

# FACTS.

## FAQ ON THE AUDITOR'S ROLE IN TACKLING FINANCIAL CRIME

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### WHY STANDING UP TO FINANCIAL CRIME IS A MATTER FOR EVERYONE?

Financial crime, such as fraud, corruption, bribery and money-laundering, affects the European Union's (EU) economy and thereby weakens citizens' situation and employment opportunities. Financial crime costs:

- 120 billion EUR annually to the EU economy (compared to the entire EU budget of 145 billion EUR)
- 10% extra cost of doing business
- 5% of a company's annual revenue
- reputational damage to companies which may adversely affect their market value

Society expects the auditor to play an important role in uncovering financial crime. To address this expectation, legislators and standard setters have introduced new rules to clarify the auditor's responsibility. This responsibility to prevent, deter and uncover incidents of financial crime is shared with the company's management and board.

This FAQ aims to further explain the auditor's role by answering questions we have been receiving. This publication builds on the information paper *Auditor's role in fighting financial crime* (2017)<sup>1</sup> which provides a comprehensive overview of the auditor's key responsibilities.

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### WHAT IS THE ROLE OF THE STATUTORY AUDITOR?

A statutory audit is a legally mandated check of financial accounts. EU law requires large and medium-sized companies to be audited. This means that the statutory auditor (hereafter: auditor) forms an opinion on companies' financial statements on which stakeholders such as investors and shareholders can rely when making decisions. The auditor thus contributes to the functioning of markets by improving the integrity of financial statements and stakeholders' confidence in them.

The auditor may help deter potential wrongdoers and uncover financial crime. Because the statutory audit's scope is legally limited to a company's accounts, an audit cannot uncover every fraud. This is a task for specialised forensic services in a specific fraud investigation.

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### WHAT IS THE AUDITOR'S ROLE IN TACKLING FINANCIAL CRIME?

The auditor can help combat financial crime by:

- alerting company's management of incidents of fraud or non-compliance with relevant laws and regulations, which the auditor may decide to communicate in the audit report
- reporting to an appropriate competent authority:
  - incidents of financial crime
  - suspicions of transactions linked to money laundering and terrorist financing
  - breaches of laws and regulations

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<sup>1</sup> [https://www.accountancyeurope.eu/wp-content/uploads/180112\\_Technical-paper-Auditors-role-in-the-fight-against-fraud-corruption-and-money-laundering.pdf](https://www.accountancyeurope.eu/wp-content/uploads/180112_Technical-paper-Auditors-role-in-the-fight-against-fraud-corruption-and-money-laundering.pdf)

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## WHAT IS THE LEGAL BASIS OF THESE RESPONSIBILITIES?

Statutory auditor is a regulated profession in the EU and, as such, it operates within a specific legal framework which contributes to tackling financial crime. For a comprehensive overview of the auditor's key responsibilities, please consult our paper *Auditor's role in fighting financial crime*. Some of these regulations and principles are:

- EU Statutory Audit Regulation 537/2014 and Directive 2014/56/EU
- EU Anti-Money Laundering Directive 2015/849
- Member States' legislation on anti-corruption and anti-money laundering
- International Standards on Auditing (ISAs), now adopted by 26 out of 28 EU Member States. ISAs are issued by the International Auditing and Assurance Standards Board (IAASB) via a rigorous due process to which Accountancy Europe actively contributes. The 2014 EU audit reform empowers the European Commission to mandate the use of ISAs for all statutory audits in the EU, which the EC has not done (yet).
- IESBA Code of Ethics for Professional Accountants. All EU statutory auditors need to adhere to the fundamental principles of ethics in this Code or national equivalents, including professional scepticism. This allows the auditor to be able to critically assess audit evidence, including suspected financial crime involving their client

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## WHAT CAN AUDITORS DO IN PRACTICE?

Auditors cannot directly prevent financial crime from happening, but they can tailor their work to increase the chance of detecting it. The law does not require the auditor to specifically look for money laundering and terrorist financing, but to report suspicion of such activities. Their work in detecting fraud is very challenging and requires professional scepticism to be duly exercised. Ultimately, it is up to a court to determine whether a criminal act has been committed.

To form an audit opinion, an auditor gathers evidence, observes, tests, compares and confirms, for example, by:

- inquiring management to gain an understanding of the organisation, its operations, financial reporting and known fraud or error
- evaluating and understanding internal control systems including the information system relevant to financial reporting, possible breaches in cybersecurity and how anti-corruption compliance is secured within the company
- observing the physical inventory count and analysing variances in account balances or transactions

When suspecting a financial crime during an audit, the auditor needs to make sure this is followed up. For example, an employee indicates that the company has fraudulently secured a contract with a public-sector organisation. The auditor will examine the contract and the related project's accounting records or specific expense accounts. He can conduct further interviews or analytical work to better understand the client's business and evaluate the impact on it. If fraud is substantiated, the auditor then communicates any conclusion to the right level within the organisation or if required, to the appropriate competent authority.

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## WHAT CAN AUDITORS NOT (YET) DO IN PRACTICE?

An audit is not a guarantee for the financial statements to be free from any fraud or error. There are limitations to what extent an auditor can tackle financial crime due to statutory audit's legally limited scope to a company's accounts. To learn more about the auditor's inherent limitations, please consult our paper *Auditor's role in fighting financial crime*.

Auditors are not alone in this. Successfully standing up to financial crime depends upon a joint effort by all relevant parties, including business leaders, the accountancy profession, regulators, standard setters and the financial sector. We call for a coordinated approach by all key players to achieve tangible results. Collaboration is essential, for example, to make the most out of the opportunities technology offers and to help develop data analytics tools and new skillsets for combating financial crime.