The New Fraud Standard

SAS No. 99

Consideration of Fraud in a Financial Statement Audit

Overview

- Why was SAS 99 issued?
- Major provisions of SAS 99.
- Responsibilities with respect to fraud.
- New required procedures.
- Required inquiries of management and others.
- New management representations.
- Antifraud programs and controls.
- Concluding remarks.

Why Was SAS 99 Issued?

- Research indicates fraud is a serious problem.
- Recent events have placed greater importance on detecting fraud.
  - Increased scrutiny of financial information because of highly publicized frauds.
  - Concern over audit quality.
- The accounting profession has been working on guidance to enhance auditor performance since 2000.
  - SAS 99 represents the culmination of years of work devoted to improving the likelihood that auditors will detect material misstatements due to fraud.

Major Provisions of SAS 99

- Responsibilities for fraud unchanged.
- Emphasis on professional skepticism.
- Focus on identifying and responding to fraud risks.
- Additional procedures now required.
- Effective for audits of financial statements for periods beginning on or after December 15, 2002.

Responsibilities with Respect to Fraud

- SAS 99 does not change the auditor’s responsibility for fraud detection.
  - Auditors have a responsibility to plan and perform the audit to obtain *reasonable assurance* about whether the financial statements are free of material misstatement, whether caused by error or fraud.
- SAS 99 does not change the company’s responsibility with respect to fraud.
  - Management continues to be responsible for designing and implementing company programs and controls to prevent, deter, and detect fraud.

New Required Procedures

- Increased procedures in early stage of the audit to identify fraud risks, including:
  - Making inquires of management and others regarding fraud.
  - Gathering additional information to identify fraud risks.
  - Analytical review of revenue.
- Other procedures to respond to identified fraud risks.
- Procedures to address management's ability to override internal controls.

Required Inquiries of Management and Others

- Management.
  - Owner.
  - President or CEO.
  - Chief financial officer.
  - Controller.
- Audit committee.
  - Or audit committee chair.
- Internal audit.
- Other company employees.

Inquiries of Management

- Required to ask about—
  - Whether you know of any fraud or have suspicions of fraud affecting the company.
  - Whether you are aware of any allegations of fraud or suspected fraud affecting the company.
  - Your understanding of the risks of fraud within the company.
  - How you communicate to employees the importance of ethical behavior and appropriate business practices.
  - Programs and controls that have been implemented to address identified fraud risks or otherwise help prevent, deter, and detect fraud and how those programs and controls are monitored.
  - The susceptibility of operating locations to fraud and how those locations are monitored.
  - Whether you have reported to the audit committee about how the company's internal control serves to prevent, deter, and detect material misstatements due to fraud.

Inquiries of Audit Committee and Internal Auditors

- Required to ask audit committee about—
  - Their views about the the risks of fraud within the company and whether they have knowledge of any actual or suspected fraud.
  - Their role in overseeing the company's fraud risk assessment and monitoring process.
- Required to ask internal auditors about—
  - Their views about the risks of fraud within the company and whether they have knowledge of any actual or suspected fraud.
  - Whether they performed procedures during the year to identify or detect fraud.
  - Whether you have satisfactorily responded to any findings resulting from their procedures.

Inquiries of Others

- We must inquire of others in the company about the existence or suspicion of fraud.
  - Based on our judgment.
- We may determine the need to talk to one or more employees—
  - With varying levels of authority in the company.
  - Outside the accounting department.
  - Operating personnel.
  - Who initiate, record, or process complex or unusual transactions.
  - In areas we identify as being vulnerable to fraud.
  - In-house legal counsel.

New Management Representations

- "We acknowledge our responsibility for the design and implementation of programs and controls to prevent and detect fraud."
- "We have no knowledge of fraud or suspected fraud affecting the company involving management, employees who have significant roles in internal control, or others where the fraud could have a material effect on the financial statements."
- "We have no knowledge of any allegations of fraud or suspected fraud affecting the company received in communications from employees, former employees, regulators, or others."

Antifraud Programs and Controls

- Antifraud programs and controls are policies and procedures put in place to help ensure that management directives are carried out.
- Three fundamental activities:
  - Creating an ethical company culture.
  - Implementing antifraud processes and controls.
  - Developing an effective oversight process.

Creating an Ethical Company Culture

- Setting the tone at the top.
- Establishing a code of conduct.
- Creating a positive workplace environment.
- Hiring and promoting ethical employees.
- Providing ethics training.
- Disciplining and prosecuting violators.

Implementing Antifraud Controls

- Identify and assess fraud risks.
- Implement controls to mitigate fraud risks.
  - General controls.
  - Specific internal controls.

Developing an Effective Oversight Process

- Management.
- Audit committee.
- Internal auditors.
- External auditors.

Concluding Comments

- The value of audit services has never been greater.
- In this time of unprecedented scrutiny and uncertainty, our firm’s core values are unchanged.
- We remain committed to providing the highest quality audit services available.

Questions?