



15 May 2024

Mr Doug Niven
Chair
Australian Auditing and Assurance Standards Board
PO Box 204
Collins St West
VIC 8007
AUSTRALIA

Dear Mr Niven

Response to Consultation Paper ‘*Exposure of the IAASB’s Proposed ISA 240 (Revised), The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements; and Proposed Conforming and Consequential Amendments to Other ISAs*’

On behalf of the Australasian Council of Auditors-General (ACAG), thank you for the opportunity to comment on the draft ***The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements***. ACAG’s detailed response is attached.

ACAG believes overall that ED-240 has achieved the objectives as outlined in the project proposal to:

- Clarify the roles and responsibilities of the auditor relating to fraud in an audit of financial statements.
- Promote consistent behaviour and facilitate effective responses to identified risks of material misstatement due to fraud.
- Enhance ISA 240 to reinforce the importance of appropriate exercise of professional scepticism in fraud related procedures.
- Enhance transparency on fraud related procedures including strengthening communications with those charged with governance and reporting requirements.

ACAG have identified several instances of improvement to further strengthen and clarify the requirements and/or application guidance for the Board’s consideration.

While acknowledging the reasons behind the move to increase transparency, ACAG continues to be concerned about the existing expectation gap on the role of the auditor to opine on the financial statements. The proposal to include fraud content within the auditor’s report may have unintended consequences. Firstly, this may alert readers to areas of weakness within the entity and expose them to being exploited. Secondly, this has the potential to widen the expectation gap, if not appropriately managed. Any proposals to require additional disclosure in the auditor’s report should ensure that the risks to expanding the expectation gap do not outweigh the benefits of transparency.

Once again, thank you for the opportunity to comment. I hope you find ACAG's comments, which represent the views of the Australian members of ACAG, helpful.

Yours sincerely

A handwritten signature in blue ink that reads 'B.P. Worrall'.

Brendan Worrall, Auditor-General Queensland
Chair
ACAG Audit Standards Committee

ATTACHMENT

QUESTIONS FOR RESPONDENTS

Responsibilities of the Auditor

- 1. Does IAASB 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?**

Overall, we agree that the responsibilities of the auditor relating to fraud are clearly set out and that the requirements and application material are more clearly articulated than the extant ISA 240.

Refer to our answer to question 4 for our feedback relating to the expanded fraud and suspected fraud responsibilities.

We would like to highlight the following for the Board's consideration:

- We appreciate the IAASB's belief that '*the focus of an auditing standard relating to fraud in an audit of financial statements should be on the role and responsibilities of the auditor and, accordingly, the IAASB described the auditor's responsibilities in ED-240 before those of management and TCWG*'. However, the first line of defence to prevent and detect fraud is the responsibility of management and TCWG. There remains a disconnect with management and TCWG in thinking the responsibility in identifying fraud is on the auditor. We believe reinforcing management's responsibility ahead of the auditor's helps to clarify this point.
- Likewise, by moving the inherent limitations explanation to seven paragraphs after the auditor's responsibilities, diminishes the difficulty an auditor experiences in detecting fraud, particularly when management fraud / collusion is involved. Not all stakeholders read a standard cover to cover and are likely to miss this explanation if it is not directly related to the responsibilities of the auditor. We therefore suggest moving revised paragraphs 9 - 11 under an italicised heading after revised paragraph 3: *Inherent limitations on the auditor's ability to detect material misstatements due to fraud*.
- To avoid public confusion, we also suggest realigning the first sentence to revised paragraph 2(a) with that of ASA 200.11(a), similar to what was previously in paragraph 5: Plan and perform the audit to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, *whether due to fraud or error*. If this standard is read in isolation, it appears as though the auditor's responsibility is just related to fraud and therefore may cause confusion with respect to revised paragraph 9 when explaining the risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error.
- The auditor's responsibilities around non-material fraud included in paragraphs 55–59 are clear, and the example scenarios are relevant and useful. We recommend that application paragraph at A11 is also attached to this requirement.

Professional Scepticism

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

Overall, we agree that professional scepticism is appropriately reinforced through the requirements in paragraphs 19-28. The enhanced application guidance at paragraphs A24-A29 (including examples) will assist auditors in exercising professional scepticism about matters relating to fraud in an audit.

We would like to highlight where the additions to the standard could be considered an expansion of the auditor's role and unintentionally exacerbate the existing expectation gap:

- The inclusion of ISQM 1 requirements in paragraphs A13-14 with respect to a firm's commitment to quality and having the appropriate resources to perform a quality audit appears to have been reframed with a fraud lens. Unlike other new additions, the explanatory memorandum is silent on this inclusion. We appreciate that the purpose was likely to reinforce the importance of professional scepticism during an audit, however introducing the fraud lens to ISQM 1 that addresses overall firm quality management could be considered an expansion of scope.
- The addition of paragraph 21 '*the auditor shall remain alert throughout the audit for information that is indicative of fraud or suspected fraud*' could unintentionally be construed that the auditor should always be on the lookout for fraud by undertaking extensive fraud related procedures throughout the engagement. Clarity is therefore required that any additional procedures as a result of ED-240 will not be expected to identify all fraudulent transactions.

Specifically in relation to accepting documents as authentic, we have a concern over the removal of the lead in sentence from extant ISA 240 '*unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine*', could lead to some ambiguity. We acknowledge that this sentence has been included in ISA 200 and the proposed removal is not intended to increase the auditor's work effort. However, without this context, there may be some confusion as to the application of the proposed paragraph 20. Therefore, we believe it would be useful if application guidance in A28 is expanded to provide more guidance when the auditor suspects documents are not genuine, on what procedures could be performed to confirm documents are genuine. For example, direct confirmations are not always successful or cost effective. This is particularly important as documents are provided electronically and fraudulent electronic documents may be difficult to identify given the multiple ways electronic documents can be generated.

Risk Identification and Assessment

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

Overall, the updated and new requirements in ED-240 build on the foundational requirements in ISA 315, with clear linkages using 'in applying ISA 315'. The enhanced application guidance, including examples, is also useful.

We would like to highlight the following for the Board's consideration:

- Paragraph 41 highlights the requirements around the rebuttal of the presumption of the significant risk of fraud in revenue recognition over '*which types of revenue, revenue transactions or relevant assertions give rise to such risks*'. To increase linkage to ISA 315, suggest that it be made clear that the rebuttal would be performed at the assertion level, given the associated inherent risk assessment is performed at the assertion level.
- There appears to be an inconsistency between paragraph 42 which explicitly calls out management override of controls as a significant risk and then paragraph 48 which states '*irrespective of the auditor's risk assessment of the risks of management override of control ...*'. To clarify that management override of controls is a significant risk, we suggest removing the wording we have quoted for paragraph 48 and including the word 'significant' in the heading of paragraph 48 so that the heading reads 'Audit Procedures Responsive to Significant Risks Related to Management Override of

Controls', acknowledging that the actual audit procedures performed should not be impacted by this wording.

- Public sector considerations in the examples proposed. The inclusion of examples where fraud risk factors may not be significant within paragraph A111 is useful and inclusion of specific factors relevant to the public sector would be beneficial, particularly public sector matters where one would rebut the presumption, such as:
 - annual appropriation revenue
 - operational and capital grant funding
 - administered items
 - rates revenue for local government.
- Additionally, the example in paragraph A106 highlights that misappropriation of funds may be a common type of fraud for the public sector. While the example mentioned may be a risk (though our entities would generally be large enough that one individual does not have sole authority to commit the entity to sensitive expenditure), a greater risk in the public sector is generally in relation to procurement / contract management (undisclosed conflicts of interest, lack of robust independence requirements about the procurement process leading to personal gain for staff etc). Suggest the examples be updated to better reflect the matters encountered in the public sector such as:
 - non-disclosure of conflicts of interest during procurement or contract management processes resulting in undue benefit for some staff, contract and service providers
 - the potential financial and economic impact of procurement fraud on the operations of government, which may include inflated costs, or reduced quality of supplies or works. The adverse impact may be ongoing due to ongoing maintenance costs or other financial obligations associated with inappropriate procurement
 - increased risks of non-compliance with laws and regulations due to goods and services not being suitable for the requirements identified
 - a reluctance for honest competitors to tender for other projects in future, leading to an ongoing increase in price and reduction in quality of services provided to the government
 - payments made for goods/ services not received
 - advance payments made which are not within the terms of the contract , and way ahead of actual goods received
 - fraudulent procurement documents, such as quotations and tender documents
 - contract extensions resulting in inflated costs without proper oversight and adequate support to motivate why these costs are additional and could not be identified during the original tender stage.

Fraud or Suspected Fraud

- 4. Does IAASB 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?**

Overall, we agree that the requirements around identified and suspected fraud are robust and appropriately supported by the application material.

We would like to highlight the following for the Board's consideration:

- There is currently no application guidance for the new requirement in paragraph 56(b) to consider the impact of identified or suspected fraud on other engagements including engagements from prior years. For example, where the fraud impacts on prior periods, it would be useful to highlight:
 - the extent of audit procedures for the prior period(s) and
 - whether you would only go back as far as the current period opening balance.

- Whether materiality / significance of the identified fraud be further considered in determining the work effort required. For example, for some large, particularly geographically dispersed public sector agencies, there are likely to be instances of fraud, with some being minor (such as theft of low value assets e.g. office supplies) and others more significant (such as significant procurement fraud). The explicit requirements in paragraph 55 and A10, requiring the auditor to obtain an understanding of each individual matter, (before consideration of materiality / pervasiveness) will likely demand more audit effort. Whilst we acknowledge the inclusion of scalability for the engagement partner to determine the overall response, the costs to do so may outweigh the benefits in the case where each matter (irrespective of materiality) is required to be assessed.
- Depending on how the audit team are made aware of the fraud or suspected fraud, legislative requirements (e.g. from a corruption body notification to us) may prevent us from making a direct enquiry to management. Indirect enquiry would be possible. We suggest the standard considers where such circumstances would limit the auditor's ability to do this.
- The impact of local requirements (such as from a corruption watchdog) that may require additional reporting and potentially work effort.

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

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

The audit profession is already facing an expectation gap dilemma. The inclusion of fraud within the auditor's report has the potential to widen the existing expectation gap, through:

- a statement that there are no KAMs related to fraud; or
- a KAM for those matters that required significant auditor attention.

This is because it implies a level of forensic analysis and testing that isn't required by ED-240.

The inclusion of a specific statement that there are no KAMs related to fraud may also create further confusion as it would not be clear to readers why auditors only specifically call out fraud.

Additionally, the reporting of fraud or suspected fraud in an audit may:

- have unintended consequences by alerting readers to areas of weaknesses that could then be exploited; or
- not be feasible if the matter is subject to litigation or ongoing criminal or other investigation; or
- be prohibited to make such disclosure depending on our legislative requirements.

We note that we do not audit listed entities and only some jurisdictions voluntarily report on KAMs.

Should the proposed increased disclosure remain, we suggest including an additional consideration to clarify the intent of paragraph A168. Paragraph A168 highlights that there may be instances where the risk of material misstatement due to fraud would not require significant audit effort and therefore not be a KAM. We suggest the Board include, for illustration, that where the presumed significant risk of fraud in relation to revenue recognition is rebutted, this is unlikely to lead to significant auditor attention, and therefore not be a KAM.

Considering a Separate Stand-back Requirement in IAASB ED-240

6. In your view, should transparency in the auditor’s report about matters related to fraud introduced in IAASB ED-240 be applicable to audits of financial statements of entities other than listed entities, such as PIEs?

Following on from question 5, we have some concerns about the potential expectation gap that an expansion of this requirement to other entities, including non-listed PIEs, may create.

An additional consideration in the public sector would be the practical challenge of applying the requirements. For many jurisdictions, KAMs are voluntarily reported at the entity level. For some jurisdictions, the total state sector or whole of government would be considered a PIE, whereas the components are usually non-PIEs. This would have an impact on the audit effort on the components in order for the total state or whole of government opinion to include a KAM regarding fraud.

Considering a Separate Stand-back Requirement in IAASB ED-240

7. Do you agree with the IAASB’s decision not to include a separate stand-back requirement in IAASB 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)?

Overall, we believe the stand back requirement is appropriately covered in ISA 315 and other standards.

Scalability

8. Do you believe that the IAASB has appropriately integrated scalability considerations in IAASB 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)?

Overall, we agree that scalability has been appropriately incorporated into ED-240.

We would however, like to highlight the impact on requiring each fraud matter (regardless of materiality) to be individually considered and the cost implication of such, as identified in our response to question 4. Consistency in practice can also be a concern, increasing the importance of the guidance to demonstrate the application of appropriate scalability.

Linkages to Other ISAs

9. Does IAASB ED-240 have appropriate linkages to other ISAs (e.g., ISA 200, ISA 220 (Revised), ISA 315 (Revised 2019), ISA 330, ISA 500, ISA 520,8 ISA 540 (Revised) and ISA 701) to promote the application of the ISAs in an integrated manner?

Overall, we agree that the linkages in ED-240 to other standards are appropriate. The addition of a new Appendix identifying other ISAs that address specific topics that reference fraud or suspected fraud is particularly helpful, as are the words ‘in applying ISA XXX’ throughout ED-240.

In relation to linkages between ED-240 and ISA 315 for procedures over journals:

- In paragraph 48, on the assumption that management override is a significant risk (refer comment under question 3 to explicitly call out that that this is a significant risk), there is a requirement to

perform procedures over journals. This suggests that controls over journals would therefore address a significant risk. To better align this requirement with ISA 315, we suggest making this explicit in ISA 315 paragraph 26(a). Currently paragraph 26(a) makes a distinction between:

- 'controls that address a risk that is determined to be a significant risk' in paragraph 26(a)(i) and
 - 'controls over journal entries...' in paragraph 26(a)(ii).
- ED-240 focuses on journal entries and other adjustments whereas ISA 315 focuses on controls over journal entries.

Other Matters

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

We are curious to know if the AUASB will add IAASB ED-240 to its agenda for the Public Sector PAG to discuss any specific considerations for public sector entities. We agree with the IAASB's sentiment that matters related to fraud are also relevant to public sector entities, however, there may be additional application considerations to be added to IAASB ED-240's explanatory material or Guidance Statement 023 Special Considerations - Public Sector Engagements.

This may be particularly relevant if the public sector examples noted in Q3 response above are not included in the standard.

Translations

11. Recognising 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 IAASB ED240.

No comment.

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?

The timeframe is reasonable, given the amended and new requirements will not significantly change current audit approaches/methodology.

AUSTRALIAN SPECIFIC QUESTIONS

1. Have applicable laws and regulations been appropriately addressed in the proposed standard and related conforming amendments?

The overarching requirement to respond to laws and regulations specific to the entity's environment has been appropriately incorporated.

While there is appropriate linkage to the ISA 250 requirements in ED-240, suggest additional guidance or examples of scenarios where additional responsibilities under law, regulation or ethical requirements may be required where fraud or suspected fraud is identified.

2. Are there any laws or regulations that may, or do, prevent or impede the application of the proposed standard and related conforming amendments, or may conflict with the proposed standard and related conforming amendments?

The overarching requirement to respond to laws and regulations specific to the entity's environment has been appropriately incorporated.

3. Are there any laws or regulations that may, or do, prevent or impede the application of the proposed standard and related conforming amendments, or may conflict with the proposed standard and related conforming amendments?

None noted.

4. What, if any, are the additional significant costs to/benefits for auditors and the business community arising from compliance with the requirements of this proposed standard and related conforming amendments? If significant costs are expected, the AUASB would like to understand:

- i. Where those costs are likely to occur;**
- ii. The estimated extent of costs, in percentage terms (relative to audit fees); and**
- iii. Whether expected costs outweigh the benefits to the users of audit services?**

Although additional costs are not expected to be significant, additional time will be spent and therefore costs will be incurred from the below:

- more requirements to obtain an understanding of the entity and its control environment, including increased enquiries of staff and performing additional procedures
- the requirement to obtain an understanding of each individual fraud matter could be costly for low-level, non systemic fraud identified by management that has a very low risk of resulting in a material misstatement. For example, timesheet fraud relating to leave or overtime
- performance of specific audit tests to address the risk. For example, further analysis to determine if conditions exist that may indicate documents are not genuine and the response to that assessment
- preparing and acquitting KAMs.

5. Are there any other significant public interest matters that stakeholders wish to raise?

As mentioned above, changes need to balance the need for transparency with the impact on the existing expectation gap of an auditor's responsibilities and ensuring that this is managed. It should be made clear that any expansion of audit procedures as a result of ED-240 will not result in the identification of all fraudulent transactions in a specific fraud risk area, as this may be misunderstood by stakeholders and increase the expectation gap.