CHARTERED ACCOUNTANTS IRELAND

Chartered Accountants House
47–49 Pearse Street
Dublin 2, D02YN40

**Tel** +353 1 637 7200
**Fax** +353 1 668 0842
**Email** ca@charteredaccountants.ie

www.charteredaccountants.ie

Keith Billing
Project Director
Financial Reporting Council
E-mail: AAT@frc.org.uk

20 January 2021

Dear Keith

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

Chartered Accountants Ireland is pleased to have the opportunity to comment on the proposed changes to ISA (UK) 240.

We have commented on the individual question posed in the attached.

We would be pleased to assist you further, in particular in relation to issues that arise for Irish auditors with UK based clients and of course for our members in Northern Ireland. Please do not hesitate to contact me at [redacted] to discuss any of the issues raised in our response.

Yours sincerely

[redacted]

Anne Sykes
Secretary
Audit and Assurance Committee
Chartered Accountants Ireland

CHARTERED ACCOUNTANTS IRELAND

## Responses to questions

1. **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.**

   While we believe the majority of the proposed revisions have increased clarity regarding the auditor's obligations relating to fraud in the audit of the financial statements, we have identified a number of revisions where we believe further clarity is needed. We set out those revisions below.

   Paragraph 14 has been revised to require the auditor to investigate responses to enquires which appear implausible. The term "appear implausible" is highly subjective. As such, we believe to achieve consistent application of this requirement, a framework of factors or indicators needs to be provided to allow auditors to assess inquiry responses against, to identify those that appear implausible.

   Paragraph 14-1 has been added, this paragraph states that the auditor must also comply with ISA (UK) 550. The auditor is already required to comply with this standard and as such, it is not clear what this paragraph achieves. We believe the intent of this paragraph should be clarified.

   An addition has been made to paragraph 15 which we believe should be revised to read "(including the individual primary statements and the disclosures)". In addition, we believe that paragraphs 15 and A10-1 are in conflict. Furthermore, we believe paragraph A10-1 is not operable in the context of an audit with a large number of team members spread across different geographies. As such, we believe this paragraph needs further clarification.

   The final sentence added to paragraph 16 refers to the susceptibility of assertions to material misstatement due to fraud. We believe this should be clarified to state "the susceptibility at the assertion level of classes of transactions, account balances and disclosures to material misstatement due to fraud."

   Paragraph 24-1 has been added to the standard which requires the auditor to determine whether the engagement team requires specialised skills or knowledge to perform risk assessment procedures. Factors the auditor may consider in making this determination are set out in paragraph A27-1, however, these factors a very subjective. We believe in order to achieve consistent application of this requirement additional application guidance is required which seeks to provide a framework of objective factors which can be assessed in making this determination.

   Paragraph 27-1 requires the auditor to consider whether a forensic expert is needed to further investigate misstatements due to fraud identified by the auditor. In order to achieve consistent application of this requirement we believe a framework of objective factors should be set out in the application guidance to assist auditors in making this determination.

   The words "at all levels" have been added to the requirement at 32(a)(i). We believe, this addition needs to be clarified. For example, in the context of a large entity with a complex financial reporting structure including on-shore and/or of- shore shared service centres or in a group with a large number of components

CHARTERED ACCOUNTANTS IRELAND

the literal application of this requirement is inoperable. We believe the intent of the requirement is to ensure auditors make inquires of individuals at a sufficiently broad level across the financial reporting personnel within an entity. This could be achieved by the addition of “on a sufficient basis”.

We do not believe the intent of the addition at paragraph 32-1 is clear. If this addition is simply to highlight the requirements of ISA (UK) 540 we feel that should be stated.

Paragraph 39-1 addresses the requirements in relation to the auditor’s report relating to fraud and setting out to what extent the auditor was considered capable of detecting irregularities including fraud. We strongly believe that this requirement will result in boiler plate additional text being added to the audit report of the expanded scope of entities to which this requirement will apply. Indeed, in respect of audit reports to which this requirement currently applies the explanations have been boiler plate in nature. In circumstances which the auditor suspects fraud or irregularities exist, legal requirements in relation to anti-money laundering legislation will prevent the auditor from providing an explanation which is specific to the circumstance of the audit entity. In other circumstances, the application of the requirements of the standard in relation to risk assessment will be carried out by auditors in a consistent and standardised manner. Therefore, the explanation, by definition, can only be uniform across entities. The individual circumstances of different entities will therefore not affect the performance of the auditor’s risk assessment procedures.

We believe in order for there to be meaningful auditor reporting in the area, there first needs to be a statement by the directors in the directors’ report or financial statements in relation to the actions they have taken to prevent fraud against which the auditor can then report in a meaningful way. Indeed this was one of the core recommendations of the Brydon review.

2. **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.**

   While we generally agree that appropriate enhancements have 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, we do have some concerns as set out below.

   We believe the addition of the words “hard to reach” in paragraph A23 is inappropriate. Businesses have a legitimate basis to set targets which are hard to reach, and shareholders and other stakeholder expect bonus-based compensation to be granted based on strong performance.

   We further believe consideration should be given to adding a risk assessment procedure which requires the auditor to specifically assess the complexity of an entity’s business model and related corporate structure and determine whether there are fraud risks arising from highly complex business models and corporate structures.

In relation to paragraph 27-1 which requires the engagement team to consider whether a forensic specialist is needed if a misstatement due to fraud is identified. The addition appears very narrow as there may be other legitimate circumstances in which an auditor may involve a forensic specialist, for example, if the auditor has concerns regarding non-compliance with law and regulations or reports received from internal audit suggesting the existence of a potential fraud.

3. **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. [CL]**

Generally, while we believe that enhancements made to the application material supports the objective of clarifying the auditor's responsibilities, we do have some concerns as noted below. Further clarity on these matters would be welcomed.

- Paragraph A9-1 includes a list of conditions which may indicate that a document is not authentic, one of which states "Information that appears implausible…". As explained under question 1, the term appears implausible is highly subjective and consistent application of this requirement may not be possible.

  Furthermore, while appreciating that paragraph A9-1 cannot include a comprehensive list, other common conditions that may exist also include references to appendices/other documents not provided, changes made to font sizes/formatting/colour of text or the appropriateness of the author when performing an electronic document modification check in the last bullet.

- Under the extant standard, paragraph A11 included the paragraph starting with "An exchange of ideas among engagement team members about how and where they believe…" – this paragraph has been removed from the proposed new standard. This paragraph originates from the IAASB's standard and we believe it to have continuing relevant , it is not clear to us why it has been removed. We believe this should be retained.

- Paragraph A25 states that "Fraud risk factors may relate to incentives, pressures or opportunities that arise from conditions that create susceptibility to misstatement, before consideration of controls."

  It would appear that the intention was to make fraud risk factors comparable to inherent risk factors as used in ISA (UK) 315 (Revised July 2020), however, operationally, when determining whether a fraud risk factor is present you would have to consider whether controls are in place as the lack of controls is often that which causes the opportunity for fraud risk factors to be present.

  This is further referred to later on in the paragraph where it says "Fraud risk factors may also relate to conditions within the entity's system of internal control that provide opportunity to commit fraud…" as well as in paragraph A26 where it lists a number of controls generally implemented in order to deter fraud. For example: effective oversight by those charged with governance; appropriate segregation of responsibilities to reduce the opportunities for a person to both perpetrate and conceal fraud; and effective IT processes that manage access to the IT environment, manage program changes or changes to the IT environment and manage IT operations (for example, to ensure that access and changes to the data is by persons with appropriate authority).

- Paragraph A25 further states "Fraud risk factors, which include intentional management bias, are, insofar as they affect inherent risk, inherent risk factors." It is not clear why only those that include intentional management bias are deemed to be inherent risk factors. Was the intent here to rather say "inherent fraud risk factors"?

- Paragraph A32 replaced the words "In doing so" with "In identifying the controls that address the risks of material misstatement due to fraud" and "obtaining this understanding" with "identifying these controls and evaluating their design and determining whether they have been implemented". In doing so, certain elements of the requirements from the IAASB's standard has been removed/altered and we are concerned that the intention of the IAASB paragraph is lost.

  For example, the requirement under the extant standard was for the auditor to "obtain an understanding of the controls that management has designed, implemented and maintained". By using the words "in identifying", it assumes that there are controls in place which might not always be case. Furthermore, the extant standard required the auditor to obtain an understanding of how the controls were maintained. This does not appear to be considered under the proposed revised wording as it only considers the identification, design and implementation.

- Paragraph A43, the third bullet proposes to replace the words "steps and procedures" with "controls" and to remove "procedures and" from the sentence. We believe this change is unnecessary, as it is not only controls that are relevant given the matter being described is "The entity's financial reporting process and the nature of evidence that can be obtained".

- Paragraph A50 included two additional items when describing unusual relationships involving year-end revenue and income, one of which says, "uncharacteristically high levels of refunds or credit notes." We believe this should include the words "in the subsequent period".

- Paragraph A59a-1 in the proposed standard has been moved up from paragraph A63-2 in the extant standard.

  In doing so, paragraph A63-1's reference to the sentence "This would include fraud or suspected fraud." is removed from the tipping off legislation paragraph and may cause confusion. We believe this may be fixed by including ", when not prohibited by paragraph A59a-1."

4. **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**

   We do not believe that the proposals sufficiently support the exercise of professional scepticism throughout the audit. Whilst effort has been made to increase the extent of risk assessment procedures to be performed, we do not believe that they necessarily explain HOW professional scepticism should be applied during the audit and, in certain instances, may also lead to inconsistent application.

For example, the term “appear implausible” is likely to have been included in the standard to strengthen the application of the auditors’ professional scepticism, however as described in questions 1 and 3 above, consistent application of this requirement may not be possible.

In general, our concerns stem from the overall complexity around articulating exactly what the exercise of professional scepticism is. We believe that this is more akin to having a questioning mind set rather than applying some form of check box risk assessment and response exercise that is performed during the audit.

Therefore, while we do not feel that the proposals necessarily achieve the objective of this question, we do acknowledge that there may be a wider uncertainty around the concept of exercising professional scepticism throughout the ISA’s and, other than the point referred to above, we are not proposing any amendments to standard on this matter.

5. **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**

   There may be engagements where certain other account balances, transactions or disclosures are more susceptible to material misstatement due to fraud especially in times of economic uncertainly and difficulty or if an entity is under pressure to report certain results.
   On that basis there may be other areas where a presumption that there are risks of fraud might be valid, but we do not feel that there is a need for “a rebuttable presumption” to be prescribed in the standards. This risk of material misstatement due to fraud should be identified and assessed by the auditor on a case-by-case basis taking into account all the relevant factors of the engagement.

   There are audits where the presumption of fraud in revenue recognition could be rebutted but is not rebutted or cases where the presumption is not always correctly applied, and we believe that further application guidance on the “rebuttable presumption” would be beneficial.

6. **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 do not believe that there are other additional audit procedures that may be required for all audits on the basis that the audit procedures should be relevant and appropriate and scaled to the nature and size of the engagement.
   In larger more complex audits, technology may be leveraged providing other means of responding to the risk related to management override of controls and we would refer to our response to question 9 for more detail on this.

7. **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?**

   Reference to ISA (UK) 250 Section A has been included in paragraph A5a-2. ISA (UK) 250 Section B has not been specifically referenced in ISA (UK) 240 (Revised). Paragraph 8a of the revised standard indicates that in complying with any additional responsibilities under other ISAs (UK), in this case ISA (UK) 250, these may provide further information that would be relevant to the auditors work on fraud. However, the application material appears to only state the objectives of the auditor under ISA (UK) 250 Section A. It is not clear from this additional paragraph (A5a-2) what the interaction between ISA (UK) 240 (Revised) and ISA (UK) 250 Sections A and B is or how the auditor should interpret this linkage in a way that is relevant to the auditor's responsibility with respect to fraud.
   We noted from the consultation paper that the intention appears to be to link the matter of noncompliance with laws and regulations to fraud, yet as noted above, this interaction is not clear from the statement that has been added in A5a-2.

8. **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 the revisions to the standard (Paragraph 27-1), there is a recommendation related to the involvement of a forensic specialist when deemed necessary. By its nature, a forensic audit is targeted such as to investigate suspected or known fraud. Accordingly, the extent of procedures performed in a forensic audit is very different to that of a financial statement audit. It is not clear how the involvement of forensics would fit with the construct of a financial statement audit.
   When considering scalability, it should be clearly established that when planning to undertake an audit, the auditor should not expect that a forensic specialist will be required, as circumstances that arise which may require such a specialist are not always foreseeable.

   Clear guidance is required in order to establish both:
   - How the use of a forensic specialist aligns with the construct of a financial statement audit and;
   - Potential circumstances of where a forensic specialist may be required.

   Forensic specialists are a scarce resource. Such resources are not readily available to all auditors in house or otherwise. If the intent is that a forensic specialist may be required more regularly, there would be a significant investment required by firms to train such specialists on the objectives of an audit and how forensic work aligns with the purpose of an audit. As such, the requirement may not be scalable for all auditors.

   The impact assessment for this revised standard includes an estimated cost to implementation for the firm in terms of familiarisation and training of 30 hours which appears low taking into consideration that forensic specialists may be required. Significant amounts of time and effort would be required on the part of the firm to provide specific guidance and training in this area to both forensic specialists and audit practitioners.

CHARTERED ACCOUNTANTS IRELAND

As noted in response to question 1 above, paragraph 32(a)(i) also requires the auditor to make enquiries of individuals “at all levels” in respect of the financial reporting process. The literal application of the requirement is not scalable and, as such, we believe this addition needs to be clarified.

Given that the proposed updates to the standard aim to achieve scalability, the above considerations are contrary to this objective.

9. **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 supplementation to the application material only indicates where the use of automated tools and techniques “may” assist the auditor, yet it does not explicitly outline “how” this can be achieved. Technology is a hot topic specifically in relation to how it is used to perpetrate fraud, and how an auditor can use technology to identify, assess and respond to risks of material misstatement due to fraud. We have seen the IAASB recently hold a series of roundtables on fraud, with one on the impact of technology advancements on fraud perpetration and detection.

Emerging technologies have provided new opportunities for perpetrators of fraud to take advantage of companies and/or customers, for example many blockchain and cryptocurrency related technologies have uncovered vulnerabilities through fake exchanges and fake wallets being used. If the audit profession is now expected to do more in respect of fraud detection as per the Brydon review observations, it is fundamentally important that the financial statement audit as we know it, is able to adapt and respond to the use of emerging technologies.

Practical guidance on how the use of technology can help in certain areas would be very helpful for audit practitioners. Considering the scalability consideration on the use of technology in audits (not widely used on smaller audits), this guidance does not need to be placed in the application material to the standard but perhaps through a Staff Guidance Note. The standard historically and still does take a very in-depth focus on journals, yet not all fraud scandals are perpetrated through journals fraud. There are other areas where fraud could potentially occur and where technology could be leveraged. In terms of useful sources of information to develop such practical guidance for auditors, this may include analysing recent fraud scandals and how technology could have helped the auditor.
Effective use of technology by the auditor also comes with its own challenges. It is very dependent on the acquisition of complete and accurate data and is also dependent on the adequacy of the systems the company itself has in place. In addition, where an analytics tool may be used on a large data population, dealing with outliers and exceptions in the results can be challenging. Practical guidance on how to deal with such challenges would be beneficial.

10. **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 have no comments to make on the effective date.

11. **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?**

    Yes, we would support this additional requirement in the standard. Effective communication and engagement between the auditor and those charged with governance is critical on the topic of fraud. The requirement should specify that this discussion be led by the engagement partner to enable a more robust and in depth focus on the risks of material fraud in the business.

    Consideration should also be given to making this a broader discussion on fraud as opposed to a focus on "material" fraud only. This may include discussion on the broader entity risks, questioning on what efforts are made to set the right tone and to foster a good corporate culture and also how those charged with governance challenge management on the processes they have in place regarding fraud and internal control.