

Fraud:

RECOMMENDATIONS TO STRENGTHEN THE FINANCIAL REPORTING ECOSYSTEM

BACKGROUND

Corporate fraud can cause irreversible harm to people, companies and the economy. Its consequences weaken the public's confidence in markets and have long lasting damaging effects on society. The COVID-19 crisis has further increased the pressure on companies and made them more vulnerable to fraud and corporate failure.

Auditors can play a crucial role in tackling fraud. For this to happen, all key parties in the financial reporting ecosystem and their interactions need to evolve. Our publication [*Fraud: recommendations to strengthen the financial reporting ecosystem*](#) explores how to clarify and improve [*all stakeholders' roles*](#) (including auditors, companies' boards and management, legislators, standard setters and regulators). They all must play their role for a joint effort to achieve tangible results in tackling fraud.

Fraud and going concern issues are often correlated. We also developed recommendations in our publication [*Going concern: recommendations to strengthen the financial reporting ecosystem*](#).

Corporate governance as a first line of defence

Company's management and board hold the primary responsibility for preventing and detecting fraud. There is no proportionate way to eliminate the fraud risk in an organisation. The most cost-effective way to limit fraud losses is to prevent fraud from occurring. An appropriate and effective corporate governance system is key as a first line of defence against fraud.

Auditors apply a risk-based approach and their main responsibility concerning fraud is to identify, assess and respond to risks of material misstatements. They consider the events or conditions that indicate an incentive or pressure; or provide an opportunity to commit fraud.

RECOMMENDATIONS FOR A STRONGER FINANCIAL REPORTING ECOSYSTEM

Our recommendations focus on European public interest entities (PIEs), however some may also be relevant for non-PIEs and their auditors. The recommendations start from the requirements in relevant international standards and EU legislation. We also explore further ideas to be considered especially by standard setters and audit oversight bodies.

OUR MAIN PROPOSALS

Require companies to have, and publicly report on, a fraud risk management program

Companies' management should be required to operate a fraud risk management program based on a well-defined framework. This framework should prescribe procedures on fraud risk assessment, internal controls and responses to allegations and incidents of fraud. Legislation should require the board and management to publicly disclose a statement about the effectiveness of this program and relevant controls.

Pay specific attention to senior management fraud

Boards and audit committees should pay specific attention to senior management



fraud and include fraud risks relevant to the company as a recurring item on their agenda. Having a trustful relationship should not stop board and audit committee members from asking controversial questions to management or making appropriate enquiries in the organisation.

Mandate an audit committee in all public interest entities

It should be mandatory for all PIEs to have a separate audit committee that is independent from company's management. This committee should have a sufficient number of members with competence in accounting and/or auditing, and risk management. Legislators should abolish provisions that allow EU Member States to derogate from such requirements.

The audit committee's effectiveness should be supported by well-established whistleblowing structures and an internal audit function.

Make early warning mechanisms for auditors effective

National legislation should specify the competent authority and the related procedures for PIE auditors to report irregularities suspected during the audit, including fraudulent acts. There should be a designated competent authority for every type of PIE and clear guidance for auditors on how to comply with their legal obligations.

Clarify auditing standards for a common understanding of the auditor's role

International (and national) standard setters should clarify the auditing standards to better explain commonly misunderstood requirements and concepts about the auditor's role on fraud. Auditing standards should also require

specific procedures addressing the risk of senior management fraud.

Improve auditors' access to knowledge and awareness about fraud

An alliance among firms should establish and maintain a platform to share (anonymised) case studies and experiences on discovered fraud. Such a platform should be supported by professional organisations and audit oversight bodies. It should provide secure and controlled access to audit firms and other relevant parties. The main characteristics of more frequently occurring types of fraud (per region, sector, and type of business) should be made available for audit teams' consideration.

Auditors to clearly communicate their work and conclusions about fraud

Auditors of PIEs should report their work on fraud and present related findings to boards and audit committees, even when they have not identified any issue to report as a key audit matter or to modify their opinion. Auditors could also be required to publicly report their conclusion on the management's statement on fraud risk management program according to an acceptable framework. In practice, such an engagement might necessitate auditors to consider the internal controls over financial reporting as a whole.

IDEAS TO BE EXPLORED

The auditor has the overall responsibility for planning and performing the audit and for reporting its results. Based on their judgement, auditors may decide to use experts and computer-assisted audit techniques during an audit engagement.

We invite relevant parties to explore how to use forensic experts and technology in the most effective way within financial statements audits. This should include the challenges associated with the ideas below and relevant cost and benefits.

More extensive use of forensic experts by auditors

Some stakeholders believe that the use of forensic experts should be mandatory for PIE audits. Others suggest that audit firms should analyse their audit client portfolio and use forensic experts for companies with a high(er) inherent risk of fraud

More extensive use of data and technology by auditors

Some stakeholders suggest that analysing publicly available external data and selected internal data, captured in systems that companies use to manage their operations, could provide useful insights to auditors in their fraud risk assessment.

SEND US YOUR FEEDBACK!

We call for a joint effort of key parties to strengthen the ecosystem. To this end, we ask you to send your thoughts and opinions on our recommendations to harun@accountancyeurope.eu by 30 April 2021.