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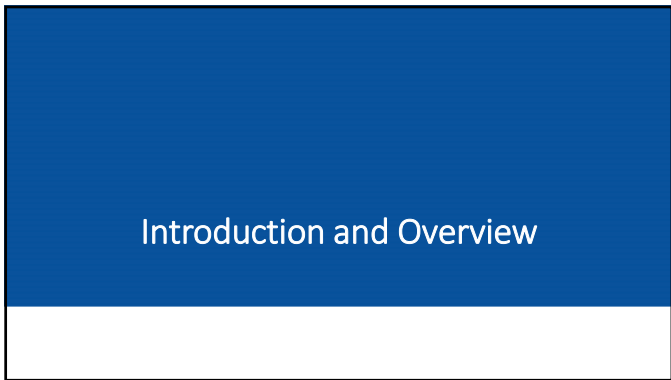
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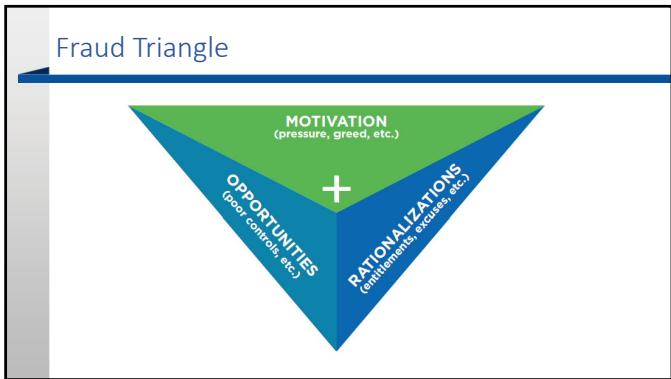
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### Fraud Triangle

**Motivation**

- Incentive or pressure to commit fraud
- Examples:
  - Meeting threshold for performance bonus
  - Significant personal debts or poor credit
  - Greed
  - Peer or family pressure to succeed
  - Living beyond one's means
  - Meeting bank covenants
  - Inflating purchase price of the business
  - Cover financial losses



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### Fraud Triangle

**Opportunity**

- Perception can "get away" with fraud
- Examples:
  - Poor corporate culture
  - No oversight of controls/poor controls
  - No required vacation or lack of segregation of duties
  - Repercussions will not be serious
  - High staff turnover
  - Smaller, but high value inventory items



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### Fraud Triangle

**Rationalization/Attitude**

- Belief that no crime being committed or is okay
- Examples:
  - Dissatisfaction with pay
  - Feeling underappreciated
  - Only taking what entitled to
  - Everybody does it
  - Will pay it back
  - Company does same thing to suppliers/customers



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### Fraud Triangle

- CAS 240 *The Auditor's Responsibilities Related to Fraud in an Audit of Financial Statements*
- CAS 240.A26 provides illustrative risk factors
  - An incentive or pressure to commit fraud
  - A perceived opportunity to commit fraud
  - An ability to rationalize the fraudulent action



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## Fraud by the Numbers

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### Report to the Nations

- Association of Certified Fraud Examiners
  - Report to the Nations
- 2020 Global study on occupational fraud
  - 2,504 cases from 125 countries
    - 23 industry categories
    - Losses of more than \$3.6 billion
- Compiled globally as well as by industry (2020) and region (2018)

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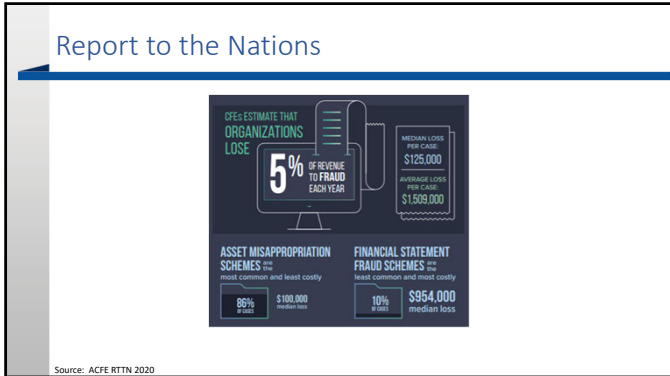
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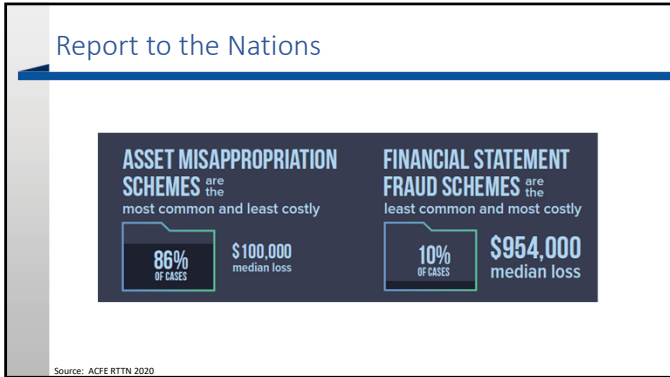
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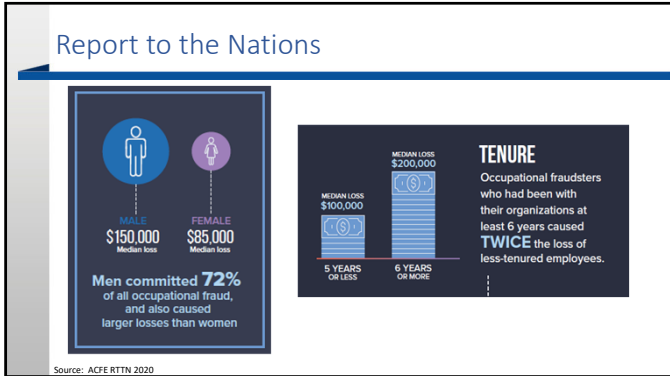
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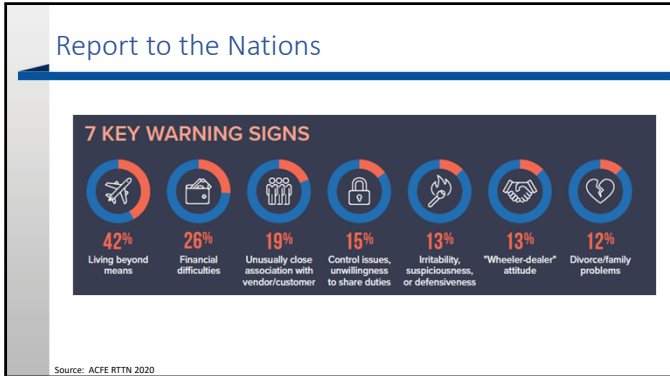
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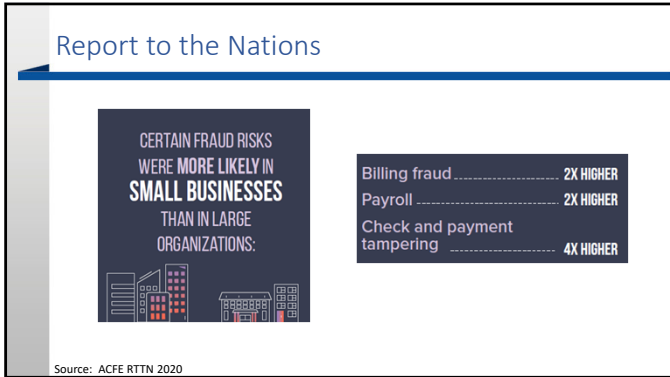
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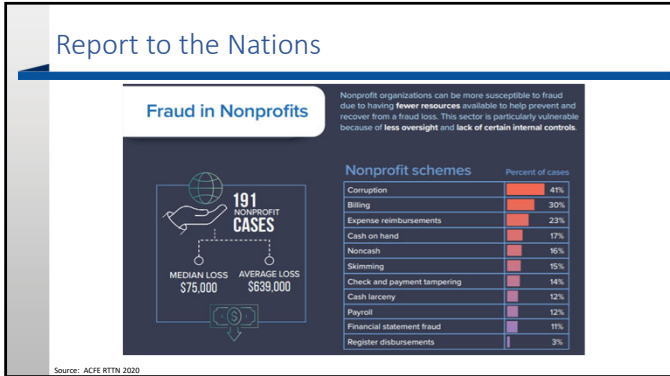
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### Organizations – Canada

Type of company	% of Cases	Median Loss
Private Company	40%	\$205,000
Public Company	22%	\$362,000
Government	20%	\$55,000
Not for Profit	12%	\$178,000
Other	6%	\$-

Source: ACFE RTTN 2018

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### Most Common Fraud Schemes – Canada

Most Common Occupational Fraud Scheme	% of Cases
Corruption	40%
Billing	20%
Non-cash	18%
Financial statement fraud	14%
Skimming	13%
Cash on hand	13%
Expense reimbursement	13%
Check and payment tampering	10%
Payroll	6%
Register disbursement	3%
Cash larceny	3%

Source: ACFE RTTN 2018

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### Size of Organization – Canada

# of Employees	% of Cases	Median Loss
<100	40%	\$200,000
100 – 999	22%	\$200,000
1,000 – 9,999	20%	\$161,000
10,000 +	12	\$200,000

Source: ACFE RTTN 2018

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### Profile of a Fraud Perpetrator – Canada

Level of Authority	% of Cases	Median Loss
Employee	47%	\$156,000
Manager	27%	\$205,000
Owner/Executive	23%	\$600,000

Where Do Perpetrators work within their Organizations?	% of Cases
Executive or Upper Management	19%
Accounting	16%
Customer Service	13%
Operations	11%
Sales	10%

Source: ACFE RTTN 2018

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### Primary Internal Controls Weaknesses – Canada

Internal Control Weakness	% of Cases
Lack of internal controls	33%
Override of existing internal controls	22%
Lack of management review	20%
Poor tone at the top	9%
Lack of competent people in oversight roles	6%
Other	4%
Lack of employee fraud education	4%
Lack of independent audits/checks	1%
Lack of clear lines of authority	1%

Source: ACFE RTTN 2018

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### Detection – Canada

How is occupational fraud initially detected in Canada?	
Tip	32%
Internal Audit	21%
Management Review	15%
Other	7%
Surveillance/Monitoring	6%
External Audit	5%
Account Reconciliation	5%
Document Examination	4%
By Accident	4%
IT Controls	1%

Source: ACFE RTTN 2018

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### Recovery – Canada

Recovery	% of Cases
Recovered nothing	52%
Made a partial recovery	28%
Recovered everything	20%

Source: ACFE RTTN 2018

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### Fraud By the Numbers

- Fraud happens . . .

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# Maintaining an Attitude of Professional Skepticism

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**Professional Skepticism**

- Assurance standards require an attitude of professional skepticism
- Necessary for:
  - Critical assessment of evidence
  - Arriving at the appropriate conclusion

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**Professional Skepticism**

- CAS 200.13 states:  
  
An **attitude** that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.

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**Professional Skepticism**

- CAS 240.13 states:  
In accordance with CAS 200, the auditor shall maintain **professional skepticism** throughout the audit, recognizing 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.

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**Professional Skepticism**

- CSRE 2400.20 states:  
The practitioner shall plan and perform the engagement with **professional skepticism** recognizing that circumstances may exist that cause the financial statements to be materially misstated.

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**Professional Skepticism**

- Audit and review engagement standards have consistent meaning
- Necessary to maintain professional skepticism to reduce risk of:
  - Overlooking unusual circumstances
  - Over-generalizing when drawing conclusions
  - Using inappropriate assumptions in determining the nature, timing and extent of the procedures performed
  - Evaluation of the results thereof

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### Professional Skepticism

- Three elements:
  - Attribute:
    - Knowledge, skill and overall ability
  - Mindset:
    - Not assuming honesty or dishonesty
    - Recognizes the possibility of fraud, misstatement or misrepresentation of essential facts
  - Action:
    - Performing robust risk assessment procedures
    - Determine responses based on risks involved
    - Diligent gathering and evaluation of audit evidence

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### Professional Skepticism

- Professional skepticism includes:
  - Questioning evidence that is inconsistent with other evidence
  - Investigating contradictory evidence
  - Being alert for information that calls into question reliability of documents
  - Being aware of conditions that may indicate possible fraud
  - Considering sufficiency and appropriateness of evidence obtained in light of the engagement circumstances
  - Addressing other circumstances

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### Professional Skepticism

- Characteristics
  - Questioning mind
  - Suspension of judgement
  - Search for knowledge
  - Interpersonal understanding
  - Self-determining
  - Self-confidence

Source: Kathy Hurr, Baylor University

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**Professional Skepticism**

- Questioning mind
  - Attitude of an individual relating to curiosity and interest
  - Continually asking questions further clarification and definition
  - Request reasons, justification or proof

Source: Kathy Hurr, Baylor University

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**Professional Skepticism**

- Suspension of judgement
  - Postpone making judgments
  - Be unwilling to simply accept assertions and claims
  - Keep an open mind and critically evaluate evidence

Source: Kathy Hurr, Baylor University

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**Professional Skepticism**

- Search for knowledge
  - Individual's curiosity or desire to investigate
  - Acquire additional information
  - Search out explicit information

Source: Kathy Hurr, Baylor University

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**Professional Skepticism**

- Interpersonal understanding
  - Motivations that drive an individual's behavior
  - Extent to which motivation and integrity of individuals is understood

Source: Kathy Hurr, Baylor University

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**Professional Skepticism**

- Self-determining
  - Ability to decide on adequacy of the information
  - Highly self-determining professionals rely less on clients' suggestions and not easily influenced by the belief or opinion of others
  - Undertake additional investigations and evidence until satisfied

Source: Kathy Hurr, Baylor University

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**Professional Skepticism**

- Self-confidence
  - Feelings of self-worth and belief in one's own abilities
  - Make own audit judgments and conclusions
  - Capable of challenging client's assumptions and decisions
  - Suspicious of evidence presented

Source: Kathy Hurr, Baylor University

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**Professional Skepticism**

- Characteristics can be developed and honed
- Use experience and knowledge
- Ask the right questions
  - Good questioning techniques assist professional skepticism

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**Professional Skepticism**

**Types of questions:**

- Open-ended questions
- Closed questions
- Funnel questions
- Probing questions
- Leading or reflective questions
- Rhetorical questions
- Clarifying questions

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**Professional Skepticism**

- Most effective when we neither a cynic nor a dupe
- Achieve the appropriate balance
  - Ask the right question
  - Follow up on responses
  - Know when to move on

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**Professional Skepticism**

**Practical application**

- Actions to maintain an attitude of professional skepticism
- Awareness of:
  - Threats to maintaining the right mindset
  - Areas of focus
  - Indicators requiring follow up
  - Resolution
  - Documentation

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**Professional Skepticism**

**Threats**

- Expectation pressure
- Deadline pressure
- Self-confidence
- Biases
- Lack of knowledge and expertise
- Inappropriate tone

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**Professional Skepticism**

**Areas of focus in engagements**

- Management bias
- Areas requiring judgment including significant estimates
- Contingencies
- Related parties and related party transactions
- Unusual revenue transactions
- Missing balances
- Accruals and cut-off
- Provisions
- Unreconciled and clearing accounts

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**Professional Skepticism**

**Tips to resolve**

- Be aware of biases and challenge them
- Obtain independent evidence
- Do not ignore conflicting evidence
- Consult
- Discuss with team members
- Chase it down until you are satisfied
- No limit to the number of questions

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**Professional Skepticism**

**Possible indicators of deception**

- Rushed responses
- Vague answers
- Too much detail
- Details do not make sense
- Responses do not agree with others' information
- Pressure to "get it done"
- Atypical attitude or behaviours
- Unusual or unexpected adjustments

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**Professional Skepticism**

**Document**

- Thought process, alternative views considered and changes in approach, not only final conclusion
- How management views were challenged
- Basis for unusual and one-time transactions
- Discussions with management
- Source of evidence and why reliable

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## Responsibilities Related to Fraud including Required Procedures

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## Fraud

Responsibilities Related to Fraud

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## Types of Fraud

- Fraud schemes fall into the following categories:
  - Financial statement fraud
  - Asset misappropriation
  - Bribery and corruption

**Practitioner's responsibilities**

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**Fraud Definition**

The intentional act by one or individual among management, TCWG, employees or third parties involving the use of deception to obtain an unjust or illegal advantage (CAS 240.12)

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**Fraud Definition**

- **Fraud:** Acts that are performed by a cunning person and intended to mislead people about the truth and/or harm the intended person or organization. If caught, the perpetrator could end up in jail.
- **Error:** Acts that are made unknowingly (mistakes) by someone who might lack knowledge or not have appropriate oversight. If caught, actions can be taken to help prevent it from happening again.

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**Responsibilities Related to Fraud**

- CAS 240.3:
  - 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
    - Misstatements resulting from misappropriation of assets
  - The auditor does not make legal determinations of whether fraud has actually occurred

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**Responsibilities Related to Fraud**

- CAS 240.4:
  - The primary responsibility for the prevention and detection of fraud rests with management and TCWG
  - Important to place a strong emphasis on fraud prevention through:
    - Creating a culture of honesty and ethical behaviour
    - Active oversight by TCWG

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**Responsibilities Related to Fraud**

- CAS 240.5:
  - An auditor is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error
- CSRE 2400.12
  - Practitioner’s responsibility is to obtain limited assurance, primarily by performing inquiry and analytical procedures, about whether the financial statements as a whole are free from material misstatement

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**Fraud**  
Required Procedures

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**Required Procedures**

- Require procedures:
  - Maintain an attitude of professional skepticism
  - Discussions with management and TCWG
  - Assignment and supervision of personnel
  - Understanding business rationale for significant transactions
  - Further procedures identified risks

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**Required Procedures**

- Discussions with management and TCWG
  - Understand where the risk of fraud exists in engagements
  - Understand the board's role in oversight and mitigation
  - Specifically inquire:
    - Aware of any known, suspected or alleged fraud?
  - Document date of discussions and who with

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**Required Procedures**

- Assignment and supervision of personnel
  - Consider assignment of staff
  - Where higher risk or complex either:
    - Assign more experienced staff
    - Ensure closer review and supervision

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**Required Procedures**

- Understanding business rationale for significant transactions
  - Transactions outside the normal course of business
  - When encounter during engagement understand basis
  - Consider related party transactions

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**Required Procedures**

- Further procedures identified risks
  - Where risk of material misstatement is significant, perform further procedures as required
    - Audit: perform substantive procedures
    - Review: inquiry, analytical procedures or “audit-type” procedures
  - Obtain sufficient appropriate evidence

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**Required Procedures**

- Additional procedures for audit engagements:
  - Unpredictability procedures
  - Journal entry testing
  - Procedures related to accounting estimates

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### Required Procedures

- Unpredictability procedures
  - Vary nature, timing and extent
    - Nature: type of procedure
    - Timing: when it is performed
    - Extent: amount of audit evidence obtained

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### Required Procedures

- Journal entry testing
  - Required to address the risk of management override of controls
  - ASK KSA PD Course on practical approach

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### Required Procedures

```
graph TD; S1[Step 1: Understand and make inquiries] --- S2[Step 2: Select journal entries for testing]; S2 --- S3[Step 3: Test the selected journal entries]; S1 --- D[Document]; S2 --- D; S3 --- D;
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# Response to Identified Risk

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## Response to Identified Fraud

- Be aware of fraud through:
  - Inquiries of management and TCWG
  - Management/TCWG may bring it to your attention
  - Results of procedures

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## Response to Identified Fraud

- If/when become aware of fraud:
  - Discuss with management and/or TCWG
  - Consider involvement of experts
  - Design additional procedures
  - Conclude on results of procedures
  - Determine impact on report

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**Response to Identified Fraud**

- Discuss with management and/or TCWG
  - If involves employees, discuss with management
  - If involves management, discuss with TCWG
  - Consider other reporting responsibilities such as to external bodies
    - Regulatory agencies
    - Law enforcement
    - Other?

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**Response to Identified Fraud**

- Consider involvement of experts
  - If complex may require involvement of experts
  - Guidance on additional procedures
  - Legal advice

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**Response to Identified Fraud**

- Design additional procedures
  - Understand where/why alleged fraud occurred
  - Lower threshold
  - Perform additional procedures such as:
    - Testing on accounts not otherwise tested
    - Lowering thresholds
    - Inspecting documents
    - Expanding timing
    - Inquiries with others in other areas of the entity

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**Response to Identified Fraud**

- Design additional audit procedures
  - Conclude on whether financial statements are materially misstated
    - NOT concluding on whether fraud occurred
  - No separate report on procedures
    - Internal control recommendations

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**Response to Identified Fraud**

- Conclude on results
  - What were results of further procedures
  - Reliability of evidence obtained
  - Further unknown factors or able to determine impact
    - Adjustments in financial statements recorded

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**Response to Identified Fraud**

- Determine impact on the report
  - Are statements materially correct?
    - No qualification
  - Remaining unknown impacts?
    - Scope limitation

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**Impact on Audit Report**

- Exceptional circumstances related to ability to continue engagement
  - Entity does not take appropriate action
  - Significant concerns about the integrity of management or TCWG
- If continuing the audit is brought into question, the auditor shall:
  - a) Determine the professional and legal responsibilities
  - b) Consider whether appropriate to withdraw
  - c) Perform specific steps if do withdraw

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**Bringing It All Together**

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**Bringing it All Together**

- Fraud occurs
- Responsibility to address the risk of fraud
  - Client specific
- Two areas:
  - Financial statement misreporting
  - Asset misappropriation

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**Bringing it All Together**

- Maintain professional skepticism
  - Questioning mindset
  - Question until satisfied
- Perform required procedures
- When fraud encountered, determine:
  - Additional procedures
  - Impact on report

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