

## RESPONSE TEMPLATE FOR THE EXPOSURE DRAFT OF PROPOSED ISA 240 (REVISED)

### Guide for Respondents

Comments are requested by **June 5, 2024**.

This template is for providing comments on the Exposure Draft (ED) of *Proposed International Standard on Auditing 240 (Revised), The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements and Proposed Conforming and Consequential Amendments to Other ISAs (ED-240)*, in response to the questions set out in the Explanatory Memorandum (EM) to the ED. It also allows for respondent details, demographics and other comments to be provided. Use of the template will facilitate the IAASB's automated collation of the responses.

You may respond to all questions or only selected questions.

To assist our consideration of your comments, please:

- For each question, start by indicating your overall response using the drop-down menu under each question. Then below that include any detailed comments, as indicated.
- When providing comments:
  - Respond directly to the questions.
  - Provide the rationale for your answers. If you disagree with the proposals in the ED, please provide specific reasons for your disagreement and specific suggestions for changes that may be needed to the requirements, application material or appendices. If you agree with the proposals, it will be helpful for the IAASB to be made aware of this view.
  - Identify the specific aspects of the ED that your response relates to, for example, by reference to sections, headings or specific paragraphs in the ED.
  - Avoid inserting tables or text boxes in the template when providing your responses to the questions because this will complicate the automated collation of the responses.
- Submit your comments, using the response template only, without a covering letter or any summary of your key issues, instead identify any key issues, as far as possible, in your responses to the questions.

The response template provides the opportunity to provide details about your organization and, should you choose to do so, any other matters not raised in specific questions that you wish to place on the public record. All responses will be considered a matter of public record and will ultimately be posted on the IAASB website.

Use the "**Submit Comment**" button on the ED [web page](#) to upload the completed template.

## PART A: Respondent Details and Demographic information

Your organization's name (or your name if you are making a submission in your personal capacity)	KPMG International Limited
Name(s) of person(s) responsible for this submission (or leave blank if the same as above)	Larry Bradley
Name(s) of contact(s) for this submission (or leave blank if the same as above)	Sheri Anderson
E-mail address(es) of contact(s)	sranderson@KPMG.com
Geographical profile that best represents your situation (i.e., from which geographical perspective are you providing feedback on the ED). Select the most appropriate option.	<a href="#">Global</a>
	If "Other," please clarify.
The stakeholder group to which you belong (i.e., from which perspective are you providing feedback on the ED). Select the most appropriate option.	<a href="#">Accounting Firm</a>
	If "Other," please specify.
Should you choose to do so, you may include information about your organization (or yourself, as applicable).	

Should you choose to do so, you may provide overall views or additional background to your submission. **Please note that this is optional.** The IAASB's preference is that you incorporate all your views in your comments to the questions (also, question no. 10 in Part B allows for raising any other matters in relation to the ED).

### Information, if any, not already included in responding to the questions in Part B:

We are supportive of the IAASB's aims and objectives in revising ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, further to the feedback received from a wide variety of stakeholders in response to the IAASB's analysis of the critical area of fraud in the context of an audit of financial statements, as part of their 2020 Discussion Paper (DP), *Fraud And Going Concern In An Audit Of Financial Statements: Exploring the Differences Between Public Perceptions About the Role of the Auditor and the Auditor's Responsibilities in a Financial Statements Audit*. We believe that the resulting changes proposed in ED-240 will drive a more robust identification and assessment of risks of material misstatement due to fraud in an audit of financial statements and will facilitate a more effective and targeted response to such identified risks. We consider the increased emphasis on the importance of appropriate exercise of professional skepticism by the auditor in fraud-related audit procedures, throughout the audit,

to be a critical enhancement to the standard as the concept of professional skepticism underpins the audit in its entirety. We also welcome the enhanced application material, including the additional, detailed examples, and believe this will better support auditors in appropriately executing the requirements of this standard.

We set out our detailed responses to the specific questions posed by the IAASB in section B of this response. These include certain concerns in respect of the proposed changes to the standard, together with our recommendations to address these matters.

## **PART B: Responses to Questions for Respondents in the EM for the ED**

***For each question, please start with your overall response by selecting one of the items in the drop-down list under the question. Provide your detailed comments, if any, below as indicated.***

### *Responsibilities of the Auditor*

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

*(See EM, Section 1-C, paragraphs 13–18 and Section 1-J, paragraphs 91–92)*

*(See ED, paragraphs 1–11 and 14)*

**Overall response:** [Disagree, with comments below](#)

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

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

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

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

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

We also have concerns about the statement, introduced at paragraph 9, that "*whilst the risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error,*

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

We recommend that the above statement be removed, and that the inherent limitations and the auditor’s responsibilities are not decoupled, and instead continue to be presented in a similar manner to their current presentation in the extant standard, i.e., that the IAASB include the statement set out in ED-240 at paragraph 10, which states that *“owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the ISAs”*, at paragraph 2(a) when describing the responsibilities of the auditor, or at least include an explicit cross-reference from paragraph 2(a) to paragraph 10. Additionally, we recommend that the statement at paragraph 8 of the extant ISA that *“the requirements of this ISA are designed to assist the auditor in identifying and assessing the risks of material misstatement due to fraud and in designing procedures to detect such misstatement”* be retained at paragraph 2 of ED-240, to clarify that in complying with the requirements of ED-240 auditors will discharge their responsibilities in respect of fraud, despite the effects of the inherent limitations.

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

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

In addition to the above, we are concerned, although to a lesser degree, with the change in paragraph order when describing the respective roles and responsibilities of the auditor, and management and those charged with governance. We understand the IAASB’s rationale, as described at paragraph 16 of the EM, that the auditor’s responsibilities should be placed first, as the focus of an auditing standard should be on the role and responsibilities of the auditor. However, given that management and those charged with governance have primary responsibility for the prevention and detection of fraud at an entity, as stated at paragraph 3 of ED-240, we would recommend placing this paragraph before the paragraph describing the auditor’s responsibilities as it provides important introductory context, such as reference to the culture and

“tone at the top” that is set by management, as well as active oversight by those charged with governance, to then help users of the auditor’s report to understand the auditor’s role. This would also be consistent with the approach taken in other International Auditing Standards, such as ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements* and ISA 570 (Revised), *Going Concern* and the approach taken in UK ISA 240.

### **Qualitatively Material Fraud**

We are supportive of the inclusion of the requirement at paragraph 8 and the related application material at A11 of ED-240, together with the further guidance addressing fraud or suspected fraud that may be qualitatively material, and the factors that may drive this determination. However, we recommend that ED-240 also make reference to the matter of “intent” in connection with these qualitative considerations, in particular, where fraud is *suspected*. In some circumstances, it may require significant professional judgement for an auditor to determine whether an action is or is not intentional (e.g., whether an expense claim outside of policy has been made with the intent to defraud, or is instead an unintentional error), and yet this is the factor on which the determination as to whether a misstatement is due to fraud versus error hinges. These qualitative considerations regarding intent are also linked to evaluating whether a misstatement is material, as a misstatement may be quantitatively not material, however, if it involves senior management and appears to be intentional, then the misstatement may be due to fraud and may be qualitatively material. We recommend that the application material provide more guidance as to relevant considerations for an auditor when determining whether intent is present, setting out factors to consider, including ethical/legal matters, and the need to exercise professional skepticism and professional judgement in the wider context of the audit, considering the fraud risk factors and other circumstances that may be indicative of fraud, in determining whether intent is present/likely to be present. Usually, the question of whether a fraud has been perpetrated is a legal one, at the heart of which lies the question of intent. Therefore, auditors would typically consider the need to consult with legal experts and also forensics experts when fraud, and, in particular, suspected fraud, is identified. We recognise that paragraph 6 of ED-240 states that “*the auditor does not make legal determinations of whether fraud has actually occurred*” when fraud is suspected, and instead is “*concerned with a material misstatement of the financial statements due to fraud*”, however, we highlight that the determination as to whether a misstatement is material or not involves consideration of qualitative factors, and that these are inextricably linked to whether or not there is intent.

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

In addition to the above, we note that a significant amount of auditor attention may be directed towards the particular matter giving rise to a suspected fraud, and the auditor may determine the matter to be a KAM. However, the auditor may consider it inappropriate to communicate information about the matter in the auditor’s report, given the uncertainty as to whether the suspected fraud is an actual fraud and the

potentially serious adverse consequences to the entity that may arise in doing so. We note that ISA 701.14 refers to the auditor's determination not to communicate a matter because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication but highlights that this would be in extremely rare circumstances. We recommend that ED-240 include linkage to ISA 701.14, and that related application material to ISA 701.14 be expanded to explicitly discuss the situation where there would be serious adverse consequences to communicating a KAM related to suspected fraud.

We also note that in such circumstances, where the auditor determines that it would not be appropriate to communicate a KAM, public interest concerns may be addressed by reporting the matter to an appropriate authority outside the entity. We therefore recommend that the additional content that we describe above also cross-refer to ED-240.69 and that additional application material to ED-240.69 be developed to explicitly address the situation where the auditor is unable to determine whether fraud has actually occurred, and determines, in accordance with ISA 701.14, that it is not appropriate to describe the matter within the auditor's report, and then determines whether law, regulation or ethical requirements require the auditor to report the matter to an appropriate authority outside the entity, either because this is required by laws, regulations or ethical requirements, or otherwise considers this to be an appropriate course of action, to discharge its obligations in the public interest. In connection with this, we recommend that such application material include similar material to that included at ISA 250.A27-A33, which discusses the interaction of content in laws and regulations, including ethical requirements, regarding reporting to an appropriate authority outside the entity, with confidentiality requirements.

### **Third-Party Fraud**

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

- factors that may be considered, such as industry-specific circumstances and events or conditions, e.g., collusion opportunities, which may increase the risk of third-party fraud that may be material to the financial statements, as well as jurisdictional-specific risks, e.g., if the entity operates in a jurisdiction that is "higher risk" in terms of fraud;
- the potential effects of the broader geopolitical and economic environment, e.g., the risk of third-party fraud may increase during an economic downturn;
- "red flags" that the auditor may identify during the course of the audit and should consider further, e.g., anomalies identified in performing analytical procedures, or a party that is a persistent late payer;
- specific enquiries that the auditor may make of management and others as to how they assess the risk of third-party fraud, and procedures that the auditor may perform to understand any policies/processes the entity has put in place to address such risks. Additionally, we suggest that

the application material explicitly clarify/emphasise that risks in relation to material third-party fraud be discussed with TCWG, where applicable, as part of the discussions required by ISA 260, *Communication with Those Charged with Governance*;

- particular areas of the financial statements that may be more susceptible to third party fraud, e.g., where a third party has custody over assets such as inventory, and related auditor considerations/procedures such as whether the third party is subject to regulation, and whether management has insight into the third party's control environment, if relevant. We also refer to our comments in response to Question 3, regarding the auditor's understanding of the entity and its environment, including the entity's internal control, in which we recommend that ED-240 include more detailed application material focused on factors that the auditor should consider when understanding and evaluating the entity's risk assessment process, including considerations in respect of how the entity identifies and addresses business risks in relation to material third-party fraud;
- in certain circumstances, the auditor may consider it necessary to perform procedures e.g., to inspect source documents to address risks of material third-party fraud, such as validating that the entity subject to audit retains title to assets that are held by a third party. Such guidance may emphasise the importance of exercising professional skepticism, and also matters such as the importance of including an element of unpredictability in the audit procedures.

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

#### *Professional Skepticism*

2. Does ED-240 reinforce the exercise of professional skepticism about matters relating to fraud in an audit of financial statements?

(See EM, Section 1-D, paragraphs 19–28)

(See ED, paragraphs 12–13 and 19–21)

**Overall response:** [Agree, with comments below](#)

**Detailed comments (if any):** We are supportive of the IAASB's objective to reinforce the appropriate exercise of professional skepticism by the auditor in fraud-related audit procedures, throughout the audit, and we welcome the following proposed enhancements:

- The inclusion of material in the introductory paragraphs, under the *Key Concepts* sub-heading, which describes the importance of exercising professional skepticism throughout the audit;
- The new explicit requirement at paragraph 21 for the auditor to remain alert throughout the audit for information that is indicative of fraud or suspected fraud;



- The new application material at paragraph A25 and paragraphs A30-31, focused on pressures on the engagement team that may impede the auditor's appropriate exercise of professional skepticism;
- The emphasis at various points in the application material on robust inquiry and challenge of management and those charged with governance and, at A42, the need to "assign tasks or actions to appropriately skilled or suitably experienced members of the engagement team... when communicating matters related to fraud with management and those charged with governance"; and
- Emphasis on the need to involve those with more specialist skills at appropriate points of the audit, e.g., forensics experts and IT experts, e.g., at paragraphs 22, A34 and A35.

Having said this, we also set out a number of recommendations below, to further enhance the auditor's exercise of professional skepticism regarding fraud in an audit of financial statements, and, in particular we recommend that ED-240 include a specific standback requirement in relation to fraud:

- Standback requirement – we recommend the inclusion of a specific standback requirement in relation to fraud towards the end of the audit, with related application material to address matters to consider at the standback stage, and to emphasise the importance of the exercise of professional skepticism when performing standback procedures. Please refer to our response to Question 7 for further details;
- We suggest that the IAASB retain the wording (included at paragraph 13 of the extant standard), of "notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance", in discussing the concept of professional skepticism, either at paragraph 19 itself, or in the related application material at A24-25. Similarly, we recommend retaining the wording (included at paragraph 16 of the extant standard) of "setting aside beliefs that the engagement team members may have that management and those charged with governance are honest and have integrity", with reference to the discussion among the engagement team. Rather than undermining the exercise of professional skepticism, we believe that these statements are helpful to remind the auditor to set aside any potential biases resulting from past experience or beliefs in respect of management and those charged with governance. As professional skepticism is a mindset/behaviour, that is adaptive to the entity's circumstances and risk environment, we believe it is helpful to include such reminders more explicitly within the standard to drive a mindset in which the auditor is able to identify and reflect on their potential biases and consciously set them aside. We note that proposed revised ISA 500, *Audit Evidence*, includes material discussing potential auditor biases and therefore inclusion of this material would align with the IAASB's intention to increase auditor awareness of these. Accordingly, the IAASB may consider identifying these specifically as "biases" rather than preconceptions, to align with descriptions elsewhere in the ISAs, and cross-reference to other material in the ISAs, e.g., in proposed ISA 500R, once issued;
- We recommend improved linkage to ISA 600 (Revised), *Special Considerations - Audits of Group Financial Statements (Including the Work of Component Auditors)*, in particular, to address frauds that arise at components and to highlight the importance of involvement of component auditors in terms of the exercise of professional skepticism, given their greater knowledge of the component environment, including local language, prevailing business culture, risks, laws and regulations,

ethical standards, corporate governance standards and established business customs/practices. This may be of particular importance when the component is in a jurisdiction that is considered to be “higher risk” because, for example, it involves a rapidly changing regulatory and business landscape and is subject to heightened fraud risks. We note that the UK ISA 240 includes references to groups at various points in the standard in respect of exercise of professional skepticism, e.g., in relation to identification of matters to discuss with component auditors, during the engagement team discussion;

- We welcome the additional material in respect of making inquiries of management at A89-91. To further enhance this important aspect of the audit, we recommend that the application material include further discussion of matters such as holding robust discussions with management (which could be cross-referred to earlier application material regarding the involvement of more experienced team members), and the importance of appropriate challenge of management. Whilst there are references to matters such as inconsistent evidence, we consider it would be helpful to use more active language to help drive more robust and meaningful discussions with management, and with others, as appropriate. In addition, such material could be cross-referenced to discussion in the standard regarding inconsistent responses to inquiry, and false representations (e.g., at paragraph 30) and the implications for the audit in respect of the auditor’s understanding of management’s honesty and integrity, which is an important aspect of the exercise of professional skepticism;
- We welcome the greater emphasis on considerations in respect of the involvement of specialists/experts, including forensics experts, at various points in the standard. However, we are concerned that paragraph 22, in referring to appropriate competence and capabilities “including... appropriate specialized skills or knowledge”, together with the related application material at paragraph A34, which states that “the nature, timing and extent of the involvement of individuals with specialized skills or knowledge, such as forensic and other experts ... may vary...”, as drafted, appear to suggest that such experts should *always* be involved in an audit, although such involvement may vary. We do not consider this to be appropriate, as we believe that forensics specialists/experts should be involved in an audit in a specific and targeted manner to respond to particular risks identified, as for other specialists/experts, commensurate with the fact that an audit is a risk-based engagement. Instead, we recommend that ED-240 clarify that the engagement partner *determines whether* to use the work of a specialist/expert, in accordance with ISA 620.7, and guide the auditor as to the factors to consider in making this determination, such as the nature of the entity and the industry sector within which it operates, and the effects of the fraud risks factors identified etc.

Additionally, we recommend that paragraph A35, in discussing how such specialists/experts could be involved, refer also to their assistance in the evaluation of subjective judgements, assistance in identifying areas of management bias, as well as their expertise in assessing whether there is intent involved when a fraud is suspected (i.e., whether circumstances indicate that there is fraud versus error). Please refer also to our response to Question 1 regarding qualitatively material fraud and auditor considerations as to whether an act is intentional;

- We recommend that the IAASB consider further enhancements to “future-proof” the standard in relation to the exercise of professional scepticism, by identifying additional factors that may impede the exercise of professional scepticism by the engagement team, such as remote or hybrid working;

- We note that paragraph 21 requires the auditor to remain alert for information that is indicative of fraud. We recommend that the standard be more explicit either within the requirement itself, or in related application material, as to the auditor remaining alert both to circumstances that may be indicative of fraud, and events or conditions that indicate an incentive or pressure to commit fraud, or provide an opportunity to commit fraud (i.e., fraud risk factors);
- We note that paragraph 70(c) refers to the documentation of “significant judgements made”. We believe this should refer to “significant professional judgements made”, similar to the requirement at paragraph 70(f). We also recommend that these requirements be cross-referenced to ISA 200.A29, which requires the appropriate documentation of professional judgement;
- We recommend that paragraph 23 also refer to taking account of the risk of management override, in respect of the engagement partner’s determination that the nature, timing and extent of direction, supervision and review is responsive to the nature and circumstances of the engagement.

### **Recommendations Relating to the ED-500 Project**

- We note the removal of the explanatory lead-in at paragraph 20 of ED-240 (paragraph 14 of the extant standard) that states “*unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine*” to give greater prominence to the conditional requirement at paragraph 20, and to avoid duplication within the ISAs, as ISA 200.A23 contains this statement. We also note that paragraph A26 of ED-240 includes the statement that “*the auditor is not required to perform procedures that are specifically designed to identify conditions that indicate that a record or document may not be authentic or that terms in a document have been modified*”. However, we note that the statement at ISA 200.A23 is application material to a more general requirement to exercise professional skepticism, at paragraph 15 of ISA 200, which is itself cross-referenced to the requirement at ISA 500.7-9 to consider the relevance and reliability of the information to be used as audit evidence. We further note that ED-500 includes more explicit focus on the attributes of relevance and reliability if information to be used as audit evidence, including consideration of the attribute of authenticity, when applicable. Whilst we recognise that the ED-500 project is currently paused, given the proposed enhancements to ED-500, as the foundational standard in respect of audit evidence, in this area, we recommend that, in finalizing ED-500, the IAASB further explore/clarify the interaction and connectivity of the above requirements and related application material with respect to the consideration of the authenticity of documents, across the different ISAs.
- In connection with auditor awareness of potential biases, as discussed above, we also refer to the proposed revised ISA 500, which includes material in respect of auditor biases in relation to potential bias regarding overreliance on technology. We acknowledge that the ED-500R project is currently paused, however, we recommend that IAASB include a cross-reference to that material in connection with considerations as to how a fraud may be perpetrated, as a conforming amendment to ED-240 on issuance of the revised ISA 500R.

3. Does ED-240 appropriately build on the foundational requirements in ISA 315 (Revised 2019)<sup>1</sup> and other ISAs to support a more robust risk identification and assessment as it relates to fraud in an audit of financial statements?

(See EM, Section 1-F, paragraphs 36–46)

(See ED, paragraphs 26–42)

**Overall response:** [Agree, with comments below](#)

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

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

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

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

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

<sup>1</sup> ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*

40(a) requires the auditor to take into account fraud risk factors when identifying and assessing the risks of material misstatement due to fraud. Furthermore, paragraph A117 refers to the requirement for the auditor to obtain more persuasive evidence the higher the auditor's assessment of risk.

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

### **Evaluation of Fraud Risk Factors**

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

- We believe that it could be clearer as to how fraud risk factors relate to inherent risk factors as described in ISA 315R. We note that the application material at paragraph A22 states that "fraud risk factors, which include intentional management bias, are, insofar as they affect inherent risk, inherent risk factors". However, we believe that this does not appropriately describe the interrelationship between these two concepts. We consider that the presence of certain inherent risk factors, e.g., in relation to complexity (e.g., revenue recognition that involves the use of complex estimates) or subjectivity (e.g., assets, liabilities or expenses that are recorded based on significant estimates, which involve subjective judgements), may give rise to fraud risk factors, primarily in relation to opportunity, which, either individually or in combination with other fraud risk factors, may give rise to risks of material misstatement due to fraud. Furthermore, certain fraud risk factors, e.g., incentives or pressures to commit fraud, may create susceptibility to misstatement, before consideration of controls, i.e., influence the inherent risk of fraud at the assertion level, but not the risk of error. Accordingly, we recommend that the IAASB clarify this interrelationship and the intended interaction between the linked but distinct concepts of inherent risk factors and fraud risk factors, with examples to illustrate;
- In connection with the above, we also recommend that the reference at paragraph A22 to "fraud risk factors, which include intentional management bias" be amended to refer to *susceptibility* to

management bias. Additionally, we recommend that the IAASB clarify that when susceptibility to management bias is present, this may affect the assessed risks of material misstatement due to error resulting from the possibility of *unintentional* management bias, and may affect the assessed risks of material misstatement due to fraud resulting from the possibility of *intentional* management bias;

- We also note that ED-240 uses the terms “circumstances”, “conditions”, “events and conditions”, “fraud risk factors” and “information” somewhat inconsistently and also interchangeably. We suggest that the IAASB check these references throughout ED-240 to ensure that they are using the appropriate terminology in each instance and are not co-mingling concepts and definitions;
- We highlight that the definition of fraud risk factors makes reference to incentive or pressure, and opportunity, but not to attitude/rationalization. However, related application material and appendix 1 provide examples of fraud risk factors that relate to the condition of attitude/rationalisation. We appreciate that aspects of attitude/rationalization may be challenging for the auditor to identify and that it is only through performing other audit procedures that they may identify these. However, we recommend that the definition include reference to attitude/rationalisation, for completeness, and that the application material explain the challenges in this area, with a focus on remaining alert to these, linked also to the material discussing the inherent limitations of an audit;
- We also note that the application material, including examples of fraud risk factors, is not always consistent with the appendices. We suggest that the application material provide higher-level information and examples, and refer out to the appendices for further details and more examples;
- We highlight the certain fraud risk factors are applicable to particular aspects of the financial statements and the entity’s financial reporting processes, e.g., in respect of related party transactions, intercompany transactions in a group audit, management override of controls, and accounting estimates. We recommend that the application material discuss such fraud risk factors more specifically, together with examples of more targeted procedures to identify/consider these;
- Similarly, there may be more pervasive fraud risk factors related to the entity’s internal control environment, culture and tone at the top etc. We recommend that ED-240 make clearer reference to these, to guide the auditor to focus and respond to related risks more effectively.

## Understanding

- We consider the requirement at paragraph 35, which overlays the requirements at ISA 315R.22 regarding the entity’s risk assessment process and related application material, is not sufficiently specific in terms of identifying risks of material misstatement due to fraud as a result of business risks relevant to financial reporting objectives. Accordingly, we recommend that ED-240 focus more clearly on fraud matters related to “business risks relevant to financial reporting objectives”, as described in ISA 315R.22, with related application material to provide clearer guidance to auditors, focused on factors such as the industry within which the entity operates, and which cross-refers to material to address fraud risks arising from related party transactions and significant and unusual transactions. We also recommend that such material cross-refer to the guidance regarding material third-party fraud, as we discuss in our response to Question 1;

- In addition to the above, we recommend that the examples, at paragraph A90, of others within the entity to whom the auditor may direct inquiries about the existence or suspicion of fraud include specific reference to individuals from the internal audit function, if applicable;
- Paragraph 42 requires the auditor to “irrespective of the auditor’s assessment of the risks of management override of controls, to treat those risks as risks of material misstatement due to fraud and thus [as] significant risks”. Furthermore, paragraph 48 requires the auditor to design and perform audit procedures [in respect of journal entries and other adjustments, accounting estimates, and significant transactions outside the normal course of business or that otherwise appear unusual] and determine whether other audit procedures are necessary in addition, to respond to the identified risks of management override of controls. Accordingly, we recommend that the “Understanding” section of the standard focus more specifically on matters related to risks of management override of controls, in order to assist the auditor in identifying these risks more specifically, considering the fraud risk factors applicable and how management may override controls and perpetrate fraud. This would better support the auditor in fulfilling the requirement at paragraph 48 in a more targeted manner, in particular, in determining whether additional audit procedures are necessary.

## Other

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

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

### *Fraud or Suspected Fraud*

4. Does ED-240 establish robust work effort requirements and application material to address circumstances when instances of fraud or suspected fraud are identified in the audit?

*(See EM, Section 1-G, paragraphs 47–57 and Section 1-E, paragraph 35)*

*(See ED, paragraphs 55–59 and 66–69)*

**Overall response:** [Agree, with comments below](#)

**Detailed comments (if any):** We are supportive of the enhancements to ED-240 in this area, which we believe will drive a robust work effort. In particular, we are supportive of the inclusion of the separate section, entitled “fraud or suspected fraud”, to address such instances of fraud or suspected fraud, which we consider would give this part of the audit greater prominence, as well as the explicit requirements for the auditor to first understand the matter, including the entity’s process to investigate and remediate, if any. Whilst certain of these requirements are implicit in the extant standard, we believe these enhancements will provide greater clarity and drive greater consistency and a more focused auditor response.

However, we have certain concerns and make recommendations to further clarify/enhance the requirements in this area, as we set out below.

### **Scalability Considerations**

We have concerns and recommendations in relation to the scalability of the requirements at paragraph 55-56 to situations where a fraud or suspected fraud is not considered material. Whilst we note that paragraphs 57-59 are inherently scalable, as well as including specific reference to materiality determinations (from both a quantitative and qualitative perspective), we believe the requirements at paragraph 55-56 may be unnecessarily onerous in certain circumstances, for example:

- In respect of audits of larger and more complex entities, including large group audits, as well as audits of entities with operations in multiple locations, e.g., retail entities, where multiple non-material frauds may occur across the entity/group, paragraph 55 appears to require the engagement team to obtain a detailed understanding of every instance of a fraud in order to determine the effect on the audit engagement. Paragraph 56 also requires the (group) engagement partner to consider each and every instance of fraud.

We recommend that additional application material be developed to enable these two requirements to be more scalable. For example, the auditor could be permitted to group frauds that are similar in nature together when performing the procedures in paragraphs 55 and 56, and perform the procedures on selected items within the group to obtain sufficient understanding in order to determine the effects on the audit engagement.

Additionally, where the auditor has determined that such frauds do not involve senior management, the auditor may consider establishing a filter mechanism, such as size thresholds, to determine whether they are required to perform all the procedures required by paragraphs 55-56.

We think it would also be useful to recognize that there may also be circumstances where the auditor may be able to conclude that a fraud is an isolated instance and clearly quantitatively and qualitatively immaterial without performing all of the procedures required in paragraphs 55 and 56. Therefore, it would be useful to acknowledge that the auditor can exercise professional judgment in determining whether all of the procedures in paragraphs 55 and 56 are necessary to make the determinations;

- Paragraph 56 of ED-240 explicitly requires the engagement partner to determine, based on the understanding in accordance with paragraph 55, 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. In certain circumstances, e.g., when auditing a large group, it may be unduly onerous to require the (*group*) *engagement partner* to fulfil this requirement. Accordingly, we suggest that the requirement be modified for the engagement partner to “take responsibility” for these determinations, to enable appropriate involvement of others within the engagement team;
- We note that Paragraph 7 states that “suspected fraud includes allegations of fraud that come to the auditor’s attention during the course of the audit”, and related application material at A10 states that “allegations of fraud by another party involving the entity are treated by the auditor as



suspected fraud once the allegations have come to the auditor's attention" and "the auditor performs audit procedures in accordance with paragraphs 55–59 to address the suspected fraud". Whilst we agree that instances of fraud/suspected fraud may be identified as a result of such allegations initially, e.g., allegations made via an entity's whistleblowing hotline, we believe that the allegations captured may be broad and application of all the requirements at paragraphs 55-59 to all such allegations would not be appropriate in all circumstances. For example, the procedures applicable to respond to a serious allegation also appear to be required to respond to a complaint that the auditor may relatively quickly determine was baseless (such as a complaint made via a whistleblowing hotline by a single disgruntled former employee, which the entity has investigated and determined to be clearly without merit, which ED-240 itself discusses in the first example at paragraph A148).

Accordingly, we recommend that, based on the audit procedures performed in accordance with paragraph 55(a), if the auditor evaluates that management's process to investigate the matter is appropriate in the circumstances, and that management's assessment of the allegation of fraud by another party involving the entity is baseless, then it is no longer a suspected fraud and paragraph 55 parts (c), and (d), and paragraph 56, are no longer applicable;

- We welcome the reference in the application material, at paragraph A146, to the involvement of an auditor's expert, such as a forensics expert. To further enhance this material, and recognising that this is likely to be applicable in the context of an audit of a larger and more complex entity, we recommend that the guidance focus on more specific matters that the expert may assist with, such as in evaluating whether the entity's investigation process is appropriate, and their remediation measures effective, as well as whether (significant) control deficiencies exist.

Additionally, and as we highlight in our response to Question 1, fraud is distinguished from error as it involves intent, however, it may be challenging for auditors to determine whether intent is, in fact, present. We recommend that this be discussed in the application material in respect of understanding the fraud/suspected fraud, and further guidance be provided as to how the auditor may approach making this determination, which may require the involvement of an expert, such as a forensics or legal expert.

We believe there is a lack of clarity regarding the applicability of paragraph 66. We note that both paragraphs 55 and 66 state "if the auditor identifies fraud or suspected fraud, the auditor shall...". In respect of paragraph 55, we believe that the requirements would apply to all instances of fraud, whether identified by the auditor directly, or identified by management and communicated to the auditor, as, irrespective of the origin of the identification, the auditor would need to understand the matter further to determine the effect on the audit engagement. However, in respect of paragraph 66, we do not consider it necessary or appropriate for the auditor to communicate fraud or suspected fraud already identified by the entity to management and TCWG, and instead believe this requirement should focus only on those frauds or suspected frauds identified by the auditor directly. We recommend that the IAASB clarify this, to avoid unnecessarily onerous communication requirements being placed on the auditor, and to avoid undermining the impact of such communications with unnecessary information that management and TCWG are already aware of.

## Structure and Flow of the Proposed Standard

We also set out certain concerns and recommendations in relation to the proposed structure and flow of the standard in Appendix 1 to this response.

### *Transparency on Fraud-Related Responsibilities and Procedures in the Auditor's Report*

5. Does ED-240 appropriately enhance transparency about matters related to fraud in the auditor's report?

(See EM, Section 1-H, paragraphs 58–78)

(See ED, paragraphs 61–64)

**Overall response:** [Disagree, with comments below](#)

**Detailed comments (if any):** We recognise the IAASB's intentions to provide greater transparency to users of the financial statements and the auditor's report in introducing the new requirements at paragraphs 61-64 of ED-240, together with conforming amendments to other ISAs, including ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report* to emphasise fraud-related considerations when determining key audit matters (KAMs). These enhanced requirements and related conforming amendments include modification of the heading for the Key Audit Matters section of the auditor's report, such that this will be "Key Audit Matters Including Matters Related to Fraud" and the inclusion of a separate section within this Key Audit Matters section to describe the KAM(s) related to fraud, or to state that there are none, as applicable. However, we have a number of concerns in relation to the proposals, as follows:

- Firstly, we find the positioning of these requirements to determine and communicate KAMs, outside ISA 701, being the standard that deals with auditor's responsibilities to communicate KAMs, to be somewhat confusing and not aligned with the underlying drafting principles for the ISAs. ISA 701.9 refers to the auditor "taking into account areas of higher assessed risks of material misstatement, or significant risks identified", which would encompass risks of material misstatement due to fraud, as the auditor is required, at paragraph 40(b) of ED-240, to treat assessed risks of material misstatement due to fraud as significant risks. It is therefore unclear how the matters set out at paragraph 61 of ED-240 relate to, or act as a standard-specific overlay to, those at ISA 701.9. Furthermore, we believe that the conforming amendments proposed to ISA 701, e.g., at A8A and A18A already address the fact that matters related to fraud are often matters that require significant auditor attention and may therefore be KAMs. Accordingly, we believe that the current requirements set out in ISA 701, together with the related application material, including the conforming amendments, are fit for purpose and we do not consider the proposed material in ED-240 to be necessary or appropriate;
- We believe that the intention of the IAASB is for auditors to consider fraud-related matters in the audit as addressed in ED-240 as an "overlay" when applying the requirements at ISA 701.9. However, as a result of the duplicative nature of the requirements at paragraphs 61-62 of ED-240, there is not only a lack of clarity as to what is explicitly required in accordance with these paragraphs that is incremental or an overlay to ISA 701, but we are concerned that these requirements may be interpreted as creating a parallel process for the determination of KAMs in respect of fraud, that is

separate and/or additional to the determination of KAMs in respect of other aspects of the audit in accordance with ISA 701;

- In connection with the above, the requirements at paragraph 61-62, and the conforming amendments to other ISAs, including to ISA 701, to require the heading for the Key Audit Matters section of the auditor's report to be labelled "Key Audit Matters Including Matters Related to Fraud", may undermine the requirement, at ISA 701.10, to determine "which of the matters determined in accordance with ISA 701.9 were of most significance in the audit...and are therefore KAMs", which already includes fraud-related matters as an integral part of this determination for the audit as a whole. This may result in teams considering that a fraud-related KAM is always expected to be included in the auditor's report, even when fraud-related matters were not, in fact, of most significance in the audit, when considered relative to other matters. As a result, we are concerned that this may drive a trend towards inclusion of "boilerplate" fraud-related KAMs, e.g., in respect of matters such as management override of controls, journal entries, or the presumed risks of material misstatement due to fraud in revenue recognition, as auditors may be hesitant to state that there are no fraud-related KAMs. This may result in clutter within the auditor's report and may detract from important information set out within other KAMs, which would not be in the public interest;
- We are concerned with the proposed requirement, at paragraph 63, to specifically identify fraud-related KAMs as such within the auditor's report, as we believe this may lead to a perception by users of the financial statements and the auditor's report thereon that the auditor has placed greater emphasis on/directed a greater work effort towards significant risks of material misstatement of the financial statements as a result of fraud as compared to significant risks in respect of other aspects of the audit and/or as compared to those in respect of error. This apparent elevation of fraud-related matters over other aspects of an audit may have unintended consequences in terms of widening the "expectation gap" in respect of the auditor's responsibilities in relation to fraud. It may also give rise to confusion, given that there are inherent limitations of an audit in relation to fraud, however, these are not applicable in respect of error, and therefore it seems counterintuitive to have increased emphasis on KAMs in relation to fraud matters only;
- Additionally, we highlight that, in a number of circumstances, the audit procedures that are designed and performed to respond to the risk of material misstatement due to fraud may not be different to/clearly delineated from those to respond to the risk of material misstatement due to error. We refer to the circumstances discussed at paragraph A172, when there are a number of separate, but related, considerations (e.g., in respect of estimates) that were of most significance to the audit, and the auditor communicates the matters together in the auditor's report. In these circumstances, the requirement to separately describe the matter that relates to fraud may only be achieved either by duplicating material or by cross-referencing material, which would clutter the description of the matters, and may cause confusion for users of the auditor's report;
- We are concerned that the statement required at paragraph 64, when applicable, that there are no KAMs in respect of fraud, may be misinterpreted by users to mean that no risks of material misstatement due to fraud were identified, and therefore the auditor has not performed audit procedures to respond to such risks. As a result, auditors may be reluctant to make such a statement, which may also drive the inclusion of boilerplate KAMs in the auditor's report.

In addition, we are concerned that a statement that there are no KAMs in respect of fraud may be interpreted by users as a form of assurance that there is "no material fraud at the entity" and

potentially widen the “expectation gap” in respect of understanding the role and responsibilities of the auditor in respect of fraud;

- We also believe that the inclusion of requirements at paragraph 61(b) and (c) are not necessarily appropriate, and appear to conflate matters that are communicated to those charged with governance, which in part are communicated to help those charged with governance to properly discharge their oversight responsibilities, with the concept of KAMs, which are intended to provide greater transparency about areas of significant auditor attention to users of the financial statements. If parts (b) and (c) of this paragraph are retained, we believe a conforming amendment to ISA 701 to include these matters explicitly in that standard would be required, as we do not consider it appropriate for requirements in respect of KAMs that go beyond ISA 701 to be established within other ISAs.

To address the above concerns, we recommend the following:

- The proposed requirements at paragraphs 61-64 are not included within ISA 240, as the requirements and related application material, including the conforming amendments, in ISA 701 are already fit for purpose. Instead, we consider that any material introduced into ED-240 should be to act as an overlay to ISA 701 in respect of fraud-related matters, building on the requirements of ISA 701, similar to the intended interaction of this standard with other ISAs, e.g., ISA 315R. Accordingly, any requirements and related application material should be restricted to addressing the application of a ‘fraud lens’ when determining KAMs in accordance with ISA 701;
- The proposed requirement, at paragraph 63, to use an appropriate sub-heading to clearly describe the matter that relates to fraud, not be included in ED-240 (or ISA 701), to address our concern, described above, that audit procedures that are designed and performed to respond to the risk of material misstatement due to fraud may not be different to/clearly delineated from those to respond to the risk of material misstatement due to error and therefore it would be inappropriate or duplicative to attempt to disentangle these into separate descriptions;
- The proposed conforming amendments to ISA 701 and other ISAs, to require the heading for the Key Audit Matters section of the auditor’s report to be labelled “Key Audit Matters Including Matters Related to Fraud” not be introduced. We believe this would help to avoid the engagement teams considering that a fraud-related KAM is always expected to be included in the auditor’s report, even when fraud-related matters were not, in fact, of most significance in the audit, and which may otherwise drive a trend towards inclusion of ‘boilerplate’ fraud-related KAMs;
- The proposed requirement to state there are no KAMs related to fraud be removed. Notwithstanding our concerns described above regarding the proposed requirements at paragraphs 63 and 64, if the IAASB decides to retain these, we suggest that these are included as further conforming amendments to ISA 701 to address the circumstances in which there are no KAMs related to fraud.

We also have concerns that the proposed requirements may require the auditor to include a KAM in the auditor’s report in respect of a *suspected* fraud, which we describe further in our response to Question 1, together with our related recommendations to address these concerns.

6. In your view, should transparency in the auditor’s report about matters related to fraud introduced in ED-240 be applicable to audits of financial statements of entities other than listed entities, such as PIEs?

(See EM, Section 1-H, paragraphs 76–77)

(See ED, paragraphs 61–64)

**Overall response:** [Disagree, with comments below](#)

**Detailed comments (if any):** Notwithstanding our response to Question 5, we would not be supportive of explicitly extending these transparency-related requirements to be applicable to audits of financial statements of entities other than listed entities, e.g., PIEs, at the current time.

Firstly, we consider that such an explicit extension would be unnecessary, and may even be inappropriate, as ED-240 prefaces each of the requirements at paragraphs 61-64 with “in applying ISA 701”. Therefore, auditors would apply these requirements whenever they are applying ISA 701, i.e., when they are performing audits of complete sets of general purpose financial statements of listed entities, in the circumstances when they otherwise decide to communicate KAMs in the auditor’s report, as well as when required by laws or regulations to communicate KAMs in the auditor’s report, or when the auditor otherwise determines that it is appropriate to do so. Accordingly, we consider that, in the absence of a conforming amendment to ISA 701 to broaden its applicability to entities other than listed entities, it would be inappropriate to include a such a requirement within ED-240 itself, as otherwise this standard would no longer be aligned with the scope and purpose of ISA 701.

Furthermore, if such requirements were to be extended to a mandated broader set of entities, such entities would need to be clearly delineated, e.g., by developing definitions that are capable of consistent application on a global basis. We are not aware of projects to attempt to do this, other than for PIEs, therefore we would not recommend exploring this further at this time.

In respect of extending the requirements to PIEs, more specifically, we refer to the IAASB’s recent Exposure Draft, *Proposed Narrow-Scope Amendments to ISQMs, ISAs and ISRE 2400R as a Result of Changes to the IESBA Code*, which proposes a revised definition and concept of a PIE as well as to extend the differential requirements of the IAASB standards for listed entities to PIEs. In our response to that Exposure Draft we state that we do not, at the current time, support adopting the proposed definition of a PIE or extending the applicability of the differential requirements in the IAASB standards beyond listed entities because we believe that a global baseline for the definition of a PIE, that is capable of being applied on a consistent basis across different jurisdictions, will not be established within the IESBA Code. As a result of the IESBA view that the definition and concept of a PIE as set out in the IESBA Code is not required to be adopted and further refined at a jurisdictional level, as appropriate, we believe it is more likely that relevant local bodies may no longer fulfil their intended critical role in determining both the size and nature of entities that would be within scope of the baseline definition. As a result, this definition/concept, if adopted into the IAASB standards, may be applied to an unnecessarily broad population of entities where there is not significant interest in their financial condition and for which it would therefore be overly burdensome from a cost-benefit perspective to apply the differential requirements set out in the IAASB standards for PIEs, in particular, in respect of requirements related to engagement quality reviews and also communication of KAMs.

Instead, we suggest that, notwithstanding our recommendations set out in our response to Question 5, the IAASB maintain alignment of the proposed requirements in ED-240 with those of ISA 701, and liaise closely with IESBA regarding any proposed definitions of a broader set of entities, in particular PIEs, and considerations regarding extension of differential requirements to such entities.

We also note that, in our response to the above ED, we express support for the adoption of the definition and concept of a “publicly traded entity” into IAASB standards (subject to the inclusion of relevant material to address the role of jurisdictional bodies in more explicitly defining “publicly traded entity” as appropriate to the circumstances of their jurisdiction). Accordingly, if this proposed term is adopted for use in place of “listed entity” throughout the IAASB standards, including in ISA 701, the changes proposed in ED-240, including in respect of KAMs, would need to be aligned.

*Considering a Separate Stand-back Requirement in ED-240*

7. Do you agree with the IAASB’s decision not to include a separate stand-back requirement in ED-240 (i.e., to evaluate all relevant audit evidence obtained, whether corroborative or contradictory, and whether sufficient appropriate audit evidence has been obtained in responding to the assessed risks of material misstatement due to fraud)?

*(See EM, Section 1-J, paragraphs 107–109)*

**Overall response:** [Disagree, with comments below](#)

**Detailed comments (if any):** We do not agree with the IAASB’s decision not to include a separate stand-back requirement within ED-240, i.e., a requirement for the auditor to evaluate all audit evidence obtained, whether corroborative or contradictory, and at that stage to consider, in respect of the assessed risks of material misstatement due to fraud, whether there are indicators of fraud or suspected fraud.

We understand the IAASB’s rationale that there are stand-backs in a number of recently issued ISAs and the IAASB does not want a proliferation of such requirements. We also recognise the view that the requirement at paragraph 21 for the auditor to “remain alert throughout the audit engagement for information that is indicative of fraud or suspected fraud” may encompass, to some degree, the matters that a standback would address. In particular, we note that the application material relating to “remaining alert”, at paragraph A30, emphasises the importance of remaining alert “including when performing audit procedures near the end of the audit [emphasis added]” and notes that “audit evidence may be obtained near the end of the audit that may call into question the reliability of other audit evidence obtained or cast doubt on the integrity of management or those charged with governance”.

However, we recommend the inclusion of an explicit standback requirement that places a more active responsibility on the auditor to evaluate the audit evidence obtained, in totality, prior to forming the audit opinion, as to whether sufficient appropriate audit evidence has been obtained in responding to the assessed risks of material misstatement due to fraud, including considering whether the audit evidence, taken as a whole, may be indicative of fraud or suspected fraud. We also consider that such a standback should involve another specific “touchpoint” for the engagement team to carefully consider and robustly discuss fraud-related matters, similar to the whole team approach taken in planning discussions. This is broader in scope, and also more specific in nature than a requirement to only “remain alert” (to information about fraud or suspected fraud), and involves consideration of disconfirming audit evidence, consideration

as to whether additional circumstances that may be indicative of fraud and additional fraud risk factors have been identified, and would also provide a specific opportunity to discuss these matters with specialists/experts, such as forensics experts, if they are involved in the audit. We highlight that in many cases it is only at the end stages of an audit, when considering the audit evidence obtained as a whole, including the underlying rationale for certain business decisions and significant or unusual transactions and whether this is clear and “makes sense”, and considering whether the audit evidence as a whole, including explanations obtained, is sufficiently reliable, that indicators of fraud/suspected fraud may be identified. ED-240 also acknowledges this to some extent, e.g., the content at A30, as referenced above.

Additionally, we believe there are a number of specific requirements in the standard that need to be “closed out”, e.g., at paragraph 21, regarding remaining alert, paragraph 48 regarding audit procedures to respond to risks related to management override of controls, paragraph 53 regarding significant unusual transactions outside the normal course of business and paragraph 54 regarding analytical procedures performed near the end of the audit. Accordingly, a standback would be an important inclusion within ED-240 in order to do so. Furthermore, we consider that there should be a specific requirement prior to forming the audit opinion, that is linked to ISA 330.25-26, that based on the audit procedures performed the auditor shall evaluate whether the assessments of the risk of material misstatement at the assertion level remain appropriate, and whether sufficient appropriate audit evidence has been obtained, considering all relevant evidence, regardless of whether it appears to corroborate or contradict the assertions in the financial statements. We believe these considerations are of particular importance in respect of fraud, as we note above, and therefore an explicit requirement, linked to ISA 330, that requires the application of a fraud lens when performing such procedures should be included. We note that the UK ISA 240 has introduced such a requirement at paragraph 37-1. We consider that in cross-referencing to ISA 330, and with the inclusion of application material to set out specific matters that the auditor would consider in respect of fraud at the standback stage, including discussion of circumstances that may be indicative of fraud that may have been identified over the course of the audit, this would avoid duplication of requirements and instead assist auditors in applying such a fraud lens when executing the requirements at ISA 330.25-26. Such material could also address scalability considerations, as we consider that a standback requirement is inherently scalable, and that when auditing a smaller and less complex entity, the nature and extent of the standback procedures would be relatively less in scope.

Furthermore, we consider that the inclusion of a standback requirement would be aligned with the IAASB’s stated objective of reinforcing the importance, throughout the audit, of the appropriate exercise of professional skepticism in fraud-related procedures, by auditors.

We acknowledge that the IAASB has paused the project to update ED-500 and will proceed with an integrated project on audit evidence and risk response, and that, as part of that project, the IAASB will review the standback requirements that have been included across a number of ISAs in recent years, with a view to rationalising these. We suggest that the IAASB consider our recommendation regarding a fraud-specific standback as part of that project, and that if a rationalisation approach is taken, that ED-240 be conformed to include a cross-reference to the primary standback included within the ISAs, and include specific guidance for the auditor as to the ED-240-specific considerations in respect of fraud to be made as part of an overarching standback requirement.

*Scalability*

8. Do you believe that the IAASB has appropriately integrated scalability considerations in ED-240 (i.e., scalable to entities of different sizes and complexities, given that matters related to fraud in an audit of financial statements are relevant to audits of all entities, regardless of size or complexity)?

*(See EM, Section 1-J, paragraph 113)*

**Overall response:** [Agree, with comments below](#)

In general, we believe that the IAASB has appropriately integrated scalability considerations within ED-240, and we believe this approach is appropriate, i.e., that the requirements of the standard are applicable to all entities (subject to interactions with other standards that are applicable only in certain circumstances, e.g., ISA 701), as fraud can occur across the spectrum of entities in terms of their size and complexity. We also note that certain requirements are conditional requirements, which are inherently scalable as they are only applicable when the particular condition actually exists.

However, we refer to our response to Question 4, in which we set out certain scalability-related concerns in respect of the requirements at 55-56.

We also refer to our comments in respect of the inclusion of material to address group audit scenarios at certain points in the standard (e.g., in respect of the appropriate exercise of professional skepticism, as we describe in our response to Question 2, and in respect of the inclusion of a standback requirement, as we describe in our response to Question 7). We recommend that ED-240 be enhanced to better address these matters, which are an important part, in particular, of enabling the standard to be scaled up, for audits of larger and more complex entities.

*Linkages to Other ISAs*

9. Does ED-240 have appropriate linkages to other ISAs (e.g., ISA 200,<sup>2</sup> ISA 220 (Revised),<sup>3</sup> ISA 315 (Revised 2019), ISA 330,<sup>4</sup> ISA 500,<sup>5</sup> ISA 520,<sup>6</sup> ISA 540 (Revised)<sup>7</sup> and ISA 701<sup>8</sup>) to promote the application of the ISAs in an integrated manner?

*(See EM, Section 1-J, paragraphs 81–84)*

**Overall response:** [Neither agree/disagree, but see comments below](#)

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

<sup>3</sup> ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*

<sup>4</sup> ISA 330, *The Auditor's Responses to Assessed Risks*

<sup>5</sup> ISA 500, *Audit Evidence*

<sup>6</sup> ISA 520, *Analytical Procedures*

<sup>7</sup> ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

<sup>8</sup> ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*



**Detailed comments (if any):**

We note that several of the proposed changes to ED-240 aim to include better linkage to other ISAs (including ISA 200, ISA 220R, ISA 315R, ISA 330, ISA 500, ISA 520, ISA 540R, ISA 701), and we are supportive of these, both in order to avoid duplication of material, as well as to promote the application of the ISAs in an integrated manner. In particular, we are supportive of the alignment with the structure and flow of ISA 315R, and the linkages to that standard.

However, we make certain recommendations throughout this response, including in Appendix 1, for clearer linkage to other ISAs in respect of particular aspects related to fraud in an audit of financial statements.

**Non-Compliance with Laws and Regulations (NOCLAR)**

One of the stated aims of the IAASB in developing ED-240 is to clarify the interrelationship between ED-240 and ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*.

However, we do not consider that ED-240 has appropriately clarified the interrelationship between ED-240 and ISA 250 in stating, at ED-240.14, that fraud constitutes an instance of NOCLAR, as it does not appear to differentiate between different types of fraud or suspected fraud, as to when the requirements of ISA 250 would be applicable. We recommend that the IAASB clarify that not all instances of fraud or suspected fraud that the auditor identifies will require the auditor to apply the requirements of ISA 250, rather, it is fraud or suspected fraud that falls within the definition of “non-compliance” in ISA 250.12, that ISA 250 is intended to address. We believe that matters such as misappropriation of assets by an individual, whilst an illegal act, should not generally give rise to the need for the auditor to perform audit procedures to comply with the requirements of ISA 250 in respect of the matter, if the fraud was not perpetrated at the direction of, or on behalf of, the entity. Accordingly, we recommend that the IAASB explicitly clarify that not all instances of fraud/suspected fraud would constitute “non-compliance” with laws and regulations, based on the meaning that is attributed to this term in ISA 250.12, and therefore the requirements of the standard would not always apply.

Furthermore, we highlight that there is an interaction between the concept of fraud and that of breaches of laws and regulations, which have a degree of overlap, especially in the case of intentional violations. In the context of laws and regulations, ISA 250.5 explicitly acknowledges the potential effects of inherent limitations on the auditor’s ability to detect material misstatements for various reasons, including that there are many laws and regulations that typically do not affect the financial statements directly, and non-compliance may involve conduct designed to conceal it, such as collusion, forgery, deliberate failure to record transactions, management override of controls and intentional misrepresentations made to the auditor (which would likely constitute fraud). ISA 250 notes that the auditor’s responsibilities with respect to laws and regulations that do not have a direct effect on the financial statements are limited to undertaking specified audit procedures to help identify non-compliance with those laws and regulations that may have a material effect on the financial statements.

We recommend that ED-240 improve linkage to the auditor’s responsibilities with respect to laws and regulations and the related inherent limitations of an audit in this specific area, and explain how these may interact with the auditor’s responsibilities with respect to fraud in an audit of financial statements. We believe it is important that ED-240 not be perceived as broadening the auditor’s responsibility to detect non-compliance with respect to laws and regulations that do not have a direct effect on the financial statements beyond those of ISA 250, when there has been conduct to conceal such non-compliance.

*Other Matters*

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.

**Overall response:** [Yes, with comments below](#)

**Detailed comments (if any):** 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 emphasise 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 emphasise 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) emphasise 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 emphasise 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.

*Translations*

11. Recognizing that many respondents may intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents note in reviewing the ED-240.

**Overall response:** [No response](#)

**Detailed comments (if any):** Not applicable

*Effective Date*

12. Given the need for national due process and translation, as applicable, and the need to coordinate effective dates with the Going Concern project and the Listed Entity and PIE – Track 2 project, the IAASB believes that an appropriate effective date for the standard would be for financial reporting periods beginning approximately 18 months after approval of the final standard. Earlier application would be permitted and encouraged. Would this provide a sufficient period to support effective implementation of the ISA?

*(See EM, Section 1-J, paragraphs 115–116)*

*(See ED, paragraph 16)*

**Overall response:** [See comments on effective date below](#)

**Detailed comments (if any):** We believe the effective date proposed would provide a sufficient period to support effective implementation of the ISA.

## **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.