

Private and Confidential

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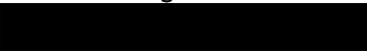
29 January 2021

Dear Keith

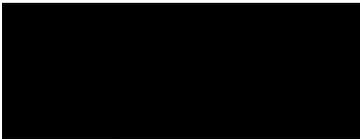
**Proposal to revise ISA (UK) 240 (Updated January 2020) The Auditor's responsibilities
Relating to Fraud in an Audit of Financial Statements**

Thank you for the opportunity to provide comment on the proposal to revise ISA (UK) 240 (Updated January 2020) The Auditor's responsibilities Relating to Fraud in an Audit of Financial Statements.

We have responded to the questions posed in the consultation in the attached Appendix for your consideration.

If you have any questions relating to our comments or would like to discuss them in more detail please contact me 

Yours sincerely



David Isherwood
Partner
For and on behalf of BDO LLP

Appendix

Answers to Specific Questions

Q1. Has ISA (UK) 240 been appropriately revised to give increased clarity as to the auditor's obligations relating to fraud in the audit of financial statements. If you do not consider this to be the case, please set out why and how you believe those obligations should be clarified.

We recognise that proposals set out in the exposure draft are intended, primarily, to provide additional clarity about the auditor's responsibilities in relation to fraud as far as fraud affects the financial statements being audited.

Auditors play an important role in the prevention and detection of fraud. It is also clear that users of financial statements have high expectations that where financial statements are materially affected by fraud, the auditor will identify such instances and react accordingly. Auditors, generally, understand this and endeavour to carry out audits that meet these high expectations.

We welcome proposals that seek to clarify expectations in respect of:

- requirements for the auditor to design procedures free from confirmatory bias;
- the importance of remaining alert to the possibility of fraud throughout the audit;
- the need for the audit team to communicate, revisiting previous conclusions and adapting the audit approach where fraud is indicated;
- making enquiries with other individuals or groups beyond financial management and those charged with governance; and
- where appropriate, specialist skills or knowledge may be required to either identify and assess risk of fraud or to design and perform appropriate audit procedures to respond to risk.

Whilst we agree that the proposals may provide additional clarity about the auditor's obligations in respect of fraud in many areas, the proposals merely reflect existing expectations of the auditor. In our view, the proposals do not fundamentally change the scope or relevance of an audit nor will they, alone, drive substantial changes in audit quality. Whilst helpful in clarifying expectations, where audits are currently performed to a high quality under extant standards, we do not expect the proposals to result in a significant increase in identification of material fraud resulting from the audit process.

However, fraud is a complex matter and we acknowledge that the desired changes needed will not be effected by any single action or event. In anticipation of wider corporate reporting reforms, we welcome these proposals as one part of what we expect to be a more wide reaching suite of actions, involving a wide spectrum of stakeholders, to prevent fraud or detect fraud when it should occur.

Q2. Have appropriate enhancements been made to the requirements for the identification and assessment of risk of material misstatement due to fraud, and the procedures to respond to those risks, to promote a more consistent and robust approach to the auditor's

responsibilities in relation to fraud? If you do not consider this to be the case, please set out why and how you believe the requirements should be enhanced.

The proposals provide clarity that fraud is expected to be high on the agenda, and be a key feature of the engagement team discussion on risk. The proposals also add emphasis to the iterative nature of the auditor's risk assessment, with the auditor remaining alert to possible concerns about fraud, communicating such concerns within the team and revisiting conclusions as appropriate.

Whilst the additional clarity provided might help to promote more consistent and robust work in this area, we consider that the proposals merely reflect existing good practice and may not go far enough to drive the consistency and robust work expected of auditors. Indeed the necessary levers to drive such enhancements may fall outside the current scope of an audit. Again, we acknowledge that the expected corporate reporting and audit reform consultation may further address this.

We welcome the proposed additional clarity in respect of whether the engagement team requires specialist skills or knowledge to be able to perform both risk assessment and performance of procedures, and to consider the need to involve forensic specialists where fraud is identified.

Ensuring consistent and robust work in this area may require providing auditors with education about the nature of common frauds, the latest techniques for perpetrating fraud, how fraud might be concealed and what procedures could be performed to reveal potentially fraudulent transactions. For the auditor to be successful in identifying fraud where it occurs, the auditor also requires experience that cannot necessarily be instilled through auditing standards alone, such as an appropriately sceptical mindset and an attitude that is truly open to the potential for fraud.

The original text of ISA (UK) 240 on which the proposals are based predates the prevalence of web-based fraud and cybercrime. We believe that the standard would benefit from additional application material in respect of technology-enabled fraud risks.

Q3. Have appropriate enhancements been made to the application material? If you do not consider this to be the case, please set out why and how you believe the application material should be enhanced.

We welcome the enhancements made to the application material. In particular, we support the addition of practical information providing the auditor with insights and examples of events, conditions or features of transactions that may be of interest in the performance of the audit.

Certain aspects of the application material may benefit from further enhancement. For instance, "forensic expert" is a term that is liberally quoted but is rarely defined. The application material could helpfully draw out what is meant by the use of this term, which we believe is more to do with relevant experience, rather than a job title.

Q4. Do the proposals sufficiently support the appropriate exercise of professional scepticism throughout the risk assessment procedures, the procedures to respond to those risks and the evaluation of audit evidence obtained? If you do not consider this to be the case, please give reasons and describe how you consider the exercise of professional scepticism could be better supported.

As explained above, we acknowledge the attempts made through the proposals to introduce certain ideas that support the notion of applying a sceptical mindset. For instance, the clarification that the auditor should design procedures that are not biased towards securing corroborative evidence and do not exclude evidence that may be contradictory. The understanding of cognitive biases and of mind-traps is an important element in demonstrating scepticism, however, we do not consider that the proposals alone can or will result in significant improvements; the right professional education and experience are critical.

Q5. ISA (UK) 240 establishes a rebuttable presumption that there are risks of fraud in revenue recognition (paragraph 26). Are there other account balances, transactions or disclosures for which such a rebuttable presumption should be established? If you consider there are, please identify them and set out why.

We do not consider that there are other classes of transactions, account balances or disclosures for which such a rebuttable presumption should be established.

Q6. ISA (UK) 240 specifies particular audit procedures responsive to risks related to management override of controls (paragraphs 31 - 33). Are there other audit procedures responsive to those risks, or any other risks of material misstatement due to fraud, that you believe should be required for all audits? If you consider there are, please describe them and set out why.

We strongly agree with the proposals to clarify that audit procedures designed to respond to the risks related to management override of controls should clarify that this work should cover both automated and manual journal entries and extend to consolidation adjustments made in the preparation of group financial statements.

We do not propose additional audit procedures that should be required for all audits.

Q7. In complying with the requirements of ISA (UK) 240 (Revised), the auditor may also need to consider whether there has been non-compliance with laws and regulations, and therefore that requirements in ISA (UK) 250 Sections A and B (Revised November 2019) also apply. Is it sufficiently clear in these ISAs (UK) of the interaction between them?

We agree that the standard is clear that ISA (UK) 240 is closely linked to ISA (UK) 250 A and B and that issues identified through application of one of these standards may lead to consequential actions being required by the other.

Q8. Are the requirements and application material sufficiently scalable, including the ability to apply ISA (UK) 240 (Revised) to the audits of entities with a wide range of sizes, complexities and circumstances? If you do not consider this to be the case, please set out why and how you believe that could be addressed.

In our view, the standard and the proposals are written with a focus on audits of the large/complex entities but with flexibility to be scalable for smaller/less complex audits.

In reality, the auditor's response to the identified risks of fraud for such smaller/less complex entities is often more straightforward than the standard may imply. For instance the auditor's response to the presumed risk of management override of controls may involve examination of only a limited number of journal entries based on particular characteristics of concern.

However, we consider that the standard has sufficient flexibility to allow a proportionate response.

Q9. References to 'computer assisted audit techniques' have been updated to 'automated tools and techniques' and we have identified that these may enable more extensive testing and assist in identifying unusual transactions or relationships (paragraphs A44, A48 and A50). Is there other guidance in relation to the use of automated tools and techniques that you believe could assist auditors in relation to their obligations with regard to fraud? If you consider there is, please give an explanation of it.

In practice, the use of automated tools and techniques primarily assists with the identification of themes, trends, outliers and unusual transactions as a risk assessment technique, interrogating data for certain identified characteristics which the auditor determines and returning results for further investigation.

Auditors may benefit from additional guidance techniques for using technology specifically to assist with the detection of fraud, particularly as many automated tools and techniques do not provide the auditor with conclusive evidence about the existence or otherwise of fraud.

It may also be beneficial to provide additional guidance that emphasises the importance of auditor judgement and necessary points of intervention in the appropriate application of automated tools and techniques. For example, the auditor will often be required to carefully consider the relevant features or characteristics of particular transactions that the automated tool will analyse or may require the auditor to examine and investigate transactions that are identified through the performance of automated techniques. The auditor will also need to conclude/opine on the results of the use of these tools and techniques.

It will be important to consider whether the proper place for this guidance will be within standards or perhaps as part professional education.

Q10. Do you agree with the proposed effective date of audits of financial statements for periods beginning on or after 15 December 2021, with early adoption permitted, which is aligned with the effective date of ISA (UK) 315 (Revised July 2020)? If not, please give reasons and indicate the effective date that you would consider appropriate.

We are content with the proposed effective date for audits of financial statements for periods beginning on or after 15 December 2021, with early adoption permitted.

Q11. Should an additional requirement be placed on auditors to have a specific discussion with those charged with governance on the risks of material fraud in the business, including those which are business sector specific, in order to further the risk assessment process in respect of the risk of material error in the financial statements relating to fraud?

We agree that such an additional requirement would be appropriate. As mentioned elsewhere in this response, enhanced and improved prevention, detection and reporting of fraud will require co-operation of a wide range of stakeholders. The addition of a requirement for the auditor to discuss risks of material fraud with those charged with governance may assist the auditor with developing a more complete picture of the potential risks and will provide the auditor with valuable insight into the attitudes of those charged with governance to fraud. Any related guidance should make clear that the auditor would need to be cautious about the nature and extent of such discussions and with whom, ensuring that appropriate scepticism is also applied to information and explanations gathered in this way.