



9 January 2021

Dear Sirs,

Following discussion at the recent webinar I would like to comment on one specific aspect of the proposed changes to ISA (UK and Ireland) 240 and that is the use of the term 'reasonable assurance' in an attempt to help clarify the auditors responsibilities in this difficult area.

The FRC seems to be aiming to achieve the same level of reasonable assurance in relation to both fraud and error. While this may be theoretically desirable, to achieve it in practice would, in my view, require a major change in audit scope. This would impact costs and there would be other consequences. However, this is not reflected in the FRC's impact assessment.

Having been involved with many IAASB debates over a prolonged period, including in relation to the current version of ISA 240, I thought you may be interested in my view that the inherent limitations of an audit were written to differentiate what was 'reasonable' in relation to fraud from what was 'reasonable' in relation to the detection of error. To my mind therefore reasonable assurance for the financial statements as a whole is a mixture of what is reasonable in relation to error, what is reasonable on fraud and indeed what is reasonable to areas such as going concern and related parties. In each case what is 'reasonable' is defined by the specified procedures in each standard.

I think it is unhelpful to imply, as I think paragraphs 7.1 and 10 of the exposure draft do, that what is considered as reasonable assurance for the financial statements as a whole provides a helpful objective for the auditor to plan the work to be performed on fraud. Indeed, an undesirable consequence on equating the level of assurance to be obtained might be to reduce the work effort on error!

For me this is an absolutely fundamental point and needs to be explored and clarified by the FRC, and indeed the IAASB, before the standard is finalised. Small procedural differences between the wording of ISAs and ISAs (UK and Ireland) may be workable – although to my mind are undesirable - changes in the underlying theoretical model are not.

I find it interesting that the FRC suggests that the ISAs may overstate the fundamental limitations of an audit and, of course some commentators may wish that they did not exist and that auditors could always detect collusive fraud within the scope of their existing audits. The Auditing Practices Board explored this issue in great detail in 1997 / 1998 (Consultation Paper: 'Fraud and Audit – Choices for Society' and again in 2001 (Consultation Paper: Aggressive Earnings Management) and I suggest you revisit these papers and the results of the consultations.

The APB specifically consulted on whether investors and companies were prepared to pay the extra costs and suffer the other consequences that would result from extending the scope of the audit to significantly improve the chances of it detecting fraud. The response received was 'no' and I doubt that their answer today would be different.

In conclusion, I am afraid I do not think that use of the term reasonable assurance (a vague and confusing concept at best) will help clarify the auditors responsibilities and I fear the FRC's superficial impact assessment massively understates the impact this would have on costs. Rather than causing further confusion in this difficult area a better approach may be for the IAASB to explore changes to ISA 240 and, if the UK wants a different approach on fraud, it should be based on any new requirements for directors that the Government introduces.

Yours faithfully

JEC Grant