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Dear Keith,

Re: Comments - 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 comment on the proposed changes and enhancements to ISA (UK) 240. In the light of recent media reporting, the long spoken of expectations gap and other points highlighted in Sir Donald Brydon's report, we believe that the auditor's responsibility regarding fraud is an area that will greatly benefit from clarification and enhancement. It's with that in mind that your proposed changes to the UK standard are, in the round, very welcome.

Though technology exists to assist the auditor in the detection of fraud in the particular area of external confirmations, we've continued to see a steady stream of cases in the media, where the external confirmation process has, in some way or another, gone wrong. This isn't the place to catalogue the possible errors or oversights that may or may not have occurred in each case, however. Many details are unknown and no doubt you'll be aware, in the course of your work, of other sources of information the general observer of the news could never be party to. That being said, though external confirmation technology is being adopted by many firms for a greater proportion of their third-party requests, it remains the case that there is still much reliance on audit evidence gained through unsecure channels, from unvalidated parties.

So, it's regarding this reliance that I comment on four of your questions. As the confirmation process is just one element of the considerations of this ISA, I'll limit my words to the questions that apply most closely to this area (Q4, 5, 6, 9). But I would emphasise that though the confirmation is but one element of an audit, it is nevertheless an important one and a particular area of risk when it comes to fraud, since so many frauds involve the manipulation of assets or liabilities under bank and cash. Where such a manipulation takes place by management, a corresponding manipulation of the confirmation process often follows. The same is true for when revenue is inflated, the offsetting journal entry should be to cash or receivables, and therefore properly performed external confirmations are an important audit technique to validating the legitimacy of revenues.

If there are questions or clarifications related to anything submitted, do please contact me directly.
Yours sincerely,


Kyle Gibbons, Managing Director, Europe – Confirmation


Question 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.

I believe they could be enhanced further.

In 13-1 it is stated that “an auditor shall remain alert for conditions that indicate a record or document may not be authentic. (Ref. Para A9-1)”. This is a professional scepticism consideration and therefore I think the following comments on it are appropriate here.

Within A9 reference to third party confirmations are made, quite correctly. Then in the added section A9-1 there is a focus on tampering and how, if tampering has occurred, this may lead the auditor to the conclusion that a document is not, or may not be, authentic. Again all right and proper. But it may also be worth emphasising at this point that, although tampering is one indication of unauthentic material, it is not the only one. If a document has been received, untampered according to all the criteria you outline, it still may be inauthentic. This would be the case, for instance, if the document received, correct in all other respects, had been sent by an impersonator of the true third party without the auditor’s awareness. This could happen if the auditor fails to effectively validate the responding party. No tampering would be present in this case, all could appear correct with the document in question, and yet it would be inauthentic. And indeed, in several confirmation fraud cases, this is exactly what has occurred.

I would therefore recommend you also emphasise the importance of the validation of the responding party, both as a crucial step in establishing the authenticity of third party audit evidence and as an action in the exercising of professional scepticism.

Question 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.

Yes, I believe so.

If there is reasonable grounds for the establishment of a rebuttable presumption that there are risks of fraud with regard to revenue recognition then I would argue that there are also reasonable grounds for a similar presumption to be introduced concerning the risk of fraud related to cash balances. Why?

Firstly, the relative ease of manipulation of bank and cash. If management are attempting to commit fraud by extracting assets from a business, or covering up the existence of liabilities, there is a strong chance this will involve the manipulation of bank and cash balances. To give a fictional example, a director of a paper producing company may attempt to commit fraud via the false accounting of PPE or he may attempt to appropriate stock, but perhaps easier and as, or more, likely will be a manipulation of the bank and cash element of the balance sheet. No movement of physical goods is required, no

physical inspection of the property is possible by a third party. All that is needed is the manipulation of a number on a page or in a spreadsheet. Far easier to perform, and far harder to catch.

Secondly, where there have been cases of fraud, many of them have, in fact, involved the manipulation of bank and cash. This point of fact is related to the first reason, of course – the ease of the method – but it is a separate, if supporting, one.

For the above reasons, a rebuttable presumption of fraud in the area of bank and cash balances is also justified.

Question 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.

Yes, I believe there are.

If one were to introduce a rebuttable presumption related to the risk of fraud within cash balances, then it would follow that one might also introduce a requirement to carry out an external confirmation process on the entity's bank balances and relationships. Currently, this is an area left to auditor judgement and while most auditors will carry out this important procedure, most of the time, the occasions where they choose not to do so can be some of the riskiest. The removal of PN16 appears to have encouraged this risk taking, or at least that is the impression given to me from conversations had with auditors over recent years.

To touch on one example, we often hear from auditors that they choose not to carry out confirmations when auditing smaller charities, because they view them as low risk. Though some will say it is because fees charged are lower and time available shorter. But controls at charities are often less rigorous and at times overseen by staff with little training. Risks in these cases can often therefore be higher than in the corporate space, charitable intent aside. So, when this area is left to auditor judgement, unhelpful motives can mix into the process, leaving robust testing unperformed in cases where one might wish it to be carried out.

Another element of this is the ability of a manager to manipulate an auditor into not carrying out the procedure or carrying it out without proper controls and validation. An auditor pushed by management into not carrying out a confirmation in just one case might be rationalised in a file as an exercise of judgement. And yet that could be the one case where a fraud could have been caught. Removing the judgement element will go a long way to protecting the auditor's professional integrity from this potential management manipulation.

Question 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.

Yes, I believe there is.

An initial point I'd make here is the non-equivalence between the two phrases 'computer assisted audit techniques' and 'automated tools and techniques'. The terms aren't synonymous and so one needs to be careful that the replacement of the former with the latter doesn't result in a loss of something important. I mention this, as the external confirmation process can be enhanced using computer assisted tools and techniques, though these may or may not be automated.

There are several ways in which computerised and/or automated tools and techniques can assist the auditor in the external confirmation process and that touch on their obligations related to fraud. These areas could be categorised under security and validation and guidance on each within this standard would be most welcome.

First security. Postal confirmation processes are open to interception by a party attempting to commit fraud. Perhaps the letter has been intercepted and picked out of an inbox or the postman bribed to lose the letter. Any number of things can, and do, happen to make this process one open to manipulation. And the email and fax processes too, though in different ways, lack of security. Emails can be hacked, wrong fax numbers entered, or documents taken from fax printing trays.

Use of an electronic, closed-network platform, which is audited on its procedures related to security and encryption of data, both at rest and in transit, greatly reduces the fraud risks that are otherwise present in postal, email or fax based confirmation procedures.

Secondly Validation. Not only is it important that the process is secure, the auditor needs to have confidence that the party that is responding to their request, is who they claim to be and that they are knowledgeable and authorised to respond. When an auditor uses a secure electronic platform, and that platform abides by, and is audited on, strict procedures relating to the validation of parties within its network, then the auditor has much greater assurance that the responding party is the true one.

With postal or email processes, this step is much harder. If one receives a letter from a responding party, one may have no way of knowing if it really did come from the proper party. One could call the phone number provided on the letter, but this hardly gives assurance if that phone number is provided by the same letter. And even if confidence is in some way gained, that the person responding to the request is an employee at the company in question, this doesn't mean they have authority to respond or that they haven't been manipulated into providing an incorrect response. A stray relationship manager at a responder may be bribed and easily, using bank headed paper and, with access to all client account information, add, subtract, or adjust whatever piece of information they choose, to an otherwise imperceptibly genuine response.

But if a closed electronic network is used, where responses are made within the secure platform and by a trained and authorised team, with access strictly limited and monitored, if robust authentication processes are followed by the overseers of this secure network, then this validation element is greatly enhanced and the audit evidence received is that much the more reliable.