

Regulatory Framework



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Auditors responsibility related to fraud

Sarbanes Oxley Act (SOX)

- Enacted in US 2002 (Enron, WorldCom etc)
- New/enhanced standards for publicly listed companies in US and public accounting firms- PCAOB
- Some provisions: Top management certification; Severe penalties; Regulation of independence / conduct of public accounting firms

SAS 99: Statement of Auditing Standards issued by AICPA

- Consideration of Fraud in a Financial Statement Audit
- Defines and categorizes: Fraud, Red flags, Auditor's responsibility, Professional skepticism

Corporate Governance

ISA 240: International Standards on Auditing

- Issued by International Federation of Accountants (IFAC) through International Auditing and Assurance Standards Board (IAASB)
- Additional guidance related to: Earnings management , Audit of small entities
- Mandatory for European Union & Also adopted by UN Board of Auditors

Auditors responsibility related to fraud

ISA 240 & INTOSAI

- Deals with auditor's responsibilities relating to fraud:
 - Objectives of financial audit broader than expressing an opinion on financials
 - Mandate from regulation, ministerial directives, government policy requirements, etc.
 - May include reporting responsibilities
 - non – compliances with authorities, including budgets and accountability frameworks
 - effectiveness of internal controls
 - Always a general expectation from the public to for above

Source: [http://www.issai.org/media\(734,1033\)/ISSAI_1240_E_Endorsement.pdf](http://www.issai.org/media(734,1033)/ISSAI_1240_E_Endorsement.pdf)

Auditors responsibility related to fraud ISA 240 & INTOSAI (contd.)

ISA definition of fraud

- **Fraud** – 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**
- **Fraud risk factors** – Events or conditions that indicate an **incentive or pressure** to commit fraud or **provide an opportunity** to commit fraud

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Auditors responsibility related to fraud ISA 240 & INTOSAI (contd.)

Overview

- **Primary responsibility** – charged with governance/management
- **Auditor's responsibility** – reasonable assurance
- **Auditor's objectives :**
 - Identify/assess the risks of material misstatement due to fraud
 - Obtain sufficient appropriate audit evidence regarding assessed risks due to fraud

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Auditors responsibility related to fraud ISA 240 & INTOSAI (contd.)

Key requirements

- **Professional skepticism** throughout the audit
- **Discussion among engagement team**
 - Objectives and related risks of material misstatement
 - *May include auditors engaged in performance audits/other audit activities*
- **Perform risk assessment procedures**
 - *Public sector auditors – may inquire as to management’s communication with other government bodies*

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Auditors responsibility related to fraud ISA 240 & INTOSAI (contd.)

Key requirements (contd.)

- **Evaluate** if result of procedures indicate a previously unrecognized risk
- Consider **withdrawal** from engagement
 - In the public sector, there may not be an option of withdrawing due the mandate/public interest
- Obtain written representations from the management

Source: [http://www.issai.org/media\(734,1033\)/ISSAI_1240_E_Endorsement.pdf](http://www.issai.org/media(734,1033)/ISSAI_1240_E_Endorsement.pdf)

Auditors responsibility related to fraud ISA 240 & INTOSAI (contd.)

Key requirements (similar to INTOSAI)

- Communicate with appropriate level of management and those charged with governance regarding assessment of risk
 - May include officials of a ministry or members of relevant legislative committees
- Document procedures carried out, results and significant decisions

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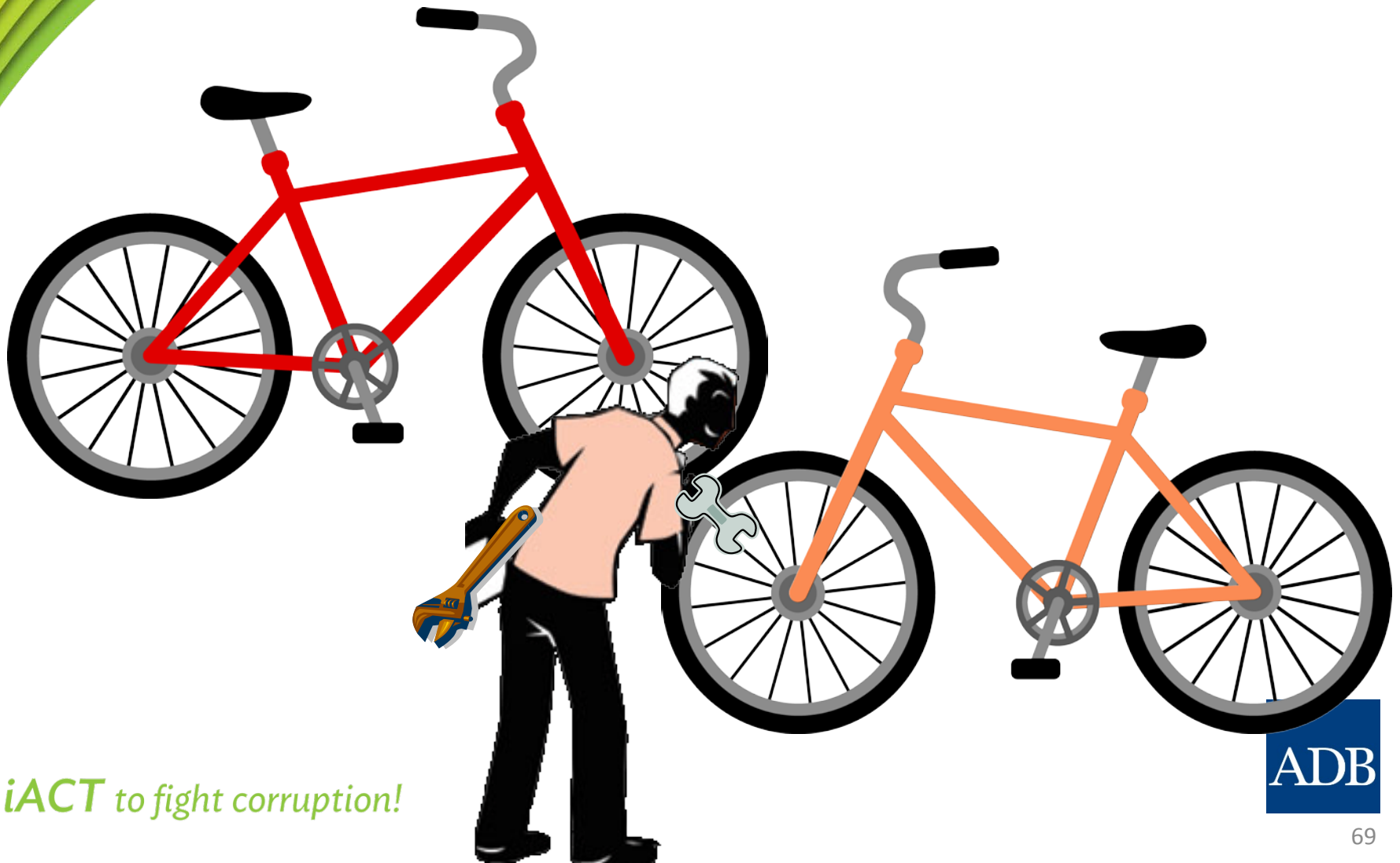
Fraud Concepts

FRAUD – tell tale signs

- There is **always evidence** of fraud when it occurs
- The real numbers **always exist**
- If you want to find fraud, you have to know **what it looks like**
- If you want to prevent fraud, you have to know **what causes it**

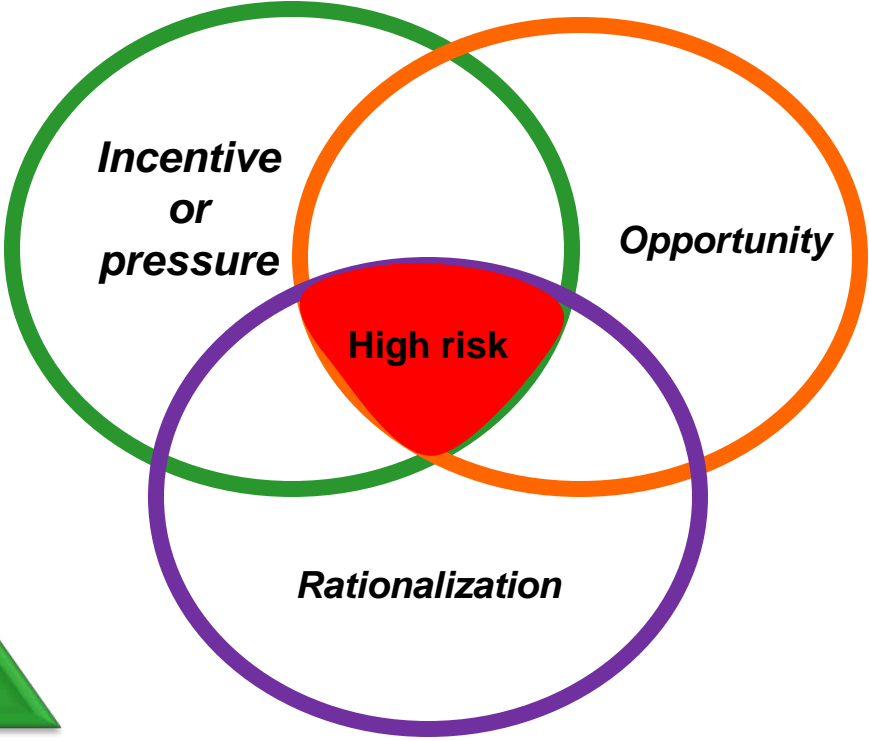


Why do people steal bicycles?

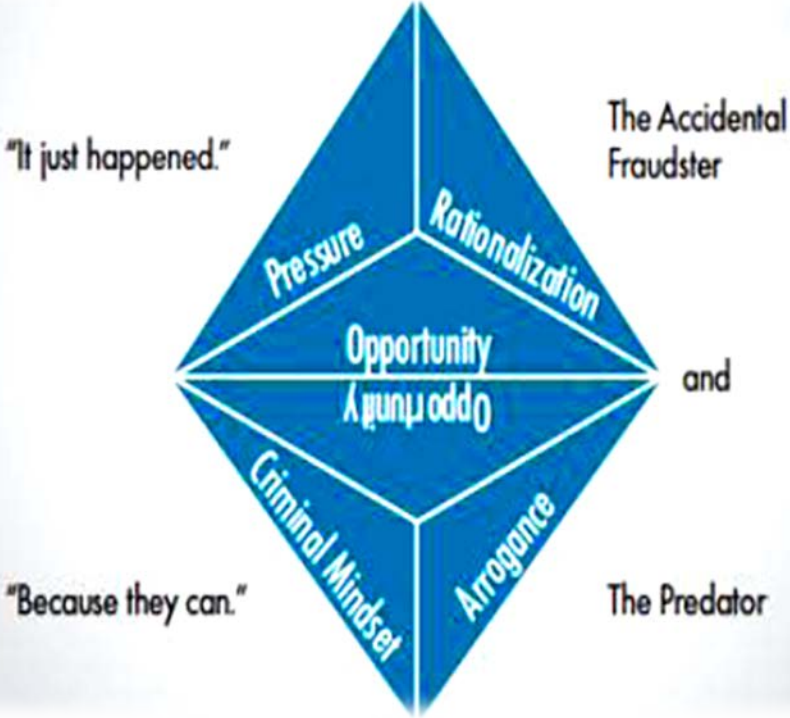


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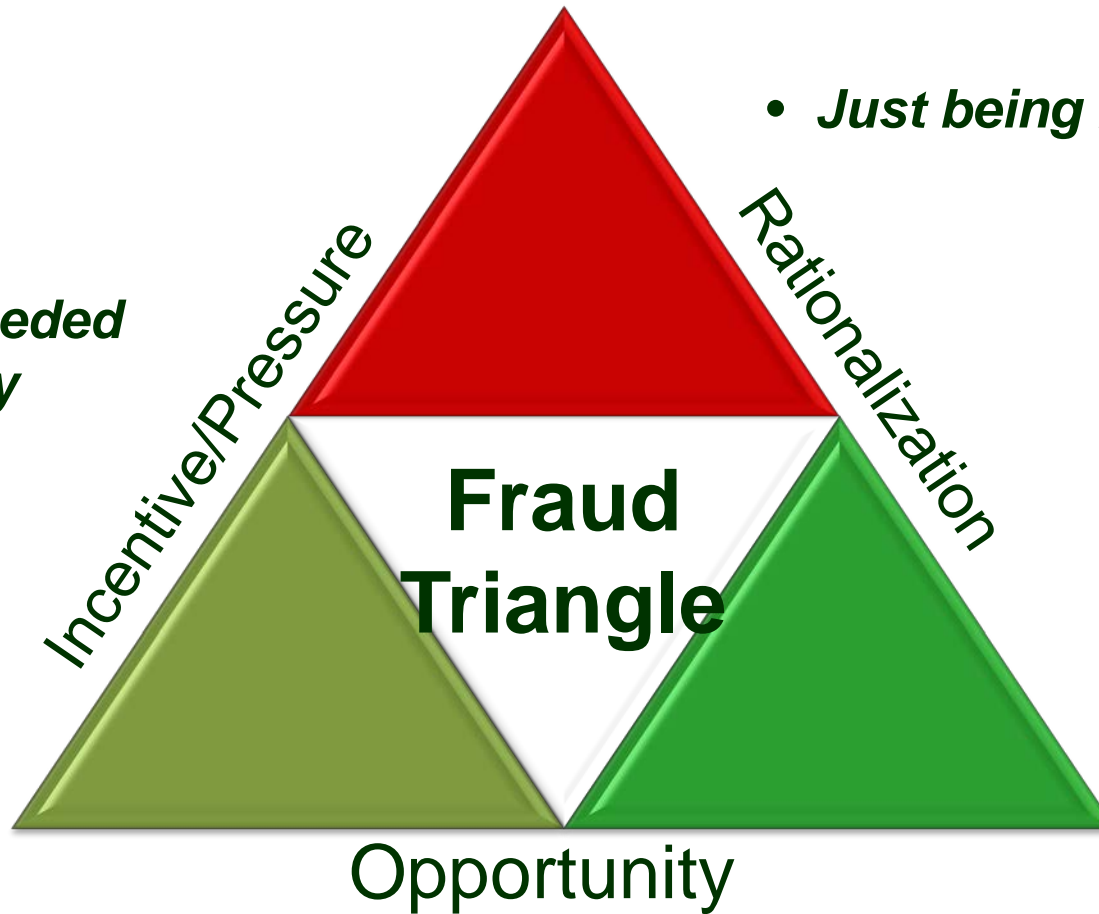
Fraud Triangle



Fraud Diamond



Source: David T. Wolfe and Dana R. Hermanson, "The Fraud Diamond: Considering the Four Elements of Fraud," *The CPA Journal*, December 2004.



- *Badly needed*
- *In a hurry*

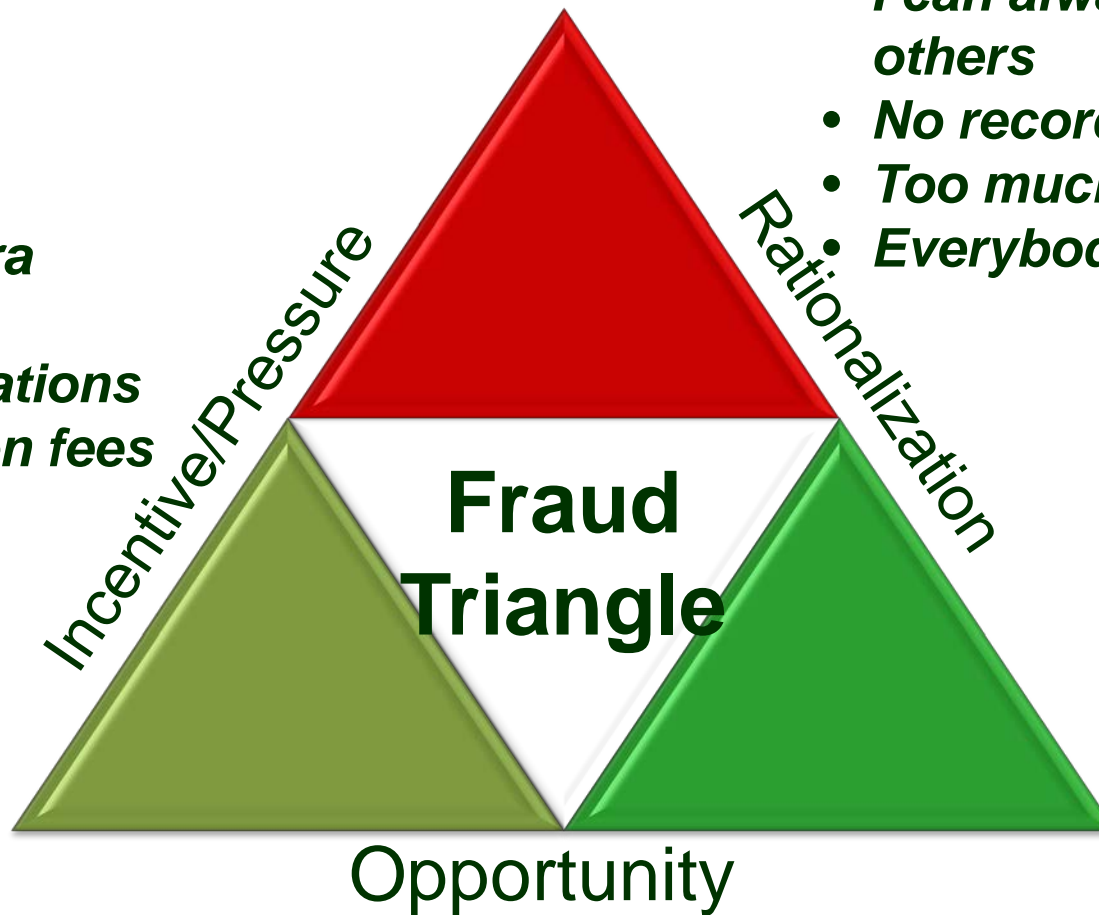
- *Just being borrowed*

- *Unlocked*
- *No one is looking*

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- **Need extra money**
- **Take vacations**
- **Pay tuition fees**



- ***I can always blame others***
- ***No records***
- ***Too much workload***
- ***Everybody's doing it***

- ***Unclear roles & responsibilities***
- ***Poor records management***
- ***Segregation of Duties issue***

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What is a Red Flag?

- Fraud indicator that requires closer reviews
- Irregularity
- Unusual event
- Activity obvious to all but disguises to appear as part of a normal activity
- Commonly found in the high risk areas

Red flags – Rationalizations

This company can hire me (Everyone else member) was doing it retirement

If I help my boss, he will promote me This will not affect

I needed the money

His company will do justice to the project

Lower salary levels in the public sector, while level of authority justifies a lifestyle similar to private sector employees

Let me do a favor for him, he helped me in the past

It was just a loan...I would have repaid it

The project is running just because of me



Common comments regarding fraud

Our internal controls will take care of fraud related issues

This is how the process is, and has been tested by others

We have no control on what bidders do

This type of fraud cannot happen here

Our staff cannot / would not commit fraud

Implementing agency will detect it, my responsibility is to just approve

It was an error and not intentional

We were not trained on this, we did not know