

## LEARNING UNIT 3 THE AUDITOR'S RESPONSIBILITIES RELATING TO FRAUD IN AN AUDIT OF FINANCIAL STATEMENTS

**Duration:** 60 minutes



### LEARNING OUTCOME AND ASSESSMENT CRITERIA

The content of this sub learning unit is based on the following learning outcome and assessment criteria:

Learning outcome	Assessment criteria
Evaluate the auditor's responsibilities relating to the identification of fraud as well as the procedures that needs to be performed when performing an audit on financial statements.	<ul style="list-style-type: none"> <li>• Explain the rights and duties of the auditor when fraud is identified when performing an audit on financial statements.</li> <li>• Apply professional ethics requirements relating to fraud.</li> <li>• Discuss the legal liability of the auditor.</li> </ul>
Exercise ethical judgements in practical situations that relates to fraud in the auditing profession.	<ul style="list-style-type: none"> <li>• Discuss and apply the ethical judgements to any practical situations that relates to fraud.</li> </ul>

### ASSUMED PRIOR LEARNING



If you wish to refresh your knowledge, you may refer to your undergraduate material, prescribed textbook and the SAICA Handbooks. For your convenience, we provide textbook references, **but it is your responsibility to revise and work through (if needed) the content of this learning unit as it will not be repeated in this learning unit.**

Learning outcomes assumed to have been attained during prior learning	<i>Auditing Notes for South African Students (Auditing Notes) (12 th edition)</i>	<i>SAICA Handbook 2024/2025</i>
<ul style="list-style-type: none"> <li>• Identify and assess the risk material misstatement of the financial statements due to fraud.</li> <li>• Obtain sufficient, appropriate audit evidence regarding the assessed risk of material misstatement through designing and implementing appropriate responses.</li> <li>• Respond appropriately to fraud or suspected fraud identified during the audit.</li> </ul>	Chapter 7, section 7.4	<i>SAICA student handbook 2024/2025, SAICA and IRBA Pronouncements, volume 2A,</i> <ul style="list-style-type: none"> <li>• ISA240: The Auditor's Responsibilities relating to Fraud in an Audit of Financial Statements including the appendices.</li> </ul>



The table above provided you with the learning outcomes for this learning unit as well as references to your undergraduate material should you need to refer to it.

However, the table below provides a breakdown relating to the of the content mentioned above relating to the SAICA Student Handbook 2024/2025. The table below provides the sub-content for the references mentioned above which will assist you when working through questions. You should then flag and underline all the important sections and/or information in the SAICA Student Handbook 2024/2025, so that you can easily refer to the related sections and pages. The SAICA Student Handbooks 2024/2025 are also the only book that you can take into the exam venue, so it will just be to your benefit to use these books during your studies and when working through the questions. This can also assist you when formulating your answers for all your formative(tests)- and summative assessments (examinations) in future.

SAICA Student Handbook, 2024/2025	Sections/Pages
<b>Volume 2A</b>	
ISA: The Auditor’s responsibilities relating to fraud in an audit of financial statements	Par 1 to 48, Par A1 to A66 Appendix 1 to 3

### 3.1 Introduction



In a society where fraud and corruption are rife, there is increasing pressure on the accounting and auditing profession to act in this regard. It is with this in mind that you should study ISA240, the appendices and the explanatory notes in Auditing Notes.

The topic of **fraud** should not be studied in isolation, but rather in the context of how it affects the entire audit process.

The existence of fraud will affect the auditor's assessment of the risks of material misstatement. Fraud should be assessed when developing the overall audit strategy.

Refer to ISA 240.12 for a definition of the following terms:

- fraud
- fraud risk factors

The auditor shall identify and assess the **risks of material misstatement** due to **fraud** at the **financial statement level** and at the **assertion level** for classes of transactions, account balances and disclosures (ISA 240.26).


For the identification and assessment of the risk of material misstatement due to fraud, the auditor must base a presumption on the fact that there are risks of fraud associated with, for instance, revenue recognition and must then evaluate the types of revenue, revenue transactions or assertions, which gave rise to such risks (ISA 240.27).

ISA 240.29 to ISA 240.34 deals with the auditor's response to the assessed risks of material misstatement due to fraud. This is a very important aspect, and students should be able to discuss the effect that the risk of material misstatement due to fraud has on both the audit strategy and the audit plan, in other words, at financial statement level as well as assertion level.

Aspects of fraud may be included in many topics, for example, in questions on the CPC, reportable irregularities and risk assessment.

Refer to the following appendices of ISA 240 for examples of fraud risk factors and possible audit procedures to deal with these.

Appendix 1:	Examples of fraud risk factors
Appendix 2:	Examples of possible audit procedures to address the assessed risk of material misstatement due to fraud
Appendix 3:	Examples of circumstances that indicate the possibility of fraud

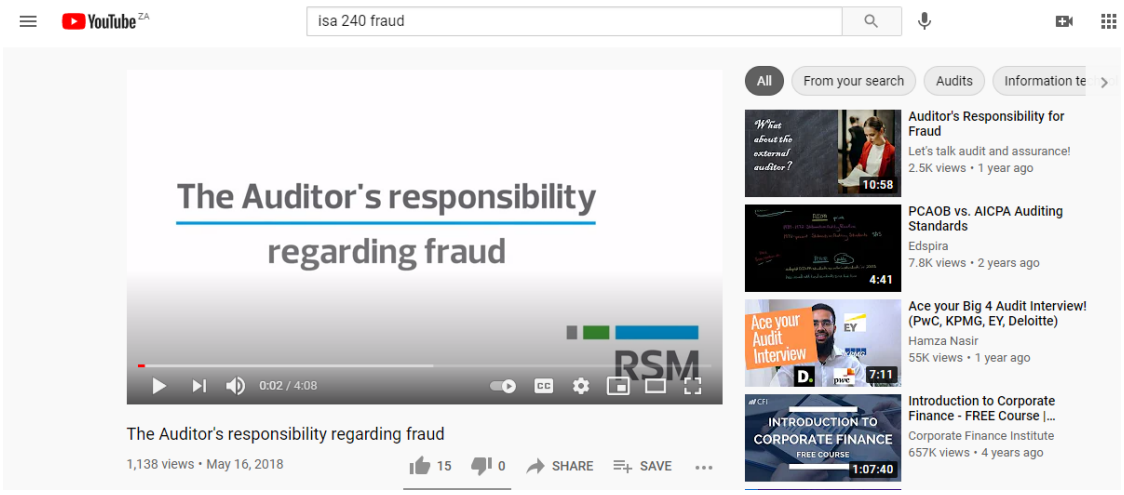


### IMPORTANT PRINCIPLE

You need to be familiar with the entire ISA 240, including all the appendices. The appendices provide guidance on the impact fraud could have on different areas of the audit process with practical examples for this auditing standard. It also highlights areas where there could be a possibility of fraud.

**Watch the following video explaining the auditor's responsibility regarding fraud**  
[https://www.youtube.com/watch?v=D\\_qpe\\_gvOwU](https://www.youtube.com/watch?v=D_qpe_gvOwU)

Please note that this YouTube video is 04:08 minutes in length.



The screenshot shows a YouTube video player for the video 'The Auditor's responsibility regarding fraud' by RSM. The video is 4:08 minutes long and has 1,138 views as of May 16, 2018. The player interface includes a search bar with 'isa 240 fraud', a play button, and a progress bar. To the right, there is a sidebar with several related video thumbnails and titles, such as 'Auditor's Responsibility for Fraud', 'PCAOB vs. AICPA Auditing Standards', and 'Ace your Big 4 Audit Interview!'.

### 3.2 LEARNING ACTIVITY



#### Activity 3.2.1 ~20 marks (duration 60 minutes)

After you have read the sections set out above, complete the following two comprehensive activities:

Activity 3.2.1 marks	Estimated time		
	Writing	Marking and review	Total
20 marks	40 minutes	20 minutes	60 minutes

#### Activity 3.2.1

##### Background information

You are the audit manager at Top Notch Auditors Incorporated (TNA). You are currently busy with the final stage of the financial statement audit of Sefofane Travel-n-Tours Ltd (Sefofane) for the financial year ending 28 February 2022. TNA is a firm with three audit partners, three audit managers and twenty audit clerks. The engagement partner for this audit is Ms Bothale who has been an audit partner at TNA for the last three years.

Sefofane was incorporated in 2010 by its executive directors, Mr Kolozi the chief executive officer (CEO), Mrs Flight, the chief financial officer (CFO) and Mrs Merc, the marketing director, all of whom are material shareholders of Sefofane. Sefofane specialises in Travel Management Solutions for the discerning business and leisure traveller. Sefofane sells directly to the public and to corporates through their online platform. Sefofane is a leading Broad-Based Black Economic Empowerment (BBBEE) travel agency with its head office situated in the Ekurhuleni Metropolitan area close to the OR Tambo International Airport. Sefofane also has office branches in Cape Town and KwaZulu Natal, which is also situated close to the Cape Town and King Shaka international airports respectively.

##### Additional information

The performance and final materiality were set at R850 000 for the financial year ending 28 February 2022. The audit of Sefofane was conducted during March 2022 and April 2022 and was finalised on 29 April 2022. Ms Bothale signed the audit report on 29 April 2022 and issued it to the board of directors on the same day at Sefofane premises in Ekurhuleni. A copy of the signed annual financial statements was immediately sent to the funders and bankers of Sefofane. The annual financial statements were issued to the public by Sefofane through publication on their website, on social media platforms and through the Business Tech newspaper. TNA subsequently received the letter of their re-appointment on 6 May 2022, which they immediately accepted and signed. The re-appointment of TNA follows an annual general meeting which was held on 5 May 2022.

Whilst on vacation in May 2022, you were shocked to read on the Business Tech newspaper, Carte Blanche as well as on Twitter, that Sefofane was pointed out in a widescale corruption. It was reported that this corruption involved officials working at the Department of Home Affairs as well as officials working in the banking industry. The reports allege that officials from the Department of Home Affairs assisted Sefofane with issuing fake passports for travellers booking with Sefofane, whilst the bank officials assisted Sefofane to defraud corporate clients as well as individual clients that used credit cards to pay for their accommodation as well as flights by deducting payments twice. The news was as a result of the investigation launched by Dr Aaron Motsoaledi, the Minister of Home Affairs, in collaboration with the Directorate for Priority Crime Investigation (the HAWKS), a specialised crime unit of the South African Police Service. The investigation further revealed that Sefofane issued their clients with falsified

Covid-19 vaccination certificates or falsified negative Covid-19 test results upon full payment of their bookings. The falsified Covid-19 certificates as well as the falsified negative Covid-19 test results were knowingly issued by Sefofane personnel as the genuine certificates and test results. As a result of all of this, the chairman of the audit committee contacted you and requested that you respond in an email as to why the fraud was not detected during the audit.

Upon reading these articles, you immediately revisited the audit working papers that were prepared for Sefofane's 2022 audit to ensure that there was compliance in all aspects. You mainly focused on the risk assessment procedures for the financial year under review and were satisfied that the audit had been performed competently in accordance with all the relevant International Audit Standards. Furthermore, there was no suspicion of falsified Covid-19 test results or vaccination certificates detected during the audit. There was also no suspicion of reference of fraudulent credit card payments or falsified/fake passports. The audit working papers were also reviewed by your firm's quality control reviewers and the audit was found to have complied with all quality control procedures and requirements as stipulated in the ISQM 1 and ISQM 2. Due to the severity of the allegations, you and Ms Bothale set up a meeting with Mrs Flight to address all the allegations and voice your concerns.

REQUIRED		Marks
(a)	Write an email to the Chairman of Sefofane's audit committee explaining why the fraud was not detected by Top Notch Auditors Incorporated in terms of the International Audit Standards.	13
	Communication mark: layout	1
(b)	Assume that the management of Sefofane granted TNA permission to perform additional procedures, what will the impact of fraud be on the audit opinion.	6
<b>TOTAL</b>		<b>20</b>

*UNISA AUE4862 2022 Test 3*

### SUGGESTED SOLUTION

- (a) **Write an email to the Chairman of Sefofane's audit committee explaining why the fraud was not detected by Top Notch Auditors Incorporated in terms of all the relating International audit standards.**

To: [ChairAuditcomm@sefofane.co.za](mailto:ChairAuditcomm@sefofane.co.za)  
 From: [You@TNA.co.za](mailto:You@TNA.co.za)  
 Date: 27 May 2022, 15h31  
 Subject: Reasons why a competently executed audit could not identify and reveal material fraud

Dear Audit Manager

1. As per ISA 210 Appendix 1, those charged with governance (management) are responsible for the preparation of the annual financial statements and not the external auditor. (1)
2. Those charged with governance and management have detailed knowledge of all the activities in Sefofane and are therefore in a better position to reveal or conceal any information not TNA. (1)
3. According to ISA 240 paragraph 4, the ultimate responsibility of the prevention and detection of fraud lies with those management and those charged with governance at Sefofane and not TNA. (1)

4. TNA have certain responsibilities with regards to fraud and they need to perform procedures (including risk assessment procedures) that will satisfy that fraud is not taking place in Sefofane. (1)
5. One of the inherent limitations to performing an audit is management overriding the controls. (1)
6. It seems as if those charged with governance (management) did override the controls based on Mrs Flight's statement saying they had to save jobs. Even though she did not admit to overriding the controls, her statement is indicative of controls being overridden by management and them using the plight of the workers as an excuse. (1)
7. Those charged with governance (management, specifically Mrs Flight: seem to have known about this criminal activity and knowingly participated in:
  - 7.1 The contravention of the Department of Home Affairs Act by issuing fake passports. (1)
  - 7.2 The contravention of the Department of Health policies / Acts by issuing falsified Covid-19 vaccination certificates and the fraudulent issuing of negative Covid-19 tests results. (1)
  - 7.3 The deduction of double credit cards payments for each booking. (1)
8. In performing audit procedures, the external auditor also relies on representations that are made by those charged with governance and more so Mrs Flight as the chief financial officer; though exercising professional skepticism and professional judgement. (1)
9. Management representation letters are signed by those charged with governance to give assurance that no fraudulent activities are taking place and that no fraudulent transactions are carried out, knowingly, in Sefofane. TNA relies on these in reaching conclusions about material misstatements in the annual financial statements. (1)
10. In terms of ISA 210 Appendix 1, when performing the audit, the auditor does not provide absolute assurance, nor does the auditor guarantee that audit procedures performed will identify **all** misstatements, including fraud and criminal activities performed. (1)
11. The nature of audit procedures is as such that audit procedures are not designed to specifically detect fraud, thus fraudulent activities may go undetected by TNA or any other auditors for that matter. (1)
12. TNA may not detect fraud because: Audit evidence is usually persuasive rather than conclusive and as such auditors have not witnessed the events that took place. Only test-checks are performed on a sample of transactions and not 100% of the population is tested. They are obliged to place reliance on the systems that Sefofane has in place and due to inherent limitations, the systems may fail to detect errors or fraud. (1)
13. Timelines of financial reporting and the balance between benefit and cost may result in the auditors' compromise in the audit because the benefit derived from the audit must exceed the cost. (1)

Hope you find the above in order. Please feel free to further engage me if you seek further clarity.

Regards,

Communication mark: email layout 1  
 Available 16  
 Maximum 13

(b) **Assume that the management of Sefofane granted TNA permission to perform additional procedures, what will the impact of fraud be on the audit opinion.**

1. As the Departments of Health and Home Affairs as well as the credit card holders may seek relief against Sefofane for the fraud (issuing of fake Covid-19 certificates, fake passports and the double payments deducted), this might result in TNA considering Sefofane's **going concern** based on the impact the relief will have on the finances of Sefofane. (1)
2. The issuing of fake passports, fake Covid-19 certificates and double credit cards deduction amounts to fraud in terms of ISA 240. (1)
3. In terms of ISA 450 fraud would lead to **misstatements in the annual financial statements**. (1)
4. These misstatements are **qualitatively material** (or material in nature) as they are contravention of the:
  - 4.1 Departments of Health Covid-19 rules/ laws for issuing fake negative Covid-19 results and fake Covid-19 vaccination certificates. (1)
  - 4.2 The Immigration Act of the Department of Home Affairs for issuing fake passports. (1)
  - 4.3 Financial services act through the double deductions of credit card payments. (1)
5. The integrity of management has been compromised and this could affect all the balances in the financial statements, thus making these misstatements **pervasive**. (1)
6. This constitutes a **disagreement with management**, as we would not agree with their contravention and gross violation of the various laws and acts and the resulting concealment of these criminal acts in trying to protect the guilty parties. (1)
7. TNA should thus recall the Audit Opinion/AFS that was issued and send out notices to the shareholders, regulators, those known to rely on the AFS (like the Stock Exchange, banks, etc.) and the general public, citing that the Audit Opinion and as such the AFS should not be relied upon in their current form. (1)
8. A revised Audit Opinion should thus be issued and widely circulated with the notices above. (1)
9. An Adverse or a Disclaimer Audit Opinion would thus be issued as the misstatements are material and pervasive, disagreements with management and the going concern questionable, as a result of the now known fraud. (1)

Available 11  
Maximum 6