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Auditing and Assurance Standards Board

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Responses to IAASB's Request for Comments in the Explanatory Memorandum for ED-240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

PART A: Respondent Details and Demographic information

Your organization's name (or your name if you are making a submission in your personal capacity)	Auditing and Assurance Standards Board (AASB), Canada
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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.	North America
	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.	Jurisdictional/ National standard setter
	If "Other," please specify.
Should you choose to do so, you may include information about your organization (or yourself, as applicable).	

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

ED Question #1 – Responsibilities of the Auditor

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):

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

Auditors' responsibilities regarding non-material fraud

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

We found the following references to non-material fraud or suspected fraud outside of ED-240:

- The "Public Interest Issues Table—Mapping of Key Changes Proposed in ED-240 to the Actions and Objectives in the Project Proposal that Support the Public Interest" states that the requirements *"apply to all instances of fraud or suspected fraud identified by the auditor, irrespective of materiality, and that the auditor is required to apply some or all of those requirements before determining the implications of the fraud or suspected fraud on the audit, including whether it is inconsequential.*"
- Paragraph 56 of the IAASB's Explanatory Memo, also states "*for all instances of fraud or suspected fraud identified by the auditor, ED-240 requires the auditor to apply at least some of the fraud or suspected fraud requirements that are applicable in the circumstances to determine the effect on the audit engagement*."

We agree with the IAASB's statements above that all instances of fraud or suspected fraud are in scope of ED-240. However, **our outreach indicated different interpretations of whether a threshold is applied to paragraphs 55-59**. Interpretations varied as follows:

- Some believe paragraphs 55-59 do not apply to inconsequential frauds even though the standard does not define inconsequential fraud.
  - For example, a coffee shop, where management is aware of inconsequential fraud with cashiers giving free coffee to their friends. In this example, management knows about the fraud or suspected fraud but does not further investigate the matter or implement additional controls to prevent a reoccurrence as they accept this level of inconsequential fraud as a cost of business.

- Others interpret paragraphs 55-59 as applicable to all frauds, including non-material and inconsequential frauds, as cumulatively it may indicate a broader issue.
    - We acknowledge and support that paragraph A152 includes an example of inconsequential fraud and as part of the engagement partner's determination, the engagement team continues with other aspects of the audit engagement while management of the entity is resolving the matter.

Given the differing interpretations of the scope of paragraph 55, we believe **there is a risk that paragraphs 55-59 in practice will be applied inconsistently across engagements**.

Suggest:

- **Adding application material to paragraph 55 to explicitly state that it applies** to all instances of fraud or suspected fraud identified by the auditor, *irrespective of materiality*. As we believe the proposals in paragraphs 56-59 appropriately build on the understanding obtained in paragraph 55.

Other suggestions:

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

Consistency of terms

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

Suggest:

- **Including *suspected fraud* in paragraph A11** to maintain consistency throughout the rest of the standard.
    - A11. Even when an identified misstatement due to fraud is not quantitatively material, it may be qualitatively material depending on:

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

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

ED Question #2 – Professional Skepticism

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 agree the proposals in ED-240 reinforce the exercise of professional skepticism about matters related to fraud in an audit of financial statements. However, we noted some application challenges which would benefit from clarification and guidance.

Documentation of professional judgment

While we believe the documentation requirement in paragraph 70(c) is clear, our outreach indicated that **auditors interpret paragraph 70(c) as requiring documentation of all judgments related to fraud risk factors** that did not result in a material misstatement due to fraud.

Suggest:

- **Adding application material to paragraph 70(c)** similar to paragraph A241 of ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*, (see below) to be explicit that not every fraud risk factor requires documentation.
  - "However, the auditor is not required to document every ~~inherent~~ fraud risk factor that was taken into account in identifying and assessing the risks of material misstatement due to fraud ~~at the assertion level~~"
- **Alternatively, Appendix 1 could clearly state that auditors are not expected to use the examples as a checklist** for documentation, particularly if the fraud risk factor is not relevant to the nature and circumstances of the entity.

Application of professional skepticism in practice

Paragraph 5(c) of the IAASB's Explanatory Memo states the changes to the standard are intended to "*reinforce the importance, throughout the audit, of the appropriate exercise of professional skepticism in fraud-related audit procedures.*" However, improving the auditor's application of professional skepticism comes as a result of behavioral changes. We heard concerns about how this can be demonstrated in practice. We believe **implementation guidance plays an important role in showing auditors practical examples of how professional skepticism can be demonstrated** relating to fraud in a financial statement audit.

Suggest:

- **Creating implementation guidance** with examples that demonstrate the practical application of professional skepticism related to fraud. Examples of circumstances where we believe it is important to demonstrate professional skepticism include:
    - Improper recognition of revenue (e.g., premature revenue recognition);
    - Related party relationships and transactions;
    - Frequent adjustments (e.g., before month or year-end) and subsequent reversal of adjustments;
    - Inadequate segregation of duties in internal control; and
    - General IT controls, especially when deficiencies are identified (e.g., inappropriate super user access).

Other suggestions:

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

Consistency of terms

One of the objectives of the project proposal was to clarify the auditor's responsibilities relating to fraud. Paragraph 21 says "*The auditor shall remain alert throughout the audit for information that is indicative of fraud or suspected fraud.*" However, the introductory sentence to Appendix 3 is a clearer explanation of the auditors' responsibilities relating to fraud; instead of saying "indicative of fraud or suspected fraud" it says, "*circumstances that may indicate the financial statements may contain a material misstatement due to fraud*."

Also, the supporting application material paragraphs A29-A32 and Appendix 3 refer to "*information*" or "*circumstances*" that may be indicative of fraud. It is unclear in paragraph 21 whether an auditor shall remain alert throughout the audit to '*circumstances*' that are indicative of fraud or suspected fraud.

Suggest:

- **Referring in paragraph 21 and the title of Appendix 3** to "material misstatement due to fraud" instead of "indicative of fraud."
- **Including a reference in paragraph 21** to "circumstances."

  21. The auditor shall remain alert throughout the audit for information or circumstances that indicate ~~is indicative~~ that the financial statements may contain a material misstatement due to ~~of~~ fraud or suspected fraud.

  Appendix 3 **-** Examples of Circumstances That May ~~Be Indicative of Fraud~~ Indicate the Financial Statements May Contain a Material Misstatement Due to Fraud

ED Question #3 – Risk Identification and Assessment

Risk Identification and Assessment

3. Does ED-240 appropriately build on the foundational requirements in ISA 315 (Revised 2019)[1] 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 agree that the proposals build on the foundational requirements in ISA 315 (Revised 2019) and other ISAs to support a more robust risk identification and assessment. We did receive suggestions for clarification in the application material that will help improve the practitioner's understanding of the requirements, which we have included below.

Relationship between inherent risk factors and fraud risk factors

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

- Paragraph A57 provides factors that could constrain management that would be considered a control (e.g., existence and enforcement of a written code of conduct).
- Paragraph A58 suggests the existence of management authorization can serve as a compensating control, reducing the risk of fraud.

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

Suggest:

- **Clarifying in paragraph A22** that fraud risk factors are a subset of inherent risk factors:
  - A22. Fraud risk factors may relate to incentives, pressures or opportunities that arise from events or conditions that create susceptibility to misstatement, before consideration of controls. Fraud risk factors, which include intentional management bias, are~~, insofar as they affect inherent risk,~~ a subset of inherent risk factors. Fraud risk factors may also relate to

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

events or conditions that may exist in the entity's system of internal control that provide an opportunity to commit fraud and may be an indicator that other fraud risk factors are present.

- **Moving paragraphs A57- A58** near paragraphs A104-A105 as these paragraphs relate to the requirement in paragraph 40(a) where the auditor is identifying and assessing the risks of material misstatement due to fraud by taking into account both inherent and control risk and the fraud risk factors.
- **Clarifying in paragraph A58** how the auditor can verify a culture where management emphasizes the importance of integrity and ethical behavior through management example.

<u>The evaluation of the significance of fraud risk factors</u>

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

Suggest:

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

<u>Presumption of risk of material misstatement due to fraud in revenue recognition</u>

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

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

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

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

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

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

Suggest:

- **Adding application material to paragraph 70(d)** to clarify the documentation required where risk(s) of material misstatement due to fraud are identified in particular types of revenue, revenue transactions or relevant assertions, but not in other revenue areas.
- **We support retaining the proposed application material in paragraphs A107-A112; however, we suggest adding further application material to clarify other circumstances**, including:
    - considerations for the auditor to help determine when fraud risk factors are not significant when rebutting the risk of material misstatement due to fraud in revenue recognition; and
    - when it would be inappropriate to rebut the presumption of risks of fraud in revenue recognition.

Whistleblower program

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

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

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

Fraud-related inquiries

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

Suggest:

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

Other suggestions:

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

Fraud risk factors definition

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

Suggest:

- **Including "attitude" in the definition of fraud risk factors in paragraph 18(b)**
  - 18. For purposes of the ISAs, the following terms have the meanings attributed below:

    …

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

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

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

Suggest:

- **Updating paragraph 26 to be consistent with the CUSP Drafting Principles and Guidelines.**
  - 26. In applying ISA 315 (Revised 2019), the auditor shall perform the procedures in paragraphs 27–39 to obtain audit evidence that provides an appropriate basis for the: (Ref: Para. A44)

    (a) Identification and assessment of risks of material misstatement due to fraud at the financial statement and assertion levels, ~~taking into account~~ considering fraud risk factors;

First-time implementation guidance

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

Suggest:

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

ED Question #4 – Fraud or Suspected Fraud

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):

While we support the requirements and application material for providing a framework for auditors to address circumstances when instances of fraud or suspected fraud are identified, we have some comments relevant to this question in our response to Question 1 and Question 8 as noted below.

Auditors' responsibilities regarding non-material fraud

Refer to our response under Question 1.

Inquires when fraud or suspected fraud is identified

Refer to our response under Question 8.

Other suggestions:

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

First-time implementation guidance

Consider first-time implementation guidance to highlight what is new compared to extant in this section as there are new requirements, relocated existing requirements, the elevation of existing application material to requirements, and enhanced application material.

ED Question #5 – Transparency on Fraud-Related Responsibilities and Procedures in the Auditor's Report

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 do not support the proposals relating to enhancing transparency about matters related to fraud in the auditor's report.

We recognize that the IAASB included in the project proposal to ***explore*** revisions to requirements and enhancements to application material to determine the need for more transparency in the auditor's report describing fraud-related matters. However, we believe that the proposals will further exacerbate the expectation gap and there is not enough evidence to support that separate requirements are needed on fraud-related matters.

Key concern: Key audit matters (KAMs) relating to fraud

Through our outreach, we heard concerns about the:

a) risk of further widening the expectation gap; and

b) practical application of the requirements.

Risks of further widening the expectation gap

Concerns expressed included:

- The **heading "Key Audit Matters Including Matters Related to Fraud**" (Illustration 1, ISA 700, *Forming an Opinion and Reporting on Financial Statements*); and the **requirement for a separate subheading** clearly describing the matter relating to fraud (paragraph 63):
  - It **creates an unbalanced representation in the auditor's report** (i.e., higher prominence on fraud-related matters when other areas required significant auditor attention) and implies the auditor is doing more about fraud than is required in the standard; and
  - It **may be interpreted that fraud has occurred at the entity**.
- Where the **auditor has concluded and is therefore required to communicate a statement in the auditor's report that "*there are no KAMs related to fraud*"** (paragraphs 64 and A177):
  - This statement can be **interpreted as an explicit conclusion that there are no instances of fraud at the entity**.
  - There may be an **auditor bias to identify a KAM related to fraud and include a boilerplate disclosure, to avoid making the explicit statement**.

- Our independent academic research found that even when the auditor decided there were no KAMs to include in the auditor's report, extensive consultations were needed resulting in incremental audit costs to support that decision. We believe that if paragraph 64 remains in ED-240, a similar experience will likely occur when auditors decide "*there are no KAMs related to fraud.*"

- In the **circumstance where there is an ongoing investigation of identified fraud or suspected fraud and the auditor has concluded there are no other KAMs related to fraud:**
  - **Under ED-240 the auditor would be required to:**
    - **disclose a KAM related to fraud, which could imply that the auditor has made a legal determination** about the fraud being investigated; **or**
    - **include a statement that "*there are no KAMs related to fraud,*"** because the issue is still being investigated. This decision could risk damage to the auditor's reputation if it becomes public soon after the audit is completed that there was fraud relating to the entity being audited.
  - Furthermore, there were questions about whether the auditor can disclose the matter in the auditor's report when a legal determination of the matter has not been made.
  - Under extant ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, paragraph 14 and ISA 701, paragraph A52 this issue does not exist. An auditor may determine that due to an ongoing investigation, it may preclude public disclosure of the matter. The auditor can choose to wait until a legal determination has been made to include the KAM related to fraud in the auditor's report and during the interim period, the auditor does not need to include a specific statement that there are no KAMs related to fraud.

The practical application of the requirements

Concerns expressed included:

- **The auditor may be expected to disclose fraud-related entity information that the entity itself has not disclosed in the financial statements**.
  - However, prevention and detection of fraud are the primary responsibility of management and those charged with governance.
  - The financial reporting disclosure standards regarding fraud are limited, and management may interpret existing disclosure requirements as not requiring the disclosure of fraud-related matters in the financial statements unless they are quantitatively material.
  - Even in the circumstances where management chooses to disclose fraud-related matters through other documents outside the financial statements, like press releases or a management discussion and analysis document, there is concern that the auditor's KAMs may inappropriately refer to these other disclosure documents and expand the auditor's responsibilities to information beyond the financial statements.
- Given the topic of fraud, it is possible **management may frequently assert that disclosing the fraud-related issue could have adverse consequences for the entity, as it could be misconstrued as an indication of actual fraud**, potentially resulting in increased regulatory scrutiny, market reactions, or negative press coverage.

- Paragraph A178 and ISA 701, paragraph 14(b) state "*that it will be extremely rare for a matter determined to be a key audit matter not to be communicated in the auditor's report*." This is based on the presumption that there is "*a public interest benefit in providing greater transparency about the audit*." However, these paragraphs note that there may be circumstances where it is appropriate not to communicate a KAM if it is believed that doing so would have "*adverse consequences to the entity or the public as a result of such communication are viewed as so significant that they would reasonably be expected to outweigh the public interest benefits of communicating about the matter.*"
- During outreach we received questions on how to determine when the "*adverse consequences to the entity outweigh the public interest benefit*," as fraud is a more sensitive topic with management than common KAMs disclosed under the extant standard such as impairments.

- By requiring the statement "*there are no KAMs related to fraud*" if none have been identified, **there is a risk of boilerplate disclosures** when:
  - year-over-year the risks of material misstatement due to fraud remain the same at the entity (e.g., the presumed risks of material misstatement due to fraud in revenue recognition and/or management override of controls); and
  - the auditor determines there are no other KAMs related to fraud.

Given the above concerns, we **do not support requiring separate KAMs related to fraud in ED-240 as we believe extant ISA 701 appropriately includes fraud-related matters as part of the existing KAM requirements.** However, changes to existing application material and further application material/guidance are needed to provide a new solution over extant that will drive behavioral change to enhance transparency in the auditor's report.

Suggest:

- **Removing the requirements in paragraphs 61-64 of ED-240.**
- **Removing reference to "reporting" in paragraphs 2(b) and 17(d)** as these responsibilities and objectives are captured under ISA 701.
  - 2. The auditor's responsibilities relating to fraud when conducting an audit in accordance with this ISA, and other relevant ISAs, are to: (Ref: Para. A1)

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

    (b) Communicate ~~and report about~~ matters related to fraud.
  - 17. The objectives of the auditor are:

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

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

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

~~(d) To report in accordance with this ISA.~~

- **Continuing to use the current KAM requirements in extant ISA 701 and making the following enhancements:**
    - Consider adding application material as a conforming and consequential amendment to ISA 701 to enhance considerations of fraud-related matters, such as the material in paragraph 61(b) regarding the identification of fraud or suspected fraud as a consideration when determining KAMs.
        - We believe the material in paragraph 61(a) is covered in extant ISA 701, paragraph 9 and paragraph 61(c) is covered in extant ISA 701, paragraph A29.
    - Retaining the proposed consequential amendment to ISA 701, paragraph A21 as the extant wording may have driven auditors not to communicate KAMs related to fraud. It also reminds the auditor that presumed risks of material misstatement due to fraud in revenue recognition and management override of controls may or may not have been a matter of most significance in the determination of KAMs.
- **Developing implementation guidance**:
    - Following the requirements of ISA 701, showing a range of KAMs relating to fraud (e.g. when fraud has not been identified but is a significant risk requiring significant auditor attention) and developing examples of scalable KAMs related to fraud disclosures (e.g. for a smaller entity without the use of forensic specialists) to encourage the communication of fraud-related matters other than when actual fraud or suspected fraud has occurred.
    - Demonstrating how to build upon common existing KAMs to include a discussion of fraud risk factors.
        - From the "Lessons Learned from KAM Reporting on Audits of TSX-Listed Entities: Observations from the 2020 Canadian Experience" study, it was identified that the most common KAM topics were related to different types of asset valuation (fixed assets, intangibles, investments, other assets).
        - This will promote more careful consideration of assessing the risk of material misstatement due to fraud in those existing areas where a KAM is already reported but focuses currently on the risk of material misstatement due to error.
        - This suggestion can address the concerns above about the expectation gap as fraud-related matters are one element of the KAM and this will result in a more robust and informative KAM.
            - For example, an existing KAM relating to impairment can be further expanded on for the fraud risk factors, when discussing management bias in making judgments about future events and conditions.

Communication of fraud-related matters in the auditor's report

Another area that risks widening the expectation gap by implying that the auditor is doing more regarding fraud, is how the auditor's communication with those charged with governance is described in the auditor's report. The consequential amendments made to ISA 700 imply that all instances of fraud or suspected fraud are communicated to those charged with governance whereas paragraph 67 of ED-240 requires a subset of fraud or suspected fraud involving "*management, employees who have significant roles in internal control or others where the frauds result in a material misstatement in the financial statements"* to be communicated to those charged with governance.

Suggest:

- **Updating the consequential amendment in ISA 700 and related illustrative reports** to remove bullet (ii) and amend (iii) (as suggested below) to be consistent with paragraph 67 of ED-240.
    - 40. The Auditor's Responsibilities for the Audit of the Financial Statements section of the auditor's report also shall: (Ref: Para. A50)

        (a) State that the auditor communicates with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any:

        (i) ~~s~~Significant deficiencies in internal control that the auditor identifies during the audit; and

        ~~(ii) Identified fraud or suspected fraud; and~~

        (ii) ~~(iii) Other m~~Matters related to fraud that are, in the auditor's judgment, relevant to the responsibilities of those charged with governance;

ED Question #6 – Expanding Transparency on Fraud-Related Responsibilities and Procedures in the Auditor's Report Beyond Listed Entities

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):

As indicated in Question 5, we do not support separate requirements about key audit matters (KAMs) related to fraud in the auditor's report.

Furthermore, we do not support expanding transparency about matters relating to fraud in the auditor's report beyond listed entities. This is consistent with our views in our response letter to Exposure Draft, Proposed Narrow Scope Amendments to ISQMs, ISAs and ISRE 2400 (Revised) as a Result of the Revisions to the Definitions of Listed Entity and Public Interest Entity (PIE) in the IESBA Code, where we did not support expanding transparency about KAMs beyond listed entities.

The benefits of extending KAM reporting to non-listed entities may not justify the cost

We **do not believe that sufficient evidence has been provided to demonstrate the public interest benefits of extending KAM requirements to non-listed entities to justify the costs**. We, therefore, believe that more information is needed before the IAASB can extend KAM reporting beyond listed entities.

We acknowledge the support for extending the differential requirement for KAM reporting to apply to PIEs in the IAASB's Auditor Reporting Post-Implementation Review (PIR) survey. However, we note the following:

- The IAASB's Auditor Reporting PIR survey was conducted in 2020, a time when KAM reporting was not yet effective in many jurisdictions. This circumstance was acknowledged in the IAASB's September 2021 Agenda Item 5, paragraph 9(c).
- Subsequent studies conducted by various national standard-setters since the IAASB's Auditor Reporting PIR survey present a more nuanced perspective on the benefits and costs associated with KAM reporting for listed entities. For example, an independent research study undertaken in Canada titled "Lessons Learned from KAM Reporting on Audits of TSX-Listed Entities: Observations from the 2020 Canadian Experience," found limited benefits to KAM reporting.

Suggest:

- **Not extending KAM requirements in extant ISA 701 or ISA 240 beyond listed entities (or publicly traded entities).**
- **Conducting a follow-up PIR survey** to provide the IAASB with more substantive evidence of the public interest benefits of extending KAM reporting to entities other than listed entities to support the increased costs.

ED Question #7 – Separate Stand-back Requirement in ED-240

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: **Agree, with comments below**

Detailed comments (if any):

We agree with the IAASB's decision not to include a separate stand-back requirement in ED-240. However, during outreach, we received mixed feedback, with many agreeing with the IAASB's decision that a separate stand-back in ED-240 is not required, but others disagreed.

Those who supported felt that it was important that a fraud lens be applied to the ISA 315 (Revised 2019) stand-back requirement. Further, they were of the view that the requirement could:

- be an effective way to demonstrate "*remaining alert*" as required in paragraph 21 of ED-240, as well as remind the auditor to effectively challenge the appropriateness of management's assumptions; and
- provide a linkage back to the risk assessment procedures to strengthen engagement team discussions and encourage those discussions at later stages of the audit.

We concluded, after considering the feedback received, that a separate stand-back requirement is not necessary in ISA 240. This is consistent with the IAASB's position in ED-240. We agree with the points highlighted in paragraphs 108 and 109 of the IAASB's explanatory memorandum that the:

- existing stand-back requirements and guidance in other ISAs sufficiently apply to audit evidence obtained from audit procedures performed in accordance with ED-240.
- requirement in paragraph 21 of ED-240 for the auditor to remain alert throughout the audit engagement for information that is indicative of fraud or suspected fraud already provides a robust overall check for responses to the assessed risks of material misstatement due to fraud.

ED Question #8 – Scalability

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: **Disagree, with comments below**

Detailed comments (if any):

While we support the intention of integrating scalability considerations in the development of the standard, we believe further revisions and application material are needed for the proposed standard to be scalable to smaller or less complex entities and not-for-profit entities (NPOs).

Scalability within this standard is important regardless of the separate ISA for LCE, as many smaller or less complex entities will be out of the scope of ISA for LCE and need an audit conducted using the full ISAs, including ED-240. Ensuring that the ISAs are scalable and practicable helps to decelerate or curb the trend toward downgrading audit engagements to review or compilation engagements.

Not enough scalability examples or signposting in the application material

Throughout outreach, we heard concerns that:

- There are **not enough scalability examples of the application of the requirements** to all entities regardless of whether their nature and circumstances are less or more complex.
- All application material that currently has a **scalability consideration is not sign-posted with a heading**.
- Many **scalability examples included in ED-240 are relevant to large or public entities**.
- **Where there are scalability considerations, the considerations do not provide practical guidance on how to effectively scale the requirements**, especially for smaller or less complex entities. For example, paragraph A58 states "*In the case of a smaller or less complex entity, some or all of these considerations may be inapplicable or less relevant…*". However, the examples provided do not clearly illustrate how or what would make any of the considerations less relevant for smaller or less complex entities.

In addition, there are inherent presumptions of formal and written processes which are likely in place for larger entities but may not be the case for smaller or less complex entities. For example, paragraph A69 bullets 2 and 3 could be interpreted as assuming all organizations have a fraud policy and fraud awareness training.

- A69. In considering the extent to which management demonstrates a commitment to ethical behavior, the auditor may obtain an understanding through inquiries of management and employees, and through considering information from external sources, about:

  …

- The entity's communications with respect to integrity and ethical values. <The following example implies that these considerations are relevant for all organizations> For example, the entity may have a mission statement, a code of ethics, or a fraud policy that sets out the expectations of entity personnel in respect to their commitment to integrity and ethical values regarding managing fraud risk. <Provides an additional consideration to scale up> In larger or more complex entities, management may also have set up a process that requires employees to annually confirm that they have complied with the entity's code of ethics.
- <Implies that this example is relevant for all organizations> Whether the entity has developed fraud awareness training. For example, the entity may require employees to undertake ethics and code of conduct training as part of an ongoing or induction program. <Provides an additional consideration to scale up> In a larger or more complex entity, specific training may be required for those with a role in the prevention and detection of fraud (e.g., the internal audit function).

Further guidance and examples for smaller or less complex entities will help with the application of the requirements to the varying nature and circumstances of entities.

Suggest:

- **Adding scalability headings within the application material and reviewing application material** that currently refers to less or more complex to see where it can be combined and contrasted to show both sides of complexity in one paragraph under the scalability heading. For example:
    - Adding a scalability consideration following paragraph A44 based on paragraph A16 of ISA 315 (Revised 2019).
    - Signposting paragraph A57 as a scalability example.
    - Adding an example in paragraph A64 of a typical user of performance measures for a smaller or less complex entity as shareholders and analysts are typically applicable for large public companies.
        - A64. Performance measures, whether internal or external, may create pressures on the entity. These pressures, in turn, may motivate management or employees to take action to inappropriately improve the business performance or to misstate the financial statements. Internal performance measures may include employee performance measures and incentive compensation policies. External performance measures may include expectations from shareholders, lenders, analysts, or other users.
    - Expanding paragraph A68 by adding a scalability consideration based on paragraph A92 of ISA 315 (Revised 2019).
        - A68. Understanding aspects of the entity's control environment that address the entity's culture and understanding management's commitment to integrity and ethical values assists the auditor in determining management's attitude and tone at the top with regards to the prevention and detection of fraud. The design and implementation of an entity's control environment can differ based on its size and complexity. For example, less complex entities may use less structured or simpler controls (i.e., policies and procedures) regarding the prevention and detection of fraud.

- Adding examples to paragraph A69 that effectively illustrate non-complex, similar to the approach used in paragraphs A79 and A88. Paragraph A79 details scaling up for larger organizations, while paragraph A88 explains scaling down for smaller or less complex entities.
- Signposting the scalability example in paragraph A89 which is currently buried in a large paragraph.
  - A89. Management accepts responsibility for the entity's system of internal control and for the preparation of the entity's financial statements. Accordingly, it is appropriate for the auditor to make inquiries of management regarding management's own assessment of the risk of fraud and the controls in place to prevent or detect it. <Scalability starts here and could be sign-posted> The nature, extent and frequency of management's assessment may vary from entity to entity. In some entities, management may make detailed assessments on an annual basis or as part of ongoing monitoring. In other entities, management's assessment may be less structured and less frequent. The nature, extent and frequency of management's assessment are relevant to the auditor's understanding of the entity's control environment. For example, the fact that management has not made an assessment of the risk of fraud may in some circumstances be indicative of the lack of importance that management places on internal control.

- **Reordering bullets to group fraud risk factors in Appendix 1** applicable to all entities and those only applicable to listed entities**.**

During our outreach, we also identified the following additional areas with scalability concerns:

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

The presumption of risks of material misstatement due to fraud in revenue recognition is an area where it **may pose particular challenges for entities where the risk of material misstatement due to fraud lies in areas other than revenue**. For example, in the audit of NPOs, the presumed risk of material misstatement due to fraud in revenue recognition may not be as relevant as it is in for-profit entities. (See our detailed concern and suggestion in Question 3)

Unpredictability in the selection of audit procedures

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

Use of forensic skills

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

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

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

It is important that this interpretation be clarified as:

- **The standard should recognize that not every audit, or even instance of fraud, necessarily calls for specialist involvement**. The decision whether to involve specialized skills should be within the auditor's professional judgment. The auditor has other approaches that may provide sufficient appropriate audit evidence – such as consulting with an auditor with more experience with corporate fraud.
- **Access to forensic skills is limited, especially among small-medium sized practices.** Our outreach with small-medium sized practices indicated they believe paragraph A49 implies an expectation to maintain in-house forensic skills.

Suggest:

- **Introducing scalability in paragraphs A35 and A49,** to acknowledge that the involvement of specialists is based on the nature and circumstances of the entity and the auditor's professional judgment.
- In the application material, **listing more experienced individuals before forensic and other experts, and providing an example of where a more experienced individual (but not a specialist or expert) can be used.** This reduces the expectation that specialist skills are needed for all engagements and highlights that there are other considerations the auditor can make depending on the nature and circumstances of the engagement.
    - A34. The nature, timing, and extent of the involvement of more experienced individuals, or ~~of~~ individuals with specialized skills or knowledge, such as forensic and other experts, ~~or the involvement of more experienced individuals,~~ may vary based on the nature and circumstances of the audit engagement.
    - A37. The engagement partner may plan for direction, supervision and review to respond to identified risks of material misstatement due to fraud by, for example:
        - Assigning more experienced individuals to the engagement team;
        - Changing the composition of the engagement team so that more experienced members of the engagement team conduct certain audit procedures for those specific audit areas that require significant auditor attention; or
        - Assigning additional individuals with specialized skills or knowledge, such as forensic and other experts.
        - ~~Assigning more experienced individuals to the engagement team; or~~
        - ~~Changing the composition of the engagement team so that more experienced members of the engagement team conduct certain audit procedures for those specific audit areas that require significant auditor attention~~.

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

Inquires when fraud or suspected fraud is identified

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

There are concerns about paragraph 55(a), which requires an auditor to "*make inquiries about the matter with a level of management that is at least one level above those involved"* when fraud or suspected fraud is identified. The **requirement is unclear on how an auditor proceeds where an entity has a simple management structure with no one above those involved** (i.e., management perpetrated the fraud and management is also those charged with governance).

Suggest:

- **Providing a scalability consideration in the application material** to clarify the auditor's response when fraud or suspected fraud is identified and there is no one in the entity above those involved in the fraud or suspected fraud.

Journal entry testing – First-time implementation guidance

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

- **The population of journal entries, that the auditor is required (paragraph 50(b)) to obtain evidence over the completeness of, is unclear.** The population of journal entries is not described in ED-240 and varies across different accounting software. For example, Sage considers all transactions as journal entries.
- **Selecting journal entries and other adjustments in accordance with paragraph 50(c).** We have heard anecdotally that there is a wide range of testing approaches in practice (e.g., testing too little or testing too much) with some engagement teams designing a generic approach to select journal entries (e.g. selecting journal entries with round numbers) without focusing on the fraud risk factors.
- **Where 100% of transactions are tested substantively**, ED-240 is not explicit on what additional work is required as a result of the requirements in paragraphs 49-50.

Suggest:

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

Other suggestions:

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

Journal entry testing – no reliance on general IT controls

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

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

Suggest:

- **Updating paragraph A128 to include a similar scalability consideration** as in Appendix 5 of ISA 315 (Revised 2019).
    - A128. Prior to selecting items to test, the auditor may need to consider whether the integrity of the population of journal entries and other adjustments has been maintained throughout all stages of information processing based on the auditor's understanding and evaluation of the entity's information system and control activities (e.g., general IT controls that safeguard and maintain the integrity of financial information) in accordance with the requirements of ISA 315 (Revised 2019) or the auditor may obtain audit evidence about the completeness and accuracy of the journal entry report by substantively testing the inputs and outputs of the report.

ED Question #9 – Linkages to Other ISAs

Linkages to Other ISAs

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

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

Overall response: **Agree, with comments below**

Detailed comments (if any):

We support the linkages mentioned in the question. However, we heard a concern that there is one other ISA where the linkage is not clear.

Linkage to ISA 550, *Related Parties*

ISA 550, paragraph 14 requires understanding controls for significant and unusual transactions:

> 14. The auditor shall inquire of management and others within the entity, and perform other risk assessment procedures considered appropriate, to obtain an understanding of the controls, if any, that management has established to:
>
> (a) Identify, account for, and disclose related party relationships and transactions in accordance with the applicable financial reporting framework;
>
> (b) Authorize and approve significant transactions and arrangements with related parties; and
>
> (c) Authorize and approve significant transactions and arrangements outside the normal course of business.

The controls around significant and unusual transactions are susceptible to management overriding controls and may present fraud risk factors. **The connection to ISA 550 is not clearly articulated in ED-240.**

Suggest:

- **Adding requirement or application material** in ED-240 to explain the linkage between the requirement in ISA 550, paragraph 14 to understand controls for significant and unusual transactions and the risk of management override of controls.

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

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

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

[5] ISA 500, *Audit Evidence*

[6] ISA 520, *Analytical Procedures*

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

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

ED Question #10 – Other Matters

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):

Unpredictability in the selection of audit procedures

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

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

Specific implementation concerns included:

- For many audits, the risk of material misstatement due to fraud may remain consistent year-over-year.
  - if previously, the auditor had a thorough and appropriate audit response to the risk of material misstatement due to fraud at the financial statement level, this revised requirement could force them to change their audit response, potentially reducing its effectiveness.
  - alternatively, it may force auditors to implement a random element of unpredictability to their audit plan, treating the requirement as a checkbox exercise.
- Clarity is needed:
  - whether there is an expectation to introduce an element of unpredictability for each risk of material misstatement due to fraud.
  - whether monetary unit sampling meets the criteria of incorporating an element of unpredictability as there are different interpretations in practice.
  - how to appropriately scale the requirement to smaller or less complex entities. Although the procedures in Appendix 2 are helpful, auditors of smaller or less complex entities indicated the procedures are more applicable to larger organizations.
- The first bullet point in paragraph A114 "*Performing further audit procedures on selected account balances or disclosures that were not determined to be material or susceptible to material misstatement*" is inconsistent with the requirement as it does not address the risk of material misstatement due to fraud at the assertion level.

Suggest:

- **Reverting paragraph 44 to be consistent with extant** to address the assessed risks of material misstatement due to fraud at the financial statement level and moving paragraph 44 under the overall responses section.
  - 44. The auditor shall incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures in determining overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level.
- **If the requirement continues to address the assessed risks of material misstatement due to fraud at the assertion level, further application material is needed**, including:
  - Explicit clarification on whether incorporating an element of unpredictability is required for each risk of material misstatement due to fraud identified and if it needs to be reassessed year-over-year.
  - The first bullet point in paragraph A114 needs further clarification to explain how performing further audit procedures on selected account balances or disclosures that were not determined to be material or susceptible to material misstatement addresses assessed risks of material misstatement at the assertion level.
- **Expanding paragraph A114** bullet point "*Using different sampling methods or using different approaches to stratify the population*" to give an example of how monetary unit sampling can meet the requirement.
- **Signposting for potential unpredictable procedures for less complex entities in Appendix 2**. For example:
  - Showing up at unexpected times.
  - Asking for something that was previously never requested.
  - Procedures over petty cash.

Corruption, bribery and money laundering

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

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

Suggest:

- **Consider if paragraphs A18-A21 are better positioned in the introduction of the standard**, connected with paragraph 14 which describes the relationship with non-compliance with laws and regulations. Currently, these paragraphs are placed under the definitions section and our outreach participants expressed they may be interpreted as requirements.
- **Adding additional application guidance** to clarify the auditor's responsibilities in assessing non-compliance with laws and regulations and clearly state that auditors are not expected to perform specific procedures in these areas.

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

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

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

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

- limiting the applicability of the application material to only reasonable assurance engagements.
- implying that fraud is not relevant in limited assurance engagements.

Suggest:

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

Public sector examples

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

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

- **Appendix 1 - Examples of Fraud Risk Factors**

  Risk Factors Relating to Misstatements Arising from Fraudulent Financial Reporting

  Incentives/Pressures

  Considerations Specific to Public Sector Entities

  - Budgets are often reported with actual spending due to the budget's significance. Laws requiring balanced budgets can pressure entities to inaccurately report revenues or expenses.
  - Austerity legislation may create pressures to reduce expenses.
  - Expenditure legislation may create pressures to not recognize expenses, as exceeding a budget allocation can result in reduced funding the following year.

  Opportunities

  Considerations Specific to Public Sector Entities

  - Trust funds under administration – public sector entities often manage assets on behalf of others, including vulnerable individuals, which can be more susceptible to misuse.
  - Using another entity's budget, such as having a related entity issue a grant due to budget constraints.
  - Overlapping government levels or public and private sector partnerships with shared responsibilities.
  - Transactions may be non-exchange transactions (e.g. taxes, grants), which may provide an opportunity to manipulate the timing or values of those transactions.

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

  Considerations Specific to Public Sector Entities

  - Ensure that grants, whether received or given, have been properly authorized and eligibility criteria or stipulations for grant recipients are met.
  - Testing whether remissions, compromises and write-offs of tax and levy balances have been appropriately authorized.

Other suggestions:

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

Documentation requirements

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

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

Suggest:

- **Cross-referencing the documentation requirements in paragraphs 70(c) – (g)** to the relevant requirements (similar to the documentation requirements in paragraphs 70(a) and (b)).
- **Removing the reference to "professional"** to be consistent with other references in the ISAs. There are currently more references to "*significant judgments*" than to "significant professional judgments."
  - 70. In applying ISA 230,[9] the auditor shall include the following in the audit documentation: (Ref: Para. A193)

    …

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

    …

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

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

__Clarity of examples__

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

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

Suggest:

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

  …

  Money laundering to facilitate fraud – A business owner generates large amounts of proceeds from illegal activities. To avoid detection and triggering mandatory reporting, the business owner deposits these proceeds at multiple banking locations, ensuring the deposits remain under the reporting threshold. The deposits are legitimized by inflating daily sales and are used by the business owner to acquire assets. ~~An employee laundered money, to an offshore bank account, that was illegally obtained from embezzling payments for fictitious purchases of inventory through the creation of false purchase orders, supplier shipping documents, and supplier invoices.~~
- A122. …

[9] ISA 230, *Audit Documentation*, paragraphs 8–11, A6–A7 and Appendix

Example:

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

ED Question #11 – Translation

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: **See comments on translation below**

Detailed comments (if any):

CPA Canada prepared a French translation for ED-240 and identified the following issues.

Translation of *corruption and bribery*

The expression "corruption and bribery," when translated to French is "corruption." Therefore, the distinction between the two concepts, which are considered separate concepts under ED-240, will not be apparent in the French translation of the standard. Without this distinction, this may lead to different interpretations between the English and French application of the relevant paragraphs.

According to Merriam-Webster Dictionary and Cambridge Dictionary, bribery is a type of corruption. This is consistent with the Association of Certified Fraud Examiners (ACFE)'s Report to the Nations[10], where corruption encompasses bribery, conflicts of interest, illegal gratuities, and economic extortion.

Below is an example of how paragraph A19 would be read in French.

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

Examples:

- Corruption involving fraud – Management colluded with other competing parties to raise prices or lower the quality of goods or services for purchasers who wish to acquire products or services through a bidding process (i.e., bid rigging). The bid rigging included monetary payments by the designated winning bidder to colluding parties using fraudulent consulting contracts for which no actual work took place.
- Corruption ~~Bribery~~ to conceal fraud – Management offered inducements to employees for concealing the misappropriation of assets by management.
- Money laundering to facilitate fraud – An employee laundered money, to an offshore bank account, that was illegally obtained from embezzling payments for fictitious purchases of inventory through the creation of false purchase orders, supplier shipping documents, and supplier invoices.

Suggest:

- **Consider if the wording in ED-240 should just be "corruption" instead of "corruption and bribery."** The impacted paragraphs include A18-A20, A62 and Appendix 1.

[10] 2024 ACFE Report to the Nations, Page 104

Translation of work effort verbs

In the past, verbs such as “evaluate” and “determine” have been used interchangeably in the French translation process. Within ED-240, there were instances where certain verbs were changed to better reflect the work effort as per the Complexity, Understandability, Scalability, and Proportionality (CUSP) Drafting Principles and Guidelines. **During the translation process, reference to the CUSP Drafting Principles and Guidelines helped to ensure the verbs aligned with the principles**.

Suggest:

- **To assist translators: Issuing the CUSP Drafting Principles and Guidelines as a final document** to be circulated to all the parties translating IAASB standards across the various jurisdictions, to ensure consistency of translation.
- **To assist practitioners in understanding and applying the ISAs: Translating the final CUSP Drafting Principles and Guidelines into each of the languages the standards are translated** so practitioners can refer to it in understanding and applying the standards.

ED Question #12 – Effective Date

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 recognize the public interest benefits of timely implementation of standards revisions. We believe this benefit is fully realized when an implementation period appropriately balances the need for:

- timely adoption of the improved standards; and
- sufficient time for a high-quality implementation by practitioners, which includes education and updates to methodologies on the changes.

Through our outreach, we heard the following concerns regarding the proposed effective date:

18-month implementation period

An **18-month implementation period creates time pressure**, making it challenging to ensure there is sufficient time for:

- developers of methodologies and training to effectively understand and reflect the changes or develop new materials; and
- practitioners to understand and apply the changes to their engagements, including applying professional judgment to consider how to appropriately scale the requirements.

Furthermore, in Canada, after the IAASB's final pronouncement, the AASB undergoes its final due process steps to adopt ISA 240 concurrently as a Canadian Auditing Standard and translate the standard. This process shortens the IAASB's implementation period by approx. 3-5 months for Canadian practitioners and practitioners in other jurisdictions who rely on our French translation.

Allowing for a longer implementation period would help to alleviate some of the time pressure, ensuring the effective implementation of the IAASB's standard. Additionally, as the effective date allows for earlier application, those jurisdictions who desire to do so could choose to adopt the final standard earlier.

Suggest:

- **Allowing for a longer implementation period.**
    - Assuming the IAASB approves the final standard in March 2025, make the standard effective for financial reporting periods beginning December 15, 2027.

Alignment of Going Concern and Fraud project

We recognize that the coordination of the effective dates for both the Going Concern and Fraud projects is intended in response to the proposed changes to the auditor's report. However, as mentioned in our response to Question 5, we have significant concerns about the audit report transparency proposals.

We also heard **concerns about the impact of revisions to multiple standards coming into effect at the same time**. These concerns were expressed by auditors (particularly those in the small-medium sized practices) as well as those who create training and methodology to implement new and revised standards.

Based on our jurisdiction's implementation experience with ISA 315 (Revised 2019) and the Quality Management standards, we understand there are significant challenges in ensuring high-quality and effective implementation of new and revised standards when the implementation periods overlap. This was further evidenced when we reflected on practice inspection findings for these standards in our jurisdiction. Although it is acknowledged that the changes to the revised standards for ED-240 and ISA 570, *Going Concern* will not be as extensive as those for ISA 315 (Revised 2019) and the Quality Management standards, auditors, especially those in small-medium sized practices, face a significant resourcing challenge to support the implementation of more than one revised standard at a time.

Suggest:

- Following comments received on exposure, **if the proposed changes to the auditor's report in ED-240 are revisited and there is no longer a new requirement that impacts the auditor's report in ED-240, we believe the effective date of the revised ISA 570 and ISA 240 standards should be staggered** (i.e., ISA 570 – December 15, 2026, and ISA 240 – December 15, 2027).
    - This will also avoid the IAASB having three standards (i.e. ISA 570, ISA 240 and ISSA 5000, *General Requirements for Sustainability Assurance Engagements*) with overlapping proposed effective dates.