

Fraud's changing dynamic

Is SAS 82 the protection against fraud that auditors have been waiting for, an added burden of responsibility, or both?

by Coleen Bondy

“**F**raud” used to be an unspeakable word in the accounting profession, but that’s clearly no longer the case with the introduction of the Statement on Auditing Standards 82, “Consideration of Fraud in a Financial Statement Audit.” The new standard developed by the American Institute of Certified Public Accountants’ Auditing Standards Board tackles the issue of fraud head-on, in plain English.

“The CPA profession didn’t want to use the ‘f’ word — the fraud word,” says Andy Mintzer, chair of the Society’s Accounting Principles and Auditing Standards Committee. Prior to SAS 82, fraud was referred to by the euphemism “irregularity,” a term the public looked upon with skepticism and even ridicule. “(SAS 82) puts the word fraud in the forefront of auditing,” Mintzer says.

ASSET OR LIABILITY?

"Fraud wasn't a word that actually existed, because we were afraid to say it," says Ric Rosario, vice president of loss prevention for CAMICO. With the new standard, however, Rosario believes auditors will have much less to fear as far as lawsuits are concerned. SAS 82 provides an extensive list of "red flags" for CPAs to look for when conducting audits that may indicate fraud (see "Fraud Finder" below). Auditors were already being held accountable in court for failing to detect fraud in financial statements, Rosario asserts. Now they have better tools to detect fraud, and if they use them, they will likely have a stronger defense if they are sued. "The fact is, the liability was already there. The public was holding us responsible for detecting fraud, but we weren't really sure how to satisfy that," he says. "If the CPA has earnestly followed the standard, it should reduce the liability."

But Ron Durkin, a CPA, former FBI agent and a Certified Fraud Examiner, believes the new standard will "turn

the auditing profession on its ear." Fraud detection is a specialty that most CPAs are not trained for, and now they will be expected to be more diligent in attempting to detect fraud under SAS 82, he asserts. "That was never part of the curriculum when (CPAs) went to college or took the exams. It's just a minefield that CPAs are walking through when they do an audit," Durkin says. "You'll find that the reason accountants have problems is that they see the evidence of some irregularity or fraudulent transactions, and they either don't recognize it, ignore it, or accept some explanation which, if carefully considered, has little or no credibility."

According to the AICPA, SAS 82 is expected to "significantly increase the auditor's awareness of factors indicative of potential fraud impacting financial statements. It provides auditors with expanded 'how-to' guidance on consideration of fraud in a financial audit. In so doing, it strengthens the auditor's ability to fulfill his or her responsibility to plan and perform the

audit to obtain reasonable assurance about whether financial statements are free of material misstatement, whether caused by error or fraud."

Unfortunately, only time and the test of numerous lawsuits will tell whether CPAs' liability will increase or decrease with the advent of the new standard for detecting fraud in financial statements. "Since SAS 82 is new we don't really know ultimately if the CPA follows SAS 82, and performs the procedure in earnest, if that will satisfy the court's point of view, or if there is an even higher expectation," Rosario says, adding, "Our view is that it will be sufficient." And it also remains to be seen if auditors will follow the time-consuming new steps in a climate of tight competition for clients. If clients are not willing to pay more for the extra steps, CPAs may end up cutting corners so they don't lose money on an audit, Rosario says. "This is adding to the workload of an audit, and someone's got to pay for it."

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Fraud Finder

Before you can really find you have to know what to look for.



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NO PANACEA

Even if CPAs do follow the standards outlined in SAS 82, the parties interviewed for this article agreed that auditors cannot protect themselves with standards alone. "SAS 82, we think, is going to be very helpful for the accounting profession, but it's not the answer in and of itself," Rosario says. "One cannot hide behind the standards. That kind of attitude is a dangerous approach. In every single fraud case, it's more than just the standards that are involved." CPAs still have to employ "professional skepticism," and pay attention to red flags even if they are not contained on SAS 82's lengthy list. CPAs should also seek additional training in the area of fraud detection, Rosario says. The AICPA, the Education Foundation and the Association of Certified Fraud Examiners all offer some type of fraud detection conferences, seminars or video instruction.

DETECTING FRAUD

Durkin, who specializes in fraud investigations, says the percentage of financial statements containing fraudulent information is probably very small. "But how do you know? It's like Russian roulette." Taking time up front

to research a potential client may save CPAs time, money and a lot of grief in the long-run, he says. Basic investigative skills can be employed even before an audit begins. "Know your client, know the industry, know the general operating characteristics of the company," Durkin offers as general advice to CPAs. "You want to understand as much about a potential client as you can before you go forward. You could be tainted (by a relationship with a fraudulent client), so you have to be real careful about who you accept as a client."

Performing a background investigation on a potential client is a good starting point, Durkin says. Check public records to find out if the company has been involved in any litigation, or if it has filed for bankruptcy. Do research on the principals in the company, and on any other companies that do a lot of business with a potential client. If an investigation reveals litigation, make appropriate inquiries to the client to find out what's going on, Durkin says.

Once a CPA takes on a new client, he or she should still be wary of possible fraud. "If you keep your ears open, you might hear things that don't make sense with the financial statement." Keep your eyes open, too, Durkin adds. "When I drive in the parking lot of a

client, I look to see if the cars they drive are consistent with the salaries they are making." Also, find out what motivates clients and make a habit of studying their behavior for anything unusual.

Basic analysis of a company's finances is also key to detecting fraud, Durkin says. Check to see if the company's performance is consistent with prior years, with other industries, and with economic and environmental constraints and situations, he advises. Perform horizontal, vertical and financial ratio analyses on the company's financial statements. Tracing assets is also important. "Everybody likes to focus on cash," Durkin says, "but real and personal property transactions should also be considered." Assets should also be compared to make sure they are being sold for their true value. Check on inventory stored in remote locations.

Probably the most important thing to remember is that fraud is not easy to detect. "The essence of fraud is concealment," Durkin says. Most fraud is detected by accident, or by anonymous tips, not through financial audits, according to industry statistics. "Unless you are told about it, or stumble on it, it won't jump out at you," he adds.

Coleen Bondy is a Society staff editor.

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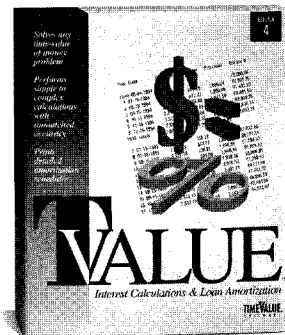
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