



29 January 2021

Keith Billing
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Via email: AAT@frc.org.uk

Dear Keith,

Re: Proposal to revise ISA (UK) 240 (Updated January 2020) The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

The Corporate Reporting Users' Forum (hereinafter referred to as CRUF) are delighted to respond to the FRC's Exposure Draft (ED): *'Proposal to revise ISA (UK) 240 (Updated January 2020) The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements'*.

Responses to the questions raised in the consultation that relate to the issues that concern investors are set out below. As always, we do not seek to reach a consensus within the CRUF but to reflect a broad spectrum of users' views.

Overall comments

CRUF supports the FRC in progressing the Brydon Review recommendation to clarify auditors' responsibilities relating to fraud to make clear that it is the obligation of an auditor to endeavour to detect material fraud in all reasonable ways. We agree generally with the clarification amendments subject to any modifications or qualifications set out in this letter. We believe these clarification amendments should reduce the "knowledge" element¹ of the expectation gap by improving public awareness of what an auditor's responsibilities are in respect of fraud; and should reduce the "performance" element² of the expectation gap which may arise because of the current ambiguous nature of ISA (UK) 240.

CRUF accepts that it is sensible that the FRC waits until after the BEIS Audit Reform consultation before progressing the other Brydon Review recommendations in relation to the directors' and auditors' responsibilities in relation to fraud. These recommendations are the directors' report statement and the auditors' disclosure of their work on this - which will go some way to reduce the "evolution" element³ of the expectation gap. In order to reduce the "evolution" element of the

¹ As described on page 11 of the IAASB's Discussion Paper: Fraud and Going Concern in an audit of Financial Statements - [Fraud and Going Concern in an Audit of Financial Statements | IFAC \(iaasb.org\)](#)

² As described on page 11 of the IAASB's Discussion Paper: Fraud and Going Concern in an audit of Financial Statements - [Fraud and Going Concern in an Audit of Financial Statements | IFAC \(iaasb.org\)](#)

³ As described on page 11 of the IAASB's Discussion Paper: Fraud and Going Concern in an audit of Financial Statements - [Fraud and Going Concern in an Audit of Financial Statements | IFAC \(iaasb.org\)](#)

expectation gap, it will be important that any audit standard or reform changes are user led more than producer led, as also suggested by the Brydon Review. The Brydon Review also recommends controls sign offs by Chief Executives and Chief Financial Officers and some audit responses to these. CRUF suggests that these recommended controls sign offs and related audit work should be considered in the further development of auditors' responsibilities in relation to fraud.

Please see below for more detailed responses to the questions in the ED.

APPENDIX – CRUF's responses to the questions raised in the ED

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.

On the basis of the Brydon Review recommendations being dealt with in the revised standard, CRUF believes that ISA (UK) 240 has been appropriately revised to give increased clarity as to these obligations. As set out in paragraph 10 of the revised standard, this is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement due to fraud.

The consultation document states that reasonable assurance is a high, but not absolute, level of assurance, meaning that some material misstatements due to fraud may be missed by the auditor. This is acceptable, as the revised standard requires that the ISA (UK) 700 paragraph 29-1 explanation in the auditor's report is entity specific regarding the extent to which the audit was considered capable of detecting irregularities, and therefore provides an indication of the probability of missed misstatements due to fraud.

From known past reported alleged frauds, including recent ones like Patisserie Holdings and Wirecard, it appears that material frauds (as they have usually resulted in the collapse of the group or company) missed by audits tend to be those where there has been senior management collusion and/or falsification of asset records, especially cash at bank. CRUF can see from new paragraph 13-1 that a sharper focus is brought on an auditor's responsibility to consider whether or not a record or document is authentic. While this should reduce the risk of auditors missing material falsifications of asset records, we would prefer to phrase paragraph 13-1 differently, for example "For each record or document, the auditor should conclude whether they can rely upon it being authentic, and document that conclusion either for specific records and documents or for categories of records and documents as appropriate." We consider that this requirement would sharpen the focus of auditors on the issue more effectively. CRUF can see also that paragraphs 31 to 33 go some way to mitigate against senior management collusion not being detected, but is not satisfied that the possibility of senior management collusion is fully addressed in the revised standard. See also Q6 below.

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.

CRUF believes that appropriate enhancements have been made to the requirements for the identification and assessment of risk of material misstatement due to fraud, and for the procedures to respond to those identified and assessed risks. However, CRUF would suggest that the standard should also include the following requirements:

- As well as discussions amongst the audit engagement team and with management and those charged with governance to identify and assess the risk of material misstatement due to fraud, similar discussions should be held:
 - with an audited entity's available shareholders, especially those who may have expressed previous concerns about the financial statements that are indicative of fraud; and
 - with an audited entity's operational management, especially those tasked with implementing controls mitigating against material frauds.
- References should be made to the exercise of any audit requirements, especially those in other standards, that concern an entity's control environment and reliance on financial or other internal controls to identify and assess the risk of material misstatement due to fraud.

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.

See our answer to Q2.

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.

CRUF believes the proposals sufficiently support the appropriate exercise of professional scepticism throughout. This is especially so where it requires in paragraph 3 that materiality be

qualitatively as well as quantitatively assessed, and in paragraph 12-1 where it emphasises a required manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory.

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.

CRUF suggests that cash transactions during the reporting period and cash balances at the balance sheet dates should also have rebuttable presumptions that there are risks of fraud with regard to them.

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.

See our response to Q1.

Paragraphs 31 to 33 appear to CRUF to address adequately the possibility of fraud arising from senior management collusion. However, CRUF is not technically proficient enough to determine whether there are other audit procedures that should be or could be required to mitigate against the risk of non-detection of fraud from senior management collusion.

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?

Without knowing the detail of ISA (UK) 250, it is hard to know if the interaction between ISA (UK) 250 and the proposed ISA (UK) 240 is sufficiently clear.

It appears to CRUF that ISA (UK) 240 (Revised) refers only to ISA (UK) 250 in the section on Application and other explanatory material. Because any interaction between the two standards is not covered in the main section of the standard, any required interaction is not clear.

Also, the references to ISA (UK) 250 in the Application and other explanatory material section suggest that both standards require a response only to identified or suspected non-compliance with laws and regulations identified during the audit. In neither is there a requirement to search for or consider material breaches or suspected breaches of laws and regulations. CRUF therefore suggests that an audit should have procedures that consider or try to identify such material or suspected breaches of laws and regulations applicable or related to the financial statements and business model of an entity. As you suggest in your consultation document, non-compliance with laws and regulations may indicate fraud. Therefore, CRUF proposes that procedures to consider or identify material non-compliance with laws and regulations should be added into ISA (UK) 240 (Revised).

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.

The requirements of the revised standard and application material appear sufficiently scalable to CRUF. Paragraph 3 makes it sufficiently clear to allow for the application of a qualitative and quantitative materiality overlay to the application of the standard.

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.

CRUF agrees that the use of automated tools and techniques in audits will improve their quality and ability to find frauds that cause material misstatements in financial statements. CRUF has no other guidance to suggest.

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.

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.

As mentioned in the response to Q2 above, there should also be requirements to have similar discussions with an audited entity's available shareholders, especially those who may have expressed previous concerns about the financial statements that are indicative of fraud, and with its operational management, especially those tasked with implementing controls mitigating against material frauds.



About the Corporate Reporting Users' Forum (CRUF)

The CRUF was set up in 2005 by users of financial reports to be an open forum for learning about and responding to the many accounting and regulatory changes that affect corporate reporting. In particular, participants are keen to have a fuller input into the deliberations of accounting and auditing standard setters and regulators. CRUF participants include buy and sell-side analysts, credit ratings analysts, fund managers, investors and corporate governance and ESG professionals. Participants focus on equity and fixed income markets. The Forum includes individuals with global or regional responsibilities and from around the world, including Australia, Canada, France, Germany, Hong Kong, India, Japan, New Zealand, South Africa, UK and USA.

The CRUF is a discussion forum. Different individuals take leadership in discussions on different topics and in the initial drafting of representations. In our meetings around the world, we seek to explore and understand the differences in opinions of participants. The CRUF does not seek to achieve consensus views, but instead we focus on why reasonable participants can have different positions. Furthermore, it would not be correct to assume that those individuals who do not participate in a given initiative disagree with that initiative. This response is a summary of the range of opinions discussed at the CRUF meetings held globally. Local country differences of opinion are noted where applicable.

Participants take part in CRUF discussions and joint representations as individuals, not as representatives of their employer organisations. Accordingly, we sign this letter in our individual capacity as participants of the Corporate Reporting Users' Forum and not as representatives of our respective organisations. The participants in the Forum that have specifically endorsed this response are listed below.

Signatures

Charles Henderson
UKSA

Sue Milton
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Peter Parry
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Jane Fuller, FSIP
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