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October 3, 2025

Auditing Standards Board
American Institute of Certified Public Accountants
1345 Avenue of the Americas, 27th Floor
New York, NY 10105

Via Email to CommentLetters@aicpa-cima.com

Re: Proposed Statement on Auditing Standards, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

Dear Board members and staff:

Grant Thornton LLP appreciates the opportunity to comment on the Proposed Statement on Auditing Standards, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*. We believe it is in the public interest to modernize AU-C section 240, *Consideration of Fraud in a Financial Statement Audit*. We support the ASB's project to consider converging this standard with the International Auditing and Assurance Standards Board's (IAASB) ISA 240 (Revised), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, to clarify the auditor's responsibilities related to fraud while also recognizing many proposed revisions memorialize procedures that auditors are already performing today.

Nevertheless, we are concerned about the overall length of the proposed standard and the related risk that it is overly prescriptive. Additionally, we have concerns about the geography of the risk assessment requirements and how the auditor's responsibilities related to third-party fraud will be operationalized. We respectfully submit our responses to the requests for comment, along with other observations, for the Board's consideration.

Responses to requests for comment

Drafting suggestions for new text is shown in **bold underline** and deleted text is shown in ~~strikethrough~~.

Question 1: Do respondents believe that if the final standard is issued no later than October 1, 2026, the proposed effective date for audits of financial

statements for periods ending on or after December 15, 2028, is appropriate and provides adequate time for implementation? If not, respondents are asked to state their reasons and suggest an alternative effective date.

We support the proposed effective date for audits of financial statements for periods ending on or after December 15, 2028 if the final standard is issued no later than October 1, 2026. We support permitting early implementation.

Question 2: Do respondents agree that the proposed SAS clearly sets out the auditor's responsibilities relating to fraud in an audit of financial statements, including fraud that may not result in a material misstatement to the financial statements? Respondents are asked to state their reasons.

Notwithstanding our responses to Questions 3 – 16 and our comment below, we agree that the proposed SAS, overall, clearly sets out the auditor's responsibilities relating to fraud in an audit of financial statements.

See our response to Question 5 for additional feedback on the proposed examples of third-party fraud.

Throughout our letter we provide commentary about the volume of application material in the proposed SAS. This application material was added even though the objectives of the auditor related to fraud or suspected fraud have not changed, nor has 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, whether due to fraud or error. Although we may not address the volume of application material specifically in each question, our concern applies to the proposed SAS as a whole.

Question 3: Do respondents agree that the proposed SAS clearly sets out the key concepts and relationship with other AU-C sections in paragraphs 4-15? Respondents are asked to state their reasons.

We agree that the proposed SAS clearly sets out the key concepts and relationship with other AU-C sections in proposed paragraphs 4-15. We agree that the key concepts in extant AU-C section 240 remain appropriate for the US legal and regulatory jurisdiction, and with the ASB's decision to retain those key concepts and to add enhanced application material in the proposed SAS. We believe the inclusion of Appendix E in the proposed SAS is helpful in directing auditors to consider their responsibilities related to fraud throughout US GAAS.

Question 4: Do respondents agree that the terms "fraud," "suspected fraud," or "fraud or suspected fraud" are used appropriately throughout the proposed SAS? Respondents are asked to state their reasons.

We agree that the terms "fraud," "suspected fraud," and "fraud or suspected fraud" are used appropriately throughout the proposed SAS. We believe the Introduction in the proposed SAS appropriately refers to "fraud" as used colloquially to explain general concepts related to fraud in a manner that is clear and concise for all stakeholders to understand. Notwithstanding our response to Question 8, we also believe it is appropriate to refer only to "fraud" as it relates to identifying and assessing the risks of

material misstatement and to designing and performing procedures to respond to assessed risks of material misstatement due to fraud. Within the requirements section, we agree with the use of the term “fraud or suspected fraud” when referring to both confirmed and suspected instances of fraud to clarify that the auditor’s responsibilities include suspicions and allegations of fraud in addition to misstatements of the financial statements due to fraud.

Question 5: Do respondents agree that the proposed SAS adequately explains the relationship between the proposed SAS and AU-C section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*? Respondents are asked to state their reasons.

We are concerned that the proposed SAS might confuse stakeholders about the auditor’s responsibilities, which seem to differ under the proposed SAS and AU-C section 250. We believe the grammatical structure of proposed paragraph 14 could be revised as follows to avoid the potential misinterpretation that instances of fraud are always instances of noncompliance with laws and regulations:

.14 For the purposes of GAAS, fraud ordinarily constitutes an instance of noncompliance with laws and regulations. As such, when the auditor identifies fraud or suspected fraud that ~~also constitutes~~ **is deemed** an instance of noncompliance with laws and regulations, the auditor also has responsibilities in accordance with AU-C section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*. (Ref: par. A17-A19)

We agree with the ASB’s proposed definition of fraud in paragraph 18 of the proposed SAS and believe it is appropriate to diverge from the definition of fraud in ISA 240 (Revised). However, we believe the proposed SAS includes several examples of third-party fraud that are examples of noncompliance with laws and regulations but do not meet the proposed definition of fraud, since they do not result in a material misstatement of the financial statements. We believe this could create confusion about the auditor’s responsibilities under the proposed SAS and AU-C section 250. In general, we recommend that examples of third-party fraud throughout the proposed SAS be limited to those examples that involve management or employees colluding with third parties to perpetrate fraud that results in a misstatement of the financial statements.

We strongly encourage the ASB to delete or revise the examples of third-party fraud as follows:

- Paragraph A8: We do not believe misappropriation of assets by a third-party necessarily results in fraud because there would be no misstatement if management appropriately accounts for such a theft. We suggest revising this paragraph as follows:

A8. Misappropriation of assets involves the theft of an entity’s assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management, who are usually better positioned to disguise or conceal misappropriations in ways that are difficult to detect. In addition, misappropriation of assets can involve third parties **colluding with management or employees to disguise or conceal misappropriations**.

Misappropriation of assets can be accomplished in a variety of ways and is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorization. ...

- Paragraphs A8 and A24: We do not agree with the statement that “fraud or suspected fraud committed against the entity by parties external to the entity is generally described as third-party fraud.” While that may be true colloquially, we believe it may be misleading as it relates to the auditor’s responsibilities in the context of this proposed SAS. In some cases, fraud committed *against* the entity by a third party may not result in a misstatement of the entity’s financial statements. Additionally, we do not believe that all instances of misappropriation of the entity’s assets by a third-party are fraud; in some instances, such misappropriation could be theft wherein the entity is in fact a victim of the theft. For example, if a third-party impersonates a vendor and tricks an employee into wiring funds to a fraudulent account, there may be no misstatement of the financial statements if the transaction is properly recorded. In this example, the entity is a victim of third-party theft. If there is no misstatement of the financial statements that are the subject of an audit (per paragraph 18), there is no instance of fraud. Note that our suggested edits to paragraph A8 above address misappropriation of assets by third parties. We also suggest revising this paragraph as follows:

~~A24. Fraud or suspected fraud committed against the entity by parties external to the entity is generally described as third-party fraud.~~ Fraud as defined in paragraph 18 can include an intentional act by a third party and, accordingly, if an intentional act by a third party is identified or suspected that may have resulted in ~~misappropriation of the entity’s assets or fraudulent financial reporting by the entity~~ **an intentional misstatement in the financial statements that are the subject of the audit**, the auditor performs audit procedures in paragraphs 55-58.

- Paragraph A25, bullet 3: We do not believe that attempted unauthorized access to the entity’s IT environment is an example of fraud, or even noncompliance, as it relates to the financial statements under audit. While this may inform the auditor’s risk assessment, *attempted* access, by definition, does not result in a misstatement of the financial statements that are the subject of the audit. We suggest deleting this bullet.
- Paragraph A42, bullet 3: We believe this example is incomplete as to how the suspected tax evasion is an example of fraud and not just noncompliance with laws and regulations. We suggest revising this example as follows:

The entity is undergoing an investigation by an authority outside the entity for fraud or suspected fraud (for example, a materially misstated tax provision related to tax evasion by management to increase net income in an industry with tight margins in order to show stronger financial performance than its competitors). Tax specialists may assist with identifying those fraudulent aspects of the **materially misstated tax provision** ~~noncompliance or suspected noncompliance that may have a financial statement effect.~~

- Paragraph A62, bullet 1: We believe that this example needs to be more specific to indicate why the lack of oversight over this particular service provider may give rise to a risk factor. We suggest revising as follows:

Based on the auditor's understanding of the entity's information processing activities, the auditor identified a fraud risk factor (that is, opportunity to commit fraud) related to misappropriation of assets resulting from management's lack of oversight over ~~significant processes~~ end-to-end processing of payroll data and direct deposit requests outsourced to a third-party service provider.

- Paragraph A62, bullet 3: We do not believe that the scenario described herein (a third-party's incentive to underreport to the entity consigned sales in order for the third-party to meet its own sales targets) would manifest in a fraud risk factor to the entity being audited; rather, this would be a fraud risk factor for the auditor of the third-party's financial statements. We suggest deleting this example.

Question 6: Do respondents agree that the requirements and application material in the proposed SAS are sufficiently scalable; that is, is the proposed SAS capable of being applied to the audits of entities with a wide range of sizes, complexities, and circumstances? Respondents are asked to state their reasons.

We agree that the requirements and application material in the proposed SAS are sufficiently scalable for audits of entities with a wide range of sizes, complexities, and circumstances. We believe the specific paragraphs addressing scalability in the application material of the proposed SAS will be helpful in applying the performance requirements to entities of differing size, complexity, and circumstances. See our response to Question 12 related to the work effort on group audit engagements when fraud or suspected fraud is identified.

Question 7: Do respondents agree that the proposed SAS has appropriate linkages to other AU-C sections (for example, AU-C section 200, AU-C section 220, AU-C section 315, AU-C section 330, AU-C section 500, AU-C section 520, and AU-C section 540)? Respondents are asked to state their reasons.

While we appreciate that some practitioners may find it helpful to include all requirements related to fraud in one place, we believe that the structure of the proposed SAS, which uses the phrase "in applying AU-C section..." and references the relevant requirement in other AU-C sections, may have unintended consequences.

One such unintended consequence is that auditors may view the risk assessment procedures in the proposed SAS as separate from, and in addition to, the risk assessment procedures in AU-C section 315 due to the volume of risk assessment requirements and guidance embedded in the proposed SAS.

We question whether the volume of application material in the proposed SAS is necessary or appropriate for a principles-based standard. For example, paragraph 32 in the proposed SAS is a requirement that refers to an existing requirement in AU-C section 315; this requirement includes 10 paragraphs of application material in the proposed SAS, which feels disproportionate given that the underlying risk assessment requirement itself is not a new requirement. The entire subsection that includes this requirement ("Obtaining an understanding the entity and its environment, the applicable

financial framework and the entity's system of internal control") includes 6 requirement paragraphs that all begin with "in applying AU-C 315..." and 48 application material paragraphs. We believe the length of the standard and prescriptive nature of requirements and application material creates a risk that auditors may revert to a check-the-box mentality or inadvertently miss certain performance requirements. We believe one benefit of a more principles-based standard is the reinforcement of the auditor's professional skepticism as opposed to a list of procedures and considerations that need to be checked off.

As an alternative drafting convention, we would prefer that performance requirements in paragraphs that use the phrase "in applying AU-C section" and related application material be incorporated in the respective AU-C sections instead of being included in AU-C section 240. We also support revising those requirements added due to the convergence project to be (1) more principles-based in achieving the same performance outcome, and (2) more clearly written to avoid the need for such extensive application material, which might indicate that the requirement itself is not as clearly written as it could be.

We encourage the Board to (1) vigorously review the application material and remove those paragraphs that do not specifically add a fraud lens, and (2) consider whether certain application material paragraphs may be better placed in a guide or moved to nonauthoritative guidance. We understand that the IAASB doesn't have the same ability to issue a separate audit and accounting guide to provide relevant examples and more detailed guidance, but we believe the ASB should take advantage of pursuing such an avenue given the number of existing auditing and accounting guides addressing other subject areas.

Another unintended consequence of including requirements that link to other AU-C sections is the time and effort that will be required of ASB members and staff to maintain the suite of AU-C sections when the foundational audit standards are updated in the future. For example, when AU-C section 315 is revised next, ASB members and staff will need to consider whether performance requirements referenced in AU-C section 240 and other standards also need to be updated. This possibility warrants increasing concern given the upcoming Audit Evidence and Risk Response project, which could result in conforming amendments to the proposed SAS as it becomes effective simultaneously as revisions to ISA 315 (Revised 2019) are being discussed.

Finally, the ASB's approach to linking to other AU-C sections appears inconsistent. For example, requirements related to written representations will continue to reside in AU-C section 580, *Written Representations*. We believe the Board's rationale provided in the Exposure Draft that the placement of these requirements does not create differences between the ISAs as a whole and US GAAS as a whole is equally relevant and important for risk assessment requirements. We support this rationale and believe it also applies to other projects on the ASB's work plan, such as the Confirmations and Going Concern projects.

Question 8: Do respondents agree that the proposed SAS appropriately reinforces maintaining professional skepticism about matters relating to fraud in an audit of financial statements? Respondents are asked to state their reasons.

We agree that the requirements in the proposed SAS appropriately reinforce maintaining professional skepticism about matters relating to fraud in an audit of financial statements.

We agree with the ASB's decision to diverge from ISA 240 (Revised) in the following paragraphs:

- Paragraph 19: We support the ASB's decision to retain the essential guidance that says "notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance."
- Paragraph 22: We support the ASB's decision to retain the essential guidance from the lead-in sentence that says "Unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine."

We agree that it is important to reinforce these concepts in the proposed SAS and that removing such guidance may unnecessarily increase the work effort related to considering the authenticity of records or documents obtained during the audit. The auditor's role is not to evaluate the authenticity of every document intended to be used as audit evidence. Rather, if the auditor becomes aware of concerns regarding the authenticity of a document when performing audit procedures over the relevant attributes, the auditor reevaluates both the use of that information and whether there is a fraud risk. For this reason, we also support the additional guidance in paragraph A39 of the proposed SAS that clarifies the auditor is rarely required to authenticate documents and is not expected to be an expert in document authentication.

Likewise, we continue to believe that the application material in paragraph .A26 of AU-C section 200, which is consistent with the lead-in sentence to paragraph 22 of the proposed SAS, remains relevant and appropriate. We do not believe it would be appropriate to modify this paragraph, particularly as the Board continues its work monitoring and influencing the IAASB's Audit Evidence & Risk Response project.

In addition, we suggest deleting two examples in the application material of how to exercise professional skepticism in response to an identified risk factor for the following reasons:

- Paragraph A32, bullet 2: The example suggests professional skepticism can be maintained by informing those charged with governance of challenging circumstances related to impediments imposed by management and telling the engagement team not to accept less than persuasive audit evidence. We question how the phrase "impediments imposed by management" is defined and whether such impediments equate to scope limitations. We believe communication requirements related to scope limitations are adequately addressed in other AU-C sections; otherwise, it appears that a new threshold for communication to those charged with governance is being established. Furthermore, the principle of applying due care on all engagements sufficiently addresses the auditor's responsibility not to accept less than persuasive audit evidence.
- Paragraphs A33 and A34 say that circumstances may arise that create threats to compliance with relevant ethical requirements and that communicating with those charged with governance on a timely basis about such matters would be sufficient to

address threats to compliance. We do not believe these paragraphs have been sufficiently linked to an identified fraud risk factor or circumstances identifying fraud, nor do we believe that simply communicating a matter to those charged with governance is an appropriate response to an identified fraud risk factor. Additionally, we note that the AICPA Code of Ethics emphasizes the use of professional judgment and consideration of whether further actions in the public interest are necessary when responding to a threat to relevant ethical requirements, in addition to communicating the threat to those charged with governance. We believe the proposed example is incomplete and suggest deleting the example in paragraphs A33 and A34 so as not to confuse guidance in the AU-C sections with the requirements in the AICPA Code of Ethics.

Question 9: Do respondents agree that the proposed SAS appropriately builds on the foundational requirements in AU-C section 315 and other AU-C sections to enhance the auditor's risk identification and assessment as it relates to fraud? Respondents are asked to state their reasons.

In contemplating the genesis for including subject matter specific to risk assessment requirements within the relevant auditing standard as opposed to the risk assessment standard, we recall the IAASB's project on auditing accounting estimates. While we understand why it was necessary to include risk assessment requirements in ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*, and in AU-C section 540, *Auditing Accounting Estimates and Related Disclosures*, due to the overlapping work streams for auditing estimates and risk assessment, we are concerned that incorporating risk assessment requirements into other standards is less effective than anticipated. In our view, doing so (i) creates confusion about whether there are separate risk assessment processes and considerations, (ii) results in unnecessary work effort to maintain standards, and (iii) creates standards that are lengthy and cumbersome to implement. We encourage the ASB to keep risk assessment procedures within AU-C section 315, which would mitigate these concerns.

Refer to our response to Question 7 related to our feedback on linkages to other AU-C sections and specific concerns about the volume of application material related to risk identification and assessment.

Question 10: Do respondents agree that the risks of material misstatement due to fraud related to management override of controls should be treated as a risk of material misstatement due to fraud at the financial statement level? Respondents are asked to state their reasons.

We agree that the risk of material misstatement due to fraud related to management override of controls should be treated as a risk of material misstatement due to fraud at the financial statement level. Based on the nature of management's ability to manipulate any class of transactions, account balances, or disclosures, we believe the risk of management override of controls is consistent with the description of financial statement level risks in paragraph 4 of AU-C section 315 as a risk that relates pervasively to the financial statements as a whole and could potentially affect many assertions.

The presumed risk of management override and the consideration of whether such risk impacts the assessment of risks at the assertion level is more clearly explained in extant AU-C section 240. We feel that the proposed drafting of the lead-in to the requirement is overly complex and does not follow plain English conventions. We strongly encourage the ASB to revert to the requirements in paragraph 31 of extant AU-C section 240 to enhance clarity and accessibility.

Question 11: Do respondents agree that the proposed SAS appropriately addresses the risks of material misstatement due to fraud in revenue recognition? Respondents are asked to state their reasons.

We support the revision in paragraph 42 of the proposed SAS for the auditor to “determine” which types of revenue, revenue transactions, or related assertions give rise to such risks, taking into account related fraud risk factors. We believe linking the presumed risk to fraud risk factors in the requirement and related application material provides an appropriate lens from which the auditor can use professional judgment to identify the associated risk of material misstatement due to fraud at a level of specificity appropriate for a significant risk. We believe the work effort associated with the word “determine” is appropriate for this presumed risk compared to the risk effort associated with “evaluate” in extant AU-C section 240.

However, we question whether the application material in paragraph A132 of the proposed SAS contradicts the application material in paragraph A118 by implying that fraud risk factors are always present. Additionally, we believe the reference to scalability in paragraph A120 could be confusing or viewed as contradictory when discussing the significance of fraud risk factors. We suggest the following revisions to paragraph A132:

A132. 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 identified fraud risk factors (see paragraphs A118-A120 ~~A119~~) related to revenue recognition, individually or in combination, ordinarily makes it inappropriate to rebut the presumption that there are risks of material misstatement due to fraud in revenue recognition.

Finally, we ask the Board to improve the readability of the standard by relocating the examples in A131 to Appendix A and categorizing the risk factors according to the three categories of fraud risk factors described in paragraph A28 of the proposed SAS. The Board should delete those examples in A131 that do not clearly fit into a category of risk factors described in paragraph A28.

Question 12: Do respondents agree that the proposed SAS appropriately establishes proper work effort requirements and application material to address circumstances when instances of fraud or suspected fraud are identified in the audit? Respondents are asked to state their reasons.

We agree that the proposed SAS establishes appropriate work effort requirements and application material to sufficiently address circumstances when fraud or suspected fraud is identified in the audit, except as noted below.

We suggest a revision to paragraph 48 in the proposed SAS to clarify that the audit procedures apply to both the presumed risk of management override of controls and any specific incremental risks of management override of controls at the assertion level that are identified in accordance with paragraph 41(b). As drafted, the requirement implies the audit procedures apply only to risks identified in accordance with paragraph 41(b), which we believe is too narrow. We believe our suggested revision below is more closely aligned with the requirement in paragraph 41 and with the requirements in extant AU-C section 240 to respond to the risk of management override of controls:

48. Even if specific risks of material misstatement due to fraud are not identified by the auditor, a possibility exists that management override of controls could occur. Accordingly, the auditor should address the risk of management override of controls, by designing and performing the audit procedures in accordance with paragraphs 49–53. In addition, the auditor should determine whether other audit procedures are needed in addition to those in paragraphs 49–53 in order to respond to the ~~identified~~ risk of management override of controls.

Additionally, we believe paragraph 56(b) of the proposed SAS is missing footnote references to the auditor's responsibilities related to subsequent events and to communications with predecessor auditors. As drafted, this requirement could imply that the engagement partner is responsible for determining the effect of an identified misstatement due to fraud on a prior period that was audited by a predecessor auditor.

Further, we believe the auditor's responsibility related to identified misstatements in paragraph 57 of the proposed SAS is unclear. In the lead-in to this paragraph, we question whether the drafting should refer to misstatements that the auditor has accumulated (that is, those above trivial). As drafted, it appears that the work effort in 57(a) – (d) applies to all misstatements, even those below trivial. Additionally, we question how the auditor would determine whether control deficiencies exist related to suspected fraud. We suggest deleting "or suspected fraud" from the end of paragraph 57(b) and adding a footnote to paragraph 57(d) referring to the auditor's underlying responsibilities in AU-C section 580.

We have several comments related to the application of proposed work effort requirements and application material in the amendments to AU-C section 600, *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*. First, we strongly suggest revising the proposed conforming amendment in paragraph 47 in AU-C section 600 to more clearly link the requirement to paragraph 48(h)(ii) of AU-C section 600 as revised by the proposed SAS. As currently drafted, the requirement in paragraph 47 implies the group auditor has responsibilities related to identifying fraud at the component beyond responding to identified or suspected fraud communicated by the component auditor:

47. In applying proposed SAS *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, the group auditor should take responsibility for obtaining an understanding of identified or suspected fraud **communicated by the component auditor in accordance with paragraph 48(h)(iii).**

Second, the communication requirement for component auditors proposed in paragraph 48(h)(iii) in AU-C section 600 is not consistent with other requirements in AU-C section

600. Paragraph 37 of AU-C section 600 requires the group auditor to determine component performance materiality and a threshold above which misstatements in the component financial information need to be communicated to the group auditor, which should not exceed the amount regarded as clearly trivial to the group financial statements. There is no requirement for the component auditor to determine a trivial amount for the component financial information. We strongly suggest reverting the requirement in paragraph 48(h)(iii) to the requirement in extant AU-C section 600, as shown below:

48(h)(iii). Others at entities or business units, ~~except for matters that are clearly inconsequential to~~ where the fraud resulted in a material misstatement of the component financial information.

Question 13: Do respondents agree that the proposed SAS should include a stand-back provision as included in paragraph 59 and, if so, where it is placed? Respondents are asked to state their reasons.

We have concerns about the proliferation of stand-back requirements across US GAAS potentially leading to a check-the-box mentality for auditors. We believe the existing stand-back requirements in other standards are sufficient. However, given that extant AU-C section 240 includes a stand-back requirement, we agree with the ASB's decision to converge with ISA 240 (Revised) and include a stand-back requirement in the proposed SAS. We agree with the placement of the stand-back requirement within the proposed SAS.

Question 14: Do respondents agree that the requirements for the auditor to communicate fraud or suspected fraud with those charged with governance are appropriate? Respondents are asked to state their reasons.

We support many of the proposed requirements for the auditor to communicate fraud or suspected fraud with those charged with governance. We agree with the ASB that timely and robust two-way communication of fraud or suspected fraud that may result in a material misstatement or is otherwise qualitatively material is in the public interest. However, refer to Question 15 for our concerns related to the proposed communication requirement in paragraph 62(c), conforming amendment to AU-C section 600, and related application material in paragraph A198.

Question 15: In particular, do respondents agree that it is appropriate for the auditor to communicate with those charged with governance identified fraud or suspected fraud involving others, except for matters that are clearly inconsequential, rather than when the fraud results in a material misstatement in the financial statements? Respondents are asked to state their reasons.

We believe the proposed requirement for the auditor to communicate fraud or suspected fraud involving others, except for matters that are clearly inconsequential, is an inappropriately low threshold. When management has robust controls to detect fraud, it is likely that management may identify, investigate, and determine that many individually immaterial instances of fraud or suspected fraud do not present a material risk to the overall control environment or financial statements. Such matters may aggregate to an amount greater than clearly inconsequential, yet still be significantly

less than the threshold for a material misstatement. Such a scenario could include tips to the whistleblower hotline by disgruntled employees, or limited instances of timecard fraud or company credit card fraud. Additionally, in certain industries, such as the retail industry where individually low value sales are conducted in cash, there is a higher risk of low value fraud that management may tolerate. In these cases, using a risk-based framework, the engagement partner may obtain an understanding of the matters in aggregate through inquiries of management and other procedures as necessary, and reasonably conclude the matter does not need to be discussed with those charged with governance. In these examples, requiring communication at this lower threshold would draw time and attention away from other matters of greater significance to the audit, such as responses to significant risks, significant estimates, and independence matters, among others.

We are also concerned that the proposed requirement could be interpreted as softening the responsibilities of management and those charged with governance to prevent, detect, and correct fraud. Setting a lower threshold for communication to those charged with governance could be interpreted by users as blurring the lines of the auditor's role and imply that auditors:

- i. Play a role in preventing and detecting fraud or otherwise compensating for poor oversight by those charged with governance as it relates to their responsibility to prevent and detect fraud; or
- ii. Plan and perform the audit to obtain reasonable assurance about whether the financial statements as a whole are free from fraud, except for fraud that is clearly inconsequential, which contradicts the auditor's responsibilities described in paragraph 2 of the proposed SAS.

We disagree that this proposed requirement is a necessary change from extant to promote consistency across AU-C sections. Although the Exposure Draft states that this proposed requirement is consistent with AU-C section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, paragraph 21 of that AU-C section is a specific requirement to communicate noncompliance with laws and regulations that come to the auditor's attention, while paragraph 14 of the proposed SAS clearly states that fraud is ordinarily, but not always, a matter of noncompliance. For these reasons, we do not agree that the proposed change from extant is necessary to promote consistency between AU-C sections.

Further, paragraph 61 in the proposed SAS establishes a requirement for the auditor to communicate fraud or suspected fraud to management. Based on the definition of fraud, this requirement would be operationalized by the auditor communicating fraud or suspected fraud that results in a material misstatement of the financial statements. We do not believe it is appropriate to require auditors to communicate fraud or suspected fraud to those charged with governance at a significantly lower level ("other than clearly inconsequential") than the threshold required for communication to management ("results in a material misstatement").

We strongly encourage the ASB to revert to the requirement in extant paragraph 40(c) of AU-C section 240 to communicate fraud or suspected fraud involving others when fraud results in a material misstatement in the financial statements. A conforming

amendment to AU-C section 600, paragraph 48(h)(iii), is also needed to revert to the language in extant paragraph 47(h)(iii) and to promote consistency within the AU-C sections (also raised in Question 12 related to the proposed work effort). We also encourage the ASB to revert to the application material in extant AU-C section 240, paragraph A70, in proposed paragraph A198 to encourage the auditor's use of professional judgment when communicating fraud involving employees other than management that does not result in a material misstatement.

Question 16: Do respondents agree with the revisions to the documentation requirements in the proposed SAS? Respondents are asked to state their reasons.

We support the proposed documentation requirements and submit a suggestion that we believe would improve internal consistency in the proposed SAS.

We believe the documentation requirement in paragraph 66(a) implies there are multiple risks of material misstatement due to fraud in revenue recognition in an audit engagement, which may not always be the case. We suggest revising as follows to clarify:

66. a. If the auditor has concluded that the presumption that there is a risk of material misstatement due to fraud related to revenue recognition is overcome in the circumstances of the engagement, the reasons for that conclusion.

Question 17: Do respondents agree that the required inquiries about matters related to fraud are appropriate? Respondents are asked to state their reasons.

We support the proposed requirements related to inquiries of management, those charged with governance, and others within the entity about matters related to fraud. We refer to our response in Question 2 about the volume of proposed application material since many of the required inquiries have not changed from extant AU-C section 240. Specifically, we question whether the application material in paragraphs A87-A89 and A106-A108 is necessary, since the underlying requirements include several detailed sub-requirements that we believe are sufficiently clear.

Question 18: Are there any other matters you would like to raise in relation to the proposed SAS? If so, clearly indicate which requirements, application material, appendix, or theme or topic to which your comments relate.

- In paragraph 3 of the proposed SAS, we suggest replacing "punishment" with "consequences" to more closely align the description of management's and those charged with governance's responsibilities with their responsibilities for fraud deterrence described in AU-C section 315, AU-C section 940, *An Audit of Internal Control Over Financial Reporting that is Integrated with an Audit of Financial Statements*, and the COSO Internal Control – Integrated Framework (2013). US GAAS and the COSO framework place an emphasis on the proactive responsibility of management, with those charged with governance, to create and maintain a culture of honesty and ethical behavior as a foundation for the entity's system of internal control. These standards do not reference punishing employees, which carries a more reactive connotation. We believe the suggested change below would improve

consistency across the AICPA's suite of standards and the controls framework often followed by management:

3. ...It is important that management, with the oversight of those charged with governance, place a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place, and fraud deterrence, which could persuade individuals not to commit fraud because of the likelihood of detection and punishment consequences. ...

- Based on the use of “in applying AU-C section 315” as the lead-in to paragraph 36 of the proposed SAS, we suggest modifying the requirement to clarify that the proposed requirement is incremental to the requirement in AU-C section 315:

36. In applying AU-C section 315, the auditor's understanding of the entity's information system and communication relevant to the preparation of the financial statements should also include understanding how journal entries and other adjustments are initiated, processed, recorded, and corrected as necessary. (Re: par. A109-A111)

- We suggest adding a reference in proposed paragraph 60(d) to proposed paragraph 64, which would provide additional guidance for the auditor to consider when reporting outside the entity that aligns with the AICPA Code of Professional Conduct.
- Several application material paragraphs include examples specific to governmental entities and not-for-profit organizations in the same paragraph or list as examples that are specific to commercial entities (paragraphs A5, A13, and A185). We suggest moving the examples specific to governmental entities and not-for-profit organizations to a separate paragraph under a specific subheader, consistent with the drafting conventions used in other AU-C sections and in paragraphs A1 and A76 of the proposed SAS.
- Several examples of fraud risk factors in Appendix A appear to be specific to listed entities; we suggest revising or deleting examples that reference the following terms: analysts, investment analysts, stock price, stock promotions, and securities law.
- We suggest subsuming proposed amendments to AU-C section 505, *External Confirmations*, in the ASB's current project to revise AU-C section 505 in order to avoid revising this standard twice in a short period of time.
- We are concerned that the proposed amendments to AU-C section 580 cannot be operationalized as drafted. Specifically:
 - In paragraph 12(a), it is not clear how to interpret the phrase “has appropriately fulfilled these responsibilities.” Would management need to perform a separate assessment to make this representation, similar to an audit of internal controls over financial reporting? We suggest reverting to the extant language.
 - In paragraphs 12(c) and 12(d) we suggest deleting “including allegations of fraud” as this phrase is not necessary to understand how fraud or suspected fraud is defined.

- In paragraph 12(c) we suggest reverting to the extant language to avoid potential misinterpretation by management who will naturally apply a materiality threshold in making this disclosure. Reverting to the extant requirement would be consistent with other drafting suggestions for AU-C sections 240 and 600 provided in our response to Question 15.

We would be pleased to discuss our comments with you. If you have any questions, please contact Jeff Hughes, National Managing Partner of Assurance Quality and Risk, at (404) 475-0130 or Jeff.Hughes@us.gt.com.

Sincerely,

/s/ Grant Thornton LLP