16.

SA 240

Auditor's Responsibilities Relating To Fraud In An Audit Of FS.

I.* Auditor is primarily concerned with [FRAUD] – that causes a (MM) in the FS.

TYPES →

INTENTIONAL → FRAUD

UNINTENTIONAL → ERROR

II. Two Types of INTENTIONAL misstatements are relevant to the Auditor:–

① Misstatements Resulting from [FFR] – [fraudulent financial Reporting]

- FFR may be accomplished in the following ways ↓
  1. Accounting Records / and Supporting Documents → manipulation / falsification OR / Alteration.
  2. Accounting principles → [Intentional misapplication.]
  3. Misrepresentation or Intentional omission.
- Possible Sources of FFR ← Q.No.12
  - [F. R. A. U. D²]
  - (F) – Fictitious JE or Recording particularly close to the end of FY ↓
    - To manipulate the operating Results or
    - Achieve other objectives.
  - ② (R) → RECORDS and Terms OF Alteration – [which is related to Significant and unusual Transactions.]
  - ③. (A) → Adjusting Assumption & changing Judgement – Inappropriately which is used to estimate Account Balances.

② Misstatements Resulting from [Misappropriation of Assets]

(1) ↳ Theft of Entity's Assets
↳ It is often done by the Employees and Sometimes involve management.

(2) It is accomplished in the following ways –

(i) Embezzling Receipts.
(ii). Stealing physical Assets or Intellectual property
(iii). causing an Entity to Pay for goods and services not-received.
(iv) using Entity's assets for personal use.

—x—x—x—

4. (U) → UNDUE | COMPLEX TRANSACTIONS

में ENGAGE होना

↓

For Misrepresenting the Financial position

OR

Financial Performance of the ENTITY.

5. (D) → NOT DISCLOSING OR CONCELING → FACTS that could affects the amount recorded in the FS.

6. (D) → DELAYING, omitting, Advancing → RECOGNITION ~~incorrect~~ of → EVENT & Transactions in the FS that have occurred during the Reporting period.

R

(3). Rationalization of the Act:-

- Fraudulent act may be rationalize by the individual for committing it.

Some possess an attitude, character or set of Ethical value that allow them knowingly and intentionally to commit a dishonest act.

Some are although honest but they commit fraud in an Environment that impose pressure to them to commit fraud.

III. Explain the

Q. Risk factors relating to misstatements arising from fraudulent financial Reporting or misappropriation of assets.

Fraud, whether fraudulent financial Reporting or Misappropriation of Assets, involves -

"I. R. P."

I. (1) Incentive or pressure to commit fraud:-

- It may exist when management is under $\boxed{\text{Pressure}}$ from the sources outside or Inside the Entity → To achieve an expected earnings Target or Financial outcomes.

- personal financial obligations may also create pressure on - management or Employees :-

To misappropriate those assets which are Susceptible to theft → like → "cash or other Assets"

P. (2) Perceived opportunity To do so:-

It may exist when an Individual believes that INTERNAL CONTROL can be overridden.

Because of Trust on him or knowledge about specific weakness in IC.

- High value of Inventory Items
- Inadequate Internal control
- Inadequate Segregation of Duties etc

→ opportunities to misappropriate assets increases.

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IV. → **Responsibility for Prevention And Detection of fraud :-**

"Primary Responsibility" for Prevention and Detection of Fraud Rests with →

"Both TCWG and management"

"To ensure prevention of fraud" → "management" must have commitment to create a culture of

[Honesty And Ethical Behaviour]

V. * OBJECTIVES OF AUDITORS *

- To ~~ask~~ IDENTIFY and ASSESS the risk of MM in the F.S. Due To Fraud.
- To obtain SAAE about the "ASSESSED RISKS of MM" due to FRAUD" AND.
- To Respond appropriately ~~for~~ to the "IDENTIFIED or SUSPECTED FRAUD".

Because fraud is carefully organised to conceal it.

Risks of non-Detection of MM resulting from fraud is higher than the Risk of Not-detecting one resulting from ERROR.

VI. * **Risk Associated for non-Detection of MM :-**

Due to the "INHERENT LIMITATIONS" of Audit - there is "UNAVOIDABLE RISKS" that - Some material misstatements of the F.S may "not be DETECTED" Eventhough the Audit is Planned and performed appropriately as per SAs.

* Risks of the Auditor for Not detecting a MM resulting from Management Fraud is greater than the Employee Fraud.

Because, management fraud is greater in position to directly or indirectly MANIPULATE

- Accounting Records or
- Present fraudulent Financial Information.

Important

VII. "Auditor's Duties for Prevention And Detection of Fraud"

(i). Auditor is responsible for obtaining "REASONABLE ASSURANCE" (RA) that F.S taken as a whole are Free from MM whether caused by – "FRAUD OR ERROR"

(ii). for obtaining RA, he should maintain an attitude of "PROFESSIONAL SKEPTICISM" through out the audit.

(iii). Auditor should recognize the possibility that MM due to fraud could exist.

• Based on his past Experience about the HONESTY and INTEGRITY of the Entity's management & TCWG.

(iv) – DOCUMENTS / Records

If Doubtful situations

Not Present → Accept it as GENUINE

Present → If conditions cause the Auditor that –

• Documents may not be Authentic OR

• Terms in the Documents have been modified

then Investigate further.

(v). If Responses to Inquiry of Mgt. or TCWG are INCONSISTENT → Auditor shall Investigate the Inconsistencies.

(vi). If any circumstances that indicate the possibility of MM in the FS due to fraud or Error :–

Perform Audit procedures to determine its existences.

If auditor identifies a misstatement → Auditor should consider whether such misstatement indicates about fraud.

If yes → Consider the implications on the other aspects of the audit of "Material misstatement" eg: Reliability of mgt. Representation.

VIII COMMUNICATION :-
- If FRAUD has been identified OR
- there is Indication of FRAUD

↓

Auditor should communicate it -

↓

- MANAGEMENT and
- TCWG.
- Regulatory & Enforcement Authority → If so.

IX. Due to such MM

↓

Auditor concludes that - It is not possible to continue Audit performance

↓ then

Auditor should :-

(i). consider the Professional & Legal Responsibilities to Report -
→ (a) the PERSON who made the appointment
OR
→ (b) To Regulatory Authority.

(ii) Withdraw from the Engagement -

(iii).
→ communicate this to → [mgt. and TCWG] - Reason
→ consider the professional & Legal Requirements to report with Reason
→ (a) the PERSON who made the appointment
OR
→ (b) To Regulatory Authority.

7. "MANAGEMENT REPRESENTATION"

SA 580 - "Written Representation" establishes the requirements and provides the Guidance on obtaining the Appropriate Representations from the Managements and TCWG :-

"I. R.A.K"

I → ① INTERNAL CONTROL (IC)

↓

mgt. acknowledge their Responsibility for
- Design
- Implement and
- Maintain

↓

IC — To Prevent and To Detect

↓

$\boxed{\text{FRAUD}}$

R → ② Result of mgt.'s FRAUD RISK Assessment wrt FS

↓

Discussed

A → ③ Knowledge of Allegation of FRAUD or suspected fraud affecting the Entity's FS

↓

Have Been disclosed

K → ④ Knowledge of FRAUD OR SUSPECTED FRAUD affecting the Entity

↓

- Have been disclosed
- Involving —
  - → mgt
  - → Employee – Role in IC
  - or
  - → others