

Proposed International Standard on Auditing (UK) 240 (Revised 2021) The Auditor's responsibilities relating to Fraud in audit of financial statements

A public consultation issued by FRC

Comments from ACCA to FRC

29 January 2021

Ref: TECH-CDR-1959

ACCA is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people around the world who seek a rewarding career in accountancy, finance and management.

ACCA supports its 219,000 members and 527,000 students (including affiliates) in 179 countries, helping them to develop successful careers in accounting and business, with the skills required by employers. ACCA works through a network of 110 offices and centres and 7,571 Approved Employers worldwide and 328 approved learning providers, who provide high standards of employee learning and development. Through its public interest remit, ACCA promotes appropriate regulation of accounting and conducts relevant research to ensure accountancy continues to grow in reputation and influence.

The expertise of our senior members and in-house technical experts allows ACCA to provide informed opinion on a range of financial, regulatory, public sector and business areas, including: taxation (business and personal); small business; audit; pensions; education; and corporate governance and corporate social responsibility. www.accaglobal.com

Further information about ACCA's comments on the matters discussed here can be requested from:

Mike Suffield
Director, Professional Insights
mike.suffield@accaglobal.com

Antonis Diolas
Head of Audit and Assurance Law
antonis.diolas@accaglobal.com

GENERAL COMMENTS:

ACCA welcomes the proposed International Standard on Auditing (UK) 240 (Revised 2021), The Auditor's responsibilities Relating to Fraud in Audit of Financial Statements, as part of the FRC's response to the concerns regarding the lack of clarity in the standard as to the auditor's obligations raised particularly in the Brydon's report¹.

ACCA conducted a global research project relevant to these concerns, published on 9 May 2019, entitled *Closing the expectation gap in audit*.² The findings of our research show that the public sees audit as part of the solution for preventing corporate failure. Furthermore, our research found that there is demand for a wider audit scope including assigning more responsibilities to the auditor for identifying and reporting fraud.

Our research on the expectation gap surveyed 11,000 people across 11 countries (including 1,000 in the UK) weighted evenly by sample size, gender and spread across age, education level and household income. The countries in scope of our research are; Greece, Czech Republic, New Zealand, South Africa, Australia, the Netherlands, Singapore, Canada, the UAE, Malaysia and the UK.

ACCA is currently working on a follow up project on the expectation gap, focusing on fraud and going concern. As part of this project, a series of roundtables were held with stakeholders of the wider financial reporting ecosystem across the globe. The IAASB's Discussion Paper on Fraud and Going Concern formed a key part of these roundtable discussions and where relevant, feedback received is reflected in this response.

SPECIFIC COMMENTS:

- 1. 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.**

Generally, we are of the view that ISA (UK) 240 has been appropriately revised providing increased clarity as to the auditor's obligations relating to fraud in the audit of financial statements. As noted in the Consultation Paper and Impact Assessment, we understand that the revisions are in response to the concerns mentioned in Sir Donald Brydon's report and reflected in recommendation 14.1.5 of the report. In our outreach regarding the IAASB Discussion Paper on Fraud and Going Concern similar concerns have been raised in respect of the International standard, in particular from stakeholders representing the regulators. There is therefore the potential for some of the proposed revisions to influence the developments at the international level.

The proposed para 15-2 states that, in the case of a group audit, the discussion among the group engagement team shall include matters to discuss with the component auditor of a significant component about the susceptibility of the component to material misstatement of the financial information of that component due to fraud. We wonder how this addition will interact with the revised definition of engagement team, which now includes component auditors, and the potential removal of the significant component concept as per IAASB's ED-600 (Revised).

¹ <https://www.gov.uk/government/publications/the-quality-and-effectiveness-of-audit-independent-review>

² <https://www.accaglobal.com/in/en/professional-insights/global-profession/expectation-gap.html>

We raise further challenges and observations in our responses to questions 2 to 11 below.

- 2. 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.**

The proposed para 27-1 states that, if the auditor identifies a misstatement due to fraud or suspected fraud, the auditor shall determine whether a forensic expert is needed to investigate further.

As part of our outreach for the IAASB's Discussion Paper on Fraud and Going Concern, we've also received extensive feedback as to whether the use of forensic experts should be mandated. The feedback suggests conditional support, with most stakeholders stating that mandating their use for all audit engagements is likely to increase costs with very little, if any, value added. In practice, mandating the use of forensic specialists is likely to be a bigger challenge for SMPs given that in many cases they would need to seek outsourced support. There may also be supply issues as forensic practitioners are specialists within the profession and there may not be enough of them to meet such a requirement.

Our stakeholders did, however, express support for increased involvement of forensic specialists where, in the auditor's professional judgement, their involvement is appropriate for the circumstances of an audit engagement, similar to the use of other experts. Furthermore, some stakeholders also suggested that the use of forensic specialists could be considered to be mandated in the planning stage of listed and/or regulated audit engagements and then, based on the auditor's judgement, determine if they should be involved throughout the engagement. We do emphasise that such developments should be considered carefully as there is a risk of widening the expectation gap, particularly, in the case where forensic specialists are used and fraud still goes undetected.

We therefore support the addition of para 27-1 as in our view, it responds to the feedback received.

- 3. 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.**

We are generally in support of the enhancements made, however we do note some challenges and suggestions in our response to questions 4 and 8.

- 4. 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.**

ACCA strongly supports the addition of para 12-1 which explicitly recognises the existence of bias towards evidence that may be corroborative or to the exclusion of evidence that may be contradictory. We would suggest a reference to 'confirmation

bias' which 'is the phenomenon whereby people tend to value evidence that corroborates their existing beliefs more highly than evidence that contradicts them.'³

However, we do note that para A7-1 of the application material could be challenging in practice, for example, where does the auditor stop when obtaining evidence from multiple sources? Or in cases where there is only one source of evidence? We therefore suggest that guidance in the form of examples would be very helpful.

- 5. 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.**

In our view, another area worth exploring is expenditure which particularly in light of Covid-19, may be more susceptible to fraud. This may be more relevant in the case of LCEs where for example, targeting reduced tax liability is quite common, particularly in owner managed businesses.

- 6. 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.**

We are supportive of the specified audit procedures responsive to risks related to management override of controls.

We do note that in the case of journal entry testing there seem to be some inconsistencies in practice, particularly in LCE audits, with practitioners often questioning the value added when for example, many, if not all, of those entries already formed part of their substantive testing. We therefore suggest providing guidance regarding the 'why' of performing certain audit procedures is better articulated, allowing practitioners to recognise the value added which in its turn will lead to better performance in this area.

- 7. In complying with the requirements of ISA (UK) 240 (Revised), the auditor may also need to consider whether there has been non-compliance with laws and regulations, and therefore that requirements in ISA (UK) 250 Sections A and B (Revised November 2019) also apply. Is it sufficiently clear in these ISAs (UK) of the interaction between them?**

Yes, in our view, it is sufficiently clear how these standards interact. However, given the high public scrutiny on this area, we suggest that further guidance is issued outside the standards that clearly explains the auditor's responsibilities for these standards, their differences and how they interact.

- 8. 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 proposed para 18-1 states that in making the determination in para 18, the auditor shall also make inquiries with management, or others within the entity as appropriate, who are responsible for dealing with allegations of fraud raised by employees or other parties. Although we agree with the addition of this paragraph and its application

³ https://www.accaglobal.com/content/dam/ACCA_Global/Technical/audit/pi-banishing-bias-profscepticism.pdf

material para A16-1, this could be a challenge for LCE audits given that such entities don't normally have designated officers/employees that deal with such allegations and/or formal whistleblowing policies. Furthermore, in the case of owner managed businesses, when there is suspicion for fraud, it is very likely that management could be involved and therefore making the requirement of this paragraph impracticable. We therefore suggest that some additional guidance is included in the application material to support the audit of LCEs.

Please also refer to our responses on questions 5 and 6.

9. 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.

We understand that the FRC, via its newly reformed Audit Technical Advisory Group will be developing guidance for auditors to aid in dealing with the volume of potential exceptions generated when using ADA. Such guidance would be particularly helpful when using ADA in journal entry testing. Additional, guidance that helps practitioners to understand the risks associated with advanced technologies would be very beneficial.

We support the FRC in the efforts that it is making to work closely with firms as the developments in the use of technologies are changing rapidly. ACCA's thought leadership report entitled, *Machine learning: more science than fiction*⁴, found that machine learning (ML) can help improve fraud detection. For example, in risk assessment, supervised learning algorithms can be used to help identify specific types or characteristics that warrant greater scrutiny; and improve targeting of the areas of focus for the audit. In this context, the choice of an appropriate ML method can be valuable for audit testing. This is only an example and we therefore encourage the FRC to continue exploring further opportunities where technology can help.

10. Do you agree with the proposed effective date of audits of financial statements for periods beginning on or after 15 December 2021, with early adoption permitted, which is aligned with the effective date of ISA (UK) 315 (Revised July 2020)? If not, please give reasons and indicate the effective date that you would consider appropriate.

Yes, we agree with the proposed effective date.

11. 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?

In our view, a requirement for auditors to discuss with those charged with governance the risks of material fraud in the business, including those which are business sector specific, would be beneficial and make the risk assessment process more robust. However, we do note that such a requirement should be scalable recognising that, in the case of LCEs, this could be more challenging based on the governance structure of the entity, similar to our comments raised in response to question 8 above.

⁴ <https://www.accaglobal.com/gb/en/professional-insights/technology/machine-learning.html>