AAT@frc.org.uk

For the attention of Keith Billing

RSM UK Audit LLP

Portland
25 High Street
Crawley
West Sussex
RH10 1BG
United Kingdom
T +44 (0)1293 565 165
rsmuk.com

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Dear Sir,

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

Whilst we are supportive in principle of the changes proposed which go some way to addressing the points raised by the Brydon Review, we have some specific concerns on some of the amendments and question whether in certain areas, particularly in relation to IT and data analytics, they could be enhanced.

We have set out our comments on the specific questions posed in the consultation below.

Yours faithfully,

[redacted]

Jonathan Ericson

Head of Audit

RSM UK Audit LLP

RESPONSE TO DETAILED 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.

YES

We consider that revised ISA (UK) 240 assists in clarifying the auditor's obligations relating to fraud including the extent of those obligations. ISA 200 sets out that it is the auditor's responsibility to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. The proposed amendment to ISA (UK) 240 paragraph 10 repeats this point rather than providing anything new. However, the new paragraph 7.1 makes it clear that whilst the detection of material misstatement due to fraud may be more difficult than the detection of material misstatement caused by error, the bar for the auditor's responsibilities is the same (i.e. the auditor is still required to obtain reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error). Paragraph 3 is also helpful to practitioners in highlighting the qualitative aspects of materiality in this area.

There is an error in paragraph 7.1 which says "the risk of not detecting a material misstatement resulting from fraud may be higher than the risk of detecting one resulting from error" when it should be consistent and refer to risk of "not detecting" a material misstatement resulting from error.

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.

YES

We consider that the enhancements made to the required risk assessment procedures will result in a more consistent and robust approach to the auditor's responsibilities in relation to fraud. In particular, the increased emphasis on the discussion among the engagement team and the enhanced guidance in this area should result in better quality and more focussed discussions.

However, aside from the new requirement in paragraph 24-1 to consider whether specialised skills or knowledge are required to design and perform audit procedures to respond to the risks identified (and to perform risk assessment procedures), there is little which is new in relation to procedures to be performed in response to the risks identified. We believe that the inclusion of this new requirement in relation to fraud at the risk assessment stage will result in increased divergence of practice. In most cases, firms will not have specialised skills and knowledge in relation to fraud that they can deploy at the risk assessment stage and the revised ISA could result in a widening of the expectation gap because users of financial statements will be expecting the auditor to be using fraud specialists at the risk assessment stage to help assess the risks of material misstatement due to fraud.

This potential disparity in resources and widening of the expectation gap is highlighted further in the requirement to determine whether a forensic expert is needed to investigate a fraud or suspected fraud. Most firms would not have this sort of specialist resource available and would have to consider involving an external specialist. Where, as a result of the audit work, a fraud has been discovered or is suspected the auditor should follow the guidance of their money laundering reporting officer. In most cases we would expect the entity to engage with a forensic specialist to investigate the fraud rather than deal with this as part of the audit. We consider that these changes should be explained in the context of ISA 500 and the use of the work of a management expert and ISA 620.

We would ask for more consultation/discussion on this point so that the intended outcomes, in the context of the audit, are clear. Given the insight which the FRC and other regulators have into how frauds have been perpetrated, we also ask whether further practical insight could be provided to auditors on this area (whilst noting confidentiality requirements).

We question the purpose of the reference to the individual financial statements in paragraph 15.

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.

YES

The additional application guidance on the engagement team discussion is helpful. The additional guidance on tampering is also helpful but could be further extended to cover tampering with reports. This guidance on reports could be linked to the new guidance given on IT considerations in paragraphs A4 and A26. Whilst references to IT are always relevant, we question whether IT should be given greater focus in the Revised ISA. There is a risk that read in isolation, A26 may, for example, lead the auditor to rely on IT controls without proper consideration of the IT general controls as a whole. A fuller discussion of fraud risks relating to IT would help to prevent mis-interpretation. In our response to question 2 we have highlighted that further guidance on the intended outcomes of the involvement of a specialist 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

We anticipate that the additions to ISA (UK) 240 will contribute to an overall mindset of professional scepticism and support the standard setters' approach of increasing the number of specific references to professional scepticism across the standards.

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.

NO

In our opinion, there are currently no other account balances, transactions or disclosures for which we consider a rebuttable presumption in relation to fraud should be established. We consider that there needs to be a balance between increased specificity in the standards and allowing auditors to identify and respond appropriately to risks relevant to the specific circumstances of the entity.

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.

YES

In our view, the requirements in relation to testing of journals made at the end of a reporting period and post-closing entries should be extended to journals posted throughout the period. Whilst there may be an increased risk of manipulation via journals at the period end, where that risk exists at the period end it is also likely to be a heightened risk during the period.

We question whether the reference to 'journals' is now outdated given that all transactions are processed as journals in some IT systems (a term such as 'adjustments outside normal transaction processing' may be more appropriate').

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

In practice we have not found that the interaction between ISA (UK) 240, ISA (UK) 250 A & ISA (UK) 250 B presents significant difficulties.

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

In most cases, we consider that the requirements and application material are sufficiently scalable but we question the scalability of the new requirement in paragraph 24-1 in relation to involving audit team members with specialised skills and knowledge of fraud at the risk assessment stage and the similar requirement in paragraph 27-1 to determine whether a forensic expert is needed to investigate further if the auditor identifies a misstatement due to fraud or suspected fraud. Please see our response to question 2 above where we highlight that most firms will not have people with specialist skills and knowledge in relation to fraud or have forensic experts available to them to investigate fraud. If these requirements are included there will be a divergence between the approaches of larger and smaller firms and potentially an increase in the expectation gap with users of financial statements expecting these experts to be used on every 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.

YES

Whilst we note the new references to automated tools and techniques in paragraphs A44, A48 and A50, in our opinion these do not convey the true power of these techniques and in particular their ability to identify the items of risk on which audit attention should be focussed regardless of the volume of transactions. As well as journals testing, identification of unusual transactions and trend analysis, these techniques can also be used in a variety of other ways where a risk of fraud has been identified, often by testing 100% of the population e.g. to identify inconsistent formula used in an impairment review, to identify unexpected changes in data such as the bank account details of employees and matching/gap detection. Greater emphasis on this area would encourage the more widespread use of these techniques which can be used to address many risks including fraud risks – where processing is automated, it is difficult to conceive of a more effective approach than data analytics.

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.

YES

We agree with the proposed effective date of periods beginning on or after 15 December 2021 for the application of Revised ISA (UK) 240 as the findings of the Brydon review should be acted upon on a timely basis.

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?

YES

We consider that an additional requirement to have a specific discussion with those charged with governance on business sector specific fraud risks would be informative and complement the new guidance provided in relation to the engagement team discussion on this point.