Good morning,

I'd like to share my views on auditors' responsibility for fraud. Please find below my responses to some of the fraud related questions included in your call for views:

Q36: Do you believe that users' expectations of auditors' role in fraud detection are consistent with the requirements in UK law and auditing standards?

Yes, to some extent. I think the problem is not in users' expectations of auditors' role in fraud detection, but in the quality of fraud risk assessment conducted by auditors. Auditors are responsible for detecting material misstatements whether due to error or fraud and they are also required to assess fraud risks arising from asset misappropriation and financial reporting fraud. However, Research and recent fraud scandals indicate that auditors are not fulfilling their responsibilities for fraud detection and that auditors fail to identify warning signs for material fraud. Conducting effective fraud risk assessment could have alerted many companies such as Tesco and Patisserie Valeri in the UK of material management fraud but unfortunately the auditors remained silent in these cases. This makes the users of financial statements and the public wonder if auditors even conducted any fraud risk assessment at all. Auditors are supposed to consider management's integrity and three fraud factors/indicators – motives for fraud, opportunity for fraud, and rationalisation of fraud – in the fraud risk assessment process. However, there are doubts that auditors of the above companies considered any of these factors in their audits. I think there should be more emphasis in the audit standards (ISA 240) on the importance of conducting effective fraud risk assessments and its impact on audit quality. Auditors still need a lot of guidance on fraud risk assessment and material fraud detection. The responsibility for providing this guidance should not be left for audit firms, but should be a shared responsibility among standard setters, audit firms, audit regulators, and professional bodies.

Q37: Do existing auditing standards help to engender an appropriate fraud detection mindset on the part of auditors?

No, the current audit standard (ISA 240) has a lot of limitations that could hinder auditors' ability to detect material fraud and engender an appropriate fraud detection mindset on the part of auditors. Some of these limitations are:

1. The statement "auditors are responsible for detecting material misstatement whether due to errors or fraud" discourages auditors from exerting enough effort to detect fraud. In a recent research study I am working on, auditors mentioned that sometimes when the audit team assess material fraud risk as high, either the client or the audit partners force them to change materiality level! Auditors should be advised to assess fraud risk and report the findings to shareholders and the audit committee regardless of materiality.
2. The standard requires auditors to assess fraud risk while considering the following fraud factors - motives, opportunity, and rationalisation. However, the standard provides no guidance on how auditors could incorporate these fraud risk factors into the fraud risk assessment process. While most auditors know how to assess the risk of opportunity for fraud, I don't think they know how to incorporate management motives, integrity, and rationale. Assuming that audit firms are responsible for providing this guidance is very risky and will lead to more inconsistency among audit firms. Auditors are legally bound by their compliance with the standards and therefore the standard needs to be revisited to include more guidance on fraud risk assessment and response

3. Some fraud factors that research confirms to be significant in fraud risk assessment are excluded from the standard such as fraud perpetrators' capabilities. Not everyone is capable of exploiting existing opportunities for fraud and therefore auditors need to think of the traits that enhance fraud perpetrators' capabilities while assessing the risk of opportunity for fraud
4. Research indicates as well as the latest reports from the FRC that auditors are not challenging management enough. Auditors are facing conflict of interests situations because they are still paid by the client and could be fired by the client! Auditors' independence need to be protected otherwise they will never challenge management or report fraud. A stronger message in the standard encouraging auditors to focus on fraud risk assessment as it has significant impact on audit quality could also help.

Q38. Would it be possible to devise a "reasonable person" test in assessing the auditor's work in relation to fraud detection?

Yes, but this needs to be done by someone or an independent body that have good knowledge about the nature of fraud and its detection.

Q39. Should auditors be required to evaluate and report on an audited entity's systems to prevent and detect fraud?

Yes, that would be great and will definitely act as a better fraud deterrent. Some companies don't care about anti-fraud controls either because of the cost or because they know auditors will not report about the effectiveness of their system in preventing and detecting fraud. We need a more proactive audit approach and this idea could help.

Thanks,

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