



# **Exposure Draft**

## **Proposed Revisions to Canadian Auditing Standard (CAS) 240**

# **The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements**

**March 2024**

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**Comments to the AASB on this Exposure Draft are due on May 6, 2024.  
Comments to the IAASB on its questions are due on June 5, 2024.**

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The Auditing and Assurance Standards Board (AASB) welcomes feedback from any interested party on any or all the questions posed in this Exposure Draft.

You can provide feedback to the AASB on the proposals in a variety of ways:

- Participate in the [Connect.FRASCanada.ca](https://connect.frascanada.ca) surveys as they become available throughout the comment period.
- Connect directly with the AASB by attending a discussion session on this Exposure Draft. Session dates and registration information will be posted to the [project page](#).
- Write a response letter and upload it via our [online form](#). Response letters can be addressed to:

Karen DeGiobbi, CPA, CA  
Director, Auditing and Assurance Standards  
Auditing and Assurance Standards Board  
277 Wellington Street West  
Toronto, ON M5V 3H2

**Note:** Response letters will be posted online shortly after this Exposure Draft closes for comment. Confidentiality can be requested when uploading letters via the online form.

Helpful tips when participating in a consultation:

- Comments are most helpful if they relate to a specific paragraph or group of paragraphs found in the Exposure Draft.
- If you identify a potential issue in this Exposure Draft's proposals, we encourage you to clearly explain the issue and include a suggested alternative, supported by specific reasoning.
- The AASB does not expect you to respond to every single question posed – only those to which you feel you can or should respond.

## HIGHLIGHTS

The Auditing and Assurance Standards Board (AASB) proposes, subject to comments received following exposure, to adopt with appropriate Canadian amendments, if any:

- 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

issued by the International Auditing and Assurance Standards Board (IAASB). The result would be revised respective Canadian Auditing Standards (CASs).

This Exposure Draft consists of:

- an explanation of why change is needed;
- key public interest considerations;
- proposed changes;
- scalability and proportionality considerations specific to less complex entities;
- a link to the IAASB's [Exposure Draft](#), including its Explanatory Memorandum;
- a description of the AASB's process for adopting ISAs;
- a discussion of proposed Canadian amendments; and
- a proposed effective date.

Please review "[Comments requested](#)" on page viii for information on preparing your response to this Exposure Draft.

## Why change is needed

High-quality audits support the smooth functioning of capital markets. The public interest is best served when participants in the financial reporting system have confidence in audits. In recent years, high-profile international corporate failures and significant accounting restatements have put a spotlight on participants in the financial reporting ecosystem who are involved in the preparation, approval, audit, analysis and use of financial reports, particularly in the area of fraud.

As part of its information-gathering activities, the IAASB issued a Discussion Paper, "[Fraud and Going Concern in an Audit of Financial Statements: Exploring the Differences Between Public Perceptions About the Role of the Auditor and the Auditor's Responsibilities in a Financial Statement Audit](#)" in September 2020. The Discussion Paper considered additional information that could be communicated by the auditor, and the issues and challenges in applying ISA 240, in light of the changing environment, jurisdictional developments and changing public expectations.

The AASB conducted extensive outreach to obtain Canadian views on the matters discussed in the IAASB's Discussion Paper. Consistent with respondents' views, the AASB expressed support for the IAASB in pursuing a project to revise ISA 240.

In addition, in October 2021 the AASB, in collaboration with the Association of Chartered Certified Accountants, the Chartered Professional Accountants of Canada and Chartered Accountants Australia and New Zealand, released a report, "[Closing the Expectation Gap in Audit – The Way Forward on Fraud and Going Concern: A Multi-stakeholder Approach](#)." The report examines the auditor's role in the areas of fraud and going concern and the related expectation gap and identifies recommendations to narrow this gap.

At its May 2021 meeting, the IAASB discussed the responses to its [Discussion Paper](#) and possible actions to address the issues that had been identified. The discussion informed the development of the IAASB's project proposal to revise extant ISA 240, which was approved in December 2021.

## Key public interest considerations

The "Mapping of Key Changes Proposed in ED-240 to the Actions and Objectives in the Project Proposal that Support the Public Interest" that accompanies the IAASB's [Explanatory Memorandum](#) outlines the key public interest considerations for this project.

## Proposed changes

The IAASB's [Explanatory Memorandum](#) outlines the detailed changes proposed.

## Scalability and proportionality considerations specific to less complex entities

The IAASB's [Explanatory Memorandum](#), paragraph 113, explains how the IAASB addressed scalability and proportionality in ED-ISA 240. In addition to writing a standard that is principles-based, they use several standard-setting tools, including:

- making some requirements conditional or differential; and
- using the application material to show:
  - examples of scalability considerations for smaller or less complex entities (LCEs); and
  - how the nature and extent of fraud-related procedures may vary based on the nature and circumstances of the audit engagement.

The AASB heard in previous consultations that there are specific requirements in CAS 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* (and other CASs) that are particularly challenging to apply in audits of LCEs. The Board summarized these challenges in its Discussion Paper, "[Exploring Standard-setting Options for Audits of Less Complex Entities](#)."

Following the Discussion Paper, the AASB has a separate [Audits of Less Complex Entities](#) project to explore more holistically the scalability challenges when applying the CASs to audits of entities whose nature and circumstances are less complex – particularly, Canada's many small and micro entities. However, given the previous feedback received on extant CAS 240, the Board would like to understand whether these challenges for audits of LCEs will continue when applying this Exposure Draft (ED-CAS 240).

As part of the outreach on this Exposure Draft, the AASB will field test with practitioners who audit LCEs to explore the challenge areas, in addition to other areas of change. The AASB welcomes your feedback on these areas as part of your response to the IAASB and AASB's Exposure Draft.

## Discussion of challenge areas specific to less complex entities

### *Background*

Each of the challenge areas identified is included in both extant CAS 240 and ED-CAS 240 as responses to the risks of material misstatement due to fraud because:

- fraud in revenue (either overstatement or understatement) may exist in entities of all sizes;
- revenue is an area highly susceptible to fraud, requiring specific auditor attention;
- individuals within the entity who are familiar with the audit procedures normally performed on an engagement may have a greater ability to conceal fraudulent financial reporting; and

- fraudulent activity often involves the manipulation of the financial reporting process by recording inappropriate or unauthorized journal entries and other adjustments.

These requirements support confidence in audits by addressing both the public interest and the auditor's role in narrowing the expectation gap.

### Challenge areas previously identified

#### Identification and response to fraud risk

Paragraph 27 of extant CAS 240 presumes there is always a risk of material misstatement due to fraud related to revenue recognition.

Feedback the AASB has received suggests that although rebuttal of the presumed risk of fraud in revenue recognition is permitted, the work effort to support and document the rebuttal is onerous and not well understood.

Extant CAS 240 Requirement	ED-CAS 240 Requirement
<p>27. When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks. Paragraph 48 specifies the documentation required where the auditor concludes that the presumption is not applicable in the circumstances of the engagement and, accordingly, has not identified revenue recognition as a risk of material misstatement due to fraud. (Ref: Para. A29-A31)</p>	<p>41. 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. (Ref: Para. A107–A112)</p>

#### Explanation of changes

##### Changes to requirement

- **Clarifying the linkage between fraud risk factors identified and the auditor's determination of** which types of revenue, revenue transactions and assertions give rise to risks of material misstatement due to fraud in revenue recognition.
- **Aligning with IAASB's "Complexity, Understandability, Scalability and Proportionality (CUSP) Drafting Principles and Guidelines"**<sup>1</sup> **by changing the work effort verb from "evaluate" to "determine"**. This change was made because "evaluate" signifies that the preparation of the relevant subject matter or analysis is the responsibility of management or those charged with governance and the auditor evaluates how the matters affect the auditor's actions. To "determine" signifies that the auditor is required to identify and analyze the relevant issues or matters to come to a specific conclusion.

##### Changes to application material

##### New application material:

- **Demonstrating that fraud risk factors may be identified when obtaining an understanding of the entity and its environment.** (Ref: Para. A109)

<sup>1</sup> The IAASB developed drafting principles and guidelines to address CUSP in developing ISAs to enable the writing of standards that result in consistent understanding and effective application of ISAs.

- **Clarifying that it is ordinarily inappropriate to rebut the presumption** of fraud risk in revenue recognition when there is a fraud risk factor present. (Ref: Para. A110) The use of “ordinarily” is intended to send a strong message that the presumption of fraud risk in revenue recognition may not be easily overcome when fraud risk factors related to revenue recognition are present.
- **Clarifying the circumstance where it may be appropriate to rebut the presumption** that there are risks of material misstatement due to fraud in revenue recognition. The auditor may conclude there are no risks of material misstatement due to fraud relating to revenue recognition in the case where fraud risk factors are not significant. (Ref: Para. A111)
- **Including new examples of revenue where fraud risk factors may not be significant.** (Ref: Para. A111)

### Incorporation of an element of unpredictability

Paragraph 30(c) of extant CAS 240 requires the auditor to incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures.

Feedback the AASB has received suggests that it can be challenging to determine an effective procedure that is unpredictable when taking a fully substantive audit approach, where many (if not all) transactions and balances are examined at the assertion level.

Extant CAS 240 Requirement	ED-CAS 240 Requirement
<p>30. In determining overall responses to address the assessed risks of material misstatement due to fraud <u>at the financial statement level</u>, the auditor shall:</p> <p>...</p> <p>(c) Incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures. (Ref: Para. A37)</p>	<p>44. The auditor shall incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures in determining responses to address the assessed risks of material misstatement due to fraud. (Ref: Para. A114–A115)</p>

### Explanation of changes

Changes to requirement

- **Broadening how auditors can implement an element of unpredictability on audits** – In extant standard, unpredictability procedures addressed the assessed risks of material misstatement due to fraud at the financial statement level, whereas in ED-CAS 240, the requirement has been revised to respond to the assessed risks of material misstatement due to fraud, which are at the assertion level.

Changes to application material

- **Including new application material expands on the list of possible audit procedures** that an auditor can use when addressing the assessed risks of material misstatement due to fraud. (Ref: Para. A114 and Appendix 2)

### Journal entry testing

Paragraph 33(a) of extant CAS 240 requires the auditor to design and perform procedures to test the appropriateness of journal entries at the end of the period and consider the need to test throughout the period.

Feedback the AASB has received suggests this requirement is not well understood when a fully substantive audit approach is taken. For example, when many of the entity's journal entries are already tested in a substantive audit approach, it is unclear how much additional testing is required.

Extant CAS 240 Requirement	ED-CAS 240 Requirement
<p>33. Irrespective of the auditor's assessment of the risks of management override of controls, the auditor shall design and perform audit procedures to:</p> <p>(a) Test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. In designing and performing audit procedures for such tests, the auditor shall:</p> <p>(i) Make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;</p> <p>(ii) Select journal entries and other adjustments made at the end of a reporting period; and</p> <p>(iii) Consider the need to test journal entries and other adjustments throughout the period. (Ref: Para. A42-A45)</p>	<p>37. In applying ISA 315 (Revised 2019), the auditor's understanding of the entity's information system and communication relevant to the preparation of the financial statements shall include understanding how journal entries are initiated, processed, recorded, and corrected as necessary. (Ref: Para. A95–A97)</p> <p>38. In applying ISA 315 (Revised 2019), the auditor's understanding of the entity's control activities shall include identifying controls that address risks of material misstatement due to fraud at the assertion level, including controls over journal entries, designed to prevent or detect fraud. (Ref: Para. A98–A101)</p> <p>...</p> <p>48. Irrespective of the auditor's assessment of the risks of management override of controls, the auditor shall design and perform the audit procedures in accordance with paragraphs 49–53, and determine whether other audit procedures are needed in addition to those in paragraphs 49–53, in order to respond to the identified risks of management override of controls.</p>
	<p>Journal Entries and Other Adjustments</p>
	<p>49. The auditor shall design and perform audit procedures to test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. (Ref: Para. A124–A127)</p>
	<p>50. In designing and performing audit procedures in accordance with paragraph 49, the auditor shall:</p> <p>(a) Make inquiries of individuals involved in the financial reporting process about their knowledge of inappropriate or unusual activity relating to the processing of journal entries and other adjustments;</p> <p>(b) Obtain audit evidence about the completeness of the population of all</p>

journal entries and other adjustments made in the preparation of the financial statements throughout the period; (Ref: A128–A129 and A135)

- (c) Select journal entries and other adjustments made at the end of a reporting period; and (Ref: Para. A130–A131, A132 and A134–A135)
- (d) Determine the need to test journal entries and other adjustments throughout the period. (Ref: Para. A130–A131 and A133–A134)

### Explanation of changes

#### Changes to requirement

- **Adding new requirements that align** with the relevant requirements in ISA 315 (Revised 2019).
- **Adding a requirement to obtain audit evidence about the completeness of journal entries**, including all journal entries and other adjustments made in the preparation of the financial statements throughout the period. This requirement was added because risks related to management override of controls are significant risks irrespective of the auditor's assessment of the risks of management override of controls. Also testing completeness of the population of journal entries is necessary because the information is generated internally from the entity's information system and is used in performing further audit procedures.
- **Aligning with IAASB's "CUSP Drafting Principles and Guidelines" by changing the work effort verb from "consider" to "determine"**. This change was made because "consider" is an active reflection by an auditor whereas to "determine" signifies that the auditor comes to a conclusion on whether to test journal entries and other adjustments throughout the period.

#### Changes to application material

Application material paragraphs have been reordered to improve the overall flow, and expanded to the following:

- **Clarifying the purpose of testing journal entries and other adjustments, as well as** what risk the testing of journal entries and other adjustments addresses. (Ref: Para. A124)
- **Including a fraud lens** to the auditor's understanding of the entity's information system and communication relevant to the preparation of the financial statements and controls over journal entries.
- **Including new examples of:**
  - how the auditor's understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control may help the auditor select journal entries and other adjustments for testing and to determine the need to test journal entries and other adjustments throughout the period. (Ref: Para. A130)
  - journal entries and other adjustments made at the end of the reporting period and throughout the period that may be tested in accordance with the requirements in ED-CAS 240, paragraphs 50(c) and 50(d), respectively.
- **Including new guidance when examining the underlying support for journal entries and other adjustments selected for testing.** (Ref: Para. A134)



- **Including new guidance that an auditor may consider using automated tools and techniques** when testing journal entries and other adjustments.

Added **Appendix 4**, which includes additional considerations that may be used by the auditor when selecting journal entries and other adjustments for testing (expanded upon from paragraph A44 of extant CAS 240).

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## IAASB Exposure Draft

The IAASB's Exposure Draft, "[Proposed International Standard on Auditing 240 \(Revised\): The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements](#)," is available on the [IAASB website](#).

In addition to the text of proposed ISA 240 (Revised), the IAASB's Exposure Draft includes the Explanatory Memorandum, which provides background to, and an explanation for, the proposed revisions to extant ISA 240.

## Process for adopting ISAs

The AASB has committed to adopting ISAs as CASs. The Board recognizes that it has a vital role in monitoring and influencing the project to ensure the proposed revisions are in the Canadian public interest. To do so, the AASB issues a Canadian exposure draft for every IAASB exposure draft of a proposed ISA. Adoption of an ISA as a CAS is not automatic. The AASB follows amendment criteria, set out in the [Appendix](#), when it considers whether Canadian amendments are required in specific circumstances.

The AASB's commitment to adopt ISAs as CASs includes aligning the effective date. The Board makes CASs available shortly after they are approved so those affected can become familiar with them and prepare to implement them by the effective date.

## Proposed Canadian amendments

The AASB is not proposing any new Canadian amendments to the requirements or application material of proposed ISA 240 (Revised).

However, the AASB proposes to retain the existing Canadian amendment to the footnote to paragraph CA57 of extant CAS 240. The Board's practice is to replace references to the International Ethics Standards Board for Accountants' (IESBA) Code with ethical requirements that are relevant to the audit of the financial statements in Canada. Consequently, the footnote to paragraph A160 (CA57 in extant CAS 240), set out below, would be unchanged and would continue to reflect the relevant ethical requirements in Canada.

A160. The auditor has professional and legal responsibilities in such circumstances and these responsibilities may vary by jurisdiction. In some countries, for example, the auditor may be entitled to, or required to, make a statement or report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities. Given the exceptional nature of the circumstances and the need to consider the legal requirements, the auditor may consider it appropriate to seek legal advice when deciding whether to withdraw from an engagement and in determining an appropriate course of action, including the possibility of reporting to shareholders, regulators or others.<sup>C78</sup>

Footnote C78: In Canada, relevant independence and ethical requirements (including guidance on communications with a proposed successor auditor) are set out in the rules of professional conduct / code of ethics applicable to the practice of public accounting issued by various

professional accounting bodies. [In ISA 240 (Revised), this footnote states: "Section 320 of the IESBA Code provides requirements and application material on communications with the existing or predecessor accountant, or the proposed accountant."]

Respondents are asked whether there are any unique circumstances in the Canadian environment that require consideration for amendment. The amendment criteria the Board followed are outlined in the [Appendix](#).

## Proposed effective date

The IAASB expects to approve the final ISA 240 (Revised) in March 2025. The IAASB proposes that ISA 240 (Revised) be effective for audits of financial statements for periods beginning approximately 18 months after the final standard is approved. The IAASB will coordinate the effective date of the final ISA 240 (Revised) with its project to revise ISA 570 (Revised 202X), *Going Concern* and the Listed Entity and PIE – Track 2 project.<sup>2</sup> Earlier application would be permitted.

The revised CAS 240 is expected to have the same effective date as the revised ISA. Auditors will be permitted to apply the revised CAS before the effective date.

## Comments requested

### Responding to the IAASB's Exposure Draft

Respondents are also asked to provide comments on the IAASB's Exposure Draft directly to the IAASB and provide the AASB with a copy of the response. Where timing permits, the AASB will take these comments into account when drafting its own response to the IAASB's Exposure Draft. Respondents are asked not to include comments on matters particular to the Canadian environment in their responses to the IAASB. Such comments should be included only in responses sent to the AASB.

Please refer to the "Questions for Respondents" contained in the [IAASB's Exposure Draft](#) and respond to the specific questions therein.

### Providing comments to the AASB

The AASB would appreciate receiving responses to the questions set out below, in addition to receiving a copy of the response to the IAASB's Exposure Draft.

1. Do you believe that the IAASB [AASB] 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)? [Copy of IAASB Question #8]

We welcome feedback on areas identified in the [Scalability and proportionality considerations specific to less complex entities](#) section or any additional areas.

2. Do you agree that there are no additional Canadian amendments required to ISA 240 (Revised) to adopt it as CAS 240? If not, what Canadian amendments do you believe are required, and why?  
Note: Any proposed amendments would need to meet the criteria set out in the [Appendix](#).
3. What implementation challenges, if any, might the proposed standard create for practitioners in Canada?

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2 In Canada, the effective date of the Listed Entity PIE – Track 2 proposed revisions is expected to differ from the IAASB's. For more details, see the AASB's Exposure Draft, "[Proposed Deferral of the IAASB's Public Interest Entity Narrow-scope Amendments](#)."

4. The AASB anticipates that the IAASB will approve the final standard in March 2025 with a proposed effective date approximately 18 months after approval. The proposed effective date for CAS 240 will be consistent with the anticipated effective date of the revised CAS 570, *Going Concern*. What concerns, if any, do you have with this timeline?

The deadline for providing your comments to the AASB on the above is May 6, 2024.

## APPENDIX

### Criteria for amending ISAs when adopting them as CASs

With respect to the adoption of ISAs<sup>3</sup> as CASs, and the adoption of an International Standard on Assurance Engagements (ISAE) as a Canadian Standard on Assurance Engagement (CSAE) and International Standard on Related Services (ISRS) as a Canadian Standard on Related Services (CSRS), on a case-by-case basis, the AASB overriding goal is to adopt ISAs into the Assurance Handbook without amendment. However, there may be circumstances where amendments are required. The following sets out the limited circumstances when the AASB will make amendments to ISAs:

1. The AASB limits additions to an ISA to those required to comply with Canadian legal and regulatory requirements.<sup>3</sup>
2. The AASB limits deletions from, or other amendments to, an ISA to the following:
  - (a) The elimination of options (alternatives) provided for in the ISA.
  - (b) Requirements or guidance, the application of which Canadian law or regulation<sup>4</sup> does not permit, or which require amendments to be consistent with law or regulation.
  - (c) Requirements or guidance, where the ISA recognizes that different practices may apply in different jurisdictions and Canada is such a jurisdiction.
3. The AASB may make amendments to an ISA with respect to requirements or guidance that do not fall within 1 or 2 above when it believes that there are circumstances particular to the Canadian environment where such amendments are required to serve the Canadian public interest and maintain the quality of auditing and reporting in Canada.
4. To the extent possible, amendments that are:
  - (a) additions to an ISA will not be inconsistent with the current requirements or guidance in the ISA; and
  - (b) deletions from, or other amendments to, an ISA will be replaced by an appropriate alternative that achieves the objective of the deleted requirement.

Proposed amendments to an ISA are highlighted in exposure drafts of proposed Canadian standards. The AASB indicates the reasoning for the amendments and respondents are invited to comment on them, including when the amendment will not result in convergence with the ISA in accordance with the IAASB's guide for national standard setters. Amendments to ISAs will be separately identified in the final Assurance Handbook material.

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3 Reference to ISAs in this appendix also includes reference to International Standards on Quality Management adopted as Canadian Standards on Quality Management, relevant ISAEs adopted as CSAEs and relevant ISRSs adopted as CSRSs, where applicable.

4 Canadian incorporating and other governing legislation often require entities to prepare financial statements in accordance with Canadian generally accepted accounting principles (GAAP). Accordingly, if Canadian GAAP necessitates a different audit response in Canada, these differences fall within the definition of a legal or regulatory requirement.

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