

## Consideration of fraud risk – discussion paper

### Introduction

- 1 This paper is designed to:
  - Provide the Policy and Finance Committee with an outline of our responsibilities and procedures in relation to fraud; and
  - Promote discussion to obtain the Committee's perspective in relation to the risks of fraud.
- 2 The primary responsibility for prevention and detection of fraud rests with both those charged with governance of the Authority (the Policy and Finance Committee) and with management.
- 3 International Standard on Auditing 240: *The auditor's responsibility to consider fraud in an audit of financial statements* requires us, as auditors, to consider the risks of material misstatements in the financial statements due to fraud. It describes two types of fraud as being relevant to the auditor:
  - Misstatements resulting from misappropriation of assets; and
  - Misstatements resulting from fraudulent financial reporting.
- 4 Misappropriation of assets involves the theft of an entity's assets and is often perpetrated in relatively small and immaterial amounts. It can be accomplished in a variety of ways including:
  - Embezzling receipts;
  - Stealing physical assets or intellectual property;
  - Causing an entity to pay for goods and services not received; and
  - Using an entity's assets for personal use.
- 5 Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as:
  - Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives;
  - Inappropriately adjusting assumptions and changing judgments used to estimate account balances;
  - Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period;
  - Concealing, or not disclosing, facts that could affect the amounts recorded in the financial statements;
  - Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity; and

- Altering records and terms related to significant and unusual transactions.

**Authority's processes for identifying and responding to the risk of fraud**

6 Our understanding of the processes that the Authority has for identifying and responding to the risk of fraud are as follows:

Process	Comment
The Authority has adopted a <b>code of conduct</b> .	The Use of Resources Evaluation requires consideration of these two areas.
The Authority has adopted an <b>anti-fraud and corruption policy</b> which is available to staff.	
Under the National Fraud Initiative ( <b>NFI</b> ), public sector providers supply sets of data from their information systems in areas such as benefit, pay and pensions. NFI then cross matches this data to identify potential inaccuracies and fraud and sends matches back on a CD-ROM for authorities to investigate.	We are unsure of the Authority's current progress in reviewing NFI data matches.
Work is undertaken by <b>internal audit</b> in relation to investigations of potential fraudulent transactions.	
<b>Finance and Policy Committee review</b> of the statutory financial statements.	

- Does this accord with the Policy and Finance Committee's understanding and are there other processes that we should consider or other measures that the Authority should implement?
- What kind of role should the Policy and Finance Committee have in overseeing the Authority's assessment of the risks of fraud and the related programmes and controls established to mitigate these risks?
- Do you as a Committee feel that you have a sufficient understanding of the Authority's fraud risks and the procedures in place to mitigate them?
- Do you receive enough information in relation to these risks throughout the year?
- Are you satisfied with the planned and actual scope of work undertaken by internal audit in relation to fraud?
- Do you ask sufficient questions about judgemental areas and estimates in the annual accounts?
- Should there be a separate discussion in the absence of senior management?

**Audit procedures**

- 7 Our audit procedures specifically related to fraud (although any work on internal financial control and on the statutory financial statements has some relevance) are as follows:
- Enquiry of management as to assessment of the risk that the financial statements may be materially misstated due to fraud;
  - Consideration of the arrangements that the Authority has to promote and ensure probity and propriety in the conduct of its business, including its anti-fraud and corruption policy as part of the Fire Use of Resources Evaluation;
  - Review of internal audit work and enquiry into their knowledge of fraud or suspected fraud;
  - Incorporation of an element of unpredictability into our audit procedures;
  - Testing of the appropriateness and authorisation of journal entries recorded and other adjustments made in the preparation of financial statements;
  - Reviewing accounting estimates for biases that could result in material misstatement due to fraud; and
  - Obtaining an understanding of the rationale for significant unusual transactions

Are there any other areas of significant risk in relation to fraud that you believe we should consider as part of our audit?

**Knowledge of fraud**

- 8 Under the Proceeds of Crime Act and the Money Laundering Regulations we have certain requirements in certain circumstances to report knowledge or suspicion of criminal offences or money laundering to the National Criminal Intelligence Service.
- 9 We are also required under ISA 240 to make inquiries of those charged with governance to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the Authority.

Do you have knowledge of any actual, suspected or alleged fraud affecting the Authority not already reported at a Policy and Finance Committee meeting?