FRAUD CONSIDERATIONS FOR AUDITORS
WEBINAR MATERIAL: 11 AUGUST 2020

Table of Contents

Module 1: Introduction

This module covers the ***IRBA Staff Alert pages 1 and 2***

1. General

The perpetration of fraud, causing material misstatements in the financial statements and/or non- compliance with laws and regulations, has become more prevalent at entities in South Africa over the past few years.

Registered auditors (auditors) are required to be alert to the possibility of fraud, thereby enabling them to respond appropriately.

Due to this prevalence, auditors have called for additional guidance relating to fraud. Consequently, the IRBA has responded to the needs identified on the auditor's considerations relating to fraud.

This IRBA Staff Audit Practice Alert serves to provide auditors with implementation guidance in responding to the risks of material misstatements due to fraud and/or non-compliance with laws and regulations.

The International Standard on Auditing (ISA) 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* (ISA 240), deals with the auditor's responsibilities relating to fraud in an audit of financial statements. Specifically, it expands on how ISA 315 (Revised) and ISA 330 are to be applied in relation to risks of material misstatement due to fraud.

What is fraud?

In ISA 240, fraud is defined as an intentional act, by one or more individuals among management, those charged with governance, employees or third parties, involving the use of deception to obtain an unjust or illegal advantage.

The auditor is concerned with fraud that causes a material misstatement in the financial statements.

Two types of intentional misstatements are relevant to the auditor:

- misstatements resulting from **fraudulent financial reporting** and
- misstatements resulting from **misappropriation of assets**.

Although the auditor may suspect or, in rare cases, identify the occurrence of fraud, the auditor does not make legal determinations of whether fraud has actually occurred5.

While this publication is written in the context of an audit of financial statements, it can be used, when adapted as necessary, for engagements other than audits of financial statements.

*Refer to **Staff Alert paragraphs 63-65** that deal with the auditor's responsibilities relating to fraud in engagements other than in an audit of financial statements.*

The Fraud Triangle

The Fraud Triangle is a frequently referenced model for explaining the factors present when fraud occurs within an organisation. *Refer to paragraph 25 that deals with fraud risk factors prevalent in the South African environment*.

Source: Deloitte Touche Tohmatsu Limited, Global Fraud Brainstorming Template

2. IRBA Staff Audit Practice Alert 4: A South African Perspective on the Auditor's Considerations Relating to Fraud

The following was released by IRBA to introduce the abovementioned Staff Alert:

IRBA Communiqué

Issued on 18 June 2020

INDEPENDENT REGULATORY BOARD FOR AUDITORS COMMITTEE FOR AUDITING STANDARDS

IRBA Staff Audit Practice Alert 4: A South African Perspective on the Auditor's Considerations Relating to Fraud

The Independent Regulatory Board for Auditors (IRBA) has today issued the IRBA Staff Audit Practice Alert 4: *A South African Perspective on the Auditor's Considerations Relating to Fraud* (IRBA Staff Audit Practice Alert), for use by registered auditors. This IRBA Staff Audit Practice Alert has been prepared by the Fraud Task Group of the IRBA's Committee for Auditing Standards (CFAS).

The perpetration of fraud, causing material misstatements in the financial statements and/or non- compliance with laws and regulations, has become more prevalent at entities in South Africa over the past few years. Registered auditors are required to be alert to the possibility of fraud, thereby enabling them to respond appropriately. Due to this prevalence, auditors have called for additional guidance relating to fraud.

This IRBA Staff Audit Practice Alert serves to provide auditors with implementation guidance in responding to the risks of material misstatements due to fraud and/or non-compliance with laws and regulations. It includes the following key themes:

- The primary responsibility for the prevention and detection of fraud rests with those charged with governance of the entity and management;
- The importance of applying professional scepticism and exercising professional judgment;

- The auditor's responsibilities to identify, assess and respond to the risks of material misstatement due to fraud;
- The auditor's considerations to respond to identified risks of material misstatement due to fraud, when there is a fraud investigation in progress;
- The use of forensic experts during fraud discussions, fraud inquiries and the execution of the audit, when specific factors are identified; and
- Guidance and examples to assist auditors in the application of the auditing standards and related guidance.

A dedicated IRBA Fraud web page contains a list of links to relevant audit-related guidance on fraud that have been developed internationally and locally. The list references information that was known to the Fraud Task Group at the time of issuing this IRBA Staff Audit Practice Alert and it is not meant to be exhaustive.

This IRBA Staff Audit Practice Alert **does not constitute an authoritative pronouncement** from the IRBA; nor does it amend or override the International Standards on Auditing, South African Auditing Practice Statements or South African Guides (collectively called pronouncements). **Furthermore, this IRBA Staff Audit Practice Alert is not meant to be exhaustive**. Reading this IRBA Staff Audit Practice Alert is not a substitute for reading the abovementioned pronouncements, as they are the authoritative texts.

The IRBA Staff Audit Practice Alert is available in PDF format and may be downloaded from the IRBA website at www.irba.co.za. Should you have any further queries, please do not hesitate to contact the Standards Department by email at standards@irba.co.za.

Imran Vanker Director: Standards

About the IRBA
The objective of the IRBA is to endeavour to protect the financial interests of the South African public and international investors in South Africa through the effective and appropriate regulation of audits conducted by registered auditors, in accordance with internationally recognised standards and processes.
The statutory responsibilities of the CFAS are to assist the IRBA to develop, maintain, adopt, issue or prescribe auditing pronouncements; to consider relevant international changes by monitoring developments by other auditing standard-setting bodies and sharing information where requested; and to promote and ensure the relevance of auditing pronouncements.

MODULE 2: ISA 240 IN A NUTSHELL

This module covers the ***IRBA Staff Alert page 3***

The International Standard on Auditing (ISA) 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* (ISA 240), deals with the auditor's responsibilities relating to fraud in an audit of financial statements. Specifically, it expands on how ISA 315 (Revised) and ISA 330 are to be applied in relation to risks of material misstatement due to fraud.

1. SUMMARY

Refer to IRBA Staff Alert page 3

- ISA 240 deals with the auditor's responsibilities relating to fraud in an audit of financial statements.
- The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.
- The auditor's objectives, in terms of ISA 240, are to: (a) identify and assess the risk of material misstatement of the financial statements due to fraud; (b) obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and (c) respond appropriately to fraud or suspected fraud identified during the audit.
- The auditor maintains professional scepticism throughout the engagement, in accordance with ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*.
- ISA 240 follows the key phases of an audit engagement where fraud is considered in an audit of financial statements:
  - Discussion among the Engagement Team.
  - Risk Assessment Procedures and Related Activities.
  - Identification and Assessment of the Risks of Material Misstatement Due to Fraud.
  - Responses to the Assessed Risks of Material Misstatement Due to Fraud.
  - Evaluation of Audit Evidence.
  - Written Representations.
  - Communications to Management and with Those Charged with Governance.
  - Communications to Regulatory and Enforcement Authorities.
  - Documentation.

The IRBA Staff Alert is available to you as a Source Document

We will not be dealing with this ISA in detail. Instead, we will focus on the issues that have been highlighted in view of the COVID-19 pandemic, and other specific considerations that have been published for the 1st time.

MODULE 3: IMPLEMENTATION GUIDANCE TO RESPOND TO THE RISKS OF MATERIAL MISSTATEMENTS DUE TO FRAUD

This module covers the ***IRBA Staff Alert pages 4 to 33***

The implementation guidance contained in this IRBA Staff Audit Practice Alert includes the following **key themes**:

1. THE PRIMARY RESPONSIBILITY FOR THE PREVENTION AND DETECTION OF FRAUD RESTS WITH THOSE CHARGED WITH GOVERNANCE OF THE ENTITY AND MANAGEMENT

Refer to IRBA Staff Alert pages 3 to 6

There has always been a difference in the auditors' actual responsibilities in terms of fraud, and the expectations that the public have of auditors in general. This leads to misconceptions, and we should be reverting to the ISAs for clarity and guidance.

In South Africa, the results of a recent research study show that users of auditor's reports (including academics and bankers) attribute the responsibilities for the detection of all fraud to the auditors.

The auditor's objectives and management's responsibilities relating to fraud and the related expectation gap

- The auditor's objectives, in terms of ISA 240, are to:
  - Identify and assess the risks of material misstatement of the financial statements due to fraud;
  - Obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and
  - Respond appropriately to fraud or suspected fraud identified during the audit6.
- The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. However, **it should be understood that the auditor cannot fully rely on those charged with governance of the entity and management to prevent and detect fraud that they may have perpetrated.** The risk of the auditor not detecting a material misstatement resulting from management fraud is greater than that from employee fraud. This is because management is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information or override control procedures designed to prevent similar frauds by other employees.

  Refer to Staff Alert paragraphs 57-60 relating to management override of controls.
- Section 76(3) of the Companies Act of South Africa9 states that subject to Subsections and (5), a director of a company, when acting in that capacity, must exercise the powers and perform the functions of a director-
  - (a) in good faith and for a proper purpose;
  - (b) in the best interests of the company; and
  - (c) with the degree of care, skill and diligence that may reasonably be expected of a person-
    - (i) carrying out the same functions in relation to the company as those carried out by that director; and
    - (ii) having the general knowledge, skill and experience of that director.

2. The importance of applying professional scepticism and exercising professional judgment

Refer to IRBA Staff Alert pages 6 to 9

In accordance with ISA 200, the auditor shall maintain professional scepticism throughout the audit, recognising the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance.

The IRBA Public Inspections Reports include a number of significant reported findings relating to a possible lack of professional scepticism.

Auditor Objectivity and Scepticism

For the auditor to apply professional scepticism, it is necessary for the auditor to display certain attributes and attitudes as well as take certain actions.

Professional scepticism is necessary to the critical assessment of audit evidence. This includes questioning contradictory audit evidence and the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance. It also includes consideration of the sufficiency and appropriateness of audit evidence obtained in light of the circumstances

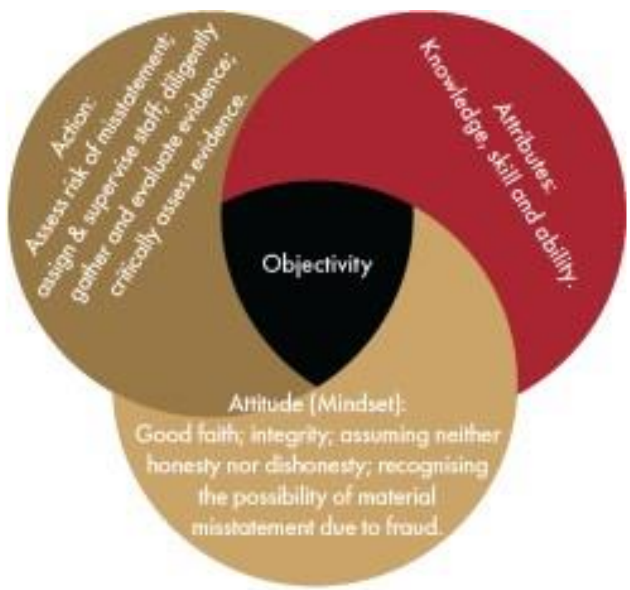

Image Source: Jeanette M. Franzel

Auditors are encouraged to develop a more sceptical mindset

How can auditors foster Professional Scepticism?

- Professional scepticism means that the auditor starts from a neutral position. The auditor should rationally and logically consider all audit evidence, not just the audit evidence that management is presenting. In doing so, the auditor should:
    - Resist the temptation to accept an easy answer.
    - Consider audit evidence, viewpoints and disclosures that are supported by facts and then compare those to what management presents to avoid anchoring/confirmation bias.

- o Corroborate what management presents, and test and challenge management's representations.

It is important that each engagement team member has the self-confidence and the strength of character and resilience required to maintain an inquiring mind.

- **The extent of professional scepticism applied by the auditor exists on a scepticism continuum. Where the auditor finds him/herself on the scepticism continuum is influenced by the auditor exercising professional judgment as to the trust he/she places in management of the entity, and other factors. This influences the extent of audit evidence to be obtained by the auditor and the documentation required.**

The Application of Professional Scepticism

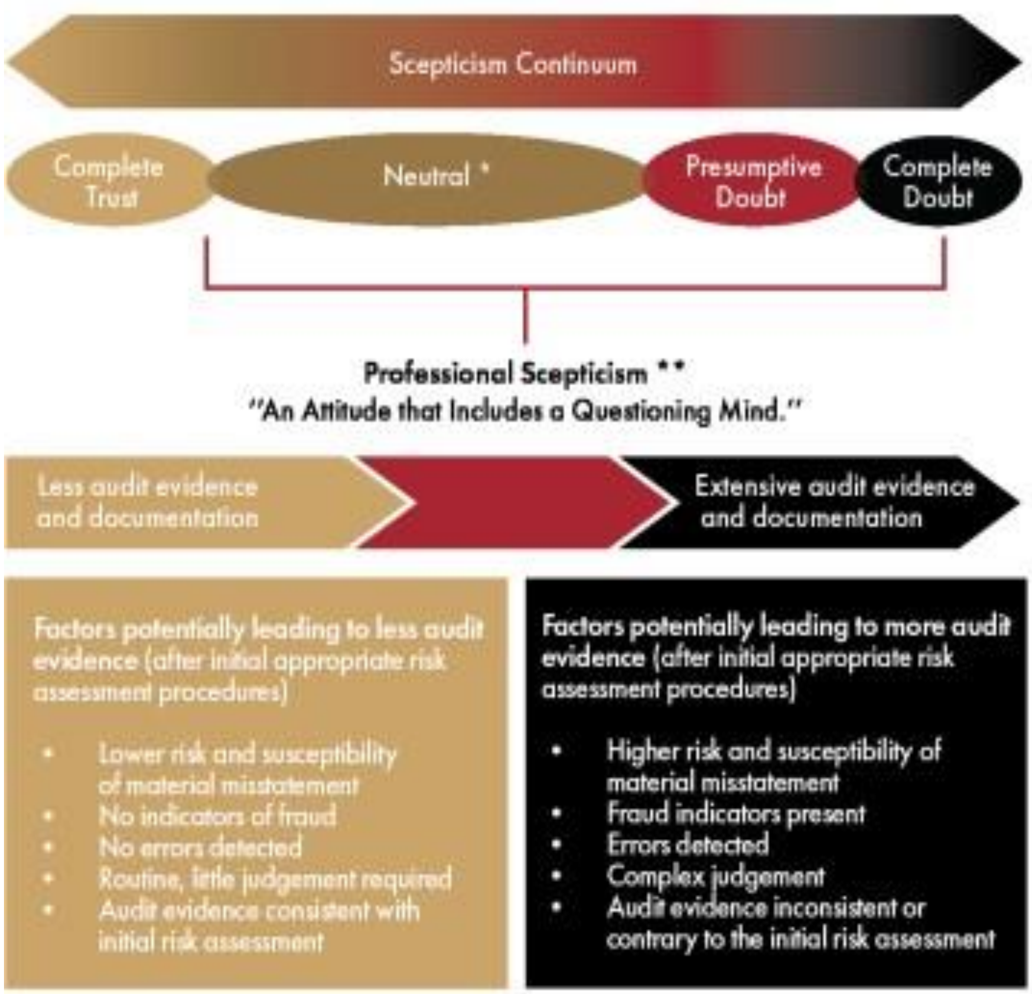

Image Source: Professors Doug Prawitt and Steve Glover, Brigham Young University

* Neutral – Neither assuming management dishonesty nor unquestioned honesty

** Professional Scepticism does not include the area of the continuum depicted by complete trust; in the area depicted as complete doubt, the auditor will move to a forensic mindset.

[Source: Publication - 'Enhancing Auditor Professional Skepticism']

Auditors are reminded that professional judgment needs to be exercised throughout the audit and appropriately documented. Professional judgment is not to be used as the justification for decisions that are not otherwise supported by the facts and circumstances of the engagement or sufficient appropriate audit evidence.

Guidance on documenting professional judgment

Consider documenting the following professional judgments about fraud-related audit procedures:

- The procedures performed to obtain the information necessary to identify and assess the risks of material misstatement due to fraud, which include:
    - Understanding the entity and its environment, including the entity's internal control, and risk assessment-related procedures.
    - Analytical procedures.
    - Inquiries of management, the audit committee, internal audit and others.
    - Fraud risk factors identified that indicate incentive or pressure to perpetrate fraud, an opportunity to carry out the fraud, or an attitude or rationalisation that justifies the fraudulent action.
- The discussion among engagement team members and brainstorming sessions held in planning the audit regarding the susceptibility of the entity's financial statements to be materially misstated due to fraud, including:
    - The audit team members who participated.
    - How and when the discussions took place.
    - The matters discussed.
- The risks of material misstatement due to fraud that were identified at the financial statement and assertion levels; the linkage of those risks to the auditor's response; and the nature, timing and extent of such audit procedures.
- The results of the procedures performed to address the assessed risks of material misstatement due to fraud, including those procedures performed to further address the risk of management override of controls.
- In relation to the risk of material misstatement due to fraud in revenue recognition:
    - If the auditor has not identified, in a particular circumstance, improper revenue recognition as a risk of material misstatement due to fraud, the reasons supporting the auditor's conclusion, including the types of revenue, revenue transactions and the assertions that may not give rise to such risks.
    - Where improper revenue recognition as a risk of material misstatement due to fraud was identified, pinpointing where such fraud may be permutated in the revenue process.

Seven critical things that auditors should do differently and which will enhance professional scepticism abilities

Refer to page 25

- The way auditors audit tends to make them predictable. If, for example, I am responsible for the petty cash and I get told that the auditors will be arriving next week Monday, do you think my petty cash will balance? Of course, it will! Surely auditors want to obtain an accurate picture of how the organisation is operating; so, a surprise audit would be the most reliable way to achieve this! Therefore, an element of unpredictability is crucial.
- Auditors get provided with a boardroom and they sit in there for two weeks examining the balance sheet, income statement and requesting samples of documents. In conjunction with this, auditors should be walking around, talking to employees, observing what is being done, who is saying what and so on. That's how you will get a more truthful picture of the business, plus you will be provided with opportunities to chat to staff members and try to discern truth from deception.
- At one of our clients, the procurement manager said I should speak only to him as his staff do not know anything. My immediate desire was to chat to his subordinates; so, I waited until he was out and approached

staff (in private) who said they were told not to talk to me. So, I pressured them and said, "time is money and I need answers now" and they would start answering me. The one employee said: "This is not how I usually do my job, but my boss said that while you were here, I should tell you that I always follow the standard operating procedures!"

- In addition to talking with management and employees, auditors are encouraged to contact a few vendors and clients to confirm transactions and agreements – remember, what management says is not audit evidence on its own.
- At one client we requested sample documents and a few hours later we had not received them, so I went looking for the person. I found him in his boss's office stamping documents that were unstamped, signing unsigned documents and creating missing documents! So, now I ask where documents, like invoices, are kept and then request the employee to take me there. When we arrive at the storeroom or strong room, I take out my list and say, please find these for me. I then see immediately if documents are missing or incomplete.
- Try and have a certified fraud examiner as part of the audit team.
- Do not get too friendly with the client.

3. THE AUDITOR'S RESPONSIBILITIES TO IDENTIFY, ASSESS AND RESPOND TO THE RISKS OF MATERIAL MISSTATEMENT DUE TO FRAUD

Refer to IRBA Staff Alert pages 9 to 25

Fraud discussions among engagement team members

ISA 315 (Revised) requires a discussion among the engagement team members and a determination by the engagement partner of which matters are to be communicated to those team members not involved in the discussion. This discussion shall place emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud might occur. **These fraud discussions should be documented, as well as significant decisions reached during these discussions.**

Auditors are encouraged to make use of forensic experts during the fraud discussions among engagement team members.

Besides the involvement of a forensic expert in fraud discussions, it is also encouraged, due to the prevalence of IT-related fraud, that an IT expert be involved in the fraud discussions among engagement team members.

Refer to Paragraphs 17-19 for examples of characteristics of high-quality fraud discussions

Making inquiries of management and others within the entity

This is usually face-to-face interviews.

It is recommended that these discussions be performed by a senior or more experienced member of the engagement team. The value of these discussions may be improved if a forensic expert is involved to conduct the interviews, where additional fraud risk factors are identified in relation to the individual from whom inquiries are made.

Examples of Fraud Risk factors that are prevalent in the South African environment

Appendix 1 of ISA 240 contains examples of fraud risk factors that may be faced by auditors in a broad range of situations.

Refer to the table on pages 12 to 13 of the Staff Alert

Examples relating to the two types of fraud relevant to the auditor's consideration are presented separately as follows:

- Risk factors relating to misstatements arising from fraudulent financial reporting; and
- Risk factors arising from misstatements arising from the misappropriation of assets

For each of these types of fraud, the risk factors are further classified based on the following three conditions contained in the fraud risk triangle, and which are generally present when material misstatements due to fraud occur (please refer to the Fraud Triangle diagram in the Introduction section of this publication):

- Incentives/pressures;
- Opportunities; and
- Attitudes/rationalisations.

Although the fraud risk factors cover a broad range of situations, they are only examples and, accordingly, the auditor may identify additional or different risk factors

Identification and assessment of risks of material misstatement due to fraud

In accordance with ISA 315 (Revised), 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.

In identifying and assessing the risk of material misstatement due to fraud, the auditor should always keep in mind **how** and **where** fraud could be perpetrated.

The following Guidance for the identification and assessment of risks of material misstatement due to fraud is set out on ***pages 14 and 15 of the Staff Alert***:

- Start by understanding the organisation's ethical and anti-fraud culture by, for example, doing the following:
  - Understand and be aware of the inherent fraud risks for the industry in which the client operates.
  - Determine whether there is a fraud and ethics policy, an independently managed whistleblowing hotline and regular follow-up on the items reported.
  - Determine whether there are regular fraud, bribery and corruption, and money laundering risk assessments being conducted.
  - Assess whether management has determined the top fraud risks in the business and how these risks are mitigated.
  - Understand what anti-fraud, anti-bribery and corruption, and anti-money laundering programmes are in place to prevent, detect and respond to fraud.
  - Analyse data on the financial, vendor and employee database to identify key fraud red flags.
- In defining **how** and **where** the fraud risk could be perpetrated, the auditor should remain cognisant of, for example, the following indicators:
  - Inconsistencies in responses from inquiries of management and those charged with governance.
  - Weak internal control environments or instances where management has overridden internal controls.
  - Instances of non-compliance with laws and regulations or failure by management to report any legislative contraventions to the relevant regulators and authorities and/or internally to the relevant governance committees.

- Existing fraud allegations against management and those charged with governance.
- Weak or non-existent processes by management for identifying fraud.
- High tolerance for poor financial disciplines and errors in the financial information.
- Unnecessary challenges, criticisms or disagreements by management with the auditors; or regular changes in audit and other professional service providers.
- Management's bonuses and incentives heavily/solely reliant on meeting financial targets.
- Fraudulent financial reporting indicated by, for example, the following:
  - Management attempting to present disclosures in a manner that may obscure a proper understanding of the circumstances, events or transactions.
  - Changes in accounting policies and/or estimates that are not justifiable.
  - Concealing/misrepresenting prior period errors
- Considerations as to **where** fraud could be perpetrated include:
  - Financial statement items with high volumes of transactions.
  - Financial statement items that affect key metrics, such as earnings before interest, taxes, depreciation and amortisation (EBITDA), price earnings ratio, etc.
  - Financial statement items that rely on significant judgment or have high levels of estimation uncertainty.
  - Related party transactions or transactions that are not transparent and at arm's length.
- Considerations as to **how** fraud could be perpetrated include:
  - Misappropriation of assets.
  - Fraudulent financial reporting.
  - Collusion and price fixing.
  - Money laundering.
  - Bribery and corruption.
  - Customs fraud (in the case of imports/exports businesses where agents or third- party intermediaries are used).
  - Tax evasion.
  - Cover-quoting and anti-competitive bidding processes.
  - System or master file data manipulation.
  - Manipulation of results/metrics in order to qualify for government funding or relief programmes.
  - Payment for goods/services not received or for lower-quality goods/services.
  - Excessive prices paid for goods/services.

The auditor is reminded that the assessed risks of material misstatement due to fraud are treated as significant risks.

Presumed risk of fraud in revenue recognition

As per ISA 240, there is a presumption that there are risks of fraud in revenue recognition.

Understanding the client's accounting policy on revenue recognition and disaggregated revenue analytics may assist in the auditor's risk identification and assessment relating to improper revenue recognition.

In determining risks of material misstatement due to fraud, engagement team members should consider which specific fraud schemes could be perpetrated by a client, based on how it contracts with customers and records revenue, and then identify the relevant assertions.

The presumption that there are risks of material misstatement due to fraud in revenue recognition may be rebutted. When deciding whether the auditor may rebut the presumed risk of material misstatement due to fraud in revenue recognition, the auditor should consider the three conditions generally present when material misstatements due to fraud occur:

(a) incentives/pressures;

(b) opportunities; and

(c) attitudes/rationalisations.

The following are uncomplicated examples of circumstances, including details of the types of revenue streams, where the presumption of risks of material misstatement due to fraud in revenue recognition could possibly be rebutted:

- A holding company that earns interest income on a positive bank balance.
- A company within a group that only receives dividend income from a 100%-held subsidiary.
- A holding company that on-charges operating costs in terms of an agreement with a fellow group company.
- A company, which is an importer and distributor of a simple product line with few variants, that supplies a very limited number of customers; and where revenue recognition takes place on delivery of the product by the company. There are no cash sales.

6 Examples of Fraud Schemes in Revenue Recognition

Timing of revenue recognition

Example 1:

- A manufacturing entity changed its quarter-end from 29 March to 31 March to make up for a revenue shortfall. The two additional days permitted the entity to record an additional R359 million in sales.

Example 2:

- A software entity sold long-term licenses. Customers paid upfront for the multi-year licenses. Despite the long-term nature of these contracts, the company recognised the present value of all licensing revenue for the entire contract immediately. Since all licensing revenue was recorded at the beginning of the contract, and cash was not collected for many years to come, the entity recorded large amounts of long-term receivables on the balance sheet. A regulator found that the entity prematurely recognised more than R59 billion from at least 363 contracts

Recording fictitious revenue

Example 3:

- A fast-food chain sold equipment to the value of R12.5 million to a potential subsidiary right before the deal closed. As part of the deal, the fast-food chain increased the amount that it would pay to acquire the subsidiary by the same amount for which the equipment was sold. This arrangement clearly had no real net economic impact, so no revenue should have been recorded. However, the fast-food chain entity recorded the sale of equipment as revenue, rather than as an offset to the increased franchise purchase price. This ruse helped the entity maintain its streak of exceeding the market expectations.

Example 4:

- A trading firm grossed up its revenue to appear to be a larger company. The firm was entitled to a commission, based on the trades that it made (as it was acting as an agent). However, the firm accounted for trades considerably more aggressively. Instead of only recording the commission as revenue, the firm recognised the entire value of the asset traded, even though it never owned the asset.

Overstating revenue through misclassification

Example 5:

- A healthcare information company improperly included in its revenue a R224 million share of the profits from an investment in a joint venture. This misclassification resulted in sales being overstated by more than 10%.

Understating sales using an electronic sales suppression tool

Example 6:

- A restaurant manager installed phantomware software37 on the restaurant's sales registers. The restaurant manager used the hidden menu to access the program, deleted all cash sale transactions on the sales registers after the transactions had occurred, and stole the cash sale proceeds. The deleted cash sales transactions could not be traced on the sales registers. This resulted in restaurant sales and the related tax liability being understated by 15%.

You can also refer to page 4 of the SAICA FAQs – available to you as a Source Document

4. THE USE OF FORENSIC EXPERTS DURING FRAUD DISCUSSIONS, FRAUD INQUIRIES AND THE EXECUTION OF THE AUDIT, WHEN SPECIFIC FACTORS ARE IDENTIFIED

Refer to IRBA Staff Alert pages 19 to 21

There is always an option to utilise experts – whether internal or external.

Knowledge, skill and ability required of auditors

The auditor may respond to identified risks of material misstatement due to fraud by, for example, assigning additional individuals with specialised skill and knowledge, such as forensic and IT experts, or by assigning more experienced individuals to the engagement.

An auditor is not required or expected to have the qualifications or competencies and skills of a forensic expert. However, the audit firm may consider it necessary to provide training to its engagement partners and engagement teams on the best practices and procedures performed by a forensic expert.

The training may specifically include:

- Forensic interview best practices (**Appendix B**).
- How to perform background checks and analyse relationships of, for example, politically connected persons.
- Basic fraud prevention, detection and investigation skills.
- Report writing skills that should incorporate general communication and persuasion skills.
- Auditor ethics that should incorporate elements of persuasion and communication to be performed in an ethical way.

Use of forensic experts on audit engagements

Auditors are encouraged to make use of forensic experts on audit engagements while executing audit procedures. However, it is understood that a forensic expert may not be used on every audit engagement, and that professional judgment is exercised in making this decision.

If the decision is made not to use a forensic expert, the auditor should document the auditor's professional judgment exercised in this decision.

Considerations that the engagement partner and team may make in deciding whether to use a forensic expert on an audit engagement

A forensic expert may be used on an audit engagement where the following factors are present:

- There are fraud allegations against management of the entity.
- Senior management of the entity has been suspended on allegations of fraud.
- There is a known history of instances of fraud committed by management.
- The entity is subject to a fraud investigation by law enforcement agencies.
- The entity is subject to an ongoing fraud investigation or litigation.
- The entity has a significant risk of material misstatement due to fraud.
- There are opportunities or incentives for management to perpetrate fraud.

5. RESPONDING TO THE ASSESSED RISKS OF MATERIAL MISSTATEMENT DUE TO FRAUD (OTHER THAN THOSE RELATING TO MANAGEMENT OVERRIDE OF CONTROLS)

Refer to IRBA Staff Alert pages 22 to 25

Once the risk has been assessed, it must be addressed by designing and implementing responses to the risk – both at financial statement level AND at the assertion level (***refer to paragraphs 51 & 52***).

The relationship between the assessed risks of material misstatement due to fraud and the auditor's response thereto – ***Refer to block on page 21***

Guidance for auditors in responding to risks of material misstatement due to fraud

Create an audit environment that is conducive to identifying fraud

- Create an environment and the mechanisms that allow any engagement team member to raise/communicate identified or suspected fraud, including escalation protocols and alternative mechanisms to raise suspected fraud.
- Consider the rotation of engagement team members and/or their responsibilities.
- The engagement quality control reviewer should effectively challenge the engagement team in areas of significant judgment and follow-up on areas of concern.
- The engagement partner should remind engagement teams of the importance of maintaining professional scepticism and remaining alert for instances of fraud throughout the audit.
- The engagement team should allow sufficient time for the performance and appropriate review of fraud-related procedures.
- The firm should institute regular fraud awareness/detection training sessions

Build an element of unpredictability into audit procedures

- Consider selecting items, in addition to the original sample, or performing additional/different procedures to those performed in previous audits.
- Rotationally test accounts below materiality and non-significant components.

- Attend cash, inventory counts and other key operational/control procedures with little/no notice.

Be on the lookout for information/action that is inconsistent with information obtained during the audit

- Talk to employees outside of the finance function. Perform additional inquiries or follow- up inquiries throughout the audit.
- Focus on current-year engagement specific facts and circumstances, rather than anchoring to prior-year documentation or another engagement.
- Remain alert for adverse media coverage or other information available in the public arena.
- Observe operations during the audit for any unusual activity.
- Arrange in-person meetings and interviews. Avoid only dealing with management via e-mail, phone calls, collaboration platforms, etc.

Be wary of limitations imposed by management

- Be extra sceptical when:
  - Denied or given limited access to information, people, customers, suppliers, shareholders, directors, etc.
  - Management takes an unreasonable amount of time to provide information.
  - Management wants to screen all information prior to it being made available to the auditors.
  - Management wants to be present in consultations held by the auditor with client staff.
  - Management refuses to have a single auditor for all components in a group audit

Corroborate the relevance and reliability of information received from management

- Obtain supporting documentation to corroborate management's explanations.
- Where possible, obtain information independently/externally from management.
- Remain aware of electronic documents (e-mails, PDFs, Excel, etc.) that may have been manipulated or created retrospectively, for example, electronic signatures may be used to create documents retrospectively, and forensic technology analysis may be required to detect such manipulation.

Involve the relevant specialists/experts when required

- Depending on the circumstances, it may be appropriate to involve specialists/experts in the following fields:
  - Forensics – especially where there is an increased likelihood or occurrence of fraud and provide guidance on potential legislative contraventions/reporting obligations.
  - IT – especially where there is high IT complexity and dependency, increased risk of data manipulation or susceptibility of the system to cyber-attacks.
  - Tax – especially where there are unusual/complex tax arrangements, numerous uncertain tax positions, or incentives for management to misstate their tax liabilities.
  - Valuations – especially where valuations are highly subjective, assumptions are difficult to support, or the valuation method selected is rarely used.

Review and follow-up on internal investigations

- Most instances of fraud are detected through tip-offs. Inquire whether there are any investigations in progress and review the reports when they are made available.
- Consider reports that were not investigated and establish the reasons thereof, particularly in respect of allegations made against those charged with governance.

- If there is a fraud hotline, inquire whether it is managed by an independent third party or within the entity. If managed within the entity, there is a higher risk of completeness of reported and investigated cases.

6. MANAGEMENT OVERRIDE OF CONTROLS

Refer to IRBA Staff Alert pages 26 to 28

Internal control, no matter how well designed and operated, can only reduce, but not eliminate, risks of material misstatement in the financial statements, because of the inherent limitations of internal control.

For example, the possibility of controls being circumvented by collusion or inappropriate management override49, when the controls otherwise appear to be operating effectively.

ISA 240 requires an auditor to, irrespective of the auditor's assessment of the risks of management override of controls, design and perform audit procedures to:

- Test journal entries;
- Review accounting estimates; and
- Evaluate the business rationale of significant transactions outside the normal course of business.

The auditor should consider ways that management could override controls and, based on the auditor's assessment of the risks of material misstatement due to fraud, decide whether further audit procedures are necessary.

Examples of ways that management could override controls

- Increasing credit terms of specific customers without regard for risk management processes that are required to be followed.
- Offering beneficial terms or prices on transactions to specific customers without the necessary approval thereof.
- Approving deliveries or services to customers and waiving the requirement for standard operating procedures to be followed (e.g. completion of proof of delivery or invoicing documentation).
- Pre- or back-dating of routine transaction documentation.
- Interference in supply chain management (SCM) by awarding tenders or bids to specific vendors without following due process, or by providing confidential information to specific vendors that will aid those vendors in obtaining the tender or bid.
- Intentionally forcing the use of specific suppliers for goods and/or services where no SCM policies or procedures apply to those particular transactions.
- Forcing the payment of supplier invoices without the necessary proof of delivery for the goods or services (e.g. delivery notes).
- Changing or causing master file changes to be made without the necessary proof or approval of changes required.
- Changing supplier banking details or otherwise altering electronic payment data without approval.
- Instructing the payment of salaries and/or wages to employees outside of the payroll, or in cash, or to connected persons, without complying with payroll standard operating procedures.
- Classifying private expenditure as business expenditure.
- Lack of documented standard operating procedures, procedures and guidelines that results in inconsistent practices being followed in the absence of the aforesaid.

- Insofar as controls that relate to the process for identifying and making accounting estimates, overriding standard operating procedures relating to the use of methodologies, assumptions, data, among others, to manipulate the value of those estimates recognised in the accounting records.
- Insofar as controls that relate to financial reporting, the omission or obscuring of facts, either by under- or over-disclosure, relating to transactions and events, while disclosure of this information would be material to the users of financial reports. Examples may include events after the reporting period, going concern, contingent liabilities or assets and related party transactions. This could also extend to management overriding controls relating to classification or presentation and disclosure to the extent that reported earnings (e.g. EBITDA, earnings per share or headline earnings per share) and/or key ratios are manipulated.

When selecting journal entries to test, the auditor should be alert to the following characteristics that may be indicative of fraudulent transactions or adjustments:

- Entries made to unrelated, unusual, or seldom-used accounts.
- Entries made by individuals and/or user profiles/user groups within the IT department who typically do not make journal entries.
- Entries recorded at the end of the period or as post-closing entries that have little or no explanation or description.
- Entries made either before or during the preparation of the financial statements that do not have account numbers.
- Abnormal entries made immediately before a reporting period, such as before VAT returns, payroll or employees' tax returns and/or monthly management reports.
- Journal entries that are not sufficiently narrated.
- Entries that contain round numbers or a consistent ending number.
- The characteristics of the accounts affected by the entries:
    - Accounts that contain transactions that are complex or unusual in nature.
    - Accounts that containsignificant accounting estimates and period-end adjustments.
    - Accounts that have been prone to errors in the past.
    - Accounts that have not been reconciled or contain unreconciled differences.
    - Accounts that contain intercompany transactions.
    - Accounts that contain related party transactions and/or balances.
    - Accounts that are otherwise associated with identified risks of material misstatement due to fraud.

You should be alert to the following:

Characteristics that may be indicative of fraudulent transactions or adjustments – when selecting journal entries to test

- Entries made to unrelated, unusual, or seldom-used accounts.
- Entries made by individuals and/or user profiles/user groups within the IT department who typically do not make journal entries.
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- Abnormal entries made immediately before a reporting period, such as before VAT returns, payroll or employees' tax returns and/or monthly management reports.
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  - Accounts that contain intercompany transactions.
  - Accounts that contain related party transactions and/or balances.
  - Accounts that are otherwise associated with identified risks of material misstatement due to fraud.

7. The auditor's considerations to respond to identified risks of material misstatement due to fraud, when there is a fraud investigation in progress

Refer to IRBA Staff Alert pages 28 to 29

There may be situations where a forensic investigation into alleged fraud is in progress when an engagement takes place.

In those situations, the considerations of the auditor are, for example:

- To understand the scope of the forensic investigation into alleged fraud and whether it is sufficiently robust to allow the auditor to reach a conclusion thereon for audit purposes upon the completion of the investigation.
- To understand who is performing the investigation and whether the party is deemed competent, independent, objective and appropriately qualified.
- Based on the outcome of the investigation, to determine whether management of the entity has discharged its reporting responsibilities in terms of legislation such as the Financial Intelligence Centre Act, 2001 (Act No 38 of 2001) and the Prevention and Combating of Corrupt Activities Act, 2004 (Act 12 of 2004); and whether there is a need for the auditor to report a reportable irregularity or non-compliance with laws and regulations (refer to paragraphs 66-72).
- Understanding the timing of the investigation as well as the impact on the audit approach and the audit reporting process.
- Understanding the nature of the matters under investigation and whether they are deemed pervasive to the financial records and the impact on the planned audit approach.
- To develop additional audit procedures to address the auditor's concerns, based on the auditor's evaluation of the sufficiency of the investigation.
- To report on the matter in the auditor's report, as appropriate. For example, this may result in the auditor communicating a key audit matter in accordance with ISA 70153, reporting an Emphasis of Matter in accordance with ISA 706 (Revised) or reporting a modified opinion in accordance with ISA 705 (Revised).

What the auditor should consider when there is an ongoing forensic investigation into alleged fraud in progress during the audit

- Making use of the internal forensic department.
- The significance of the matter, other than only the financial materiality. Considerations may include, among others:
  - Is the matter relevant to the audit?
  - If it is in respect of allegations made by a whistle-blower, do the allegations appear to be credible?
  - Does the matter cause the auditor to raise concerns about management's integrity?
- Evaluate the sufficiency of the investigation being conducted. The auditor may consider, among others:
  - Whether the client's response to the matter was sufficient such that the auditor can rely upon the response in connection with the audit.
  - Who the investigation sponsor is.
  - Whether there were any limitations placed on the investigation.
  - Whether there is any interference by management in the investigation.
  - Whether the investigation scope is sufficient to address audit concerns.
  - The procedures performed and related findings that affect the audit.
  - The basis for the investigative conclusions, and whether the conclusions are based on facts supported by relevant evidence.
  - Whether there was a request by management to change any of the findings and conclusions in the report.
- Whether the statutory audit team needs to be withdrawn from the audit engagement while the forensic fraud investigation is in progress.
- The impact of the ongoing forensic fraud investigation on the timing of completion of the audit engagement and the issuing of the auditor's report.

8. THE AUDITOR'S RESPONSIBILITIES RELATING TO FRAUD IN ENGAGEMENTS OTHER THAN IN AN AUDIT OF FINANCIAL STATEMENTS

Refer to IRBA Staff Alert page 30

ISA 240 only applies to the auditor's responsibilities relating to fraud in an audit of financial statements.

However, the auditor's responsibilities relating to fraud may also need to be considered when performing a review or other assurance engagements in accordance with the International Standards on Review Engagements (ISREs) or the International Standards on Assurance Engagements (ISAEs), respectively, and in non-assurance engagements such as when performing an agreed-upon procedures engagement in accordance with the International Standard on Related Engagements (ISRS) 4400, Engagements to Perform Agreed-Upon Procedures Regarding Financial Information56. An example of such engagements includes the review and other assurance engagements performed in terms of Regulation 46 of the Banks Act, 1990 (Act No. 94 of 1990).

The auditor should refer to the relevant ISRE, ISAE or ISRS to understand the auditor's responsibilities relating to fraud under these engagements. However, the requirements and application material contained in ISA 240 may be useful when considering fraud under these engagements

9. THE AUDITOR'S REPORTING RESPONSIBILITIES WHEN A FRAUD IS DISCOVERED

Refer to IRBA Staff Alert pages 30 & 31

The auditor may have additional responsibilities under law, regulation or relevant ethical requirements regarding an entity's non-compliance with laws and regulations, including fraud, which may differ from or go beyond ISA 240 and other ISAs, such as:

(a) Responding to identified or suspected non-compliance with laws and regulations, including requirements in relation to specific communications with management and those charged with governance, assessing the appropriateness of their response to non-compliance and determining whether further action is needed;

(b) Communicating identified or suspected non-compliance with laws and regulations to other auditors (e.g. in an audit of group financial statements); and

(c) Documentation requirements regarding identified or suspected non-compliance with laws and regulations.

Complying with any additional responsibilities may provide further information that is relevant to the auditor's work, in accordance with ISA 240 and other ISAs (e.g. regarding the integrity of management or, where appropriate, those charged with governance).

Law, regulation or relevant ethical requirements may require the auditor to perform additional procedures and take further actions. For example, the IRBA Code of Professional Conduct (Revised November 2018) requires the auditor to take steps to respond to identified or suspected non-compliance with laws and regulations and determine whether further action is needed.

The auditor is referred to paragraphs 19-22 and paragraphs 23-29, respectively, as well as the respective related application material of ISA 250 (Revised) that deals with *Audit Procedures When Non-Compliance Is Identified or Suspected* and *Communicating and Reporting Identified or Suspected Non-Compliance* for further guidance in this regard.

In South Africa, the auditor is further required to report on reportable irregularities in terms of Section 45 of the Auditing Profession Act. The auditor is referred to the IRBA Revised Guide for Registered Auditors: *Reportable Irregularities in Terms of the Auditing Profession Act* (Revised May 2015) that provides guidance to auditors on their responsibility to report reportable irregularities.

The Auditor-General of South Africa (AGSA) performs its audits in terms of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA). The 2018 amendments to the PAA60 introduces the term material irregularity. A material irregularity is similar to a reportable irregularity in terms of the Auditing Profession Act. In terms of the PAA, a material irregularity is defined as any non-compliance with, or contravention of, legislation, fraud, theft or breach of a fiduciary duty identified during an audit performed under the Act that resulted in or is likely to result in a material financial loss, the misuse or loss of a material public resource or substantial harm to a public sector institution or the general public.

The AGSA may refer any suspected material irregularity identified during an audit to a relevant public body for investigation; and the relevant public body is required to keep the AGSA informed of the progress and inform the AGSA on the final outcome of the investigation. The PAA also empowers the AGSA to take any appropriate remedial action against an accounting officer or accounting authority who fails to implement recommendation(s) by the AGSA to address a material irregularity and to furthermore issue a certificate of debt if the remedial action related to a financial loss is not implemented.

The auditor is further referred to the South African Institute of Chartered Accountants (SAICA) Guide on Regulatory Reporting Duties that provides guidance on regulatory reporting duties.

MODULE 4: APPENDICES

1. APPENDIX A – THE EVOLVING ENVIRONMENT AROUND THE AUDITOR'S CONSIDERATIONS RELATING TO FRAUD

This appendix sets out a *Wish-list of Future projects and expectations*

Refer to IRBA Staff Alert pages 34 to 35

The IRBA Staff Alert is available to you as a Source Document

2. APPENDIX B – FORENSIC INTERVIEW TECHNIQUES

The purpose of this appendix is to provide an auditor with guidelines on how to approach interviews with executives, managers and other relevant employees at a client, with a view to clarify or uncover the root causes of irregularities (including fraud) uncovered during an engagement.

These guidelines are not exhaustive and therefore cannot replace the knowledge, skills and experience obtained through the practical honing of interviewing skills.

Refer to IRBA Staff Alert pages 36 to 39

- General principles relating to interviews
- What is interviewing?
- Preparation for an interview
- The interview
- Guidance for auditors
- After the interview

The IRBA Staff Alert is available to you as a Source Document

MODULE 5: IRBA FRAUD WEBPAGE

A dedicated IRBA Fraud web page contains a list of links to relevant audit-related guidance on fraud that have been developed internationally and locally.

The list references information that was known to the Fraud Task Group at the time of issuing this IRBA Staff Audit Practice Alert and it is not meant to be exhaustive.

https://www.irba.co.za/guidance-for-ras/technical-guidance-for-ras/staff-practice-alerts/fraud-guidance

1. CONTENTS, LINKS & OVERVIEW

The following **6 items** are listed on the IRBA Fraud webpage, and contain links to useful information regarding fraud:

SAICA Frequently Asked Questions: Application of the requirements of the International Standards on Auditing in relation to matters arising from monitoring findings and other in-practice challenges – *The presumption of risks of fraud in revenue recognition (page 4)*

https://www.saica.co.za/Portals/0/Technical/assurance/AssuranceFAQs.pdf

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Contents:

Conclusion

ISA 240.26 refers to “types of revenue”, “revenue transactions” or “assertions” and is therefore not prescriptive that the significant risk presumption must be rebutted per assertion. It would however not be appropriate for the auditor to consider revenue for an entity in total/ overall when the entity’s revenue comprises different types of revenue (revenue streams) or revenue transactions.

When identifying and assessing risks of material misstatement due to fraud, the auditor could conclude, based on the understanding obtained, that the risk of fraud is not applicable to a type of revenue (revenue stream) or class of revenue transactions, and document the reasons for the rebuttal.

If none of the assertions are considered to be significant risks in the circumstances (i.e. no risks of material misstatement due to fraud have been identified in relation to any of the assertions), the auditor has to document why the significant risk presumption does not apply (i.e. rebut the presumption) to revenue recognition related to the type of revenue (revenue stream) or class of revenue transactions concerned (or to revenue overall, if the entity's revenue does not comprise different types of revenue (revenue streams) or revenue transactions). The auditor's judgements relating to revenue recognition will be supported by the auditor's risk assessment at assertion level, documented in sufficient detail to enable an experienced auditor to understand such judgements and the conclusions reached.

This FAQ document is available to you as a Source Document

Transparency International: Corruption Perceptions Index

https://www.transparency.org/en/cpi#

The CPI scores and ranks countries/territories based on how corrupt a country's public sector is perceived to be by experts and business executives. It is a composite index, a combination of 13 surveys and assessments of corruption, collected by a variety of reputable institutions. The CPI is the most widely used indicator of corruption worldwide.

Association of Certified Fraud Examiners (ACFE): Fraud Resources

https://www.acfe.com/fraud-resources.aspx

The following are just some of the fraud resources available to you:

TOPIC

- Investigation & Examination
- Prevention & Deterrence
- Financial Transactions & Fraud Schemes
- Interviewing & Reporting
- Legal Elements
- Ethics & Compliance
- Accounting & Auditing
- Computers & Technology
- Professional & Career Development

RESOURCE TYPE

- Case Studies
- Tips & Tools
- Profiles
- Surveys & Statistics

Institute of Commercial Forensic Practitioners (ICFP): Industry Research

https://www.icfp.co.za/industry-research.html

RESOURCE SECTIONS

- Industry Resources
  - Commercial Forensic Investigations
  - Commercial Forensic Information Technology
  - Commercial Forensic Accounting
  - Commercial Forensic Law
  - Practice and Fraud Risk Management
- Research
  - Industry Publications
- Laws
  - Statutory Laws
  - International Laws
  - South African Law
  - Case Laws

AICPA Frequently Asked Questions: Audit Matters and Auditor Reporting Issues Related to COVID-19 – Fraud Inquiries (page 12)

https://future.aicpa.org/resources/download/aicpa-risk-assessment-resources

Audit and Financial Reporting Matters Related to COVID-19

The following list of representative frequently asked questions (FAQs) and topics has been compiled to aid (1) practitioners as they perform audit engagements in these uncertain times, and (2) preparers of financial statements. The guidance offered in this document is not applicable to preparation and issuance of audit reports within the jurisdiction of the Public Company Accounting Oversight Board (PCAOB). Additionally, this document does not focus on accounting, disclosure, and reporting nuances for public companies.

To download the A&A FAQs related to COVID-19 Issues, go to the website above and click on the Download link.

This FAQ document is available to you as a Source Document

Center for Audit Quality (CAQ): Managing Fraud Risk, Culture, and Skepticism During COVID-19

https://www.thecaq.org/managing-fraud-risk-culture-and-skepticism-during-covid-19/

The COVID-19 pandemic has resulted in unprecedented social and economic paralysis. Most companies have transitioned to an entirely remote workforce, and while existing technologies have facilitated connectivity via cloud computing and video and teleconferencing services, working in this new environment still poses numerous challenges. It is hard to predict the effects this "new normal" will have on operations because even experts can't say with certainty how long it will take to contain the virus or how long its economic effects will last.

In the past several weeks, much has been written about the wide range of issues that companies are facing as a result of COVID-19. Abundant resources discuss the accounting and reporting implications. The Center for Audit Quality (CAQ) i

s working to create resources, as well as curate and distill information from regulators, its member firms, and Anti-Fraud Collaboration partners.

This resource is intended to heighten awareness of the risk for fraud and misconduct that might occur inside an organization during, or as a result of, this crisis. Even if most people behave ethically, members of the financial reporting supply chain should review the controls, processes, and procedures that they have in their arsenals: a robust crisis and fraud risk management plan, a healthy dose of skepticism, and a strong culture of integrity.

The following sections are discussed:

- The Importance of Crisis Planning and Fraud Risk Management
- COVID-19 Presents Heightened Fraud Risk
    - Pressure
    - Opportunity
    - Rationalisation
    - Could Fraud happen here?
- Encouraging Skepticism as a Fraud Deterrent
    - Management
    - Boards and Audit committees
    - Internal auditors
    - External auditors
        - Review the Public Company Accounting Oversight Board's COVID-19 Spotlight, which states that the risk assessment "is not a discrete phase of the audit, but rather a continual and iterative one." The current business environment may require review and/or revision of previous risk assessments to consider how COVID-19 will impact financial statement areas, including the company's disclosures.
        - Explore the CAQ's COVID-19 Resource Collection for the latest information to help auditors, management, and audit committees understand the impact of the COVID-19 pandemic on financial reporting and oversight.
- Keep your eye on Corporate Culture

You can download the document by clicking on the following link:

https://www.thecaq.org/wp-content/uploads/2020/04/Managing-Fraud-Risk-Culture-and-Skepticism-during-COVID-19.pdf

MODULE 6: DISCLAIMER & COPYRIGHT

1. DISCLAIMER

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