engagement team discussions based on the occurrence of events or conditions that have impacted the entity, which may identify new or provide additional information about existing fraud risk factors (see Appendix 1 for examples of fraud risk factors).

Examples:

Sudden changes in business activity or performance (e.g., decrease in operating cashflows of an entity arising from economic conditions resulting in increased pressure internally by management to meet publicly disclosed earnings targets).

Unexpected changes in the senior management of the entity (e.g., the chief financial officer resigns, with no explanation given for the sudden departure, providing an opportunity for other employees in the treasury department to commit fraud given the lack of senior management oversight).

Application Material Related to Paragraph 34

Suggested Edit: Paragraph A71

Additionally, we suggest slightly revising application paragraph A71 to clarify that the auditor should be obtaining an understanding of the respective responsibilities of management and those charged with governance:

A71. In many jurisdictions, corporate governance practices are well developed and those charged with governance play an active role in oversight of the entity's assessment of risks, including risks of fraud and the controls that address such risks. Since the responsibilities of those charged with governance and management may vary by entity and by jurisdiction, it is important that the auditor understands their respective responsibilities of management and those charged with governance to enable the auditor to obtain an understanding of the oversight exercised by the appropriate individuals with respect to the prevention and detection of fraud.

Suggested Edit: Paragraph A75

Lastly, we suggest making the following revision for paragraph A75 to improve the consistency in language and align with the terminology cited in paragraph 118 of the explanatory memorandum to ED-240 that describes the terms "fraud risk(s)" and "risk of material misstatement due to fraud". We encourage the IAASB to reconsider the use of the term "risk of fraud" throughout ED-240 and align such terms with paragraph 118. If the IAASB wants to continue to use the term "the risk of fraud" we believe the usage of such term should be explained and the IAASB should determine whether further conforming changes are needed in other ISAs.

A75. The auditor may also inquire of those charged with governance about how the entity assesses fraud risk the risk of fraud, the entity's controls to prevent or detect fraud, the entity's culture and management's commitment to integrity and ethical values.

Application Material Related to Paragraph 35

Suggested Edit: Paragraph A89

We suggest making the following revision for paragraph A89 to improve the consistency in language:

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 assessment of fraud risk the risk of fraud and the controls in place to prevent or detect it. The nature, extent and frequency of management's assessment may vary from entity to entity. In some entities, management may make detailed assessments on an annual basis or as part of ongoing monitoring. In other entities, management's assessment may be less structured and less frequent. The nature, extent and frequency of management's assessment are relevant to the auditor's understanding of the entity's control environment. For example, the fact that management has not made an assessment of fraud risk the risk of fraud may in some circumstances be indicative of the lack of importance that management places on internal control.

Suggested Edit: Paragraph 39

We recommend adding the following language to paragraph 39 to remain consistent with ISA 315:

Control Deficiencies Within the Entity's System of Internal Control

39. In applying ISA 315 (Revised 2019), based on the auditor's understanding and evaluation of each of the components of the entity's system of internal control, the auditor shall determine whether there are deficiencies in internal control identified that are relevant to the prevention or detection of fraud. (Ref: Para. A102–A103)

Paragraph 40 and Related Application Material

Suggested Edit: Paragraph 40

We recommend the following changes to paragraph 40 for clarity and conciseness:

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

- (a) Identify and assess the risks of material misstatement due to fraud and determine whether they exist at the financial statement level, or the assertion level for classes of transactions, account balances and disclosures, taking into account fraud risk factors. (Ref: Para. A104–A106)
- (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 their designed effectively and determine whether they the controls have been implemented.

Responses to the Assessed Risks of Material Misstatement Due to Fraud

Overall Responses

Paragraph 46 and New Paragraph A116A

Recommended Change: Paragraph 46

Auditors should recognize that fraud, while always involving an intentional act, is not always malicious. Fraud could stem

from management's natural inclination to support the organization, which can result in biased assumptions and even intentional misstatements, during financial statement preparation. Highlighting this scenario in paragraph 46 could enhance the auditor's professional skepticism toward management bias. We believe the following language should be added to paragraph 46.

46. In determining overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level, the auditor shall evaluate whether the selection and application of accounting policies by the entity, particularly those related to subjective measurements and complex transactions, may be indicative of fraudulent financial reporting or a bias that may create a material misstatement. (Ref: par. A116A)

Recommended Change: New Paragraph A116A

We also encourage the IAASB to add the following application paragraph relating to paragraph 46. This language identifies specific areas that are particularly susceptible to management bias. When auditors are aware of these high-risk areas, it can strengthen their professional skepticism while performing procedures related to them.

A116A. Management bias that may indicate fraud in the selection and application of accounting principles may individually or collectively involve matters such as contingencies, fair value measurements, revenue recognition, accounting estimates, related party transactions, or other transactions without a clear business purpose.

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

Recommended Change: Paragraph 47

We encourage the IAASB to make the following revisions to paragraph 47:

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

47. In accordance with ISA 330, the auditor shall design and perform further audit procedures whose nature, timing and extent are based on, and are responsive to, the assessed risks of material misstatement due to

fraud at the assertion level, and in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory. When evaluating audit evidence with respect to the assessed risks of material misstatement, the auditor maintains professional skepticism, including when considering information that may be used as audit evidence and what procedures would be appropriate in the circumstances. (Ref: Para. A117–A123)

This language is consistent with the IAASB's ED-500 and will prevent auditors from seeking or interpreting evidence in ways that support their preexisting beliefs or expectations, also known as confirmation bias. Making auditors aware of confirmation bias and clearly reminding the auditor to maintain professional skepticism may enhance professional skepticism and overall audit quality.

Audit Procedures Responsive to Risks Related to Management Override of Controls

Recommended Change: Paragraph 48

We suggest the following revisions to paragraph 48:

Audit Procedures Responsive to Risks Related to Management Override of Controls

48. Even if specific risks of material misstatement due to fraud are not identified by the auditor, a possibility exists that management override of controls could occur. Accordingly, the auditor shall address Irrespective of the auditor's assessment of the risks of management override of controls, apart from any conclusions regarding the existence of more specifically identifiable risks, by designing and performing the auditor shall design and perform the audit procedures in accordance with paragraphs 49–53, and determining 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.

The revised language incorporates similar language as paragraphs 31 and 32 in extant ISA 240, which clarifies the inherent risk associated with management override of controls and emphasizes the auditor's responsibility to perform procedures related to these risks.

Journal Entries and Other Adjustments

Paragraph 49 and Related Application Material

Recommended Change: Paragraph 49

We recommend calling out “entries posted directly to the financial statements” as part of the requirements outlined in paragraph 49. This step is crucial because auditors may not provide the needed focus on entries that are not made through journal entries recorded in the general ledger.

Journal Entries and Other Adjustments

49. The auditor shall design and perform audit procedures to test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements, including entries posted directly to the financial statements. (Ref: Para. A124–A127)

Recommended Change: Paragraph A124

We recommend that the IAASB make the following revision to paragraph A124 in order to clarify the distinction between journal entries in the general ledger and adjustments to the financial statements. This clarification will reinforce the auditor's consideration of both methods and encourage them to design and perform appropriate procedures for each.

Why the testing of journal entries and other adjustments is performed

A124.

Material misstatements of financial statements due to fraud often involve the manipulation of the financial reporting process by (i) recording inappropriate or unauthorized journal entries in the general ledger and other adjustments. This may occur throughout the year or at period end, or (ii) by management making adjustments to amounts reported in the financial statements that are not reflected in formal journal entries, such as through consolidation adjustments, report combinations, and reclassifications.

Recommended Change: Paragraph A125

We recommend that the IAASB include the following addition to paragraph A125 in order to maintain consistency with our recommendations for paragraphs 49 and A124.

A125. Testing the appropriateness of journal entries recorded in the general ledger and other adjustments (e.g., entries made directly to the financial statements such as eliminating adjustments for transactions, unrealized profits and intra-group account balances at the group level) may assist the auditor in identifying fraudulent journal entries and other adjustments.

Recommended Change: Paragraph 50

We recommend the following revisions to paragraph 50 of ED-240 to further emphasize the importance of considering entries posted directly to the financial statements along with the entries recorded in the general ledger. Further, we recommend a new requirement for the auditor to consider fraud risk factors, the nature and complexity of accounts, and unusual entries processed. We believe these additions are important for designing appropriate audit procedures. We also believe it would be helpful for the IAASB to include additional application material in paragraph A130 that talks about the consideration of fraud risk factors and emphasizes the risk-based approach to selecting items for testing. The remaining edits to paragraph 50 are consistent with our recommendations for paragraph 49.

50. In designing and performing audit procedures in accordance with paragraph 49, the auditor shall:

- (a) Make inquiries of individuals involved in the financial reporting process about their knowledge of inappropriate or unusual activity relating to the processing of journal entries and other adjustments.
- (b) Obtain audit evidence about the completeness of the population of all journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements throughout the period; (Ref: Para. A128–A129 and A135)
- (c) Consider fraud risk factors, the nature and complexity of accounts, and unusual entries processed.
- (dc) Select journal entries recorded in the general ledger and other adjustments made at the end of a reporting period, including those posted directly to the financial statements; and (Ref: Para. A130–A131, A132 and A134–A135)
- (fd) Determine the need to test journal entries recorded in the general ledger and other adjustments throughout the period, including those posted directly to the financial statements. (Ref: Para. A130–A131 and A133–A134)

Accounting Estimates

Recommended Change: Paragraph 52

Paragraph 52(b) as written in ED-240 is broader than necessary, which poses challenges for auditors when applying it in practice. Our recommendation introduces a fraud lens and a materiality threshold, thereby clarifying the auditor's responsibilities and making the requirement more scalable.

We recommend the IAASB retains the following language from extant ISA 240 to paragraph 52(b):

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

Consider the audit evidence obtained from the retrospective review performed in accordance with paragraph 28; and

If indicators of possible management bias that may represent a risk of material misstatement due to fraud are identified, reevaluate the accounting estimates taken as a whole. (Ref: Para. A138–A140)

Paragraph 53 and Related Application Material

Recommended Change: Paragraph 53

We encourage the following procedures be added to paragraph 53 to clarify the auditor's responsibilities related to transactions outside the normal course of business. Because these transactions are more susceptible to fraud, it is important to include additional requirements to ensure risks associated with such transactions are sufficiently addressed.

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

53. 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. The procedures shall include the following: (Ref: Para. A141-A141B)

(a) Reading the underlying documentation and evaluating whether the terms and other information about the transaction are consistent with explanations from inquiries and other audit evidence about the business purpose (or the lack thereof) of the transaction

(b) Determining whether the transaction has been authorized and approved in accordance with the entity's established policies and procedures

(c) Evaluating whether significant transactions outside the normal course of business that the auditor has identified have been properly accounted for and disclosed in the financial statements

Recommended Change: Paragraph A141 and New A141A-A141B

Additionally, we believe adding the following application material will also help auditors perform procedures around

transactions outside the normal course of business.

Significant Transactions Outside the Normal Course of Business or Otherwise Appear Unusual (Ref: Para. 53)

A141. Indicators that may suggest that significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual, may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets include:

The form of such transactions appears overly complex (e.g., the transaction involves multiple entities within a consolidated group or multiple unrelated third parties).

Management has not discussed the nature of and accounting for such transactions with those charged with governance of the entity, and there is inadequate documentation is inadequate.

Management is placing more emphasis on the need for a particular accounting treatment than on the underlying economics of the transaction.

Transactions that involve non-consolidated related parties, including special purpose entities, have not been properly reviewed or approved by those charged with governance of the entity.

Unusual activities with no logical business rationale.

Transactions involve related parties or relationships or transactions with related parties previously undisclosed to the auditor.

The transactions involve previously unidentified related parties or other parties that do not have the substance or the financial strength to support the transaction without assistance from the entity under audit or any related party of the entity.

Transactions lack commercial or economic substance or are part of a larger series of connected, linked, or otherwise interdependent arrangements that lack commercial or economic substance individually or in the aggregate (for example, a transaction is entered into shortly prior to period end and is unwound shortly after period end).

Transactions occur with a party that falls outside the definition of a related party (as defined by the applicable financial reporting framework), with either party able to negotiate terms that may not be available for other, more clearly independent parties on an arm's-length basis.

Transactions exist to enable the entity to achieve certain financial targets.

A141A. Procedures for evaluating significant transactions outside the normal course of business or that otherwise appear unusual may include evaluating the financial capability of the other parties with respect to significant uncollected balances, loan commitments, supply arrangements, guarantees and other obligations, if any. Examples of information that might be relevant to the auditor's evaluation of a related party's financial capability include, among other things, the audited financial statements of the related party, reports issued by regulatory agencies, financial publications, and income tax returns of the related party, to the extent available.

A141B. If the auditor identifies fraud or suspected fraud, the auditor is required to communicate with management and those charged with governance in accordance with paragraphs 66-68. The auditor is also required to determine whether reporting to an appropriate authority outside the entity is necessary in accordance with paragraph 69.

Analytical Procedures Performed Near the End of the Audit in Forming an Overall Conclusion

Paragraph 54 and Related Application Material

Recommended Change: Paragraph 54

As previously stated in our response to question 7, it is important for the auditor to consider the outcomes of all auditing procedures, not just analytical procedures, when evaluating whether the initial assessment of the risks of material misstatement due to fraud remains appropriate. Accordingly, we recommend the revisions to paragraph 54 as shown in question 7.

Recommended Change: Paragraph A142

We also recommend the following revisions to application paragraph A142 to better align with paragraph A18 of ISA 520.

A142. ISA 520 explains that the analytical procedures designed and performed near the end of the audit may identify a previously unrecognized risk of material misstatement. are intended to corroborate conclusions formed during the audit of individual components or elements of the financial statements. However, the auditor may perform the analytical procedures at a more granular level for certain higher risk classes of transactions, account balances, and disclosures to determine whether certain trends or relationships may indicate a previously unidentified risk of material misstatement due to fraud. Determining which particular trends and relationships may indicate a risk of material misstatement due to fraud requires professional judgment. Unusual relationships involving year-end revenue and income are particularly relevant. These may include, for example...

Application Material Related to Paragraph 55

Recommended Change: Paragraph A146

Insights from ASB Outreach Related to Whistleblower Hotlines

The ASB outreach highlighted the importance of whistleblower hotlines and internal audit in identifying fraud, therefore we recommend reordering the list so that these are the first two items listed in paragraph A146.

Obtaining an Understanding of the Fraud or Suspected Fraud

A146. When obtaining an understanding of the fraud or suspected fraud, the auditor may do one or more of the following depending on the facts and circumstances of the audit engagement and the nature of the fraud:

Involve an auditor's expert, such as an individual with forensic skills. [reordered below to list whistleblower first, followed by

internal audit]

Inspect whistleblower files for additional information, if applicable.

Make further inquiries of:

The entity's in-house counsel or external legal counsel.

Individuals within the internal audit function (if the function exists).

Involve an auditor's expert, such as an individual with forensic skills.

Suggested Edit: Paragraph A149

We offer the following changes for consideration.

A149. When evaluating the appropriateness of the entity's process to investigate and remediate the fraud or suspected fraud in accordance with paragraphs 55(b) and 55(c), the auditor may consider:

How management:

Responded to any misstatements that were identified (e.g., the timeliness of when the identified misstatements were corrected by management).

Responded to the fraud (e.g., disciplinary, or legal sanctions imposed on the individuals involved in perpetrating the fraud).

Addressed the control deficiencies regarding the prevention or detection of the fraud.

Whether the outcome of the process is likely to prevent the reoccurrence of the fraud or suspected fraud (e.g., new controls control activities are designed and implemented to prevent and detect such frauds).

Suggested Edit: Paragraphs A150 and A151

We offer the following changes to put the application material in the context of the requirement, otherwise this is verbatim from ISA 265.

Determining if Control Deficiencies Exist

A150. ISA 265 provides requirements and guidance about the auditor's communication of significant deficiencies in internal control identified during the audit to those charged with governance. Examples of matters related to fraud or suspected fraud that the auditor considers in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency include:

The susceptibility to loss due to fraud of the related asset or liability.

The importance of the controls to the financial reporting process (e.g., controls over the prevention and detection of fraud).

A151. The following are examples of Indicators of significant deficiencies in internal control related to fraud or suspected fraud that may constitute a significant deficiency. include, for example:

Evidence of ineffective aspects of the control environment, such as the identification of management fraud, whether or not material, that was not prevented by the entity's system of internal control.

The lack of a process to investigate the fraud or suspected fraud or a process to investigate the fraud or suspected fraud that is not appropriate in the circumstances.

The lack of, or ineffective, remediation measures implemented by management to prevent or detect the reoccurrence of the fraud or suspected fraud.

Application Material Related to Paragraph 57

Suggested Edit: Paragraph A155

We believe that certain examples in paragraph A155 could be categorized as both qualitative and quantitative indicators of fraud. Therefore, we recommend eliminating the distinction between qualitative and quantitative examples.

A155. The following are examples of qualitative or quantitative circumstances that may be relevant:

Examples:

Qualitative circumstances include whether a misstatement:

Involves those charged with governance, management, related parties, or third parties that brings into question the integrity or competence of those involved.

Affects compliance with law or regulation which may also affect the auditor's consideration of the integrity of management, those charged with governance or employees.

Affects compliance with debt covenants or other contractual requirements which may cause the auditor to question the pressures being exerted on management to meet certain earnings expectations.

Affects key performance indicators such as earnings per share, net income and working capital, that may have a negative effect on the calculation of compensation arrangements for senior management at the entity.

Quantitative circumstances include whether a misstatement:

Affects key performance indicators such as earnings per share, net income and working capital, that may have a negative effect on the calculation of compensation arrangements for senior management at the entity.

Affects multiple reporting periods such as when a misstatement has an immaterial effect on the current period's financial statements but is likely to have a material effect on future periods' financial statements.

Documentation

Recommended Change: Paragraph 70

We recommend the following revisions to paragraph 70 to better align with ISA 230 and to further clarify that this is not separate risk assessment documentation, but rather is part of the documentation required in ISA 315 (Revised 2019). Further, we recommend the IAASB include additional application material to explain that this is not a separate risk assessment from that performed and documented in accordance with ISA 315 (Revised 2019), but instead is a requirement to document the incremental considerations when applying ED-240.

70. In applying ISA 230, the auditor shall include the following in the audit documentation of the identification and the assessment of the risks of material misstatement required by ISA 315 (Revised 2019): (Ref: Para. A193)

The matters discussed among the engagement team regarding the susceptibility of the entity's financial statements to material misstatement due to fraud in accordance with paragraph 29 and how and when the discussion occurred and the audit team members who participated.

Key elements of the auditor's understanding in accordance with paragraphs 33–38, the sources of information from which the auditor's understanding was obtained and the risk assessment procedures performed.

The identified and assessed risks of material misstatement due to fraud at the financial statement level and at the assertion level, and the rationale for the significant judgments made.

70A. In applying ISA 230, the auditor shall include the following in the audit documentation:

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.

The results of audit procedures performed to address the risk of management override of controls, the significant professional judgments made, and the conclusions reached.

Fraud or suspected fraud identified, the results of audit procedures performed, the significant professional judgments made, and the conclusions reached.

The matters related to fraud or suspected fraud communicated with management, those charged with governance, regulatory and enforcement authorities, and others, including how management, and where applicable, those charged with governance have responded to the matters.

Technology

We recognize that the IAASB is planning to establish a position addressing the impact of technology in the IAASB's standards. We recommend the IAASB retain a principles-based approach in the ISAs and consider creating a separate technology addendum to address technology issues that can be continuously updated as

technologies evolve. We believe that some of the technology-related guidance included in ED-240 may be misleading and confusing to the auditor. We believe the brief references to artificial intelligence throughout the application material are overly abstract and lack practical guidance. Additionally, we are concerned the application material relating to cybersecurity may create confusion among auditors regarding their responsibilities in this domain. We are also concerned the application material relating to automated tools and techniques (ATTs) and technology for evaluating document authenticity could inadvertently imply that it is always necessary to use these tools to obtain sufficient appropriate audit evidence relating to the risks of material misstatement due to fraud. Furthermore, because technology is rapidly evolving, it is likely that the technology-related content in ED-240 will quickly become obsolete.

Auditing and Assurance Standards Board Canada

Unpredictability in the selection of audit procedures

Unpredictability in the selection of audit procedures is an area where it may pose particular challenges for audits when taking a fully substantive approach. (See our detailed concern and suggestion in Question 10)

Use of forensic skills

As currently drafted, concerns were raised during our outreach that ED-240 may create an expectation to use forensic skills on all engagements.

There is a greater emphasis on the use of specialized skills, such as forensics throughout ED-240 (“forensic” is referenced in paragraphs A34-A35, A37, A49, A97, A140 and A146) compared to extant (e.g., ISA 240, paragraph A35). Given the prevalence of the term “forensic,” outreach participants were unclear whether forensic skills are expected to be used if there is no identified fraud or suspected fraud.

Paragraph A35 suggests such skills “may” assist the auditor in evaluating management override of control (a presumed risk in every audit). Paragraph A49 suggests individuals with such skills “may” be invited to attend the engagement team discussion. However, given the greater emphasis noted above, there is concern that this is open to inconsistent interpretation/application between practitioners, as well as between regulators and practitioners.

It is important that this interpretation be clarified as:

The standard should recognize that not every audit, or even instance of fraud, necessarily calls for specialist involvement. The decision whether to involve specialized skills should be within the auditor’s professional judgment. The auditor has other approaches that may provide sufficient appropriate audit evidence – such as consulting with an auditor with more experience with corporate fraud.

Access to forensic skills is limited, especially among small-medium sized practices. Our outreach with small-medium sized practices indicated they believe paragraph A49 implies an expectation to maintain in-house forensic skills.

Suggest:

Introducing scalability in paragraphs A35 and A49, to acknowledge that the involvement of specialists is based on the nature and circumstances of the entity and the auditor’s professional judgment.

In the application material, listing more experienced individuals before forensic and other experts, and providing an example of where a more experienced individual (but not a specialist or expert) can be used. This reduces the expectation that specialist skills are needed for all engagements and highlights that there

are other considerations the auditor can make depending on the nature and circumstances of the engagement.

A34. The nature, timing, and extent of the involvement of more experienced individuals, or of individuals with specialized skills or knowledge, such as forensic and other experts, or the involvement of more experienced individuals, may vary based on the nature and circumstances of the audit engagement.

A37. The engagement partner may plan for direction, supervision and review to respond to identified risks of material misstatement due to fraud by, for example:

Assigning more experienced individuals to the engagement team.

Changing the composition of the engagement team so that more experienced members of the engagement team conduct certain audit procedures for those specific audit areas that require significant auditor attention; or assigning additional individuals with specialized skills or knowledge, such as forensic and other experts.

Assigning more experienced individuals to the engagement team; or changing the composition of the engagement team so that more experienced members of the engagement team conduct certain audit procedures for those specific audit areas that require significant auditor attention.

A97. When performing risk assessment procedures, the auditor may consider changes in the entity's IT environment because of the introduction of new IT applications or enhancements to the IT infrastructure, which may impact the susceptibility of the entity to fraud or create vulnerabilities in the IT environment (e.g., changes to the databases involved in processing or storing transactions). There may also be an increased susceptibility to misstatement due to management bias or other fraud risk factors when there are complex IT applications used to initiate or process transactions or information, such as the use of artificial intelligence or machine learning algorithms to calculate and initiate accounting entries. In such circumstances, the auditor may assign more experienced individuals, or individuals with specialized skills and knowledge, such as forensic and IT experts, or more experienced individuals to the engagement.

Journal entry testing – First-time implementation guidance while there have been enhancements in procedures to test the appropriateness of journal entries, there are areas identified through our outreach that require further clarification and that we believe can be addressed through first-time implementation guidance.

The population of journal entries, that the auditor is required (paragraph 50(b)) to obtain evidence over the completeness of, is unclear. The population of journal entries is not described in ED-240 and varies across different accounting software. For example, Sage considers all transactions as journal entries.

Selecting journal entries and other adjustments in accordance with paragraph 50(c). We have heard anecdotally that there is a wide range of testing approaches in practice (e.g., testing too little or testing too much) with some engagement teams designing a generic approach to select journal entries (e.g. selecting journal entries with round numbers) without focusing on the fraud risk factors.

Where 100% of transactions are tested substantively, ED-240 is not explicit on what additional work is required as a result of the requirements in paragraphs 49-50.

Suggest:

Creating first-time implementation guidance – focusing on what the relevant population of journal entries is for testing, testing the completeness of the population of all journal entries and other adjustments and selecting journal entries that will assist the auditor in responding to the risks of material misstatement due to fraud.

Other suggestions:

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

Journal entry testing – no reliance on general IT controls

Paragraph A128 can be interpreted, due to the part in bold below, that an evaluation of general IT controls is expected when a fully substantive audit approach is taken with no reliance on general IT controls.

A128. Prior to selecting items to test, the auditor may need to consider whether the integrity of the population of journal entries and other adjustments has been maintained throughout all stages of information processing based on the auditor's understanding and evaluation of the entity's information system and control activities (e.g., general IT controls that safeguard and maintain the integrity of financial information) in accordance with the requirements of ISA 315 (Revised 2019).

Suggest:

Updating paragraph A128 to include a similar scalability consideration as in Appendix 5 of ISA 315 (Revised 2019).

A128. Prior to selecting items to test, the auditor may need to consider whether the integrity of the population of journal entries and other adjustments has been maintained throughout all stages of information processing based on the auditor's understanding and evaluation of the entity's information system and control activities (e.g., general IT controls that safeguard and maintain the integrity of financial information) in accordance with the requirements of ISA 315 (Revised 2019) or the auditor may obtain audit evidence about the completeness and accuracy of the journal entry report by substantively testing the inputs and outputs of the report.

Yes, with comments below

Unpredictability in the selection of audit procedures

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

Through our outreach, significant concerns were raised about the interpretation of the requirement in paragraph 44. The requirement now responds to assessed risks of material misstatement due to fraud at the assertion level, whereas extant was a response to assessed risks of material misstatement due to fraud at the financial statement level and was located under overall responses. The IAASB's explanatory memo did not outline the basis for this change.

Specific implementation concerns included:

For many audits, the risk of material misstatement due to fraud may remain consistent year-over-year.

if previously, the auditor had a thorough and appropriate audit response to the risk of material misstatement due to fraud at the financial statement level, this revised requirement could force them to change their audit response, potentially reducing its effectiveness.

alternatively, it may force auditors to implement a random element of unpredictability to their audit plan, treating the requirement as a checkbox exercise.

Clarity is needed:

whether there is an expectation to introduce an element of unpredictability for each risk of material misstatement due to fraud.

whether monetary unit sampling meets the criteria of incorporating an element of unpredictability as there are different interpretations in practice.

how to appropriately scale the requirement to smaller or less complex entities. Although the procedures in Appendix 2 are helpful, auditors of smaller or less complex entities indicated the procedures are more applicable to larger organizations.

The first bullet point in paragraph A114 “Performing further audit procedures on selected account balances or disclosures that were not determined to be material or susceptible to material misstatement” is inconsistent with the requirement as it does not address the risk of material misstatement due to fraud at the assertion level.

Suggest:

Reverting paragraph 44 to be consistent with extant to address the assessed risks of material misstatement due to fraud at the financial statement level and moving paragraph 44 under the overall responses section.

44. The auditor shall incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures in determining overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level.

If the requirement continues to address the assessed risks of material misstatement due to fraud at the assertion level, further application material is needed, including:

Explicit clarification on whether incorporating an element of unpredictability is required for each risk of material misstatement due to fraud identified and if it needs to be reassessed year-over-year.

The first bullet point in paragraph A114 needs further clarification to explain how performing further audit procedures on selected account balances or disclosures that were not determined to be material or susceptible to material misstatement addresses assessed risks of material misstatement at the assertion level.

Expanding paragraph A114 bullet point “Using different sampling methods or using different approaches to stratify the population” to give an example of how monetary unit sampling can meet the requirement.

Signposting for potential unpredictable procedures for less complex entities in Appendix 2. For example:

Showing up at unexpected times.

Asking for something that was previously never requested.

Procedures over petty cash.

Corruption, bribery and money laundering

As part of the project proposal, there was an action to clarify how concepts such as bribery, corruption, and money laundering, relate to the definition of fraud for purposes of an audit of financial statements. However, our outreach indicates that further clarification is needed. We had to refer to resources beyond ED-240 (e.g., the Association of Certified Fraud Examiners (ACFE)’s Report to the Nations) to understand the concepts and relationships in ED-240.

Significant discussion and concern were raised about whether the proposed wording expands, or conflicts with, an auditor’s responsibilities beyond the scope required in ISA 250, Consideration of Laws and Regulations in an Audit of Financial Statements. While we appreciate that it is application material, many during outreach expressed concerns that paragraph A18 may be interpreted as requiring auditors to investigate all instances of non-compliance with laws or regulations to assess whether it is related to corruption, bribery, or money laundering without explicit clarification.

Suggest:

Consider if paragraphs A18-A21 are better positioned in the introduction of the standard, connected with paragraph 14

which describes the relationship with non-compliance with laws and regulations. Currently, these paragraphs are placed under the definitions section and our outreach participants expressed they may be interpreted as requirements.

Adding additional application guidance to clarify the auditor's responsibilities in assessing non-compliance with laws and regulations and clearly state that auditors are not expected to perform specific procedures in these areas.

Conforming and consequential amendments to International Standard on Assurance Engagements (ISAE) 3000, Assurance Engagements Other than Audits or Reviews of Historical Financial Information

We recognize the IAASB is being mindful of maintaining consistency across other IAASB standards with specific requirements that refer to fraud or suspected fraud. However, we do not support the proposed conforming and consequential amendments to ISAE 3000.

ISAE 3000 contains requirements, application and other explanatory material specific to both reasonable and limited assurance engagements.

The revised wording in paragraph A86 of ISAE 3000 "The extent to which the risk of material misstatement due to fraud is relevant to the engagement," changes from "the risk of fraud" to "the risk of material misstatement due to fraud." However, the "risk of material misstatements" is only relevant for reasonable assurance engagements. Therefore, the change could be interpreted as:

limiting the applicability of the application material to only reasonable assurance engagements.

implying that fraud is not relevant in limited assurance engagements.

Suggest:

Removing the proposed conforming and consequential amendment to ISAE 3000 paragraph A86 as the reference in extant to "the risk of fraud" appropriately encompasses both reasonable and limited assurance engagements and does not create an inconsistency with ED-240.

Public sector examples

We believe the standard, as written, can be applied to public sector entity audits. We acknowledge what is included in ED-240 specific to the public sector as highlighted in paragraph 114 of the IAASB's explanatory memorandum. However, given some of the unique characteristics of the public sector, we believe the standard could be enhanced by including additional application material specific to the public sector.

We have identified several paragraphs: A3, A11, A64, A66, A81, A155, Appendix 1, and Appendix 2, that could benefit from including considerations for the public sector. We have included detailed suggestions for the Appendix. If the IAASB agrees to add more public sector specific considerations in the application material, we can provide suggestions for the other paragraphs mentioned.

Appendix 1 - Examples of Fraud Risk Factors

Risk Factors Relating to Misstatements Arising from Fraudulent Financial Reporting

Incentives/Pressures

Considerations Specific to Public Sector Entities

Budgets are often reported with actual spending due to the budget's significance. Laws requiring balanced budgets can pressure entities to inaccurately report revenues or expenses.

Austerity legislation may create pressures to reduce expenses.

Expenditure legislation may create pressures to not recognize expenses, as exceeding a budget allocation can result in reduced funding the following year.

Opportunities

Considerations Specific to Public Sector Entities

Trust funds under administration – public sector entities often manage assets on behalf of others, including vulnerable individuals, which can be more susceptible to misuse.

Using another entity's budget, such as having a related entity issue a grant due to budget constraints.

Overlapping government levels or public and private sector partnerships with shared responsibilities.

Transactions may be non-exchange transactions (e.g. taxes, grants), which may provide an opportunity to manipulate the timing or values of those transactions.

Appendix 2 - Examples of Possible Audit Procedures to Address the Assessed Risks of Material Misstatement Due to Fraud

Considerations Specific to Public Sector Entities

Ensure that grants, whether received or given, have been properly authorized and eligibility criteria or stipulations for grant recipients are met.

Testing whether remissions, compromises and write-offs of tax and levy balances have been appropriately authorized.

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.

Documentation requirements

The documentation requirements in paragraphs 70(c) – (g) do not reference the relevant requirements.

In paragraph 70, there is an inconsistency between the use of significant professional judgment and significant judgment.

Suggest:

Cross-referencing the documentation requirements in paragraphs 70(c) – (g) to the relevant requirements (similar to the documentation requirements in paragraphs 70(a) and (b)).

Removing the reference to “professional” to be consistent with other references in the ISAs. There are currently more references to “significant judgments” than to “significant professional judgments.”

70. In applying ISA 230, the auditor shall include the following in the audit documentation: (Ref: Para. A193)

(c) The identified and assessed risks of material misstatement due to fraud at the financial statement level and at the assertion level, and the rationale for the significant judgments made.

(e) The results of audit procedures performed to address the risk of management override of controls, the significant professional judgments made, and the conclusions reached.

(f) Fraud or suspected fraud identified, the results of audit procedures performed, the significant professional judgments made, and the conclusions reached.

Clarity of examples

The money laundering example in paragraph A19 is related to employee theft and does not demonstrate an example of money laundering. Money laundering is the process of illegally concealing the origin of money, obtained from illicit activities.

The example in paragraph A122 can be simplified for better understandability.

Suggest:

A19. Corruption, bribery and money laundering are forms of illegal or unethical acts. Corruption, bribery, and money laundering may be distinct concepts in law or regulation; however, they may also be fraudulent acts, or may be carried out to facilitate or conceal fraud.

Money laundering to facilitate fraud – A business owner generates large amounts of proceeds from illegal activities. To avoid detection and triggering mandatory reporting, the business owner deposits these proceeds at multiple banking locations, ensuring the deposits remain under the reporting threshold. The deposits are legitimized by inflating daily sales and are used by the business owner to acquire assets. An employee laundered money, to an offshore bank account, that was illegally obtained from embezzling payments for fictitious purchases of inventory through the creation of false purchase orders, supplier shipping documents, and supplier invoices.

A122. ...

Example:

A response to a bank confirmation request indicated that a bank account, in the name of a wholly owned subsidiary incorporated in an offshore financial center, did not exist. Upon investigating the exception, the auditor determined that management created fraudulent journal entries to inflate the cash balance to avoid disclosing a liability that the entity misstated its financial statements by falsely using excess cash balances deposited in the bank account (which did not actually exist) to repurchase the entity's debt securities, when in fact those obligations still remained outstanding.

Australian Auditing and Assurance Standards Board

Yes, with comments below

Documentation

Paragraph 70 of the ISA-240 ED contains detailed documentation requirements but these requirements are not complete. For example, paragraph 70(c) does not require documentation on the responses to identified and assessed risks. While it may be arguable that the principles in ASA 230 Documentation are sufficient, the IAASB should consider whether including many detailed documentation requirements but excluding some others might imply to some practitioners that the excluded requirements do not apply in the case of fraud.

The IAASB should also consider the following matters in connection with communications with those charged with governance (TCWG):

Paragraph 67 requires an auditor to communicate to TCWG identified fraud or suspected fraud involving management, employees who have significant roles in internal control or others where the fraud results in a material misstatement in the financial statements. Paragraph 67 should cover all identified fraud or suspected fraud, for example, including third party fraud matters. The only exclusion should be where the auditor has clear direct evidence that TCWG are already aware of a fraud, its nature and extent (e.g. through Board minutes, investigation reports commissioned by the Board, public announcements by the company, or communications by TCWG to the auditor).

Requiring the auditor to sense check why there is no KAM for a risk or matter communicated to TCWG.

The IAASB could consider providing additional application guidance in the following areas:

The content of paragraph 55 of the Explanatory Memorandum could be included in paragraphs A7-A9 to make it clear that the phrase “fraud or suspected fraud identified by the auditor” covers both fraud and suspected fraud (including allegations of fraud) and fraud identified directly or indirectly.

Paragraph A31 could include remote working by members of the engagement team as another example of a circumstance that may impede the exercise of professional skepticism.

Application guidance could be provided to paragraph 56(b) about the impact of identified or suspected fraud on other engagements including engagements from prior years. Where the fraud impacts on prior periods, it may be useful to cover:

the extent of audit procedures for the prior period(s); and

whether the auditor should only go back as far as the current period opening balance.

A decision tree or flowchart could be provided showing the potential progression from alleged or suspected fraud to identified fraud and the iterative nature of fraud risk assessment.

The example in paragraph A166 could refer to management overlays for ECLs to cover data, assumption and model limitations. Such overlays may also be subject to management bias.

Other matters that should be considered by the IAASB are:

Analytical procedures: paragraph A114 of ISA-240 ED should specifically refer to ‘substantive analytical procedures’ rather than ‘analytical procedures’.

Fraud risk factors: The first sentence of paragraph A22 refers to consideration of fraud risk factors as inherent risk factors. The third sentence of paragraph A22 says that fraud risk factors may also relate to events or conditions that exist in the entity’s system of internal controls. There should be clarity that fraud risk factors are inherent risks that may not be adequately addressed by the system of internal controls. If the IAASB is of the view that the system of internal controls could be the source of a fraud risk in itself in the absence of an inherent risk, it would be useful to provide further explanation or examples.

Austrian Chamber of Tax Advisors and Public Accountants

Yes, with comments below

We note that the term “fraud” is often used where it would actually be appropriate to use the term “material misstatement due to fraud” or “risk of material misstatement due to fraud” and therefore urge the IAASB to ensure that correct terminology is used throughout.

In addition, the term “fraud” could have different meanings in various jurisdictions.

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

Yes, with comments below.

Paragraph 43 EM “enhancements include changing the work effort verb from “evaluate” to “determine” to adhere to the CUSP Drafting Principles and Guidelines” refers to the CUSP publication.

This could be an opportunity to provide easy access to the final version of the CUSP publication. For the moment, only a draft 2022 version is available, and it is not easy to find on the IAASB website.

Hong Kong Institute of Certified Public Accountants

Yes, with comments below

In general, our stakeholders provided positive feedback that the appendices 1-5 give a comprehensive list of factors or considerations with regard to the concerned areas which help facilitate an auditor’s better understanding of the requirements. In addition to these appendices, our stakeholders suggested that the IAASB offer implementation guidance to assist them in transitioning smoothly from the current ISA 240 to ED-240 once the final standard is released.

In addition, ED-240.48 requires the auditor to determine whether other audit procedures are needed in addition to those in paragraphs ED-240.49-53 to respond to the identified risks of management override of controls. Procedures in paragraphs ED-240.49-53 include inquiries of management, journal entries testing, evaluation of accounting estimates as well as evaluation of unusual transactions. We recommend the IAASB to provide practical examples or case studies to demonstrate the auditor’s thought process involved in the determination and what appropriate “other audit procedures” as referred to in ED-240.48 would enable the auditors to effectively respond to the identified risks related to management override of controls.

Besides, we would suggest that the IAASB consider rephrasing ED-240.A11(a) as the current drafting of ED-240.A11(a) implies fraud involving staff or management other than senior management is considered not significant or not qualitatively material. We do not believe that fraud involving lower grade staff is insignificant. In addition, we are of the view that the requirement set out in ED-240.A11(b) is not practical as in reality, auditors might not know the reasons why a fraud was perpetrated and might involve undue resources to investigate the reasons. Therefore, we seek clarification by the IAASB on its expectation on the extent of work in this area.

Moreover, we also recommend the IAASB together with professional accountancy bodies to continuously educate stakeholders that not all misstatements in the financial statements, including those related to fraud, will be detected, even though the audit is properly planned and performed in accordance with ISAs. Given that good corporate culture and integrity of the management team lay the foundations of corporate governance and internal controls system of the entity which are essential in detecting and preventing fraudulent activities in an entity, the importance of setting the “tone at the top” by senior management should be periodically reiterated.

Institut der Wirtschaftsprüfer in Deutschland

Appendix to the Response Template for the Exposure Draft of Proposed ISA 240 (Revised):

Editorial Comments and Other Drafting Issues by Paragraph

The third sentence of this paragraph begins with “This”. It is not clear what “this” relates to. We surmise that “this” relates to the importance of management, with the oversight of those charged with governance, place a

strong emphasis on fraud prevention. If that is the case, “This” should be changed to read “Such a strong emphasis on fraud prevention involves....”.

65. Item (d) in this paragraph contains an unusual list of parties, that have communicated suspected fraud, that actually represents examples of parties, which ought to be in application material. We suggest that the list of be moved to the application material as examples of parties and after the word communicated to simply state “by others”.

67. The last two sentences can be combined into one sentence as a requirement; the last sentence does not actually reflect a requirement as such. This can be done as follows:

“If the auditor identifies suspected fraud involving management, unless the communication is prohibited by law or regulation, the auditor shall communicate the suspected fraud with those charged with governance and discuss with them the nature, timing, and extent of audit procedures necessary to complete the audit.”

A16. The entity was not perpetrated by a third party (the “that” after the word “entity” incorrectly refers to the “entity”), but the fraud, so the phrase “affecting the entity” should be set off in commas.

A31 A comma is missing after “When performing audit procedures”.

A43. The last sentence using “It is important” appears to represent a hidden requirement. We suggest that to alleviate this, the word “ordinarily” be inserted prior to “important”.

A44. At the beginning of the last sentence, the word “Therefore” should be replaced with “Consequently”, since the sentence deals with a consequence of having a dynamic and iterative process, rather than a logical conclusion.

A54. The sentence structure is awkward and can be improved by moving the phrase “when performing analytical procedures in accordance with ISA 315 (Revised 2019)” to the beginning of the sentence and setting it off with a comma.

A67. The last sentence in the last sub-bullet of the first bullet is not a sentence – there appears to be a verb missing, or the phrase should be set off with a comma and become a part of the previous sentence. It is not clear what the last bullet point in this paragraph is trying to convey that would lead to increased susceptibility to misstatement due to management bias or other fraud risk factors: further clarification is needed.

A69. Since specific training for each of prevention or detection, depending upon the role, may be needed, we suggest that the word “and” between “prevention” and “detection of fraud” be changed to “or”, which is inclusive under CUSP.

A74. It is not clear what is meant by “no action” on the part of the auditor – we surmise that what is meant is that an auditor need not seek to understand the oversight exercised by those charged with governance or to seek to communicate with them. If that is the case, that is what should be said.

A75. We are not convinced that those charged with governance, who are entrusted with an oversight function, would necessarily have a detailed knowledge of how the entity assesses the risk of fraud and about the entity’s controls to prevent or detect fraud, etc. – with the possible exception of these matters relating to fraud by senior management. We therefore suggest that the words be changed to read “... inquire of those charged with governance of their understanding about how...”.

A76. Since ISA 240 deals only with fraud and not error, including error resulting from unintentional management bias, we suggest that the reference to “management bias or management fraud” in the first sentence be changed to read “intentional management bias or other management fraud”.

A76. Since ISA 240 deals only with fraud and not error, including error resulting from unintentional management bias, we suggest that the reference in the third sentence to “or unintentional” prior to “management bias” be deleted.

A79. In the last bullet point, it is unclear to us what a “total” fraud risk management program” is. We suggest that the word “total” be deleted.

A85. In the first bullet under Detective controls in the example box this paragraph, to improve the flow of the sentence, we suggest moving “for further investigation” to after the word “activities”.

A96. The wording at the end of this paragraph is awkward: we suggest changing it to read “... including matters about which the auditor obtains knowledge through the required understanding.”

A97. The reference to “forensic and” in the last ought to be deleted because the paragraph content prior to the last sentence deals solely with IT matters and therefore bears no relation to this prior content. Furthermore, the inclusion of “forensic” suggests that forensic experts are generally required when dealing with changes in the IT environment or complex IT applications, when often IT experts would suffice.

A100. The sentence suffers from an awkward construction and is difficult to understand. We suggest it be worded as follows: “Information obtained from understanding controls over journals entries designed to prevent or detect fraud, or from the absence of such controls, may also be ...”.

A101.

In the first bullet of the example box after this paragraph, mention is made of “segregate access” – the question arises, segregate access from what? Furthermore, the word “make” should be changed to “making”, since it is presumably

about the act of making changes.

A102. The second sentence states that such a determination “may be an indicator” – an indicator of what: fraud, suspected fraud, fraud risks?

A104. In line with ISA 315 (Revised 2019), the word “Determining” at the beginning of the sentence should be changed to “Identifying”. In the last bullet in the example box after this paragraph, a hyphen is missing in between “management” and “defined”.

A109. In the last bullet in the example box after this paragraph, the article “the” needs to be added prior to the word “presentation”, since this is a separate matter from the disclosures (i.e., the sentence no longer reads properly if one were to delete “required disclosures or”). The slash in between “investor” and “market expectations” should be replaced with an “or”.

A114. The semi-colon in the first sentence should be replaced with a comma. The second sentence beginning with “It is therefore important that” appears to represent a hidden requirement: we therefore suggest inserting the word “ordinarily” prior to “therefore” to remedy this. The example box thereafter starts with the word “examples” and a colon, but it is not clear as examples of what? The same applies to the example box after paragraph A116.

A117. In the second bullet in the example box after this paragraph, the words “of material misstatement” should be added after the word “risk”. It is unclear what is meant by “preclude” revenue recognition. We

surmise that what is meant is that the agreements include terms that, under the financial reporting framework, would not lead to revenue recognition. If that is the case, that is what should be said.

A155. In the first sentence, is unclear – relevant to what? In the second bullet of the example box after this paragraph, a comma needs to be inserted in between “regulation and “which”. The same applies to the next bullet point after the word “requirements”.

A175. It is unclear from the construction of this paragraph the three circumstances are mutually inclusive or exclusive. It appears to us that (a) and (b) are mutually exclusive, whereas (c) can be mutually inclusive with both (a) and (b). If this is the case, then the word “either” should be placed at the same level prior to (a) and (b) and denoted (a), (a) and (b) should be denoted (i) and (ii), respectively, (i) and (ii) and be should then be connected with an “or”, and (c) should be denoted (b) and be connected with (a) with an “or” (which would be inclusive in this case).

Appendix 1

Under “Risk Factors Relating to Misstatements Arising from Fraudulent Financial Reporting”, “Opportunities” and “Deficiencies in internal control as a result of the following”, the matter in the fourth bullet point could certainly cause a deficiency in internal control, but the other bullets describe the deficiency, not just the matters that given rise to the deficiency – i.e., what is not effective?

Under “Risk Factors Relating to Misstatements Arising from Misappropriation of Assets”, “Opportunities”, “Inadequate controls over assets ...”, the last bullet point is unclear as to what is not effective. Certainly, lack of oversight is not what is not effective.

Appendix 2

Under “Consideration at the Assertion Level”, the fourth bullet refers to “detailed review” as an audit procedure. In our view, the appropriate term for the audit procedures in line with ISA 500 would be “inspection”.

Under “Consideration at the Assertion Level”, the sixth last bullet point refers to the work of an expert, it is unclear whether a management’s expert or an auditor’s expert is meant, particularly since reference is made to using “another expert”, which appears to relate to using an auditor’s expert. We suggest that reference to the latter “another expert” be termed “another auditor’s expert” and then the first reference to “expert” would then also need to be changed to “auditor’s expert”.

In the bullet point immediately thereafter, in line with CUSP, the verb “assesses” for what auditors do ought to be changed to “evaluate”.

Under “Specific Responses – Misstatement Resulting from Fraudulent Financial Reporting”, fourth last bullet, reference is made to “provide assurance” – term that is avoided in IAASB literature. We suggest that the term be change to “provide evidence”.

Appendix 3

Under “Conflicting or missing evidence, including”, the reference to “which” in the eleventh bullet under American English usage should be changed to “that” and the comma deleted.

Under “Problematic or unusual relationships....” in the seventh bullet, we suggest that the example within the parentheses be augmented by reference to “or entity legal counsel”, which is an example that occurs more frequently.

Appendix 4

In the third bullet, from a grammatical point of view, the infinitive “to identify” should be changed to “in identifying”.

Yes, with comments below

Responses to Assessed Risks

Unpredictability in the Selection of Audit Procedures

The first bullet in the example box following paragraph A114 addresses performing further audit procedures on selected account balances or disclosures that were not determined to be material or susceptible to material misstatement. This choice of words does not align conceptually with that in ISA 315 (Revised 2019) or ISA 330, in which auditors are required to assess the risks of material misstatement for classes of transactions, account balances or disclosures that have been identified as significant (i.e., contain a relevant assertion – that is an inherent risk exists, which means it is reasonably possible for a material misstatement to occur) and then respond to the assessed risks, unless they are acceptably low (see paragraph A4 of ISA 330). Since, pursuant to the draft (but with which we disagree), all identified risks (for relevant assertions) of material misstatement at the assertion level in classes of transactions, account balances or disclosures are treated as significant risks and therefore need a response, it means that only those classes of transactions, account balances or disclosures for which no risk of material misstatement has been identified (i.e., there is no reasonable possibility of a material misstatement) would not require a response under the draft. Consequently, in line with the draft, the words would need to be changed to “Performing further audit procedures on selected classes of transactions, account balances or disclosures for which no risk of material misstatement has been identified”.

Overall responses

The second bullet in the example box of paragraph A116 refers to corroborating management’s explanations or representations concerning material matters. However, there may be significant judgements by management that are not per se material (they may relate to material matters). We therefore suggest that the word “material” be replaced with “significant” in line with its usage in the ISAs.

Journal-entry testing

There is a lack of clarity on what evidence is needed to determine the completeness of the population of journal entries in paragraph 50(b) and A128 of the draft. Completeness of the underlying data before information processing takes place is not mentioned in the application material. There is a danger that the reference to general IT controls in the example in paragraph A128 will be interpreted as being sufficient for determining completeness. Additional guidance on what may be needed beyond consideration of general IT controls may be helpful. Furthermore, paragraph A135 implicitly suggests that completeness of journal entries can be determined using automated tools and techniques alone, which is incorrect. Often automated tools test “completeness” by reconciling opening balances and journals to closing balances, which is only part of the evidence needed to determine completeness. The potential for misunderstanding here could be avoided by an additional reference to paragraph A128 in paragraph A135, and including additional text to qualify the example in A135, “... (e.g., determining some aspects of the completeness of the population ...”

In the second bullet in the example box following paragraph A130, reference is made to management bias. Since fraud relates only to intentional management bias, the word “intentional” should be inserted prior to the word “management”.

In Appendix 4, the text inappropriately slips into specifying requirements in the second sub-bullet of the second bullet. The second sub-sub-bullets stipulates controls that are covered by paragraph 38 and therefore required

to be considered by the auditor. Although the situations described are often relevant there is quite a wide variation in practice about what, for example, standard and non-standard journals are. We would therefore suggest inserting the word “may” in between the words “these controls” and “include” in the last sentence of the second sub-bullet of the second bullet.”

Auditor unable to continue the engagement

In relation to the first bullet of paragraph A158, we note that there ought to be some guidance provided on when auditors may consider appropriate action not to be necessary in the circumstances. In particular, an entity may be justified in not taking action when the costs of controls to prevent or detect non-material fraud considerably exceed the cost of the fraud. The second bullet of paragraph A158 refers to a “significant risk of material and pervasive fraud”. Since the draft requires risks of material misstatement due to fraud to be treated as significant risks, referring to significant risks is inappropriate. We therefore suggest that the word significant be replaced with “high”. In relation to the fourth bullet of paragraph A158, it is difficult to understand how fraud at the entity is a threat to auditor compliance with the fundamental principles of relevant ethical requirements; if there is such a connection, that should be spelled out.

Appendix 1 on fraud risk factors

Whether the circumstance, “tolerance of petty theft”, included in the fifth bullet under Attitudes/Rationalizations in the section on misappropriation of assets is an indicator of potential fraud risk factors depends upon whether such petty theft can be prevented, detected and, only if the individual perpetrators can be identified, penalized in a reasonable way. If the establishment of effective controls to prevent, detect and penalize such theft considerably exceeds the cost of such theft, tolerance of such petty theft may be a reasonable business decision and therefore not be a fraud risk factor. This does mean that management does not have a responsibility to address petty theft when the perpetrating individuals can be identified. For this reason, we suggest adding “unless cost of effective controls to prevent or detect such theft considerably exceeds the cost of such theft”.

Conforming amendments

ISA 450 and ISA 505

In relation to paragraph 5A, since the indication of fraud relates to only a misstatement, and misstatements due to fraud can only arise from misappropriation of assets or fraudulent financial reporting, we suggest that the term “fraud” be replaced by “misappropriation of assets or fraudulent financial reporting”. The same applies to the reference fraud in paragraph A6A.

The same considerations apply to paragraph A21 of ISA 505, in which “fraud” should be replaced by “misappropriation of assets or fraudulent financial reporting”.

ISA 700 (Revised)

We have become aware that many users of auditors’ reports do not understand the responsibilities of auditors in relation to fraud. In particular, when reference is made to fraud in the auditor’s report, users do not understand that this reference relates only to misappropriation of assets and fraudulent financial reporting. For this reason, when the IDW translated into German and then transposed ISA 700 (Revised) into our IDW Auditing Standard, we added a short, required explanation in parentheses in the auditor’s report directly subsequent to the first mention of fraud in that report. We have found that this addition greatly improves user understanding of what is meant by fraud in auditors’ reports. For this reason, we recommend that the IAASB insert parentheses encompassing the words “misappropriation of assets or fraudulent financial reporting” after

the word “fraud” in the requirement in paragraph 38(a). This would then need to be adjusted accordingly in all of the example reports in the ISAs, when relevant.

The amendment to paragraph 40(a)(i) refers to the communication of identified or suspected fraud to those charged with governance. This wording is not in line with the requirement in paragraphs 67 and 68 of the draft, in which the communication is (also for paragraph 67, since only certain fraud matters are communicated) effectively limited to those matters related to fraud that are, in the auditor’s judgment, relevant to the responsibilities of those charged with governance, unless communication is prohibited by law or regulation. For these reasons, the wording in paragraph 40(a)(i) and (ii) should be changed to read:

“Identified or suspected fraud and other matters related to fraud that are, in the auditor’s judgment, relevant to the responsibilities of those charged with governance, unless the communication is prohibited by law or regulation”.

In paragraph 40(c), the matters related to fraud are a subset of those of most significance to the audit of the financial statements – that is, they are not separate therefrom. For this reason, the word “those” should be inserted in the amendments prior to both uses of the word “matters”.

ISA 701

In line with our comments on paragraph 40(c) of ISA 700, the word “those” should be inserted into the title required in paragraph 11 as follows: “Key Audit Matters Including Those Matters Related to Fraud”. This also applies to paragraph 16 and the heading after paragraph A58. The reports would need to be adjusted accordingly. With respect to paragraph A18A, we refer to our response to Question 5 and the use of the term “ordinarily”.

Alignment with CUSP and current drafting practice

Paragraph A91 uses the verb “judge”, which is not one of the verbs covered by the CUSP conventions. We suggest that the verb be replaced with “consider”.

With the exception of one short sentence in extant ISA 240 (which albeit, does not necessarily represent good practice), none of the ISAs include footnotes with text taken from the IESBA Code. Rather, the content of the Code is provided in the application material as an example and then a footnote reference to the paragraphs in the Code is provided. This draft is the first ISA in which the IAASB proposes including long footnotes with text from the Code, which we believe is neither in line with CUSP nor good practice in standard setting and sets a bad precedent. The first instance is paragraph A15. Rather than including the text in the footnote, a sentence could have been added to the end of paragraph A15 that states “For example, the IESBA Code provides requirements and application material relating to communication with respect to groups”. This sentence could then include a footnote reference to the source paragraph in the IESBA Code. The other footnotes suffering from text substantive text (from the IESBA Code unless otherwise indicated) include the footnotes numbered 46, 56 (in relation to ISA 260 (Revised)), 77, 85, 91, 93 (not a reference that could be placed directly into the text), and footnote 65 for ISA 701 (conforming amendments). Footnote 59 in the conforming amendments of ISA 701 is particularly unusual for a requirement: Perhaps this should be an addition as a separate paragraph to the definitions section, in which usage of terms that are not definitions is sometimes described.

Editorial comments and other drafting issues

In the Appendix to this Response Template, for the benefit of IAASB staff, we have provided a list of matters that we have identified during our analysis of the draft that we would classify as editorial comments and other drafting issues.

Instituto de Auditoria Independente do Brasil

We also have concerns about paragraph 22, if in all situations we have to involve fraud specialists and paragraph A36, if its specialist would be required in all audits. We recommend more guidance about these two paragraphs.

Instituto Mexicano de Contadores Publicos

Yes, with comments below

We believe in terms of transparency of our audit report, the users of such financial statements might misunderstand the scope of the auditor procedures and conclusions related to the Fraud's KAMs included in auditor report.

We also consider that management representation standard should be enhance in order to integrate into the body of the standard that management acknowledge its responsibilities related to fraud, i.e. Management have established the necessary controls for the identification and evaluation of material error risks derived from fraud; have also disclosed to the auditor any fraud or suspected fraud that occurred during the audit period, among other things.

Japanese Institute of Certified Public Accountants

Yes, with comments below

Paragraph A37 provides examples of when the engagement partner plans for direction, supervision and review to respond to identified risks of material misstatement due to fraud as the application material of paragraph 23. Since these examples are related to Engagement Resources, it would be more appropriate for paragraph A37 to reference paragraph 22 as a related requirement.

Three examples are given in paragraph A138. Since similar examples are given in paragraph A134 of ISA 540 (Revised), we propose reconsidering the necessity of including them in paragraph A138.

Paragraph A143 states that, as the analytical procedures performed near the end of the audit, automated tools and techniques (ATT) may be used to identify unusual or inconsistent transaction posting patterns in order to determining if there is a previously unrecognized risk of material misstatement due to fraud. However, we believe that such procedures are typically performed as part of the risk assessment and are unlikely to be performed near the end of the audit. Therefore, we propose paragraph A143 to be removed.

The title of ISA 805 in the Proposed Conforming and Consequential Amendments is mixed up with the title of ISA 800, which needs to be corrected.

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

Yes, with comments below

In our outreach we heard concerns, particularly from small and medium practices, regarding the challenge of how and to what extent to document their thinking about fraud into the audit workpapers. We believe guidance might be helpful in this regard.

Nordic Federation of Public Accountants

Yes, with comments below

Royal Dutch Institute of Chartered Accountants

Yes, with comments below

Constructive critical remarks:

Regarding par. 70, we suggest the IAASB clarify how to document fraud risk factors.

We believe it's appropriate to add a requirement to par. 70 involving the proposed requirement in par. 30:

if 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 should document the actions the auditor has taken as well as the outcomes.

In the examples after par. A104, the example regarding the presentation of profit before tax from continuing operations is not clear after minimizing tax.

Regarding par. A111, we suggest the IAASB clarify that the rebut is to be considered per type of revenue, transaction, or assertion. In this respect, the examples following the first one leave room for improper interpretation. Moreover, the fourth example will maintain the extant rebut regarding financial institutions' revenues.

Wirtschaftsprüferkammer

Regarding the aspects of smaller or less complex entity, additional examples should be provided of specific requirements that can be omitted or applied in a more straightforward way.

5. Accounting Firms

BDO International

Yes, with comments below

We have the following additional comments related to ED-240:

The title prior to paragraph 53 of ED-240 of 'Significant Transactions Outside the Normal Course of Business or Otherwise Appear Unusual' should be updated to include the word 'that' so it states, 'Significant Transactions Outside the Normal Course of Business or That Otherwise Appear Unusual'.

In paragraph 60a of ED-240, the auditor is required to report to 'the person or persons who made the audit appointment'. We assume this would either be management or those charged with governance; however, we believe the text can be made clearer here.

CohnReznick

Yes, with comments below

We believe it is important for the IAASB to bear in mind that what constitutes "fraud" may not necessarily be fully and/or consistently understood amongst, or even inside, different jurisdictions. We believe it is in the public interest that the auditor's report continues to include brief descriptions for fraud detection and deterrence by management and those charged with governance, and that fraud-related key audit matters should be determined based on the criteria in extant ISA 701. We are concerned that some of the IAASB's proposed changes to the auditor's report may inadvertently exacerbate the expectations gap as some users may believe that there is assurance of a type other than what the auditor is required to provide under auditing standards.

Crowe

While we do not disagree with the requirements and application guidance related to engagement resources, we note that the extent of guidance related to forensic skills could lead some to believe that there is an expectation that forensics should be involved in most audits. We do not believe that this is the intent of the IAASB.

Deloitte

We do, however, have scalability concerns related to paragraph 55, as highlighted in our response to question 4 (Fraud or Suspected Fraud), paragraph 22, and paragraph A36 of ED-240.

Yes, with comments below

We have the following recommendations for clarity and to improve the language within various paragraphs:

Paragraph 23(a): Remove reference to “significant engagement responsibilities” since there is no definition or related application material, and without which there would be inconsistent understanding and practice. In addition, as currently worded, this paragraph expands the requirements within ISA 220 (Revised)”

“In applying ISA 220 (Revised), the engagement partner shall determine that the nature, timing and extent of direction, supervision and review is responsive to the nature and circumstances of the audit engagement, taking into account the:

Skills, knowledge, and experience of the engagement team individuals to be given significant engagement responsibilities; and”

Paragraph 50: Clarify the requirements responding to the risk of management override of controls specifically related to the requirements outlined in paragraphs 50(b) and 50(c). Paragraph 50(b) requires the auditor to obtain evidence about the completeness of the population of journal entries and other adjustments made in the preparation of the financial statements throughout the period, whereas paragraph 50(c) requires the auditor to select journal entries and other adjustments made at the end of the reporting period. It is unclear why paragraph 50(b) would be necessary if the audit procedures are to only test the population of journal entries at the end of the reporting period. We recommend changing paragraph 50(b) to provide clarity as follows:

“Obtain audit evidence about the completeness of the population of all journal entries and other adjustments made in the preparation of the financial statements for the period for which the auditor will perform journal entry testing as required in 50(c) and 50(d); (Ref: Para. A128–A129 and A135)”

Paragraph A19: Update the third bullet point, as it states money was laundered to facilitate fraud but describes a scenario whereby the embezzlement occurs before the laundering of the embezzled money. We propose two alternative wording options, the first to reflect the money laundering occurring subsequent to, and concealing, the fraud and the second to reflect the money laundering occurring prior to, and facilitating, the fraud:

Option 1: “Money laundering to facilitate conceal fraud – An employee laundered money, to an offshore bank account, that was illegally obtained from embezzling payments for fictitious purchases of inventory through the creation of false purchase orders, supplier shipping documents, and supplier invoices.”

Option 2: “Money laundering to facilitate fraud – An employee laundered money to an offshore bank account that was then used to provide kickbacks to customers for preferential treatment.”

Paragraph A117: Remove the first bullet point example, as (1) it is not sufficiently detailed, especially compared to the other examples, and (2) physical observation or inspection are procedures that are already typically performed for physical assets (i.e., those that may be susceptible to misappropriation) even when the inherent risk may be lower, and no fraud risk is present.

Physically observe or inspect certain assets to respond to assessed risks of material misstatement due to fraud related to the misappropriation of those assets.

Paragraph A122: Clarify language in the example, specifically the contradiction of using funds deposited in a non-existent bank account and the obligations remaining outstanding:

“A response to a bank confirmation request indicated that a bank account, in the name of wholly owned subsidiary incorporated in an offshore financial center, did not exist. Upon investigating the exception, the auditor determined that the entity misstated its financial statements by overstating its cash balance, falsely using excess cash balances deposited in the bank account (which did not actually exist) to repurchase the entity's debt securities, when in fact those obligations still remained outstanding.”

Paragraph A157: Clarify language in this application material paragraph since the term “unlikely” may imply, without basis, that the auditor should always believe there are multiple instances of fraud when one is identified:

“Since fraud involves incentive or pressure to commit fraud, a perceived opportunity to do so or some rationalization of the act, an identified instance of fraud may not be unlikely to be an isolated occurrence. Misstatements, such as numerous misstatements at a business unit or geographical location even though the cumulative effect is not material, may also be indicative of a risk of material misstatement due to fraud.”

Paragraph A100: We recommend the IAASB include in paragraph A100 examples of controls that address risks of material misstatement due to fraud at the assertion level, in accordance with paragraph 38. Further, we recommend that any

examples added include a qualifier statement indicating such examples are not exhaustive.

“Information from understanding controls over journal entries, designed to prevent or detect fraud, or the absence of such controls, may also be useful in identifying fraud risk factors that may affect the auditor's assessment of the risks of material misstatement due to fraud. This may include, but is not limited to, controls that address risks at the assertion level in:

Revenue recognition.

Accounting estimates.

Significant transactions outside the normal course of business.”

Paragraph A142: We recommend that paragraph A142 be updated to (1) include at least one example of analytical procedures at a more granular level, and (2) expand upon, and provide more clarity on, the “unusual transactions” example.

“ISA 520 explains that the analytical procedures performed near the end of the audit are intended to corroborate conclusions formed during the audit of individual components or elements of the financial statements. However, the auditor may perform the analytical procedures at a more granular level for certain higher risk classes of transactions, account balances, and disclosures to determine whether certain trends or relationships may indicate a previously unidentified risk of material misstatement due to fraud. One such example being performing analytical procedures at the customer invoice level. Determining which particular

trends and relationships may indicate a risk of material misstatement due to fraud requires professional judgment. Unusual relationships involving year-end revenue and income are particularly relevant.

Examples:

Uncharacteristically large amounts of income being reported in the last few weeks of the reporting period.

Unusual transactions, such as transactions with specific customers that are significantly higher or more frequent than historical trends without an associated rationale.

Income that is inconsistent with trends in cash flow from operations:

Uncharacteristically low amounts of revenue at the start of the subsequent period; or

Uncharacteristically high levels of refunds or credit notes at the start of the subsequent period.”

Appendix 1: The “opportunities” subsection of Appendix 1 states “The nature of the industry or the entity’s operations provides opportunities to engage in fraudulent financial reporting that can arise from the following” but includes examples such as internal controls or low morale of senior management, which are not industry or operations related. We recommend the IAASB enhance the aforementioned sentence to be broader than the nature of the industry or the entity’s operations.

We believe that, as currently drafted, paragraph 22 and the related application material could be interpreted as requiring all audits to include a forensic expert. Accordingly, we believe the requirement for the engagement partner to determine the competence and capabilities of the engagement team in ISA 220 (Revised) is sufficient, and, therefore, paragraph 22 from ED-240 should be removed with paragraphs A33–A36 being attached to current paragraph 23 in ED-240. We are supportive of including application material in ED-240 (or in ISA 220 (Revised)) regarding the potential need for specialized skill or knowledge of engagement resources. Further, application material could also reinforce the requirement in ISA 620, paragraph 7, which prescribes the requirement for auditors to determine whether specialized skill or knowledge is needed to obtain sufficient appropriate audit evidence, as it relates to the consideration of fraud.

We also recommend the following edits to paragraph A36 to ensure there is no implicit expectation in the application material that an IT, data, or other specialist is required on every audit engagement:

Paragraph A36: In When determining whether the engagement team has the appropriate competence and capabilities, specific to the facts and circumstances of the engagement related to consideration of fraud risk, the engagement partner may consider matters such as whether expertise is needed in IT systems or IT applications used by the entity or automated tools or techniques that are to be used by the engagement team in planning and performing the audit (e.g., such as the testing of high volumes of journal entries and other adjustments, or complex accounting estimates, when responding to the significant risk related to management override of controls).

Ernst & Young Global

Communications with those charged with governance: The extant ISA 240 requirement that addresses required communication with those charged with governance about identified or suspected fraud has not been revised in ED-240, as it continues to limit communication of fraud to only those matters involving management, employees who have significant roles in internal control, and others where fraud results in a material misstatement of the financial statements. As a result, the required communication does not align with either the communication requirement for instances of non-compliance with laws and regulation in ISA 250 (Revised) or the ED-240 proposed changes to the auditor’s report that describe the auditor’s responsibilities to communicate with those charged with governance about all instances of fraud.

Completeness of the population of journal entries: The new requirement in ED-240 to obtain audit evidence about the completeness of the population of all journal entries and other adjustments appears contradictory to the “determination of whether to test” journal entries throughout the period. Because the auditor is permitted to determine that additional testing beyond the population of journal entries made at the end of the reporting period is not necessary, it is unclear why the auditor would be obtaining audit evidence about the completeness of all journal entries made in the preparation of the financial statements throughout the period.

Yes, with comments below

Enhancements related to management’s responsibilities for the prevention of fraud

We support the IAASB’s issuance of ED-240 and agree that revisions to ISA 240 are needed to effectively enhance or clarify the auditor’s responsibilities related to fraud in an audit of financial statements. We also agree there are opportunities for enhancements that would assist in addressing the expectation gap related to fraud, but we believe it is equally important to recognize that enhancements to the ISAs alone are not likely to have a substantial enough effect on the expectation gap.

Although the auditor plays an important role in detecting material fraud, it is important for the public to understand that the prevention and detection of fraud within an entity is primarily the responsibility of management under the oversight of those charged with governance. Acknowledgement of this responsibility, and how it has been fulfilled, in our opinion, should be more evident from the entity’s corporate reporting.

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

Journal entries and other adjustments

In addition to comments provided in our response to Q3 related to the auditor’s understanding of the entity’s processes and controls over journal entries, we have the following additional comments as it relates to testing the appropriateness of journal entries and other adjustments:

In paragraph 50(a) of ED-240, the auditor is instructed to make inquiries of individuals involved in the financial reporting process about their knowledge of inappropriate or unusual activity relating to the processing of journal entries and other adjustments. While we appreciate this language conforms with extant ISA 240, paragraph 25 of ISA 315 (Revised 2019) makes a distinction between the financial reporting process used to prepare the entity’s financial statements (paragraph 25(a)(iii)) and how information about transactions are incorporated into the general ledger (paragraph 25(a)(i)). We believe that when designing audit procedures to test journal entries and other adjustments, it is important to make inquiries of individuals involved in both processes. Accordingly, we propose the following revision:

50(a). Make inquiries of individuals involved in the information processing activities to report transactions to the general ledger and the financial reporting process used to prepare the entity’s financial statements about

their knowledge of inappropriate or unusual activity relating to the processing of journal entries and other adjustments; ...

Further to the previous comment, we believe the following changes to Appendix 4 of ED-240 should be made:

The first bullet of Appendix 4 of ED-240 indicates that the auditor's understanding of the entity's information system and communication relevant to the preparation of the financial statements, including "the entity's financial statement closing process" provides the auditor with knowledge relevant to their selection of journal entries and other adjustments for testing. We believe that this reference should be amended to state "the entity's financial statement closing process information processing activities to report transactions to the general ledger and the financial reporting process used to prepare the entity's financial statements".

When considering the identification and assessment of the risks of material misstatement due to fraud in the fourth bullet of Appendix 4 of ED-240, the auditor considers whether journal entries and other adjustments are susceptible to unauthorized or inappropriate intervention or manipulation from, among other items, "opportunities from privileged access granted to individuals involved in the financial statement closing process". As privileged access is generally granted by the entity by application or process, we believe that this reference should be amended to state "opportunities from privileged access granted to individuals involved in the financial statement closing process information processing activities to report transactions to the general ledger and the financial reporting process used to prepare the entity's financial statements".

In paragraph 50(b) of ED-240, we propose the following edits to align with the wording in paragraph 49 of ED-240:

50(b). Obtain audit evidence about the completeness of the population of all journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements throughout the period; (Ref: Para. A128–A129 and A135)

On a related note, paragraph A129 of ED-240 refers to the population of journal entries that are made directly to the financial statements, which we believe represents the financial reporting process used to prepare the entity's financial statements as described in paragraph 25(a)(iii) of ISA 315 (Revised 2019). We believe that ascertaining the completeness of the population of all journal entries and other adjustments made in the preparation of the financial statements extends not only to this population, but also to the transaction processing of information that is incorporated into the general ledger (i.e., journal entries recorded through the period) as described in paragraph 25(a)(i) of ISA 315 (Revised 2019).

We note that enhancements have been made to paragraphs 50(d) and A133 of ED-240 with the intention of strengthening

the work effort related to testing journal entries and other adjustments by elevating the current requirement from a "consideration of whether to test" to a "determination of whether to test" journal entries and adjustments made throughout the period. We do not believe this is a meaningful change in the performance requirement. Currently in practice, consideration is given to the likelihood of management overriding journal entries when deciding whether to test journal entries throughout the period. Where that likelihood is determined to be low, we believe it may be appropriate to only test the journal entries made at the end of the reporting period. If the expectation of the IAASB is to instead require some testing of journal entries throughout the period, we believe this performance requirement needs clarification.

Further to the concept of testing journal entries throughout the period, the new requirement in paragraph 50(b) of ED-240 to obtain audit evidence about the completeness of the population of all journal entries and other adjustments appears contradictory to the "determination" of whether to test journal entries throughout the

period. When the auditor determines that additional testing beyond the population of journal entries made at the end of the reporting period is not necessary, it is unclear why the auditor would be obtaining audit evidence about the completeness of all journal entries made in the preparation of the financial statements throughout the period. Rather, we believe that if the “determination” in paragraph 50(d) is intended to allow the auditor to scale their testing based on the likelihood of management override, then the requirement to ascertain completeness should also be scaled.

When determining the completeness and accuracy of the population of journal entries made throughout the period, it is important to recognize that the auditor will likely need to make use of an automated technique to extract and analyze the data. If the expectation is that auditors will often be using automated techniques, we believe the application material would benefit from emphasizing the ability to use, and benefits of using, automated techniques.

We have the following additional comments as it relates to Appendix 4 of ED-240:

When understanding the entity’s information system and communication relevant to the preparation of the financial statements when considering the selection of journal entries and other adjustments for testing, we note that the auditor is directed to understand “the types of journal entries (whether standard or non-standard) incorporated in the general ledger” (first bullet of Appendix 4 of ED-240). We then note in the final bullet to Appendix 4 of ED-240 that the auditor is directed to consider “journal entries or other adjustment processed outside the normal course of business.” We believe the final bullet of Appendix 4 of ED-240 should be combined with the discussion of non-standard journal entries in the first bullet with clarity that such journal entries include those outside the normal course of business, including those used to post significant unusual transactions in paragraph 53 of ED-240.

The auditor is directed to consider the characteristics of fraudulent journal entries and other adjustments when selecting items for testing (fifth bullet of Appendix 4 of ED-240). While we agree that the auditor may use recent information, such as data on actual perpetrated frauds or reports regarding trends in occupational fraud to inform them of the characteristics of fraudulent journal entries, we believe that it is equally as important for the auditor to analyze the entity’s own data to identify anomalous transactions, particularly when they have the complete population of journal entry data and can make use of automated techniques.

The auditor is directed to consider the nature and complexity of the accounts when selecting items for testing (sixth bullet of the Appendix 4 of ED-240). We note that journal entries that “contain significant estimates” introduce a different element of management override, that being the introduction of bias in the selection of assumptions rather than management override of controls over journal entries. We recommend including a reference to paragraphs 51-52 of ED-240 for this consideration. Additionally, given the importance of considering the opportunity for management to collude with related parties, we recommend the following change to the intercompany transactions’ consideration: “Contain intercompany transactions or transactions with related parties”.

Engagement resources

We believe the wording of the requirement in paragraph 22 of ED-240 is misleading, as it seems to imply that engagement teams members with specialized skills or knowledge would be needed in most cases to address the procedures related to identifying, assessing and responding to the risks of material misstatement due to fraud, which we do not believe is the case. Our view is that it would be typical for the auditor to have the necessary competence and capabilities to perform these procedures.

In addition, we believe that the wording inappropriately implies that members of the engagement team would only need to have the appropriate competence and capabilities to perform some of the procedures (due to the use of “or” in the requirement). We however agree that engagement team members with specialized skills or knowledge may only be needed to perform certain aspects of these procedures, or they may not be needed at all. Therefore, we suggest the following revisions to paragraph 22 of ED-240:

22. In applying ISA 220 (Revised), the engagement partner shall determine:

(a) that members of the engagement team collectively have the appropriate competence and capabilities, including sufficient time and appropriate specialized skills or knowledge to perform risk assessment procedures, identify and assess the risks of material misstatement due to fraud, design and perform further audit procedures to respond to those risks, or and evaluate the audit evidence obtained.

In making the determination in 22(a), whether engagement team members with specialized skills or knowledge are needed to perform risk assessment procedures, identify and assess the risks of material misstatement due to fraud, design and perform further audit procedures to respond to those risks, or evaluate the audit evidence obtained.

We also suggest the following revisions to paragraph A34 of ED-240 to make it clear that the use of forensic specialists is

not always necessary:

A34. The nature, timing, and extent of the involvement of individuals with specialized skills or knowledge, such as forensic and other experts, when determined to be necessary, or the involvement of more experienced individuals, may vary based on the nature and circumstances of the audit engagement.

We also encourage the IAASB to challenge the first two examples presented in paragraph A34 of ED-240. In both examples, there is a material effect on the financial statements. In these extreme situations, before the auditor brings in an individual with forensic skills or a tax or anti-money laundering expert, we believe the auditor should consider the requirement in paragraph 60 of ED-240, which is whether the auditor is able to continue with the audit engagement.

Finally, we believe that it should be acknowledged in the examples listed in paragraph A35 of ED-240 that, while the specialized skills or knowledge listed would be skills of a forensic specialist, the auditor is expected to have the appropriate competence and capabilities to perform the audit, and therefore possess many of these same skills or knowledge. We would suggest revising these examples to specify those skills or knowledge that a forensic specialist may have beyond that of the auditor (for example, analyzing the authenticity of information intended to be used as audit evidence; applying knowledge in fraud schemes, and specific techniques for interviews, information gathering and data analytics for the detection of fraud; interviewing techniques used in discussing sensitive matters with management and those charged with governance).

Engagement performance

As further explained in our response to Q3, we believe paragraphs 45 and 46 of ED-240 (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.

Paragraph 23(a) of ED-240 refers to "significant engagement responsibilities," which is not a concept in ISA 220 (Revised). Although this concept was used in extant ISA 240, we believe this term would need further

context as to why it is used in ED-240 but is not an overall consideration in 220 (Revised) paragraph 30(b). We would suggest that the requirement in ISA 220 (Revised) paragraph 30(b) is sufficient to cover the overall consideration of the responsiveness of the direction, supervision and review to the responsiveness of the resources assigned or made available to the engagement team. We believe that the requirement in paragraph 23(a) of ED-240 should be more specific to the skills, knowledge and experience of individuals to be assigned responsibilities for fraud-related procedures.

Because the matters to be considered in paragraph 24 of ED-240 are matters that will typically be identified during the course of the audit and may require revisions to direction, supervision and review, we suggest the following revisions to paragraph 24 of ED-240:

24. The engagement partner determines whether revisions to direction, supervision and review are needed, including when in making the determination in paragraph 23, the engagement partner shall consider matters identified during the course of the audit engagement, including: (Ref: Para. A38)

(a) New Events or conditions are identified that indicate an incentive or pressure to commit fraud, or provide an opportunity to commit fraud (i.e., new fraud risk factors are identified are present).

(b) Fraud is identified or suspected fraud; and

(c) Control deficiencies related to the prevention or detection of fraud are identified.

We suggest that the IAASB revise paragraph A38 of ED-240. This paragraph states that “the engagement partner’s approach to direction, supervision and review may include increasing the extent and frequency of the engagement team discussions.” In our view, the use of the word “the” in this sentence implies there are several required team discussions. As there is only one engagement team discussion required in ED-240, we question whether this sentence is referring to changing the extent and frequency of the engagement team discussion required by paragraph 29 of ED-240, or whether this is more general to the engagement partner possibly needing to have more frequent and extensive discussions with the engagement team.

The second example in paragraph A38 of ED-240 states that “the chief financial officer resigns, with no explanation given for the sudden departure, providing an opportunity for other employees in the treasury department to commit fraud given the lack of senior management oversight.” We believe in this extreme situation; the auditor should first consider the requirement in paragraph 60 as to whether the auditor is able to continue with the audit engagement and suggest revising the example accordingly.

Written representations

Paragraph 65(a) of ED-240 creates a requirement for the auditor to obtain written representations that management and where appropriate, those charged with governance “acknowledge their responsibility for the design, implementation, and maintenance of internal control to prevent or detect fraud and have appropriately fulfilled those responsibilities.” This proposed requirement is in conflict with paragraph 12 of ISA 580 that requires that “management’s responsibilities shall be described in the written representations... in the manner in which these responsibilities are described in the terms of the audit engagement” because the language of the new written representation is different from the language required to be included in the terms of engagement by ISA 210 about management responsibilities for internal control.

To proceed with the proposed requirement in paragraph 65(a), which alters the description of management’s responsibilities, conforming amendments would be needed to both:

ISA 210 paragraph 6(b)(ii), which currently requires that the auditor “obtain the agreement of management that it

acknowledges and understands its responsibility for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error”

ISA 700 paragraph 34(a), which requires that the auditor’s report include a description of management’s responsibility for “preparing the financial statements in accordance with the applicable financial reporting framework, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error”

We however do not believe the current description of management’s responsibility for internal control, which is inclusive of fraud, is fundamentally flawed. We would therefore suggest not moving forward with the written representation in paragraph 65(a) as proposed.

In addition, we believe that paragraphs 65(c) and (d) of ED-240 create inconsistencies between the required representations from management regarding their disclosure of fraud to the auditor and the scope of fraud that the auditor has responsibilities to address. Paragraph 65(c)(iii) requires management to represent that they have disclosed their knowledge of fraud or suspected fraud involving others only where the fraud “could have a material effect on the financial statements.” Paragraph 65(d) requires that management represent that they have disclosed their knowledge of suspected fraud only when “affecting the entity’s financial statements.”

To appropriately support the auditor’s responsibilities to perform procedures on instances of identified fraud and suspected fraud, we expect that management would be required to disclose all known instances of fraud or suspected fraud, even if those instances do not affect or do not have a material effect on the entity’s financial statements. The required inquiries of management (paragraph 35(b)(i) of ED-240) include management’s knowledge of any fraud or suspected fraud, which we believe should be the scope of the management representation requirement in paragraphs 65(c) and (d) of ED-240.

Further, as fraud constitutes an instance of non-compliance with laws and regulations (as stated in paragraph 14 of ED-240), management and, where appropriate, those charged with governance are required to provide written representation in accordance with ISA 250 (Revised) paragraph 17 that “all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements have been disclosed to the auditor.” As explained in our response to Q9, we have concerns about the linkage between ED-240 and ISA 250 (Revised). We believe that the requirements for written representations in ISA 250 (Revised) should be better aligned to those in ED-240 because fraud is now explicitly defined to constitute an instance of non-compliance with laws and regulations.

Documentation

We do not believe the restructuring of the documentation requirements in ED-240 provides the appropriate linkages to the requirements of other ISAs. Absent this linkage, we believe ED-240 implies these requirements are separate and distinct from the procedures performed in accordance with ISA 315 (Revised 2019) and ISA 330. Therefore, we suggest the following revisions to paragraph 70(b):

70. In applying ISA 230, the auditor shall include the following in the audit documentation of the identification and the assessment of the risks of material misstatement required by ISA 315 (Revised 2019):

- (a) The matters discussed among the engagement team regarding the susceptibility of the entity’s financial statements to material misstatement due to fraud in accordance with paragraph 29.
- (b) Key elements of the auditor’s understanding in accordance with paragraphs 33–38 (including identified controls in the control activities component that address assessed risks of material misstatement

due to fraud), the sources of information from which the auditor's understanding was obtained and the risk assessment procedures performed.

(c) The identified and assessed risks of material misstatement due to fraud at the financial statement level and at the assertion level, and the rationale for the significant judgments made.

71. In applying ISA 230, the auditor shall include the following in the audit documentation of the auditor's responses to the assessed risks of material misstatement required by ISA 330:

(d) 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.

(e) (a) The results of audit procedures performed to address the risk of management override of controls, the significant professional judgments made, and the conclusions reached.

72. In applying ISA 230, the auditor shall also include the following in the audit documentation:

(d) (a) 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.

(f)(b) Fraud or suspected fraud identified, the results of audit procedures performed, the significant professional judgments made, and the conclusions reached.

(g)(c) The matters related to fraud or suspected fraud communicated with management, those charged with governance, regulatory and enforcement authorities, and others, including how management, and where applicable, those charged with governance have responded to the matters.

We also suggest developing additional application material to clarify that the requirements of our proposed paragraphs 70 and 71 are not separate from those performed and documented in accordance with ISA 315 (Revised 2019) and ISA 330, but instead are requirements to document the incremental considerations in applying ED-240.

Additional drafting suggestions

We have the following additional drafting suggestions to assist the IAASB in finalizing the standard:

We suggest the following revisions to paragraph 29 of ED-240 as we do not believe using the phrase "exchange of ideas" is clear as the basis for a requirement (i.e., how a required "exchange of ideas" would be different than a required "discussion"). We suggest retaining "discuss" as the required action by the engagement team for clarity.

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 shall discuss discussion shall include: (Ref: Para. A48–A49 and A53)

(a) An exchange of ideas about:

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

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

- a.(i) Incentives or pressures on management, those charged with governance, or employees to commit fraud;
- b.(ii)

We suggest the following editorial suggestions to paragraph 34 of ED-240:

34. ...

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

(d) Make inquiries of those charged with governance about: (Ref: Para. A75–A78)...

(iii) 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.

We suggest the following revision to paragraph 56 of ED-240:

56. ... (iii) There are additional responsibilities for the auditor under law, regulation or relevant ethical requirements about the entity's non-compliance with laws or regulations in accordance with ISA 250 (Revised). ...

We suggest the following addition to the example in paragraph A5 of ED-240:

A5. Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as intentionally: taking advantage of inadequate information processing controls in information technology (IT) applications, including controls over and review of IT application event logs (e.g., modifying the application logic, or where users can access a common database using generic access identification, or modify access identification, to conceal activity, or altering of master data).

We suggest the following revision to first bullet point in the example in paragraph A29 of ED-240:

The auditor (e.g., when performing audit procedures in accordance with ISA 550, the auditor becomes aware of the existence of a related party relationship that management intentionally did not disclose to the auditor).

We suggest the following revisions to paragraph A37 of ED-240:

A37. The engagement partner may plan for direction, supervision and review to respond to identified risks of material misstatement due to fraud by, for example:

Assigning additional individuals with specialized skills or knowledge, such as forensic and other experts.

Assigning more experienced individuals to the engagement team; or

Changing the composition of the engagement team to include more experienced individuals; or

Assigning so that more experienced members of the engagement team to conduct certain audit procedures for those specific audit areas that require significant auditor attention.

We suggest the following revisions to paragraph A40 of ED-240:

A40. The extent of the auditor's communications with management and those charged with governance depends on the fraud risk factors and related risks of material misstatement identified by the auditor fraud-related facts and circumstances of the entity, as well as the progress and outcome of the fraud-related audit procedures performed in the audit engagement.

We suggest the following revisions to paragraph A49 of ED-240:

A49. Individuals who have specialized skills or knowledge, such as forensic and other experts, may be invited to attend the engagement team discussion to provide deeper insights about the susceptibility of the entity's financial statements to material misstatement due to fraud. The involvement and contributions of experts' individuals with specialized skills or knowledge may elevate the quality of the discussion taking place.

We suggest the following revisions to paragraph A53 of ED-240:

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: ...

Remind engagement team members of their responsibilities regarding quality management at the engagement level for an audit of financial statements in accordance with ISA 220 (Revised), and 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.

We suggest the following revisions to the examples to paragraph A62 of ED-240:

Offshore financial centers that have looser less restrictive regulations and tax incentives that may facilitate fraud through money laundering.

Cultural norms in which using bribery to conceal fraud is deeply ingrained as an accepted practice of doing business

We suggest the following revisions to paragraph A71 of ED-240:

A71. In many jurisdictions, corporate governance practices are well developed and those charged with governance play an active role in oversight of the entity's assessment of risks, including how the entity's risk assessment process addresses risks of fraud and the controls that address such risks. Since the responsibilities of those charged with governance and management may vary by entity and by jurisdiction, it is important that the auditor understands their respective responsibilities to enable the auditor to obtain an understanding of the oversight exercised by the appropriate individuals with respect to the prevention and detection of fraud.

We suggest the following revisions to paragraph A72 of ED-240:

A72. An understanding of the oversight exercised by those charged with governance may provide insights regarding the susceptibility of the entity to management fraud, the adequacy of controls that address risks of fraud the entity's risk assessment process in addressing fraud risks, and the competency and integrity of management. The auditor may obtain this understanding in several ways, such as by attending meetings where such discussions take place, reading the minutes from such meetings, or making inquiries of those charged with governance.

We suggest the following revision to paragraph A73 of ED-240:

A73. The effectiveness of oversight by those charged with governance is influenced by their objectivity and familiarity with the processes and controls management has put in place to prevent or detect fraud. For example, the oversight by those charged with governance of the effectiveness of controls to prevent or detect fraud is an important aspect of their oversight role and the objectivity of such evaluation is influenced by their independence from management.

We suggest the following revision to paragraph A74 of ED-240 to clarify what requirements are being referred to:

A74. In some cases, all of those charged with governance are involved in managing the entity. This may be the case in a smaller or less complex entity where a single owner manages the entity and no one else has a governance role. In these cases, there is ordinarily no action on the part of the auditor regarding the requirements in paragraphs 34(b) – 34(d) because there is no oversight separate from management.

We suggest the following revisions to paragraph A75 of ED-240:

A75. The auditor may also inquire of those charged with governance about how the entity assesses the risk of fraud, the entity's controls to prevent or detect fraud how the entity addresses those risks, and the entity's culture and management's commitment to integrity and ethical values.

We suggest the following revision to paragraph A77 of ED-240:

A77. Inquiries on whether those charged with governance are aware of any control deficiencies in the system of internal control related to the prevention and detection of fraud...

We suggest the following revisions to the examples to paragraph A94 of ED-240:

A94. In applying ISA 315 (Revised 2019) and ISA 610 (Revised 2013) in the context of fraud, the auditor may, for example, inquire about:

How the entity's risk assessment process addresses the risk of fraud risk assessment.

The entity's processes and controls to prevent or detect fraud.

We suggest the following revisions to paragraph A97 of ED-240:

A97. When performing risk assessment procedures, the auditor may consider changes in the entity's IT environment because of the introduction of new IT applications or enhancements to the IT infrastructure, which may impact the susceptibility of the entity to fraud or create vulnerabilities in the IT environment (e.g., changes to the databases involved in processing or storing transactions). There may also be an increased susceptibility to misstatement due to management bias or other fraud risk factors when there are new or innovative complex IT applications used to initiate or process transactions or information, such as the use of artificial intelligence or machine learning algorithms to initiate and process calculate and initiate accounting entries. In such circumstances, the auditor may assign individuals with specialized skills and knowledge, such as forensic and IT experts, or more experienced individuals to the engagement.

We suggest the following revision to paragraph A99 of ED-240:

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 whether due to fraud or error. Paragraphs 49–50 of this ISA require the auditor to design and perform audit

procedures 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).

We suggest the following revisions to paragraph A102 of ED-240 to align with the terminology used in ISA 315 (Revised 2019) paragraph A182:

A102. In performing the evaluations of each of the components of the entity's system of internal control, the auditor may determine that certain of the entity's policies controls in a component are not appropriate to the nature and circumstances of the entity. ...

We believe that the circumstances described in paragraph A111 should be increasingly rare. We therefore suggest the following revision:

A111. There may be limited circumstances where it may be appropriate to rebut the presumption that there are risks of material misstatement due to fraud in revenue recognition. 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.

We suggest the following revisions to paragraph A112 of ED-240:

A112. Paragraph 70(d) specifies the documentation required when where the auditor concludes that the presumption is not applicable in the circumstances of the engagement and, accordingly, has not identified revenue recognition as a risk of material misstatement due to fraud.

We suggest that the discussion of the auditor maintaining an open mind "to new ideas or different perspectives in selecting the audit procedures to be performed to address the risks of material misstatement due to fraud" in paragraph A114 of ED-240 be expanded to include the potential sources of such new ideas and perspectives.

We suggest the following revision to paragraph A128 of ED-240:

A128. Prior to selecting items to test, the auditor may need to consider whether the integrity of information (i.e., the completeness, accuracy and validity of information) in the population of journal entries and other adjustments has been maintained throughout all stages of information processing based on the auditor's understanding and evaluation of the entity's information system and control activities (e.g., general IT controls that safeguard and maintain the integrity of financial information) in accordance with the requirements of ISA 315 (Revised 2019).

We suggest the following revision to paragraph A140 of ED-240:

A140. Applying forensic skills through analyzing accounting records, conducting interviews, reviewing internal and external communications, investigating related party transactions, or reviewing internal controls may also assist the auditor in evaluating whether the indicators of possible management bias represent a material misstatement due to fraud.

We suggest the following revisions to paragraph A149 of ED-240:

A149. When evaluating the appropriateness of the entity's process to investigate and remediate the fraud or suspected fraud in accordance with paragraphs 55(b) and 55(c), the auditor may consider: ...

Whether the outcome of the process is likely to prevent the reoccurrence of the fraud or suspected fraud (e.g., new controls activities are designed and implemented to prevent and detect such frauds).

We suggest the following revision to paragraph A150 of ED-240:

A150. ISA 265 provides requirements and guidance about the auditor's communication of significant deficiencies in internal control identified during the audit to those charged with governance. Examples of matters that the auditor considers related to fraud or suspected fraud in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency include...

We suggest the following revision to paragraph A155 of ED-240:

A155. The following are examples of qualitative or quantitative circumstances that may be relevant when determining whether a misstatement due to fraud is material...

We suggest the following revision to paragraph A158 of ED-240:

A158. Examples of exceptional circumstances that may arise and that may bring into question the auditor's ability to continue performing the audit include: ...

The auditor's consideration of the risks of material misstatement due to fraud and the results of audit tests procedures performed indicate a significant risk of material and pervasive fraud.

We suggest the following revision to paragraph A163 of ED-240 as we believe this is indicative of a point in time and will be outdated going forward:

A163. Users of financial statements have expressed an interest in matters related to fraud about which the auditor had a robust dialogue with those charged with governance and have called for additional transparency about those communications. The considerations in paragraph 61 focus on the nature of matters communicated with those charged with governance that are intended to reflect matters related to fraud that may be of particular interest to intended users.

We suggest the following revisions to the example in paragraph A166 of ED-240:

Example:

Based on the auditor's identification of aggressive profitability expectations of investment analysts about the entity, the auditor identified assessed a risk of material misstatement due to fraud because of the subjectivity involved in the expected credit losses estimate and the incentive this creates for intentional management bias.

We suggest the following revisions to paragraph A167 of ED-240:

A167. In accordance with ISA 265, the auditor may communicate a significant deficiency in internal control to management and those charged with governance that is relevant to the prevention and detection of fraud. Significant deficiencies may exist even though the auditor has not identified misstatements during the audit. For example, the lack of a reporting mechanism (e.g., whistleblower program) may be indicative of weaknesses in the entity's control environment, but it may not directly relate to a risk of material misstatement due to fraud. The auditor is required to communicate significant deficiencies in internal control in accordance with ISA 265.

We suggest the following revision to paragraph A168 of ED-240:

A168. However, this may not be the case for all these matters.

We suggest the following revisions to paragraph A170 of ED-240:

A170. ... to intended users' understanding of the financial statements as a whole. one or more of the matters related to fraud that required significant auditor attention in performing the audit, determined in accordance with paragraph 61,

We suggest that paragraph A6 in the conforming amendments to ISA 265 be expanded to include the following examples that have been added to paragraph A151 of ED-240, with revisions as noted:

A6. Examples of matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency include: ...

The lack of a process to investigate non-compliance with laws and regulations, including the fraud or suspected fraud or a process to investigate the non-compliance with laws and regulations, including fraud or suspected fraud that is not appropriate in the circumstances.

The lack of, or ineffective, remediation measures implemented by management to prevent or detect the reoccurrence of non-compliance with laws and regulations, including the fraud or suspected fraud.

We suggest adding a footnote to paragraph A6A in the conforming amendments to ISA 450 to reference ED-240 paragraphs 55-59.

We suggest the following revisions to the conforming amendments to ISA 701:

A21. In addition, ISA 240 (Revised) indicates that, due to the unpredictable way in which management is able to override of controls could occur, it is a risk of material misstatement due to fraud at the financial statement level on all audits and thus a significant risk...

Written representations: We believe the new requirement in ED-240 to obtain written representations regarding management's responsibility for the design, implementation, and maintenance of internal control to prevent or detect fraud is in conflict with certain extant requirements in ISA 580, ISA 210 and ISA 700 (Revised). We do not believe the current description of management's responsibility for internal control, which is inclusive of fraud, is fundamentally flawed. We would therefore suggest not moving forward with the written representation in ED-240 as proposed, but if pursued, there should be appropriate conforming amendments to other ISAs. We also believe there are inconsistencies between the required representations from management regarding their disclosure of fraud to the auditor and the scope of fraud that the auditor has responsibilities to address.

Forvis Mazars

Yes, with comments below

The changes highlighted in para. 104 of the explanatory memorandum regarding journal entry testing are not transformative and, in reality, merely reflect what most auditors are already doing when testing journal entries and will not therefore have a significant impact on identification of fraud. Furthermore, changing "consideration" to "determination" of the need to test journals throughout the year is not going to make a difference to the work performed. Again, these changes may raise an unreasonable expectation that the revised ISA 240 will make a significant difference when, in reality, not much will change in many audits.

The first example in ED240.A63, relating to the construction industry, conflates incentive and opportunity and would benefit from clarification.

We believe that further guidance would be helpful in relation to fraudulent financial reporting, including by whom and why fraudulent financial reporting may be committed. For example:

Financial reporting fraud can be committed by anyone at any level of the organization, from top to middle management to executive staff. Several studies in the United States show that in the majority of cases, the CEO, CFO or both were the perpetrators.

Extant Standard 240.A2 states that management in particular is motivated to prepare fraudulent financial reports as a result of pressures and incentives. However, management is often not the person who makes journal entries or prepares financial statements. Often, management instruct or enforce an employee to process transactions in a certain way. Thus, management is often the intellectual perpetrator and the employee the factual perpetrator.

Fraudulent financial reporting does not always begin with an intentional act to distort financial statements. In some cases, fraudulent financial reporting is the result of a series of actions designed to respond to operational problems with the goal of achieving financial objectives or being able to meet expectations. For example, a manager may begin by maximizing the maximum useful life for fixed assets within the boundaries of the accounting policies but when this fails to achieve the desired results, the manager becomes a potential fraudster by engaging in actions that violate accounting policies. This is particularly the case when top management allows or even encourages this type of action. Albrecht et. al (2019) calls this a "slippery slope". that what begins as a seemingly innocent case of "earnings management" develops into fraudulent financial reporting.

Hamilton & Smith (2021) find that auditors are less skeptical of an omitted transaction compared to a mis-recorded transaction. They are also less skeptical of a misstatement that results from management omitting information from a supporting document compared to misrepresenting information. Overall, their studies identify a method of fraud—omission—that managers are likely to use, but that auditors are unlikely to judge as being intentional.

Forensic specialist involvement is usually restricted to audits of large, complex entities performed by larger firms with in-house forensic accountant teams at their disposal and, typically, their involvement is in response to known issues (e.g. identified fraud indicators) rather than when identifying and evaluating fraud risks as part of the audit engagement. The importance of managing the expectation around the use of forensic experts and scalability cannot be overstated. Many firms will not have access to forensic skills and any expectation that such skills are applied routinely in audit engagements could have significant unintended consequences around competition and choice in the audit market.

However, we do have significant concerns that the standard is clearly written for, and targeted to, audits of larger, more complex, public interest entities, as with many of the revised standards in recent years. There are two main areas where ED240 gives rise to scalability concerns, with the proposals predicated on:

an expectation of the use of forensic experts - In the extant ISA240, forensic experts are referred to only once, compared to more than 25 references in ED 240, suggesting a potential expectation gap around forensic specialists being required on audits, which in the majority of cases would be unnecessary

In this way, conditional requirements may typically apply for larger, more complex, public interest entities than for a smaller, less complex entity with a simple control environment, but would also reflect the circumstances of individual engagements. Additional guidance including examples of situations where the audit engagement team could deal with a fraud situation itself, or which may give rise to the need to involve forensic experts, would be very helpful.

We believe that greater scalability could be built into the standard through the use of more conditional requirements, based on complexity of the condition rather than necessarily the complexity of the audit or the audited entity, including:

the complexity of the control environment (driving requirements around controls and deficiencies) and

the complexity of any frauds or suspected frauds identified (driving the need to consider involvement of forensic experts).

We note that the IAASB has expanded the requirements around incorporating an element of unpredictability in the response to cover all fraud risks, not just those at financial statement level. This change has gone largely unnoticed but is likely to impact on the work effort and documentation when responding to assertion level

fraud risks. It would be helpful if the IAASB could clarify whether this was its intention and, if so, provide examples to support auditors in applying unpredictability in assertion level risks.

Grand Thornton International

We suggest the IAASB consider revising the objective in ED-240, paragraph 17(d) to say to “communicate” in accordance with this ISA in order to capture the auditor’s responsibility to communicate certain matters to management and those charged with governance as well as to report to users via the auditor’s report.

Yes, with comments below

We have identified the following additional matters in relation to ED-240:

We support the IAASB’s project to revise ISA 240 to clarify the auditor’s responsibilities related to fraud and recognize that many proposed revisions memorialize procedures that auditors are performing today. As such, many of the revisions will not result in changes in practice by auditors at larger firms which have methodologies based on the ISAs.

We question whether the volume of application material added is necessary or appropriate for a risk-based standard. We have concerns that the volume of application material compared to requirements is not aligned with the IAASB’s CUSP principles. According to CUSP, the purpose of application material is to support the proper application of the requirements and should not impose additional requirements. It further states that not all requirements need application material. We note that nearly all requirements in ED-240 have multiple application material paragraphs supporting the requirement, with one requirement having nine paragraphs of application material. While we appreciate that one of the purposes is to explain more precisely what a requirement means or is intended to cover, the requirements themselves need to be clear on what the auditor is required to do. We suggest the IAASB 1) more vigorously review the application material and remove those paragraphs that do not specifically add a fraud lens, and 2) consider whether certain application material paragraphs may be better placed in an appendix or moved to nonauthoritative guidance.

KPMG International

Appendix 1 – Other Recommendations and Editorial Matters

Alignment of ED-240 With the Structure and Flow of ISA 315R

In connection with the IAASB’s objective of achieving close alignment with ISA 315R, we recommend that ED-240 include:

An explicit requirement at the end of the section entitled Identifying and Assessing the Risks of Material Misstatement due to Fraud to require the auditor, in evaluating whether the audit evidence obtained from the risk assessment procedures provides an appropriate basis for the identification and assessment of the risks of material misstatement in accordance with ISA 315R.35, to specifically evaluate whether this is the case in respect of material misstatement due to fraud. We note that paragraph A105 of ED-240 makes reference to this requirement and notes that the auditor is required to perform additional risk assessment procedures until audit evidence has been obtained to provide such a basis. However, we recommend that a specific requirement, linked to ISA 315R.35, be included to give appropriate focus to this evaluation. We also suggest that related application material provide guidance to the auditor as to particular factors they may consider in making this evaluation.

A further explicit requirement at the end of the section entitled Identifying and Assessing the Risks of Material Misstatement due to Fraud to require the auditor to revise their risk identification or assessment if the auditor obtains new information which is inconsistent with the audit evidence on which the auditor originally based

the identification or assessments of the risks of material misstatement due to fraud, building on the foundational requirement at paragraph 37 of ISA 315R. We consider this to be important given the iterative nature of an audit, including, in respect of fraud-related matters, and, in particular, regarding the requirement for the auditor to remain alert throughout the audit for information that is indicative of fraud or suspected fraud. We recommend that this requirement be linked also to the overall stand-back procedure that we recommend including (please see our response to Question 7).

Structure and Flow of the Proposed Standard Regarding Circumstances When Instances of Fraud or Suspected Fraud are Identified in the Audit

We set out recommendations in relation to the proposed structure and flow of the standard, below:

We note that paragraph 55(d) requires the auditor to “determine whether control deficiencies exist, including significant deficiencies in internal control related to prevention or detection of fraud, relating to the identified fraud or suspected fraud”. We recommend that this required determination be more clearly linked to the evaluations required at paragraphs 55(b) and (c).

For clarity purposes, we recommend that ED-240.57 specifically link/cross-reference to the proposed new requirement in ISA 450 that requires the auditor, if the auditor identifies a misstatement, to evaluate whether such a misstatement is indicative of fraud.

We recommend that the applicability of paragraph 57(c) be broadened to all situations where the misstatement due to fraud is determined to be material (qualitatively or quantitatively), and not limited only to possible collusion being present, as, whilst the implications when collusion may be present are of particular concern, there are likely to be implications for management’s representations and audit evidence obtained in any circumstances where an individual in a senior/managerial position is involved, even if there does not appear to be broader collusion between individuals;

Furthermore, we also recommend that paragraph 57(c) explicitly require the auditor to consider whether circumstances or conditions indicate possible collusion, as in the extant standard (at paragraph 37), before considering the implications of this for the audit as a whole, including in respect of the reliability of management’s representations, and audit evidence previously obtained, in particular.

In connection with the above, we also recommend that paragraph 57(b) and (c) be linked/cross-referenced to paragraphs 56(a) and (b) regarding the auditor’s determination as to whether to perform additional risk assessment procedures and to design and perform further audit procedures to appropriately respond to the risks of material misstatement due to fraud.

We also recommend that paragraphs 55(d) and 61(c) in relation to determining whether control deficiencies, including significant deficiencies in internal control, exist, and communicating these to TCWG, are both linked to application material at A151, and are also linked to ISA 265, Communicating Deficiencies in Internal Control to Those Charged with Governance and Management where significant deficiencies are defined and discussed in more detail, e.g., at paragraph A7, which refers to evidence of an ineffective response to identified significant risks;

Paragraph 57(a) and (c) refer to considering the nature of the “circumstances” giving rise to the misstatement, and the “circumstances or conditions” giving rise to the misstatement. We recommend that the language be consistent (both here and elsewhere in the standard, as we note in our responses to Questions 3 and 10), and that ED-240 also clarify whether, in referring to conditions, they mean “events or conditions”, i.e., fraud risk factors, or whether the intention is to reference circumstances only. We also note that the reference to “qualitative or quantitative, at 57(a) should be to “qualitative and quantitative”.

Communication with management and TCWG

We recommend that paragraphs 66 and 67 of ED-240 be clearly linked to ISA 260, Communication with Those Charged with Governance and ISA 265, Communicating Deficiencies in Internal Control to Those Charged with Governance and Management. We also recommend that requirements in respect of auditor identification of significant deficiencies in

internal control (paragraphs 24(c), 25, 55(d), 61(c) and 68 of ED-240) be specifically linked to the requirements of ISA 265 regarding timely, written communications, as control deficiencies relating to a significant risk are indicators of a significant deficiency in internal control.

We also highlight that the proposed conforming amendments to ISA 700 arising from ED-240 include changes to the auditor's responsibilities, both at paragraph 40 of ISA 700, and within the illustrative reports in the section entitled "Auditor's Responsibilities for the Audit of the Financial Statements". These set out that the auditor is required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any identified fraud or suspected fraud. We do not consider this requirement to be expressed appropriately, as paragraph 67 of ED-240 requires the auditor "to communicate fraud or suspected fraud that the auditor has identified, involving management, employees who have significant roles in internal control, or others where the fraud results in a material misstatement in the financial statements, to those charged with governance".

Accordingly, we recommend that the conforming amendments described above be clarified by inclusion of the qualifying language of "involving management, employees who have significant roles in internal control, or others where the fraud results in a material misstatement in the financial statements" to appropriately align with ED-240.67 and to avoid a description that would incorrectly broaden the scope of the auditor's responsibilities in this area to all fraud or suspected fraud, regardless of materiality considerations, both quantitative and qualitative.

Yes, with comments below

Please see below for additional concerns regarding certain matters that are not addressed by the specific questions above, and our recommendations to address these concerns.

Responses to the Assessed Risks of Material Misstatement Due to Fraud

We are supportive of the enhancements to this section of the standard, including the clearer cross-references included in ED-240 to ISA 330, the additional focus on key areas such as accounting estimates, and the greater emphasis on the application of professional skepticism in performing procedures to respond to the assessed risks of material misstatement due to fraud.

However, we note the following concerns and make related recommendations to further enhance the clarity and effectiveness of ED-240 in this area:

Linkage to ISA 330 – we note that the requirements in this section of the standard are not clearly aligned with those in ISA 330, although there are certain high-level cross-references. Accordingly, we recommend that ED-240 more clearly set out fraud-specific incremental requirements to ISA 330 and require the auditor to apply a "fraud lens" when addressing fraud risks at the financial statement level and at the assertion level. We suggest that ED-240 include more explicit guidance for the auditor to help ensure that audit procedures are appropriately targeted to respond to identified and assessed fraud risks, taking account of relevant fraud risk factors identified.

Financial Statement Level Fraud Risks - we recommend that the application material in ED-240 discuss, or cross-refer to other material that addresses, circumstances, events or conditions that may indicate that there are risks of fraud at the financial statement level, and that such guidance explicitly refer to the auditor's evaluation of the components of the entity's system of internal control in terms of its ability to prevent and detect fraud, including the entity's business culture and "tone at the top", which may indicate that there are more pervasive fraud risks. We believe this would help auditors to design procedures that are more responsive to such risks.

We also suggest that ED-240 more clearly emphasize that certain required responses set out in the standard are designed to address such pervasive risks, e.g., in respect of incorporating an element of unpredictability in the selection of the nature, timing and extent of audit procedures, and considerations in respect of greater involvement of more senior and experienced team members in directing, supervising and reviewing the performance of audit procedures that are designed to address risks of fraud at the financial statement level. We recommend that application material also refer to other examples of responses to pervasive fraud risks, such as increasing the extent of substantive procedures across the audit as a whole, performing more tests of details, and increasing sample sizes in testing.

We also recommend that the guidance related to such matters cross-refer to other application material that more specifically discusses how a fraud may be perpetrated and to application material that addresses risks of fraud at the assertion level, as we believe the interconnectivity between financial statement-level and assertion-level fraud risks is not sufficiently signposted. We note that paragraph A116 is helpful in describing that overall responses are required to address fraud risks at the financial statement level, and that these involve the exercise of professional skepticism, however, we recommend that more specific guidance, including examples, is included in relation to how the auditor may change the nature, timing and extent of tests of controls and substantive procedures to respond both to financial statement level fraud risks as well as to specific fraud risks at the assertion level.

Furthermore, we recommend that ED-240 explicitly refer to the need to obtain more persuasive audit evidence (in terms of the relevance and reliability, and sufficiency), throughout the audit, when such pervasive risks are present. Paragraph A117 discusses more persuasive audit evidence and provides examples, however, this application material is cross-referenced to assessed risks of material misstatement due to fraud specifically at the assertion level. We recommend that this material also be cross-referenced to paragraph 45 of ED-240.

We also recommend that application material be developed to address financial statement level fraud risks more specifically, with greater context as to why the auditor may consider it appropriate to perform certain procedures, e.g., obtaining more evidence from external sources. In such circumstances, we believe it would be helpful for the guidance to focus on the importance of the auditor "casting a wide net" in terms of obtaining information to be used as audit evidence.

Unpredictability in the selection of audit procedures – we consider the requirement at paragraph 44 of ED-240, and related application material, are not sufficiently clear as to whether unpredictability in the selection of the nature, timing and extent of audit procedures is expected to be applied in respect of each identified and assessed risk of material misstatement due to fraud or is to be considered as a more overarching concept. We believe that greater emphasis should be given to the latter, and, accordingly, we recommend placing this within the Overall Responses section of the standard. We also suggest that the related application material emphasize that unpredictability is important to address not only identified fraud risks, but also as an overall response to help the auditor to address fraud risks that have not been previously identified.

Evaluation of the selection and application of accounting policies by the entity – we consider that the requirement at paragraph 46 of ED-240 to address the auditor evaluation of whether the selection and application of accounting policies by the entity may be indicative of fraudulent financial reporting, lacks clarity and specificity. We recommend that application material be developed that clearly links such considerations to the auditor's understanding of the entity and its environment and the assessed risks of material misstatement due to fraud, including the fraud risk factors identified (e.g., where there is pressure for management to reach certain financial targets). We also recommend that the application material provide examples of circumstances where the selection and application of accounting policies may be indicative of fraud. We

highlight that ED-240 (and the extant standard) emphasize the area of revenue recognition, however, we recommend that ED-240 consider providing additional examples.

Presentation of the financial statements - we also recommend that ED-240 emphasize that the auditor applies a "fraud lens" when performing the procedures at ISA 700.13, including in respect of evaluating the presentation of information in the financial statements and considering whether the financial statements provide adequate disclosures and whether their overall presentation may have been undermined by the inclusion of information that is not relevant or that obscures a proper understanding of the matters disclosed. We suggest that such material reference relevant auditor considerations such as whether there may be indicators of possible management bias when evaluating the financial statements as a whole, as management bias may be difficult to detect at an individual disclosure level (similar to the principle in ISA 540R.32). We refer also to our response to Question 7, in which we recommend the inclusion of an explicit fraud-related standback requirement, which this could form a part of.

Significant unusual transactions and related party transactions - we recommend that paragraph 53 of ED-240, regarding significant and unusual transactions outside the normal course of business, also refer explicitly to related party transactions, and be clearly linked to ISA 550, Related Parties. We also recommend that the auditor be required to understand processes and controls over the identification and capture of such transactions and be directed to respond in a targeted manner to any identified risks of fraud in this area, as an ED-240-specific "overlay" to the requirements in ISA 315 and ISA 330.

Journal Entries - we welcome the introduction of material to address obtaining audit evidence about the completeness of the population of all journal entries and other adjustments made in the preparation of the financial statements throughout the period. We also support the application material at paragraph A135, which discusses using automated tools and techniques when testing journal entries and other adjustments.

However, as the recording of inappropriate journal entries and other adjustments in order to manipulate the financial reporting process may frequently be the means by which a fraud is perpetrated at an entity, we do not consider that the requirements at paragraphs 49-50 of ED-240 are sufficiently clear and specific to address fraud risks in this area.

Firstly, we do not consider that these requirements are sufficiently responsive/directly related to the fraud risks that have been identified and assessed by the auditor and instead appear to be a more prescriptive set of procedures that are focused on making inquiries, and on testing journal entries made at the end of the reporting period. We note that certain application material provides useful context, but requirements and application material appear to be overly focused on entries made at the end of the reporting period rather than driving a risk-based approach. Appendix 4 does set out helpful considerations when selecting journal entries and other adjustments for testing, including clearer linkage to the fraud risk factors identified. However, we believe that the characteristics of fraudulent journal entries, described in Appendix 4, remain somewhat

generic, e.g., which individuals made the journal entries, whether they are made at the period end, whether they contain round numbers etc. which may no longer be the most relevant criteria to denote higher risk entries.

Accordingly, we recommend that the requirements and related application material drive a more targeted approach in order to respond to the particular fraud risks identified, as follows:

Paragraph 50(c) and (d) be combined to require the auditor to select journal entries and other adjustments for testing, with application material providing guidance, and factors for the auditor to consider, in determining the selection, including whether selection should be from those journal entries made at the end of the reporting period, or those made throughout the period, or both. Such factors would include the auditor's evaluation of the entity's internal control environment, and fraud risk factors that may indicate whether and how a fraud may be perpetrated.

Application material include greater emphasis on auditor considerations relevant to selection for testing of other adjustments made specifically as part of a group consolidation, where applicable, (e.g., elimination of intercompany balances, "top side" entries etc. may be susceptible to an increased risk of fraud).

Certain matters included in the application material examples, e.g., the focus on journal entries with round numbers, appear somewhat dated. Instead, we recommend that the application material focus more clearly on high-risk criteria for selection of journal entries, based on the auditor's understanding and consideration of fraud risk factors. Additionally, we recommend that the material at paragraph A135, regarding the use of automated tools and techniques to select and test journal entries and other adjustments, be developed further, as part of the IAASB's project to consider the integrated project on risk and response and involve the technology consultation group.

Whilst paragraph A118 and Appendix 4 provide helpful context and guidance for the auditor as to their considerations in selecting journal entries to test, it is unclear as to how this relates to overarching considerations such as management override of controls, and the fraud risk factors, in terms of ensuring that substantive testing is appropriately targeted. It is also unclear whether and how the engagement team may take into account fraud risk factors, such as pressures and incentives to reach financial targets, when selecting journal entries in relation to particular account balances for testing. We recommend that the IAASB explore these matters further and provide clarity within ED-240.

In relation to obtaining audit evidence, as required at paragraph 50(b), regarding the integrity of the population of journal

entries and other adjustments, it is unclear whether ED-240 envisages that the auditor would be able to conclude that integrity has been maintained based only on their understanding of the entity's internal control environment, including information processing and their evaluation of the design and implementation of GITCs, or whether the auditor would need to test the operating effectiveness of such controls in order to be able to conclude. Furthermore, there is a lack of clarity in the event that GITCs are not tested or are tested and found not to be operating effectively, as to the implications for the audit. We recommend that ED-240 provide further guidance in this area.

We do not consider that ED-240 is sufficiently reflective of the complexity of the journal entry process, e.g., the fact that journal entries may be recorded in a sub-ledger and not the general ledger, and/or that they may be automatically posted and not be manual entries. They may even be made "offline". IT systems may also be complex, with a number of different systems integrated and different interfaces between these. We recommend that paragraph A135, in addressing the completeness of the population and selecting of items to

test, address this complexity further, and include considerations for the auditor in a modern and complex environment, e.g., whether and how they may use D&A tools to investigate the system as a whole, how to address complexities introduced by multiple systems, as well as processing issues such as the use of batch journals. We recommend that the application material discuss considerations in respect of when and how to involve experts, such as IT experts and forensics experts, in this area.

MNP

Yes, with comments below

Whether ED-240 Addresses the Drivers for Change

We understand that the drivers for change that initiated the ISA 240 revisions were corporate failures and accounting scandals in recent years as well as questions from stakeholders about the roles and responsibilities of the auditor related to fraud (expectation gap). In reading and understanding the changes in ISA 240, it is difficult to determine whether these changes will truly address these drivers and will result in more financial statement frauds being identified.

We suggest that more work needs to be done to evaluate the root causes of recent financial statement frauds and auditor failures in identifying them. It is not entirely clear whether the root causes were missing requirements from ISA 240 or whether it was more pervasive industry-related issues such as independence breaches, employee workload, lack of training, timeline pressures, or issues related to firms' systems of quality management.

Use of Forensic or Other Experts

When addressing the need for specialized skills (including forensic skills) the proposed revisions are not clear as to when the use of forensic or other experts would be needed when there is no suspected or alleged fraud. The expectation gap between practitioners and regulators continues to grow in this area, and many auditors of small and medium-sized businesses do not have the forensic resources available to assist on audits. We recommend additional guidance to assist practitioners in making risk-based determinations as to whether forensic or other experts are needed when there's no suspected or known fraud.

Unpredictability

We identified that the changes regarding the auditor's use of unpredictability in the selection of audit procedures will make it more and more difficult for auditors to incorporate unpredictability. Under extant ISA 240, incorporating elements of unpredictability in the selection of audit procedures was part of the determination of overall responses to address the risk of material misstatement due to the fraud at the financial statement level. This provided many areas and opportunities for auditors to incorporate unpredictability. Under ED-240 the unpredictability requirement has been repositioned as a response to the addressed risks of material misstatement due to fraud at the assertion level. For many audits, the fraud risks may be the same year-over-year. If the auditor previously had a thorough appropriate audit response to the fraud risk, this requirement is potentially forcing them to perform their procedure differently, which may reduce its effectiveness. Additionally, the examples listed in A114 should be reviewed in this context as some of them do not make sense when the procedure is being designed for the purposes of addressing an identified fraud risk (for example, performing a procedure over a balance that is not material would likely not address a risk of material misstatement due to fraud).

Public Sector Entity Examples

We have identified the following application material paragraphs where it would be beneficial to add an example specific to the public sector, as they generally carry a different risk profile from profit-oriented entities:

A6

A11

A52

A64-A66

A81

A155

Appendix 2 pg. 113

Other items

We have identified the following suggestions that could improve the readability and understanding of ED-240:

Documentation – It would be beneficial to make references back to the relevant requirements for paragraph 70 (c)-(g) the same way that paragraph 70 (a) and (b) do.

Paragraph A105 – It would be beneficial to include an example of what is meant by evidence obtained from the risk assessment procedures that does not provide an appropriate basis for the identification of risks of material misstatement due to fraud.

Paragraphs A107-A112 – It would be beneficial to provide guidance for entities that have more than one stream of revenue that there may be instances where certain streams may not have an associated fraud risk.

PriceWaterhouseCoopers

Yes, with comments below

We recommend that paragraph 32 of ED-240 be relocated for improved alignment within the standard. This paragraph focuses on evaluating evidence derived from risk assessment procedures to identify potential fraud risk factors. Paragraphs 33 to 39 represent key risk assessment procedures most likely to yield indicators of such fraud risk factors. As such, in order to ensure a logical flow from identification to evaluation of fraud risk factors, we suggest relocating paragraph 32 after paragraph 39.

In paragraph A2 and A157, we recommend including the word “often” before “involves” when describing fraud, as it could be read as implying all three elements of the fraud triangle must be present, when this may not be the case, especially in relation to third-party fraud.

Paragraph A11, while helpful in principle, could lead to an expectation that the auditor is required to determine why a fraud was perpetrated (e.g., form a view on management’s intentions). This would be inconsistent with paragraph 6 that the auditor does not make legal determinations of whether fraud has actually occurred, which includes the concept of intent. We suggest the IAASB reframe this in the context of the auditor’s understanding of the matter, when applicable, obtained in accordance with paragraph 55.

We suggest adding to the list in paragraph A35 skills in evaluating the matters required by paragraph 55 in relation to the appropriateness of the entity’s process to investigated matters as well as remediation measures.

Paragraph A78 could be read as implying that the auditor has to form a view on the sufficiency of those charged with governance’s ability to objectively assess the actions of management. We recommend the

IAASB be clearer about the linkage to ISA 260 and avoid suggesting that the auditor is evaluating the effectiveness of those charged with governance as part of the financial statement audit.

In paragraph A157 we suggest referring to the fact that “an instance of fraud may not be an isolated occurrence” rather than suggesting that it is unlikely to be. That may convey that when a fraud is encountered there is always likely to be multiple frauds being perpetrated. Unless the IAASB has evidence of that fact, we think this should be more balanced.

Conforming and consequential amendments

ISA 450, paragraph A1 – The footnote contains a reference to examples of misstatements provided by paragraphs A2-A6 of ISA 240 (Revised). Paragraph A2 describes incentives and opportunities, rather than examples of misstatements. We suggest the reference should be to A3-A6.

RSM International

Yes, with comments below

Engagement Resources

Paragraphs A34 and A35 of ED-240, including the examples therein, appear to indicate that the use of a specialist is required in applying paragraph 22 of ED-240, which may not be scalable to firms that do not have a specialist readily available. To address this, we suggest the following revisions are made to the body of these two paragraphs:

A34. The nature, timing, and extent of the involvement, if any, of individuals with specialized skills or knowledge, such as forensic and other experts, or the involvement of more experienced individuals, may vary based on the nature and circumstances of the audit engagement.

A35. Forensic skills or other relevant experience, in the context of an audit of financial statements, may combine accounting, auditing and investigative skills. Such skills may be applied in an investigation and evaluation of an entity’s accounting records to obtain possible evidence of fraudulent financial reporting or misappropriation of assets, or in performing audit procedures. The use of forensic skills may also assist the auditor in evaluating whether there is management override of controls or intentional management bias in financial reporting.

We also believe there should be more guidance on determining when the nature and circumstances of the audit engagement may warrant the use of a specialist or when the use of a specialist may not be necessary and someone with relevant experience may be appropriate. Including examples of the nature and circumstances of the audit engagement when a specialist may not be needed would be useful to auditors when making such determination.

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

Paragraph A109 of ED-240 provides examples of conditions or events relating to revenues that may give rise to fraud risk factors that may affect the auditor’s assessment of the risks of material misstatement due to fraud in revenue recognition. We believe that it may be more helpful to provide more specific examples of conditions or events relating to the risks of material misstatement due to fraud in revenue recognition and therefore recommend the following revisions to paragraph A109 of ED-240:

A109. Understanding the entity’s business and its environment, the applicable financial reporting framework and the entity’s system of internal control helps the auditor understand the nature of the revenue transactions, the applicable revenue recognition criteria and the appropriate industry practice related to revenue. This

understanding may assist the auditor in identifying events or conditions (see examples below) relating to the types of revenue, revenue transactions, or relevant assertions, that could give rise to fraud risk factors.

Examples:

When there are changes in the financial reporting framework relating to revenue recognition, which may present an opportunity for management to commit fraudulent financial reporting or bring to light the lack of (or significant deficiency in) controls for managing changes in the financial reporting framework.

When there is a high degree of returns or credit memos particularly if issued after the period end.

When there are issues with accounts receivables, for example, significant delays, disputes, or lack of payment.

When an entity's accounting principles for revenue recognition are more aggressive than, or inconsistent with, its industry peers.

When the entity operates in emerging industries for which there may be a lack of authoritative guidance or benchmarks for comparison.

When revenue recognition involves complex accounting estimates or subjective inputs to accounting estimates.

When revenue recognition is based on complex contractual arrangements with a high degree of estimation uncertainty, for example, construction-type or production-type contracts and multiple-element arrangements.

When contradictory evidence is obtained from performing risk assessment procedures or throughout the audit process.

When the entity has a history of significant audit adjustments due to for the improper recognition of revenue (e.g., premature recognition of revenue).

When circumstances indicate suggest the possibility of the recording of fictitious revenues, such as delays in the availability or lack of audit evidence (e.g., invoices, purchase order), incentive for management to maximize compensation linked to the entity's financial performance or undue pressure to manipulate the entity's financial performance due to pressure to meet investor, market, or internal expectations.

When the timing of revenue recognition is significantly or unexpectedly weighted toward the end of the reporting period.

When circumstances indicate backdating or manipulation of agreements or other documents to achieve a desired accounting result.

When circumstances indicate the omission of required disclosures or presentation of incomplete or inaccurate disclosures regarding revenue, which may mislead financial statement users or otherwise obscure material facts for example, to manipulate the entity's financial performance due to pressures to meet investor / market expectations, or due to the incentive for management to maximize compensation linked to the entity's financial performance.

6. Public Sector Organizations

Government Accountability Office – United States

As part of our review of the ED-240, we identified a few areas for which we suggest changes. We recommend changing the definition of fraud to remove the phrase “unjust or illegal.” We believe the concept of justification is frequently used to support an individual's fraudulent actions as just. We suggest modifying the definition as follows:

Fraud— An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain a personal or professional advantage.

In addition, we believe that there is frequently an unclear connection between the examples in boxes in the application material and the surrounding application material paragraphs. We suggest removing these boxes if they are not more clearly introduced and linked to the related

application materials. If the examples are maintained in the documents as they are currently presented, then they should have specific discrete paragraph numbers so they can be clearly identified within the guidance. Placing the examples in a box after an application material paragraph does not clearly connect the two.

In paragraph 36(b), we believe the structure of the sentence should be revised to clearly reflect the conditional nature of the requirement. We suggest the revision as follows:

(b) If an internal audit function exists, inquire with appropriate internal audit individuals 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 risk of fraud.

We believe that paragraph 38 should be reorganized to better convey the requirement as follows:

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

Paragraph A106 is not clearly written. As proposed, it could be interpreted to mean that misappropriation of assets is not a common type of fraud for private sector entities, which is not necessarily true. 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, contracts, and social welfare/benefit programs. 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.

70(d). We suggest that the IAASB consider restoring the text in 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.

Provincial Auditor Saskatchewan

See response to question 5 above.

Also, we would suggest the guidance should be improved in certain areas as the examples provided do not relate to the public sector.

The examples under paragraphs A3, A111, A166, and in Appendix 1 – Incentives/Pressures are not normally as applicable in the public sector.

The example under paragraph A106 (which is specific to the public sector) only discusses misappropriation of assets and does not provide a common example for misstatements resulting from fraudulent financial reporting such as reporting expenses in the incorrect period in order to meet budget.

The examples under paragraph A142 focus on income and revenues and exclude expenses which can be a more relevant area of concern in the public sector. We suggest the example should be changed to say, “income or expenses” and “revenue or expenses.”

7. Member Bodies and Other Professional Organizations

Accountancy Europe

Yes, with comments below

We note that the term “fraud” is often used where it would be more appropriate to use the term “material misstatement due to fraud” or “risk of material misstatement due to fraud” and therefore urge the IAASB to ensure that correct terminology is used throughout the standard. This is particularly important not to widen the expectation gap.

Asociacion Interamericana de Contabilidad

Yes, with comments below

An additional consideration that may be relevant to ED-240 is the need to provide additional guidance on how auditors should address the specific challenges presented by emerging technologies, such as artificial intelligence and big data analytics, in the context of fraud. As these technologies become more integrated into business operations and audit processes, new types of fraud risks could emerge, or existing risks could be altered.

We believe the following specific aspects to consider could include:

Technological Risk Assessment. This could include additional requirements or guidance on how to assess the risks associated with technologically advanced systems that process financial transactions and data. This assessment should consider both the vulnerabilities inherent in these technologies and those related to their implementation and use in specific contexts.

Training and competencies. It may be useful to address the need for auditors to develop and maintain specific competencies to deal with emerging technologies. This would include understanding how these technologies can be manipulated to commit fraud.

Use of analytical tools. While ED encourages the use of analytical procedures, providing detailed guidance on how to apply advanced data analysis techniques to identify unusual patterns or patterns indicative of fraud could be beneficial and would be especially relevant in environments where the volume and complexity of data exceeds traditional analytical capabilities.

We understand that the points specifically cited above could further enhance the effectiveness of ED-240 by ensuring that auditors are equipped to meet current and future challenges in fraud detection in an increasingly technological financial world, otherwise, in short order, a revision of the ISA 240 reviewed here would again be necessary.

Center for Audit Quality

Considerations relating to the use of forensic specialists

As described in the ED, determining the need for specialized skills, as well as the nature, timing and extent of direction, supervision and review in accordance with paragraphs 22 through 24 of ED-240 would allow the application of judgment by the engagement partner in light of the varying circumstances of an audit. We recognize and appreciate that ED-240.A33 emphasizes that the engagement partner's determination of whether additional engagement level resources are required to be assigned to the engagement is a matter of professional judgment and is influenced by the nature and circumstances of the audit engagement. Additionally, we appreciate that the Board included specific examples in ED-240.A34 with the intention of illustrating the scalability of the proposed standard. However, we are concerned that, while well-intentioned, the inclusion of a separate requirement in ED-240 could have the unintended effect of implying an expectation that the engagement of forensic, IT, data and/or other specialist(s) is expected in all or most audits. We do not believe that such widespread use of such specialists in financial statement audits is necessary, nor do we believe this is the Board's intention.

In order to minimize the potential for such an unintended effect, we recommend that the Board consider eliminating proposed paragraph 22 from ED-240, maintaining the overall requirement for the engagement partner to determine the competence and capabilities of the engagement team in ISA 220 (Revised). We recommend that the application material within proposed ED-240.A33 through A36 be added to the existing application material applicable to ISA 220 (Revised), paragraph 26. We believe this approach will more clearly demonstrate that the engagement partner's determination regarding the competence and capabilities of the engagement team is expected to be a holistic determination that includes consideration of specialized skills or knowledge to perform procedures related to fraud and will minimize the potential implication that a fraud specialist would be required or expected on every audit.

Chamber of Auditors of the Czech Republic

Yes, with comments below

Engagement resources

We believe that, for example, paragraphs 22 and A36 focus too much on human resources. We suggest adding that the available technology (IT equipment) for performing audit procedures, e.g. for testing journal entries, should be considered when assessing engagement resources before accepting the engagement.

We consider that it is not possible to verify the completeness of the journal entries (see requirement A135) without the use of automated tools and techniques.

Analytical procedures

We would appreciate more detailed guidance related to preliminary and final analytical procedures in relation to the risk of material misstatement due to fraud.

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

Another area that is particularly concerning for SMPs is regarding the use of forensic experts. They argued that ED-240 appears to assume that firms have access to forensic experts and while this might be true for the larger firms where they often employ various experts including forensic experts, in the case of SMPs forensic experts are not normally employed in-house and external expertise could be restricted in certain countries and markets. Furthermore, the involvement of external forensic experts comes with a high cost and therefore

could challenge the recoverability of smaller audit engagements. These factors combine to exacerbate the issues associated with the language as described in our response to question 2 in the case of SMPs.

Yes, with comments below

The other matters we would like to raise in relation to ED-240 are as follows:

Accounting estimates

There were differing interpretations of paragraphs 51–52. One interpretation was that by virtue of complying with paragraph 52, then the auditor will have also complied with paragraph 51. We are not sure this is the intention.

Documentation

Our attention was drawn to some potential gaps in the documentation requirements:

Paragraph 70 – There is no requirement to document the ongoing fraud discussions with management/TCWG that are required by paragraph 25.

2 ISA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing

3 ISA 220 (Revised), Quality Management for an Audit of Financial Statements

4 ISA 330, The Auditor's Responses to Assessed Risks

5 ISA 500, Audit Evidence

6 ISA 520, Analytical Procedures

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

8 ISA 701, Communicating Key Audit Matters in the Independent Auditor's Report

Paragraph 70(a) – There is no requirement to document the conclusions reached in the discussion amongst the engagement team, only the matters discussed.

Paragraph 70(e) – There is no requirement to document the audit procedures performed to address the risk of management override of controls, only the results of audit procedures performed, the significant professional judgments made, and the conclusions reached.

Paragraph 70(f) – There is no requirement to document the audit procedures performed in relation to fraud or suspected fraud identified, only the results of audit procedures performed, the significant professional judgments made, and the conclusions reached.

Chartered Accountants Ireland

A117- the examples set out how an auditor may alter the nature, timing and extent of procedures to respond to risks of material misstatement due to fraud however the paragraph above this does not refer to nature, timing and extent. It would be helpful to add this to the paragraph above to show the linkage. Further, the example under "Timing" is hard to follow as it initially discusses performing procedures at period end as the most effective method and then talks to performing procedures earlier in the process- it would be helpful to clarify that this is as well as the procedures at period end.

A122- The example is hard to follow as it is not clear how cash can be deposited in a bank account that does not exist; further clarification is needed on this point.

A178- the final bullet point does not follow from the lead in which are examples of when a KAM may not be communicated- we suggest this is moved.

Yes, with comments below

We have noted the following other matters in our consideration of ED-240:

We note that the term “fraud” is often used where it would actually be appropriate to use the term “material misstatement due to fraud” or “risk of material misstatement due to fraud” and therefore urge the IAASB to ensure the correct terminology is used throughout.

In ED Paragraph 46, the other two overall responses from the extant standard have been moved to other sections. The remaining one on accounting policy selection feels out of place in this section due to the way it is worded i.e. "In determining response...shall evaluate whether". Clearer wording might be "The auditor shall evaluate whether the selection and application of accounting policies by the entity, particularly those related to subjective measurements and complex transactions, may be indicative of fraudulent financial reporting, and determine overall responses to address such assessed risks of material misstatement at the financial statement level."

Response to risks, journal entries and other adjustments in ED Paragraph 50(c) - we would suggest adding a requirement to test post-closing entries in line with UK revisions. It is mentioned in the application paragraphs but should be a requirement to be included in selection.

Application material A6- the lead-in paragraph has three scenarios in which misappropriation of assets can occur with examples in bullet points following this. We recommend that the examples are linked through to the three scenarios for further clarity.

Overall, we believe the ED has integrated scalability considerations as it is principles based and there are conditional requirements however there are numerous references to the use of forensic specialists. This is not usually a skillset available routinely to auditors in smaller audit firms and an alternate suggestion such as seeking input from a more experienced auditor could be included.

We note that the ISA for LCE will need to be updated in due course.

CPA Australia

Yes, with comments below

Clarity on procedures expected to be directly fulfilled by the engagement partner.

We note that paragraph 52 of the EM expects the engagement partner, based on the understanding obtained as per paragraph 55, to make determinations about the effect of the fraud or suspected fraud on the audit according to paragraph 56.

However, it was unclear if paragraph 22 of ED-240 also intends for the engagement partner to “identify and assess the risks of material misstatement due to fraud, design and perform further audit procedures to respond to those risks or evaluate the audit evidence obtained.” We suspect this is a minor drafting issue and recommend that the IAASB clarify the level of involvement required from engagement partners and revise the wording of paragraph 22 accordingly. We believe that expecting engagement partners to perform detailed procedures, such as identifying and assessing risks of material misstatement due to fraud, would be impractical. The role should focus on making determinations rather than performing these detailed tasks.

Potential gaps in documentation requirements

We have identified some potential gaps in the documentation requirements of ED-240. Firstly, paragraph 70 does not mandate the documentation of ongoing fraud discussions with TCWG as required by paragraph 25. This omission could lead to a lack of accountability and oversight in monitoring and addressing fraud risks. Secondly, Paragraph 70(a) lacks a requirement to document the conclusions reached during discussions amongst the engagement team, focusing solely on the matters discussed. This gap may result in incomplete records, making it difficult to trace the decision-making process and rationale behind key judgments. Addressing these gaps would enhance the thoroughness and transparency of the documentation process.

CPA Ontario Small and Medium Practices Advisory Committee

Yes, with comments below

When considering the application of ED-240 from the perspective of a small firm, several additional points are worth raising to ensure that the standards are both practical and effective for audits conducted by smaller practices:

It's crucial for the IAASB to ensure that there is adequate training and support mechanisms in place for small firms. These firms might not have the same access to training resources as larger firms. Providing targeted training resources or guidance specifically designed for small firms could help ensure proper understanding and implementation of ED-240.

ED-240 raises the expectations for auditors in their consideration and detection of fraud. However, small firms might not always have in-house forensic expertise, which is often critical in complex fraud detection scenarios. Clarifying the expectations or providing guidelines on when and how to seek external forensic expertise could be beneficial.

The application of enhanced fraud detection and reporting requirements could lead to increased audit costs and efforts, particularly impacting smaller entities audited by small firms. The IAASB might consider ways to mitigate these impacts, possibly through scalability guidelines that explicitly address cost-benefit considerations in fraud-related procedures.

With the increasing use of technology in audits, there should be clear guidance on the use of technological tools in fraud detection to ensure small firms are not disadvantaged if they have less access to advanced audit technology. Practical guidance on affordable technologies that can support fraud detection efforts would be valuable.

While transparency is crucial, the requirement for detailed reporting on fraud matters in the auditor's report might need to be balanced with considerations of the practical impacts on small entities. Specific guidance on how to report fraud findings in a manner that is proportionate to the size and complexity of the entity could prevent unnecessary reputational damage or concern.

Encouraging peer review and collaboration among small firms might help in sharing best practices and experiences in dealing with fraud-related challenges in audits. This could be facilitated through regional workshops, online forums, or professional networking groups.

Small firms often work closely with their clients. Providing auditors with tools or resources to educate their clients about the importance of fraud prevention measures and the role of the audit in detecting fraud could help in setting realistic expectations and improving the overall quality of the financial reporting environment.

Addressing these areas in the application material or through supplementary guidance from the IAASB can help ensure that ED-240 is effectively and efficiently implemented across all sizes of audit practices, thereby enhancing the overall quality and reliability of audits in detecting and addressing fraud.

European Federation of Accountants and Auditors for SMEs

Yes, with comments below

We note that the proposals in ED-240 refer to ISA 230 and include a long list of documentation requirements in paragraph 70. Since these requirements would be applicable (to the extent relevant) to all engagements, there will be cases where some of the required documentation may add little value to the audit. Hence, we urge the IAASB to reconsider which of the documentation requirements outlined are in fact critical to all engagements and differentiate those which are more appropriate where a significant risk of fraud is identified. In this way one can avoid unnecessary or boilerplate documentation.

Institute of Chartered Accountants in England and Wales

Notwithstanding IAASB's efforts to make ED-240 scalable, the standard still reads as though it is addressing auditors of larger and more complex entities and potentially creates an uneven playing field, particularly in relation to the forensic expert-related content. We note 12 references to the term 'forensic' in the proposed standard as opposed to one in the extant standard.

Forensic team involvement is indeed occurring in audits of more complex financial statements performed by larger and more well-resourced audit firms. They may be present at audit team engagement discussions, and they may be engaged when a fraud is identified or suspected. Consultees from such firms confirmed that internal guidance is in place for audit teams to involve forensic teams if certain criteria are met. Such firms commonly have direct access to an in-house forensic accounting team, however, and need only pick up the phone to make use of the expertise referred to in ED-240.

SMPs may not have an in-house forensics team and may primarily work with smaller and less complex entities whose fraud controls are relatively unsophisticated. The pool of qualified forensic experts available externally to audit firms is not large and, in some jurisdictions, simply does not exist.

This important issue is exacerbated by the proposal that forensic experts may be used in the following circumstances:

In the case of 'changes in the entity's IT environment (...) which may impact the susceptibility of the entity to fraud.' (ED-240 Para. A97)

In 'identifying and evaluating the risk of material misstatement due to fraud.' (ED-240 Para. A35)

In 'performing the review of accounting estimates' (ED-240 Para. A140).

Forensic experts we consulted noted that their involvement in audits is still often reactionary in nature, in the presence of fraud indicators or where senior management raises specific concerns, for example. We question ED-240's implication that individuals with forensic (and, in the case of Para. A97, IT) skills should intervene in areas such as those listed above, which are generally the purview of internal and external auditors. Assuming an increasingly widespread use of experts and specialists in financial statement audits in general is unrealistic and has the potential to devalue, and ultimately de-skill the auditor, and diminish their responsibilities in relation to fraud.

The forensic expert community and SMPs concurred that the application material which speaks to the use of forensic experts in an audit of financial statements, albeit non-mandatory, is not viable for smaller audit firms. If regulators take the view that the use of such experts is customary in PIE audits, IAASB will have effectively, and unnecessarily, made it even harder than it already is for SMPs to enter that market.

Ultimately, the decision whether to engage a forensic expert is a judgement call based on individual circumstances. Given the range of unsophisticated and sophisticated frauds occurring in the simplest privately-owned businesses to the largest public interest entities, auditing standards should not inadvertently, but effectively, steer auditors towards using experts. We do not believe that this is IAASB's intention.

At the very least, IAASB should consider taking stock of the forensic-related content in ED-240 and condensing it into fewer higher-level paragraphs. The need to apply judgement, on a case-by-case basis, as to whether a specialist is needed should also be made clear. The finer detail regarding how and when forensic specialists may assist with the audit engagement could then be issued in the form of non-authoritative guidance, rather than in the standard itself.

Experts are not the auditor's first and only recourse, even when a more complex fraud is identified or suspected. The engagement team might consider consulting another auditor at their own firm with experience of corporate fraud. They may also be able to use the work of management's forensic expert, should appropriately qualified individual(s) be appointed. Setting out these alternatives would be a useful addition to the standard.

In his 2019 report on the effectiveness of audit, Sir Donald Brydon recommended that 'training in both forensic accounting and fraud awareness be parts of the formal qualification and continuous learning process to practice as a financial statements auditor.' ICAEW supports improved training for auditors in forensic techniques and understanding what forensic accountants do in practice. A recent ICAEW webinar covered these issues. Training is always accessible and useful to smaller firms.

Yes, with comments below

We note the requirement in ED-240 Para. 50(d) to 'determine the need to test journal entries and other adjustments throughout the period.' Automated tools and techniques, which have been available to most UK audit firms for many years, can facilitate the testing of journal entries throughout the financial period. The revised standard should make this clear. Fraudsters may know that the auditor is required to select (and not simply asked to consider testing) journals posted at the end of the reporting period and may consequently avoid this period.

ISA (UK) 240 (Revised May 2021) contains a section dedicated to testing the appropriateness of journal entries (Para. 33(a)). The UK standard not only requires the auditor to select journals made at the end of a reporting period but also to select post-closing entries. We appreciate that Appendix 4 to ED-240 highlights 'post-closing entries that have little or no explanation or description' as a potential characteristic of fraudulent journal activity. However, history has shown a number of fraudulent entries that have been reversed in the post-closure period. IAASB should consider emphasizing the importance of considering these types of journals in the standard itself and not just an Appendix.

Institute of Chartered Accountants of Jamaica

Yes, with comments below

Institute of Chartered Accountants of Scotland

ED-240 in several places appears to be more designed for the audit of large complex entities. We have concerns that the IAASB is nudging auditors to make use of forensic experts and away from them exercising professional judgement as to whether the use of such forensic experts is required based on the specific facts and circumstances. This is illustrated by the various references to forensic expert-related content. The involvement of forensic experts does occur, and such expertise is available in the larger firms, however, other

audit firms are not as likely to have such in-house expertise, and this may not be easily accessible externally in the given jurisdiction.

Institute of Chartered Accountants of Sri Lanka

Yes, with comments below

Whether combating bribery and corruption be considered within this standard needs to be evaluated.

Institute of Singapore Chartered Accountants

Yes, with comments below

Communication to stakeholders

While many of the ISAs have been revised to address public interest concerns, we feel that the perception of the audit profession has not improved. One reason could be that it is not apparent to the users of financial statements how the revisions to the ISAs would benefit them in terms of better-quality audits. Instead of emphasizing the limitations of an audit (in the area of fraud and other matters), communication should be focused on major revisions to the standards that are most impactful to audit quality, for example, ISA 315 (Revised 2019).

Also, we continue to observe lack of understanding on the role of the auditor vis-à-vis management and those charged with governance. Further outreach efforts by IAASB are necessary to educate the public about the important components of the financial reporting ecosystem, including company culture, corporate governance and internal control environment, all of which play crucial roles in determining the quality of financial reporting information.

International Federation of Accountants

Yes, with comments below

The proposals within ED-240 refer to ISA 230 and include a long list of documentation requirements in paragraph 70. As these requirements would be applicable (to the extent relevant) in all engagements, there will be cases where some of the required documentation may add little value to the file. The wording of some of these may also result in quite broad documentation requirements, for example 70(f) which requires documentation of fraud or suspected fraud identified. The IAASB should reconsider which of the documentation requirements outlined are actually critical to all engagements and differentiate those which are more appropriate where a significant risk of fraud is identified to avoid unnecessary or boilerplate documentation becoming the norm, which could ultimately have an impact on audit quality through the mindset this can create in auditors.

We note the explanatory memorandum, and the application guidance contain several references to the use of forensic specialists. There may be sufficient availability of such in-house expertise in larger firms to support audit engagements, but if expectations of use are made, this could create problems for SMPs who may be reliant on external expertise in this area. We note the proposed wording of A35 suggests such skills 'may' be applied, but this could be interpreted inconsistently by regulators, leading some to take this to be an indication such skills 'must' be applied. Where there have been specific risks identified in relation to fraud, it may be appropriate for SMPs to engage forensic specialists, but the IAASB should be careful not to create expectations (even if implied rather than actual) that such experience would be needed on all engagements.

Korean Institute of Certified Public Accountants

Need to revise the requirements relating to forensic skills.

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

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

Malaysian Institute of Accountants - Auditing and Assurance Standards Board

Although ISA 240 is not a recent addition, numerous amendments have been proposed, potentially leading the public to perceive a broadening of auditors' responsibilities. To manage these perceptions, the IAASB should prioritize effective communication and education initiatives aimed at clarifying the role of auditors in addressing fraud matters. It is important to underscore that while auditors play a crucial role, the primary responsibility for preventing and detecting fraud still lies with management and TCWG. Therefore, it is imperative for management and TCWG to implement robust controls to safeguard against fraudulent activities.

Pennsylvania Institute of Certified Public Accountants

Yes, with comments below

The committee would like to highlight the importance of an organization's whistleblower hotline and related controls and suggests that the IAASB enhance ED-240 to include additional consideration of the whistleblower hotline and related controls as well as make inquiries regarding any tips communicated through the hotline and how the communications were handled by management or those charged with governance.

South African Institute of Chartered Accountants

Yes, with comments below

SAICA recommends the following enhancements to the paragraphs referred to below:

Par. 11. Furthermore, the risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud because management is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information, or override controls designed to prevent similar frauds by other employees.

Par 11: Consider updating this paragraph to include material misstatement resulting from those charged with governance.

As part of the examples in Par. A7 we recommend that the IAASB should consider adding guidance on Supply Chain Management (SCM) and its direct impact on financial statements. There are possible irregularities that can occur during the awarding of a tender that could result in a preferred bidder being appointed at a higher price. Other examples include instances where the project has been delayed due to inferior work or even no delivery of services.

Par. A10. Consider adding guidance to provide clarity on how the auditor should address matters reported in the media.

P A11 (a): This paragraph only relates to management, consider including those charged with governance.

Par. A12: Consider adding guidance to provide clarity of instances of inherent limitations such as lost documents.

Par 11: Consider adding to material misstatement from management fraud - “those charged with governance” as this is also an area where fraud often occurs.

8. Academics

Accounting and Finance Association of Australia and New Zealand

Yes, with comments below

Responses to assessed risk of material misstatement

In the absence of a specific question on auditor responses to assessed risk of material misstatement due to fraud (i.e., paragraphs 43-54 and associated application and explanatory material), we provide our comments here.

We encourage the IAASB to consider introducing requirements and associated application and explanatory material that requires auditors to determine evidence that would be indicative of the realization of the identified risks of material misstatement due to fraud and the response that will be triggered should such evidence be encountered.

Research highlights that auditors may not effectively respond to elevated fraud risk assessments, often overly relying on past procedures and extending procedures in the audit plan rather than performing new procedures specifically related to the changed risk (e.g., Zimbelman 1997; Asare and Wright 2004; Asare et al. 2015; Bauer et al 2020; Aghazadeh and Joe 2022). Care is needed to ensure that auditors appropriately respond to the assessed risk of material misstatement.

Research on improving auditors’ responses to heightened fraud risk is limited. Austin (2023) finds that planning for the appropriate response when information encountered during fieldwork indicates fraud risk may enhance auditors’ attention to fraud while collecting evidence. This suggests an audit plan that both specifies what the auditor is looking for when conducting fieldwork and the response that will be initiated should such evidence be encountered. With one exception (paragraph 53), ED-240 does not speak to the type of information the auditor is looking for, nor the response that will be activated. To enhance the effectiveness with which auditors respond to the assessed risk of material misstatement due to fraud, we encourage the IAASB to require the determination of information that would be indicative of the realization of the risk of fraud and the response that would be initiated should such evidence be encountered.

Aghazadeh, S., and Joe, J.R. 2022. Auditors’ response to management confidence and misstatement risk. *Accounting, Organizations and Society* Vol.101, 101348

Asare, S.K., and Wright, A.M. 2004. The effectiveness of alternate risk assessment and program planning tools in a fraud setting. *Contemporary Accounting Research* Vol.21 No.2, pp.325-352.

Asare, S.K., Wright, A., and Zimbelman, M.F. 2015. Challenges facing auditors in detecting financial statement fraud: Insights from fraud investigations. *Journal Forensic Investigation and Accounting* Vol.7 No.2, pp.325-352.

Austin, A.A. 2023. Remembering fraud in the future: Investigating and improving auditors’ attention to fraud during testing. *Contemporary Accounting Research* Vol.40 No.2, pp.925-951.

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

Zimbelman, M.F. 1997. The effects of SAS No.82 on auditors' attention to fraud risk factors and audit planning decisions. *Journal of Accounting Research* Vol. 35, Supplement, pp.75-97.

9. Individuals and Others

Albert Bosch

Yes, with comments below

In addition to the detailed comments in question 1 and 3, we want to address an issue regarding qualitative circumstances or factors as mentioned in paragraphs 8 and 57 of ED 240 (and the corresponding application material).

Qualitative considerations and circumstances matter. However, stating that “an otherwise insignificant fraud perpetrated by senior management is ordinarily considered qualitatively material irrespective of the amount involved” (paragraph A11 in ED 240) creates an expectation and by doing so an implicit requirement for the auditor to detect all frauds committed by management, since these types of fraud are “ordinarily considered qualitatively material”. This means that the auditor needs to identify and assess all possible fraud risks that could involve management and accordingly needs to respond to all these fraud risks in the audit plan. That is a mission impossible for the auditor and the auditor will be a scapegoat by default in case of a fraud involving management.

The requirement in paragraph 57 is in the section ‘Fraud or Suspected Fraud’ (starting at paragraph 55). We advise to stipulate in paragraphs 8 and A11 of ED 240 that, once fraud is found or suspected and it appears to involve management, only then qualitative factors are to be considered.

We also challenge you, similar to appendices 1 to 3, to provide examples of frauds that are otherwise insignificant, but become material due to qualitative factors/circumstances. Paragraph A155 of ED does not go further than providing examples of qualitative circumstances, but that’s not helping auditors sufficiently.

Altat Noor Ali Chartered Accountants

10.2 We see quality of documentation on an audit engagement to be a function of the resources assigned to the audit. The link is missing in the diagram of para 11. Its placement is inappropriate as para 93 of EM.

10.21 Documentation and the audit cost>> Metaphorically documentation is the base on which the edifice of fraud stands. We frequently find blemishes found by our regulators as statements to justify their existence. Who is going to audit them? Where will this cycle end? What we know is not everything requiring documentation is documented: not all in an audit can be documented. There is no concept of perfect documentation. Given its centrality to the auditor, guidance is sought in the Application.

We also notice a missing appendix which associates foundation standards with documentation requirements of other ISAs.

What will be the impact of the documentation requirements in ED240 over the cost of the audit? ED240 avoids the topic. It is obvious that every new requirement in terms of procedure, documentation, communication or reporting will raise the cost of the audit. Let client be ready to foot the bill to bridge the expectation gap.

Irrespective, the Board should rise above these considerations to do its job properly: it’s simply not possible to carry out the spirit of the Standard properly otherwise.

10.3 Use simple (and correct) English; and short sentences. The language used for communicating a matter directly impacts its understanding and hence application. The comprehension and understanding and therefore effectiveness of this Standard can easily be doubled by using a better language.

How good is the language of the Standard? Very Good? Good? Average? Below average? Create a Task Force of non-native Users to assess and/or bring in some language experts to have an independent view of this ED (and others). Let them conclude if the present is the best form of coming up with an ISA.

The Board must relentlessly make an effort to revise and simplify the syntax of the ED. The English used in your publications creates difficulties in understanding for the non-native language users of this ED.

Use simple English for improving understandability of the Standard.

10.4 Use of Topic-wise Index to save time and facilitate navigation. Our Standards have always been without Index. The volume of a document may not be warranting one. This changed in recent times where we see a Standard comes with a Basis of Conclusion, and linkages to others. It's time to include topic-wise index to facilitate users to access the target material fast.

10.5 Use of flowchart/diagrams. We appreciate use of a relevant diagram in Explanatory Memorandum to explain the changes proposed in the ED240.

10.51 Example: Conditional scalability.

10.6 Using hyperlinks within the document (Explanatory Memorandum, proposed ED, Application material) would ease navigation.

10.7 Link the individual Appendix to the main body of the ED240, along with the Application material). This will connect ED240 with individual appendix directly.

Appendix 1: Direct ref. Para 18(b). Via or indirect ref. para A23, A38, A56.

Appendix 2 direct reference to para 44 and indirect sub ref. to A115, A123.

Appendix 3: Direct ref. Para 12-13 and 19-21. Indirect sub ref to A30.

Appendix 4 : Direct ref. Para 36(b). Indirect ref. A96, A99, A131

Appendix 5: Direct ref. Para 15. Indirect ref. A17

Colin Semotiuk

Yes, with comments below

ED-240 would be improved by adding examples/considerations for the public sector. Examples of where public sector examples/considerations would be beneficial include (see underlined wording):

A6 [new example] “Misappropriation of assets for the public sector may include tax avoidance schemes or underreporting revenues by taxpayers or public sector entities knowingly issuing grants to ineligible recipients.”

A11 “. . . an otherwise insignificant fraud perpetrated by senior management, or a public official is ordinarily considered . . .”

A64 “. . . External performance measures may include expectations from shareholders, analysts, legislators, elected officials, or other users.”

A66 bullet 2, “Short-selling reports, negative media attention, negative analyst reports or political criticisms from opposition parties or citizens.”

A155 [new example for both qualitative and quantitative circumstance] “Impacts to surplus or deficit and whether or not the public sector entity meets or exceeds its approved budget.”

Dr. Rasha Kassem

Yes, with comments below

Improvements in the communication of fraud are necessary, particularly when auditors suspect the involvement of management and those charged with governance in fraudulent activities. Currently, the standard leaves it up to the auditor's discretion to decide whether to report suspected fraud to the authorities. This lack of clear accountability and encouragement undermines the auditors' responsibility to take appropriate action. This issue is particularly significant given the challenges that compromise auditors' independence, such as concerns related to the payment of audit fees by the client and the provision of non-audit services. Additionally, the absence of legal protections for auditors against client retaliation further exacerbates the problem. In light of these circumstances, it is crucial to provide auditors with clear and stronger instructions to report fraud to the authorities in cases where management and those charged with governance are suspected perpetrators. Without explicit guidance, auditors may be reluctant to report fraud due to the reasons I have highlighted.

Q10 No or no response

2. Investors and Analysts

Corporate Reporting Users' Forum

No response

Eumedion

No response

3. Regulators and Audit Oversight Authorities

Botswana Accountancy Oversight Authority

No, with comments below

We do not have any other matters to raise in relation to ED-240.

Securities and Exchange Commission of Brazil

No (with no further comments)

4. Jurisdictional and National Auditing Standard Setters

Saudi Organization for Chartered and Professional Accountants

No (with no further comments)

5. Accounting Firms

Baker Tilly International

No response

Crowe Global

We have no other matters.

Moore Global Network

No (with no further comments)

SRA

No (with no further comments)

6. Public Sector Organizations

Office of the Auditor General of Canada

No (with no further comments)

Office of the Auditor General of Ontario

No.

Riksrevisionen (Swedish National Audit Office)

No comments

7. Member Bodies and Other Professional Organizations

ASEAN Federation of Accountants

No (with no further comments)

Botswana Institute of Chartered Accountants

No response

California Society of Certified Public Accountants

No (with no further comments)

Federación Argentina de Consejos Profesionales de Cs. Económicas

Answer 10: We have no other matter to discuss regarding ED 240.

Answer 10: We have no other matter to discuss regarding ED 240.

Federation of Accounting Professions of Thailand

No (with no further comments)

Fraud Advisory Panel

No response

Institute of Certified Public Accountants of Rwanda

No (with no further comments)

Institute of Certified Public Accountants of Uganda

No, with comments below

Except for the matters as mentioned earlier, we have no further comments on the proposed standard.

Institute of Chartered Accountants of Ghana

No (with no further comments)

Instituto Nacional de Contadores Públicos de Colombia

No (with no further comments)

Malaysian Institute of Certified Public Accountants

No (with no further comments)

Malta Institute of Accountants

No response

Pan-African Federation of Accountants

No (with no further comments)

Virginia Society of Certified Public Accountants

No (with no further comments)

8. Academics

University of KwaZulu-Natal

No (with no further comments)

9. Individuals and Others

John Keyser

No (with no further comments)

Moises Gonzalez Mercado

No (with no further comments)