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International Auditing and Assurance Standards Board (IAASB)  
529 Fifth Avenue  
New York, 10017  
USA

3 June 2024

**Re: Comment letter relating to the IAASB's Exposure Draft of Proposed ISA 240 (Revised) The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements**

Dear Mr. Seidenstein,

1. The CEAOB (Committee of European Auditing Oversight Bodies) appreciates the opportunity to comment on the IAASB's consultation paper on the *Proposed International Standard on Auditing 240 (Revised) The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, issued in February 2024. As the organisation representing the audit regulators of the European Union and the European Economic Area, the CEAOB encourages and supports continuing improvement of professional standards for the audit profession.
2. The content of this letter has been prepared by the CEAOB International Auditing Standards Subgroup and has been adopted by the CEAOB. The comments raised in this letter reflect matters agreed within the CEAOB. It is not intended, however, to include all comments that might be provided by the individual regulators that are members of the CEAOB and their respective jurisdictions.

**General comments**

3. As part of our analysis of the exposure draft (ED 240), we considered the CEAOB's letter dated 29 January 2021<sup>1</sup> in which the CEAOB encouraged the IAASB to further explore the role of the auditor in relation to fraud.
4. While we think that ED 240 is a good step forward and addresses many of the issues identified in our January 2021 letter, the CEAOB has identified a number of areas where we recommend that the IAASB makes further enhancements. Our detailed comments are set out below in response to the questions raised in the IAASB's consultation.

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<sup>1</sup> <https://ifacweb.blob.core.windows.net/publicfiles/publications/exposure-drafts/comments/CEAOBcommentlettertoIAASBconsultationonFraudandGoingConcern.pdf>



### *Responsibilities of the Auditor*

1. Does ED-240 clearly set out the auditor's responsibilities relating to fraud in an audit of financial statements, including those relating to non-material fraud and third-party fraud?
5. ED 240 is an improvement on the extant standard, including the structure, better alignment with other standards, the added objective regarding reporting, the responsibilities of management and those charged with governance, what should be done when fraud occurs, emphasis on qualitative materiality and clarification that difficulty in detecting material misstatements in the financial statements resulting from fraud (rather than error) does not reduce the auditor's responsibilities. We also support the requirement to design and perform audit procedures in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory (paragraph 43).

### **Role of the Auditor**

6. It is essential to be clear on the current scope of the auditor's duties in ISA 240. According to ISA 200, auditors should obtain reasonable assurance about whether the financial statements as a whole are free from material misstatements whether due to fraud or error. This means that, when auditors express an unmodified opinion, they have obtained sufficient and appropriate audit evidence to reduce audit risk to an acceptably low level thereby enabling them to draw reasonable conclusions that there are no such misstatements, including due to fraud. We believe it is important to emphasise in the standard that these existing provisions drive the role of the auditor conducting an audit in accordance with ISAs.



### *Professional Skepticism*

#### 2. Does ED-240 reinforce the exercise of professional skepticism about matters relating to fraud in an audit of financial statements?

##### **Professional scepticism**

7. The CEAOB welcomes the strengthening of requirements regarding the exercise of professional scepticism in relation to fraud throughout the audit of financial statements in ED 240. However, we have identified a number of areas where, in our view, further enhancements should be made.
8. In our January 2021 letter, we suggested that the use of stronger language in ISA 240 (such as “challenge”, “question” and “reconsider”) would be a good way to foster an appropriate mindset and action by the auditor. We remain of this view.
9. In paragraph 30 of ED 240, the IAASB should emphasize the importance for the auditor to investigate responses to inquiries of management and those charged with governance (TCWG) that are implausible in addition to those that are inconsistent. We note that implausibility is only mentioned as example of a risk factor.
10. We welcome the deletion of paragraph 14 of extant ISA 240 which stipulates that, unless the auditor has a reason to believe the contrary, the auditor may accept records and documents as genuine and that if conditions are identified the auditor shall investigate further. The IAASB should also remove this language in paragraph A24 of ISA 200, as it weakens the key message that the auditor is required to consider the reliability of audit evidence.



### *Risk Identification and Assessment*

3. Does ED-240 appropriately build on the foundational requirements in ISA 315 (Revised 2019)<sup>2</sup> and other ISAs to support a more robust risk identification and assessment as it relates to fraud in an audit of financial statements?

### **Integrated approach and consideration of all the ISAs**

11. In the January 2021 letter, the CEAOB raised the need to facilitate the integrated application of all the ISAs. In this regard, the CEAOB welcomes the improved alignment with ISA 315 which can, in our view, lead to a more robust risk identification and assessment in relation to fraud.

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<sup>2</sup> ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*



### *Fraud or Suspected Fraud*

4. Does ED-240 establish robust work effort requirements and application material to address circumstances when instances of fraud or suspected fraud are identified in the audit?

#### **Definition of fraud**

12. In our opinion the definition of fraud in ED 240 is too narrow. The IAASB should consider adding corruption, bribery and anti-money laundering. Additionally, the language in paragraph A19 should be amended to make it clear that corruption, bribery and money laundering are fraudulent acts.
13. Paragraph 14 states that “fraud constitutes an instance of non-compliance with laws and regulations” (NOCLAR). This may also apply the other way around as NOCLAR could also be fraud. This is not clear in the current versions of ED 240 and ISA 250. We urge the IAASB to make amendments and add additional explanations in the final version of ED 240 on this subject to make it clearer. Language such as: ‘Because of the nature of some instances of non-compliance with laws and regulations, they meet the definition of fraud (refer to the definition in paragraph 18a), such as corruption, money laundering and breach of competition law (cartel)’ could be used.
14. In addition, paragraph A11 states: ‘Even when an identified misstatement due to fraud is not quantitatively material, it may be qualitatively material depending on: (a) Who instigated or perpetrated the fraud – an otherwise insignificant fraud perpetrated by senior management is ordinarily considered qualitatively material irrespective of the amount involved. This may in turn give rise to concerns about the integrity of management responsible for the entity’s system of internal control.’ We suggest:
- Material fraud often begins with quantitatively non-material fraud and we support the inclusion of ‘qualitative materiality’. A further example could be ‘cumulative materiality’ such as the period of time covered by the fraud. Misappropriation of assets that is not quantitatively material in the current financial year could be if the fraud has taken place over several years and cumulatively is larger than the quantitative materiality. Also the size of the illegal advantage should be taken into account, for example bribery for a small amount to obtain large contracts. We suggest inserting some of the key elements of paragraph A157 (‘Misstatements, such as numerous misstatements at a business unit or geographical location even though the cumulative effect is not material, may also be indicative of a risk of material misstatement due to fraud’) in paragraph A11; and
  - Moving the application material in paragraph A11 to the requirements section of the ISA. This will reduce room for interpretation and decrease the risk of inconsistent application by auditors.
15. Our understanding is that paragraph 40 requires a gross approach (the auditor must identify and assess the risks of material misstatement due to fraud before taking internal controls in consideration). Furthermore, paragraph A22 explains that fraud risk factors may relate to incentives, pressures or opportunities that arise from events or conditions that create susceptibility to misstatements before consideration of controls. Paragraph A56 states that one condition that is generally present when fraud exists is the perceived





opportunity to commit fraud. However, as this is usually due to inadequate internal controls, the IAASB should consider clarifying this point in the context of the requirements in paragraph 40. The risk is that auditors tend to conclude that significant fraud risk factors (before consideration of controls) are mitigated by the strong internal controls implemented by the entity (often without testing their operating effectiveness), leading them to reduce the significance of the fraud risk factors and thus the identification and assessment of the risk of material misstatement due to fraud. For this reason, the IAASB should clarify that:

- the identification of fraud risks should not be limited or mitigated by internal controls in place in an entity;
- weaknesses in internal controls should be considered when analysing opportunities for fraud; and
- testing the operating effectiveness of controls in accordance with ISA 330 is a mandatory response when, in the auditor's assessment, the risks of material misstatements due to fraud have been reduced due to the internal controls implemented by the audited entity.

### **Understanding the entity and its environment**

16. For improved clarity and consistency of approach, it is our view that paragraph 35(b) should require the auditor to make inquiries of individuals within the entity that have responsibility for dealing with fraud reports as well as 'other appropriate individuals'.

### **Engagement team discussion**

17. The IAASB should consider including a provision to require communication by the group auditor with component auditors of material components regarding the risk of fraud at the component in a group audit.

### **Presumed fraud risk – revenue recognition**

18. Based on the inspections findings recorded in the CEAOB database in recent years, some regulators have found that rebuttal of the presumption of the fraud risk regarding revenue recognition is common practice in their country. For example, one regulator has seen large financial institutions with many different revenue streams where the risk of fraud in revenue recognition has been rebutted and questions if that is appropriate.

19. The majority of findings by inspection teams in this area arose due to insufficient documentation of the reasons for the rebuttal. Therefore, we appreciate the fact that the rebuttal of the presumed fraud risk regarding revenue recognition is no longer included in the requirements (paragraph 41 of ED 240). While this is a step forward in our opinion, we still think that there is too much room given to auditors in the application material (paragraphs A110 and A111) as well as the documentation requirements (paragraph 70(d)) to rebut the presumed risk. We explain this in more detail below.

20. The examples of events or conditions given in the application material (paragraphs A109 and A111) are either very complex or very simple. Paragraph A109 relates to very complex and risky situations where it is evident that fraud risk factors can emerge, while A111 relates to very simple situations where it is evident that fraud risk is remote. However the



most challenging situations for auditors are likely to arise when dealing with situations that are in between these two extremes. For instance, what would be the decision when, the audited entity has:

- numerous different types of services, each of which is not very complex and not subject to significant estimates; or
- numerous rental properties with numerous different tenants, but there is no complexity or estimates in the determination of revenues?

In the above situations, there is a risk that auditors will conclude that the presumption may be rebutted, considering there are no significant fraud risk factors. Consequently, we believe clarification is needed for the situations that are “in between”, which could complement paragraph A110.

21. Paragraph A111 contains examples of situations where fraud risk factors may not be significant. However, the final example (“simple or straightforward ancillary revenue sources, which are determined by fixed rates or externally published rates”) is very unclear and gives too much room for auditors to rebut the presumed risk. In our opinion this example should be removed as:

- The term ‘simple and straightforward’ is open to interpretation and gives room for auditors to put a lot of revenue streams under this category to rebut the presumed fraud risk.
- The inclusion of “interest or dividend revenue from investments with level 1 inputs” as an example could be arguable. Level 1 inputs are part of the measurement of the fair value of financial instruments; using them in examples of revenue is from that point not logical. Additionally, financial instruments with level 1 inputs have assumptions that could contain fraud risks factors such as: is there an active market? are the transactions orderly? are related parties involved in transactions?

22. Some regulators have noted the situation where the auditor does not consider the fraud risk, i.e. when auditing revenue, the auditor collects sales invoices and related proof of payment without performing any procedures validating that the revenues invoiced are accurately computed based on for instance the agreement. Based on that, the auditor considers that an invoice paid is the best audit evidence to support the accuracy of the revenue. The same applies with suppliers (in that case as a potential third-party fraud). We believe ISA 240 should clarify that payment of an invoice alone is not necessarily sufficient to prove the accuracy of revenues or charges, that fraud risk and its impact on financial statements are to be considered by the auditor in those situations.

23. We urge the IAASB to also reword paragraph 70(d) regarding the documentation required when the presumption related to revenue recognition is “not applicable in the circumstances of the engagement”. It may be seen as an encouragement to auditors to rebut the presumption of fraud risks for all revenue streams in an audit. We suggest that this should be replaced by a requirement to document the analysis to be performed in paragraph 41 (determine which types of revenue exist, revenue transactions and relevant assertions that give rise to fraud risks, including any revenue types where the presumption has been rebutted and the reasons for that conclusion).

24. Paragraph 70(d) should also stress the need for the documentation to be sufficient to enable another practitioner to understand the rationale for the rebuttal as well as requiring







documentation to show that, where applicable, all the entity's revenue streams have been considered. This would go some way towards addressing the issues identified in the CEAOB inspections findings database. Additionally, the IAASB should consider including application material to provide guidance for auditors on the documentation that would be appropriate in such cases e.g. engagement team discussions, discussions with technical experts, experience in previous audits and no changes to the revenue streams, internal controls or key client personnel in this area.

25. We urge the IAASB to consider removing the first line in paragraph A110: 'If fraud risk factors related to revenue recognition are present, determining whether such fraud risk factors indicate a risk of material misstatement due to fraud is a matter of professional judgment.' It could be interpreted that the presumed risk is dependent on the existence of one or more fraud risk factors. However, if an auditor does not identify any fraud risk factors regarding revenue, is the fraud risk of revenue automatically rebutted? It seems unnecessary to state this, especially as paragraph A111 contains examples where fraud risk factors may not be significant. We also suggest stating in this paragraph that the bar to rebut the presumption (that there are risks of material misstatement due to fraud in revenue recognition) is a high one.

### **Use of specialists**

26. While ED 240 includes additional material on the use of specialists, it should be made clear that the use of a specialist does not reduce the auditor's responsibility for the audit. The auditor remains responsible for forming and expressing the audit opinion. In addition, it is important for auditors to be clear on the expertise that they expect from that specialist and the link with the audit engagement. Discussing the need for a specialist's involvement with TCWG may prove beneficial.

### **Engagement quality review (EQR)**

27. Additional quality control review procedures focused on the engagement team's responsibilities relating to fraud should be considered for all engagements where an EQR is required. In particular, the engagement quality reviewer should be required to review the reasons used to conclude that the presumed fraud risk related to revenue recognition has been rebutted.

### **Communications with TCWG and other parties**

28. Communicating more information to TCWG, including audit committees, and to other authorities allows the entity to take remediation measures in relation to fraud on a timely basis. For example, for PIE audits in the European Union, when an auditor suspects or has reasonable grounds to suspect that irregularities including fraud with regard to the financial statements of the audited entity, may occur or may have occurred, the auditor is required to inform the audited entity and invite it to investigate the matter and take appropriate measures to deal with such irregularities in the future<sup>3</sup>. Where the audited entity does not investigate the matter, the auditor is required to inform the authorities responsible for

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<sup>3</sup> Article 7 of Regulation 537/2014/EU





investigating such irregularities (for example regulatory and/or enforcement authorities). Those provisions should be fully integrated in the ISAs.

29. In the same vein, in such circumstances, the IAASB should also consider requiring the auditor to assess whether the measures taken by management are appropriate and evaluate the impact on its relationship with the audited entity.

### **Significant Risks Related to Management Override of Controls (including journal entry testing)**

30. The purpose of the statement in paragraph A113 that ‘... the level of risks of management override of controls will vary from entity to entity...’ is unclear, particularly as paragraph 42 requires that the auditor shall always treat them as significant risks. Additionally, the IAASB should consider providing examples of the types of procedures that should be performed in response to such risks. In paragraph 42 the IAASB could also consider requiring the auditor to evaluate the risk of management override in the audit and to identify and evaluate where in the financial statements or specific assertions and classes of transactions the risk of management override may arise.

### **Written representations**

31. The statement in paragraph A180 of ED 240 that “although written representations are an important source of audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal” should be moved to the requirements section as it is integral to the auditor’s use of written representations. A corresponding amendment should also be made to ISA 580.

### **Application material**

32. A further example of misappropriation of assets that could be provided in paragraph A6 is over or underpayment for goods and services.
33. The statement in paragraph A10 that allegations of fraud involving the entity are treated as suspected fraud by the auditor is of such importance that it should be moved the requirements section of the standard.
34. Paragraph A17 states that Appendix 5 to the standard “identifies other ISAs that address specific topics that reference fraud or suspected fraud”. For the avoidance of doubt, it should be clarified that this does not reduce the responsibility on the auditor to consider all relevant ISAs, whether or not they are listed in Appendix 5.
35. Given the continuing evolving nature of technology and its importance in many audits, the language in paragraph A36 should be amended to state that the engagement partner would usually be expected to consider expertise in IT systems etc when determining if the engagement team have the necessary competence and capabilities.
36. In paragraph A147 it would be helpful to include the use of forensic expertise in the second example.
37. The intent of the examples in paragraph A148 is unclear as the question of what the auditor needs to do in response to such investigations by the entity remains unanswered, such as for example evaluating the expert hired by the entity (as required in ISA 500, paragraph 8).



Additionally, legal privilege could be applicable in investigations by clients, when performed by a lawyer. It would be helpful to give guidance on what an auditor should do with these reports.

38. In paragraph A152, the IAASB should replace the word 'believed' in the first example. Auditors have to perform procedures to determine that the suspected fraud was not material, no management was involved etc. It is not sufficient for an engagement partner to "believe" a suspected fraud to be inconsequential without performing further audit procedures.



## *Transparency on Fraud-Related Responsibilities and Procedures in the Auditor's Report*

### 5. Does ED-240 appropriately enhance transparency about matters related to fraud in the auditor's report?

#### **Auditor's report**

39. In our January 2021 letter we expressed the view that, to increase transparency, the IAASB should require the auditor to explain the extent to which the audit was considered capable of detecting fraud in the auditor's report and that, at a minimum this should be required for PIE audits, as required by European Union legislation. We remain of this view and recommend that the IAASB consider including this requirement in the final version of the standard.

#### **Key audit matters (KAMs)**

40. The CEAOB supports paragraph 63, which requires an appropriate subheading in all audit reports regarding fraud related KAMs. In our view, fraud related matters should always be highlighted in the KAMs, particularly given the public interest in and heightened stakeholder expectations regarding entities that are required to apply ISA 701.

41. The CEAOB also support the proposal that the auditor shall include a statement when no specific KAMs related to fraud have been identified. However, we do not support the content of paragraph A175 (and A57 in ISA 701) which sets out 3 circumstances in which this statement can be made. "The auditor determines ... that there are no KAMs regarding fraud" should only arise in exceptional situations and so should not be included in this paragraph.

42. We also recommend strengthening paragraph A176 which states: "it may be rare that the auditor of ... a listed entity would not determine at least one key audit matter related to fraud". Based on our inspection experience, this situation is unfortunately not 'rare' in practice. Additional clarity is thus needed in both ISA 240 (for example in paragraph 64 and the related application material) and ISA 701 that fraud risks should be disclosed in the KAMs and that disclosing no key audit matters in relation to fraud is the exception.

43. ED 240 and ISA 701 leave room for interpretation regarding whether fraud risks are risks that require significant auditor attention or not. For example:

- Paragraph A168 of ED 240 states 'the auditor may determine that certain risks of material misstatement due to fraud did not require significant auditor attention and, therefore, these risks would not be considered in the auditor's determination of key audit matters in accordance with paragraph 62.'
- Paragraph A21 of ISA 701 states 'The auditor may determine certain risks of material misstatement due to fraud did not require significant auditor attention'.

This application material seems to imply that some fraud risks do not need significant auditor attention. We think that this is a wrong signal to auditors and ask the IAASB to remove this from both ED 240 and ISA 701.

44. We note that there is a lot of overlap between ED 240 and ISA 701 on the responsibilities and procedures in the Auditor's Report. We suggest that the IAASB should review the application material in ED 240 to ensure it is fully consistent with ISA 701. Otherwise, there



is a risk that these paragraphs may give rise to confusion and leave too much room for interpretation rather than providing clarification.

45. A number of countries already require reporting on fraud in the auditor's report. Early experience indicates that, while fraud risk and procedures performed by the auditor are communicated, relevant findings and conclusions about fraud risk are not. The IAASB should consider whether auditors should be required to report findings related to fraud, including findings and conclusions regarding fraud risk, and how to discourage the use of boilerplate text by auditors in this area.



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6. In your view, should transparency in the auditor's report about matters related to fraud introduced in ED-240 be applicable to audits of financial statements of entities other than listed entities, such as PIEs?
46. Yes - in addition to our response to Q5, we support the reporting of fraud related KAMs for all PIE audits.



### *Considering a Separate Stand-back Requirement in ED-240*

7. Do you agree with the IAASB's decision not to include a separate stand-back requirement in ED-240 (i.e., to evaluate all relevant audit evidence obtained, whether corroborative or contradictory, and whether sufficient appropriate audit evidence has been obtained in responding to the assessed risks of material misstatement due to fraud)?
47. It is our view that a stand-back requirement should be included in ISA 240 given the high level of public interest in this area. While there are stand-back requirements in other ISAs, they are not focused on fraud. There is a risk that, in the absence of such a requirement, the auditor may not adequately assess whether information obtained late in the audit process may be indicative of fraud. Additionally, the auditor should be required to consider both contradictory and corroborative information.
48. The application material (paragraph A30) highlights the importance of remaining alert when performing audit procedures near the end of an audit when time pressures may impede the exercise of professional scepticism. The IAASB should re-consider if this is the appropriate location for this statement, given the IAASB's choice not to insert a stand back requirement, for the auditor to take all audit evidence into account in forming conclusions at the end of the audit, as suggested in our January 2021 letter.



### *Scalability*

8. Do you believe that the IAASB has appropriately integrated scalability considerations in ED-240 (i.e., scalable to entities of different sizes and complexities, given that matters related to fraud in an audit of financial statements are relevant to audits of all entities, regardless of size or complexity)?
49. We welcome the IAASB's approach to integrate scalability considerations into ED 240. However, the IAASB should review the provisions of ED 240 that refer to other ISAs to ensure that they are sufficiently clear on their scope where relevant differential requirements apply in those other ISAs. For example, ISA 701 in respect of KAMs (paragraphs 61-64) applies to listed entities and where required by law or regulation (see also our response to Q6).







### Linkages to Other ISAs

9. Does ED-240 have appropriate linkages to other ISAs (e.g., ISA 200,<sup>4</sup> ISA 220 (Revised),<sup>5</sup> ISA 315 (Revised 2019), ISA 330,<sup>6</sup> ISA 500,<sup>7</sup> ISA 520,<sup>8</sup> ISA 540 (Revised)<sup>9</sup> and ISA 701<sup>10</sup>) to promote the application of the ISAs in an integrated manner?
50. While we welcome the improved links to other ISAs, we think that ED 240 could be clearer on the importance of its interaction with ISA 250, for example by including a reference to ISA 250 in the introductory section (e.g. paragraph 1).

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<sup>4</sup> ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

<sup>5</sup> ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*

<sup>6</sup> ISA 330, *The Auditor's Responses to Assessed Risks*

<sup>7</sup> ISA 500, *Audit Evidence*

<sup>8</sup> ISA 520, *Analytical Procedures*

<sup>9</sup> ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

<sup>10</sup> ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*





### *Other Matters*

10. Are there any other matters you would like to raise in relation to ED-240? If so, please clearly indicate the requirement(s) or application material, or the theme or topic, to which your comment(s) relate.

### **Coordination with IESBA**

51. As with other standard-setting projects, we highlight the importance of appropriate coordination between the IAASB and the IESBA. Changes to the ISAs, if any, should be mirrored to ensure consistency with the provisions of the IESBA Code and coordinated with the IESBA.

### **Specific items for consideration by others**

52. We encourage the IAASB to liaise with relevant other parties which are likely to take action on the following matters to ensure a convergence of efforts to address fraud issues:

- Delivering educational actions, for instance explaining the role of auditors regarding fraud more clearly and precisely to stakeholders; and
- Further developing the two-way communication culture in the audit profession with audit committees and TCWG, in order to facilitate efficiency of the dialogue on fraud risks.



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### *Translations*

11. Recognizing that many respondents may intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents note in reviewing the ED-240.
53. The CEAOB has not examined this subject.



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### *Effective Date*

12. Given the need for national due process and translation, as applicable, and the need to coordinate effective dates with the Going Concern project and the Listed Entity and PIE – Track 2 project, the IAASB believes that an appropriate effective date for the standard would be for financial reporting periods beginning approximately 18 months after approval of the final standard. Earlier application would be permitted and encouraged. Would this provide a sufficient period to support effective implementation of the ISA?
54. We support the IAASB's proposed effective date.



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Please do not hesitate to contact me or the Chair of the CEAOB International Auditing Standards Sub-group should you have any questions on the content of this letter.

Yours faithfully,

Patrick Parent

Chairman