

Our ref DLC/ISA240

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Dear Mr Billing

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

We welcome the opportunity to comment on the proposed International Standard on Auditing (UK) 240 (Revised 2021) The auditor's responsibilities relating to fraud in and audit of financial statements.

We generally support the proposals and the need to respond to the challenges presented by Sir Donald Brydon in his review of the quality and effectiveness of audit. We consider that many of the proposals within the consultation are appropriate and application guidance helpful. However, we highlight some areas where additional consideration is needed particularly in applying the standard to the audit of smaller entities.

We respond to the specific queries within the consultation document as follows.

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 agree that it adds clarity to state that the objectives of the auditor are "to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement due to fraud". The proposed objective is an explicit statement of the level of assurance expected to be achieved by the audit rather than the specific, procedural objectives in the extant standard. The objectives in the extant standard are now clearly intended to be only part of the means by which reasonable assurance is obtained but the use of the word 'including' makes it clear that these alone do not give reasonable assurance.

Whilst strengthening the auditor's objectives may achieve clarity within the context of auditing standards it will not necessarily achieve the desired clarity within the wider community as to the auditor's responsibilities. Changes are required within audited entities themselves to ensure that the prevention and

detection of fraud is prioritised and that there is a clear understanding of the responsibilities of both the directors and the auditors.

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.

Some appropriate enhancements have been made to the requirements for the identification and assessment of risk of material misstatement due to fraud, however some are more robust than others. For example, additional requirements around considering whether information is authentic and whether information is consistent with the responses to the inquiries of management are useful additions. Other proposed amendments, however, are enhancements of existing procedures only and are unlikely to significantly change the audit approach to fraud. For example, the enhanced requirements around the engagement team meeting.

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.

The additions to application material are helpful especially considerations around whether documentation may be authentic and the identification of the need for specialist skills. Further guidance would be helpful in certain areas such as:

- The process of escalation should a fraud be discovered and how it is possible to involve forensic experts in this situation without “tipping off”. We acknowledge however, that any further guidance would need to be consistent with existing requirements under AML legislation around discovery of suspicious activity.
- Guidance would also be helpful on how to resolve issues in the event that responses to inquiries with those charged with governance are inconsistent with those of management.
- It is surprising that further guidance around the use of data analytics to support the testing of journal entries and identification of unusual or suspicious entries has not been included given the increasing use of such techniques.
- In respect of contradictory evidence, the proposed standard is vague about what this means in practice clarifying only that “the auditor is not required to perform an exhaustive search to identify all possible sources of audit evidence”, further examples would be helpful.

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.

Yes the proposed amendments do support the appropriate exercise of professional scepticism in particular the stand-back requirement to assess the sufficiency and appropriateness of audit evidence, the requirement to consider both corroborative and contradictory evidence and the requirement to consider whether inquiries with others are inconsistent with the responses to the inquiries of management. These amendments are consistent with some of the recent revisions to ISA (UK) 540 Auditing Accounting Estimates and Related Disclosures (Revised December 2018) and ISA (UK) 570 Going Concern (Revised September 2019). This consistency aids the implementation as there is already a level of understanding around these requirements albeit in different contexts.

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.

Auditing standards are principles-based and therefore it should be down to the auditor to apply professional judgement to identify the specific risks as they relate to the specific circumstances. Adding additional rebuttable presumptions detracts from the principles-based approach. Should additional rebuttable presumptions be established it would need to be supported by evidence of consistent failings in the particular area together with application material that supports any specific procedures to address the issue. In all audits there is a potential fraud risk arising from undisclosed related party transactions but this has always been the case so it is not clear what the reason would be for including additional presumptions at this point.

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 think that the particular procedures responsive to risks related to management override of controls are sufficient although note response to question 3 regarding the use of data analytics. We would like to see the standard future-proofed to support the increasing use of computer-based techniques.

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?

Yes, the interaction between ISA (UK) 250 Sections A and B and ISA (UK) 240 (Revised) is sufficiently clear.

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.

No we do not consider that the requirements and application material are sufficiently scalable. It is clear that the revisions have the largest sized businesses in mind with enhancements to cover larger entities but no consideration of specific procedures that may be more appropriate for smaller entities. For example, there are enhanced procedures covering making inquiries of those charged with governance and being aware of inconsistencies with responses from management with only minor acknowledgement that these may be one and the same person. In the instance where this is the case opportunities for assessing the consistency of management's responses may be more limited. Further, the very person to whom most of the inquiries are directed during the course of an audit including assisting in identifying fraud risk factors may be the person with the most ability to perpetrate a fraud.

It is also likely that larger audit firms with the larger audit clients have a comprehensive range of forensic experts, computer-generated interrogation techniques and a wide range of specialised skills within their business. The same cannot be expected to the same extent of smaller audit firms.

We also note that the proposed standard clarifies that the explanation in the audit report of the extent to which the audit was considered capable of detecting irregularities, including fraud is not intended to be 'boilerplate'. In the case of smaller entities, the most appropriate audit procedures to address the risk arising from fraud are more limited in nature and whilst a boilerplate approach to the audit report would not be intended there is a likelihood that these procedures will be similar, and thus the audit report explanation will look similar.

In respect of the impact assessment and the estimated costs of implementation, based upon experience of the implementation of revisions to ISA (UK) 540 and ISA (UK) 570, we consider that the estimated cost is a significant underestimate. In addition, the estimated cost per audit of 10 hours does not take into account the economies of scale that are achieved for larger audits but not achieved on smaller audits. For a smaller business, 10 hours would add a significant element to audit fees. The requirements to possibly involve forensic or other experts into the audit team is also not reflected in this assessment. We feel that it will be the SME part of the market which will be most significantly affected by the increased cost of the audit.

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.

The references to automated tools and techniques seem to be very high level. It is not really clear the extent to which such tools would be usefully applied and more guidance in this area is needed rather than simply a change in terminology. For example, in what circumstances would it be appropriate to apply automated tools and techniques which might give more persuasive audit evidence than substantive testing? How would it be expected that use of automated tools is documented on the audit file? What are the risks around the completeness of data being used for the automated techniques? What additional procedures might be required to supplement the outputs from automated techniques? In what areas would it not be appropriate to use automated tools? Journal entry testing is the most likely area for which automated tools and techniques are currently used and therefore it is appropriate that further guidance is given in this standard.

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 agree with the proposed effective date of audits of financial statements for periods beginning on or after 15 December 2021. An implementation date that coincides with the adoption of ISA (UK) 315 (Revised July 2020) creates efficiencies since changes can be communicated and incorporated into methodologies simultaneously. We therefore welcome this proposal.

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?

A discussion with those charged with governance may be beneficial in audits of large and listed businesses not just in terms of identifying fraud risks but also in terms of raising awareness of the risks related to fraud with those charged with governance and gathering a different perspective. However, in many cases those charged with governance in smaller, non-listed or owner-managed businesses are the same as management and therefore it is unlikely to be of any benefit. Any requirement must therefore be considered in this context also and what, if any, alternative procedures could be performed.

If you have any questions regarding this letter, please contact me at donna.caira@saffery.com

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Yours sincerely



For and on behalf of Saffery Champness LLP