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

## Guide for Respondents

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

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

You may respond to all questions or only selected questions.

To assist our consideration of your comments, please:

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

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

Use the "**Submit Comment**" button on the ED web page to upload the completed template.

## PART A: Respondent Details and Demographic information

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

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

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

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

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

*Responsibilities of the Auditor*

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

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

   *(See ED, paragraphs 1–11 and 14)*

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

**Detailed comments (if any):**

We generally agree that ED-240 sets out the auditor's responsibilities relating to fraud in an audit of financial statements; however, we believe the following recommendations (and related changes) to ED-240 would provide additional clarity.

*Perceived Shift in Responsibilities Relating to Fraud Detection*

We are concerned that the proposed changes to ED-240, when taken together, may be perceived as inappropriately shifting the onus of fraud prevention and detection solely onto the auditor, despite the primary responsibility resting with management and those charged with governance. To retain the appropriate emphasis on the responsibilities of management and those charged with governance, and clearly define the auditor's role and circumscribe it to the auditor's core competencies, there are certain recommendations we have provided throughout this comment letter to better align the responsibility of the auditor to detect fraud, including the following:

- We have concerns with the reordering of the ED-240 paragraphs relating to (1) the responsibilities of management and those charged with governance and (2) the responsibilities of the auditor. While we acknowledge that ED-240 still states that management and those charged with governance have the primary responsibility for the prevention and detection of fraud, the placement of this paragraph below the responsibilities of the auditor does not adequately demonstrate that management and those charged with governance are first and foremost responsible for preventing and detecting fraud. Accordingly, we recommend that the order of paragraphs 2 and 3 within ED-240 be reversed such that the paragraph describing the responsibilities of management and those charged with governance is first as paragraph 2.

- Paragraph 2 of ED-240 omits the responsibility of the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement due to error (i.e., in addition to fraud). This omission places undue emphasis on the auditor's responsibility to detect fraud.

  **Paragraph 2**: "The auditor's responsibilities ~~relating to fraud~~ when conducting an audit in accordance with this ISA, and other relevant ISAs, are to:
  (a) Plan and perform the audit to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement due to **error or** fraud. These

responsibilities include identifying and assessing risks of material misstatement in the financial statements due to **error or** fraud and designing and implementing responses to address those assessed risks."

- We believe that certain language that was removed from extant ISA 240 should be included in ED-240 to avoid overstating the role and ability of the auditor to detect fraud.

  It is a bedrock principle in the preparation and auditing of financial statements that management and those charged with governance have primary responsibility in fraud detection. As recognized in the extant standard and ED-240, paragraph A12, the auditor is inherently limited in its ability to detect fraud because it may involve "sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations to the auditor." Therefore, we recommend the following edits in paragraph 6 of the ED to better reflect auditor's capabilities:

  **Paragraph 6**: "Although fraud is a broad legal concept, for the purposes of the ISAs, the auditor is concerned with a material misstatement of the financial statements due to fraud. Although the auditor may **suspect or, in rare cases,** identify ~~or suspect~~ the occurrence of fraud as defined by this ISA, the auditor does not make legal determinations of whether fraud has actually occurred."

- We believe that certain existing language (bolded and underlined below) should be carried forward, with some minor edits, to ED-240, as it serves a key function in delineating the auditor's responsibilities and inherent limitations in detecting fraud, the removal of which may signal an expansion in the auditor's role, which we note to be at odds with the IAASB's intent: See, for example, the IAASB's statement in the EM that removal of certain language in the extant standard "is not intended to increase the work effort as it pertains to considering the authenticity of records and documents obtained during the audit."

  - **Paragraph 20**: "**Unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine.** If conditions identified during the audit cause the auditor to believe that a record or document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, the auditor shall investigate further. (Ref: Para. A26–**A32**~~28~~)"

  - **Paragraph A12:** "The risk of not detecting a material misstatement resulting from fraud exists because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. Such attempts at concealment may be even more difficult to detect when accompanied by collusion. Collusion may cause the auditor to believe that audit evidence is persuasive when it is, in fact, false. The auditor's ability to detect a fraud depends on factors such as the skillfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved. **While the auditor may be able to identify potential opportunities for fraud to be perpetrated, it will be more challenging for the auditor to definitively determine whether misstatements in judgment areas such as accounting estimates are caused by fraud or error.**"

- **Paragraph A26: "**The auditor is not required to perform procedures that are specifically designed to identify conditions that indicate that a record or document may not be authentic or that terms in a document have been modified. **An audit performed in accordance with the ISAs rarely involves the authentication of documents, nor is the auditor trained as or expected to be an expert in such authentication.** However, audit procedures performed in accordance with this or other ISAs, or information from other sources, may bring to the auditor's attention**, through the exercise of professional skepticism,** conditions that cause the auditor to believe that a record or document may not be authentic or that terms in a document have been modified but not disclosed to the auditor. Paragraph 20 applies if the auditor identifies such conditions during the course of the audit."

- **Paragraph A56:** "Fraud risk factors reflective of an attitude that permits rationalization of the fraudulent action may not be susceptible to observation by the auditor. **Also, the fact that fraud is usually concealed can make it very difficult to detect.** Nevertheless, the auditor may become aware of the existence of such information through, for example, the required understanding of the entity's control environment.

*The Auditor's Responsibility Relating to Fraud - Third-Party Fraud*

While we acknowledge that the definition of fraud in ED-240 remains unchanged from extant ISA 240, we are concerned that ED-240, as revised, implies an expanded scope of auditor responsibility for third-party fraud without fully addressing the impacts of doing so across the financial reporting ecosystem. This expanded scope appears to contradict paragraph 92 of the EM, which indicates that the IAASB did not support expanding the role of the auditor to detect third-party fraud that is not directly related to a risk of material misstatement due to fraud in the financial statements. Consequently, we have the following concerns with respect to third-party fraud and the role of the auditor to detect third-party fraud:

- Paragraph A21, which expands on the definition included in paragraph 18, fails to limit the role of the auditor with respect to third-party fraud that poses a risk of material misstatement due to fraud to the financial statements and, accordingly, could vastly broaden the role of the auditor as it exists today, which would have implications to the scope, timing, and cost of financial statement audits (and possibly integrated reporting in the future when other subject matters, such as sustainability, could be included in the scope of the auditor's report). As such, we recommend the IAASB revise ED-240, paragraph A21, to better align with the intention to not expand the role of the auditor when considering the detection of fraud related to third parties.

- ED-240, paragraph 29(a)(ii)(c) states that engagement teams, as part of their fraud risk factor discussion, should consider "how assets could be misappropriated by … third parties". We recommend that the IAASB either remove reference to third parties from this paragraph or provide more clarity around instances of third-party misappropriation of assets resulting in fraud risk factors and limit the brainstorming on third-party fraud to significant instances only. We believe that it should not be incumbent of the auditor to consider every potential instance of third-party misappropriation of assets (of which most instances would likely not rise to the level of a material misstatement).

We acknowledge and agree with the IAASB's aim to emphasize that fraud discussions should not take place only during the planning phase of an audit but, should rather continue throughout the audit process.

However, the second example within paragraph A52 does not relate to an exchange of ideas around an entity's third-party relationships that give rise to a fraud risk factor, or a risk of third-party fraud. Instead, the example discusses an already identified instance of third-party fraud that would be responded to in a timelier and more direct manner than through an engagement team discussion on fraud risk factors. In addition, we believe this example does not appropriately state how an auditor should identify fraud risk factors for any potential material third-party fraud that is reasonably likely to occur. For example, the instance of fraud in this example details third parties using falsified documents in a loan application document but does not indicate how the auditor was reasonably able to design procedures to detect this. To the contrary, the example alludes to the fact that the auditors were made aware through means that were not their planned audit procedures. To address both observations, we recommend the IAASB consider including an alternative example such as the following:

> "Based on the auditor's understanding of the entity's physical access controls, the auditor identified a fraud risk factor (i.e., opportunity to commit fraud) resulting from the entity's lack of sufficient security at locations with a material amount of small, lightweight, high-value assets."

*The Auditor's Responsibility Relating to Fraud - Other Matters*

We recommend the IAASB remove the word "any" from ED-240, paragraph 29(b), as the current wording would require an audit engagement team discussion to encompass any conceivable fraud rather than only those that may pose risk(s) of material misstatement:

> **Paragraph 29(b)**: "A consideration of ~~any~~ fraud or suspected fraud, including allegations of fraud, that may impact the overall audit strategy and audit plan, including fraud that has occurred at the entity during the current or prior years."

We also believe more clarity is warranted in paragraph A11, which considers when an identified misstatement due to fraud that is not quantitatively material may be qualitatively material:

- Extant ISA 240 explicitly states that an otherwise insignificant fraud involving senior management is an example whereby the fraud may be deemed to be significant. ED-240, paragraph A11(a) includes solely this example but is worded in a manner that implies that any otherwise insignificant fraud involving anyone other than senior management would not be considered significant. We recommend the IAASB clarify this is just an instance of one example.
- Paragraph A11(b) discusses that a quantitatively immaterial fraud may be qualitatively material depending on why the fraud was perpetrated. Although the bullet is included in application material, the context of how it is written implies this is a matter that would always be considered. We do not believe this should be a matter for auditors to always consider, as there are often times when the auditor may never know the reason, or all the reasons, as to why a fraud was perpetrated and the auditor should not be expected to conduct what could be an exhaustive and unwarranted exercise.

*Professional Skepticism*

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

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

*(See ED, paragraphs 12–13 and 19–21)*

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

**Detailed comments (if any):**

We are supportive of reinforcing the exercise of professional skepticism about matters relating to fraud in an audit of financial statements and recognize the efforts of the IAASB to do so through ED-240. However, we have several recommendations about certain paragraphs addressing professional skepticism within ED-240:

- We believe there should be consistency in how professional skepticism is described in the ISAs, including consistency with the definition of professional skepticism as stated in ISA 200, as well as to incorporate information that provides guidance on how the definition is applied (consistent with the structure of the ISAs) into the application material to paragraph 19 of ED-240. Accordingly, we recommend the edits below:

  **Paragraph 19:** "In applying ISA 200, the auditor shall maintain professional skepticism throughout the audit~~, recognizing the possibility that a material misstatement due to fraud could exist~~."

  **Paragraph A24:** "Maintaining professional skepticism **throughout the audit involves** ~~requires~~ an ongoing questioning of whether the information and audit evidence obtained suggests that a material misstatement due to fraud may exist. It includes considering the reliability of the information intended to be used as audit evidence and identified controls in the control activities component, if any, over its preparation and maintenance. Due to the characteristics of fraud, the auditor's professional skepticism is particularly important when considering the risks of material misstatement due to fraud."

- ED-240, paragraph A25, Example Box, includes the same two examples of impediments to the exercise of professional skepticism at the engagement level as those in ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*, paragraph A34, except paragraph A25 differs only by the inclusion of a statement that "These circumstances were, based on the engagement partner's professional judgment, indicative of possible efforts by management to conceal fraud". As these examples give no context to the fraud being concealed, we recommend that paragraph A25 of ED-240 refer to ISA 220 (Revised) only, and that these examples be removed.

*Risk Identification and Assessment*

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

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

   *(See ED, paragraphs 26–42)*

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

**Detailed comments (if any):**

We agree that ED-240 appropriately builds 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. To improve the clarity of ED-240 further we recommend the following:

- We believe that any paragraphs in ED-240 that reference the application of ISA 315 (Revised 2019) should only build upon the requirements in ISA 315 (Revised 2019), rather than duplicate them or include similar requirements worded in a different manner, as appears to be the case for several requirement paragraphs. It is not clear whether differences in language between ISA 315 (Revised 2019) and ED-240 are intended to reemphasize the ISA 315 (Revised 2019) requirements or for the auditor to perform additional procedures beyond those required to be performed in accordance with ISA 315 (Revised 2019). One such example is whether there is an expected difference in the nature and extent of procedures regarding controls that address a fraud risk, including controls over journal entries, as demonstrated by the difference in wording in the following paragraphs:

  > **ED-240, paragraph 38**: "In applying ISA 315 (Revised 2019), the auditor's understanding of the entity's control activities shall include identifying controls that address risks of material misstatement due to fraud at the assertion level, including controls over journal entries, designed to prevent or detect fraud."
  >
  > **ISA 315 (Revised 2019), paragraph 26(a)**: "Identifying controls that address risks of material misstatement at the assertion level in the control activities component as follows:
  >
  > > i. Controls that address a risk that is determined to be a significant risk;
  > > ii. Controls over journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments;"

  In the above example, paragraph 26(a) of ISA 315 (Revised 2019) requires the auditor to understand the entity's controls over journal entries that address a risk of material misstatement at the assertion level, which would include due to fraud or error. Therefore, it is unclear whether the language used in paragraph 38 of ED-240 implies a different requirement or the same requirement using different language. As a result, we are concerned that there will be confusion and inconsistent application of the IAASB's intended expectations. Accordingly, we recommend the IAASB reconsider any ISA 315 (Revised 2019) paragraphs that are referenced in ED-240 and only include additional paragraphs if ED-240 is clearly indicating additional requirements or include application material related to fraud when the language in ISA 315 (Revised 2019) does not sufficiently address the fraud element of the requirement.

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

- Extant ISA 240, paragraph 33, focused on the retrospective review of significant accounting estimates as an audit procedure responsive to the significant fraud risk of management override of controls (it does not address retrospective review as a risk assessment procedure). ED-240 includes retrospective reviews as <u>both</u> a risk assessment procedure (paragraph 28) and an audit procedure responsive to the significant fraud risk of management override of controls (paragraphs 51 and 52).
  We believe the responsive procedure to the risk of management override in paragraph 51 is not an application of the risk assessment procedure from ISA 540 (Revised), but rather a separate audit procedure that may take into consideration information learned from the risk assessment procedure. As paragraph 51 is a further audit procedure that is substantive in nature, we believe the procedure should apply to those accounting estimates that have been determined to be significant accounting estimates to the financial statements. As such, we recommend providing clarity as follows:

  > **Paragraph 28:** "In applying ISA 540 (Revised), the auditor shall perform a retrospective review of management judgments and assumptions related to the outcome of previous accounting estimates, or where applicable, their subsequent re-estimation to assist in identifying and assessing the risks of material misstatement due to fraud in the current period. In doing so, the auditor shall take into account the characteristics of the accounting estimates in determining the nature and extent of that review<u>**, including if, at an individual accounting estimate level, a review is necessary**</u>."
  >
  > **Paragraph 51:** "~~In applying ISA 540 (Revised) t~~<u>**T**</u>he auditor shall evaluate whether management's judgments and decisions in making the <u>**significant**</u> accounting estimates included in the financial statements, even if they are individually reasonable, are indicators of possible management bias that may represent a risk of material misstatement due to fraud."

- We recommend that a paragraph similar to ISA 540.A58 be added as application material to paragraph 28 to further explain how the characteristics of the estimate are considered in determining the extent of review, if any, that is necessary.

- We recommend clarifying in ED-240, paragraph 29, that the list of examples is not exhaustive to emphasize that there may be other salient ideas for engagement teams to discuss.

- We recommend that the IAASB reword the example in paragraph A62 since, while there may exist in certain geographies cultural norms of using bribery to conduct business, this is different from a cultural norm of using bribery to conceal fraud.

  - Cultural norms in which ~~using~~ bribery <u>**is an accepted practice of doing business, which could lead to bribery being used to facilitate or**</u> ~~to~~ conceal fraud~~ is deeply ingrained as an accepted practice of doing business~~.

- We recommend moving certain language from paragraph 34(a) to the application material, as indicated below, given that some of the language in paragraph 34(a) mirrors the application material within ISA 315 (Revised 2019) and is further elaborated upon already within the ED-240 application material (paragraphs A68 and A69).

  > Paragraph 34(a) "Obtain an understanding of how management's oversight responsibilities are carried out, such as the entity's culture and management's commitment to integrity and ethical values~~, including how management communicates~~

~~with its employees its views on business practices and ethical behavior with respect to the prevention and detection of fraud~~."

Paragraph A68 "Understanding aspects of the entity's control environment that address the entity's culture and understanding management's commitment to integrity and ethical values**, including how management communicates with its employees its views on business practices and ethical behavior with respect to the prevention and detection of fraud,** assists the auditor in determining management's attitude and tone at the top with regards to the prevention and detection of fraud."

- We recommend including "to monitor the system of internal control" in paragraph 36(a) since currently only the heading of this section in ED-240 includes such reference:

  "Obtain an understanding of aspects of the entity's process **to monitor 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."

- We recommend including a statement within paragraph A104 of ED-240 that the list of examples is not exhaustive. We also recommend that the IAASB make the following changes to the examples:

  - **Paragraph A104 - 4th bullet**: As profit before tax is a calculation of the financial statement line items that precede it, the example of the presentation of profit before tax from continuing operations may not be a meaningful example of earnings management. Accordingly, we recommend replacing this example with the below example:

    "Classification — certain income or expenses may be susceptible to misclassification within the statement of comprehensive income, for example, to manipulate key performance measures."

  - **Paragraph A104 - 5th bullet**: Since performance measures such as non-GAAP performance measures are not always subject to an auditor's opinion, we propose the below edits to the following example:

    "Presentation of disclosures — disclosures may be susceptible to omission, or incomplete or inaccurate presentation, for example, disclosures relating to contingent liabilities, off-balance sheet arrangements, financial guarantees, **or** debt covenant requirements~~, or management defined performance measures (i.e., performance measures that depart from those set forth in the financial reporting framework)~~."

- Paragraph A110 of ED-240 references paragraphs A55–A57 in relation to the significance of fraud risk factors and, specifically, paragraph A56 states that the fraud risk factors in Appendix 1 are categorized by incentives or pressures, opportunities, and rationalizations (i.e., the fraud triangle). Paragraph A111 provides examples whereby fraud risk factors are not significant, but the examples provided do not address the fraud triangle. We recommend enhancing the examples in paragraph A111 to provide a better linkage between fraud risk factors, especially their significance (or lack thereof), and for the instances provided describing why the risk of fraud in revenue recognition is being rebutted. We believe this may result in better fraud risk identification and assessment.

For example, in the first example in paragraph A111, rather than the text "Leasehold revenue from a single unit of rental property, or multiple rental properties with a single tenant", we recommend replacing that text with the following built out example:

> "Related to leasehold revenue from a single unit of rental property, or multiple rental properties, with a single tenant, the auditor, based on other risk assessment procedures performed, determined that revenue is not a key performance indicator for the lessor such that there are no significant incentives or pressures related to revenue and the lease accounting is outsourced to an independent asset management company such that there are no significant opportunities for management to manipulate revenue."

We recommend the IAASB apply similar changes to all the examples in paragraph A111. Further, we recommend including a statement within the lead in to the examples in A111 to indicate the list of examples is not exhaustive.

In addition, we recommend the IAASB update the wording in paragraph A110 as follows to read in a manner that does not indicate the auditor should essentially never rebut the presumed risk of fraud in revenue recognition:

> "If fraud risk factors related to revenue recognition are present, determining whether such fraud risk factors indicate a risk of material misstatement due to fraud is a matter of professional judgment. The significance of fraud risk factors (see paragraphs A55–A57) related to revenue recognition, individually or in combination,~~ ordinarily makes~~ **<u>may make</u>** it inappropriate for the auditor to rebut the presumption that there are risks of material misstatement due to fraud in revenue recognition."

*Fraud or Suspected Fraud*

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

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

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

**Overall response:** **<u>Agree, with comments below</u>**

**Detailed comments (if any):**

We agree that ED-240 appropriately establishes robust work effort requirements and application material to address circumstances when instances of fraud or suspected fraud are identified in the audit; however, we have the following recommendations to improve the clarity of ED-240:

- We are supportive of the IAASB's proposal, as outlined in paragraph 55 of ED-240, which states that "If the auditor identifies fraud or suspected fraud, the auditor shall obtain an understanding of the matter in order to determine the effect on the audit engagement." This emphasizes the importance of auditors responding to such matters comprehensively, based on the understanding of the matters identified. However, paragraph 55 as written may be construed differently by readers, as it does not clarify if the requirement is related solely to instances of fraud or suspected fraud discovered by the auditor or all instances of fraud or suspected fraud, including those identified by the auditor and those identified by others such as management.

Our interpretation is that this paragraph is meant to encompass all instances of fraud or suspected fraud regardless of the party who identified the matter. If this is the case, we are concerned that paragraph 55, as currently drafted, may be too prescriptive for practical application to every identified fraud or suspected fraud, requiring the auditor to execute each step as an audit procedure for each instance rather than a consideration based on the understanding the auditor obtained of the matter. This is concerning when the fraud or suspected fraud is identified by management, as this may result in duplicative efforts by the auditors to understand the matter. This could give rise to scalability and feasibility issues when the auditor needs to determine the course of action in each instance of fraud or suspected fraud.

Consequently, we recommend the IAASB move items (b) through (d) in paragraph 55 of ED-240 to a new requirement paragraph that follows the auditor obtaining an understanding of the identified fraud or suspected fraud. This would allow scalability and auditor judgment in applying audit procedures for those instances of fraud or suspected fraud that may reasonably pose a risk of material misstatement in the financial statement due to fraud, aligning with the objective of paragraph 17(a). Also, this will focus the auditor's attention to those matters that are important to the financial statement versus matters that are clearly inconsequential and do not warrant significant auditor attention (for example, customer theft in a retail environment). Accordingly, we recommend the following edits:

> **Paragraph 55:** If the auditor identifies, **or otherwise becomes aware of,** fraud or suspected fraud, the auditor shall obtain an understanding of the matter **by making inquiries about the matter and management's associated response with a level of management that is at least one level above those involved and, when appropriate in the circumstances, make inquiries about the matter with those charged with governance** in order to determine the effect on the audit engagement. ~~In doing so, the auditor shall:~~
> ~~(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 inquiries about the matter with those charged with governance;~~
>
> ~~(b) If the entity has a process to investigate the matter, evaluate whether it is appropriate in the circumstances;~~
> ~~(c) If the entity has implemented remediation measures to respond to the matter, evaluate whether they are appropriate in the circumstances; and~~
> ~~(d) Determine 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.~~
>
> **Paragraph 55.A**: **If, after obtaining an understanding of an identified fraud or suspected fraud, including the associated entity response, the matter is deemed to be more than inconsequential to the audit, the auditor shall:**
> **(a) If the entity has a process to investigate the matter, evaluate whether it is appropriate in the circumstance;**
> **(b) If the entity has implemented remediation measures to respond to the matter, evaluate whether they are appropriate in the circumstances; and**

**(c) Determine 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.**

- Paragraph A149 is intended to provide guidance on how to evaluate the appropriateness of the entity's process to investigate and remediate the fraud or suspected fraud to which an auditor has become aware. The application material is focused on providing guidance on the remediation element; however, there is no guidance on how to evaluate the sufficiency of an investigation. We recommend the IAASB provide guidance on matters to consider when evaluating the appropriateness of the entity's process to investigate, for example, when an independent investigation would be expected versus an internal investigation, among other matters.

- We are concerned that paragraph 56(a) may be impractical, especially related to group audits, given that the current wording requires the engagement partner to determine everything provided in this paragraph. There will be engagements whereby it will be impossible for the engagement partner to directly perform certain of the actions without needing assistance from other engagement team members. For example, paragraph 56(a)(iii) requires the engagement partner to determine whether there are additional responsibilities under law, regulation or relevant ethical requirements about the entity's non-compliance with laws and regulations. If the entity's non-compliance with a law or regulation is in another jurisdiction whereby a component auditor is assisting the engagement partner, the engagement partner would need that component auditor's involvement to assist in making this determination. Accordingly, we recommend the following edits to paragraph 56(a) of ED-240:

    **Paragraph 56**: "Based on the understanding obtained in accordance with paragraph 55, the engagement partner shall: (Ref: Para. A152–A153)

    (a) **Take responsibility for the determination as to** ~~Determine~~ whether:"

- We are also concerned with paragraph 56(b), which requires an auditor to, as applicable, consider the impact of identified fraud or suspected fraud on other engagements, including audit engagements from prior years. ISA 510 does not include similar requirements to consider prior engagements. In addition, there are certain jurisdictions that do not permit restatements of financial statements. Such requirement in ED-240 fails to provide context on the extent of other engagements one needs to consider or the nature of what one needs to consider for other engagements. Accordingly, we recommend the IAASB remove paragraph 56(b) from ED-240.

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

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

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

   *(See ED, paragraphs 61–64)*

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

**Detailed comments (if any):**

We are supportive of the IAASB's effort to enhance transparency around the auditor's responsibilities related to fraud in an audit of financial statements, such as is being proposed in the amendment to ISA 700, paragraph 40(a). However, we believe that the proposal to introduce Key Audit Matters (KAMs) related to fraud does not meet this objective and may, conversely, have a detrimental effect on (1) existing frameworks with respect to reporting such matters, which should begin with the entity itself, and (2) comparability and understandability by users of the auditor's report. Our concerns include the following:

- We believe that fraud is a legal determination that should be made by the appropriate authorities and is not a determination to be made, and reported, by auditors. By publicly communicating a conclusion that fraud has occurred, the auditor would be making a legal determination.

- Paragraph 61 of ED-240 requires the auditor to determine, from the fraud-related matters communicated with those charged with governance, those matters that required significant auditor attention. Paragraph 62 then requires an auditor to determine which matters from paragraph 61 were of most significance and, therefore, are KAMs. We have the following concerns with these paragraphs:

    - As currently drafted, paragraph 61(b) specifically puts more responsibility on the auditor than management to disclose information that may be original information related to the entity. It should not be incumbent upon the auditor to disclose to the public fraud or suspected fraud, especially when management does not have a similar responsibility to do so.

    - As it relates to paragraph 61(c), similar to paragraph 61(b), management is responsible for maintaining internal control, including related to the prevention and detection of fraud. First lines of public communication about deficiencies related to internal control should come from management. Auditors should report significant deficiencies to management and those charged with governance, in accordance with ISA 265.

- ISA 701, paragraph 9, includes factors that auditors are required to take into account when determining which matters required significant auditor attention in performing the audit and, consequently, should be communicated as Key Audit Matters. Among these factors are:

    - Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with ISA 315 (Revised 2019).

    - 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.

    - The effect on the audit of significant events or transactions that occurred during the period.

  We believe that ISA 701 appropriately addresses the considerations an auditor should make in determining which matters required significant auditor attention in performing the audit, including matters related to fraud or suspected fraud, which would be scoped into the first bullet above since fraud risks are by nature significant risks. Accordingly, we do not believe the supplemental requirements related to KAMs proposed in ED-240 are warranted.

While ED-240 does not explicitly require the inclusion of at least one fraud KAM, we believe the language within paragraphs A170 and A176 of ED-240, specifically the use of terms such as "ordinarily", "rare", and "certain limited circumstances", may be interpreted by many as there being an implicit requirement to include at least one fraud KAM in the audit report, which does not align with the intent of ISA 701, paragraph A21 (emphasis added):

- **Paragraph A170**: "… one or more of the matters related to fraud that required significant auditor attention in performing the audit … would <u>ordinarily</u> be of most significance in the audit of the financial statements … and therefore are key audit matters"

- **Paragraph A176**: "… <u>rare</u> that the auditor … would not determine at least one key audit matter related to fraud" and "…in <u>certain limited circumstances</u>, the auditor may determine that there are no matters related to fraud that are key audit matters"

- We acknowledge that the IAASB, in proposing this new standard, took steps to try to avoid any fraud-related KAMs from being "boilerplate." We believe, however, that expecting all audit reports, except in rare circumstances, to include at least one fraud-related KAM will inevitably result in boilerplate language that is not meaningful to a reader of an audit report. Despite the language in paragraph A168 of ED-240, we believe that auditors will be compelled by the standard to include at least one fraud-related KAM, even when there are no matters that required significant auditor attention. When compelled to do so, against the judgment of the auditors and consideration of ISA 701, any communicated KAM language would be generic, especially year-over-year and particularly when management override of controls is the sole fraud-related KAM identified, since the response to this presumed risk of fraud is prescriptive in the auditing standards. Further, this may result in expanding the expectation gap of auditors' responsibilities related to fraud in an audit.

- Paragraph 64 of ED-240 requires the auditor to include an explicit statement in the auditor's report to the effect that, based on the facts and circumstances of the entity and the audit, there are no KAMs related to fraud to communicate. We believe a statement like this may have detrimental consequences. For example, a reader may, instead of interpreting this statement as there being no fraud-related matters that required significant auditor attention in performing the audit, interpret the statement as there being no fraud risks in the audit.

For the reasons described above, we recommend the IAASB remove the fraud-related KAM requirements (paragraphs 61 through 64) and related application material from ED-240, as the existing KAM requirements and related application material in ISA 701 are sufficient; additional requirements in ED-240 may signal that ISA 701 is not fit for purpose as currently written. In addition, we recommend that the title in the audit report should not be updated to "Key Audit Matters Including Matters Related to Fraud", but instead should remain as "Key Audit Matters". If the IAASB maintains that more of a fraud focus is required for KAMs, we recommend that guidance for fraud considerations when identifying KAMs be added to ISA 701 application material rather than ISA 240.

| | |
|---|---|
| 6. | In your view, should transparency in the auditor's report about matters related to fraud introduced in ED-240 be applicable to audits of financial statements of entities other than listed entities, such as PIEs?<br>*(See EM, Section 1-H, paragraphs 76–77)* |

*(See ED, paragraphs 61–64)*

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

**Detailed comments (if any):**

As noted in our response to Question 5, we disagree with the IAASB's proposals related to disclosure of fraud matters in the auditor's report, including in the Key Audit Matters section, for any audit.

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

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

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

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

**Detailed comments (if any):**

As there are existing stand-back requirements in other salient ISAs such as ISA 220 (Revised), ISA 315 (Revised 2019), ISA 330, and ISA 540 (Revised), and the existence of too many stand-back requirements could detract from their intended purpose and potentially lead to a checkbox mentality in practice, we do not believe that ED-240 warrants a separate stand-back requirement.

*Scalability*

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

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

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

**Detailed comments (if any):**

We acknowledge that it can be challenging to scale a topic such as fraud to the same extent as other ISAs, but we believe that the extent of scalability within ED-240 is reasonably consistent with that of other ISAs, specifically the inclusion throughout the standard of guidance for matters to consider followed by examples in various application material paragraphs.

We do, however, have scalability concerns related to paragraph 55, as highlighted in our response to question 4 (Fraud or Suspected Fraud), paragraph 22, and paragraph A36 of ED-240.

We believe that, as currently drafted, paragraph 22 and the related application material could be interpreted as requiring all audits to include a forensic expert. Accordingly, we believe the requirement for the engagement partner to determine the competence and capabilities of the engagement team in ISA 220 (Revised) is sufficient, and, therefore, paragraph 22 from ED-240 should be removed with paragraphs A33–A36 being attached to current paragraph 23 in ED-240. We are supportive of including application material in ED-240 (or in ISA 220 (Revised)) regarding the potential need for specialized skill or knowledge of engagement resources. Further, application material could also reinforce the requirement in ISA 620, paragraph 7, which prescribes the requirement for auditors to determine whether specialized skill or knowledge is needed to obtain sufficient appropriate audit evidence, as it relates to the consideration of fraud.

We also recommend the following edits to paragraph A36 to ensure there is no implicit expectation in the application material that an IT, data, or other specialist is required on every audit engagement:

> **Paragraph A36:** ~~In~~**When** determining whether the engagement team has the appropriate competence and capabilities**, specific to the facts and circumstances of the engagement related to consideration of fraud risk**, the engagement partner may consider matters such as **whether expertise is needed** in IT systems or IT applications used by the entity or automated tools or techniques that are to be used by the engagement team in planning and performing the audit (e.g., such as the testing of high volumes of journal entries and other adjustments, or complex accounting estimates, when responding to the significant risk related to management override of controls).

*Linkages to Other ISAs*

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

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

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

**Detailed comments (if any):**

We generally agree that ED-240 has appropriate linkages to other ISAs but, as commented in our response to Question 5, we disagree with the fraud-related KAM requirements and guidance within ED-240. We believe that ISA 701 should continue to be the source for requirements and any related

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

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

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

5 ISA 500, *Audit Evidence*

6 ISA 520, *Analytical Procedures*

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

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

application material related to KAMs. Also, refer to our comments in response to Question 3 regarding additional clarity when linking to ISA 315 (Revised 2019) requirements.

*Other Matters*

10. Are there any other matters you would like to raise in relation to ED-240? If so, please clearly indicate the requirement(s) or application material, or the theme or topic, to which your comment(s) relate.

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

**Detailed comments (if any):**

- We have the following recommendations for clarity and to improve the language within various paragraphs:
  - **Paragraph 23(a):** Remove reference to "significant engagement responsibilities" since there is no definition or related application material**, and** without which there would be inconsistent **understanding and** practice. In addition, as currently worded, this paragraph expands the requirements within ISA 220 (Revised)"

    "In applying ISA 220 (Revised), the engagement partner shall determine that the nature, timing and extent of direction, supervision and review is responsive to the nature and circumstances of the audit engagement, taking into account the:

    (a) Skills, knowledge, and experience of the **engagement team** ~~individuals to be given significant engagement responsibilities~~; and"
  - **Paragraph 50**: Clarify the requirements responding to the risk of management override of controls specifically related to the requirements outlined in paragraphs 50(b) and 50(c). Paragraph 50(b) requires the auditor to obtain evidence about the completeness of the population of journal entries and other adjustments made in the preparation of the financial statements throughout the period, whereas paragraph 50(c) requires the auditor to select journal entries and other adjustments made at the end of the reporting period. It is unclear why paragraph 50(b) would be necessary if the audit procedures are to only test the population of journal entries at the end of the reporting period. We recommend changing paragraph 50(b) to provide clarity as follows:

    "Obtain audit evidence about the completeness of the population of ~~all~~ journal entries and other adjustments made in the preparation of the financial statements **for the period for which the auditor will perform journal entry testing as required in 50(c) and 50(d)**; (Ref: Para. A128–A129 and A135)**"**
  - **Paragraph A19:** Update the third bullet point, as it states money was laundered to facilitate fraud but describes a scenario whereby the embezzlement occurs before the laundering of the embezzled money. We propose two alternative wording options, the first to reflect the money laundering occurring subsequent to, and concealing, the fraud and the second to reflect the money laundering occurring prior to, and facilitating, the fraud:

*Option 1:* "Money laundering to ~~facilitate~~ **conceal** fraud – An employee laundered money, to an offshore bank account, that was illegally obtained from embezzling payments for fictitious purchases of inventory through the creation of false purchase orders, supplier shipping documents, and supplier invoices."

*Option 2:* "**Money laundering to facilitate fraud – An employee laundered money to an offshore bank account that was then used to provide kickbacks to customers for preferential treatment.**"

- **Paragraph A117:** Remove the first bullet point example, as (1) it is not sufficiently detailed, especially compared to the other examples, and (2) physical observation or inspection are procedures that are already typically performed for physical assets (i.e., those that may be susceptible to misappropriation) even when the inherent risk may be lower and no fraud risk is present.

  ~~Physically observe or inspect certain assets to respond to assessed risks of material misstatement due to fraud related to the misappropriation of those assets.~~

- **Paragraph A122:** Clarify language in the example, specifically the contradiction of using funds deposited in a non-existent bank account and the obligations remaining outstanding:

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

- **Paragraph A157:** Clarify language in this application material paragraph since the term "unlikely" may imply, without basis, that the auditor should always believe there are multiple instances of fraud when one is identified:

  "Since fraud involves incentive or pressure to commit fraud, a perceived opportunity to do so or some rationalization of the act, an **identified** instance of fraud **may not** ~~is unlikely to~~ be an isolated occurrence. Misstatements, such as numerous misstatements at a business unit or geographical location even though the cumulative effect is not material, may also be indicative of a risk of material misstatement due to fraud."

- **Paragraph A100:** We recommend the IAASB include in paragraph A100 examples of controls that address risks of material misstatement due to fraud at the assertion level, in accordance with paragraph 38. Further, we recommend that any examples added include a qualifier statement indicating such examples are not exhaustive.

  "Information from understanding controls over journal entries, designed to prevent or detect fraud, or the absence of such controls, may also be useful in identifying fraud risk factors that may affect the auditor's assessment of the risks of material misstatement due to fraud. **This may include, but is not limited to, controls that address risks at the assertion level in:**
  - **Revenue recognition.**
  - **Accounting estimates.**
  - **Significant transactions outside the normal course of business.**"

- **Paragraph A142:** We recommend that paragraph A142 be updated to (1) include at least one example of analytical procedures at a more granular level, and (2) expand upon, and provide more clarity on, the "unusual transactions" example.

"ISA 520 explains that the analytical procedures performed near the end of the audit are intended to corroborate conclusions formed during the audit of individual components or elements of the financial statements. However, the auditor may perform the analytical procedures at a more granular level for certain higher risk classes of transactions, account balances, and disclosures to determine whether certain trends or relationships may indicate a previously unidentified risk of material misstatement due to fraud. **One such example being performing analytical procedures at the customer invoice level**. Determining which particular trends and relationships may indicate a risk of material misstatement due to fraud requires professional judgment. Unusual relationships involving year-end revenue and income are particularly relevant.

Examples:

- Uncharacteristically large amounts of income being reported in the last few weeks of the reporting period.
- Unusual transactions**, such as transactions with specific customers that are significantly higher or more frequent than historical trends without an associated rationale**.
- Income that is inconsistent with trends in cash flow from operations:
    - Uncharacteristically low amounts of revenue at the start of the subsequent period; or
    - Uncharacteristically high levels of refunds or credit notes at the start of the subsequent period."

- **Appendix 1:** The "opportunities" subsection of Appendix 1 states "The nature of the industry or the entity's operations provides opportunities to engage in fraudulent financial reporting that can arise from the following" but includes examples such as internal controls or low morale of senior management, which are not industry or operations related. We recommend the IAASB enhance the aforementioned sentence to be broader than the nature of the industry or the entity's operations.

*Translations*

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

**Overall response:** **No response**

**Detailed comments (if any):**

*Effective Date*

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

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

*(See ED, paragraph 16)*

**Overall response:** **See comments on effective date below**

**Detailed comments (if any):**

We believe that the effective date should be for audits beginning after December 15 of a given year that allows 18 months, at a minimum, between the approval of the final standard and the effective date.