

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)	Accounting and Finance Association of Australia and New Zealand (AFAANZ)
Name(s) of person(s) responsible for this submission (or leave blank if the same as above)	<u>Committee Members</u> Noel Harding (UNSW Sydney) (Co-Chair) David Hay (University of Auckland) (Co-Chair) Michael Kend (RMIT University) Gladys Lee (Monash University) Radiah Othman (Massey University) Jean You (UNSW Sydney) Jessica Zhang (Macquarie University)
Name(s) of contact(s) for this submission (or leave blank if the same as above)	Professor Noel Harding
E-mail address(es) of contact(s)	n.harding@unsw.edu.au
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.	Asia Pacific
	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.	Academic or Academic body
	If "Other," please specify.
Should you choose to do so, you may include information about your organization (or yourself, as applicable).	<p>The Accounting and Finance Association of Australia and New Zealand (AFAANZ) is the peak regional academic accounting and finance association and counts among its membership the region's leading and emerging accounting and finance researchers. The Auditing Standards Committee is an ad-hoc committee under the governance of AFAANZ's Auditing and Assurance Special Interest Group, formed to give a voice on standard setting deliberations to the academic research literature.</p> <p>The views expressed in the comments that follow are those of the committee members noted above and do not necessarily reflect the official position of AFAANZ. While the views expressed represent a consensus view of the committee, they do not necessarily reflect the individual views of every member.</p>

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).

We commend the International Auditing and Assurance Standards Board (IAASB) for their work on revising the standard on auditor responsibilities related to fraud. Auditors' responsibilities for, and performance in, the identification of material misstatements due to fraud is a significant component of the audit expectations gap (see Quick 2020 for a review). In this area, the audit expectations gap is accounted for by both a reasonableness gap and a performance gap. While there is a need for ongoing education and communication with stakeholders as to the role that can reasonably be attributed to the auditor (both in terms of inherent limitations in the audit and the responsibilities of others in the financial reporting ecosystem), there is also a need to both elevate what is expected of auditors and to help auditors meet those expectations. Overall, the extant research suggests that ED-240, once implemented, will reduce the expectations gap and improve the extent to which auditors are able to meet evolving societal expectations as to the identification of material misstatements due to fraud.

However, with reference to the extant literature, we believe that the proposed standard does not reinforce the appropriate exercise of professional scepticism. We fear that this will mean that the improvements in the proposed standard will not realise their potential. We refer the IAASB to our response to Question 2 where we recommend more robust requirements.

We also comment on other questions for which the extant research literature may meaningfully contribute to deliberations.

Quick, R. 2020. The audit expectation gap: A review of the academic literature. *Maandblad Voor Accountancy en Bedrijfseconomie* 94 (1/2): 5–25.

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: [Agree, with comments below](#)

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

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

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

We further note, and commend, changes in the work effort verbs employed throughout the standard. Stepankova et al. (2022) highlights that different work effort verbs impact auditor judgments and research highlights the increased work effort necessary when dealing with fraud in an audit of financial statements (e.g. Brazel et al. 2024). For example, replacing 'evaluate' with 'determine' (a verb implying greater work effort) more effectively reinforces auditors' responsibilities.

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

Andolia, L.M. 2024. How do reviewers' goal framing and novice auditors' receptivity to negative feedback affect follow-through performance? *Auditing: A Journal of Practice and Theory* Vol.43 No.2, pp.19-41.
Bauer, T.D., Hillison, S.M., Peecher, M.E., and Pomeroy, B. 2020. Revising audit plans to address fraud risk: A case of 'Do as I advise, Not as I Do'? *Contemporary Accounting Research* Vol.37 No.4, pp.2558-2589.

- Brazel, J.F., Carpenter, T., Gimbar, C., Jenkins, J.G., and Jones, K.L. 2024. Recent research on identification, assessment, and response to fraud risks: Implications for audit practice and topics for future research. *Accounting Horizons* In Press.
- Jamal, K., Johnson, P., and Berryman, R.G. 1995. Detecting framing effects in financial statements. *Contemporary Accounting Research* Vol.12 No.1, pp.85-105.
- Johnson, P.E., Jamal, K., and Berryman, R.G. 1991. Effects of framing on auditor decisions. *Organizational Behavior and Human Decision Processes* Vol.50 No.1, pp. 75-105.
- Levin, I.P., Johnson, R.D., Russo, C.P., Deldin, P.J. 1985. Framing effects in judgment tasks with varying amounts of information. *Organizational Behavior and Human Decision Processes* Vol.36 No.3, pp.362-377.
- Nolder, C.J., and Kadous, K. 2018. Grounding the professional skepticism construct in mindset and attitude theory: A way forward. *Accounting, Organizations and Society* Vol.67, pp.1-14
- Stepankova, S., Harding, N., Mayorga, D.M., and Trotman, K.T. 2022. Using more effective instructional verbs to elevate auditors' professional scepticism. *International Journal of Auditing* Vol.26 No.2, pp.240-251.
- Tversky, A., and Kahneman, D. 1981. The framing of decisions and the psychology of choice. *Science* Vol.211 No.4481, pp.453-458.
- Vinson, J.M., Pike, B.J., Chui, L., and Zhou, M. 2024. The influence of audit evidence framing on auditors' judgment. *Behavioral Research in Accounting* Vol.36 No.1, pp.105-120.

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: [Disagree, with comments below](#)

We believe that revisions to extant ISA 240 reflected in ED-240 reinforce a lower level of professional scepticism than what is presently the case. Moreover, we believe that the unique characteristics of fraud mean that that the auditor’s work effort in exercising professional scepticism needs to be greater than that which is currently required in the extant standard (and reinforced in ED-240).

We believe that the deletion of reference in paragraph 19 of ED-240 to putting aside the auditor’s past experience of the honesty and integrity of the entity’s management diminishes (rather than reinforces) the exercise of professional scepticism about matters relating to fraud. More importantly, we believe that paragraph 21 of ED-240 encourages the inappropriate (insufficient) application of professional scepticism and we encourage the IAASB to consider introducing a stronger requirement that reinforces the importance of a more robust application of professional scepticism relating to fraud in an audit of financial statements. Doing so will make the realisation of other improvements in ED-240 more likely.

Research (e.g., Harding and Trotman 2017; Brasel et al. 2019; Verway and Asare. 2022; Hardies et al. 2024) highlights the importance of professional scepticism on positive auditor behaviours relating to fraud in an audit of financial statements. Moreover, research further suggests that a more questioning approach, where auditors presume a degree of dishonesty and/or bias by management, often referred to as presumptive doubt (see for example Nelson 2009 and Glover and Prawitt 2014), likely results in more effective audit judgments relating to fraud (Quadackers et al. 2014; Chui et al. 2022). Indeed, paragraphs 41 and 42 in ED-240 (and corresponding requirements in extant ISA 240) require a presumption of dishonesty and/or bias in relation to revenue recognition and management override of controls. We further note that requirements in the proposed standard to report fraud KAMs may lead auditors to infer a ‘moral license’ to exercise lower levels of professional scepticism (Asbahr and Ruhnke 2019), making the reinforcement of an appropriate level of professional scepticism even more critical.

We believe that to effectively apply the requirements in ED-240, and to meet society’s expectations as they relate to auditors’ responsibility relating to fraud, auditors must apply a higher work effort when applying professional scepticism than is currently required.

We note the IAASB’s discussions in 2016 and 2017 around the concept of professional scepticism and the decision to accept an invariant level of professional scepticism and neutral (rather than, for example, a presumptive doubt) mindset, but that the auditor’s actions in effectively applying professional scepticism vary with the circumstances. We believe that the auditor’s consideration of fraud in a financial statement audit is one area where the auditor’s actions must involve greater work effort.

Although paragraph 21 in ED-240 reflects the wording embedded in the definition of professional scepticism, we note that the verb ‘remain alert’ is at the lower end of the work effort spectrum (see IAASB Drafting Principles and Guidelines). Different work effort verbs impact auditor judgment and decision making (Stepankova et al. 2022) and we believe that ‘consider’ more effectively reflects the necessary auditor work effort relating to the application of professional scepticism concerning the identification of material misstatements due to fraud. We encourage the IAASB to replace ‘remain alert’ with ‘consider’ in

paragraph 21 (and make consequential changes to the wording of the paragraph). We further encourage the IAASB to expand on the application material, and in particular paragraph A30, to reinforce and illustrate the increased work effort necessary when applying professional scepticism as it relates to fraud in an audit of financial statements. We do not believe that such a change would conflict with the current definition of professional scepticism, nor would it be contradictory to the IAASB's 2016 and 2017 deliberations and conclusions on professional scepticism.

We further note that ISA 220 (paragraphs A33-A36) speaks to the impediments in exercising professional scepticism and the IAASB might consider cross references to that information in terms of addressing these impediments in an environment requiring more effort in fulfilling requirements as to the exercise of professional scepticism.

Finally, we believe that the deletion of material in extant paragraph 13 (paragraph 19 in ED-240) diminishes rather than enhances the exercise of professional scepticism. Auditors rarely encounter fraud (Loebbecke et al. 1989; Asare and Wright 2004; Hoffman and Zimbelman 2009; Gold et al. 2010), and research suggests that ongoing exposure to clients for which no material fraud is identified lowers the auditor's beliefs as to the base rate frequency of fraudulent activity and makes the identification of fraud when it does arise less likely (e.g., Zimbelman 1997; Rose et al. 2003; Rose 2007; Cassel et al. 2022). Reminding auditors to put aside past experiences of the honesty and integrity of the entity's management likely reduces this base rate bias. We encourage the IAASB to reinstate this material prior to issuing the revised standard. In addition, we encourage the IAASB to reflect on the possibility, in application material, to elaborate on the risk that ongoing exposure to engagements for which there is no material misstatement due to fraud may inappropriately desensitise the auditor to the likelihood of fraud, meaning that the maintenance of professional scepticism is of critical importance. This could be incorporated into paragraph A24 of ED-240 when the importance of professional scepticism is considered.

- Asare, S.K., and Wright, A.M. 2004. The effectiveness of alternate risk assessment and program planning tools in a fraud setting. *Contemporary Accounting Research* Vol.21 No.2, pp.325-352.
- Brasel, K.R., Hatfield, R.C., Nickell, E.B., and Parsons, L.M., 2019. The effect of fraud risk assessment frequency and fraud inquiry timing on auditors' skeptical judgments and actions. *Accounting Horizons* Vol.33 No.1, pp.1-15.
- Cassel, C.A., Dearden, S.M., Rosser, D.M., Shipman, J.E. 2022. Confirmation bias and auditor risk assessments: Archival evidence. *Auditing: A Journal of Practice & Theory*. Vol.41 No.3, pp.67-93.
- Chui, L., Curtis, M.B., and Pike, B.J. 2022. How does an audit or forensic perspective influence auditors' fraud-risk assessment and subsequent risk response? *Auditing: A journal of Practice & Theory* Vol.41 No.4, pp.57-83.
- Glover, S.M., and Prawitt, D.F. 2014. Enhancing auditor professional skepticism: The professional skepticism continuum. *Current Issues in Auditing* Vol.8 No.2, pp.P1-P10.
- Gold, A., Knechel, W.R., and Wallage, P. 2012. The effect of the strictness of consultation requirements on fraud consultation. *The Accounting Review* Vol.87 No.3, pp.925-949.
- Harding, N., and Trotman, K.T. 2017. The effect of partner communications of fraud likelihood and skeptical orientation on auditors' professional skepticism. *Auditing: A Journal of Practice & Theory* Vol.36 No.2, pp.111-131.
- Hoffman, V.B., and Zimbelman, M.F., 2009. Do strategic reasoning and brainstorming help auditors change their standard audit procedures in response to fraud risk? *The Accounting Review* Vol.84 No.3, pp.811-837.
- Hardies, K., Janssen, S., Vanstraelen, A., and Zehms, K.M. 2024. Using field-based evidence to understand the antecedents to auditors' skeptical actions. *Auditing: A Journal of Practice & Theory* In press.

- Loebbecke, J.K., Eining, M.M., and Willingham, J.J. 1989. Auditors' experience with material irregularities: Frequency, nature, and detectability. *Auditing: A Journal of Practice & Theory* Vol.9 No.1, pp.1-28.
- Nelson, M.W. 2009. A model and literature review of professional skepticism in auditing. *Auditing: A Journal of Practice & Theory*. Vol.28 No.2, pp.1-34.
- Rose, J.M., 2007. Attention to evidence of aggressive financial reporting and intentional misstatement judgments: Effects of experience and trust. *Behavioral Research in Accounting* Vol.19 No.1, pp.215-229.
- Rose, A.M., and Rose, J.M. 2003. The effects of fraud risk assessments and a risk analysis decision aid on auditors' evaluation of evidence and judgment. *Accounting Forum* Vol.27 No.3, pp.312-338.
- Stepankova, S., Harding, N., Mayorga, D.M., and Trotman, K.T. 2022. Using more effective instructional verbs to elevate auditors' professional scepticism. *International Journal of Auditing* Vol.26 No.2, pp.240-251.
- Verway, I.G.F., and Asare, S.K. 2022 The joint effects of ethical idealism and trait skepticism on auditors' fraud detection. *Journal of Business Ethics* Vol.176 No.2, pp.381-395.
- Zimbelman, M.F. 1997. The effects of SAS No.82 on auditors' attention to fraud risk factors and audit planning decisions. *Journal of Accounting Research* Vol.35, Supplement, pp.75-97.

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](#)

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

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

Extending application material beyond the traditional fraud triangle

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

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

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

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

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

prevent fraud, but it is the opportunity that prompted the fraud commission (Villaescusa and Amat 2022). Such preventative controls are less effective in situations involving collusion and management override (Trompeter et al. 2013).

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

Fraud Prediction Models

We also believe that ED-240 could recognise the potential contribution of existing and evolving fraud prediction models in assessing risk of material misstatement due to fraud. For example, Beneish (1997) M-Score and Dechow et al. (2011) F-Score models present opportunities to complement traditional approaches. While the use of fraud prediction models can be costly in terms of false positives (i.e., flagged clients for which material misstatement due to fraud is not present) (see Beneish and Vorst 2022 for an analysis and discussion), we note that when used in conjunction with other techniques, these models have the potential to contribute to a more complete assessment of the risk of material misstatement due to fraud. Models continue to be developed (e.g., Craja et al. 2020; Bao et al. 2020; Brown et al. 2020) and we encourage the IAASB to reflect on opportunities to extend application and explanatory material to include the use of fraud prediction models in obtaining evidence that provides an appropriate basis for the identification of potential risks of material misstatement due to fraud (paragraph 26).

Engagement Team Discussion

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

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

Whistleblowing

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

The conduct of analytical procedures

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

- Aghazadeh, S., and Joe, J.R. 2022. Auditors’ response to management confidence and misstatement risk. *Accounting, Organizations and Society* Vol.101, 101348.
- Altman, E. 1968. Financial ratios: Discriminant analysis and the prediction of corporate bankruptcy. *The Journal of Finance* Vol.23 No.4, pp.589-609.
- Ameer, R., and Othman, R. 2022. Gender, fraud opportunity, and rationalization. *Journal of Criminology* Vol.55 No.1, pp.81-105
- Asare, S.K., and Wright, A.M. 2004. The effectiveness of alternate risk assessment and program planning tools in a fraud setting. *Contemporary Accounting Research* Vol.21 No.2, pp.325-352.
- Asare, S.K., Wright, A., and Zimbelman, M.F. 2015. Challenges facing auditors in detecting financial statement fraud: Insights from fraud investigations. *Journal Forensic Investigation and Accounting* Vol.7 No.2, pp.325-352.
- Bao, Y., Ke, B., Li, B, Yu, Y.J., Zhang, J. 2020. Detecting accounting fraud in publicly traded US firms using a machine learning approach. *Journal of Accounting Research* Vol.58 No.1, pp199-235.
- Bauer, T.D., Hillison, S.M., Peecher, M.E., and Pomeroy, B. 2020. Revising audit plans to address fraud risk: A case of ‘Do as I advise, Not as I Do’? *Contemporary Accounting Research* Vol.37 No.4, pp.2558-2589.
- Beneish, M.D. 1997. Detecting GAAP violation: Implications for assessing earnings management among firms with extreme financial performance. *Journal of Accounting and Public Policy* Vol.16 No.3, pp.271-309
- Boyle, D.M., DeZoort, F.T., and Hermanson, D.R. 2015. The effect of alternative fraud models on auditors’ fraud risk judgments. *Journal of Accounting and Public Policy* Vol.36 No.6, pp578-596.
- Brazel, J.F., Jones, K.L., and Zimbelman, M.F. 2009. Using non-financial measures to assess fraud risk. *Journal of Accounting research* Vol.45 No.5, pp. 1135-1166.
- Brown, N.C., Crowley, R.M., and Elliott, W.B. 2020. What are you saying? Using topic to detect financial misreporting. *Journal of Accounting Research* Vol.58 No.1, pp.237-291.
- Carpenter, T.D. 2007. Audit team brainstorming, fraud risk identification, and fraud risk assessment: Implications of SAS No.99. *The Accounting Review* Vol.82 No.5, pp.1119-1140.
- Carpenter, T.D., and Reimers, J.L. 2013. Professional skepticism: The effects of a partner’s influence and the level of fraud indicators on auditors’ fraud judgments and actions. *Behavioral research in Accounting* Vol.25 No.2, pp.45-69.
- Chen, C.X., Trotman, K.T., and Zhou, F. 2015. Nominal versus interacting electronic fraud brainstorming in hierarchical audit teams. *The Accounting Review* Vol.90 No.1, pp.175-198.

- Chen, W., Trotman, K.T., and Zhang, X. 2022. The impact of a structured electronic interacting brainstorming platform. *Auditing: A Journal of Practice & Theory* Vol.41 No.2, pp.93-111.
- Chiu, P.C., Teoh, S.H., Zhang, Y., and Huang, X. 2023. Using Google searches of firm products to detect revenue management. *Accounting, Organizations and Society* Vol.109, 101457.
- Clarke, R.V. 2012. Opportunity makes the thief. Really? And so what?. *Crime Science* Vol.1 No.3, pp.1-9.
- Craja, P., Kim, A., and Lessmann, S. 2020. Deep learning for detecting financial statement fraud. *Decision Support Systems* Vol.139, 113421.
- Dechow, P.M., Ge, W., Larson, C.R., and Sloan, R.G. 2011. Predicting material accounting misstatements. *Contemporary Accounting Research* Vol.28 No.1, pp.17-82.
- Dennis, S.A., and Johnstone, K.M. 2018. A natural field experiment examining the joint role of audit partner leadership and subordinates' knowledge in fraud brainstorming. *Accounting, Organizations and Society* Vol.66, pp.14-28.
- Dorminey, J., Fleming, A.S., Kranacher, M., and Riley, R.A. Jr. 2012. The evolution of fraud theory. *Issues in Accounting Education* Vol.27 No.2, pp.555-579.
- Free, C. 2015. Looking through the fraud triangle: A review and call for new directions. *Meditari Accounting Research* Vol.23, No.2, pp.175-196.
- Free, C., and Murphy, P.R. 2015. The ties that bind: The decision to co-offend in fraud. *Contemporary Accounting Research* Vol.32 No. 1, pp.18-54.
- Gissel, J.L., and Johnstone, K.M. 2017. Information sharing during auditors' fraud brainstorming: Effects of psychological safety and auditor knowledge. *Auditing: A Journal of Practice & Theory* Vol.36 No.2, pp.87-110.
- Harding, N., and Trotman, K.T. 2017. The effect of partner communications of fraud likelihood and skeptical orientation on auditors' professional skepticism. *Auditing: A Journal of Practice & Theory* Vol.36 No.2, pp.111-131.
- Holtfreter, K. 2013. Gender and other people's money: An analysis of white-collar offender sentencing. *Women and Criminal Justice* Vol.23 No.4, pp.326-344.
- Hoffman, V.B., and Zimbelman, M.F., 2009. Do strategic reasoning and brainstorming help auditors change their standard audit procedures in response to fraud risk? *The Accounting Review* Vol.84 No.3, pp.811-837.
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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](#)

We agree that ED-240 establishes more robust work effort requirements, but there is an opportunity to enhance application and other explanatory material to improve auditors' understanding of, and response to, fraud or suspected fraud.

Research suggests that managers may have a preference for fraudulent activity that involves omission rather than commission (Hamilton and Smith 2021). Concerningly, this same research also highlights that auditors may perceive omissions as being less serious than commissions. Relatedly, auditors apply less scepticism to excuses for an omission (i.e., a management contention that the omission was unintended) (Hamilton et al. 2024). Paragraph A3 in ED-240 notes the prospect of omissions giving rise to intentional misstatements. We believe that this should be supplemented by expanding paragraph A152 to reinforce that the requirements in paragraph 56 are unaffected by whether the fraud or suspected fraud is characterised by commission or omission.

Hamilton, E.L., and Smith, J.L. 2021. Error or Fraud? The effect of omissions on management's fraud strategies and auditors' evaluations of identified misstatements. *The Accounting Review* Vol.96, No.1, pp.225-249.

Hamilton, E.L., Smith, J.L., and Carlisle, M. 2024. Explaining away intentional misstatements: Do management-provided excuses decrease auditor skepticism?. *Auditing: A journal of Practice & Theory* Vol.43 No.1, pp.151-166.

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: [Agree, with comments below](#)

We believe that ED-240 (and proposed conforming and consequential amendments to ISA 700 and ISA 701) do have the potential to enhance transparency but are of the view that the IAASB should temper expectations as to the extent of any enhancement and consider the potential costs of the proposed changes. Research is mixed, but suggests that improve transparency, if any, will likely be small.

We note that beyond the requirement to disclose fraud related matters that must be discussed with those charged with governance, the major change introduced with the aim of improving transparency is Key Audit Matters relating to fraud. Church et al. (2008) notes that improved disclosures in the auditor's report could enhance the quality of communication between the auditor and users, but ISA 701 limits the ability of auditors to provide information that is not already known (for example see paragraphs A34 and A35) and auditors have little incentive to disclose information in KAMs that would improve transparency (see Minutti-Meza 2021 for a discussion). We encourage the IAASB to consider enhanced application material encouraging sufficient detail in fraud KAMs.

Research on the information content in, and user reactions to, the reporting of Key Audit Matters (KAMs) or Critical Audit Matters (CAMs) reports mixed results (Minutti-Meza 2021; Burke et al. 2023; Lennox et al. 2023; Seebeck and Kaya 2023). For example, Czerney et al. 2019 find that investors do not react to the explanatory language in US, audit reports because they were already privy to the information. However, some experimental research evidence suggests that investors may perceive auditor-provided information as more credible and react to KAM disclosures (Christensen et al. 2014; Elliott et al. 2020).

KAMs may provide useful information on the audit client (e.g., Camacho-Minano et al. 2024), may enhance audit quality (e.g., Li et al. 2019; Espahbodi 2023), and may motivate improved corporate disclosure (e.g., Burke et al. 2023), so fraud KAMs should not be discounted as a means of improving confidence in capital markets, but the extent to which KAMs enhance transparency (the stated objective of the revisions) is unclear. We also note research highlighting that KAMs might not impact on audit quality (e.g., Lennox et al. 2023) and research examining the impact on audit fees of requiring KAM disclosures (which reports mixed results) (e.g., Li et al. 2019; Reid et al. 2019; Al-Mulla and Bradbury 2022).

Minutti-Meza (2021) reflects on the relationship between significant examples of management misconduct in the UK in the late 2010s and the KAMs that were reported in the Auditor's Report at the time. He concludes that the language used in KAMs is unlikely to be such that the user would be alerted to the risk of irregularities. It will be important, therefore, that users are prompted to consider fraud when reviewing KAMs. The IAASB's proposal to amend the headings to reinforce the fraud related implications of the KAM may help in this regard, but this may draw attention away from other core messages contained in the Auditor's Report and the risk that 'boilerplate' language will attenuate any benefits remains.

Moroney et al. (2021) highlight the risk that KAMs may draw attention away from other messages that are considered core elements of the Auditor's Report and Sirois et al. (2018) find that KAMs may direct attention away from non-KAM related disclosures in the financial statements. This is likely to be especially

the case when mention is made of such an emotive term as 'fraud'. Moreover, there is a risk that KAMs relating to fraud may become standardised / boilerplate (e.g., Brasel et al. 2016). Research to date highlights that there is some variability in the linguistic characteristics of KAMs (Zeng et al. 2021; Li 2022; Smith 2023), somewhat alleviating concerns around boilerplate disclosures. However, we note that the impact of disclosing that there are no fraud related KAMs on auditor judgments is presently unclear and standardised KAMs may be drafted (perhaps around revenue recognition or management override of controls) that relieve the auditor of having to say that there are no fraud KAMs, and to minimise potential liability that this may give rise to. In this regard, Kachelmeier et al. (2020) find that the potential for KAMs to forewarn of issues, and the perception that KAMs may disclaim auditors of responsibility, may lead auditors to be predisposed toward reporting KAMs. In addition, we note research highlighting that CAMs can reduce perceptions of auditor culpability when the auditor fails to detect fraud (Brown et al. 2020). By comparison, there is research highlighting that KAMs have the potential to increase assessments of auditor negligence (Gimbar et al. 2016).

We believe that, on balance, the detail that auditors report in fraud KAMs is likely to be limited, thereby limiting any improvements in transparency. We encourage the IAASB to consider further application material encouraging information relevant fraud KAMs.

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- Brasel, K., Doxey, M.M., Grenier, J.H., and Reffett, A. 2016. Risk disclosure preceding negative outcomes: The effects of reporting critical audit matters on judgments of auditor liability. *The Accounting Review* Vol.91, No.5, pp.1345-1362.
- Brown, T., Majors, T.M., and Peecher, M. 2020. Evidence on how different interventions affect juror assessment of auditor legal culpability and responsibility for damages after auditor failure to detect fraud *Accounting, Organizations and Society* Vol.87, 101172.
- Burke, J.J., Hoitash, R., Hoitash, U., and Xiao, S. 2023. The disclosure and consequences of US critical audit matters. *The Accounting Review* Vol.98 No.2, pp.59-95.
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- Christensen, B.E., Glover, S.M., and Wolfe, C. 2014. Do critical audit matter paragraphs in the audit report change nonprofessional investors' decisions to invest? *Auditing: A Journal of Practice and Theory* Vol.33 No.4, pp.71-93.
- Czerney, K., Schmidt, J., and Thompson, A. 2019. Do investors respond to explanatory language included in unqualified audit reports? *Contemporary Accounting Research* Vol.36 No.1, pp.198-229.
- Elliott, W.B., Fanning, K., and Peecher, M. 2020. Do investors value higher financial-reporting quality, and can expanded audit reports unlock this value? *The Accounting Review* Vol.95, No.2, pp.141-165.
- Espahbodi, R., Lin, J., Liu, N., Mock, T.J., and Song, M. 2023. The effect of reporting key audit matters on audit fees and financial reporting quality: Evidence from Hong Kong. *Journal of International Accounting Research* Vol.22 No.2, pp.83-102.
- Gimbar, C., Hansen, B., and Ozlanski, M. 2016. The effects of critical audit matter paragraphs and accounting standard precision on auditor liability. *The Accounting Review* Vol.91 No.6, pp.1629-1646.
- Kachelmeier, S., Rimkus, D., Schmidt, J., and Valentine, K. 2020. The forewarning effect of critical audit matter disclosures involving measurement uncertainty. *Contemporary Accounting Research* Vol.37 No.4, pp.2186-2212.

- Lennox, C., Schmidt, J., and Thompson, A. 2023. Why are expanded audit reports not informative to investors? Evidence from the United Kingdom. *Review of Accounting Studies* Vol.28 No.2, pp.497-532.
- Li, L. 2022. Key Audit Matters: Understanding the Communicative value and readability of audit reports. New Zealand External Reporting Board. Wellington: New Zealand. Available at <https://www.xrb.govt.nz/dmsdocument/4741>
- Li, H., Hay, D., and Lau, D. 2019. Assessing the impact of the new auditor's report. *Pacific Accounting Review* Vol.31 No.1, pp.110-132.
- Moroney, R. Phang, S., and Xiao, X. When do investors value key audit matters? *European Accounting Review* Vol.30, No.1, pp.63-82.
- Minutti-Meza, M. 2021. The art of conversation: the expanded audit report. *Accounting and Business Research* Vol.51 No.5, pp.548-581.
- Reid, L.C., Carcello, J.V., Li, C., Neal, T.L. 2019. Impact of auditor report changes on financial reporting quality and audit costs: Evidence from the United Kingdom. *Contemporary Accounting Research* Vol.36 No.3, pp.1501-1539
- Seebeck, A., and Kaya, D. (2023). The power of words: An empirical analysis of the communicative value of extended auditor reports. *European Accounting Review* Vol.32 No.5, pp.1185-1215.
- Sirois, L.P., Bédard, J., and Bera, P. 2018. The informational value of key audit matters in the auditor's report: Evidence from an eye-tracking study. *Accounting Horizons* Vol.32 No.2, pp.141-162.
- Smith, K. W. 2023. Tell me more: A content analysis of expanded auditor reporting in the United Kingdom. *Accounting, Organizations and Society* Vol.108, 101456.
- Zeng, Y., Zhang, J.H., Zhang, J., and Zhang, M. 2021. Key audit matters reports in China: their descriptions and implications of audit quality. *Accounting Horizons* Vol.35 No.2, pp.167-192.

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: No response

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](#)

We do not agree with the IAASB’s decision not to include a stand-back requirement in ED-240. Research highlights the advantages in having auditors make a second judgment (e.g., Brasel et al. 2019; Zimbelman 2022) and the benefits of auditor’s challenging their own judgment processes (Grenier 2017; Harding and Trotman 2017). Identified circumstances, in isolation, may appear innocuous, but when considered with regard to the full suite of evidence collected, may highlight that the auditor has not collected sufficient appropriate evidence. Specifically related to stand-back provisions, Zhu et al. (2024) highlight the benefits of stand-back on auditor fraud judgments.

This reflection on the evidence obtained and the wholistic interpretation of that evidence, makes for a more robust consideration of fraud in an audit of financial statements. While we acknowledge stand-back provisions in other standards, we believe that the importance of a wholistic evaluation of the evidence warrants a specific stand-back requirement in the revised standard on fraud. This would also facilitate specific application and explanatory material on the application of stand-back with reference to fraud.

We further note the IAASB’s comment in the Explanatory Memorandum that paragraph 21 of ED-240 “provides a robust overall check for responses to the assessed risks of material misstatement due to fraud” (p.31). Paragraph 21 in ED-240 is aimed at reinforcing the exercise of an appropriate level of professional scepticism while considering fraud in an audit of financial statements. While the exercise of professional scepticism is critically important in the execution of any stand-back that may be required, stand-back is more than just the exercise of professional scepticism. Moreover, we note in our response to Question 2 our concern that paragraph 21 does not encourage an appropriate level of auditor work effort when exercising professional scepticism. We do not believe, therefore, that paragraph 21 is a substitute and will not achieve the benefits that research suggests will derive from a stand-back requirement. We encourage the IAASB to consider introducing a stand-back requirement before issuing the revised standard.

Brasel, K.R., Hatfield, R.C., Nickell, E.B., and Parsons, L.M., 2019. The effect of fraud risk assessment frequency and fraud inquiry timing on auditors’ skeptical judgments and actions. *Accounting Horizons* Vol.33 No.1, pp.1-15.

Grenier, J.H. 2017. Encouraging professional skepticism in the industry specialization era. *Journal of Business Ethics* Vol.142, No. 2, pp.241-246.

Harding, N., and Trotman, K.T. 2017. The effect of partner communications of fraud likelihood and skeptical orientation on auditors’ professional skepticism. *Auditing: A Journal of Practice and Theory* Vol. 36 No.2, pp.111-131.

Zhu, S., Phang, S.Y., Wang, I.Z., and Cooray, A. 2024. How do the stand-back requirement and root cause analysis influence auditors’ fraud judgments? Working Paper. Monash University.

Zimbelman, A.F. 2022. Can auditors improve their judgment by drawing on the crowd within? *Contemporary Accounting Research* Vol.39 No.2, pp.1334-1357.

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: [No response](#)

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 701⁸) to promote the application of the ISAs in an integrated manner?

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

Overall response: [No response](#)

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*

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](#)

Responses to assessed risk of material misstatement

In the absence of a specific question on auditor responses to assessed risk of material misstatement due to fraud (i.e., paragraphs 43-54 and associated application and explanatory material), we provide our comments here.

We encourage the IAASB to consider introducing requirements and associated application and explanatory material that requires auditors to determine evidence that would be indicative of the realisation of the identified risks of material misstatement due to fraud and the response that will be triggered should such evidence be encountered.

Research highlights that auditors may not effectively respond to elevated fraud risk assessments, often overly relying on past procedures and extending procedures in the audit plan rather than performing new procedures specifically related to the changed risk (e.g., Zimbelman 1997; Asare and Wright 2004; Asare et al. 2015; Bauer et al 2020; Aghazadeh and Joe 2022). Care is needed to ensure that auditors appropriately respond to the assessed risk of material misstatement.

Research on improving auditors' responses to heightened fraud risk is limited. Austin (2023) finds that planning for the appropriate response when information encountered during fieldwork indicates fraud risk may enhance auditors' attention to fraud while collecting evidence. This suggests an audit plan that both specifies what the auditor is looking for when conducting fieldwork and the response that will be initiated should such evidence be encountered. With one exception (paragraph 53), ED-240 does not speak to the type of information the auditor is looking for, nor the response that will be activated. To enhance the effectiveness with which auditors respond to the assessed risk of material misstatement due to fraud, we encourage the IAASB to require the determination of information that would be indicative of the realisation of the risk of fraud and the response that would be initiated should such evidence be encountered.

Aghazadeh, S., and Joe, J.R. 2022. Auditors' response to management confidence and misstatement risk. *Accounting, Organizations and Society* Vol.101, 101348

Asare, S.K., and Wright, A.M. 2004. The effectiveness of alternate risk assessment and program planning tools in a fraud setting. *Contemporary Accounting Research* Vol.21 No.2, pp.325-352.

Asare, S.K., Wright, A., and Zimbelman, M.F. 2015. Challenges facing auditors in detecting financial statement fraud: Insights from fraud investigations. *Journal Forensic Investigation and Accounting* Vol.7 No.2, pp.325-352.

Austin, A.A. 2023. Remembering fraud in the future: Investigating and improving auditors' attention to fraud during testing. *Contemporary Accounting Research* Vol.40 No.2, pp.925-951.

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

Zimbelman, M.F. 1997. The effects of SAS No.82 on auditors' attention to fraud risk factors and audit planning decisions. *Journal of Accounting Research* Vol. 35, Supplement, pp.75-97.

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](#)

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: [No response](#)