

21 May 2024

Sub 4 ED 240

The Chairman
Australian Auditing and Assurance Standards Board
PO Box 204, Collins Street West
Melbourne VIC 8009

Dear Chairman

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

Deloitte Touche Tohmatsu (Deloitte) is pleased to have the opportunity to share our views and provide comments on the Australian Auditing and Assurance Standards Board’s (AUASB) Consultation Paper on the exposure draft of the proposed International Standard on Auditing (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* (IAASB ED or the proposed standard) issued by the International Auditing and Assurance Standards Board (IAASB or the Board) in February 2024.

We appreciate the approach the IAASB has undertaken to identify and propose changes to the extant ISA 240, *The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements*. In our view these changes will promote consistent practice and behavior and facilitate effective responses to identified risks of material misstatement due to fraud. It will also clarify the role and responsibilities of the auditor for fraud in an audit of financial statements and enhance the appropriate exercise of professional scepticism in fraud related audit procedures.

Deloitte supports the overall direction of the IAASB ED, in particular with respect to the more significant actions and key changes to meet its objectives as outlined in the proposed standard:

- a) Decoupling the descriptions of inherent limitations of the audit and the auditor’s responsibilities because the inherent limitations do not diminish the auditor’s responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement due to fraud.
- b) Enhancing the guidance related to determining the need to include specialised skills including forensic skills.
- c) Strengthening the requirements and application material to make fraud risk identification and assessment more robust, including requirements describing the auditor’s explicit or specific fraud considerations as well as reinforcing the exercise of professional scepticism.
- d) Introducing guidance related to the use of technology, both in highlighting an increasing risk of fraudulent activity and in performing fraud related procedures by auditors.
- e) Clarifying the requirements and application material in the IAASB ED on the approach to testing journal entries, presumption of fraud risk in revenue and considerations related to non-material fraud.
- f) Introducing the section and related requirements when fraud is identified or suspected.

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Whilst we believe the enhancements and clarifications will strengthen the auditor's efforts to drive further quality improvements when performing audit procedures related to fraud, we do, however, have more significant concerns which we have outlined below and in more detailed comments in the Appendix.

Significant concerns:

- **Added requirements and application material that expand on the requirements for the auditor to report key audit matters related to fraud:**

Based on the current drafting, the auditor is required for listed entities to include in the Key Audit Matters section of the auditor's report the matters related to fraud communicated with Those Charged With Governance (TCWG) that required significant auditor attention in performing the audit and were of most significance in the audit of the financial statements of the current period. If there are no key audit matters related to fraud to communicate in the Key Audit Matters section of the auditor's report, the auditor is expected to add a statement to that regard. The application paragraphs further state that it would be "rare" that the auditor would not determine at least one key audit matter (KAM) which will be interpreted by the auditor that a KAM is always required irrespective of whether it was a matter of most significance in the audit of the financial statements.

Whilst we appreciate the intention to provide transparency, we are concerned that a KAM related to fraud will significantly increase the expectation gap of the auditor's responsibility related to fraud in an audit. Although the IAASB acknowledges that it was not seeking to expand the role and responsibilities of the auditor relating to fraud in an audit of financial statements and the IAASB ED acknowledges that the primary responsibility for the prevention and detection of fraud rests with both management and TCWG of the entity, by including a fraud related KAM, as currently drafted, the IAASB ED puts more responsibility on the auditor than management when disclosing such matters.

Furthermore, we believe that expecting auditors to include at least one fraud-related KAM would result in boilerplate KAMs year over year eventually diluting the significance and purpose of a KAM and thereby the impact of the communication. We also note that some forms of fraud are often complex, highly confidential and at the date of the audit report may still be under investigation whereby, considering the timing and persons involved, communication of the matter in a KAM could create legal risk for both the company and the auditor.

- **Auditor's responsibility related to fraud including third-party fraud.**

Based on the current drafting, IAASB ED implies an expanded scope of auditor responsibility in the following manner:

- a) To detect third-party fraud that is not directly related to a material misstatement due to fraud in the financial statements and;
- b) Requiring the auditor to have an understanding of all potential fraud schemes that could exist and take place in the entity being audited.

Deloitte acknowledges that management may have an incentive to underemphasise or choose to not disclose financial statement fraud within the financial report, and therefore, the auditor should be objective and conscious of confirmation bias. Accordingly, auditors would have the presumption that fraud is most likely occurring in some form at the entity being audited and therefore, design audit procedures to address the risk of a material misstatement in the financial statements due to fraud. However, an auditor should not be required to serve as a forensic auditor. The concepts of forensic audit thinking and financial statement audit thinking should not be fused within the IAASB ED.

Deloitte is concerned that the IAASB ED does not adequately convey that auditors are only responsible for financial statement fraud that could result in a material misstatement and not all other forms of fraud or fraud schemes including third-party fraud. We do caution that the IAASB ED, as currently drafted, could be interpreted as requiring the auditor to identify all possible instances of fraud and as a result, Deloitte is concerned that the auditor's responsibilities have been extended whilst management's and TCWG's responsibilities are unchanged and hence an imbalance could occur where over-reliance is placed on the auditor's responsibilities related to fraud.

We have outlined our responses, in addition to those made in this letter in Appendix I, "Response to Requests for Comments."

We appreciate the opportunity to provide perspectives on the IAASB ED and would be pleased to discuss this letter with you or your staff at your convenience. If you have any questions, please contact me via email (jacqustrydom@deloitte.com.au) or at 07 3308 7244.

Yours sincerely

A handwritten signature in black ink that reads "Jacques Strydom". The signature is written in a cursive, flowing style.

Jacques Strydom
National Professional Practice Director (NPPD)
Deloitte Touche Tohmatsu

APPENDIX I - RESPONSE TO REQUESTS FOR COMMENTS

Deloitte's responses to the detailed questions included in the AUASB's Consultation Paper accompanying the proposed standard are set forth in this appendix. In these comments, recommended additional text is shown using **bold underline**; recommended deletions to the text are shown using double ~~strike through~~.

Overall Questions

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?

Deloitte agrees that the proposals in the IAASB ED clearly set out the auditor's responsibilities relating to fraud in an audit of financial statements considering the project objectives to decouple the key concepts of the auditor's responsibilities relating to fraud and the inherent limitations of an audit related to detecting fraud.

Regarding non-material fraud, the IAASB ED clearly indicates that the auditor's responsibility is related to material fraud and provides a framework to identify how to evaluate if a fraud is material or not, thereby meeting the proposed objective of providing clarity on the auditor's responsibilities relating to non-material fraud.

Deloitte is however, concerned with respect to third-party fraud and the role of the auditor to detect third-party fraud. While the definition of fraud in IAASB ED includes reference to third-party fraud, the IAASB ED, as currently drafted, does not adequately convey that it is not the responsibility of the auditor to detect third-party fraud that is not directly related to a risk of material misstatement due to fraud in the financial statements. That is, the auditor should not plan and perform the audit to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement specifically due to third party fraud.

Furthermore, as currently drafted, the IAASB ED expands on the role of the auditor such that it implies that the auditor is required to identify and detect all forms of fraud. Specifically related to misappropriation of assets, the IAASB ED implies that the expectation of the auditor is to identify and detect any material misappropriation of assets either internally or externally that remain undiscovered. This significantly broadens the auditor's responsibility related to fraud beyond what the auditor is capable of doing in practice.

In relation to the above, within paragraph A133, the first example implies that there is an expectation that the auditor is or should be aware of all fraud schemes that could be linked to a risk of material misstatement. Deloitte suggests updating the wording to link back to the engagement team discussion and fraud risk factors as it relates to fraud schemes that could be relevant to the entity under audit.

Proposed wording of paragraph A133 of IAASB ED:

Examples:

- Risks of material misstatement that may be strongly linked to fraud schemes **identified during the engagement team discussion** that can occur over a long period of time (e.g., complex related party transaction structures that may obscure their economic substance).
- Anomalies or outliers in the journal entry data throughout the period that may be detected from the use of automated tools and techniques

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

Deloitte agrees that the proposals reinforce the auditor's responsibility to apply professional scepticism about matters relating to fraud in an audit of financial statements.

Deloitte would, however, like to note that paragraphs 19 and 21 are repetitive. We propose appending the application paragraphs of paragraph 21 (A29-32) to paragraph 19 and deleting paragraph 21.

Additionally, Deloitte acknowledges the paragraph 20 of IAASB ED is similar to the extant ISA 240. However, we would like to raise concern that the authenticity of documents is only one specific example of where professional scepticism should be maintained and therefore, it narrows the requirement to maintain professional scepticism in relation to fraud. We recommend this to be moved to the application material.

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?

Deloitte believes that the IAASB ED is more definitive in the requirements of the auditor as it pertains to fraud related matters.

Deloitte would, however, like to note that the project objective of clarifying when it may, or may not, be appropriate to rebut the presumption of fraud risk in revenue recognition is not appropriately met by the enhancements in paragraph 27 of extant ISA 240 (paragraph 41 of IAASB ED). If the IAASB has identified a key issue related to the inconsistent application of the rebuttal of the presumption of fraud risk in revenue recognition, Deloitte believes that the IAASB should be clear on what the expectation is related to the rebuttal of fraud risk in revenue recognition. As the proposed standard currently reads, it implies that there is a rebuttable presumption unless stated otherwise which does not change from the way the extant ISA 240 is worded. In order to meet the project objective, the application material clarifying that the significance of fraud risk factors related to revenue recognition, individually or in combination, ordinarily makes it inappropriate for the auditor to rebut the presumption that there are risks of material misstatement due to fraud in revenue recognition, would be more impactful if it were to be moved to the guidance paragraphs instead.

Proposed wording of paragraph 41 of IAASB ED:

When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of material misstatement due to fraud in revenue recognition, determine which types of revenue, revenue transactions or relevant assertions give rise to such risks, taking into account related fraud risk factors. The significance of fraud risk factors related to revenue recognition, individually or in combination, may make it inappropriate for the auditor to rebut the presumption that there are risks of material misstatement due to fraud in revenue recognition. (Ref: Para. A55–A57 and A107–A112)

Proposed wording of paragraph A110 of IAASB ED:

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. ~~The significance of fraud risk factors (see paragraphs A55–A57) related to revenue recognition, individually or in combination, ordinarily makes it inappropriate for the auditor to rebut the presumption that there are risks of material misstatement due to fraud in revenue recognition.~~

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?

Deloitte agrees that the IAASB ED appropriately establishes robust work effort requirements and application material to address circumstances when instances of fraud or suspected fraud are identified in the audit. The structure of the proposed standard follows through logical steps of what the auditor's responsibility is when fraud or suspected fraud is identified.

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

Deloitte is supportive of the IAASB's effort to enhance transparency on fraud-related procedures where appropriate, including strengthening communications with TCWG and the reporting requirements in ISA 240 and other relevant ISAs.

However, Deloitte believes that the proposal to introduce Key Audit Matters (KAMs) related to fraud does not meet this objective and may, conversely, have an unfavourable outcome. Accordingly, Deloitte is not supportive of this requirement and associated application material due to the following reasons:

- A KAM related to fraud would ordinarily be appropriate if there was a fraud that required significant auditor attention in performing the audit and would be of most significance in the audit of the financial statements. In principle, the same KAM should not repeat every year. However, by indicating that it is “rare” that the auditor would not determine at least one KAM related to fraud, the IAASB ED implies that the auditor will be compelled to include in the audit report at least one KAM related to fraud even when there are no matters that required significant auditor attention. When compelled to do so, the auditor may subsequently default to one of the existing presumed risks, such as revenue recognition or management override of controls, to meet the requirements under the IAASB ED. Deloitte believes that this will consequently result in boilerplate language that is not meaningful to a reader of an audit report. Hence, the language of the KAM related to fraud will most likely be generic, broad and at a high-level year-over-year along with other potential KAM requirements (e.g., Going Concern) which gives rise to the risk that when an actual KAM related to fraud needs to be communicated, it would not be evident to the users of the financial statements and may result in the misunderstanding of the significance of a fraud related matter when critical.
- Deloitte acknowledges that the IAASB, in proposing this new standard, took steps to try to avoid any fraud related KAMs from being “boilerplate”. However, considering the aforementioned, of the five alternatives provided by the IAASB in paragraph 62 of the explanatory memorandum, Option 1: ‘Describing the auditor’s approach to fraud risks’ may be more effective. This option could be a suitable alternative to achieve the IAASB’s project objective of enhancing transparency about matters related to fraud in the auditor’s report while mitigating the increased concerns in including a KAM related to fraud in the audit report. Option 1 may enable the auditor to make a positive statement acknowledging the auditor’s responsibility related to fraud in an audit of the financial statements and affirmation that the auditor has complied with such requirements per the standard and could provide entity-specific information in describing the auditor’s approach to identify possible risks of material misstatement related to fraud.
- As it relates to paragraph 61(b), an auditor should not be required to report matters of fraud or suspected fraud that may not be public knowledge. It should not be incumbent upon an auditor to disclose to the public fraud or suspected fraud, which could later be determined to not be fraud or if management has not reported on such matters. We believe that fraud is a legal determination that should be made by the appropriate authorities and is not a determination to be made, and reported, by auditors. As currently drafted, paragraph 61(b) specifically puts more responsibility on the auditor than management when disclosing such matters. As such, if fraud related matters are incorporated into the audit report, Deloitte believes this will increase the legal exposure of auditors especially if the fraud or suspected fraud is under investigation. Deloitte is uncomfortable that more information could be included in the auditor’s report than what is disclosed in the financial statements. If the IAASB’s intent is to drive management’s disclosure of such matters, the requirement should be brought about through the IASB as management has the primary responsibility to prevent and detect fraud and due emphasis should be placed on management’s or TCWG’s responsibility to address and report on its response to the fraud related matter. If the auditor’s responsibility is extended to reporting on fraud related matters, then a corresponding extension should be reflected in the responsibility of TCWG’s paragraph of the audit report.
- In general, Deloitte anticipates there to be heightened sensitivity and variation in practice around how the KAM related to fraud will be articulated by the auditors and be interpreted by the public as users may interpret this additional disclosure in the auditor’s report to indicate that there is fraud at the entity, when no such fraud exists. Further, in practice, it would be challenging to have discussions regarding this and obtain management agreement if the auditor would be required to disclose to the public a key audit matter related to fraud that has not previously been disclosed. In reality, it is a relatively rare occurrence for auditors to find fraud.

The IAASB ED does not account for instances such as, where there is a fraud that can't be reported due to legal exposure or it is under investigation, a fraud is uncovered in an area of the financial statements that were not susceptible to material misstatement due to fraud and the auditors have designed and performed all the required procedures appropriately to address the risk of material misstatement of fraud or a misappropriation of assets that has been correctly accounted for and concealed in a manner such that the auditor's procedures would most likely not uncover the fraud due to collusion. In such instances, when the auditor makes a statement that there are no KAMs related to fraud and such fraud was uncovered after the financial statements have been issued, it will significantly expand the expectation gap of auditor's responsibility related to fraud in an audit.

- As it relates to paragraph 61, Deloitte believes that ISA 701 offers the appropriate framework and addresses the considerations an auditor should make in determining which matters required significant auditor attention in performing the audit and appropriately addresses fraud. The inclusion of a fraud lens to the filtering mechanism in paragraph 9 of ISA 701 through paragraphs 61 and 62 of the IAASB ED implies the existing requirements in ISA 701 are not sufficient. Furthermore, Deloitte is concerned that by explicitly linking a KAM related to fraud to matters communicated with those charged with governance separate to the requirements stated in ISA 701 would incentivise the auditor to not report certain fraud related matters to those charged with governance. Accordingly, Deloitte believes supplemental requirements related to KAMs in IAASB ED are not required.

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?

Considering Deloitte's response to question (5) as described above highlighting our concerns on including a KAM related to fraud in the audit report, Deloitte does not support expanding the requirements to entities other than listed entities and believes that the scope should be narrow.

Refer to those comments made above in question (5).

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)?

Deloitte supports the IAASB's decision to not include a separate stand-back requirement as there is an overall collective stand-back requirement within the IAASB ED and other ISAs, especially within ISA 315 (revised 2019) and ISA 300. This is also consistent with how the other standards have been revised recently by the IAASB.

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)?

Deloitte believes that the current wording will lift the base level of the auditor's responsibility related to fraud and Deloitte agrees that the IAASB has appropriately integrated scalability considerations in the IAASB ED. We appreciate that a matter such as fraud may be challenging to scale, so the IAASB ED is probably not fully scalable. However, Deloitte is supportive of how the proposed standard is not prescriptive but rather gives guidance on consideration factors and examples in the application paragraphs on how matters related to fraud could be scaled.

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, ISA 540 (Revised) and ISA 701) to promote the application of the ISAs in an integrated manner?

Deloitte agrees that the IAASB ED does have appropriate linkages to other ISAs to promote the application of the ISAs in an integrated manner.

Deloitte would, however, like to note that paragraph 20 of IAASB ED does not have an appropriate linkage to ISA 200 that describes the presumption you can start on, which is the application paragraphs of ISA 200 paragraph 15 (A21 - A25). We recommend the IAASB update paragraph 20 as follows and then include a footnote referring to the specific application material.

Proposed wording of paragraph 20 of IAASB ED and footnote:

In applying ISA 200,¹ If conditions identified during the audit cause the auditor to believe that a record or document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, the auditor shall investigate further. (Ref: Para. A26–A28)

¹ ISA 200, paragraph 15 and paragraph A24

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.

Deloitte does not have any other matters to raise in relation to IAASB ED.

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 ED- 240.

Deloitte does not have any potential translation issues.

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?

Deloitte is supportive of the effective date for the standard being approximately 18 months after approval of the final standard.

Australian Specific Questions

For All Australian Stakeholders:

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

Deloitte believes that the following conforming amendments should be appropriately supplemented by the AUASB similar to how the conformity page exists in the extant ASA 240:

- Appropriate “Aus” amendments regarding the auditor’s requirements under the *Corporations Act 2001* to notify the Australian Securities and Investments Commission (ASIC) of certain circumstances under sections 311, 601HG and 990K.
- Amendment related to circumstances in which the possibility of withdrawing from the engagement or resigning from the appointment as an auditor is possible under the *Corporations Act 2001*.

14. 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?

Deloitte does not believe there are any laws or regulations that prevent or impede the application of the proposed standard or may conflict with the proposed standard other than what is described in question (13) above.

15. Are there any principles and practices considered appropriate in maintaining or improving audit quality in Australia 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?

There are no other principles or practices which Deloitte believes should be maintained and which do not prevent or impede the application of the IAASB ED.

16. 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?**

Deloitte does not believe that the expected costs outweigh the benefits to users of audit services, however, as noted in question (1) above regarding the auditor's responsibility related to fraud in the financial statements, this is considered to be a significant uplift in auditor's responsibilities and will require additional effort by the auditors and therefore, result in a corresponding increase in cost. Although Deloitte expects there to be incremental costs, we also believe that it would be the most suitable outcome since the proposed standard enhances the appropriate exercise of professional scepticism in fraud-related audit procedures and drives effective responses to identified risk of material misstatement due to fraud.

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

Deloitte does not have any other significant public interest matters to raise in relation to the IAASB ED.