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529 Fifth Avenue, 6th floor
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Exposure Draft: Proposed International Standard on Auditing (ISA) 240 (Revised), The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements (ED-240)

Dear Mr. Botha,

Ernst & Young Global Limited, the central coordinating entity of the Ernst & Young organization, welcomes the opportunity to offer its views on the Exposure Draft, *Proposed International Standard on Auditing (ISA) 240 (Revised), The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements (ED-240)*, issued by the International Auditing and Assurance Standard Board (IAASB).

We support the IAASB's issuance of ED-240 and agree that revisions to ISA 240 are needed to effectively enhance or clarify the auditor's responsibilities related to fraud in an audit of financial statements. We also agree there are opportunities for enhancements that would assist in addressing the expectation gap¹ related to fraud, but we believe it is equally important to recognize that enhancements to the ISAs alone are not likely to have a substantial enough effect on the expectation gap.

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

As we included in our response to the *IAASB's Discussion Paper on Fraud and Going Concern in an Audit of Financial Statements* (dated 1 February 2021), we continue to believe that additional actions could be taken by others to address the expectation gap, including enhancements to corporate reporting, with a focus on expanding transparency related to management's responsibilities for prevention of fraud. We also see an opportunity for improvements in corporate governance for public

¹ As described in the *IAASB Discussion Paper on Fraud and Going Concern in an Audit of Financial Statements*, the audit expectation gap is "the difference between what users expect from the auditor and the financial statement audit, and the reality of what an audit is" (page 11).

interest entities, such as setting expectations for a system of strong internal control that specifically addresses fraud risk as well as management and director certifications on the content of financial statements and internal control over financial reporting. We strongly encourage the IAASB to continue to engage with stakeholders and organizations that address corporate reporting and corporate governance about further actions that can be taken to address management's responsibilities for prevention of fraud.

As it relates to the proposals included in ED-240, our more substantive concerns are summarized below. Overall, we are supportive of the IAASB's project objectives and the underlying intent of the revision of ISA 240. However, given the paramount importance of the auditor's responsibilities in relation to fraud, as well as the heightened attention from stakeholders, we believe it is critical that ED-240 is unequivocally clear and capable of consistent implementation. On that basis, we have many comments and drafting suggestions that we believe are necessary to achieve clarity or consistency within ED-240 and with other ISAs.

Transparency in the auditor's report

In ED-240, we find it unclear as to whether there is one process to determine key audit matters (KAMs) (under ISA 701²) that includes the consideration of fraud-related matters, or a separate parallel process for determining KAMs related to fraud from which additional matters are reported together with the matters from the ISA 701 process under the heading of key audit matters in the auditor's report.

We believe the IAASB should incorporate the auditor's assessment of fraud risk, and the related impact it has on our audit strategy and response, in the determination of KAMs under the existing requirements in ISA 701 rather than establishing new requirements for the determination of fraud-related KAMs in ISA 240. We are concerned with an approach of determination of KAMs for specific topics, irrespective of whether they genuinely represent key aspects of the audit, because this diminishes the overall purpose of KAMs to be matters of most significance in the audit.

Although we agree with the inclusion of identified and assessed risks of material misstatement due to fraud and identified fraud as required considerations in the auditor's determination of KAMs, we do not believe suspected fraud should be included. If it remains included, there is a need for specific further guidance. We believe unintended consequences are likely to arise if the auditor is put in a position of disclosing original information about suspected fraud, particularly when it may be determined to be unfounded or erroneous, including reputational damage to the entity and reduced transparency between management and the auditor, as well as a further widening of the expectation gap when the auditor communicates information that management is not required to communicate.

We also disagree with requiring a statement in the auditor's report when there are no fraud-related KAMs that there are no matters related to fraud to be reported. Such a statement may be misunderstood by financial statement users as providing an opinion or disclosure as to whether fraud has occurred at the entity.

² ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

Auditors' required procedures related to fraud or suspected fraud

We do not believe it is practical for the auditor to perform all the required procedures proposed in ED-240 for *all* instances of fraud or suspected fraud, including those that are clearly inconsequential, such as minor instances of misappropriation of assets by employees or customers. We suggest that the requirements be bifurcated to require an initial understanding of the fraud or suspected fraud, through inquiries, in all instances. We then believe it would be more realistic to require further procedures by the auditor only when the auditor determines the fraud or suspected fraud has the potential to be more than clearly inconsequential and warrants further understanding and possible actions.

Other substantive concerns with ED-240

Third-party fraud: To assist auditors in understanding the treatment of third-party fraud in ED-240, we believe additional guidance is needed. We include suggestions in our letter that include ED-240 more clearly describing the potential perpetrators of third-party fraud, which would then facilitate a more focused identification of risks and enable auditors to design appropriate responses. We also believe that explicit thresholds and supporting guidance should be established to aid auditors in determining when actions by third parties constitute fraud or suspected fraud for purposes of ED-240. Such clarity is essential for the auditor determining the applicability of the requirements to respond to identified or suspected fraud.

*Clarity with relationship to ISA 315 (Revised 2019)*³: While we agree that ED-240 enhances the linkage to the requirements in ISA 315 (Revised 2019), in our view, greater clarity is needed to distinguish the *incremental* requirements in ED-240 necessary to apply a fraud lens to the risk assessment process from the requirements of ISA 315 (Revised 2019) that when executed as intended would not require any additional work effort to identify and assess risks of material misstatement due to fraud. We also believe that the requirements and application material in ED-240 need closer alignment in several respects with their equivalent requirements in ISA 315 (Revised 2019) and have suggested several clarifications.

Controls over journal entries: We are unclear as to whether the requirement for the auditor to identify “controls that address the risks of material misstatement due to fraud at the assertion level, including controls over journal entries, designed to prevent or detect fraud” is intended to be consistent with the related requirement in ISA 315 (Revised 2019), or whether the IAASB intends for ED-240 to require the auditor to understand controls beyond those already required to be understood by ISA 315 (Revised 2019).

Risk of management override of controls: We believe that ED-240 should be explicit that the risk of management override of controls is required to be identified as a risk of material misstatement due to fraud at the financial statement level for all audits, and thus a significant risk.

Communications with those charged with governance: The extant ISA 240 requirement that addresses required communication with those charged with governance about identified or suspected fraud has

³ ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*

not been revised in ED-240, as it continues to limit communication of fraud to only those matters involving management, employees who have significant roles in internal control, and others where fraud results in a material misstatement of the financial statements. As a result, the required communication does not align with either the communication requirement for instances of non-compliance with laws and regulation in ISA 250 (Revised)⁴ or the ED-240 proposed changes to the auditor's report that describe the auditor's responsibilities to communicate with those charged with governance about all instances of fraud.

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

Written representations: We believe the new requirement in ED-240 to obtain written representations regarding management's responsibility for the design, implementation, and maintenance of internal control to prevent or detect fraud is in conflict with certain extant requirements in ISA 580⁵, ISA 210⁶ and ISA 700 (Revised)⁷. We do not believe the current description of management's responsibility for internal control, which is inclusive of fraud, is fundamentally flawed. We would therefore suggest not moving forward with the written representation in ED-240 as proposed, but if pursued, there should be appropriate conforming amendments to other ISAs. We also believe there are inconsistencies between the required representations from management regarding their disclosure of fraud to the auditor and the scope of fraud that the auditor has responsibilities to address.

Our responses to the specific questions on which the IAASB is seeking feedback are set out below.

Responsibilities of the Auditor

Q1. 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)

Agree, with comments below

We believe that ED-240 clearly sets out the auditor's responsibilities relating to fraud in an audit of financial statements and are supportive of the IAASB's revisions to the Introduction section of ED-240, with the exception of third-party fraud for which we believe the auditor's responsibilities are not as clear as they need to be for consistent understanding and implementation.

⁴ ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*

⁵ ISA 580, *Written Representations*

⁶ ISA 210, *Agreeing the Terms of Audit Engagements*

⁷ ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

We acknowledge that paragraph A21 of ED-240 states that third-party fraud is included in the definition of fraud (and is therefore included in the terms “identified or suspected fraud” used throughout ED-240). However, we believe that paragraph A21 of ED-240 can be clarified, at a minimum, as follows:

A21. **Fraud or suspected fraud committed against the entity by customers, suppliers, service providers, or other external parties is generally described as third-party fraud.** Fraud as defined in paragraph 18(a) can include an intentional act by a third party, **and accordingly, if an intentional act by a third party is identified or suspected by the auditor that could result in misappropriation of the entity’s assets or fraudulent financial reporting by the entity, the auditor performs the audit procedures in paragraphs 55 – 59.** ~~Fraud or suspected fraud committed against the entity by customers, suppliers, service providers, or other external parties is generally described as third-party fraud.~~

Additionally, we note that the definition of “third-party” in paragraph A21 of ED-240 extends to “customers, suppliers, service providers, or other external parties”. We also note that paragraph A52 of ED-240 makes mention of “third-party relationships”, which are not defined in ED-240 and which appear distinct from related party relationships (as addressed by ISA 550⁸) and external parties that are unknown to the entity. We believe that paragraph A21 of ED-240 would further benefit from guidance that expands upon who perpetrators of third-party fraud may be, which would then allow for a focused identification of risks by the auditor. We suggest the IAASB consider the following distinctions in paragraph A21 of ED-240:

- ▶ Related parties, where the most significant concerns are collusion with management, overly complex transactions, or bias in the structure of transactions, as explained in ISA 550.
- ▶ Third-party relationships that include third-parties with which the entity has a relationship to support their business model such as customers, suppliers, service providers or other external parties known to the entity and with whom the entity has a business relationship. In addition to fraudulent activity that benefits the third party and creates a risk of material misstatement for the entity, the nature of these relationships may also introduce the risk of collusion with employees of the entity, as well as the risk of unauthorized access to the entity’s IT systems and assets.
- ▶ External parties unknown to the entity, which include nefarious actors that may attempt to gain unauthorized access to an entity’s IT systems and/or assets, disrupt the entity’s business operations and financial reporting processes, harm the entity’s reputation or render the entity non-compliant with laws and regulations related to data privacy.

We believe that the above clarifications would provide the right context for explaining the auditor’s responsibilities for each category, as well as how the nature of the auditor’s response to third-party fraud differs from risks of fraud internal to the entity. The clear distinction between the types of third parties will allow for the auditor’s consideration of fraud risks that could arise from transacting with

⁸ ISA 550, *Related Parties*

those parties. Refer also to our additional comments related to enhancing risk assessment procedures that address fraud risks related to third parties in our response to Q3.

We also believe that thresholds or guidance should be established to aid auditors in determining when actions by third parties constitute fraud or suspected fraud for purposes of ED-240. Such clarity is essential for determining the applicability of the requirements set forth in paragraphs 55-59 of ED-240. Refer to our response to Q4 for our suggestions in this regard.

Professional Skepticism

Q2. 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)

Agree, with comments below

Professional skepticism

While we agree that ED-240 reinforces the exercise of professional skepticism about matters relating to fraud, we suggest that the IAASB reinstate the last part of the extant requirement in ISA 240 paragraph 13 (“...recognizing the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance”) to paragraph 19 of ED-240, as we do not agree this statement undermines the exercise of professional skepticism (as stated in paragraph 23 of the Explanatory Memorandum to ED-240). Instead, we believe this statement is an important part of the requirement, reminding auditors that they should not get too comfortable and solely rely on past experience with management and those charged with governance (as stated in extant ISA 240 paragraph A9) and should recognize there may have been changes in circumstances.

In addition, although we are supportive of paragraph A25 of ED-240 that references the application material in ISA 220 (Revised)⁹ dealing with time pressures on the audit, we believe this application material is too narrowly focused. We believe more could be done in ED-240 to emphasize risks related to auditor bias. The enhanced guidance on types of auditor biases included in paragraph A35 of ISA 220 (Revised) is useful and could be supplemented in ED-240 with guidance specific to how such biases could negatively affect the effectiveness of the auditor's identification, assessment and response to fraud risks.

Additionally, paragraph 30 of ED-240 outlines the auditor's responsibilities when the responses to inquiries of management, those charged with governance, individuals within the internal audit function, or others within the entity, are inconsistent with each other. We note that this consideration is no longer presented as part of the *Professional Skepticism* section as it was in extant ISA 240 and is instead included in the *Understanding the Components of the Entity's System of Internal Control* section of ED-240. We continue to believe that this requirement is better placed in the professional

⁹ ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*

skepticism section of ED-240 (paragraphs 19-21) because it should not be limited in application to only inquiries performed in conjunction with risk assessment procedures.

Finally, we note that paragraph A9 of ED-240 cautions the auditor on the need to maintain professional skepticism when using automated tools and techniques. We believe that, equally, the use of automated tools and techniques can enhance an auditor's professional skepticism through their deeper understanding of the entity's business model, their ability to identify anomalous or unusual transactions and their ability to ask more directed questions of the entity. We believe that the enhancement of professional skepticism should also be explained.

Authenticity of records and documents

Paragraph 25 of the Explanatory Memorandum (EM) explains that the rationale for deleting the explanatory lead-in sentence of paragraph 14 of extant ISA 240 "Unless the auditor has reason to believe the contrary, the auditor may accept records as genuine" is in part because paragraph A24 of ISA 200¹⁰ already includes this sentence. Although we agree with the deletion of this phrase in the requirement, we also agree with the IAASB's statement in the EM that there should not be an increase in the work effort of the auditor. We view paragraph A24 of ISA 200 as important context to the revised requirement in paragraph 20 of ED-240 for the auditor to investigate any identified conditions that call into question the authenticity of a record or document. Because the explanatory guidance removed from the lead-in is now only located in a different ISA, this guidance could be easily overlooked. Accordingly, we suggest that the IAASB include the statement from, or a reference to, ISA 200 paragraph A24 within paragraph A26 of ED-240 to appropriately link the two standards on this concept.

In addition, we note that paragraph A27 of ED-240, which supports paragraph 20, indicates that ISA 500¹¹ includes authenticity as an attribute of the reliability of information. While we acknowledge that paragraph A56 of ED-500 introduces attributes that may be considered by the auditor in considering the degree to which information intended to be used as audit evidence is reliable, extant ISA 500 does not include these attributes and we believe it is premature to introduce the concept of attributes ahead of the final revisions to ISA 500. We therefore propose the deletion of paragraph A27 of ED-240, and, in its place, we propose expanding A26 of ED-240 to explain that when conditions that cause the auditor to believe that a record or document may not be authentic come to the auditor's attention, these conditions affect the reliability of audit evidence pursuant to ISA 500.

Finally, we note that paragraph A28 of ED-240 outlines additional audit procedures that the auditor may perform when they have concerns that a record or document may not be authentic or that terms in a document have been modified. We believe that it is important to note that when those further procedures lead the auditor to identify an alteration of documents, then that circumstance may be considered a suspected fraud and subject to the considerations in paragraph 55 of ED-240.

¹⁰ ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

¹¹ ISA 500, *Audit Evidence*

Risk Identification and Assessment

Q3. Does ED-240 appropriately build on the foundational requirements in ISA 315 (Revised 2019) 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)

Agree, with comments below

Although we support the approach taken in ED-240 to build on the foundational requirements in ISA 315 (Revised 2019) and other ISAs to support a more robust risk identification and assessment as it relates to fraud, we have several concerns about the clarity of the requirements and their consistency with ISA 315 (Revised 2019).

Distinction of incremental requirements

While we agree that ED-240 enhances the linkage to the requirements in ISA 315 (Revised 2019), in our view, greater clarity is needed to distinguish the *incremental* requirements in ED-240 necessary to apply a fraud lens to the risk assessment process from the requirements of ISA 315 (Revised 2019) that when executed as intended would not require any additional work effort to identify and assess risks of material misstatement due to fraud.

We think it is necessary to clearly state in ED-240 that the risk assessment required by this standard is not a separate or distinct risk assessment. Rather, certain requirements should be understood as an elaboration of how auditors are to consider fraud risk when applying the requirements of ISA 315 (Revised 2019) while other requirements in ED-240 require incremental work effort (with clear identification of such requirements).

Order of risk assessment procedures

We believe the order of the risk assessment procedures and related activities as presented in ED-240 is confusing because the flow is not consistent with the expected order of the performance of the requirements. We suggest improving the ordering of the requirements as follows:

- ▶ Moving paragraph 30 of ED-240 to the professional skepticism section of ED-240 (paragraphs 19-21) (refer to our response to Q2).
- ▶ Moving paragraph 32 of ED-240 to evaluate whether one or more fraud risk factors are present after the *Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework, and the Entity's System of Internal Control* section. We believe that this requirement should be placed immediately before the requirement in paragraph 40 of ED-240 to identify and assess the risks of material misstatement due to fraud, taking into account fraud risk factors. The auditor is only able to make the evaluation of fraud risk factors after they have obtained the required understanding of the entity. Re-positioning the paragraph as we suggest will also help auditors understand the purpose of the risk assessment procedures to identify fraud risk factors and assess whether they give rise to risks of material misstatement due to fraud.

Understanding the entity and its environment

We believe the requirement in paragraph 33 of ED-240 should better align with paragraph 19 of ISA 315 (Revised 2019). Certain matters are missing from ED-240 that are relevant to understanding whether there is an increased susceptibility to misstatement due to management bias or other fraud risk factors (and therefore relevant to identifying fraud risk factors). Specifically:

- ▶ Paragraph 33(a)(i) of ED-240 should include an understanding of the entity's business model, instead of focusing only on the entity's objectives and strategies which support the business model, as currently drafted. In our view, understanding the entity at a strategic level and its business risks is very relevant to identifying fraud risk factors. In addition, we believe that understanding the entity's business model supports the auditor in understanding whether and where third-party relationships may exist (e.g., customers, suppliers, service providers), which is important to the auditor's consideration of third-party fraud as explained in our response to Q1.
- ▶ Paragraph 33(a)(ii) of ED-240 should include an understanding of regulatory and other external factors. For example, climate regulations maybe important to many entities (and are not industry specific) and pressure to meet climate targets could be an incentive for fraud.

Control environment

We suggest the following revisions to paragraph 34 of ED-240 as we believe the intention of the requirement is for the auditor to understand how those charged with governance oversee the entity's risk assessment process related to fraud risks.

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

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

We also suggest that the IAASB revise the supporting application material in paragraphs A71-A73 and A75 of ED-240 to clarify that the auditor is not understanding or evaluating individual controls as part of this understanding of the oversight of those charged with governance. Refer to our response in the Appendix to this letter for our suggested revisions to these paragraphs.

The guidance in paragraph A70 of ED-240 discusses following up on matters identified by inspecting whistleblower files "that are under investigation by the entity as these matters may be indicative of suspected fraud with financial reporting implications that require a response by the auditor." We believe this guidance needs to make an explicit linkage to the requirement in paragraph 55 of ED-240.

We question why paragraph A78 was added to ED-240. In our view, it is not clear why it is necessary to have application material related to those charged with governance's objectivity being insufficient or impaired in ED-240 without an apparent fraud lens. In our view, it would be beneficial to explain the relationship of this application material to ISA 315 (Revised 2019) and the auditor's overall



evaluation of the control environment, as well as provide fraud-related considerations, which may include increased opportunity for management override of controls.

The entity's risk assessment process

Although we agree with the requirement in paragraph 35 of ED-240, we believe that the related application material is inconsistent with the requirement (and with the application material in ISA 315 (Revised 2019)) as it inaccurately:

- ▶ Implies that there is a separate “fraud risk management program” that would exist in all entities
- ▶ Implies the “entity's fraud risk identification process” is always a separate process from the entity's overall risk assessment process
- ▶ Implies that the understanding of the entity's risk assessment process needs to include understanding individual controls

Paragraph A79 of ED-240 introduces a discussion of an entity's “fraud risk management program.” We believe that this type of program would only be expected to be implemented in larger, more complex entities and that this application material is not scalable or relevant to less complex entities. We do not believe this is meaningful guidance to have as the first application material paragraph explaining the auditor's understanding of how an entity's risk assessment process addresses fraud risks. We suggest that paragraph A79 of ED-240 be moved to the first paragraph in the scalability section (before paragraph A88) to illustrate a consideration for larger entities.

The heading preceding paragraph A79 of ED-240 (“The entity's process for identifying, assessing, and addressing fraud risks”) implies that entities are expected to have a separate risk assessment process for fraud risks, which is inconsistent with the requirement in paragraph 35 of ED-240 that requires an understanding of how the entity's risk assessment process (i.e., the component of the system of internal control) identifies, assesses and addresses fraud risks. Similarly, paragraph A80 of ED-240 refers to the “entity's fraud risk identification process.” We believe this is misleading as it also implies there is always a separate process from the entity's risk assessment process. We believe that the wording in the application material should be consistent with the requirement as follows:

A80. The entity's ~~fraud risk identification~~ **risk assessment** process may include an assessment of the incentives, pressures, and opportunities to commit fraud, or how the entity may be susceptible to third-party fraud. **An entity's risk assessment** ~~fraud risk identification~~ process may also consider the potential override of controls by management as well as areas where there are control deficiencies, including a lack of segregation of duties.

A82. There are several approaches management may use to assess fraud risks and the approach may vary depending on the nature and circumstances of the entity. The ~~fraud risk assessment~~ **entity may be reported in assess fraud risks using** different forms, such as a complex matrix of risk ratings or a simple narrative.

If needed, guidance could be added in the scalability section that some entities may have separate or distinct risk assessment processes for fraud risks.

We also do not believe it is correct to include a discussion of preventive and detective controls in the application material paragraphs describing the auditor's required understanding of the entity's risk assessment process. In our view, understanding individual controls should be performed in the control activities component as part of the requirement to understand controls that address risks of material misstatement due to fraud. We believe the application material in paragraphs A82-A86 of ED-240 should focus on the auditor obtaining a higher-level understanding of how the entity's risk assessment process addresses fraud risks, such as through fraud risk management programs (which should not be expected to be implemented formally in all entities), and controls that operate above the transaction level (e.g., whistleblower hotlines, internal audit departments). As such, we recommend moving any guidance or examples of transaction-level controls to address risks of material misstatement due to fraud to support paragraph 38 of ED-240, such as:

- ▶ Paragraph A85 of ED-240: The examples in this paragraph are a mixture of indirect and direct controls. Controls over authorizations of transactions, exception reports and general IT controls are the types of controls that should be identified and addressed in the control activities component.
- ▶ Paragraph A87 of ED-240: We do not believe it is appropriate to include guidance on the extent to which specialized skills are needed to assist the auditor in obtaining an understanding of controls in the guidance discussing the entity's process to address fraud risks.
- ▶ Paragraph A89 of ED-240: We do not believe it is appropriate to include inquiries about transaction-level controls as part of inquiries related to the entity's risk assessment process.

For consistency with the requirement in paragraph 35 of ED-240, and because we believe understanding the entity's process to address fraud risks is relevant for smaller and less complex entities, we suggest the following revisions:

A88. ...When there are no formalized processes or documented policies or procedures, the auditor is still required to obtain an understanding of how management, or where appropriate, those charged with governance identify fraud risks related to the misappropriation of assets and fraudulent financial reporting, ~~and~~ **and assesses the significance of the identified fraud risks, and addresses the assessed risks.**

Related to our comments expressed above about the inappropriate expectation of a separate fraud risk assessment process in all entities and for the auditor to understand individual controls as part of the risk assessment process, we believe that the application material in paragraph A89 of ED-240 also needs to be revised. We encourage the IAASB to challenge the relevance of the guidance in paragraph A89 (and whether it is better placed to support the requirement in paragraph 34(c)), but at a minimum to make the following revisions:

A89. Management accepts responsibility for the entity's system of internal control and for the preparation of the entity's financial statements. Accordingly, it is appropriate for the auditor to make inquiries of management regarding management's own **process for identifying and responding to the risks of fraud in the entity** ~~assessment of the risk of fraud and the controls in place to prevent or detect it~~. The nature, extent and frequency of management's **risk assessment process** ~~assessment~~ may vary from entity to entity. In some

entities, management's process may ~~occur~~ ~~make detailed assessments~~ on an annual basis or as part of ongoing monitoring. In other entities, management's process assessment may be less structured and less frequent. The nature, extent and frequency of management's ~~assessment~~ risk assessment process ~~is~~ ~~are~~ relevant to the auditor's understanding of the entity's control environment. For example, the fact that management ~~does not have a risk assessment process~~ or when the entity's risk assessment process does not address the identified fraud risks ~~has not made an assessment of the risk of fraud~~ ~~may in some circumstances~~ be indicative of the lack of importance that management places on internal control.

The entity's process to monitor the system of internal control

We suggest the following revisions to paragraph 36(a) of ED-240 to make it clear that this requirement is part of understanding the entity's overall monitoring process and to better align this requirement with ISA 315 (Revised 2019):

36. In applying ISA 315 (Revised 2019), the auditor shall:
(a) Obtain an understanding of those aspects of the entity's process for monitoring the system of internal control that address the ongoing and separate evaluations for monitoring the effectiveness of controls to prevent or detect fraud, and the identification and remediation of related control deficiencies identified. (Ref: Para. A92)

We suggest the following revisions to paragraph A92 of ED-240 as the term "fraud mitigation process" is not clear:

A92. Matters that may be relevant for the auditor to consider ... may include:

- How the entity monitors controls that address fraud risks ~~fraud mitigation processes~~ in each component of the entity's system of internal control, including the operating effectiveness of anti-fraud controls, and the remediation of control deficiencies as necessary.

The information system and communication

Paragraph 37 of ED-240 that requires an understanding of how journal entries are initiated, processed, recorded and corrected aligns with the understanding required by paragraph 25(a)(i) of ISA 315 (Revised 2019). However, in our view, it is not complete because it does not include understanding the process for making journal entries as part of the financial reporting process to prepare the entity's financial statements (paragraph 25(a)(iii) of ISA 315 (Revised 2019)). We suggest that paragraph 37 be expanded accordingly.

As the auditor is obtaining their understanding of how, where and when journal entries are made, it is important that they obtain an understanding of the types of journal entries (whether standard or non-standard) incorporated in the general ledger, and, in turn, reported in the financial statements, as well as other adjustments made directly to the financial statements. We also suggest that the linkage to ISA 315 (Revised 2019) paragraph 25(a)(i) and 25(a)(iii) is strengthened in paragraph A95 of ED-240

to consider the types of journal entries posted as part of transaction processing as well as the entity's financial reporting process.

Given the importance of the understanding obtained from paragraph 37 and paragraph A95 of ED-240 to the auditor's design and performance of audit procedures to test journal entries and other adjustments, we believe that paragraph 50(b)-(d) should also reference paragraph A95 of ED-240.

Please refer to additional comments as it relates to the auditor's design and performance of audit procedures to test journal entries and other adjustments in our response to Q10.

Control activities component

We are unclear, based on the drafting of the requirement, whether paragraph 38 of ED-240 is intended to be consistent with the related requirements in ISA 315.26(a)(i) and 315.26(a)(ii), or whether the IAASB intends for paragraph 38 of ED-240 to require the auditor to understand controls beyond those already required to be understood by ISA 315 (Revised 2019). Based on the supporting application material, it appears the IAASB intends for there to be alignment with the controls in scope under the existing ISA 315 (Revised 2019) requirements.

In addition, we believe there is an opportunity to clarify the scope of controls over journal entries required to be understood for both the purposes of ED-240 and the related ISA 315 (Revised 2019) requirements by linking the requirement in paragraph 38 of ED-240 to the required understanding in paragraph 37 of ED-240. We believe this is a better approach because, in our experience, the controls over journal entries are generally designed to prevent or detect risks of material misstatement whether due to fraud or error, and there may not be controls specifically designed by management to prevent or detect fraud. In our view, the auditor only needs to be satisfied that the controls identified over journal entries are sufficient to address both fraud and error (i.e., the evaluation of the design of the controls should include evaluating whether there are controls in this population of journal entries that, as designed, would address risks of material misstatement due to fraud).

We also suggest:

- ▶ Clearly stating in paragraph 38 that the auditor is required to evaluate whether these controls are designed effectively and have been implemented by combining the requirements in paragraphs 38 and 40(b).
- ▶ Adding application material to explain that although paragraph 26 of ISA 315 (Revised 2019) only addresses controls at the assertion level, ED-240 also requires the auditor to understand controls that address the risks of material misstatement due to fraud at the financial statement level because these risks need to be treated as significant risks.

The following represents our suggested revisions to paragraph 38 and paragraph 40:

38. In applying ISA 315 (Revised 2019)¹², the auditor's understanding of the entity's control activities shall include: (Ref: Para. A98-A101)
- (a) ~~Identifying controls that address risks of material misstatement due to fraud at the financial statement level or assertion level (which are significant risks),~~¹³
 - (b) ~~including Based on the auditor's understanding obtained in paragraph 37, identifying controls over journal entries¹⁴ designed to prevent or detect fraud, and~~
 - (c) **Evaluating whether the controls are designed effectively; and determining whether the controls have been implemented.**¹⁵
40. In applying ISA 315 (Revised 2019), the auditor shall:
- (a) ...
 - (b) Treat those assessed risks of material misstatement due to fraud as significant risks. ~~Accordingly, to the extent not already done so, the auditor shall identify controls that address such risks, evaluate whether they have been designed effectively and determine whether they have been implemented.~~

We also do not believe the application material in paragraphs A98-A101 adequately supports the requirements in paragraph 38 of ED-240. For example:

- ▶ Paragraphs A99 and A100 of ED-240 only mention controls over journal entries and do not adequately explain the relationship between the requirement in ISA 315 (Revised 2019) paragraph 26 and ED-240 paragraph 38 because they do not provide any guidance more broadly related to the requirement to identify controls that address risks of material misstatement due to fraud.
- ▶ Paragraph A101 of ED-240 provides examples of general IT controls that may address the risks arising from the use of IT. It would be helpful to link this guidance to the requirement in ISA 315 (Revised 2019) paragraph 26(b).

We also suggest that the IAASB include a consequential amendment in ISA 315 (Revised 2019) to explain the connection to ED-240 paragraph 38. Further, as mentioned above, we suggest that the IAASB consider repurposing and relocating certain of the application material included in *The Entity's Risk Assessment Process* section of ED-240 that would be applicable to identifying controls in the control activities component, including general IT controls, and evaluating their design and implementation.

¹² ~~ISA 315 (Revised 2019), paragraph 26~~

¹³ ~~Refer to ISA 315 (Revised 2019), paragraph 26(a)(i)~~

¹⁴ ~~Refer to ISA 315(Revised 2019), paragraph 26(a)ii~~

¹⁵ ~~Refer to ISA 315(Revised 2019), paragraph 26(d)~~

Procedures related to third-party fraud

We suggest the IAASB consider enhancing guidance about risk assessment procedures that can address identifying fraud risks related to third parties as follows:

- ▶ The application material to paragraphs 33 and 37 of ED-240 could emphasize that as part of obtaining an understanding of the entity and its environment and the system of internal control pursuant to ISA 315 (Revised 2019), the auditor considers whether and where third-party relationships exist (e.g., customers, suppliers, service providers). This explanation would provide better context for addressing how third-party relationships may give rise to fraud risk factors in the required engagement team discussion, as expected by paragraph A52.
- ▶ We note that paragraph A80 of ED-240 acknowledges that the entity's fraud risk identification process may include how the entity may be susceptible to third-party fraud. However, we believe additional guidance is necessary as it relates to the auditor's responsibility to obtain an understanding of how the entity's risk assessment process identifies and addresses risks related to third-party relationships. For example, as it relates to external parties unknown to the entity, we believe the auditor could consider how management is governing their exposure to third-party fraud from unknown external parties (e.g., cyber risk management program).

Significant risks related to management override of controls

Paragraph 42 of ED-240 is focused on the auditor treating any identified risks related to management override as significant risks; it does not directly require the auditor to identify a risk of management override of controls. We believe that paragraph 42 should be explicit that the risk of management override of controls is required to be identified as a risk of material misstatement due to fraud at the financial statement level for all audits, and thus a significant risk. Given that the responsive audit procedures to this risk are required on every audit (i.e., paragraphs 48-53 of ED-240), ED-240 appears to require this risk be identified without the possibility of rebuttal. We believe the standard can be strengthened, as follows:

- ▶ We propose changing the header to paragraph 42 of ED-240 to read "**Risk of Material Misstatement Due to Fraud at the Financial Statement Level Related to Management Override of Controls**".
- ▶ We propose revising paragraph 42 of ED-240 as follows:

42. Due to the unpredictable way in which management is able to override controls and irrespective of the auditor's assessment of the risks of management override of controls, the auditor shall **identify management override of controls as a risk of material misstatement due to fraud at the financial statement level on all audits.** ~~Treat those risks as risks of material misstatement due to fraud and thus treat this risk as a significant risks.~~ (Ref: Para. A113)
- ▶ Auditors should also consider whether any risks of management override exist at the assertion level (e.g., a risk specific to a particular account). Auditors find it challenging in practice to distinguish between a specific risk of management override of controls, which would necessitate a

specifically designed response, and the risk of management override at the financial statement level that requires completion of the responsive procedures outlined in paragraphs 48-53 of ED-240. We therefore propose the following additions to paragraph A113 of ED-240:

A113. When considering the significant risk related to management override of controls, the auditor acknowledges the following:

- Management is in a unique position to perpetrate fraud because of management's ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Although the level of risks of management override of controls will vary from entity to entity, the risk is nevertheless present in all entities. See also paragraphs 48-53.
 - **While the risk of material misstatement due to fraud at the financial statement level related to management override of controls exists on every audit and requires the responsive procedures outlined in paragraphs 48-53, the auditor may, in the performance of the identification and assessment of risks of material misstatement due to fraud pursuant to paragraph 40, identify specific risks of material misstatement due to fraud related to management override of controls. For example, the auditor may identify a risk of management override as it relates to a specific class of transactions, account balance or disclosure. When a specific risk of material misstatement due to fraud related to management override of controls is identified, the auditor designs and performs further audit procedures that are responsive to the identified specific risk in accordance with paragraph 47.**
- ▶ We propose changing the header to paragraph 48 of ED-240 to read "*Audit Procedures Responsive to **the Risk of Material Misstatement Due to Fraud at the Financial Statement Level Related to Management Override of Controls***". We also propose revising the requirement in paragraph 48 of ED-240 as follows:
48. Irrespective of the auditor's assessment of the risks of management override of controls, the auditor shall design and perform the audit procedures **to respond to the risk of material misstatement due to fraud at the financial statement level related to management override of controls** in accordance with paragraphs 49-53, and determine whether other audit procedures are needed in addition to those in paragraphs 49-53, in order to respond to the identified risks of management override of controls.

Responses to the assessed risks of material misstatement due to fraud

In determining overall responses to address the assessed risks of material misstatement due to fraud, extant ISA 240 paragraph 30 requires the auditor to specifically consider assignment and supervision of personnel and incorporate an element of unpredictability in the selection of audit procedures (in addition to the evaluation of the selection and application of accounting policies by the entity, which is

included in ED-240 paragraph 46). We believe that the structure of extant ISA 240, which connects these specific procedures to the auditor's overall response, is beneficial to auditors. We do not believe it was the IAASB's intention to remove these requirements in ED-240 from the context of required overall responses.

Therefore, we believe ED-240 paragraphs 45 and 46 (and the related application material) that address overall responses need to be expanded in some manner to acknowledge that certain requirements that precede these paragraphs are also overall responses to address the risks of material misstatement due to fraud at the financial statement level. These include the requirements in paragraph 22 that addresses determining whether the engagement team has appropriate specialized skills or knowledge, paragraph 23 that addresses determining appropriate direction, supervision and review and paragraph 44 that addresses incorporating unpredictability in audit procedures. We also believe that the application material in paragraphs A114-116 of ED-240 should be revised to more closely align with the guidance in paragraphs A34-A37 of extant ISA 240 to provide more robust guidance for how an auditor can comply with the requirement in paragraph 45 of ED-240 to determine overall responses (which should include consideration of the requirements in paragraphs 22, 23 and 44).

Finally, we suggest that the IAASB add application material to make it clear that the reference in paragraph 45 of ED-240 to the "assessed risks of material misstatement due to fraud at the financial statement level" includes the risk of management override of controls at the financial statement level (at a minimum) and then any other financial statement level risks of fraud that the auditor has identified.

Fraud or Suspected Fraud

Q4. 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)

Agree, with comments below

We believe that ED-240 is a substantial improvement over extant ISA 240 related to establishing robust work effort requirements and application material to address circumstances when instances of fraud or suspected fraud are identified in the audit. However, we do not believe it is practical for the auditor to perform all the required procedures in paragraph 55 of ED-240 for *all* instances of fraud or suspected fraud, including those that are clearly inconsequential. We also do not believe there are sufficient parameters and guidance for the auditor's response to third-party fraud.

Requirements related to identified or suspected fraud

We agree with paragraph 56 of the EM that for all instances of fraud or suspected fraud, it is necessary for the auditor to apply "at least some of the fraud or suspected fraud requirements that are applicable in the circumstances to determine the effect on the audit engagement" because in many cases, the materiality of a matter identified may not be truly understood without obtaining further information about the instance of fraud or suspected fraud.

However, we believe ED-240 should be clearer about which procedures are necessary in all cases as we do not believe that scalability has been clearly introduced.¹⁶ We are concerned that the requirements in paragraph 55 of ED-240 could result in unnecessary work effort and documentation by the auditor on matters that are clearly inconsequential. This is especially the case for large, complex entities that may have numerous whistleblower allegations, or for any entity where there could be misappropriation of assets involving the theft of an entity's assets that is perpetrated by employees (or customers) in relatively small and immaterial amounts (as is often the case for misappropriation of assets as acknowledged in paragraph A6 of ED-240).

Therefore, we suggest that paragraph 55 of ED-240 be bifurcated to require an initial understanding of the fraud or suspected fraud through inquiries in all instances. We then believe it would be more realistic to require the procedures in paragraph 55(b)-(d) of ED-240 only when the auditor determines the fraud or suspected fraud is more than clearly inconsequential and warrants further understanding.

We also note that paragraph A152 of ED-240 includes an example that states that "based on an understanding of the suspected fraud, the engagement partner believed the suspected fraud was *inconsequential* because it was limited to the *misappropriation of immaterial assets* by employees. Consequently, the engagement partner determined to continue with other aspects of the audit engagement while the matter was being resolved by management of the entity." This example supports our recommendation to limit the initial understanding of the matter to inquiries about the nature and circumstances of the matter in order to determine if further procedures by the auditor are necessary (i.e., to determine whether the matter is more than clearly inconsequential).

Paragraph 14 of ED-240 clearly states that fraud constitutes an instance of non-compliance with laws and regulations. It is therefore important for the procedures related to responding to identified or suspected fraud in ED-240 to be interoperable with the requirements of Section 360 of the IESBA Code¹⁷ such that there are not implementation issues for those auditors that need to comply with both the ISAs and IESBA Code. In particular, we refer to the following requirements with which ED-240 could be closer aligned (emphasis added):

- ▶ 360.7 A2 A professional accountant who encounters or is made aware of matters that are *clearly inconsequential* is not required to comply with this section. Whether a matter is clearly inconsequential is to be judged with respect to its nature and its impact, financial or otherwise, on the client, its stakeholders and the general public.
- ▶ R360.10 If a professional accountant engaged to perform an audit of financial statements becomes aware of information concerning non-compliance or suspected non-compliance, the accountant shall obtain an understanding of the matter. *This understanding shall include the nature of the non-compliance or suspected non-compliance and the circumstances in which it has occurred or might occur.*

¹⁶ Paragraph 57 of the Explanatory Memorandum to ED-540 states that "...the IAASB notes that scalability has been introduced into ED-240 because, depending on the nature of the fraud or suspected fraud, some of the fraud or suspected fraud requirements may not be applicable." We do not agree that this is evident in paragraphs 55-59 of ED-240.

¹⁷ The International Ethics Standards Board for Accountants' International Code of Ethics for Professional Accountants (including International Independence Standards), Section 360 *Responding to Non-Compliance with Laws and Regulations*.

- ▶ R360.19 The professional accountant shall assess the appropriateness of *the response* of management and, where applicable, those charged with governance.

Given our comments above to bifurcate the requirement and better align the procedures in ED-240 with the IESBA Code, we suggest the following revisions to paragraph 55 of ED-240:

55. If the auditor identifies fraud or suspected fraud, the auditor shall:

- (a) Obtain an understanding of **the nature and circumstances of the** matter in order to determine the effect on the audit engagement. ~~In doing so, the auditor shall:~~ **including making** (a) Make inquiries about the matter with a level of management that is at least one level above those involved and, when appropriate in the circumstances, ~~make~~ **making** inquiries about the matter with those charged with governance.;
- (b) **If the matter is determined to be more than clearly inconsequential, obtain a further understanding of the matter to determine the effect on the audit engagement, including:**
- (i) ~~If the entity has a process to investigate the matter,~~ **evaluate**ing whether **management's response to the matter** it is appropriate in the circumstances;
 - (ii) If the entity has implemented remediation measures to respond to the matter, **evaluate**ing whether they are appropriate in the circumstances; and
 - (iii) **Determine**ing whether control deficiencies exist, including significant deficiencies in internal control related to the prevention or detection of fraud, ~~relating to the identified fraud or suspected fraud.~~

Responding to third-party fraud

Our responses to Q1 and Q3 suggests needed clarifications to provide the right context for explaining the auditor's responsibilities for each category of third-party fraud, which include external parties known to the entity and unknown to the entity, as well as how the nature of the auditor's response to third-party fraud differs from risks of fraud internal to the entity.

We are particularly concerned that, as the standard is currently written, it would seem that all cyber breaches are considered fraud. However, all cyber breaches do not result in misappropriation of assets or fraudulent financial reporting, nor do they always affect the entity's non-compliance with laws and regulations. We therefore suggest a clearer distinction is needed between cyber breaches and fraud and the circumstances in which cyber breaches require a response from the auditor.

For each category of third-party fraud, we recommend clarifications are made to the requirements and guidance of ED-240 so that appropriate distinctions are made in the threshold for, and nature of, the auditor's required response. In our view, such clarifications could include that:

- ▶ Fraud or suspected fraud involving a related party should always require further procedures by the auditor to respond to the matter (i.e., such instances of fraud are always “more than clearly inconsequential”).
- ▶ For known third parties, a threshold of “more than clearly inconsequential” applies, as suggested in our revised paragraph 55(b) above.
- ▶ For cyber breaches, the auditor obtains an understanding sufficient to determine the possible effect on the financial statements and also to consider whether the event constitutes fraud for the purposes of ED-240 (for which clarifying guidance is needed), as well as any implications for the entity’s compliance with laws and regulations (e.g., required reporting to authorities or other required disclosures). When appropriate conditions are met, which need to be more clearly defined, the auditor is required to respond to the matter in accordance with paragraph 55(b).

Application material related to the requirements for identified or suspected fraud

To help the auditor in determining when the procedures in our proposed paragraph 55(b) would be required, we suggest that the IAASB add supporting application material, for example:

- ▶ Guidance could be added to explain that determining whether a matter is more than clearly inconsequential, involves evaluating its nature and its impact to the financial statements. In addition, an instance of fraud or suspected fraud is likely “more than clearly inconsequential” when it:
 - Involves management, or employees who have significant roles in internal control
 - Causes the auditor to doubt the integrity of management or those charged with governance
 - Involves related parties
- ▶ Guidance could be added that suggests that instances of identified fraud or suspected fraud involving misappropriation of assets (that do not involve the parties listed above) may be determined to be “clearly inconsequential” after completing the initial understanding required by our proposed paragraph 55(a). This would eliminate the need for the auditor to spend time further understanding and documenting matters, for example, related to employees stealing immaterial amounts of office supplies or using a company vehicle for personal use. On the other hand, instances of identified fraud or suspected fraud involving fraudulent financial reporting may need further understanding in all instances.
- ▶ We suggest re-positioning the procedures suggested in paragraph A146 of ED-240 as procedures that the auditor would perform in response to our proposed paragraph 55(b). This would avoid, implying that procedures such as involving an auditor’s expert, inspecting whistleblower files or making inquiries of legal counsel or internal audit would be necessary for every instance of identified or suspected fraud.

We also urge the IAASB to challenge the examples provided in paragraphs A147, A148 and A152 of ED-240 that are illustrating the extent of the understanding required by paragraph 55 of ED-240. We do not believe these examples fully reflect the requirements in paragraph 55 of ED-240 and suggest

that the IAASB either specifically state as part of the example which requirements the example is illustrating or create one comprehensive example (possibly combining the partial examples provided) to more accurately illustrate the procedures required by paragraph 55 of ED-240. We believe these examples, as proposed, contradict the requirements in ED-240 and will cause confusion as auditor's attempt to reconcile the examples with the requirements in ED-240. Specifically:

- ▶ The examples in paragraph A147 are illustrating the "extent of the understanding of the fraud or suspected fraud", however, the examples only seem to be illustrating the requirement in paragraph 55(a), and not the requirements in paragraph 55(b)-(d) (i.e., there is no illustration of how the auditor evaluated the entity's process, evaluated the remediation measures or determined whether control deficiencies exist).
- ▶ The second example in paragraph A147 illustrates that changes were made to the overall group audit strategy and group audit plan, which goes beyond illustrating the extent of the understanding of the fraud or suspected fraud (as indicated in the lead-in to the examples). This is also misleading as the other procedures required by paragraph 56 are not addressed in the example.
- ▶ We do not believe the examples in paragraph A152 effectively illustrate what is required by paragraph 56, which is the requirement for the engagement partner to determine whether to perform further audit procedures. In our view, they only illustrate when an auditor would continue working versus ceasing the audit work. We suggest that the IAASB provide guidance and examples that more closely align with the requirements in paragraph 56 (examples of relevant additional risk assessment procedures or further audit procedures). We also suggest that in the second example, consideration is given as to whether the auditor is able to continue the engagement (i.e., include a reference to the requirement in paragraph 60).

We also recommend that further guidance and/or examples be added to ED-240 on how the auditor's understanding can be performed for larger entities with mature whistle-blower programs and developed processes for responding to allegations of fraud. As paragraph 55 requires procedures to be performed for all identified or suspected fraud, we believe it is essential that the IAASB provides guidance on the auditor's responsibility to complete the procedures in paragraph 55 when there are large volumes of whistleblower files, tips or complaints that allege fraud. This could be in the form of a "scalability" application material paragraph. For larger entities, our experience is that categorization of the allegations may be applied, and assessments done by category. Having to assess each of them separately, and document that assessment separately, would be impractical when applying the procedures required in paragraph 55.

Finally, we are struggling with how the application material in paragraph A149 of ED-240 provides guidance for evaluating the appropriateness of the entity's process to investigate a fraud or suspected fraud. Rather, the considerations focus on the auditor's understanding of the entity's process to remediate the fraud or suspected fraud (i.e., how management responded to any misstatements, how management responded to the fraud, how management addressed control deficiencies and the outcomes of the process). We nevertheless support the guidance because it is consistent with our recommended revision above to paragraph 55(b) to require the auditor to understand whether management's response to the matter is appropriate. If the IAASB decides to retain the requirement for the auditor to evaluate the entity's process to investigate the matter, we suggest that the IAASB

include application material to better explain how the auditor would do that, which could include the auditor considering the objectivity and competence of those investigating the matter.

Evaluation of whether the financial statements are materially misstated

We suggest that the requirements in paragraphs 58 and 59 of ED-240 be merged as we believe the required procedures would be the same whether the financial statements are materially misstated, or whether the auditor is unable to conclude whether the financial statements are materially misstated.

58. If the auditor determines that the financial statements are materially misstated due to fraud or the auditor is unable to conclude whether the financial statements are materially misstated due to fraud, the auditor shall:

- (a) Determine the implications for the audit and the auditor's opinion on the financial statements in accordance with ISA 705 (Revised); and
- (b) If appropriate, obtain advice from legal counsel.

~~59. If the auditor is unable to conclude whether the financial statements are materially misstated as a result of fraud, the auditor shall determine the implications for the audit or the auditor's opinion on the financial statements in accordance with ISA 705 (Revised).~~

Communications with management and those charged with governance

Paragraph 67 of ED-240 that addresses required communication with those charged with governance about identified or suspected fraud has not been revised from extant ISA 240, as it continues to limit communication of fraud to only those matters involving management, employees who have significant roles in internal control, and others where fraud results in a material misstatement of the financial statements. We believe this requirement should be better linked to paragraph 55 of ED-240 as communications with those charged with governance may be needed to obtain the required understanding of a fraud or suspected fraud.

In addition, the communication requirement in paragraph 67 of ED-240 does not align with either the communication requirement for instances of non-compliance with laws and regulation in ISA 250 (Revised) or the ED-240 proposed changes to the auditor's report. We point out the following inconsistencies that require revisions either in ED-240 or as conforming changes to other ISAs:

- ▶ The requirement in paragraph 67 of ED-240 only requires communication with those charged with governance in certain situations, while the proposed amendments to paragraph 40 of ISA 700 includes a statement in the auditor's report that the auditor communicates any identified fraud or suspected fraud to those charged with governance.
- ▶ Because fraud is defined to be a matter involving non-compliance with laws and regulations, instances of identified or suspected fraud would also seem to be subject to paragraph 23 of ISA 250 (Revised), which requires communication with those charged with governance other than when the matters are clearly inconsequential, which is not consistent with the scope of

communications required by paragraph 67 of ED-240 or the scope of communications described in the auditor's report.

We suggest that the IAASB align the scope of required communications with those charged with governance in ED-240 about identified and suspected fraud to the current communication requirement in ISA 250 (Revised) to communicate matters unless they are clearly inconsequential. We also suggest conforming changes to the proposed description of the auditor's communication responsibilities for fraud in the auditor's report.

Finally, we suggest that the IAASB consider providing a link between paragraphs A183 of ED-240 that describes communication with management about instances of fraud and the new requirement in paragraph 55 of ED-240 for the auditor to make inquiries of management about instances of fraud or suspected fraud as part of obtaining an understanding of the matter, as these communications may occur concurrently.

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

Q5. 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)

Disagree, with comments below

To enhance transparency about matters related to fraud in the auditor's report, we believe the IAASB should incorporate the auditor's assessment of fraud risk, and the related impact it has on our audit strategy and response, in the determination of KAMs under the existing requirements of ISA 701 rather than establishing new requirements for the determination of "fraud-related KAMs" within ISA 240. Our view is based on the concerns we have about whether:

- ▶ The proposed requirements and application material in ED-240 are capable of consistent implementation
- ▶ The inclusion of suspected fraud as a required consideration for KAMs will have unintended consequences
- ▶ The proposed revision to the key audit matters wording in the auditor's report, as well as the statement required when no KAMs related to fraud are identified, will widen the expectation gap

Requirements and application material for determining key audit matters are unclear

Based on the revisions proposed in ED-240, we find it unclear as to whether there is one process to determine KAMs (under ISA 701) that includes the consideration of fraud-related matters, or a separate parallel process for determining KAMs related to fraud from which additional matters are reported together with the matters from the ISA 701 process under the heading of key audit matters in the auditor's report.

It is our understanding that an objective of ED-240 is to add a "fraud lens" to the existing auditor reporting requirements in ISA 701. We support that objective, but do not believe that the requirements and application material in ED-240 provide the necessary clarity for auditors to execute

the determination and communication of KAMs appropriately and in a consistent manner. In our view, this objective would be best achieved by integrating considerations related to fraud into ISA 701, resulting in a singular standard addressing the auditor's responsibility to identify and communicate KAMs in the auditor's report.

We believe there are inconsistencies between ED-240 and the requirements of ISA 701 regarding how an auditor determines which matters rise to the level of KAMs. The application material in paragraphs A162-A171 of ED-240 necessitates the auditor undertake a seemingly separate process for matters related to fraud than they would for any other potential KAMs. For example, a risk of material misstatement due to fraud may not be assessed by the auditor as requiring significant auditor attention under ISA 701.09. However, the same matter would then need to be taken into account by paragraph 61(a) of ED-240. It is unclear how the results of the ISA 701 process for determining KAMs influence or interact with the results of the separate process in ED-240.

It is also our understanding that by applying paragraph 61 and considering paragraph A170 of ED-240, which states that matters related to fraud are "often matters that require significant auditor attention" and "one or more of the matters related to fraud that required significant auditor attention would ordinarily be of most significance... and therefore are key audit matters", the auditor is expected to identify a KAM related to fraud, when applying this separate process. Although the requirements appear to allow the auditor to determine that there are no KAMs related to fraud, we believe this application material could be interpreted to imply that there is a required presumption that the auditor will identify a fraud-related KAM.

We acknowledge and agree with the intention of the proposed requirements and guidance to promote enhanced reporting of matters related to fraud within key audit matters, but do not believe this objective is effectively achieved by the requirements and application material currently proposed. We believe that the objective of adding a "fraud lens" on the determination of KAMs is better achieved with revisions to paragraph 9 of ISA 701 as follows, with conforming updates to the related application material:

9. The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:
 - (a) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with ISA 315 (Revised 2019), **including risks of material misstatement due to fraud.**
 - (b) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that are subject to a high degree of estimation uncertainty
 - (c) The effect on the audit of significant events or transactions that occurred during the period.
 - (d) Identified fraud**
 - (e) Identified significant deficiencies in internal control**

In addition, we believe that application material to paragraph 10 of ISA 701 should be added specifically to address how the auditor considers the significance of fraud-related matters relative to



all other matters that required significant auditor attention in determining KAMs. This could be achieved through revisions to paragraphs A27-A30 of ISA 701. However, we would be concerned with an approach that establishes a presumption that any fraud-related matter is a KAM, irrespective of whether the matter genuinely represents a key aspect of the audit, because such a presumption diminishes the overall purpose of KAMs. It is important that key audit matters remain (as defined) the matters of most significance in the audit.

Significant deficiencies in internal control relevant to the prevention and detection of fraud

With regard to the nature of identified significant deficiencies in internal control, we believe it is practically challenging to determine that a significant deficiency is not one that “is relevant to the prevention and detection of fraud” (i.e., paragraph 61(c) of ED-240). Any significant deficiency may create, or contribute to, an opportunity for fraud. We believe that, if the identification of significant deficiencies in internal control is to be considered in the auditor’s determination of KAM, any significant deficiencies identified should be required to be taken into account. With this proposed change, conforming revisions to ISA 701 paragraph A29 would be necessary and the application material in paragraphs A162-A179 of ED-240 would also need to be integrated into the existing application material to ISA 701.

Significant concerns with disclosing suspected fraud in the auditor’s report

We have significant concerns with including suspected fraud in the list of required matters that the auditor is required to take into account to determine KAMs because of the unintended consequences that are likely to arise from communicating suspected fraud in the auditor’s report.

The application material to ISA 701 clearly establishes that an auditor may appropriately seek to avoid the description of a KAM inappropriately providing original information about the entity. When an entity identifies a fraud that affects the entity, it is more likely that there will be public disclosures about the matter, particularly if it has a material effect on the financial statements. The same cannot be expected when a fraud is suspected because of the many circumstances that may result in suspected fraud and the processes established by entities to investigate allegations, neither of which may require public disclosure, particularly when disclosure may negatively affect the investigative process or when suspicions are determined to be unfounded.

Additional unintended consequences may arise from the auditor’s disclosure of original information about suspected fraud, including reputational damage to the entity and resulting reduced transparency between management and the auditor, as well as a further widening of the expectation gap when the auditor communicates information about fraud at the entity that management is not required to communicate.

In many cases, suspected fraud will (and should) require significant auditor attention. However, through a robust investigation, including with assistance from professionals with forensics skills, suspicions may be determined to be unfounded or erroneous. Such matters do not have an effect on the financial statements or the audit opinion. Therefore, we do not believe suspected fraud that may ultimately be determined to be unfounded should be disclosed by the auditor; disclosure decisions on these matters should remain with the entity in the context of the applicable financial reporting and regulatory frameworks.

Short seller and whistleblower reports alleging financial fraud at an entity have increased over the last decade. Some of these reports are available publicly (e.g., short seller reports) while other types of



reports alleging fraud (e.g., whistleblower reports) may be made directly to the entity without disclosure to the public. Short seller and whistleblower reports alleging fraud are not always well-supported and it is not unusual for an investigation into allegations of fraud to conclude that the allegations have no merit. Even where the allegations prove to be unfounded, the investigation into these matters may, in some instances, involve significant auditor attention. In this circumstance, ED-240's presumption that fraud-related matters are often KAMs would likely result in the auditor identifying a suspected fraud as a KAM and could put the auditor in the position of disclosing original information when the entity has no parallel obligation to disclose these unfounded allegations. Increased transparency related to unfounded allegations of fraud will not benefit the investing public and, indeed, may lead to confusion about the merits of the matter (e.g., if the fraud allegations were unfounded, why is the auditor referencing the matter in its report?). Users may believe that the audit opinion is perhaps not as sound as it should be.

We believe that the proposed inclusion of suspected fraud may also give rise to other unintended consequences, which could be significant. Auditors may find themselves in legal conflict with the entity (as further explained below), or management or those charged with governance may become less forthcoming to the auditor with information about allegations of fraud or whistleblower allegations if those allegations are likely to result in disclosure as KAM even where the fraud allegations prove to be unfounded.

In addition, we believe it will be rare that a suspected fraud that could have a material effect on the financial statements would not be fully investigated by the entity prior to the release of its audited financial statements. The outcome of these internal investigations, often led by a special committee overseen by those charged with governance and conducted under legal privilege by independent counsel, are typically shared with the auditor pursuant to protocols that seek to minimize the scope of waiver of legal protections where feasible and consistent with the needs of the audit.

If the investigation concludes that a material fraud occurred, applicable securities or other regulations are likely to require that the matter be disclosed by the entity. However, if the entity concludes, after investigating, that the suspected fraud did not occur, there would ordinarily be no regulatory requirement that the entity disclose the matter. If unfounded allegations of fraud (which are assumed to require significant auditor attention) are expected to be disclosed as KAMs, the auditor could find itself in legal conflict with the entity that may assert the information is protected from disclosure or otherwise does not need to be disclosed by the entity under the applicable financial reporting framework. ED-240, as currently drafted, does not address any of these legal issues.

We do not believe the public interest exception proposed in ISA 701 paragraph 14(b) solves the legal issues. The exception is far too narrow, referencing "extremely rare circumstances." We believe auditor reporting on suspected fraud must align with reporting obligations of the entity to avoid disclosure of original information. Accordingly, if the IAASB determines to retain suspected fraud as a required consideration for KAMs, we propose:

- ▶ Removing "In extremely rare circumstances" from paragraph 14(b) of ISA 701.
- ▶ Adding application material to provide guidance for the auditor in the situation when suspected fraud was identified and the matter required significant auditor attention. When the matter is determined to be a KAM, the auditor should be directed to specifically consider paragraph 14(b) of ISA 701 in the context of whether the entity has disclosed the issue, and if not, the legal issues

that may arise from the auditor doing so, as well as the potential adverse consequences to the investing public as discussed above.

Auditor's report revisions

We have concerns about the conforming amendments to ISA 700 and 701. As noted in our response above, we believe that matters related to fraud should be incorporated into a singular process for determination of KAMs in paragraphs 9 and 10 of ISA 701. Reference to “matters related to fraud” in the section heading of the auditor’s report (as proposed by the conforming amendments to ISA 701 paragraph 11) and use of that phrase in the auditor’s responsibility section in the auditor’s report (as proposed by the conforming amendments to ISA 700 paragraph 40(c)) give prominence to the auditor’s consideration of fraud matters, but do not appropriately reflect the other important matters an auditor considers as part of their determination of KAMs (e.g., significant risks, accounting estimates that are subject to a high degree of estimation uncertainty, significant deficiencies).

In our view, the section heading “Key Audit Matters” should be retained without revision and revisions to the auditor’s responsibilities section of the auditor’s report (or the introductory language of the KAM section) should be made instead to provide transparency about which matters in the audit are specifically considered in the auditor’s determination of KAMs. This wording could explain how the auditor’s determination of KAMs factors in fraud-related matters alongside the other matters the auditor is required to take into account.

In addition, we disagree with the requirement in ED-240 paragraph 64 for the auditor to include a statement in the Key Audit Matters section of the auditor’s report that there are no key audit matters related to fraud to communicate because such a statement may be misunderstood by financial statement users as providing an opinion or disclosure as to whether fraud has occurred at the entity.

Finally, as further explained in our response to Q4, we also suggest that the IAASB align the proposed changes to the auditor’s report in ISA 700 paragraph 40(a)(ii) to the scope of required communications with those charged with governance in ED-240 paragraphs 67.

Q6. 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)

Disagree, with comments below

As stated in our comment letter submitted to the IAASB on 8 April 2024 in response to the Exposure Draft, *Proposed Narrow Scope Amendments to International Standards on Quality Management (ISQMs), International Standards on Auditing (ISAs) and International Standard on Review Engagements (ISRE) 2400 (Revised), Engagements to Review Historical Financial Statements, as a Result of the Revisions to the Definitions of Listed Entity and Public Interest Entity (PIE) in the IESBA Code*, we are not supportive of the IAASB adopting the definition of PIE at this time due to the lack of clarity about the adoption protocol. Therefore, we do not believe the IAASB should consider expanding the transparency requirements in ED-240 to PIEs at this time.

Considering a Separate Stand-back Requirement in ED-240

Q7. 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)

Agree, with comments below

We agree with the IAASB's decision not to include a separate stand-back requirement in ED-240 as we agree that existing stand-back requirements in other ISAs, such as ISA 315 (Revised 2019), also apply to audit evidence obtained from audit procedures performed in accordance with ED-240. However, we encourage the IAASB to continue to consider an alternative and more coherent stand-back model throughout the suite of ISAs, as presented in Appendix 2 of Agenda Item 5 of the Audit Evidence project for the March 2024 IAASB meeting.

Scalability

Q8. 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)

Agree, with comments below

Generally, we believe that the scalability considerations included in ED-240 are appropriate; however, we believe ED-240 could be improved by moving certain guidance in the application material that relates only to larger, more complex entities to a separate *Scalability* section of the application material and providing more scalability considerations for smaller, less complex entities. For example:

- ▶ We suggest that the IAASB revise and add application material throughout the Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework and the Entity's System of Internal Control section of ED-240 to more clearly differentiate the considerations for larger, more complex entities and to provide more guidance on how to obtain this understanding for smaller, less complex entities. Specifically, we believe the addition of the more detailed, less principles-based requirements to the required risk assessment procedures (paragraphs 33 - 39 of ED-240) are written for larger, more complex or listed entities that have more robust systems of internal control related to the identification, assessment and monitoring of the entity's fraud risks. We strongly suggest that the IAASB provide guidance on how these requirements can be achieved for smaller, less complex entities.
- ▶ We also believe that some of the new application material is skewed toward understanding the fraud-related aspects of a more complex system of internal control, and as such, suggest that the IAASB move these considerations into scalability sections to illustrate considerations for larger, more complex entities, for example:
 - Paragraph A79 of ED-240, which introduces an entity's fraud risk management program

- Paragraph A65 of ED-240, which states that the auditor may consider “listening to the entity’s earnings calls.” We suggest the IAASB consider changing this to “understanding information shared with analysts about earnings or other business developments” to keep this guidance from becoming dated.
 - Paragraph A66 of ED-240, which states that the auditor may consider short-selling reports, negative media attention, or negative analyst reports.
- ▶ As explained in our response to Q4, while we acknowledge that the requirements in paragraph 55 of ED-240 are conditional to when an auditor identifies fraud or suspected fraud, we do not believe the requirements are scalable as proposed, as they are currently required for all identified fraud or suspected fraud, which, in a large complex entity, could include a large volume of inconsequential matters. Also, as explained in our response to Q4, we do not believe the examples to paragraph 55 of ED-240 effectively illustrate how the required procedures in paragraphs 55 and 56 can be scaled.

Linkages to Other ISAs

Q9. Does ED-240 have appropriate linkages to other ISAs (e.g., ISA 200, ISA 220 (Revised), ISA 315 (Revised 2019), ISA 330, ISA 500, ISA 520, ISA 540 (Revised) and ISA 701) to promote the application of the ISAs in an integrated manner? (See EM, Section 1-J, paragraphs 81-84)

Agree, with comments below

Generally, we believe ED-240 has the appropriate linkages to other ISAs to promote the application of the ISAs in an integrated manner and we believe the alignment in structure with ISA 315 (Revised 2019) is a significant improvement. However, we have some concerns about the linkage to certain ISAs, as explained below.

Linkage with ISA 315 (Revised 2019) and ISA 330¹⁸

We have some concerns about the clarity of the requirements and their consistency with ISA 315 (Revised 2019) (refer to our response to Q3). We also do not believe the restructuring of the documentation requirements in ED-240 provides the appropriate linkages to the requirements of ISA 315 (Revised 2019) and ISA 330. Absent this linkage, we believe ED-240 implies these requirements are separate and distinct from the procedures performed in accordance with ISA 315 (Revised 2019) and ISA 330 (refer to our response to Q10).

We also suggest that the IAASB add a linkage in paragraph 3 of ED-240 to the requirement to understand and evaluate the entity’s control environment in ISA 315 (Revised 2019) paragraph 21. We believe the linkage to ISA 315 (Revised 2019) would be helpful to explain that a lack of involvement or commitment by management or those charged with governance for the prevention and detection of fraud, and their commitment to creating and maintaining a culture of honesty and

¹⁸ ISA 330, *The Auditor’s Responses to Assessed Risk*

ethical behavior, can affect the auditor's evaluation of the entity's control environment as required in ISA 315 (Revised 2019).

Linkage with ISA 600 (Revised)¹⁹

We suggest that the IAASB consider ISA 600 (Revised) and whether it is clear how the revisions and incremental requirements in ED-240 are to be applied in group audits, particularly as it relates to responding to identified or suspected instances of fraud.

Linkage with ISA 250 (Revised)

We have concerns about the linkage between ED-240 and ISA 250 (Revised) as follows:

- ▶ As explained in our response to Q4, the requirement to communicate fraud or suspected fraud as proposed in ED-240 paragraph 67 is inconsistent with the requirement in ISA 250 (Revised) paragraph 23.
- ▶ We agree with the IAASB's addition of the statement in paragraph 14 of ED-240 that "for the purposes of this and other relevant ISAs, fraud constitutes an instance of non-compliance with laws and regulations," however, we believe conforming amendments to ISA 250 (Revised) are needed to make this relationship clear. We suggest paragraph A6 of ISA 250 (Revised) is amended to state that fraud is a sub-set of non-compliance with laws and regulations and therefore, the requirements of both ISA 250 (Revised) and ISA 240 are applicable. In addition, the IAASB could make it clear in paragraph A6 of ISA 250 (Revised) that corruption, bribery and money laundering (as described in paragraphs A18 and A19 of ED-240) may be fraudulent acts, or may be carried out to facilitate or conceal fraud, in which case the requirements of ISA 240 are applicable.

Linkage with ISA 700 (Revised)

Refer to our response to Q4 for our comment on the necessity to align the conforming amendment to ISA 700.40(a) in ED-240 to the requirement in paragraph 67 of ED-240 regarding our communications with those charged with governance about identified or suspected fraud.

Linkage with ISA 550

As part of the IAASB's consideration of the auditor's responsibilities for third-party fraud, we encourage the IAASB to consider whether further revisions may be warranted to ISA 550 to better explain the linkage of the concepts of related parties and third parties, with a further clarification that related party fraud is a type of third-party fraud that is subject to ISA 240.

¹⁹ ISA 600 (Revised), *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*

Written representations

Refer to Q10 for our comments related to paragraph 65 of ED-240 and the need to better align these requirements in ED-240 related to written representations with certain related requirements in ISA 210 and ISA 250 (Revised).

Other Matters

Q10. 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.

Yes, with comments below

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

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

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

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

Journal entries and other adjustments

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

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

50(a). Make inquiries of individuals involved in **the information processing activities to report transactions to the general ledger and the financial reporting process used to prepare the entity's financial statements** about their knowledge of inappropriate or unusual activity relating to the processing of journal entries and other adjustments;...

- ▶ Further to the previous comment, we believe the following changes to Appendix 4 of ED-240 should be made:
 - The first bullet of Appendix 4 of ED-240 indicates that the auditor's understanding of the entity's information system and communication relevant to the preparation of the financial statements, including "the entity's financial statement closing process" provides the auditor with knowledge relevant to their selection of journal entries and other adjustments for testing. We believe that this reference should be amended to state "the entity's ~~financial statement closing process~~ **information processing activities to report transactions to the general ledger and the financial reporting process used to prepare the entity's financial statements**".
 - When considering the identification and assessment of the risks of material misstatement due to fraud in the fourth bullet of Appendix 4 of ED-240, the auditor considers whether journal entries and other adjustments are susceptible to unauthorized or inappropriate intervention or manipulation from, among other items, "opportunities from privileged access granted to individuals involved in the financial statement closing process". As privileged access is generally granted by the entity by application or process, we believe that this reference should be amended to state "opportunities from privileged access granted to individuals involved in the ~~financial statement closing process~~ **information processing activities to report transactions to the general ledger and the financial reporting process used to prepare the entity's financial statements**".
- ▶ In paragraph 50(b) of ED-240, we propose the following edits to align with the wording in paragraph 49 of ED-240:

50(b). Obtain audit evidence about the completeness of the population of all journal entries **recorded in the general ledger** and other adjustments made in the preparation of the financial statements throughout the period; (Ref: Para. A128-A129 and A135)
- ▶ On a related note, paragraph A129 of ED-240 refers to the population of journal entries that are made directly to the financial statements, which we believe represents the financial reporting

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

- ▶ We note that enhancements have been made to paragraphs 50(d) and A133 of ED-240 with the intention of strengthening the work effort related to testing journal entries and other adjustments by elevating the current requirement from a "consideration of whether to test" to a "determination of whether to test" journal entries and adjustments made throughout the period. We do not believe this is a meaningful change in the performance requirement. Currently in practice, consideration is given to the likelihood of management overriding journal entries when deciding whether to test journal entries throughout the period. Where that likelihood is determined to be low, we believe it may be appropriate to only test the journal entries made at the end of the reporting period. If the expectation of the IAASB is to instead require some testing of journal entries throughout the period, we believe this performance requirement needs clarification.
- ▶ Further to the concept of testing journal entries throughout the period, the new requirement in paragraph 50(b) of ED-240 to obtain audit evidence about the completeness of the population of all journal entries and other adjustments appears contradictory to the "determination" of whether to test journal entries throughout the period. When the auditor determines that additional testing beyond the population of journal entries made at the end of the reporting period is not necessary, it is unclear why the auditor would be obtaining audit evidence about the completeness of all journal entries made in the preparation of the financial statements throughout the period. Rather, we believe that if the "determination" in paragraph 50(d) is intended to allow the auditor to scale their testing based on the likelihood of management override, then the requirement to ascertain completeness should also be scaled.
- ▶ When determining the completeness and accuracy of the population of journal entries made throughout the period, it is important to recognize that the auditor will likely need to make use of an automated technique to extract and analyze the data. If the expectation is that auditors will often be using automated techniques, we believe the application material would benefit from emphasizing the ability to use, and benefits of using, automated techniques.
- ▶ We have the following additional comments as it relates to Appendix 4 of ED-240:
 - When understanding the entity's information system and communication relevant to the preparation of the financial statements when considering the selection of journal entries and other adjustments for testing, we note that the auditor is directed to understand "the types of journal entries (whether standard or non-standard) incorporated in the general ledger" (first bullet of Appendix 4 of ED-240). We then note in the final bullet to Appendix 4 of ED-240 that the auditor is directed to consider "journal entries or other adjustment processed outside the normal course of business." We believe the final bullet of Appendix 4 of ED-240 should be combined with the discussion of non-standard journal entries in the first bullet with clarity that such journal entries include those outside the normal course of

business, including those used to post significant unusual transactions in paragraph 53 of ED-240.

- The auditor is directed to consider the characteristics of fraudulent journal entries and other adjustments when selecting items for testing (fifth bullet of Appendix 4 of ED-240). While we agree that the auditor may use recent information, such as data on actual perpetrated frauds or reports regarding trends in occupational fraud to inform them of the characteristics of fraudulent journal entries, we believe that it is equally as important for the auditor to analyze the entity's own data to identify anomalous transactions, particularly when they have the complete population of journal entry data and can make use of automated techniques.
- The auditor is directed to consider the nature and complexity of the accounts when selecting items for testing (sixth bullet of the Appendix 4 of ED-240). We note that journal entries that "contain significant estimates" introduce a different element of management override, that being the introduction of bias in the selection of assumptions rather than management override of controls over journal entries. We recommend including a reference to paragraphs 51-52 of ED-240 for this consideration. Additionally, given the importance of considering the opportunity for management to collude with related parties, we recommend the following change to the intercompany transactions' consideration: "Contain intercompany transactions or transactions with related parties".

Engagement resources

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

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

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

- (a) ~~That~~ members of the engagement team collectively have the appropriate competence and capabilities, including sufficient time and appropriate specialized skills or knowledge to perform risk assessment procedures, identify and assess the risks of material misstatement due to fraud, design and perform further audit procedures to respond to those risks, ~~or~~ and evaluate the audit evidence obtained.
- (b) In making the determination in 22(a), whether engagement team members with specialized skills or knowledge are needed to perform risk assessment procedures,

identify and assess the risks of material misstatement due to fraud, design and perform further audit procedures to respond to those risks, or evaluate the audit evidence obtained.

We also suggest the following revisions to paragraph A34 of ED-240 to make it clear that the use of forensic specialists is not always necessary:

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

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

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

Engagement performance

As further explained in our response to Q3, we believe paragraphs 45 and 46 of ED-240 (and the related application material) that address overall responses need to be expanded in some manner to acknowledge that certain requirements that precede these paragraphs are also overall responses to address the risks of material misstatement due to fraud at the financial statement level.

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

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

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

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

(b) Fraud is identified or suspected ~~fraud~~; and

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

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

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

Written representations

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

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

- ▶ ISA 210 paragraph 6(b)(ii), which currently requires that the auditor “obtain the agreement of management that it acknowledges and understands its responsibility for such internal control as

management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error”

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

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

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

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

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

Documentation

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

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

- (a) The matters discussed among the engagement team regarding the susceptibility of the entity's financial statements to material misstatement due to fraud in accordance with paragraph 29.
- (b) Key elements of the auditor's understanding in accordance with paragraphs 33-38 (including identified controls in the control activities component that address assessed risks of material misstatement due to fraud), the sources of information from which the auditor's understanding was obtained and the risk assessment procedures performed.
- (c) The identified and assessed risks of material misstatement due to fraud at the financial statement level and at the assertion level, and the rationale for the significant judgments made.

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

- ~~(d)~~ If the auditor has concluded that the presumption that a risk of material misstatement due to fraud related to revenue recognition is not applicable in the circumstances of the engagement, the reasons for that conclusion.
- (e) (a) The results of audit procedures performed to address the risk of management override of controls, the significant professional judgments made, and the conclusions reached.

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

- ~~(d)~~ (a) If the auditor has concluded that the presumption that a risk of material misstatement due to fraud related to revenue recognition is not applicable in the circumstances of the engagement, the reasons for that conclusion.
- ~~(f)~~ (b) Fraud or suspected fraud identified, the results of audit procedures performed, the significant professional judgments made, and the conclusions reached.
- ~~(g)~~ (c) The matters related to fraud or suspected fraud communicated with management, those charged with governance, regulatory and enforcement authorities, and others, including how management, and where applicable, those charged with governance have responded to the matters.

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



Additional drafting suggestions

Refer to the Appendix to this letter for additional specific drafting suggestions.

Translations

Q11. 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.

No response

Effective Date

Q12. 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*)

See comments on effective date below

We believe that an effective date for periods beginning on or after 15 December 2026 would provide a sufficient period to support effective implementation if the final revised ISA 240 is approved as targeted in March 2025.

Should the approval date be deferred and occur later than June 2025, we believe that an effective date of audits of periods beginning on or after 15 December 2027 may be more appropriate.

We would be pleased to discuss our comments with members of the International Auditing and Assurance Standards Board or its staff. If you wish to do so, please contact Eric Spiekman, Global Professional Practice (Eric.Spiekman@ey.com).

Yours sincerely,

Ernst + Young Global Limited

Appendix: *Additional drafting suggestions*

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

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

29. In applying ISA 315 (Revised 2019), when holding the engagement team discussion, the engagement partner and other key engagement team members shall place particular emphasis on how and where the entity’s financial statements may be susceptible to material misstatement due to fraud, including how fraud may occur. In doing so, the engagement team **shall discuss** ~~discussion shall include~~: (Ref: Para. A48-A49 and A53)

(a) ~~An exchange of ideas about:~~

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

(ii) ~~Fraud risk factors, including: (Ref: Para. A51-A52)~~

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

~~b-~~(ii) ~~....~~

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

34. ...

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

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

(iii) Whether they are aware of deficiencies in ~~the system of~~ internal control related to the prevention and detection of fraud, and the remediation efforts to address such deficiencies.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

A53. The engagement partner and other key engagement team members participating in the engagement team discussion may also, as applicable, use this as an opportunity to:...

- Remind engagement team members of their **responsibilities regarding quality management at the engagement level for an audit of financial statements in accordance with ISA 220 (Revised), and their** role in serving the public interest by performing quality audit engagements and the importance of engagement team members remaining objective in order to better facilitate the critical assessment of audit evidence obtained from persons within or outside the financial reporting or accounting functions, or outside the entity.

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

- Offshore financial centers that have ~~looser~~ **less restrictive** regulations and tax incentives that may facilitate fraud through money laundering
- Cultural norms in which using bribery to conceal fraud is ~~deeply ingrained as~~ an accepted practice of doing business

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

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

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

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

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

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

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

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

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

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

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

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

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

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

- ~~How t~~ **The entity's risk assessment process addresses the risk of** fraud ~~risk assessment.~~
- The entity's **processes and** controls to prevent or detect fraud.

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

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

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

A99. ISA 315 (Revised 2019) requires the auditor to obtain an understanding of controls over journal entries as well as to evaluate their design and determine their implementation as part of understanding the entity's system of internal control. This understanding focuses on the controls over journal entries that address risks of material misstatement at the assertion

level whether due to fraud or error. Paragraphs 49-50 of this ISA require the auditor to design and perform audit procedures to test the appropriateness of journal entries and is specifically focused on the risks of material misstatement due to fraud (see Appendix 4 for additional considerations when testing journal entries).

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

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

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

A111. There may be limited circumstances where it may be appropriate to rebut the presumption that there are risks of material misstatement due to fraud in revenue recognition. The auditor may conclude that there are no risks of material misstatement due to fraud relating to revenue recognition in the case where fraud risk factors are not significant.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Example:

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

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

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

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

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

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

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

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

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

- The lack of a process to investigate **non-compliance with laws and regulations, including the fraud or suspected fraud** or a process to investigate the **non-compliance with laws and regulations, including** fraud or suspected fraud that is not appropriate in the circumstances.
- The lack of, or ineffective, remediation measures implemented by management to prevent or detect the reoccurrence of **non-compliance with laws and regulations, including the fraud or suspected fraud**.

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

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

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