

DFA

Standards on Forensic Auditing

Forensic Accounting & Investigation Standards

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ISA 240 : Consideration of Fraud in FS Audit

Characteristics of Fraud:

1. Misstatements in Financial Statements can be arise from either Error or Fraud. The distinguishing factor between Error and Fraud is the underlying actions performed by management i.e intentional or unintentional.
2. Two types of intentional misstatements that are relevant to audit - Misstatements resulting from i) Fraudulent Financial Reporting and ii) Misappropriation of Assets.

Responsibility of Prevention and Detection of Frauds:

1. The Primary responsibility of prevention and detection of frauds is lies with the management.
2. The Management and Those charged with governance should implement the internal controls for prevention of frauds.

Objectives of Auditor:

To identify and assess the risks of material misstatement in the Financial Statements due to Fraud

To obtain Sufficient appropriate Audit evidence about the assessed risks of material misstatement due to fraud. (ISA 500)

To respond appropriately to identified or suspected Fraud.

Fraud

- intentional act
- one or more persons
- use of deception
- obtain unjust advantage

Fraud Risk factors – *indicate*

- Incentive/ pressure to commit fraud
- Provide opportunity for fraud

Sec 447

Management Representations

The Auditor shall obtain written representations from management and, where applicable, those charged with governance that :

1. They Acknowledge their responsibility for the design, implementation and maintenance of internal control to prevent and detect Fraud.
2. They have disclosed to the Auditor their knowledge of fraud or suspected fraud affecting entity involving:
 - a. Management,
 - b. Employees who have significant role in Internal Controls,
 - c. Others, where the fraud could have a material affect on the Financial Statements.

Responsibilities of Auditor: ISA 240

1. An Auditor conducting an Audit in accordance with SA's is responsible for obtaining the reasonable assurance that the financial statements are free from Material Misstatements i.e., From Error or Fraud.
2. While obtaining the reasonable assurance, the auditor is responsible for maintaining professional skepticism throughout the audit.
3. As inscribed in SA 200, owing to certain inherent limitations of an audit, an Auditor cannot obtain absolute Audit assurance that the Financial Statements are free from material misstatement whether due to Fraud or Error.
4. Further, the risk of non detection of fraud is higher than the non detection of Errors. Because, Frauds are intentionally done by Management or Employees and they may involve sophisticated and carefully organized schemes designed to conceal it.
5. The requirements in this SA are designed to assist the auditor in identifying and assessing the risks of material misstatements due to fraud and in designing procedures to detect such misstatement.

ISA 240 :

Auditors Responsibility

As regards the auditors', the standard states that when planning and performing audit procedures and evaluating and reporting the results thereof, the auditor should consider the risk of material misstatements in the financial statements resulting from fraud or error.

Inherent Limitations of an audit

An auditor cannot obtain absolute assurance that material misstatements in the financial statements will be detected.

The auditor is able to obtain only a reasonable assurance that material misstatements in the financial statements will be detected.

The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting a material misstatement resulting from error.

The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements / ISA 240

Primary responsibility for prevention & detection of F&E rests with management & those charged with governance

In planning, performing procedures, evaluating & reporting consider risk of material misstatement arising from F&E

Audit is a deterrent but auditor cannot be held responsible for prevention of F&E

No absolute assurance that material misstatements be detected due to inherent limitations of audit, auditor can obtain only a reasonable assurance

Risk of not detecting fraud is higher than risk of not detecting error, audit procedures effective for detecting errors may be ineffective for detecting fraud

ISA 240 : Principles

Risk of not detecting management fraud is greater than not detecting employee fraud

Plan/ perform audit with professional skepticism

In planning, discuss with audit team, susceptibility of entity to material misstatements

Make inquiries from management/ those charged with governance to understand management's assessment of risk of F&E & systems in place to prevent F&E

Identification & assessment of inherent, control & detection risk & presence of fraud risk factors

Perform procedures to see if FSs are materially misstated in case he encounters such circumstances

Evaluate & dispose the misstatements & consider effect on auditor's report

Document risk factors present & auditor's response to such factors

Contd....

Obtain management representations as to responsibility of FS s & accounting & internal control systems

Communicate misstatements to management/ those charged with governance/ regulatory & enforcement authorities

Communicate material weakness in internal control to management

If unable to complete the engagement due to misstatements, then consider possibility of withdrawing, legal & professional responsibility

Communicate with incoming auditor

If the auditor has:
identified a fraud, whether or not it results in a material misstatement in the financial statements; or
obtained evidence that indicates that fraud may exist (even if the potential effect on the financial statements would not be material);
the auditor should communicate these matters to the appropriate level of management on a timely basis, and consider the need to report such matters to those charged with governance.

Communications to Regulatory and Enforcement Authorities:

Further he shall communicate such fraud details to regulatory Authorities if such communication is required as per Applicable Financial Reporting Framework. (E.g., Sec. 143(12) of Companies Act, 2013)

Auditor Unable to Continue Engagement:

As a Result of a Fraud or Suspected Fraud resulting to Material Misstatement, if the Auditor encounters exceptional circumstances that bring into question the Auditor's ability to perform the Audit, The Auditor shall:

1. Determine the professional and legal liabilities applicable in the circumstances.
2. Consider whether to withdraw from the engagement, where withdrawal from engagement is legally permitted.
3. If the Auditor withdraws:
 - a. Discuss with appropriate level of management and those charged with governance, the Auditor's withdrawal from the engagement and the reasons for withdrawal.
 - b. Determine whether there is a legal or professional requirement to report by whom Auditor is appointed.

STANDARD ON INTERNAL AUDIT (SIA) 11
CONSIDERATION OF FRAUD IN AN INTERNAL AUDIT*

SIA -11 :

Standard on Internal Audit (SIA) 11

Introduction

1. Fraud is defined as an intentional act by one or more individuals among management, those charged with governance, or third parties, involving the use of deception to obtain unjust or illegal advantage. A fraud could take form of misstatement of an information (financial or otherwise) or misappropriation of the assets of the entity.
2. The primary responsibility for prevention and detection of frauds rests with management and those charged with governance. They achieve this by designing, establishing and ensuring continuous operation of an effective system of internal controls.

Application of knowledge & competence

“The internal auditor should exercise due professional care, competence and diligence expected of him while carrying out the internal audit. Due professional care signifies that the internal auditor exercises due professional care in carrying out the work entrusted to him in terms of deciding on aspects such as the extent of work required to achieve the objectives of the engagement, relative complexity and materiality of the matters subjected to internal audit, assessment of risk management, control and governance processes and cost benefit analysis. Due professional care, however, neither implies nor guarantees infallibility, nor does it require the internal auditor to travel beyond the scope of his engagement.”

An internal auditor should, therefore, use his knowledge and skills to reasonably enable him to identify indicators of frauds. However, the internal auditor cannot be expected to possess the expertise of a person with specialized knowledge and skills in detecting and investigating frauds.

Role of Internal auditor

Although, normally, an internal auditor is not expected to possess skills and knowledge of a person expert in detecting and investigating frauds, he should, however, have reasonable knowledge of factors that might increase the risk of opportunities for frauds in an entity and exercise reasonable care and professional skepticism while carrying out internal audit

The internal auditor should, assist the management fulfill its responsibilities relating to fraud prevention and detection.

Control assessment

The internal auditor should assess whether the controls implemented by the management to ensure that the risks identified are responded to as per the policy or the specific decision of the management, as the case may be, are in fact working effectively and whether they are effective in prevention or timely detection and correction of the frauds or breach of internal controls

The internal auditor should evaluate the mechanism in place for supervision and assessment of the internal controls to identify instances of any actual or possible breaches therein and to take corrective action on a timely basis

The internal auditor should carefully review and assess the conclusions drawn from the audit evidence obtained, as the basis for his findings contained in his report and suggest remedial action

Documentation of fraud risk

The internal auditor should document fraud risk factors identified as being present during the internal auditor's assessment process and document the internal auditor's response to any other factors.

If during the performance of the internal audit fraud risk factors are identified that cause the internal auditor to believe that additional internal audit procedures are necessary, the internal auditor should document the same.

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