

LEARNING UNIT 3 – THE AUDITOR'S RESPONSIBILITIES RELATING TO FRAUD IN AN AUDIT (ISA 240 REVISED)



Duration: 5 hours 35 minutes

Your time should be divided between two aspects:

- Obtaining the required knowledge
Although this learning unit was covered in your undergraduate studies. Since ISA 240 (Fraud) was revised and new ISA 240 (revised) will be effective from 15 December 2026. More time will be spent on this learning unit to ensure students grasp the fundamental changes in the new ISA 240.
- Application of knowledge
This entails the completion of the self-assessment questions included in this learning unit. After completion of the learning unit, you will have the opportunity to test your knowledge by completing some questions which will comprise of integrated activities covering other learning units, these integrated questions will be included in your additional resources folder.

The following time allocation is recommended:

ISA 240 (Fraud)		Minutes
3.1	Introduction	1
3.2	Learning Outcome and Assessment Criteria	1
3.3	Learning Assumed to be in Place	2
3.4	Background	60
3.5	Self-assessment question 3.1	26
3.6	Announcements	3
3.7	Lectures	240
	Total	333



3.1 INTRODUCTION

In an environment where fraud, corruption and governance failures are increasingly prevalent, the auditor’s responsibilities relating to fraud have become a critical focus area in audit quality and public confidence. ISA 240 (Revised) strengthens and clarifies the auditor’s responsibilities relating to fraud across the entire audit process, including risk assessment, responses to assessed risks, professional scepticism, and communication with those charged with governance



3.2 LEARNING OUTCOME AND ASSESSMENT CRITERIA

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

Learning outcome	Assessment criteria
Exercise ISA 240 ethical judgments, corporate governance principles, and statutory requirements in practical situations.	<ul style="list-style-type: none">• Discuss and apply ethical principles in given case studies.• Carry out evaluations of ISA 240 non-adherence practices and make recommendations.• Carry out ISA 240 quality controls for firms that perform review of historical information and other assurance and related service engagements.

3.3 LEARNING ASSUMED TO BE IN PLACE

The auditor's responsibilities relating to fraud in an audit was covered as part of your undergraduate studies. You must revise the content below if you are not familiar with the content.

SAICA Student Handbook, 2025/2026, International Audit Standards, Part I, Volume 2A:

- ISA 240 (Revised): The Auditor's Responsibility Relating to Fraud in an Audit of Financial Statements

3.4 BACKGROUND

The topic of **fraud** should not be studied in isolation, but rather in the context of how it affects the entire audit process. As stated in ISA 240.1 *“The requirements and guidance in this ISA refer to, or expand on, the application of other relevant ISAs, in particular ISA 200, ISA 220 (Revised), ISA 315 (Revised 2019), ISA 330, and ISA 701. Accordingly, this ISA is intended to be applied in conjunction with other relevant ISAs.”*

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. ISA 240 (Revised) emphasises that fraud considerations are not a stand-alone exercise but are integrated throughout the audit process. Fraud affects the overall audit strategy and audit plan, the identification and assessment of risks at both financial statement and assertion levels, the nature, timing and extent of audit procedures, as well as the auditor’s reporting, documentation and

communication responsibilities.

One of the changes you will notice with the new ISA 240 (Revised) is that the responsibility of the auditor has been clarified in paragraph 2. Please ensure you know the difference between the responsibilities of the auditor and management when it comes to fraud.

ISA 240 (Revised) clearly distinguishes between the responsibilities of the auditor and those of management and those charged with governance. While the auditor is responsible for planning and performing the audit to obtain reasonable assurance that the financial statements are free from material misstatement due to fraud, the primary responsibility for the prevention and detection of fraud rests with management and those charged with governance.

Refer to ISA 240.18 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 240.39a). This links with ISA315 that deals with identifying and assessing the risks of material misstatement. This highlights how ISA 240 should be viewed in the context of the entire audit process.

More guidance is also provided on professional skepticism during the audit. This is covered in ISA 240.19-2. ISA 240 (Revised) reinforces that professional scepticism must be maintained throughout the audit and not only during planning. Auditors are required to remain alert to fraud risk factors, contradictory audit evidence, unreliable management explanations and circumstances that may indicate fraud or suspected fraud. Professional scepticism is particularly critical where management bias, significant estimates, complex transactions or opportunities for management override of controls exist.

When identifying and assessing the risks of material misstatement due to fraud, the auditor is required to assess fraud risks at both financial statement level and assertion level. ISA 240 (Revised) introduces a mandatory presumption that risks of material misstatement due to fraud exist in revenue recognition unless this presumption is rebutted with documented justification. In addition, risks relating to management override of controls must always be treated as significant risks.

ISA 240 (Revised) requires the auditor to design and perform audit procedures that are responsive to assessed fraud risks at both financial statement and assertion levels. These responses include overall responses to address fraud risks, the incorporation of unpredictability in audit procedures, and specific mandatory procedures addressing management override of controls, such as journal entry testing, review of accounting estimates for bias, and evaluation of significant unusual transactions. ISA 240.42 to ISA 240.53 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 as well as the audit plan, in other words at financial statement level as well as assertion level.

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



IMPORTANT PRINCIPLE – LEARNING ASSUMED TO BE IN PLACE

You need to be familiar with the entire of ISA 240 (Revised), including all the appendices. Appendices provide guidance on how fraud could impact on different areas of the audit process by making it practical with the examples provided in this auditing standard. It also highlights areas where there could be a possibility of fraud.



Watch the following video explaining the changes with regards to fraud risk assessment

https://www.youtube.com/watch?v=pQv_XIPNK3k

Please note that this YouTube video is 05:21 minutes in length.

Premium ^{ZA}

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What Auditors Need to Know About the Revised
Fraud Standard:

A Sharper Focus on Fraud Risk Assessment



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ACTIVITY 3.1 How many fraud risk factors and related audit procedures can you list?

In responding to this activity, students must clearly link identified fraud risk factors to specific audit procedures and refer to relevant ISA 240 (Revised) paragraphs, as would be required in an IAC examination.

Refer to the **following appendices of ISA 240 (Revised)** for examples of **fraud risk factors and audit procedures** to deal with these. The last two appendices have been added to ISA 240 (Revised).

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
Appendix 4:	Additional considerations that may inform the auditor when selecting journal entries and other adjustments for testing
Appendix 5:	Other ISAs addressing specific topics that reference fraud or suspected fraud

3.5 Self-assessment Question 3.1

Activity	Estimated Time		
	Reading and Writing	Marking and review	Total
SAICA ITC 2022 (Adapted)	20 minutes	6 minutes	26 minutes

DOCUMENT B: Information on the planning and execution phases – Transfrontier Steel Commodities (Pty) Ltd ('TSC')

Company background

TSC is a manufacturer and distributor of steel products. Over the years, TSC has grown from a company based in South Africa to a Pan-African company with operations in Mozambique and Namibia. On 20 December 2021, TSC signed and concluded a purchase agreement to acquire 100% of a competitor's shares, TZ Commodity Traders (Pty) Ltd, which also deals specifically in the manufacturing and distribution of steel products. Not much is currently known about the new acquisition, the management team or the rationale for TSC's acquisition of the company.

TSC has a December year end. The audit was initially scheduled to be concluded and signed off by 28 January 2022.

Minutes of meeting

Present: Thuli Tau (partner); Catherine Mashego (audit senior)

Agenda item: Significant events noted during the 2021 financial year (FY2021) for TSC

- TSC took over the entire physical aluminium inventory as a favour to the chief executive officer (CEO) of MuZi Commodity Traders (Pty) Ltd ('MuZi') towards the end of the financial year at no cost. He is a personal friend of TSC's CEO. MuZi is based in Mozambique and is currently in business rescue. TSC has never traded in aluminium before.
- TSC installed a new inventory management system six months into FY2021. The new inventory management system does not integrate with TSC's accounting system. The accounting system is 15 years old and was never designed to integrate with other systems. TSC has hired five temporary accounting staff to manually capture inventory transactions into the accounting system.

Agenda item: Matters relating to audit staff and management

- Thuli told Catherine that she believes that TSC's management is very honourable and law abiding. Therefore, Thuli does not believe that any areas of the annual financial statements are susceptible to fraud and no fraud procedures are necessary.
- Thuli stated that she would not hold fraud discussions with the other audit team members as she did not have any time to spend on that.
- Thuli stated that TSC's management is under a great deal of pressure because they are very busy dealing with potential takeover deals. Therefore, while conducting the audit, Catherine should only send queries to management if these were absolutely necessary.
- Further, all queries from the audit staff should first be sent to Thuli, because she wanted to check what questions were going to be asked of management.
- No other matters regarding fraud risk considerations were discussed or considered.

Required

Describe, with reference to Document B, non-compliance by the auditors with their responsibility with regard to fraud in terms of ISA 240 The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statement.

10 minutes

Solution 3.1

Part (c) Describe, with reference to Document B, non-compliance by the auditors with their responsibility with regard to fraud in terms of ISA 240 <i>The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements</i>	Marks
<p>1. The following fraud considerations are not evident: An auditor needs to maintain his / her professional scepticism before and during the execution of the audit (<i>ISA 240.19 – ISA240.22</i>):</p> <ul style="list-style-type: none"> • <u>Thuli, the audit partner, has stated that the management of TSC are very upstanding and law abiding</u> but there is no discussion / evidence about how she came to this conclusion therefore illustrating poor application of professional scepticism. 	1
<p>2. There have been no considerations relating to fraud discussions among the engagement team before the start of the audit (<i>ISA 240.29</i>):</p> <ul style="list-style-type: none"> • <u>Thuli has not held discussions with the entire audit team</u> about any areas of the financial statements that may be susceptible to fraud <u>only discussion with Catherine</u> was held during the planning meeting where opposite is evident. 	1
<ul style="list-style-type: none"> • <u>Thuli specifically stated that she will not hold any such discussion</u> as she does not have time, she also does <u>not request Catherine to hold such discussions</u>. Therefore, illustrating direct non-compliance with the standard. 	1
<p>3. There have been no considerations relating to fraud risk assessment procedures and related activities (<i>ISA 240.39 to ISA240.53</i>):</p> <ul style="list-style-type: none"> • <u>Thuli has limited any access to management</u> by telling Catherine to only ask management questions if absolutely necessary, therefore it appears as if a fraud risk assessment is not possible as Catherine is not allowed to ask management questions. 	1
<ul style="list-style-type: none"> • Furthermore, <u>Thuli stated that she wants to review all questions before they go to management</u>, therefore as Thuli has already stated that fraud procedures are not necessary she will not approve fraud risk assessment questions. 	1
<ul style="list-style-type: none"> • <u>Thuli is not considering the fraud risk relating to changes in the client, new transactions, new system</u>, etc. that will influence the risk assessment as this could create opportunities for fraudulent activities as no other matters regarding fraud risk considerations were discussed. 	1
<ul style="list-style-type: none"> • <u>Thuli stated that management is busy with takeover deals and therefore should not be bothered</u>, Thuli is not considering that this is not appropriate as management needs to be available for questions prior to the commencement of the audit in order to effectively identify any fraud risk considerations. 	1
<ul style="list-style-type: none"> • No information has been provided to illustrate whether Thuli considered / assessed whether those charged with governance (if they are not involved in the management of the entity) <u>exercise oversight of managements processes of identifying risks</u>. 	1
<ul style="list-style-type: none"> • It is doubtful, based on the <u>comment made by Thuli to Catherine that no fraud procedures are necessary</u>, that <u>risk assessment analytics</u> have been performed and the preliminary results discussed with the engagement team. 	1

4.	There has been no consideration about any unusual / unexpected relationships within the organisation's structure that could be indicators of fraud risk (<i>ISA 240.30</i>):	
	<ul style="list-style-type: none"> • <u>TZ Commodity Traders has recently been acquired by TSC</u> and not much is known about the transaction or the business rationale, this could be an indicator of fraud. 	1
	<ul style="list-style-type: none"> • <u>TSC CEO is a personal friend of Muzi CEO</u>, therefore there is a further risk of collusion considering the business rescue status of the company. 	1
5.	There were no considerations relating to classes of transactions, account balances, etc., where fraud risk could potentially exist as evidenced by the following (<i>ISA 240</i>):	
	<ul style="list-style-type: none"> • The fact that TSC <u>acquired the aluminium inventory from MZ Commodity Traders for no consideration</u>. This transaction does not appear to be at arms-length and could potentially be a fraudulent transaction. 	1
	<ul style="list-style-type: none"> • <u>Since TSC has never traded in aluminium and the operations are in Mozambique</u>, there is a risk of potential fraud owing to the operations not being in South Africa, unfamiliar control environments, as well as the company being in business rescue. 	1
	<ul style="list-style-type: none"> • The issue of what <u>value the inventory should be recorded at</u> should also be considered as it was fraudulently obtained at no cost. 	1
	<ul style="list-style-type: none"> • Another example could be the fact that TCS installed a new inventory system (six months into the current financial year). Potential fraud considerations to be made: <ul style="list-style-type: none"> ○ There is an <u>element of manual intervention</u> which opens the possibility of fraud risk. The inventory management system does not integrate with the accounting software and manual processing has to take place. ○ <u>Management could easily influence temporary staff</u> to capture fraudulent transactions as they do not seem to be qualified as they are temporary staff. 	1
6.	No consideration has been made regarding the other information obtained by the auditor ; this is a <u>potential limitation as management appears to be very busy dealing with other takeovers</u> and therefore it is unlikely that the auditors will be granted access to any other information that may impact consideration for fraud (<i>ISA 240</i>).	1
7.	There is no evidence that Thuli or the audit team have considered significant estimates and judgements made by management and whether there is <u>any indication of management bias</u> , especially the impact of IFRS 3 and the determination of NRV of inventory (<i>ISA 240.50 to ISA240.53</i>).	1
	Available	18
	Maximum	12
	Total for part (c)	12

Examiner guidance:

Marks are awarded not only for identifying instances of non-compliance with ISA 240, but also for clearly linking the facts in the scenario to specific ISA requirements and explaining why the auditor's actions constitute non-compliance.

EXAM FOCUS – ISA 240 (REVISED)

Students must be able to:

- Distinguish between **management** and **auditor** responsibilities relating to fraud;
- Apply professional scepticism in fraud-related scenarios;
- Identify fraud risk factors and link them to appropriate audit responses;
- Address management override of controls and revenue recognition fraud risks; and
- Integrate ISA 240 with ethical principles, corporate governance and statutory requirements.

3.6 Announcements

Please refer to the **Additional Resources** folder for Learning Unit 3 for some additional resources on the content of this Learning Unit.

3.7 Lectures

Lectures will be held during the year. Additional learning material and questions will also be loaded under the **Additional Resources** folder. Refer to the **Announcements** for additional information on lectures.