

## DETECTING FRAUD

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Auditors in the accounting profession have long been responsible for determining if financial statements are free of misstatement, whether caused by error or through fraud. Despite this role, corporate America, and the accounting world in particular, were shaken up by the reports of fraud at large companies such as Enron, World Com, Tyco and Health South. In response to the issues that were raised in these and other cases, both the U.S. government and the accounting profession took action.

The accounting profession took it upon itself to develop new standards aimed at restoring investor confidence and re-establishing audited financial statements as a reliable source for financial information. The Auditing Standards Board of the American Institute of Certified Public Accountants (AICPA) approved the *Statement on Auditing Standards (SAS) 99: Consideration of Fraud in a Financial Statement Audit*. This new standard gives auditors expanded guidance for detecting fraud. As a result of *SAS 99*, auditors will be asking different questions this year and talking to more members of their clients' management as well as to additional employees. *SAS 99* is effective for audits of financial statements for periods beginning on or after December 15, 2002.

The following are some of the new required procedures you'll notice:

- Specific fraud discussions will take place with management, audit committees, Internal Auditors, and other employees. By creating an environment where employees are encouraged to report irregularities, it is hoped they will be more apt to step forward and "blow the whistle" if necessary.
- Special attention will be directed at gaining additional understanding of the revenue process and the risks associated with accounts.
- Engagement teams will conduct required testing of Journal entries.
- Specific testing will be conducted for identified fraud and misappropriation of assets' risks.
- Engagement teams will test for management override controls.
- Meetings will be conducted by engagement teams to assess the risk of fraud at companies.
- Reports of all fraud will be provided to management.

Historically, there has been an "expectations gap" between what audit clients perceive accountants do to anticipate fraud risks and the activities they actually perform. While accountants are not responsible to find all fraud, these additional procedures will enable the profession to better assess the fraud risk and design improved audit procedures. The new standard will help to bridge the expectations gap.

Instituting the standard is not optional within the accounting profession; all accountants must adhere to its mandates. There is little doubt that the additional time spent by accountants is critical to protect against the kind of criminal fraud that made recent headlines. But it also creates a side effect that many clients are not yet aware of. Normal audit fees will increase up to 10-20 percent of a business' current audit fee. If you haven't had a chance yet to discuss this impending change with your accountant, now is the time to make contact in order to budget accordingly.

What has the government done about the scandals? Congress responded by passing the Sarbanes-Oxley Act in 2002. This act took the standard setting process for public companies away from the AICPA and created a new government board called the Public Companies Accounting Oversight Board (PCAOB). The PCAOB has the responsibility for standards, enforcement and review of accounting firms. We firmly believe that these standards will cascade into the audit standards of non-public entities. Therefore, you will probably see additional audit standard changes in the future, based on the changes in the audit standards of public companies.

We remain committed to providing you with information you can trust and upon which you can make sound business decisions. Our adoption of all of the mandates of *SAS 99* and the PCAOB will only strengthen the quality of work that we provide to our clients. If you would like to discuss how these regulations will affect your company, please contact me at [jpoti@wittmares.com](mailto:jpoti@wittmares.com).

