

## 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)	ICAEW
Name(s) of person(s) responsible for this submission (or leave blank if the same as above)	
Name(s) of contact(s) for this submission (or leave blank if the same as above)	
E-mail address(es) of contact(s)	Helen.Pierpoint@icaew.com
Geographical profile that best represents your situation (i.e., from which geographical perspective are you providing feedback on the ED). Select the most appropriate option.	<a href="#">Global</a>
The stakeholder group to which you belong (i.e., from which perspective are you providing feedback on the ED). Select the most appropriate option.	<a href="#">Member body and other professional organization</a>
Should you choose to do so, you may include information about your organization (or yourself, as applicable).	<p>ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 169,000 chartered accountant members in over 146 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.</p> <p>Recognised internationally as a leading authority and source of expertise on audit and assurance issues, the ICAEW Audit and Assurance Faculty is responsible for audit and assurance submissions on behalf of ICAEW. The faculty has over 25,000 members drawn from practising firms and organisations of all sizes in the private and public sectors.</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).

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

ICAEW welcomes the opportunity to comment on the Exposure Draft of Proposed ISA 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, published by the International Auditing and Assurance Standards Board (IAASB) on 6 February 2024 (ED-240). For questions on this response, please contact the ICAEW Audit and Assurance Faculty at [tdaf@icaew.com](mailto:tdaf@icaew.com). This response of 5 June 2024 has been prepared by the ICAEW Audit and Assurance Faculty.

**MAIN POINTS**

Many players in the financial reporting ecosystem, not just auditors, directly or indirectly influence the likelihood that fraud will be prevented or detected. There is, however, a public perception that auditors can and should be doing more to detect fraud. While ICAEW appreciates this sentiment and understands the steps IAASB is taking in the form of proposed revisions to the standard, we also recognise that fraud, first and foremost the responsibility of management and those charged with governance (TCWG), is a complex issue. Tackling fraud requires the combined efforts of companies, investors and regulators, as well as auditors.

**We agree that the proposed revisions provide, to a certain extent, greater clarity regarding an auditor's responsibilities relating to fraud and reinforce behaviours and attitudes that good audits already display.**

**We also agree with IAASB's decision not to proceed with including a separate stand-back requirement, and with the proposed effective date.**

**We do not agree, however, with the proposed enhanced requirements regarding communication of fraud-related matters in the auditor's report because they elevate fraud over other matters and may exacerbate misconceptions about what an audit is capable of achieving.**

**We also do not agree that efforts to clarify the auditor's responsibilities in relation to third-party fraud have been successful.**

**We have concerns about the scalability of some of the proposals.**

ICAEW consulted with a wide range of stakeholders including auditors across the full range of the UK audit market, financial crime specialists, ethics partners, academics, and forensic experts.

For many auditors, concerns relate to the moment in time when an auditor can be expected to 'spot' a fraud and raise the alarm. The reality for many auditors familiar with corporate fraud is that they emerge from the shadows over time. A fraud might start with directors changing an accounting policy or method, or pushing the boundaries in existing policies or methods, at which point there is no error, still less a fraud. Over time, often several years, changes and boundary-pushing degenerate into error, and finally fraud.

ICAEW believes that standard-setting must be complemented by action by companies, timely intervention and guidance from regulators, and improved training. Nevertheless, ED-240 is a step forward and we draw attention to the following key issues which we encourage IAASB to address.

**Key Audit Matters**

ICAEW supports improved transparency relating to matters of genuine importance to users of financial statements in the auditor's report. We believe this can be best achieved by applying a 'fraud lens' to the existing ISA 701 requirements.

We do not agree with IAASB's proposals for fraud-related disclosures in the auditor's report (ED-240 Paras. 61 – 64). The audit opinion is not a fraud opinion. Requiring auditors to disclose the presence or absence

of Key Audit Matters (KAM) clearly described as relating to fraud singles fraud out as having particular importance to businesses and auditors. ICAEW is not persuaded by the suggestion that fraud matters more than say, cyber risks or inflation. The proposals appear to suggest that this is so.

It is important that users of financial statements understand the inherent limitations of an audit. Rightly or wrongly, users may mistake a statement to the effect that there are no KAM related to fraud as a clean bill of health and conclude that no fraud occurred. This is not a desirable outcome.

### **Third-party fraud**

One of the key issues identified in IAASB's project proposal was the extant standard's lack of clarity with respect to third party fraud (EM, Section 1-J, Para. 89(b)). We note that intentional acts by third parties are included in the definition of fraud in ED-240. ICAEW does not believe that this, together with the 'additional responsibilities' (ED-240 Para. A16) arising from third-party fraud, provides the intended clarification.

Many third-party frauds do not directly impact the financial statements and IAASB needs to address this in the application material. The standard should explain what can trigger the 'additional responsibilities' and be clearer about what the auditor's response, should they identify such fraud, may involve.

### **Scalability**

ICAEW is not persuaded that ED-240 is sufficiently scalable.

Many stakeholders we consulted represented or had backgrounds in small and medium-sized audit firms. Their concerns lay primarily with ED-240's forensic-related content which in practice is generally more applicable to larger firms. Although confined to the application material, with 12 references in ED-240 as opposed to one in the extant standard, the emphasis on forensic experts or individuals with forensic skills is hard to ignore.

Para. A34 of extant ISA 240 simply states that forensic experts may be engaged as part of the auditor's response to identified risks of material misstatement due to fraud. This is appropriate. The pool of external forensic experts available to firms without their own in-house team is small, and non-existent in some jurisdictions. It remains the case that forensic experts are rarely used routinely outside large audits. The standard should make it clearer that not every audited entity or every instance of fraud necessarily calls for the involvement of forensic specialists, and that any involvement should be contingent on the auditor's judgement and the circumstances of a given fraud. Regardless of IAASB's intentions, the extensive references to forensic specialists and skills in ED-240 could be read as diminishing the responsibility of auditors to exercise judgement in this area.

IAASB should condense and consolidate the proposed forensic-related material into fewer paragraphs which stress the need to base conclusions on the need for specialist engagement on the complexity of the fraud. Finer detail on how and when forensic specialists may assist in an audit could then be issued as non-authoritative guidance. If the auditor concludes that a forensic specialist is not required or appropriate, alternative procedures should be outlined, such as consulting with another auditor who has experience with corporate fraud.

Paragraph 55(a) of ED-240 does not deal with the situation in which there is no 'level of management (...) at least one level above those involved', with whom the auditor could make fraud-related enquiries, especially for smaller and less complex entities. It is important that the revised standard clarifies to whom auditors of such entities address their fraud enquiries.

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

### **Detailed comments (if any):**

ICAEW welcomes IAASB's efforts to provide clarity around the auditor's responsibilities relating to fraud in an audit of financial statements. However, the revisions do not adequately address the auditor's responsibilities relating to third-party fraud. Intentional acts by third parties have been clarified in ED-240 as falling under the umbrella of the definition of fraud (ED-240 Para. A21). IAASB has stated that it 'did not support expanding the role of the auditor to detect third-party fraud (...) not directly related to a risk of material misstatement due to fraud (...)'*(EM, Section 1-J, Para. 92)* while simultaneously stating in ED-240 Para. A16 that third-party fraud 'may also give rise to additional responsibilities for the auditor under law, regulation, or relevant ethical requirements (...)'. Clarity is needed regarding the circumstances which may trigger these additional responsibilities and the expected work effort in the event of a third-party fraud. Of particular concern are those instances of third-party fraud which do not directly impact the financial statements. The inexactitudes of the proposals might lead auditors and others to infer that their responsibilities extend to these situations.

We are also concerned by clarifications around the auditor's responsibilities for 'qualitatively' material fraud (ED-240 Para. 8). We agree that the materiality of a fraud depends on its circumstances as well as its quantum. We also appreciate that the application material (Paras. A11 and A155) expands on this (auditors should consider who perpetrated the fraud and why). Nevertheless, the determination of what is and what is not a material fraud can be a challenging subjective judgement and we suggest including more specific examples of a quantitatively immaterial fraud that is qualitatively material, over and above the high-level circumstances already proposed.

ED-240's emphasis on qualitative as well as quantitative fraud may lead to an expectation that auditors increase their work effort by, for example, reviewing every expense claim for every director and following up every error irrespective of quantitative materiality, which would be neither desirable nor feasible. An alternative interpretation is that the ED aims to clarify the auditor's response supposing they do identify non-material fraud. Clearer wording around this and the associated work effort would be helpful to avoid misunderstandings and inconsistent practices.

The proposals could also make a clearer distinction between financial reporting fraud and fraud through misappropriation of assets. The latter is fairly common for certain types of businesses such as retailers and ED-240 could have more focus on financial reporting fraud, which may be rarer but potentially more damaging to the business.

In its 2024 '[Report to the Nations](#)', the Association of Certified Fraud Examiners found that although financial reporting fraud is the least common form of fraud, when it occurs, it results in the highest median loss for companies. It is also harder to detect. Risk factors for financial reporting should have more prominence in the engagement team discussion and we urge IAASB to amend ED-240 Para. 29 to reflect this. In addition, the auditor cannot be expected to consider every act of third-party misappropriation of assets, regardless of its materiality and impact on the audited entity. This should be made clear in ED-240 Para A21.

ICAEW supports IAASB's approach to the inherent limitations of an audit. In May 2021 the Financial Reporting Council (FRC) revised ISA (UK) 240 to address some of the concerns raised by Sir Donald Brydon in his 2019 [review](#) of the quality and effectiveness of audit, including providing increased clarity as to the auditor's obligations in respect of fraud. One of these revisions was to make clear that the auditor's responsibilities were not diminished by the inherent limitations and challenges of an audit in relation to fraud (ISA (UK) 240 Para. 7-1). IAASB has followed suit in its own revisions to ISA 240.

We agree with the proposal to place the description of the auditor's responsibilities (ED-240 Para. 2) before those of management and TCWG (ED-240 Para. 3), as well as before the inherent limitations caveat (ED-240 Paras. 9 – 11). ISA 240 is an auditing standard and the description of the auditor's responsibilities should go first.

The primary responsibility for the prevention and detection of fraud rests with management and TCWG, however, and there is an unavoidable risk that some material misstatements may not be detected even in a fully ISA-compliant audit. The proposals prudently continue to make this clear.

There is a danger, however, that the proposals could be perceived as raising the bar for auditors with no corresponding levelling-up for directors and TCWG. Although there is undoubtedly a public perception that auditors can and should be doing more to detect fraud to help prevent the unexpected failures of companies due to fraud, directors, governments, and audit regulators must also play their part and be held to account. In July 2022, ICAEW published a [report](#) *Sharpening the Focus on Corporate Fraud: An Audit Firm Perspective* in which we explain what more can be done, and what can be done differently, by all these groups, not just auditors, to better detect fraud, and thereby reduce the risk of disorderly corporate failure. Collective responsibility must be kept in mind when it comes to improving external reporting in relation to fraud.

*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):**

Professional scepticism by its very nature is subjective. Its application requires careful consideration when it comes to fraud which can be complex.

As ISA 200 Para. 13(l) rightly points out, professional scepticism is an attitude and therefore may not be something that can be cemented by auditing standards. Auditing standards must at least be supplemented by enhanced training, well-articulated methodologies, and informal encouragement of the right behaviours to foster a culture and mindset of independence and robust challenge of management.

IAASB notes in its August 2017 *Toward Enhanced Professional Scepticism* [report](#), jointly issued with the International Ethics Standards Board for Accountants (IESBA) and the International Accounting Education Standards Board (IAESB), that 'standard setting alone will not be enough' and that 'education and continuing, effective training remain vital' to the exercise of professional scepticism

Nevertheless, IAASB is right to emphasise the importance of maintaining this attitude towards the end of the audit (in ED-240 Para. A30). This is when pressures, such as the audited entity insisting on a sign-off date, may erode the auditor's ability or willingness to challenge and question. The examples provided of such pressures, along with other impediments to the exercise of professional scepticism, and of mitigating actions (ED-240 Para. A25) are also welcome.

In the spirit of encouraging the auditor to approach each audit with a fresh pair of eyes, we do not object to the removal of the reference to the auditor not relying on preconceptions based on past experience of the honesty and integrity of management and TCWG in Para. 12 of extant ISA 240.

We do not agree, however, with the removal of the reference in extant ISA 240 Para. 13 to the auditor's ability to accept records as genuine and unmodified unless they suspect the contrary. Despite its preservation in ISA 200 Para. A21 and IAASB's insistence that this was 'not intended to increase the work effort' (EM, Section 1-D, Para. 25), it is unclear why the reference has been removed from the requirements themselves. It has the potential to sow confusion around the efforts an auditor needs to expend to validate the legitimacy of records and documents. An expectation may be inadvertently created that audit teams treat every record or document as potentially fraudulent. We believe that either the reference should be reinstated as a requirement in ED-240 (since it is an important factor in the development of the auditor's response to fraud) or a clear cross reference to the relevant section of ISA 200 should be made.

We note that several of the application material paragraphs dealing specifically with professional scepticism are simply restatements of the requirements of other standards with no substantively new content added. IAASB should try to build on the relevant foundational requirements with a 'fraud lens', rather than simply repeat material. ED-240 Para. A13, for example, recites concepts from ISQM 1 and Para. A14 appears directly lifted from ISQM 1 (Para. A31). The same is true of ED-240 Para. A25 which both repeats ISA 220 Para. A33 and directs the auditor to ISA 220 Paras. A34 – A36. The scenario-based examples of impediments to professional scepticism presented in this paragraph are the same as those presented in ISA 220. As a minimum, IAASB should consider simply referring to the other standards.

*Risk Identification and Assessment*

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

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

(See ED, paragraphs 26–42)

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

**Detailed comments (if any):**

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

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

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

Examples we have identified include:

- ED-240 Para. 26 is lifted almost entirely verbatim from ISA 315 Para. 13, with the only adjustment being that the auditor should take 'fraud risk factors' into account when identifying and assessing risks of material misstatement.
- There is little substantive difference between ED-240 Para. 33 and ISA 315 Para. 19. Again, the only real difference is the addition of 'fraud risk factors' when gaining an understanding of the entity and its environment and the applicable financial reporting framework.
- There is a lack of clarity regarding the interrelationship between ED-240 Para. 34(a) and ISA 315 Para. 21(a). ISA 315 already requires the auditor to obtain an understanding of how management's oversight responsibilities are carried out, including the entity's culture and management's commitment to integrity and ethical values. The proposed ED-240 requirement is not articulated in a clearly incremental manner
- The language used in ED-240 Para. 36(a) is almost identical to that of ISA 315 Para. 24(a), the only difference being that the reference to the effectiveness of controls in ED-240 specifically cites controls to prevent or detect fraud.

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



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

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

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

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

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

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

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

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

**Detailed comments (if any):**

Most SMPs we consulted had concerns about the requirement of ED-240 Para. 55(a) to make enquiries about identified or suspected fraud with ‘a level of management that is at least one level above those involved.’ Applying this requirement to smaller, less complex entities with a simplified management structure and no internal audit function or audit committee is problematic.

In many cases of corporate fraud, it is not uncommon for there to be a notable void above the individual(s) involved, of whom to make enquiries. The standard does not make clear what the auditor’s response should be in this scenario.

Where an entity has a simplified management structure, particularly where management and TCWG are one and the same, the standard does not alert the auditor to potential ‘tipping off’ concerns when making fraud-related enquiries. In the UK and other jurisdictions a criminal offence is committed by making a disclosure likely to prejudice a money laundering investigation. This could include discussing an identified or suspected fraud with the potential perpetrators. In the UK, this can lead to potential penalties of an unlimited fine and up to five years’ imprisonment.

In addition, ED-240 Para. 7 makes it clear that suspected fraud ‘includes allegations of fraud that come to the auditor’s attention during the course of the audit’, underscored by Para. A10. Neither the requirement nor the application material address clearly trivial allegations. At present ED-240 implies that any allegation must be classed as suspected fraud without exception for vexatious allegations.

We acknowledge the challenge of articulating the judgement needed to determine whether an alleged fraud is vexatious, but ED-240 could at least refer to the distinction. A good first step for any auditor in this area that should be highlighted in the revised standard, is to make enquiries with the person at the audited entity responsible for any whistleblowing function, and to inspect whistleblower files.

We agree that it makes sense to highlight the importance of considering the potential for internal control deficiencies when obtaining an understanding of identified or suspected fraud, as made clear in ED-240 Para. 55. However, the requirement for the auditor to ‘determine whether control deficiencies exist’ must not lead to any expectation that the auditor will test the operating effectiveness of controls where they otherwise would not have been tested, as in many smaller audits. The revised standard should clarify that this is not the requirement’s intent.

*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):**

ICAEW supports enhanced transparency in the auditor's report where the matters communicated are of demonstrable benefit to financial statement users and serve the public interest. However, we believe that the proposals in ED-240 Paras. 61 – 64 are fundamentally flawed.

ED-240 acknowledges that an auditor 'does not make legal determinations of whether fraud has actually occurred' (ED-240 Para. 6). However, we believe that the proposals require auditors to make what is, in effect, a legal determination in the auditor's report. A statement that there are no fraud-related Key Audit Matters (KAM) to communicate indirectly requires auditors to determine whether a fraud has taken place. The audit opinion is not a fraud opinion. It is an opinion on whether financial statements as a whole are free from material misstatement, whether due to fraud or error. The inclusion of a section on fraud-related KAM under an 'appropriate subheading that clearly describes the matter relates to fraud' or a statement that there are no fraud-related KAM to communicate undermines the understanding of this key concept among stakeholders

As acknowledged in ED-240 Paras. 9 – 11, an audit is not capable of detecting all fraud. Stakeholders may misinterpret an explicit statement that there are no fraud-related KAM as meaning that the financial statements are fraud-free. Furthermore, there is a risk that a regular KAM might encourage auditors to hide behind standard wording, where currently there is no such shield.

If auditors are required to report the presence or absence of fraud-related issues in the auditor's report, they may need to update their letters of engagement to reiterate what an audit is capable of achieving.

Furthermore, confidentiality laws in many jurisdictions preclude the auditor from reporting certain fraud matters (ED-240 Para. A178). The requirement of ED-240 Para. 64 conflicts with this. Auditors should not be put into the position of having to state, misleadingly, that there are no KAM related to fraud to communicate.

Similarly, enhanced transparency should not encourage auditors to report fraud-related matters simply for fear of the potential legal repercussions should a fraud be uncovered following an audit report which explicitly highlighted no fraud matters. The result in practice is likely to be extensive boilerplate relating to the presumed fraud risks or other generic fraud matters with little value to users of the financial statements and which deflect from genuinely significant matters unrelated to fraud.

Fraud is rarely the primary risk facing an entity. PwC's Global Risk [Survey](#) 2023 states that the top threats facing global businesses over the next 12 months are inflation, cyber risks and macroeconomic volatility. Fraud does not even feature in the top eight threats. IAASB's proposals might suggest that fraud issues have a higher profile or are the predominant risk for companies, which is demonstrably not the case.

If an auditor judges a matter relating to fraud to be of most significance in the audit, its communication to TCWG is already covered by the existing requirements of ISA 701. Rather than laying out fresh criteria for

a fraud-related KAM, ED-240 should direct its attentions to the application of the existing requirements through the fraud lens.

The revisions may also set a significant precedent when it comes to auditors providing original information, potentially raising expectations around other categories of original information that auditors should disclose, including through the requirement for auditors to consider 'significant deficiencies in internal control that are relevant to the prevention and detection of fraud' in determining key audit matters relating to fraud (ED-240 Para. 61(c)). In this case, the auditor may be disclosing more information than management is required to disclose in certain jurisdictions.

Consultees observed that these proposals appear to be an indirect attempt to enforce director responsibilities for implementing, maintaining, and monitoring a robust system of controls over fraud prevention and detection via their auditors. IAASB recognises the need to discourage boilerplate language in ED-240 Para. A173, which states that auditors should avoid 'generic or standardized language'. The effective requirement for an auditor to say something about fraud is likely to lead to the very boilerplate reporting IAASB seeks to discourage.

IAASB should seek positive outcomes, in the form of useful auditor reporting, rather than negative ones such as 'avoiding standardised language'. Avoiding standardised language is not achieved by finessing the wording of auditing standards. It is achieved by a complex set of behavioural dynamics involving auditors, the companies engaging them, the regulators inspecting them and investors. Standardised language is a safe default position. It is almost inevitable that auditors and companies will seek safety by emulating both themselves and each other over time, but this does not mean that the process of getting there is not worthwhile.

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):**

We do not agree with IAASB's proposals relating to transparency in the auditor's report about matters related to fraud, nor do we believe they should be extended to audits of non-listed entities.

There is little appetite to expand existing KAM to non-listed entities and it makes no sense for fraud alone to be the exception. This would give fraud an even greater, inappropriate pre-eminence.

The FRC extended the existing requirement for the auditor to explain to what extent the audit was capable of detecting irregularities, including fraud, from PIE audits only, to non-PIE audits (ISA (UK) 700 (Revised)) in 2019. Despite urging auditors to tailor such disclosure to each audited entity's individual circumstances, we believe that the value that the FRC's revision has provided to financial statement users has not been commensurate with the length that it has added to the auditor's report.

*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):**

The proliferation of stand-back requirements in auditing standards was highlighted by consultees. It is reassuring to note that IAASB is cognisant of this, acknowledging in EM, Section 1-J, Para. 108 that such requirements already exist in four other ISAs, including those in ISA 700 which act as overall stand-backs on whether the financial statements are materially misstated. We agree with the decision not to duplicate this content in ED-240.

We note the analysis on the various stand-backs across the ISAs presented to IAASB by the Audit Evidence Task Force in September 2023, and that a project to improve the coherence of the stand-back architecture of the ISAs will be considered as part of the new integrated risk response work stream. We agree with a more holistic approach to codifying the stand-back requirement and hope that IAASB's efforts focus on what a stand-back entails to improve consistency in application. The finer details of where stand-back requirements are needed will follow.

*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):**

ICAEW notes that the ISA for LCE has been finalised. However, the ultimate arbiters of which entities are in scope are local audit regulators. It may not be adopted in some jurisdictions. It is therefore important that the ISAs remain scalable. IAASB should clarify whether and to what extent the revisions to ISA 240 will be incorporated into the ISA for LCE.

While we acknowledge a) IAASB's efforts to signpost conditional requirements (as detailed in EM, Section 1-J, Para. 113(b)) and to include application material such as ED-240 Para. A58; and b) that fraud-related matters are relevant to audits of all entities, regardless of size or complexity, there are several scalability concerns that we believe are worthy of IAASB's attention.

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

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

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

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

- In the case of 'changes in the entity's IT environment (...) which may impact the susceptibility of the entity to fraud.' (ED-240 Para. A97)
- In 'identifying and evaluating the risk of material misstatement due to fraud.' (ED-240 Para. A35)
- In 'performing the review of accounting estimates' (ED-240 Para. A140).

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

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

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

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

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

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

Further scalability concerns include:

- The potential expectation that auditors will test the operating effectiveness of controls even in a fully substantive audit implied by ED-240 Para. 55 ([Question 4](#))
- The requirement of ED-240 Para. 55(a) for fraud-related enquiries with 'a level of management that is at least one level above those involved.' ([Question 4](#))
- The projected expansion of ED-240 requirements regarding transparency in the auditor's report to audits of financial statements of entities other than listed entities ([Question 6](#)).

#### *Linkages to Other ISAs*

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

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

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

#### **Detailed comments (if any):**

Notwithstanding IAASB's efforts to incorporate and reference material from other auditing standards in ED-240, we note elsewhere in this response several examples of material inappropriately excluded or included from other ISAs, and issues of alignment and repetition with little substantially new or fraud-specific perspectives, such as:

- Removal of the reference to auditor acceptance of documents and records as genuine from ISA 240, and its preservation in ISA 200 ([Question 2](#)).

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

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

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

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

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

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

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

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

- Repetition of material relating to professional scepticism from ISQM 1 and ISA 220 with no ostensible fraud-specific angle ([Question 2](#)).
- Repetition of and circularity of references to ISA 315 (Revised 2019) with insufficient application of the 'fraud lens' ([Question 3](#)).
- Misalignment of fraud risk assessment considerations between ED-240 and ISA 315 ([Question 3](#)).

*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):**

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

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

*Translations*

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

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

**Detailed comments (if any):**



*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):**

Providing the Fraud, Going Concern and Listed Entity projects are delivered as a package, ICAEW has no objection to the effective date. 18 months from approval to effective date should give firms sufficient time to address the proposed changes.