

## Fraud main recommendations from Accountancy Europe: ECIIA's reaction

Accountancy Europe	ECIIA
<p><b>Require companies to have and publicly report on a fraud risk management system EU</b> (and national) legislation should ensure that companies' risk management and compliance management systems include anti-fraud mechanisms. These mechanisms should set out specific procedures, and clear responsibilities for boards, audit committees, and management. As part of these systems and based on a well-defined framework, companies' management should be required to operate a fraud risk management program, covering fraud risk assessment, internal controls and responses to allegations and incidents of fraud. Legislation should require board and management to publicly disclose a statement about the effectiveness of this program and relevant controls. This disclosure could be made as part of a broader statement included in company's management report, along with statements on the internal controls over financial reporting.</p>	<p>Companies should have a suitable fraud prevention and response plan in place allowing effective limitation and swift response to the identification of fraud and management of the situations. <i>A sound system of internal controls, with the right balance of preventive, deterrent, and detective controls, can significantly reduce an organization's vulnerability to fraud.</i></p> <p>Internal Audit will include the fraud risk management program in its audit plan, with sufficient coverage to provide the board and management with reasonable assurance on the design and operating effectiveness. This will enable the board to publicly disclose on it.</p>
<p><b>Pay specific attention to senior management fraud</b></p> <p>If senior management members are involved in fraud, this means they are breaching the company's code of conduct and overriding internal controls. Consequently, the board's and the audit committee's role becomes more critical in adequately addressing such fraud risk.</p> <p>The board should therefore strengthen the functioning of audit committees and ensure their independence from management. Board and audit committees should include fraud risks relevant to the company as a recurring item on their agenda. Discussions around (potential) fraud by senior management can often be misinterpreted as mistrust. <sup>8</sup> Having a trustful relationship, however, should not stop board and audit committee members from asking controversial questions to management or making appropriate enquiries in the organisation. Audit committees should review and approve the company's annual internal audit plan to ascertain that it is aligned with audit committee's expectations and addresses management fraud risk appropriately. Audit committee's collaboration with external auditors is also vital for addressing management fraud risk. Auditors would benefit from audit committees' commitment and cooperation, based on openness and honesty. Audit committees should also ensure that external auditors have sufficient resources to perform their engagements in a highly qualitative way.</p>	<p>ECIIA agrees with the importance of strong oversight of the board and audit committee, as well as with the direct involvement and support for the board and audit committee in addressing senior management fraud risk. Asking the right questions, and enabling both the internal and external auditor to spend sufficient time to assess this risk, and perform the audit work required. The audit committee should therefore review and discuss the audit plans, discuss audit findings with the auditors and with senior management, and should focus on progress of timely remediation of findings.</p>



**Mandate an audit committee in all public interest entities**

According to the EU audit legislation<sup>9</sup>, member states may allow a PIE not to have an audit committee in case it has a body that performs equivalent functions. Given the critical role of audit committees in mitigating fraud risk, it should be mandatory for all PIEs to have:

- a separate audit committee independent from management
- a sufficient number of members in the audit committee with competence in accounting and/or auditing as well as risk management
- an independent internal audit function supervised by the audit committee

Legislators should abolish provisions that allow member states to derogate from the requirements above. In addition, audit committee's effectiveness should be supported by well-established whistleblowing structures<sup>10</sup>

Internal auditors preferably report to Audit Committees as part of the board. We fully support the setup of audit committees as independent committee, with specific competences (risk management, audit,..).

**Make early warning mechanisms for auditors effective**

In accordance with the EU Audit Regulation<sup>11</sup>, auditors should inform the audited company and invite its management to investigate and take appropriate measures when they suspect that irregularities, including fraud regarding the financial statements may have occurred. If management does not investigate the matter, the auditor has to inform the authorities responsible for investigating such irregularities. National legislation should specify the competent authority and the related procedures for PIE auditors to report instances of irregularities, including fraudulent acts, suspected during the audit. In many EU countries, it is unclear how the auditors should report and to which authority for some types of PIEs. This leads to an ineffective and inconsistent implementation of the Regulation. There should be a designated competent authority for every type of PIE and clear guidance for auditors about how to comply with their legal obligations

The internal audit standards (IPPF Standard 1220) recommend to internal auditors to exercise due professional care by considering the extent of work needed to achieve the engagements' objectives and the related complexity, materiality or significance. They should decide if they are best placed to undertake the investigation or to engage qualified resources (fraud examiners) inside or outside the organization.

If senior management decides not to investigate a suspicion of fraud, the internal auditor will discuss this with the audit committee or relevant board member.

**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. These include:

- auditor's responsibility and the inherent limitations, especially related to fraud
- application of professional scepticism
- the relationship between fraud and intentionally committed non-compliance with laws and regulation
- qualitative materiality with regards to misstatements due to fraud
- two-way communication with audit committees on fraud risk

Auditing standards should also require specific procedures addressing the risk of senior management fraud. These could include:

- having a purposeful and timely discussion with board

Internal audit standards define clearly the role of internal auditors including detecting, preventing and monitoring fraud risks and addressing those risks in audits and investigations. They must consider where fraud risk is present within the business and respond appropriately by auditing the controls of that area, evaluating the potential for the occurrence of fraud and how the organization manages fraud risk through risk assessment and audit planning. It is not internal audit's direct responsibility to prevent fraud from happening within the business. It is the responsibility of the first line. (Standards IPPF 2120A2)

Having said that, we feel that it will be beneficial to clarify the roles of the internal and external auditors, and indeed also clarify the inherent limitation of any audit work, to avoid the assumption that it is easy – and only a matter of attention - to detect and prevent fraud.



and audit committee on this specific risk • communicating specific procedures performed to address the risk of senior management fraud (see recommendation below

**Improve auditors' access to knowledge and awareness about fraud** Establishing and maintaining a platform to share (anonymised) case studies and experiences on discovered fraud could help auditors understand the main indicators of fraud schemes. Such a platform should provide a secured and controlled access to audit firms and other relevant parties. An alliance among firms, with support from professional organisations as well as relevant subject matter experts and audit oversight bodies, could be the best mechanism for operationalising this initiative. 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. Audit teams could use this information when developing certain fraud risk scenarios during their risk assessment process and when designing specific audit procedures accordingly.

Auditors to clearly communicate their work and conclusions about fraud Auditors of PIEs should report their work on fraud and present related findings to board and audit committees even when they have not identified any issue to report as a key audit matter or to modify their opinion. This could include: • a description of the specific audit procedures performed to address common fraud schemes observed in the industry or region where the company operates • an overview of any further audit procedures, including forensic elements, auditors decided to incorporate into the audit procedures, including the ones addressing risk of management fraud Auditors should also describe specific procedures performed rather than having boilerplate explanations when communicating with board and audit committees. For instance, if a forensic expert is involved for the first time, the reasons behind this could be explained to the audit committee in a more detailed manner. In addition, auditors could be required to report publicly their conclusion on the management's statement on fraud risk management (against an acceptable framework as described in the recommendation (1) above). This could be done as part of the financial statements audit or in a separate assurance engagement. In practice, such an engagement might necessitate auditors to consider the internal controls over financial reporting as a whole

The internal auditors possess intimate control and risk management knowledge of the organization. They provide necessary assurance services over internal controls designed to detect and prevent fraud. They collaborate with experts in a combined assurance approach to understand the gaps in controls that allow for the manifestation of fraud.

The 3 lines model is recommended as a strong governance model that define clearly the responsibilities and the collaboration internally and externally.

The idea to have a platform for sharing of and learning from cases and experiences, is good. It however builds on the assumption that companies are willing and allowed to share.

Auditing culture and behavior over the last years has become more and more an integrated part of the internal auditor's audit plan. Results of these auditors also can be strong indicators for intentional and unintentional wrong behavior, with potential fraud risk connected.

