Assessing the relevance of external auditors and forensic accountants when performing fraud risk assessments

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ABSTRACT

The International Standards on Auditing 240 requires auditors to identify and assess the risk of material misstatements due to fraud. Significant focus is placed on fraud and fraud risk assessment (FRA), and the public constantly relies on auditors to identify fraud and protect companies against the act. FRA assists in protecting a company against fraud as it is used by auditors to assess whether the controls implemented by the client are effective in identifying, preventing and detecting fraud.

Even though FRA performed by auditors is essential for companies, several authors have determined that auditors find it challenging to identify fraud within a company due to the lack of experience and sufficient knowledge. Extensive knowledge of fraud together with a specific set of skills is imperative to effectively identify the possibility of fraud. The question can be therefore be asked as to whom have the necessary skills, knowledge and experience to perform an effective FRA: the auditor or the forensic accountant?

The main objective of this study was to determine the skills needed by an auditor to perform FRAs in terms of ISA 240. For the purpose of determining who is better suited for such a task, between the auditor and forensic accountant, an understanding of the following aspects needed to be acquired:

- The concept “fraud” through analysing different fraud models and fraud risk indicators.
- FRA by means of discussing the objective and procedures to enhance the effectiveness thereof.
- The attributes needed to identify fraud and perform an effective FRA

In summary, it seems that auditor’s knowledge and understanding of fraud is limited due to the inadequacies of ISA 240. In addition the majority of auditors have insufficient experience as they have never encountered fraud in their career. Forensic accountants are proven to be equipped with the necessary attributes, experience and knowledge required to identify fraud and perform an effective FRA. This study contributed to the auditing and forensic accounting practices by developing a new fraud model to be used in identifying and detecting fraud and indicating how the effectiveness of FRA could be enhanced when making use of forensic accountants.

Keywords: Auditor; Forensic accountant; Fraud; Red flags; Risk assessment

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LIST OF ABBREVIATIONS

ACFE	Association of Certified Fraud Examiners
APA	Auditing Profession Act
CA	Chartered Accountant
CA(SA)	Chartered Accountant of South Africa
CFE	Certified Fraud Examiner
CFO	Chief financial officer
CPA	Certified public accountant
CPC	Code of Professional Conduct
CTA	Certificate in Theory of Accounting
EY	Ernst & Young
FICA	The Financial Intelligence Centre Act
FRA	Fraud risk assessment
FRM	Fraud risk management
ICFP	Institute of Commercial Forensic Practitioners
IRBA	Independent Regulatory Board for Auditors
IRS	Internal Revenue Services
ISA	International Standards on Auditing
POCA	Prevention of Organised Crime Act
PRECCA	Prevention and Combatting of Corrupt Activities Act
PwC	PricewaterhouseCoopers Inc.
RI	Reportable Irregularities
RMM	Risk of material misstatement
SAICA	South African Institute of Chartered Accountants

CHAPTER 1

1. PURPOSE, SCOPE AND PROGRESS OF STUDY

1.1 Introduction and background

The first major corporate fraud, namely the South Sea Bubble, was reported in 1720 (Singleton & Singleton, 2010:3). In short, the South Sea Company started trading in 1717 and made a slight profit while owing the government £10 million. In order to cover their expenditures, the company became involved in a fraudulent scheme of £30 million by corrupting its directors and company officials. Charles Snell was hired as part of the investigation team to audit the company's books (Singleton & Singleton, 2010:4). This was the first time chartered accountants (CAs) were used in England and the first time in accounting history that an independent auditor was hired to audit a company's records (Singleton & Singleton, 2010:4).

Fraud is defined as an "intentional perversion of the truth for the purpose of inducing another in reliance upon it to part with some valuable asset belonging to him or to surrender a legal right" (Williams, 1997:46). Kranacher, Riley and Wells (2011:2) concur by viewing fraud as "an intentional deception, whether by omission or co-mission, that causes its victim to suffer an economic loss and/or the perpetrator to realize a gain". Therefore, fraud can be defined as an act by a person with the intention of misrepresenting the truth and concealing a deed in order to persuade another person to part from their possessions and/or cause them potential or definite harm which could, ultimately, lead to legal action.

In order to detect fraud, one requires knowledge of the nature of fraud, the reasons for committing fraud, the method to commit fraud, and the technique to conceal the action (Kassem & Higson, 2012:191). When organisations discover fraud that includes embezzlement, asset misappropriation and manipulation of financial statements, the boards of directors and audit committees are continually surprised that the external auditor had failed to detect the fraud (Allen & Zikmund, 2009).

In the early 1900s, the main purpose of external auditors was detecting financial statement fraud during periodical financial audits while, in the 20th century, their focus shifted from detecting fraud to merely expressing an opinion on the fair presentation of the financial statements (Kranacher *et al.*, 2011:176). According to public perception, the independent auditor's primary function is to detect fraud (Kranacher *et al.,* 2011:176). Taylor (2011:36), however, claims that external auditors have no responsibility to detect

fraud, even though the public believes this to be one of their primary functions. In reality, the auditor's overall objective is to provide reasonable assurance that the financial statements are free from material misstatements due to fraud or error (ISA 200:11).

External auditors are hired to determine whether a company's financial statements are presented fairly in all material aspects. Still, it is unlikely that they would uncover fraud, because they audit financial statements and do not focus on fraud aspects (Hopwood, Leiner & Young, 2008:6). In addition, most auditors complete their audits without exposing fraud within the financial statements (Kranacher *et al.*, 2011:9). According to Giles (2012:29,175), managers and directors rely too much on auditors to protect their companies against fraud and to manage their fraud risk. Shareholders need to be made aware of the fact that auditors are neither capable nor responsible for detecting acts of fraud within an organisation (Allen & Zikmund, 2009). In this regard, Taylor's (2011:33) research indicates that auditors are not capable of apprehending fraudsters and detecting fraud. The International Standards on Auditing (ISA) (240:4) states that management and those charged with governance of an entity are responsible for preventing and detecting fraud within a company.

Since the Enron scandal and other fraud cases, there has been a significant focus on fraud, internal control and fraud risk assessment (FRA) (Singleton, Singleton, Bologna & Lindquist, 2006:191). Auditors use FRAs during their interim and/or final audits in order to identify the strategies which were used to conceal fraud schemes (Vona, 2008:55). The entire assessment process involves the evaluation of the probability of fraud occurring inside the organisation by aiding auditors in identifying the risk that the organisation faces due to fraud (Vona, 2008:9). Du Plessis (2010:8) affirms that FRAs play an important role in identifying the possible fraud risk within a company. In order to perform an FRA, skills are required such as an understanding of the elements of fraud, the ability to identify risks according to these elements, and reporting these risks in an applicable manner.

According to Ojo (2012), forensic accounting is known as the integration of accounting, auditing and investigative skills and their application to investigating fraud and theft. Ramaswamy (2007:33) concurs by stating that forensic accounting uncovers fraud by means of accounting analysis in a manner that can be presented in court. The forensic accountant searches for fraudulent transactions and misrepresentations (Ramaswamy, 2007:31). Forensic accountants have been active for almost 200 years, with the first reference in 1824 (Ramaswamy, 2007:32). According to Ramaswamy (2007:32), the

Internal Revenue Service (IRS) was one of the first institutions to make use of forensic accountants in the capture of Al Capone for tax evasion. Forensic accountants are viewed as "public accountants first who have an understanding of accounting principles and procedures, and secondly who are able to distinguish accounting mistakes from wilful fraud or other illegal activities" (Wiley, 2013).

From the corporate scandals of fraudulent financial statements that were uncovered in the early 2000s, it is clear what the forensic accountant's contribution is with regard to uncovering financial irregularities and tracing illegal financial activities (Wiley, 2013). It seems as if forensic accountants might be more suited to perform these FRAs, firstly, because they are experts at detecting and documenting fraud, based on their "attitudes, characteristic, skills, knowledge and experience" (Singleton *et al.,* 2006:4) and, secondly, because they take a "sceptical and pro-active" approach in order to expose fraud, while auditors only verify statements (Ojo, 2012).

ISA (315:25) requires auditors to identify and assess the risk of material misstatements (RMM) due to fraud or error at financial statement level and assertion level. Although ISA 315 requires an auditor to perform these assessments, the question arises as to whether an auditor is suitably equipped for such a task. This study will attempt to explore the possibility of transferring this task to the forensic accountant.

1.2 Motivation

In the Crazy Eddie case, Sam E Antar remarked on how easy it was for him to deceive the auditors: "[M]ost large firms use relatively inexperienced kids right out of college to do basic audit leg work" (Chui & Pike, 2013:205). In 1980, Antar was a CPA and CFO of the Crazy Eddie electronics chain, a business involved in "skimming, money laundering, fictitious revenue, fraudulent asset valuations, concealed liabilities and expenses" and securities fraud (Kranacher *et al.,* 2011:8). The acts of fraud were concealed from the auditors by distracting them, rather than obstructing their work, which resulted in them running out of time and not completing their procedures (Kranacher *et al.*, 2011:8).

In the ABC Corp case, financial statement fraud occurred in one of the organisation's foreign subsidiaries where the general manager arranged a series of large fictitious sales to falsified and existing companies and convinced the companies' owners to cooperate (Bishop, 2004:120). The independent auditors obtained written confirmation of the receivables from the customers on their year-end audit, while the bills continued to go unpaid (Bishop, 2004:120). The internal and independent auditors did not perform the

required tests that could have detected financial statement fraud, because they did not anticipate fraud within the company (Bishop, 2004:12). From this case, it is evident that fraudsters and their allies can deceive auditors by ensuring that all the correct documentation is in place, making auditors ineffective in detecting financial statement fraud (Bishop, 2004:121). Moreover, convicted felons agree that auditors lack the ability to detect fraud (Chui & Pike, 2013:205).

According to Vona (2011:1), "[t]he title 'auditor' does not immediately confer knowledge regarding fraud, and it certainly doesn't infer the mastery of identifying the risk". Auditors need to possess specific knowledge regarding fraud in order to unravel the problems in addressing fraud (Vona, 2011:2). The Association of Certified Fraud Examiners (ACFE) (2014:5) states that one should not rely on external audits as a fraud detection method. Forensic accounting applies investigative and analytical skills to resolve financial issues while concentrating on areas that are most likely to contain fraud (Hopwood *et al.,* 2008:6).

Ojo (2012) and Singleton *et al.* (2006:4) agree that forensic accountants are trained to detect fraud and have the auditing, accounting and investigative skills necessary to identify fraud. It is evident from the above that a need exists to determine who is best suited to perform risk assessments.

1.3 Problem statement

The problem that was addressed in this research was whether the skills that auditors possess are sufficient to perform FRAs in the most efficient way and whether the effectiveness of FRAs within an audit programme would be enhanced if forensic accountants were to perform the assessment.

1.4 Research objectives

1.4.1 Primary objective

The primary objective of this study was to determine the skills needed by an auditor to perform FRAs in terms of ISA 240. The purpose was to determine whether a forensic accountant might be more suited for such a task.

1.4.2 Secondary objectives

The secondary objectives of this research were to:

1. Achieve an understanding of the concept “fraud” in order to determine the characteristics that a person should possess to be able to perform FRAs; and
2. Understand the objectives of FRAs in order to determine the skill set necessary to perform an effective FRA.

1.5 Research method

This study consists of a combination of a literature study and an empirical study.

1.5.1 Literature study

Onwuegbuzie, Leech and Collins (2012:2) state that a literature study comprises a written document which displays a comprehensive understanding of a topic presented by a logically argued case.

The sources that were consulted to complete this literature study included:

- Standards relating to auditing;
- Law reports;
- Publications in newspapers, magazines and journals;
- Books; and
- Internet sources.

1.5.2 Empirical study

According to Amsberry (2008), an empirical study is based on observing and measuring phenomena, and knowledge is gained from actual experience and not from theory or belief. Empirical research should be warranted and transparent (Onwuegbuzie *et al.*, 2012:4):

- The word “warranted” can be defined as when results and conclusions are supported by evidence; and
- The word “transparent” indicates that the logic and activities associated with the research, from initial interest through outcomes of the study, be presented by following a clear and understandable method.

To perform the empirical study, a questionnaire was distributed to the Big 4 accounting firms' forensic accounting and auditing departments. The same questionnaire was also administered to University X's Certificate in Theory of Accounting (CTA) and forensic accountancy honours students. The results were documented and analysed.

The questionnaire attempted to obtain proof that forensic accountants have more knowledge and experience on fraud and are, therefore, more suitably equipped to perform FRAs. In order to achieve this goal, the questionnaire aimed to answer the following questions in comparing forensic accountants with auditors:

- Do they have experience and knowledge on fraud?
- Have they been educated on fraud?
- Are they capable of identifying circumstances that indicate possible fraud?
- Are they able to separate fraud from other offences?
- How will they go about in assessing the risk of fraud?

1.6 Progress of study

Chapter 1: Purpose, scope and progress of study

The reason auditors use FRAs is explained. This chapter also discusses the expectations from an auditor with regard to fraud and shows that auditors are not responsible for detecting fraud.

Chapter 2: Research methodology

This chapter will elaborate on the methodology that was used in order to address the research objectives.

Chapter 3: Fraud models and related concepts

This chapter will attempt to define fraud. The six different fraud models will be discussed and analysed. Red flags that indicate possible fraud will be described also.

Chapter 4: Understanding fraud risk assessments

This chapter will define FRAs and discuss their objective. This chapter will also elaborate on the way in which FRAs should be performed based on research and standards.

Chapter 5: Characteristics of auditors and forensic accountants

> In this chapter, “forensic accountant” and “auditor” will be defined and compared. In order to determine who is more suited to perform FRAs, their responsibility and the characteristics they possess will be determined.

Chapter 6: Results: Empirical study

> This chapter will present, discuss and analyse the findings of the empirical research.

Chapter 7: Conclusion and recommendations

> A conclusion will be drawn based on all the evidence from the previous chapters with regard to whether forensic accountants must replace auditors in performing FRAs. Recommendations will be provided for future research and the implementation of changes according to the findings in chapter 6.

1.7 Conclusion

Lord Justice Lopes in the Kingston Cotton Mills Case (Sarup, 2004:1) stated:

> It is the duty of an auditor to bring to bear on the work he has to perform with skill, care, and caution which a reasonably competent, careful, and cautious auditor would use. An auditor is not bound to be a detective, or, as was said, to approach his work with suspicion, or with a foregone conclusion that there is something wrong. He is a watchdog, but not a bloodhound. Auditors must not be made liable for not tracking out ingenious and carefully laid schemes of fraud, when there is nothing to arouse their suspicion.

The “watchdog-driven audit philosophy” has unquestionable flaws that have been proved by the recent corporate failures which reduced the Big 5 auditing firms to the Big 4 (Sarup, 2004:1). Up until 2002, Arthur Andersen was part of the Big 5 auditing firms, but after they were implicated in falsifying financial records in the Enron case, they were dropped from the Big 5 (Anon, 2014). Auditors who audit financial statements are not fraud examiners, and to require them to be aware only of the possibility of fraud is not enough to detect financial statement fraud during financial statement audits (Chui & Pike, 2013:205).

Chui and Pike (2013:207) confirm the problem of this study by stating that “without proper and adequate forensic training, expecting financial statement auditors to detect fraud is similar to pouring new wine into old bottles”.

CHAPTER 2

2. RESEARCH METHODOLOGY

2.1. Introduction

There are various philosophical paradigms, theories and fundamental principles that the researcher in auditing and forensic accountancy could apply in a study. The main purpose of this study, as stated in chapter 1 (par 1.4.1), was to determine who is more suited to assess the RMM due to fraud, auditors or forensic accountants. The research approach that was followed in addressing this purpose will be explained in this chapter.

The chapter further intends to provide insight into the research methodology used in this study by means of exploring the philosophical paradigms of research and concluding on their relevancy to this study. A distinction will be drawn between the different types of research and research designs. The remainder of this chapter will explore and state the importance of reliable and valid research, followed by the ethical considerations in conducting research.

2.2. Research paradigms

It is important to understand the contribution that philosophy can make to research that social science cannot, as well as the relationship between philosophy and social science. Philosophy can be defined as "the study of the fundamental nature of knowledge, reality and existence" (Concise Oxford English Dictionary, 2011:1077). In social science, the researcher needs certain skills and tools to apply specific research instruments and obtain the required data – and these aspects cannot be separated from theory (Hughes, 1990:11). When looking at research instruments from a philosophical point of view, one will come to the conclusion that the effectiveness of the research is dependent on the researcher's understanding of reality (Hughes, 1990:11).

The focus and experience of researchers, together with their epistemological and ontological assumptions, will determine the philosophical approach they follow in conducting their study (McKerchar, 2008:7). In philosophy, ontology can be understood as the "world," or reality, while epistemology is the knowledge of the world (Buchanan, Henig & Henig, 1998:338). Ontology is the way the researcher views reality, which influences the researcher's assumptions (Holden & Lynch, 2004:399). Epistemology, in contrast, is concerned with the nature of knowledge and seeks to determine the philosophical claims about the way we know or can get to know the world (Hughes,

1990:5). Justification of beliefs is a standard topic in epistemology, the reason being that subjects can only truly know something when they are able to justify their beliefs (DeRose, 2005). When considering the above statements, the conclusion can be drawn that, in philosophy, ontology is the researcher's view of reality, whereas epistemology is the researcher's understanding of reality.

Research philosophy can be divided into paradigms such as positivism, interpretivism, critical inquiry, constructivism, feminism and postmodernism (Gray, 2014:21). Social science can be divided into the following paradigms: positivism, interpretivism and constructivism (Terre Blanche, Durrheim & Painter, 2006:6). All these paradigms can be applied to the field of forensic accounting research, but for the purposes of this study, the focus will fall on positivism and interpretivism.

Positivist philosophy, traditionally, supports empirical social science and dominates the production of knowledge within empirical research (Hughes, 1990:35, 36). The positivist paradigm refers to scientific knowledge based on uncontaminated observation that excludes individual interest, values and purposes (Howe, 1988:13). In positivism, the researcher is separated from the subject, and the outcome of the study is based on theory and empirical evidence, resulting in an objective approach (McKerchar, 2008:7). Positivism supports quantitative methods, whereas interpretivism supports qualitative methods (McKerchar, 2008:7). Therefore, positivism generates objective results, because the evidence is obtained from observations instead of personal opinions.

The researcher conducting research in the interpretivism paradigm disagrees with the positivists by stating that it is impossible to eliminate individual interest, values and purposes in research due to the fact that the researcher cannot be separated from the subject (Howe, 1988:13). In interpretivism, the researcher explains social science using his/her own subjective interpretation (McKerchar, 2008:7). In contrast with positivism, interpretivism generates subjective results, because the evidence is obtained from the researcher's personal interpretation instead of observation.

Subjectivity and objectivity within social science are affected by the researcher's assumptions of ontology, epistemology, human nature and methodology (Holden & Lynch, 2004:398). According to Holden and Lynch (2004:398), it is possible to approach philosophy with objectivity or subjectivity. In social science, subjectivity and objectivity can be described as "a continuum's polar opposites with varying philosophical positions aligned between them" (Holden & Lynch, 2004:398). Knowledge will be regarded as

objective if individuals or a community belief that the knowledge they share is in reality objective (Buchanan *et al.,* 1998:339). Alternatively, reality is subjective when only one person's perception thereof is considered (Buchanan *et al.,* 1998:337).

Objectivity can be found in the following research approaches: quantitative, positivist, scientific and experimental, whereas subjectivity is found in qualitative, phenomenological and humanistic research (Holden & Lynch, 2004:399). According to Holden and Lynch (2004:401), large-scale surveys will fall within objectivity and will be strictly positivistic with room for interpretation, whereas in-depth surveys, which include open-ended questions, will mostly involve the researcher's interpretation, resulting in subjectivity. According to Buchanan *et al.* (1998:343), it is important to separate subjectivity from objectivity when making decisions in research.

Objectivists claim they are capable of observing the subject of their research independently without letting their own skills, values and beliefs influence their observation (Holden & Lynch, 2004:402). Subjectivists, on the other hand, acknowledge that they are unable to distance themselves from the subject of the research and are bias as a result of their status, skills, beliefs and background (Holden & Lynch, 2004:404). Objectivity in social science aspires to identify and explain regularities in human social behaviour, while subjectivity aims at understanding the occurrence, as Holden and Lynch (2004:403) argue.

From the above, it can be concluded that, when a researcher is objective at all times, a positivist approach will be followed. In contrast, a subjective researcher who is not separated from the subject and whose own skills, values and beliefs influence the study, will take an interpretivist approach.

2.3. Research outlined

Research can be defined as the process of gathering facts and information on a specific topic (Oxford Advance Learner's Dictionary, 2010:1255). The American Psychological Association Dictionary of Psychology (hereafter APA Dictionary of Psychology) (2007:791) defines research as when both systematic approaches and experiments are used in order to learn, confirm or study a problem or subject. Tuckman and Harper (2012:3) view research as when an overall or definite answer is being given to a question by applying specific methods. It can, therefore, be concluded that research is applying methods and experiments to investigate a problem or question of a specific topic with the intention of discovering more knowledge and facts on the subject.

"Research methodology" and "research method" are two different terms and serve different purposes in research. Research methodology is the method and philosophy followed to execute an action, while research method refers to the tools or technique used to perform the action (Oxford Advance Learner's Dictionary, 2010:932). Adams, Khan, Raeside and White (2007:20) concur by describing the difference between research methodology and research method as follows: the one is the knowledge and philosophy behind research, while the other is the technique used to conduct the research.

Research can be divided into three categories, as set out below.

2.3.1. Descriptive, explanatory and exploratory research

This type of research explains phenomena, investigates the nature of behaviour and predicts behaviour based on variables (Adams *et al*., 2007:20). Terre Blanche *et al.* (2006:44) claim that exploratory research try to find new perspectives, questions and hypotheses with regard to phenomena, while descriptive research seeks to describe the phenomena. Explanatory research only explains the phenomena (Terre Blanche *et al.*, 2006:44). Pinsonneault and Kraemer (1993:10) concur by stating that descriptive research describes phenomena in a population, whereas explanatory research aims to explain the relationship between variables. Alternatively, exploratory research attempts to acquire new methods and hypotheses (Pinsonneault & Kraemer, 1993:10). Explanatory studies deliver excellent research, whereas exploratory and descriptive studies are usually sub-standard (Pinsonneault & Kraemer, 1993:3).

When conducting a survey, descriptive, explanatory, and exploratory research has the following objective (Pinsonneault & Kraemer, 1993:10):

- Descriptive research observes a population's phenomenon, for example, events and attitudes that occur in the population;
- Explanatory research analyses relations and theories; and
- Exploratory research produces a variety of responses from individuals with different opinions.

When considering all the above-mentioned factors, descriptive, explanatory and exploratory research can be described in one sentence: Descriptive research determines facts in order to describe phenomena, whereas explanatory research explains phenomena and exploratory research finds new information on phenomena by observing behaviour.

2.3.2. Applied and basic research

Applied and basic research are used when researcher wants to study the same phenomena using different perspectives (Terre Blanche *et al.*, 2006:45). Basic research is used to broaden our knowledge on theories about psychological, social and physical processes and events by proving or disproving the theories (Terre Blanche *et al.*, 2006:45). Roll-Hansen (2009:7) defines basic research as "experimental or theoretical work undertaken primarily to acquire new knowledge of the underlying foundation of phenomena and observable facts, without any particular application or use in view". In contrast, applied theories follow a practical approach in order to resolve problems, analyse policies and make decisions (Terre Blanche *et al.*, 2006:45). Applied research can also be defined as an investigation with the aim of gaining new knowledge (Roll-Hansen, 2009:7).

Hence, applied research follows practical approaches to gain knowledge and draw conclusions, where basic research relies on theories to gain knowledge and draw conclusions.

2.3.3. Quantitative and qualitative research

Quantitative research can be described as when the researcher tests theories in order to prove or disprove a hypothesis (Newman & Benz, 1998:3). According to Adams *et al.* (2007:26), quantitative research is used in almost every area of life and is based on the methodological principles of both positivism and neo-positivism. A quantitative approach includes surveys and experiments through the use of closed-ended questions for the purpose of rating behaviours and measuring attitudes (Creswell, 2003:13–20).

Qualitative research, on the other hand, can be described as when the researcher develops theories through interpreting and observing reality (Newman & Benz, 1998:3). Qualitative research has been used in social science for a long time and involves methods such as data collection and analysis in order to explore social science and describe reality through the eyes of respondents (Adams *et al.*, 2007:26). Creswell (2003:13–20) adds that a qualitative approach includes case studies, narratives and grounded theories through the use of open-ended questions for the purpose of collecting opinions from participants.

Qualitative research, generally, focuses on the quality of the results, whereas quantitative research focuses on the extent of the results (Oxford Advance Learner's Dictionary, 2010:1198). In other words, qualitative research develops valuable theories

by observing reality and quantitative research tests many theories to prove or disprove hypotheses.

Creswell (2003:13–20) mentions the mixed method (combination), which includes pragmatic knowledge and seeks to measure and observe both quantitative and qualitative data through the use of both open-ended and closed-ended questions. A mixed method research design includes transformative and sequential methods (Creswell, 2003:13). The mixed method approach is used to collect sets of data at the same time or consecutively in order to understand the research problem (Creswell, 2003:18). It, therefore, employs both the quantitative and qualitative research methodologies to measure the same phenomenon and to inform one another to obtain a triangulation of the research results. Below follows a discussion on how the data can be collected by means of applying the instruments mentioned above.

2.4. Data collection method

In order to execute the research design and reach the objectives of the study, data need to be collected. Data can be defined as facts and figures collected for use in referencing or study (Concise Oxford English Dictionary, 2011:364). There are two sources from which information can be gathered for research purposes (Adams *et al*., 2007:85):

- *Primary sources*: new surveys to be conducted in order to gather information; and
- *Secondary sources*: information already available from other researchers who collected the information for their research purposes.

The research in this study made use of both secondary and primary sources. The literature review in the study was conducted from secondary sources, while primary sources were instrumental in gathering data in the empirical research.

There are two main types of data, namely qualitative and quantitative data (Adams *et al*., 2007:85). Quantitative data can be defined as numerical data which can be verified and are always open for manipulation, according to The Business Dictionary (2014b). Qualitative data, in contrast, can be defined as data that describe the characteristics of occurrences (The Business Dictionary, 2014a). Qualitative data classify groups according to their characteristics (Oxford Dictionary of Economics, 2012:333). Surveys are usually quantitative in nature in order to gather information from a large population representing the research sample, according to Mouton (2001:152).

2.5. Literature review

Broadly, literature can be defined as information provided on a specific topic (Oxford Advance Learner's Dictionary, 2010:869). Five criteria must be considered when performing a literature review: the literature review must cover the main aspects of the study; authors cited must receive due recognition; recent sources must be consulted; information should not be limited to internet sources; and the literature review must be logically and well structured (Mouton, 2001:91).

Literature is indispensable in many ways, as Gray (2014:98) explains:

- It provides a broad understanding on the subject being researched;
- It helps identify gaps in issues that necessitate additional research;
- It assists in developing/generating/formulating/constructing research topics and questions;
- It informs forthcoming researchers on the goal of the research; and
- It provides research methodologies which can be used for future studies.

The literature review in this study aimed to provide deeper insight into the following concepts: fraud, FRAs, auditors and forensic accountants. The literature review set out to achieve the secondary objectives, as stated in chapter 1 (par 1.4.2).

2.6. Empirical research

When empirical research is conducted, conclusions are based on experiments or experience on a specific topic and not on theories (Oxford Advance Learner's Dictionary, 2010:480). The APA Dictionary of Psychology (2007:327) concurs by stating that empirical research involves investigations and observations to determine the result of a study instead of following a theoretical approach.

According to Mouton (2001:157), surveys are classified under empirical research as a research design. Surveys can be defined as the use of questions to study the opinions and behaviour of a population (Oxford Advance Learner's Dictionary, 2010:1505). Gray (2014:236) adds that surveys are used when data need to be obtained by means of interviews, questionnaires or observations. Surveys also include the use of face-to-face interviews or mailed questionnaires in order to gather information (The American Management Association (AMA) Dictionary of Business and Management, 2013:265). From the above, it can be concluded that the use of questionnaires as a method of collecting data is viewed as a survey.

Surveys can be divided into two categories, namely analytical and descriptive (Gray, 2014:237). Analytical surveys are used to examine theory, assess correlations between different variables and place focus on the credibility of data (Gray, 2014:236, 240). Descriptive surveys assess the characteristics of a population through questions leading to different points of view (Gray, 2014:236, 237).

This study's research design can be classified as both descriptive and analytical. The research study relied on the integrity of the participants and aimed at finding similarities between the participants' responses. As already mentioned, the questionnaire sought to determine the characteristics of the population. Because both forensic accountants and auditors were involved, of which some were students and some practitioners, the questionnaire evoked different opinions.

The appropriateness of the methodology chosen for a research study will depend on the researcher's ability to address the strengths and weaknesses of this methodology (McKerchar, 2008:10). As with all research designs, surveys have both strengths and limitations. One advantage of using surveys when applying the correct research design is that surveys have the ability to generalise the results to large populations, similar to the population used for the survey (Mouton, 2001:153). When proper questionnaires are used to perform surveys, the results are usually very reliable (Mouton, 2001:153). If the researcher implements proper controls when performing a survey, the survey conclusions will be valid (Mouton, 2001:153).

A few general limitations in surveys restrict the researcher in some ways: the researcher will be able to criticise participants' responses, depending on the type of survey; and due to a lack of in-depth and insider perspective, the data gathered from surveys can be sample and context specific (Mouton, 2001:153).

An electronic survey was used in this research study. This type of survey has its own advantages and disadvantages. A few advantages of mailing the survey to participants are (Fink, 2009:9):

- The survey can reach a large population;
- Participants will be able to complete the survey anywhere; and
- People are used to participate in surveys in this manner.

Disadvantages of mailing the survey are (Fink, 2009:9):

- The response rate might be low because participants do not have the time to take part;
- Respondents' abilities and senses play an important role (they have to be able to read, write and see); and
- Respondents must be motivated to complete the survey.

2.6.1. Research sampling

Sampling is the process of observing a population in order to gain evidence for research (Terre Blanche *et al*., 2006:49). Adams *et al*. (2007:87) described sampling as "the process or technique of selecting a suitable sample for the purpose of determining parameters or characteristics of the whole population". According to Fink (2009:5), a sample is representative of the number of characteristics of participants in a survey. It can be concluded that sampling is selecting a group of people in order to determine their characteristics or gather information from the group.

Probability and non-probability sampling are the main methods for sampling. Probability sampling occurs when each element in the study has an equal chance of being selected and the selection process is completely random (Somekh & Lewin, 2005:217). With probability sampling, the results of the study can usually be generalised to the overall population (Somekh & Lewin, 2005:217). Non-probability sampling occurs when a specific group is used in a study and it is not always possible to generalise the results to the overall population (Somekh & Lewin, 2005:219).

In this study, non-probability sampling was used, because the population was not selected randomly, but based on specific criteria. The criterion of exclusivity was used to select University X – this university offers a degree in forensic accountancy. The criteria of being the most influential auditing firms in South Africa and having both forensic accountancy and auditing departments were followed in selecting the Big 4 accounting firms.

2.6.2. Survey

A survey is a set of questions with several answers from which the respondent can choose (Concise Oxford English Dictionary, 2011:1178). Questionnaires can consist of interviews or self-completion forms which provide the researcher with the opportunity to gather information from respondents (Somekh & Lewin, 2005:219). Questionnaires must

be constructed in a logical manner to answer the research question and should have a clear aim (Somekh & Lewin, 2005:219).

Mouton (2001:104) mentions a few errors that can arise when using questionnaires as part of a study, for instance, not conducting a pre-test, as discussed in this chapter (par 2.7); ambiguous or vague questions; and two questions combined into one question. Furthermore, confusing layout of the questions can affect the accuracy of the response; leading questions can influence the respondent's answer; lengthy questionnaires can impact the quality of the responses; and sensitive questions can make the respondents refuse to participate (Mouton, 2001:104).

For this study, a self-completion questionnaire was compiled and distributed. The main focus of the questionnaire was to obtain proof that forensic accountants have more knowledge and experience on acts of fraud and are, therefore, more suitably equipped to perform FRAs. The questionnaire was distributed to:

- The forensic accounting and auditing departments of the following companies in South Africa: PwC, KPMG, Deloitte and EY; and
- Honours students in chartered accountancy and forensic accountancy at University X.

2.7. Validity, reliability and generalisability

A research study must be reliable, valid and generalisable in order to ensure the quality of both quantitative and qualitative research (Adams *et al*., 2007:235). This study comprised both qualitative and quantitative data. The results of the empirical study were converted to numerical data in order to make it more understandable. The questionnaire used for the empirical study aimed also to identify certain characteristics of both auditors and forensic accountants.

Information is regarded as reliable if it is consistent (Adams *et al*., 2007:235). The concept of "reliability" refers to the fact that the same data must be delivered each time an instrument is used under the same conditions with the same subjects (Adams *et al*., 2007:235). Fink (2009:41) states that a survey is reliable if the characteristics measured stay consistent no matter the background influence. Reliability should not be confused with validity. Information has to be reliable to be considered valid, while information does not have to be valid in order to be reliable (Adams *et al*., 2007:235).

Validity determines whether the research is measuring what it is supposed to measure and whether the results are truthful (Adams *et al*., 2007:237). The results of a research study will also be valid if the results from surveys conducted are accurate and without error (Fink, 2009:41). There are four types of validity: internal, external, construct and conclusion validity (Adams *et al*., 2007:237). Figure 2.1 describes each of these types of validity.

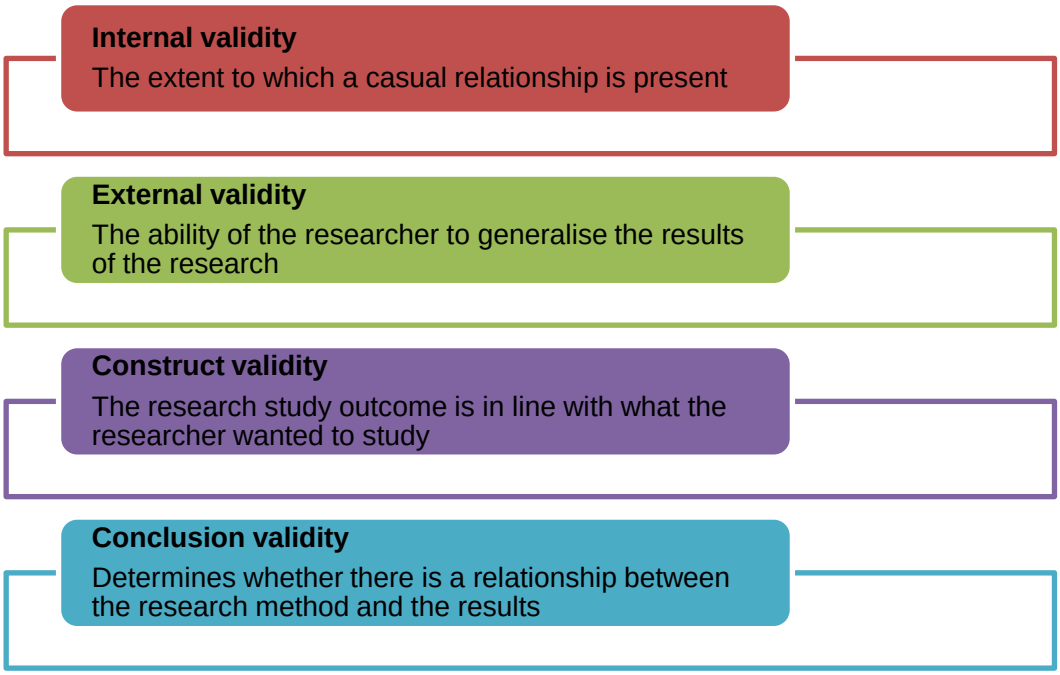

Figure 2.1. Types of validity

Source: (Adapted from Adams *et al*., 2007:237)

The bottom line of generalisability is the ability of the research design to provide the same explanation of the phenomenon no matter what the time or place (Adams *et al*., 2007:239).

It is clear that the research design used to collect data determines whether the results will be reliable, valid and generalisable. As mentioned in paragraph 2.6, this study used a survey to collect data. There are two phases for collecting data, or in this case conducting a survey, namely pre-testing and the main study (Adams *et al*., 2007:87). The main purpose of pre-testing is to use a small sub-sample to determine whether the survey is an appropriate procedure for the main study (Adams *et al*., 2007:87). This will allow the researcher to eliminate improper design elements and assess the wording and length of the questionnaire (Adams *et al*., 2007:87). In addition, the pre-test will provide

the researcher with a chance to determine what to expect from the main study regarding the knowledge to be gained (Adams *et al*., 2007:87).

The pre-test of this study involved a discussion of the questionnaire with two forensic accountants and two trainee accountants who completed their honours the prior year at University X. The main purpose of the pre-test was to:

- Determine whether the questions were understandable;
- Determine whether the length of the questionnaire was appropriate;
- Rephrase vague questions;
- Determine whether the questions would reach the research objective; and
- Determine whether the participants would interpret the questions correctly.

The study endeavoured to provide valid, reliable and generalisable information by:

- Basing conclusions on theory and observation instead of the researcher's personal interpretation;
- Drawing conclusions relevant to all auditing firms;
- Basing the results on the knowledge of both auditors and forensic accountants in big auditing firms; and
- Basing the results on the knowledge of both auditing and forensic accountancy students at the crest of their knowledge.

2.8. Research ethics

Ethics evaluates the behaviour of researchers towards their research subjects (i.e. the respondents) and those affected by the research, and ensures the research is carried out responsibly and honestly (Gray, 2014:68). Any research making use of data gathering or human interaction must consider ethics (Gray, 2014:73).

Research ethics can be defined as the values, principles and morals by which the researcher conducts research (APA Dictionary of Psychology, 2007:791). The Oxford Advance Learner's Dictionary (2010:500) views research ethics as the values that affect a person's behaviour.

The Economic and Social Research Council mentioned in 2005 that the following six principles must be considered when conducting research (Dowling & Brown, 2010:35):

1. Research must be conducted in a manner that ensures integrity and quality;
2. The research subject must be informed of the purpose, methods, possible use and risk (if any) of the study;
3. The research participants identity and information supplied must be held confidential and respected;
4. Participants must assist the researcher voluntarily;
5. Participants must not be harmed; and
6. Conflicts of interest must be revealed.

This study did not require respondents to provide any personal information, and the identity of the respondents was kept confidential. The questionnaire was also completed voluntarily by the respondents at University X and the Big 4 firms. No harm came to the participants and no conflict of interest was present within this research study.

2.9. Summary

From the above, the conclusion can be drawn that the survey's philosophical plausibility was based on the knowledge of the participants and the participants' view of fraud and of the ISA 240. A large sample was selected, and the research was conducted objectively, because only the results from the literature and empirical study were used to draw conclusions.

It was determined that both the quantitative and qualitative methods were the most appropriate for this study, and both primary and secondary data were used. The research design was a descriptive and analytical survey, because a questionnaire was distributed to the research sample. The questionnaire included both open- and closed-ended questions in order to determine the participants' characteristics and views with regard to fraud. Even though this study comprised both quantitative and qualitative methods, only a positivism paradigm was followed, because the results were based only on theory and participants' responses. Some aspects of interpretivism were involved in the form of open-ended questions in the questionnaire. However, the degree of interpretivism used was not enough to influence the end result and conclusion.

This research study collected and analysed the data to determine whether the forensic accountant is better equipped to perform FRAs. The results were based on the

respondent's opinions and knowledge. The advantages and disadvantages of the survey used in this study can be set out as follows:

- The survey attempted to be reliable and valid, because the questionnaire was based on the theory from the literature review performed in this study;
- This study attempted to produce generalisable results, because the aim was for any auditing firm performing FRAs to be able to relate to the survey and use the information provided;
- The study attempted to ensure all participants had access to the internet and were able to read and write;
- Owing to the fact that the questionnaire was distributed to professionals, the risk remained that they would not have the time to participate; and
- There was a risk that the participants could influence one another while answering the questionnaire.

Adams *et al*. (2007:240) stated the following:

> The ability of any research design to produce findings which are applicable to other situations, organisations, countries and other people is dependent on the quality of the underlying theory which allows us to interpret the 'world' in the context of a given research problem.

The succeeding chapters will elaborate on fraud, FRAs, forensic accountants and auditors to address some of the remaining secondary research objectives.

CHAPTER 3

3. FRAUD MODELS AND RELATED CONCEPTS

3.1. Introduction

In order to adequately assess the responsibility of an external auditor and forensic accountant when performing FRAs, an understanding of the concept “fraud” needs to be acquired. Each component of fraud needs to be discussed in order to determine the responsibility of both the auditor and forensic accountant in FRAs. Chapter 1 (par 1.1) stated that the auditor is responsible for assessing the RMM due to fraud and that auditors need both an understanding of the elements of fraud and the ability to identify the risk according to these elements. Auditors also need to report the matters in an applicable manner in order to perform an effective FRA.

Chapter 3 will attempt to define fraud as it relates to this study. Different fraud models from various authors will be discussed to find similarities and develop one extensive fraud model. Furthermore, a link will be made between red flags provided by ISA 240 and other resources in order to determine whether ISA 240 is sufficient to enable an auditor to identify possible fraud during the execution of an FRA.

3.2. Fraud

Auditors need to constantly keep in mind that fraudsters conceal the act of fraud deliberately and intentionally (Vona, 2008:5). The first step in performing an effective FRA is to acquire knowledge on the definition of fraud and the types of fraud that an organisation can face (Vona, 2008:5). Fraud is defined in terms of the South African Criminal Law as the unlawful and intentional making of a misrepresentation that can lead to actual or potential harm for someone else (Snyman, 2006:523). ISA (240:11) defines fraud as an act committed by an employee, management or third party through the use of deception for the purpose of obtaining an advantage illegally or in an unjust manner. The Concise Oxford English Dictionary (2011:564) defines fraud as “wrongful or criminal deception intended to result in financial or personal gain”. Roybark (2014:1) concurs by stating that an action can be described as fraud when a person gains a personal benefit by intentionally violating another’s trust.

To summarise, fraud can be defined as an act by a person with the intention of misrepresenting the truth and concealing a deed in order to persuade another person to part from their possessions and/or cause them potential or definite harm which could,

ultimately, lead to legal action as concluded in chapter 1 (par 1.1). According to the definition of fraud in terms of the South African Criminal Law, four elements need to be present in order for an act to be classified as fraud:

- Unlawfulness;
- Misrepresentation;
- Intent to deceive; and
- Actual or potential harm.

Paragraph 3.3 will elaborate on the six different fraud models.

3.3. Fraud models

As there is no general answer as to why someone commits fraud (Taylor, 2011:144), it is important for auditors to understand the different types of fraud models to enable them to gain insight into the motive behind committing fraud (Kassem & Higson, 2012:194).

Because authors and researchers hold different viewpoints as to the reasoning behind the act of fraud, six different fraud models have originated: the fraud triangle; MICE; the fraud diamond; the fraud scale model; the reasoning process; and Crowe's fraud pentagon. Even though the six models have been introduced by different authors, they all link back to the fraud triangle, with one or two additional element.

3.3.1. The fraud triangle

ISA (240:A1) upholds that fraud has three characteristics: incentive or pressure, opportunity, and rationalisation. These three characteristics are always present when someone violates trust and can also be said to be the reason why people commit fraud (Kassem & Higson, 2012:191). These three factors can be found within the fraud triangle first created by Donald Cressey, a criminologist, in 1950 (Kassem & Higson, 2012:191). Vona (2008:7) suggests that the fraud triangle be incorporated into a fraud audit plan in order to perform FRAs.

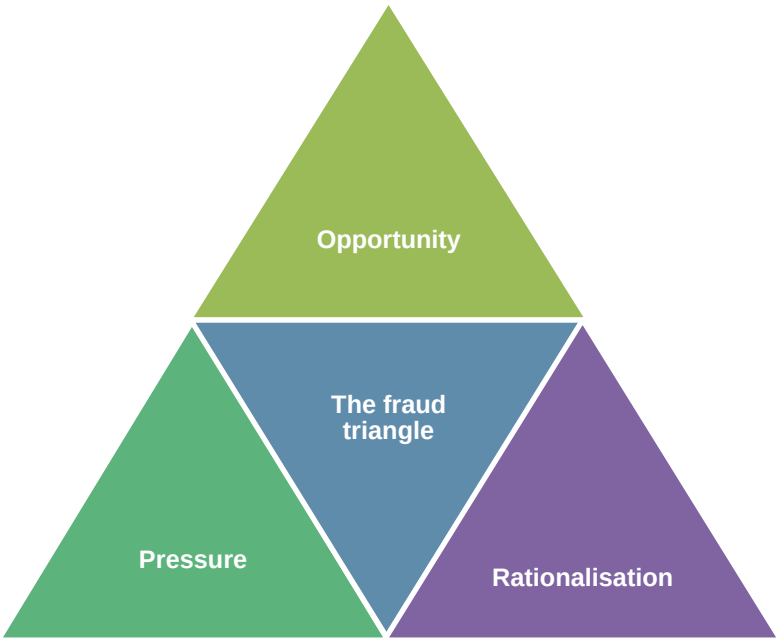

Figure 3.1. The fraud triangle

Source: (Taylor, 2011:142; Wells, 2013:8)

The three elements collectively provide the fraudster with the necessary tools to be able to commit fraud, because the three elements link with one another and is, therefore, called the fraud triangle. According to the model, all three elements need to be present for fraud to occur: pressure provides the motivation to commit the act; opportunity provides the fraudsters with the ability to abuse their power; and rationalisation refers to the moral reasoning fraudsters use to justify their action (Kassem & Higson, 2012:191&192). Auditors need insight into the opportunities available to fraudsters in order to identify fraud schemes and potential risks should the controls set out by management fail (Kassem & Higson, 2012:192).

The cycle of committing fraud according to the fraud triangle can be illustrated in a simple example (Kassem & Higson, 2012:191, 193):

- Firstly, the individual feels pressure from having non-shareable financial issues, which provides the individual with a reason to commit fraud;
- Secondly, the individual has the opportunity by being in a position of trust to solve these financial struggles; and
- Lastly, the individual rationalises the act by justifying the crime and making it acceptable.

Auditors need to keep in mind that pressure can be either financial or non-financial and can be derived from personal, employment or external sources (Kassem & Higson, 2012:195). Personal pressure can include gambling addiction, high living standards (Kassem & Higson, 2012:191, 193), greed, medical bills, children's education, high debt and drug addiction (Kranacher *et al.*, 2011:13). Corporate pressure can comprise the fear of losing one's job, unreasonable circumstances at work, pressure from management (Kassem & Higson, 2012:191, 193), pressure to qualify for bonuses, and meeting deadlines or high expectations from management (Kranacher *et al.*, 2011:13). External pressure can include high expectation from markets or threats to the company's reputation (Kassem & Higson, 2012:191, 193). Opportunity can include circumstances such as ineffective or a lack of controls at work, or management's ability to override controls (Kassem & Higson, 2012:193; Kranacher *et al.*, 2011:13). Rationalisation, on the contrary, occurs when fraudsters view themselves as honest people in a bad situation (Kassem & Higson, 2012:191, 192), when they receive low compensation at work, or experience work dissatisfaction (Kranacher *et al.*, 2011:13).

These three elements are usually present when people feel they are not able to share their financial troubles with anyone (Kassem & Higson, 2012:191). According to Kassem and Higson (2012:192), Cressey divided non-financial troubles into six categories in 1953 in his book *Other people's money.* Cressey indicated that non-shareable financial issues can include business failure, inability to pay debts, financial problems due to personal failure, isolation from people who will be able to lend a hand, high living standards and employee's being treated unreasonably (Kassem & Higson, 2012:192).

The perpetrator's position within an organisation or work-related circumstances provides the opportunity to commit fraud and can be easily identified. However, pressure and rationalisation are dependent on the perpetrator's individual or work-related circumstances, which are not easily observable, making it difficult for the auditor to identify.

The fraud triangle is perhaps not the best model to apply in fighting, preventing and detecting fraud, firstly, because pressure and rationalisation are not observable and, secondly, the fraudsters' capabilities are not taken into consideration (Kassem & Higson, 2012:192). Dorminey, Fleming, Kranacher and Riley (2010:19) concur by stating that the fraud triangle is ineffective when used as a tool to prevent, detect and deter fraud due to the users' inability to observe rationalisation and pressure.

The question can be asked whether ISA 240 is sufficient to assist the auditor in assessing the risk of fraudulent transactions, seeing that ISA 240 only considers the fraud triangle. Other fraud models have been developed to fulfil the fraud triangle's shortcomings. These fraud models will be discussed below.

3.3.2. MICE model

The MICE model was suggested by Professor James Thomas in an attempt to elaborate on perpetrators' motivations for committing fraud (Dorminey *et al.,* 2010:21). This model expands the element of motivation by considering money, ideology, coercion and ego (Dorminey *et al.,* 2010:21). The MICE model should be considered together with the fraud triangle and can be illustrated in figure 3.2 below:

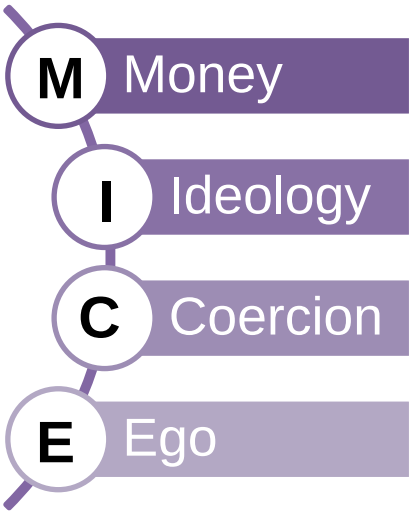

Figure 3.2. The MICE model

Source: (Adapted from Kranacher *et al.,* 2011:13)

Kranacher *et al.* (2011:13) argued that money (greed) and ego (power) are the most observed motivators behind fraud. Coercion occurs when someone is approached to be part of the fraud scheme unwillingly; these individuals can often be turned into whistle-blowers (Kranacher *et al.*, 2011:14). Dorminey *et al.* (2010:21) add that coercion involves people who commit fraud against their will. In contrast, ideology refers to the justification people use for committing fraud, namely to achieve some perceived greater good in line with their beliefs (Kranacher *et al.*, 2011:14). Simply put, ideology allows the perpetrator to do something wrong because the outcome will be good (Dorminey *et al.,* 2010:21).

Even though Professor James Tomas intended the MICE to only be an extension to the element of motivation, all the components, namely money, ideology, coercion and ego, can be allocated to the two elements of pressure/motivation and rationalisation. Dorminey *et al.* (2010:21) posited that the MICE model provides a framework when considering pressure and rationalisation. The following extension can be made to the fraud triangle when considering the MICE model: 1) Money and ego can be considered to be motivators to commit fraud and, therefore, form part of pressure; 2) Coercion is when someone is pressured to commit fraud and, hence, falls under pressure; 3) Ideology is when people justify their means, the same as with rationalisation.

In short, the MICE model links to the fraud triangle and cannot be considered as a model on its own, but rather an extension to the fraud triangle.

3.3.3. The fraud diamond

The fraud diamond was proposed by David T Wolfe and Dana R Hermanson in 2004 (Dorminey *et al.,* 2010:20; Kassem & Higson, 2012:194). The fraud diamond considers the three elements of the fraud triangle with one additional element, "capability" (Wolfe & Hermanson, 2004:38). Wolfe and Hermanson (2004:38) believed that these four elements together would improve the prevention and detection of fraud. They argued that various frauds would not have occurred without a person with the right capabilities in place, as capability provides the fraudster with the necessary abilities to commit the act (Wolfe & Hermanson, 2004:39). Dorminey *et al. (*2010:20) concur by stating that capabilities refer to a person's character and abilities. Thus, capability includes a person's ability to perform a certain act.

Once pressure, opportunity and rationalisation are present, both character and abilities will ultimately determine whether an individual would commit fraud (Dorminey *et al.,* 2010:20). Dorminey *et al.* (2010:20) explained the four elements of the fraud diamond as follows: "Opportunity opens the door, and incentive and rationalization draw the potential fraudster towards the open doorway, but the individual must have the capability to walk through that opening". The fraud diamond is depicted in figure 3.3 below.

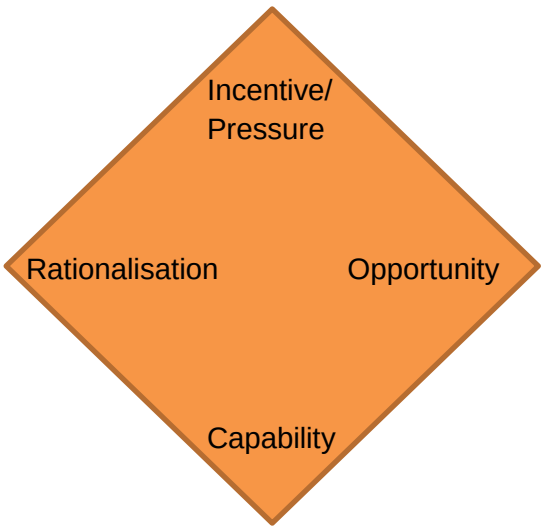

Figure 3.3. The fraud diamond

Source: (Adapted from Wolfe & Hermanson, 2004:38)

Wolfe and Hermanson (2004:40) identified six characteristics that are always present when committing fraud:

1. *Authority in the organisation:* The fraudsters' position inside the organisation will provide them with the ability to create an opportunity;
2. *Intelligence and experience:* Fraudsters are capable of identifying weaknesses within internal controls and accounting systems and use them to their advantage;
3. *Confidence:* Fraudsters believe they will not be caught or that they will be able to talk themselves out of any situation;
4. *Strong personality:* Fraudsters are able to convince other people to go along with the act or to keep quiet;
5. *The perfect liar:* Fraudsters are able to look the auditor, investors and co-workers in the eye and lie; and
6. *Stress dealer:* Fraudsters are able to deal very well with the stress that goes along with committing fraud.

Capability can be regarded as a vital element in the behaviour behind fraud. Thus, auditors would be wise to consider capabilities together with pressure, opportunity and rationalisation. If auditors consider all four elements and use professional scepticism, brainstorming sessions and critical thinking, they will enhance their ability to perform FRAs.

3.3.4. Fraud scale model

The fraud scale model was introduced by Steve Albrecht, Keith Howe and Marshall Romney in 1984 in their book *Deterring fraud: the internal auditor's perspective* (Dorminey *et al.,* 2010:19; Kassem & Higson, 2012:194). This model replaces rationalisation in the fraud triangle with personal integrity (Kassem & Higson, 2012:194). When considering pressure, opportunity and personal integrity at the same time, the fraud scale model will assist in determining whether a situation indicates a high possibility of fraud (Dorminey *et al.,* 2010:20).

Broadly, integrity refers to a person's moral principles (Concise Oxford English Dictionary, 2011:738). A person's integrity can be seen by observing his/her whole decision-making process up until the final decision (Kassem & Higson, 2012:194). Only once the ethics behind a perpetrator's decision has been considered, can the perpetrator's integrity be assessed and, ultimately, the likely occurrence of fraud (Dorminey *et al.,* 2010:20). Integrity plays a crucial role in an individual's behaviour, as behaviour is driven by moral principles. Consequently, integrity should also be considered as an element together with pressure, opportunity, rationalisation and capability.

The fraud scale model has been deduced from the fraud triangle and has only three interlinking elements: pressure, opportunity and integrity. All three elements still need to be present in order for fraud to occur. The fraud scale model determines the probability of fraud occurring and can be illustrated in figure 3.4:

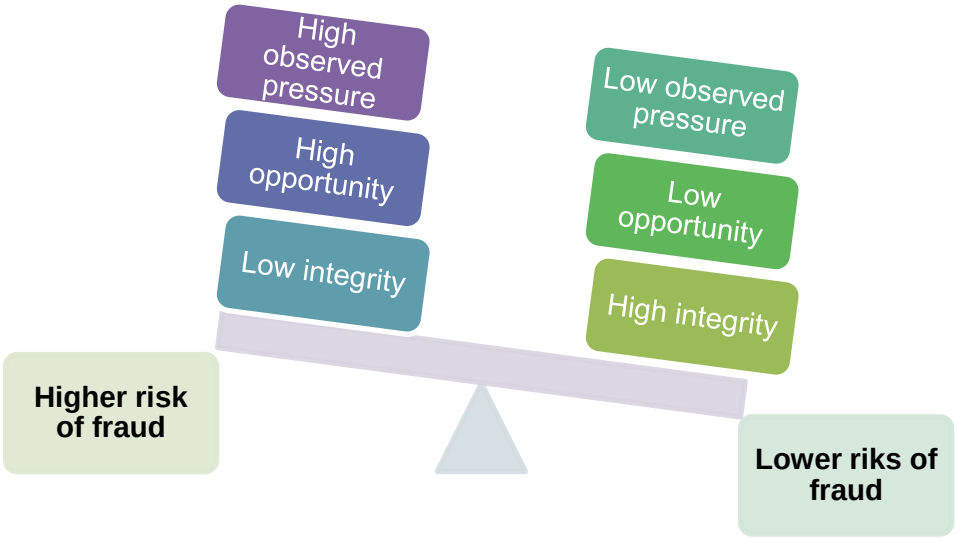

Figure 3.4. Fraud scale model

Source: (Adapted from Dorminey *et al.*, 2010:21)

3.3.5. The rational choice perspective

The rational choice perspective was first published in 1986 by Derek Cornish and Ronald Clarke (Cornish & Clarke, 2014:1). This perspective postulates that individuals who commit criminal acts made a decision to commit the act, and the decision-making process exhibits rationality (Cornish & Clarke, 2014:1). Taylor (2011:143) stated that an individual will not commit a criminal act out of desperation but rather purposefully, by making a rational choice. In a similar vein, Murphy and Dacin (2011:609) argued that individuals who want to commit fraud make a rational decision before committing the act. Rationalisation, therefore, is a pivotal part in the decision-making process to commit fraud.

The rational choice perspective posits that, before committing a crime, the alleged criminal will first weigh his/her options and then compare the rewards with the risk that will follow when committing the crime (Taylor, 2011:143). This perspective, however, has a few shortcomings, because it does not take into account the fact that people sometimes commit crime spontaneously and without thinking it through (Taylor, 2011:143).

Figure 3.5. The rational choice perspective

Source: (Adapted from Taylor, 2011:143)

Figure 3.5 depicts the rational choice perspective and illustrates that, before committing fraud, perpetrators will rationalise their actions by considering the risks associated with the crime and the rewards to be gained. Should the risk outweigh the rewards, the perpetrators would consider whether they are prepared to take the risk and still commit fraud.

As mentioned, this perspective does have its shortcomings, because there are perpetrators who will still commit a crime without weighing the risks and rewards. For this reason, this perspective cannot be considered as a model on its own, because it only expands on the element of rationalisation and is, therefore, considered to be an expansion of the fraud triangle.

3.3.6. Crowe's fraud pentagon

According to Crowe Horwath (2009:2), fraud could be deterred effectively if one had insight into why a lawful employee would perform an illegal act. Crowe Horwath (2009:2) stated that modern fraudsters are more independent and have more knowledge and access to companies' assets as they had in the 1900s when Cressey created the fraud triangle. Therefore, Crowe Horwath (2009:3) expanded the fraud triangle by adding two elements to create Crowe's fraud pentagon. The two elements are an employee's competence/power and an employee's arrogance or a lack of conscience (Crowe Horwath, 2009:3).

Competence provides an opportunity as it refers to fraudsters' ability to override internal controls and direct a situation to their advantage (Crowe Horwath, 2009:3), whereas arrogance and a lack of conscience refer to the fraudsters' believing they are superior to others and that rules do not apply to them (Crowe Horwath, 2009:3). Figure 3.6 below illustrates Crowe's fraud pentagon.

Figure 3.6. Crowe's fraud pentagon

Source: (Crowe Horwath, 2009:3)

Crowe's fraud pentagon adds two elements, a lack of conscience and competence, which should be considered by the auditors when assessing the risk of fraud. Crowe Horwath's definition of competence has the same meaning as capability mentioned in the fraud diamond – both refer to the fraudster's ability. (It has been concluded in paragraph 3.3.3 that capability plays a vital role in the occurrence of fraud.) A lack of conscience refers to a belief that one is superior to others, leading to the absence of feelings of guilt when committing fraud. Based on this conclusion, this model will be considered as an expansion on the fraud triangle with the two additional elements of competence and a lack of conscience.

3.3.7. The fraud combination model

The six models described above have considerable similarities and can, therefore, be combined. The proposal is made that a combination of the six models would be the most sufficient fraud model to deter, prevent and detect fraud and enable the auditor to perform the most effective FRA. All the elements combined reflect the motivation and reasoning behind the act itself; however, each element needs to be considered on its own.

The distinguishable elements from the six models can be set out as follows:

- *Opportunity:* fraud triangle, fraud scale, fraud diamond, fraud pentagon;
- *Motivation/Pressure*: fraud triangle, fraud scale, fraud diamond, fraud pentagon, MICE;
- *Rationalisation:* fraud triangle, fraud diamond, fraud pentagon, reasoning process and MICE;
- *Capability:* fraud diamond and fraud pentagon;
- *Integrity:* fraud scale; and
- *Lack of conscience:* fraud pentagon.

The combined six elements mentioned can be illustrated as follows:

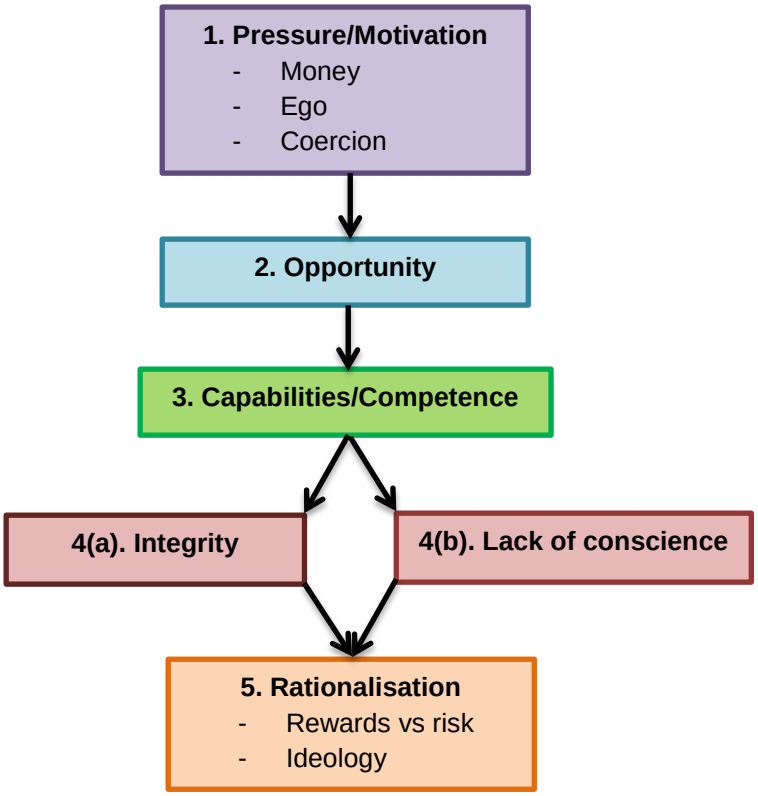

Figure 3.7. Fraud combination model

When using the fraud combination model, the fraud cycle can be explained as follows:

1. The person feels pressure, whether it be financial or non-financial, personal, occupational or from external sources, which provides the reason to commit fraud. The person might also have motivation, which enforces the reason to commit fraud, for example, financial rewards, ego boost, or the relief from the repayment of debts;

2. The person is provided with the opportunity to commit fraud. The person is able to either use his/her power and/or position within the company or abuse the trust of someone to commit the act;
3. The person possesses the necessary skills, knowledge and intelligence to be able to perform the act or finds someone with the necessary capabilities to help complete the act;
4. At this stage, it depends on the person's morals and values. The person will have either integrity, which will delay him/her in the act, such as having second thoughts, or no conscience, which will enable him/her to commit the act without feelings of guilt;
5. The person then rationalises the act. At this stage, the person uses either integrity or a lack of conscience to rationalise the decision to commit the act. People with integrity are more likely to try to justify the act to make the act acceptable to them, but they will also compare the rewards with the risk. People with a lack of conscience, on the other hand, will be more likely to consider only the rewards and risk, and spend little time, if at all, justifying the act of committing fraud; and
6. The person now either commits fraud or decides against it.

As mentioned previously, ISA 240 refers only to pressure, opportunity and rationalisation (fraud triangle) but, as explained above, there are more elements to be considered in order to determine why someone will commit fraud. Kassem and Higson, as already stated, mentioned that the auditor needs to understand all the fraud models to be able to understand the reasoning behind the act. Based on all the information provided in paragraph 3.3, it can be concluded that ISA 240 might be insufficient in explaining the reasons behind committing fraud as it only refers to the fraud triangle and does not mention or consider the fraudster's capabilities, integrity or lack of conscience.

3.4. Categories of fraud

Two categories of fraud are of relevance to the auditor, namely financial statement fraud and asset misappropriation (ISA 240:3). In this section, each category will be defined and the offences that fall within each type will be mentioned. It is important to note that, in South Africa, fraud is not categorised into different offences.

Auditors often make the mistake of using fraud as a generic term that includes any dishonest act (Labuschagne, 2006:30). In other countries, such as the USA, corruption is considered to be a category of fraud, whereas in South Africa corruption and fraud are

considered to be two different types of offences. Corruption is not included in ISA 240 and, therefore, the professional auditing standard ignores corruption as a fraud type, which is in accordance with the South African Criminal Law.

ISA (240:3) states that auditors are only responsible for identifying fraud that will cause financial statements to be materially misstated. Misstatement is defined by ISA (200:13) as when reported financial statements vary from the applicable financial reporting framework. A misstatement is considered to be material when the misstatement within the financial statements will influence the economic decisions of financial statement users (ISA 320:2). As a result, auditors will only focus on fraud that misinterprets the financial position of an entity and, in effect, influences the financial statements users' economic decisions.

3.4.1. Asset misappropriation

Asset misappropriation can be defined as when an employee or management uses false or misleading records to conceal the theft of an entity's assets (ISA 240:A5). Roybark (2014:2) defines misappropriation of assets as when the entity's resources are being embezzled. According to Wells (2013:3), embezzlement is "to [wilfully] take, or convert to one's own use, another's money or property of which the wrongdoer acquired possession lawfully, by reason of some office or employment or position of trust". A further definition of misappropriation of assets, by Kranacher *et al.* (2011:4), is the misuse of the organisation's assets. In summary, these definitions state that when someone within an organisation takes or misuses the organisation's assets and conceals the act by using false or misleading records, it can be viewed as misappropriation of assets.

Asset misappropriation refers to fraud involving cash, inventory and other assets of a company (ACFE, 2014:11). According to the Association of Certified Fraud Examiners (ACFE, 2014:11), fraud relating to cash, inventory and other assets can include offences such as theft of cash (skimming and cash larceny), fraudulent disbursements (billing schemes, payroll schemes, expense reimbursement schemes, check tampering and register disbursements) and the misuse of inventory and other assets (false sales and shipping and asset requisition and transfers). Asset misappropriation can, thus, take many forms and include different types of acts. It is imperative for auditors to fully understand the types of crimes that are included in asset misappropriation since they are required to be competent in identifying the act and assessing the risk associated with the

act in terms of ISA 240. The ACFE (2014:12) indicated in their Report to the Nation that asset misappropriation is the most common type of fraud that occurs in organisations. The statistics show that 85% of fraudulent cases reported in 2014 were related to asset misappropriation, whereas 36.8% involved corruption and 9% financial statement fraud (ACFE, 2014:12). These statistics highlight the importance of auditors having sufficient knowledge on asset misappropriation, as well as the ability to effectively identify the act.

3.4.2. Financial statement fraud

Fraudulent financial reporting can be defined as the intention to deceive financial statement users by altering financial statement records (ISA 240:A2). Financial statement fraud can also be described as "the intentional misrepresentation of financial or non-financial information to mislead others who are relying on it to make economic decisions" (Kranacher *et al.*, 2011:4). When upper management of an entity manipulates, falsifies or alters accounting records with the intention of misrepresenting the financial position or performance of the entity, financial statement fraud has occurred also (Zimbelman, Albrecht, Albrecht & Albrecht, 2011:35). Fraudulent financial reporting is defined as a misrepresentation of the financial information of a company by falsifying or altering financial records with the intention of deceiving financial statement users and, in effect, influencing their decision making.

Financial statement fraud includes the overstatement and understatement of assets and/or revenue (ACFE, 2014:11). Assets and revenue can be overstated or understated by recognising accounting records in the incorrect financial year, creating fictitious accounting records and providing improper valuations and disclosures (ACFE, 2014:11). Financial statement fraud is usually committed by management to benefit the organisation (Singleton & Singleton, 2010:99). Zimbelman *et al.* (2011:55) explained that management commits fraud due to a lack of moral values, misplaced incentives, high expectations, high debt levels, skewed focus on rules rather than principles, a lack of auditor independence, and greed. The ACFE (2014:12) indicated in their Report to the Nation that financial statement fraud has the most significant financial impact on organisations even though it occurs less frequently. In 2014, companies lost great amounts due to the occurrence of fraud in their organisation (ACFE, 2014:12). Financial statement fraud accounted for 92% of the financial losses in comparison with asset misappropriation making up 3% and corruption 5% (ACFE, 2014:12).

Management commits financial statement fraud to enhance the business' performance and financial state. Even though financial statement fraud does not occur as often as asset misappropriation, it can have tremendous financial consequences and can lead to an organisation's downfall. These facts emphasise the importance for auditors to have the ability to effectively identify and assess the risk involved.

3.4.3. Corruption

Even though ISA 240 makes no mention of corruption, the impact of corruption on financial statements cannot be underestimated. The Prevention and Combating of Corrupt Activities Act (PRECCA) (12 of 2004) defines corruption as: a person acting or inducing another person to act in an illegal manner resulting in a breach of trust or abuse of authority by offering, accepting or giving any form of gratification directly or indirectly to benefit themselves. The ACFE (2014:71) sees corruption as employees misusing their position in the company with the objective of gaining a direct or indirect benefit. Thus, in short, corruption entails people who misuse their position of power in a company with the aim of acquiring a direct or indirect benefit in an illegal or deceitful manner.

Under the ACFE's definition of corruption, the main offences include conflicts of interest, bribery, illegal gratuities and economic extortion (ACFE, 2014:11). Corruption is usually committed by an employee for personal gain. In order to successfully commit the act, someone inside the organisation needs to work with someone outside the organisation with the intent to harm the organisation (Singleton & Singleton, 2010:101).

According to Wells (2013:262), bribery in a business context usually involves offering, providing, receiving or asking for something valuable in exchange for influencing business decisions. For example, kickbacks involve undisclosed, overpriced or fictitious invoices for goods and services between a vendor and employee (Wells, 2013:264). Wells (2013:263) also stated that the only reason kickbacks are not included in asset misappropriation is because the act involves collusion between the employee and a vendor. However, with conflict of interest, it is possible for employees to keep their financial interest undisclosed in certain transactions, resulting in the organisation's losing or gaining business (Wells, 2013:278). With extortion, employees demand payments from vendors and, in return, favour these vendors (Wells, 2013:278). Illegal gratuities are usually prohibited by most companies' code of ethics and involve employees' receiving gifts for benefitting a person or company (Wells, 2013:262).

According to Crowe Horwath (2009:6), conflict of interest occurs at both manager and director level, and one of the possible reasons why management commits bribery is to benefit the company and not only for personal gain. The ACFE (2014:12) stated that corruption occurs 27.8% more frequently than financial statement fraud and causes an average of $70 000 more financial losses for organisations than asset misappropriation. It was also stated that, in 2014, 32.9% of the 173 cases reported in sub-Saharan Africa related to fraud committed in South Africa (ACFE, 2014:73). In addition, the ACFE (2014:54, 55) mentioned that the majority of perpetrators are highly educated and work within the accounting and operations department of organisations. Entity managers and owners who commit asset misappropriation, financial statement fraud and corruption cause the most financial losses for their entity (ACFE, 2014:43–45). It is, therefore, evident that managers and owners who commit corruption have the ability to cause significant financial losses for an organisation.

Concluding from the literature, it is clear that corruption affects the financial statements of an entity. Bribery is an illegal act and kickbacks can involve fictitious invoices affecting the organisation's assets and resulting in the financial statements' not reflecting actual and true information. In contrast, conflict of interest results in undisclosed information within the financial statements that contradicts the applicable financial reporting framework. Corruption can, therefore, cause the financial statements to be materially misstated as both bribery and conflict of interest are capable of affecting the financial statement users' decisions.

In light of the above, the question can be raised as to why ISA 240 does not include corruption as a type of fraud relevant to an auditor. Corruption causes more financial losses than asset misappropriation and occurs more frequently than financial statement fraud. The objective of corruption is to gain an illegal advantage and the act can be committed by employees, managers and third parties. Based on the facts above, the inclusion of corruption as a category of fraud in ISA 240 should definitely be considered.

3.5. Red flags

In the past, auditors have relied on internal controls to protect the company against fraud. Now they can no longer rely on these controls, because management has started to override controls implemented to protect the company (Hegazy & Kassem, 2010:69). When people are capable of identifying red flags, they will be successful in detecting and preventing fraud, according to Singleton and Singleton (2010:96) and, ultimately, in

performing an effective FRA. For this reason, it is pertinent that auditors are aware of red flags.

Red flags can be described as indicators of a fraudulent activity taking place (Gullkvist & Jokipii, 2013:44; Taylor, 2011:130). ISA (240:A23) states that fraud risk factors are indicators of circumstances providing an opportunity, motivation or pressure to commit fraud. Fraud risk factors can be said to be the opposite of fraud risk indicators. Fraud risk factors provide the fraudster with the most favourable circumstances for committing fraud, therefore, helping the auditor to implement the fraud triangle, as used by ISA 240. On the other hand, fraud risk indicators, or red flags, point towards the possibility of fraud occurring.

Auditors tend to consider red flags relating to fraudulent financial statements as more important than those relating to asset misappropriation (Gullkvist & Jokipii, 2013:51). The reason for this is that financial statement fraud is far more risky and costly for auditors than asset misappropriation; it attracts more media coverage and is considered to be more material to the financial statements (Gullkvist & Jokipii, 2013:51). This becomes a concern because the importance of red flags is influenced by external auditors' sensitivity to materiality and their roles and responsibility towards the organisation (Gullkvist & Jokipii, 2013:51). ISA (240:A24) states that auditors must use their professional judgement to determine whether fraud risk factors are present in certain circumstances and whether they should be taken into consideration when performing FRAs. Gullkvist and Jokipii (2013:51) also mentioned that determining whether an item is material or immaterial, as well as choosing fraud risk indicators and fraud types, are essential aspects for FRA.

Clearly, the auditor's judgement plays a vital role in determining whether circumstances will be taken into consideration when performing an FRA. The question arises, however, as to whether the auditor's judgement is sufficient to perform an effective FRA.

Listed in table 3.1 below, are a few fraud risk indicators provided by ISA (240: Appendix 3):

Table 3.1. Fraud risk indicators

Fraud risk indicator	Examples of fraud risk indicator
Inconsistencies within the accounting records	- Transactions not completed on time or recorded incorrectly - Unauthorised transactions - Unauthorised access by employees - Last-minute alterations having a significant effect on the financial statements
Inconsistent or omitted evidence	- Incomplete or altered documents - Unusual or missing items - Missing original documents - Unusual changes on balance sheet and ratios - Inconsistencies between entities records and supporting documents - Missing assets
Abnormal relationship between management and auditors	- Denying auditor access to records, IT facilities, vendors and employees - Time pressure from management - Unwillingness to revise financial statements or address deficiencies - Entity delaying the availability of requested information
Other	- Unusual changes in accounting estimates - Violations to the code of conduct - Inability of auditor to meet with those charged with governance

According to Singleton and Singleton (2010:101), auditors need to become familiar with red flags relating specifically to financial statement fraud and asset misappropriation to allow them to enhance their fraud mind-set. In light of the conclusion that corruption should be considered for ISA 240, red flags regarding corruption will also be examined. Table 3.2 below depicts a list of red flags for financial statement fraud, asset misappropriation and corruption, as mentioned by Singleton and Singleton (2010:101–110):

Table 3.2. Red flags

Financial statement fraud	
General	- Company shows rapid growth - There are weaknesses in internal controls - Company shows unusual profits - Executive manager is obsessed with stock prices - Executive manager is aggressive - Senior management shows weakness in personal ethics
Fictitious revenues	- There is abnormal increase in assets - Data are missing from customer files - Changes occur in relationships or ratio trend without explanations
Concealed liabilities	- Excessive or unusual transfers take place between the entity and a related party - Vendor invoices and liability transactions are unrecorded
Inadequate disclosures	- Disclosure notes are complicated - Non-disclosure if significant events occurs - Non-disclosure if fraud occurs
Improper asset valuation	- There is unusual increase in value of assets - Reporting standards are violated

Asset misappropriation	
General	- There are changes in employee behaviour - Employee with a high personal code of ethics struggles to look people in the eye and is irritable, or more than usual - Employee shows anger, or more than usual - Employee tends to start blaming others - Employee shows irregularity in work - There is a change in employee's lifestyle - Employee rejects transfers, promotion or job offers - Employee never takes vacations - Employee has financial strains or debt problems - Employee might have psychotic problems - Employee is constantly complaining about working

	conditions - Employee needs to control everything
Cash larceny	- There is unusual decrease in deposits in the bank - There are unusual differences between bank statements and accounting records
Billing schemes	Shell company: - Address of company matches an employee's address - One vendor/some vendors get(s) paid more than others - There is unusual increase in cost of sales - Invoices are incomplete - Vendor only bills for services Pass-through vendor: - Profits decrease but cost of sales increase - Invoice amounts are always below approval level - Weak segregation of duties relating to vendors takes place - Higher prices are paid for goods and services Personal purchase: - Unusual items are being purchased - Unusual activity is occurring on corporate credit card - Employee always exceeds the budget
Payroll schemes	Ghost employee: - There is unusual increase in wages - Payments are made to employees who: never take vacation or sick leave, have no deductions, have the same address as another employee and have no phone number Commission: - There is unusual increase in commissions - There is a change in commission rates Falsified wages: - Unusual overtime is paid - There is a change in pay rates - Unusual hours are paid Cheque-tampering: - Cheques are missing - Cheques are made out to employees who are not on

	payroll - Amounts on cheques are altered - Cheque numbers are duplicated Skimming - Actual profits are below projections - Revenues and gross margins are lower than expected Lapping - Employees have a lot of overtime - Customers receive invoices after they have paid

Corruption	
General	- There is a change in the employee's behaviour - There is a change in the employee's lifestyle - Key employees and authorised vendors have a good relationship - Vendor's approval shows irregularities - Transactions recorder shows irregularities - Third-party relationship is kept secret - Deficiencies occur in the review of management approval for third-party relationships
Conflicts of interest	- There is a specific vendor with a large number of transactions - Weak segregation of duties relating to invoices and contracts takes place - There is a secret relationship between an employee and a third party
Bribery and extortion	- There is a change in employee's lifestyle - There is a secret relationship between a vendor and an employee - Weak segregation of duties relating to invoices and vendors takes place

The ACFE (2014:60) also provided a list of common red flags that are relevant to asset misappropriation, financial statement fraud and corruption. The following factors can be viewed as red flags in the behaviour of employees, managers and executives (ACFE, 2014:60):

- The individual has close relationships with suppliers and customers;
- The individual always has the need to be in control;
- The individual is likely to have family, financial and/or legal problems;
- The individual keeps to him/herself;
- The individual refuses to take vacations;
- The individual comes across as defensive, irritated and/or aggressive;
- The individual complains about remuneration and a lack of authority; and
- The individual faces a great deal of pressure, and feels pressured to be successful.

When comparing the red flags provided by Singleton and Singleton and the ACFE with those provided by ISA 240 the following similarities and difference can be noted:

- ISA 240 focuses only on events that can be found within the financial statements with little focus on the behaviour of management;
- Singleton and Singleton focuses on incidents within the financial statements, as well as on the behaviour of management and employees;
- The ACFE focuses only on the behaviour and circumstances of the employee, management or executive;
- The ISA 240 distinguishes only between inconsistencies within accounting records and missing evidence, and focuses on the relationship between the manager and auditors; and
- Singleton and Singleton distinguish between the categories of fraud and elaborate by providing red flags of the specific types of fraud.

The red flags provided by Singleton and Singleton seem far more extensive and effective than those provided by ISA 240. Based on all the information in paragraph 3.5, the assumption can be made that the red flags provided by ISA 240 are not sufficient to enable the auditor to identify possible fraud occurring inside an organisation. Various other authors have compiled lists of red flags to be used when performing investigations on fraud that have not been written for the auditor necessarily, but can be taken into account when performing FRAs.

3.6. Summary

ISA 240 refers to the auditor's responsibility relating to fraud during the audit of the financial statements. This chapter determined that an extensive understanding of the elements of fraud, the ability to identify the risk according to these elements and reporting the matters in an applicable manner are needed in order to perform an effective FRA.

Fraud can be defined as an act by a person with the intention of misrepresenting the truth and concealing a deed in order to persuade another person to part from their possessions and/or cause them potential or definite harm which could, ultimately, lead to legal action. There are four elements that need to be present in order for an act to be classified as fraud, namely unlawfulness, misrepresentation, intent to deceive, and actual or potential harm. In addition, the different fraud models with regard to the motivation and reasoning behind the act of fraud was examined, namely the fraud triangle, the MICE model, the fraud diamond, the fraud scale model, the rational choice perspective, and Crowe's fraud pentagon. It was shown that the fraud triangle used by ISA 240 might not be the most effective model to assist an auditor in determining the reason why fraud has been committed. The fraud triangle does not consider the fraudster's capabilities, integrity or lack of conscience, which are all critical factors in determining the reason and motivation behind fraud.

When combining the six fraud models, a new fraud model can be created to include all relevant factors that need to be considered when determining the reason for committing fraud. The combination model will provide the auditor with the best fraud model to follow in order to gain deeper knowledge on fraud and to perform an effective FRA. This combined model includes the following elements: pressure/motivation; opportunity; capabilities/competence; integrity or lack of conscience; and rationalisation.

Auditors are responsible for obtaining reasonable assurance that financial statements are free from material misstatements due to fraud. They are also responsible for assessing the RMM due to fraud. In terms of ISA 240, auditors are required to focus only on asset misappropriation and financial statement fraud. It was, however, determined that corruption can cause a company more financial loss than asset misappropriation and occurs more often than financial statement fraud. Both asset misappropriation and financial statement fraud have an impact on the financial statements either because the financial records have been altered or the assets have been affected. Corruption can

lead to undisclosed information and financial statements' reflecting misleading information – as a result, the financial statements will be materially misstated. It was concluded that corruption as a category of fraud needs to be included in ISA 240.

It was also concluded that the fraud risk indicators provided by ISA 240 are vague and that they limit auditors' knowledge and understanding on fraud, making it more challenging for auditors to identify fraud. ISA 240's fraud risk indicators need to be extended to include red flags for each specific fraud type and to place more focus on the behaviour of management. By extending the fraud risk indicators of ISA 240, auditors' understanding and knowledge on fraud will be enhanced. If their knowledge on fraud is based solely on ISA 240, auditors will have little understanding and insufficient knowledge on fraud, and be less capable of identifying fraud. Consequently, their ability to perform effective FRAs will be reduced. In addition, this chapter has shown that the auditor's judgement plays a vital role in determining whether circumstances will be taken into consideration when performing FRAs. It should, therefore, be determined whether the auditor's judgement is sufficient to perform an effective FRA.

With the combination model and the extended red flags provided by Singleton and Singleton, auditors will be able to gain full understanding of fraud, which will enhance their ability to identify fraud and perform effective FRAs. Chapter 4 will elaborate on FRAs with reference to what they entail and how they should be performed.

CHAPTER 4

4. UNDERSTANDING FRAUD RISK ASSESSMENTS

4.1 Introduction

International auditing standards have been set with the aim to develop guidelines that auditors can use to manage the risk of fraud effectively and sufficiently (Graham & Bedard, 2003:55). In South Africa, auditors refer to the ISA to guide them in performing an audit, specifically ISA 240, because it outlines the auditor's responsibility towards fraud when auditing financial statements. ISA 240 addresses the objective of the auditor towards fraud, refers to specific audit procedures auditors need to follow and outlines the characteristics of fraud and fraud risk factors. In addition, auditors focus on ISA 315 to assist them in identifying and assessing the RMM due to fraud. In short, auditors use ISA 240 to obtain an understanding of fraud and specific fraud audit procedures, and then use ISA 315 to assess the risk of fraud.

To be able to adequately assess the relevance of the auditor and the forensic accountant in performing FRAs, one needs an understanding of the definition of FRAs, how to perform FRAs and the difference between FRAs performed by an auditor and a manager respectively. In chapter 3, various fraud concepts were clarified. Chapter 4 will focus on how to assess the risk of fraud from an auditor's perspective when performing financial statement audit.

This chapter will further define the concepts "risk" and "risk assessment". A distinction will be drawn between the term "fraud" and "error," as well as between "fraud risk assessment" and "fraud risk management". The chapter will also elaborate on the methods used to assess the risk of fraud and the auditor's response to the assessed risk.

4.2 Definitions

The term "fraud" was defined and outlined in chapter 3 (par 3.2); in this section, the term "risk" and "risk assessment" will be discussed.

The American Management Association Dictionary of Business and Management (hereafter The AMA Dictionary of Business and Management) (2013:240) defines risk as when an effort is made to achieve something and uncertainty exists regarding the possible financial loss the effort might have. Another definition of risk is when uncertainty exists regarding the occurrence of an event together with the outcome of the event

(Oxford Dictionary of Economics, 2012:355). Hence, risk can be defined as when uncertainty exists concerning the occurrence of an event together with the effect the occurrence might have or the standard deviation of the expected outcome.

Identifying the areas with the highest risk of fraud and assessing this risk are critical in identifying fraud in financial statements (Golden, Skalak & Clayton, 2006:125). Four types of risks are important to an auditor, namely audit risk, control risk, detection risk and inherent risk (Hopwood *et al.,* 2008:88). Audit risk can be defined as the risk of the auditor expressing an inappropriate opinion that the financial statements are free from material misstatements when, in fact, they contain material misstatements (Hopwood *et al.,* 2008:88; ISA 200:13). Audit risk involves the RMM and detection risk (ISA 200:13). The risk that the auditor will not identify material misstatements during the audit is defined as detection risk (Hopwood *et al.,* 2008:89) and the RMM is the risk that the financial statements will be materially misstated before the commencement of the audit (ISA 200:13).

Figure 4.1 below illustrates the level of audit risk as the RMM multiplied by detection risk.

Figure 4.1: Audit risk

Risk of material misstatement consists of control risk and inherent risk (ISA 200:13). Inherent risk refers to the risk that the financial statements will contain material misstatements before any relevant controls have been considered (Hopwood *et al.,* 2008:88; ISA 200:13), whereas control risk is the risk that the controls implemented by the client will not detect or prevent misstatements in a timely manner (Hopwood *et al.,* 2008:89; ISA 200:13). Figure 4.2 illustrates that RMM consists of inherent risk and control risk.

Figure 4.2: Risk of material misstatement

Risk assessment is the process of determining the various levels of risk whereby a company attempts to identify possible risks, together with the probability of the risks occurring, as well as the outcome should the risks occur (Oxford Advanced Learner's Dictionary, 2010:1278). Risk assessment can also be described as when an auditor performs the procedures necessary to obtain an understanding of the audit client, enabling the auditor to identify and assess the RMM (ISA 315:4). Zack (2013:205) adds that risk assessment is when the risks associated with the steps taken by audit clients to reach their objectives are identified and assessed. Fraud risk assessment is when auditors use their audit plan to identify risks that are caused by fraud and are considered to be fundamental to their client (Vona, 2008:21).

Risk assessment can, therefore, be defined as the action of identifying possible risks and assessing the possible impact of the occurrence of these risks. Fraud risk assessment can be described as the action of identifying the possibility of fraudulent transactions occurring and assessing the impact the occurrence of fraud might have on the organisation and the financial statements.

4.3 The auditor versus management

Fraud risk assessments can be used by both the auditor and the management of a business. For this reason, a distinction between the responsibility of management and auditors should be drawn as both have different goals and responsibilities regarding FRAs.

Fraud risk assessments are used by auditors and managers to manage the risk of fraud (Vona, 2008:37). Management uses FRAs to make important decisions, for example, with regard to how they will go about uncovering the risk of fraud, the controls they can implement to protect the company from possible fraud, and how they can prevent the risk from occurring (Vona, 2008:39). Auditors, in turn, take FRAs into account when determining the nature, timing and extent of their audit procedures and they also use the assessment to deal with current risk affecting their client's organisation (Vona, 2008:37, 39). Auditors further use FRAs to determine whether the organisation's internal controls have the ability to reduce the risk of fraud to an acceptable level and to narrow their focus on areas where the company is most vulnerable to fraud (Vona, 2008:40, 55). Auditors use managers' FRAs when planning their own response to the risk of fraud (Vona, 2010:70). Thus, auditors use the controls put into place by management to

reduce the risk of fraud and use management's FRA to assist them in addressing the risk of fraud.

In summary, management uses FRA to prevent and detect fraud and implement controls to protect the company against fraud, whereas auditors use FRA to assess whether the controls implemented by the client are effective in identifying, preventing and detecting fraud and to assess the current risk of fraud faced by the company. For purposes of the study, this chapter will focus only on FRA as used by the auditor during an audit.

In contrast to FRAs, fraud risk management (FRM) is performed only by the management of the client's organisation. It is vital to distinguish between FRAs and FRM to place emphasis on the responsibility of the auditor versus that of management. The AMA Dictionary of Business and Management (2013:240) defines risk management as when the risk of business deals are evaluated by way of determining the success rate and the outcome should the business deals fail. Risk management can also be described as when measurements are put into place to not only reduce risk within a business, but also identify, analyse and assess risk (Oxford Dictionary of Economics, 2012:357). Taylor (2011:183) views risk management as when directors or senior managers attempt to determine the risk within their organisation by taking the necessary action to minimise risk and reduce the effect of the identified risks. Risk management is when the company identifies business risk and implements controls to prevent, reduce or protect the company against such risk in order to minimise its exposure to financial loss or fraud.

Fraud risk management, therefore, attempts, firstly, to prevent fraud by reducing the risk of fraud, secondly, to detect fraud by being attentive to misconduct that could relate to fraud and, thirdly, to respond to the risk of fraud by taking action when it occurs (Taylor, 2011:184). To summarise, FRM is performed when management takes the necessary steps to, firstly, identify possible risks of fraud that can affect the organisation and then to implement controls to prevent, detect and respond to these risks in order to minimise them and reduce their effect.

4.4 Performing fraud risk assessments

As mentioned, auditors are responsible for "obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error" (ISA 240:5). Reasonable assurance does not equal absolute assurance, only a high level of assurance (Zack, 2013:249). Auditors are not able to

provide absolute assurance, because there is always the risk that they would not identify material misstatements. Although ISA 240 assists them in identifying and assessing the risk of fraud, auditors are always faced with the unavoidable risk of not identifying material misstatements caused by fraud due to the fact that fraud involves concealment and misrepresentation (ISA 240:6, 8). Allen, Hermanson, Kozloski and Ramsay (2006:161) agree by adding that auditors find it challenging to assess the risk of fraud, firstly, because of the element of deception that is involved and, secondly, the fact that auditors have limited experience with fraud. Another obstacle that auditors face is the fact that they are being made responsible for assessing the risk of fraud even though many of them have never encountered fraud during their career (Beasley & Jenkins, 2003:32).

In light of the above, it is vital to determine the relevance of forensic accountants and auditors respectively in performing FRAs. Because they have limited experience on fraud, auditors need to be equipped with the necessary knowledge on fraud in case they encounter fraud or are responsible for performing an FRA. As Singleton and Singleton (2010:114) emphasised, an understanding of fraud concepts is necessary to perform an effective FRA – an understanding that auditors seem to be lacking, as indicated in chapter 3 (par 3.6). Knapp and Knapp (2001:27) confirm that auditors' knowledge influence their understanding and interpretation of information and, in turn, the effectiveness of the assessment.

When auditors perform FRAs, they are concerned only with fraud or errors that will result in the material misstatement of financial statements (ISA 240:3), and rightfully so. According to Zack (2013:249), auditors are expected to only detect material misstatements caused by fraud and/or error and not all misstatements. Therefore, auditors are concerned only with fraudulent financial reporting and misappropriation of assets (ISA 240:3).

It is important to distinguish error from fraud, as this chapter focuses on materially misstated financial statements caused by fraudulent financial reporting. ISA (Glossary:7) defines an error as an unintentional omission or misstatement in the financial statements. Error can also be defined as a mistake that affects the results and, in effect, causes difficulties (Oxford Advanced Learner's Dictionary, 2010:496), or when an individual strays from the correct information (APA Dictionary of Psychology, 2007:341). Fraud involves the intention to deceive or violate, while an error is unintended and

merely the result of a mistake. As Pincus (1989:154) stated, an error results in an unintentional misstatement, whereas fraud is the reason for intentional misstatements.

Auditors have the following objectives when performing FRAs: identifying and assessing the risk of fraud that causes material misstatements; designing and implementing procedures to help them obtain enough evidence to respond to the risk of fraud; and responding to the risk of fraud they have identified during the audit (ISA 240:10). A discussion of each objective is provided below.

4.4.1. Identifying and assessing the risk of fraud

Auditors are required to identify and assess the RMM at financial statement level and assertion level (ISA 315:25). Choosing the method to perform FRAs depends on the purpose of the risk assessment (Vona, 2008:37). As auditors find it challenging to assess the risk of fraud, an audit approach is needed specifically designed to assess the risk of fraud (Knapp & Knapp, 2001:26).

Beasley and Jenkins (2003:32) expressed that brainstorming is an essential part of FRA. It helps develop ideas on possible fraud risks that auditors normally would not have considered on their own and highlights the importance of professional scepticism to each audit team member (Beasley & Jenkins, 2003:32). Graham and Bedard (2003:66) add that FRA is more effective when auditors work as a team to assess the risk of a client. ISA (315:10) affirms this statement by mentioning that the engagement manager together with the engagement team members need to discuss the vulnerability of the entity's financial statements to fraud. It is clear that brainstorming is a vital part of assessing the RMM and can increase the effectiveness thereof.

Brainstorming and discussion can assist the auditor in many ways (ISA 315:A21):

- The inexperienced auditor can gain the insight and knowledge of more experienced auditors;
- Auditors can share information regarding the business risks the entity is faced with and the extent to which the entity's financial statements are vulnerable to material misstatement due to fraud;
- Auditors are given the opportunity to discuss potential areas within the financial statements where fraud can occur and how fraud can occur;

- Auditors can gain a better understanding of potential risk in specific areas that can cause material misstatements and how the outcome might affect the nature, timing and extent of audit procedures and other aspects of the audit; and
- Auditors are given the opportunity to communicate the information acquired throughout the audit and procedures performed in connection with the RMM caused by fraud.

Allen *et al.* (2006:162) suggested that brainstorming sessions in the engagement team will enhance the auditor's sensitivity to fraud risk and enable the auditor to identify fraud risk indicators. In a similar vein, Knapp and Knapp (2001:25) mention that the effectiveness of FRA is enhanced when auditors are given specific instructions to be attentive to the presence of fraud.

From the above, the importance of brainstorming sessions for the audit team members is clear. Having these sessions before performing the FRA would add to the effectiveness of the assessment.

4.4.2. Design and implementation procedures

There are three procedures auditors can follow to assess the risk of fraud when performing a financial statement audit. This paragraph will aim to determine the best procedures to effectively and sufficiently perform FRAs. Procedures that can be used by the auditor to identify and assess the risk of fraud in order to obtain enough evidence to respond to the risk are discussed below.

4.4.2.1. Inquiry from management

The auditor can use the following procedure to obtain the necessary information to identify the RMM (ISA 240:17-19):

- The auditor can inquire information from members of management regarding:
  - Procedures they use to identify and respond to the risk of fraud;
  - Knowledge they might have of actual or potential fraud;
  - Communications made to employees on ethical behaviour; and
  - Whether they have identified areas where the entity is vulnerable to fraud.
- The auditor can inquire from employees whether they know of any fraud affecting the entity;
- The auditor can use the internal auditors, if possible, to gain knowledge on any fraud affecting the entity;

- The auditor needs to ascertain whether unusual or unexpected relationships exist and whether the relationships indicate an RMM; and
- The auditor must consider other information that emerges indicating the possibility of RMM.

Inquiry can be a useful procedure to gain information that is not found in written form to clarify inconsistencies (Hopwood *et al.,* 2008:100). Even though inquiry from management can be used as a tool to identify and assess the risk of fraud, the method should be used with caution, because management can still deceive the auditor. According to Vona (2008:15), members of management can conceal acts from the auditor, because they can easily override internal controls due to their position of authority. Management is in the best position to deceive auditors and manipulate financial statements. Hence, the auditor is required to find additional evidence to support the information provided by management.

Another obstacle the auditor faces by only using review and inquiry procedures is that the inquiry will be based on those risk factors identified during the audit and the assessed risk of fraud (Graham & Bedard, 2003:56). According to Graham and Bedard (2003:66), fraud risk factors are more likely to be identified during the planning stage of the audit than through FRA. Thus, inquiries do not address fraud risk factors that might have been missed by auditors during their planning, resulting in an ineffective FRA.

One of the biggest disadvantages of inquiry is the fact that auditors need to obtain additional information before they can accept management's responses as true. Should auditors not identify fraud risk factors, these will not be addressed in the auditors' FRA. In conclusion, inquiry from management on its own might not be sufficient to perform an effective FRA and should, therefore, be incorporated with other procedures.

4.4.2.2. Red-flag questionnaire

The purpose of the red-flag approach is to make the auditor more attentive to the possibility of fraud as this approach is only effective to the extent that the auditor is attentive to the possibility of fraud (Pincus, 1989:155). Golden *et al.* (2006:124) argued that auditors' ability to identify red flags is dependent on their understanding of the business and the business environment. Graham and Bedard (2003:57) stated that the first step in performing an FRA is to gain an understanding of the client's environment, to identify characteristics of the client that can indicate the possibility of fraud and then to assess the risk of fraud. It can be concluded that auditors' understanding of their client's

business will enhance their ability to identify red flags and, ultimately, assess the risk of fraud.

As mentioned in chapter 3 (par 3.5), red flags are considered to be fraud risk indicators pointing towards the possibility of fraud occurring. Pincus (1989:153) concurs that red flags are considered to be indicators of potential fraud. Red flags are further useful to auditors, because they can indicate the possibility of fraud early in the audit, manage audit risks and assist in identifying fraud (Koornhof & Du Plessis, 2000:70, 76). The red-flag questionnaire is a tool auditors can use to assess the risk of fraud and it adds structure to the approach to ultimately assist auditors in their ordinary audit engagement (Pincus, 1989:154, 155).

Red flags, thus, have the ability to assist auditors in identifying and assessing the risk of fraud and to mitigate the audit risk. As with any methodology, the red-flag approach has its benefits and shortcomings.

The benefits of the red-flag approach are the following, according to Pincus (1989:154, 155, 161):

- The red-flag approach assists auditors in gaining data that are consistent and thorough, thereby obtaining relevant information which could, ultimately, support their opinion;
- The questionnaire requires auditors to communicate with the client in order to complete the form, therefore, the approach improves client communication;
- The audit costs and risk will be minimised, because the red-flag questionnaire is a structured approach;
- The responsibility still lies with the auditor to interpret and evaluate the information provided by the questionnaire; and
- The red-flag approach enables auditors to justify their results.

The shortcomings of the red-flag questionnaire are (Pincus, 1989:154, 155, 156):

- The questionnaire will lead the auditor to focus only on the questions and not consider other relevant information that points out the possibility of fraud;
- The structure of the questionnaire could lead the auditor to pay too much attention to a certain part of the information and neglect the other parts; and
- Red flags are indicators only of the possibility of fraud, and indicators could thus be present where fraud has not been committed.

Golden *et al.* (2006:127–128) add the following obstacles auditors face when using red flags to identify and assess the risk of fraud:

- Red flags indicate only the increased RMM due to fraud; they do not prove the presence of fraud. Koornhof and Du Plessis (2000:76) claimed that the red-flag approach is not enough to establish fraud; only once the identified risk areas are investigated further will auditors be able to confirm the presence of fraud;
- Red flags can indicate both fraud risk areas and non-fraud risk areas;
- Auditors can easily misinterpret fraud risk factors and should, therefore, support their interpretation with facts and evidence;
- Red flags cannot be considered in isolation. Koornhof and Du Plessis (2000:76) mentioned that red flags are only effective when they are used in combination with other red flags; and
- It is not possible for auditors to observe all red flags, because some might relate to an individual's personal life. Koornhof and Du Plessis (2000:77) indicated that the red flags that best predict fraud refer to the pressure and attitude of management (personal debt, inadequate income, living beyond ones means, etc.).

Once they have completed the red-flag questionnaire, auditors must evaluate the information for indications of the existence of fraud (Pincus, 1989:156). As seen from the above information, Koornhof and Du Plessis and Golden *et al.* are in agreement that red flags are not enough to determine the presence of fraud – auditors need to perform additional procedures. This has been proved by a study performed by Pincus. Pincus (1989:158) divided auditors into two groups to assess the risk of fraud, the one half used a red-flag questionnaire and the other did not. Pincus (1989:161) found that there was no significant difference between the responses received from the auditors who followed the questionnaire and those who did not. Instead, it was determined that the auditors who did not use the questionnaire performed better in situations where fraud was present than those who had used the questionnaire (Pincus, 1989:161). In conclusion, the red-flag questionnaire is a method auditors can use to assist them in assessing the risk of fraud, but it does not necessarily increase their ability to effectively perform an FRA.

The red-flag questionnaire seems to be the most ineffective approach to identify and assess the RMM. Even though the red-flag questionnaire would lead to consistent evidence and auditors would be able to justify their results, the approach is successful only if auditors are attentive to the possibility of fraud. The main shortcoming of the red-

flag approach is the fact that it limits the auditor's knowledge to the questionnaire, meaning the auditor might neglect factors outside the questionnaire that could be indicating the possibility of fraud. The red-flag approach can be valuable in assessing the risk of fraud if it is used in combination with analytical procedures, according to Koornhof and Du Plessis (2000:90). They also indicated that red flags are not considered important in South Africa due to the high levels of crime in the country (Koornhof & Du Plessis, 2000:88).

4.4.2.3. Analytical procedures

Analytical procedures are considered to be the most useful technique for identifying fraudulent transactions within the financial statements (Zack, 2013:209). These procedures involve a comparison between actual figures and projected figures (Knapp & Knapp, 2001:27). ISA (240:A50) states that analytical procedures are used to identify relationships that indicate the possibility of fraud and are capable of materially misstating the financial statements. Analytical procedures can be described as: "evaluations of financial information through analysis of plausible relationships among both financial and non-financial data" (ISA 520:4). When the auditor's expectations are compared to the actual recorded amounts, analytical procedures are being performed (Hopwood *et al.,* 2008:99). Thus, analytical procedures can be described as a technique used to identify relationships between financial and non-financial data by comparing actual figures to budgeted figures or by comparing current figures to prior figures.

The main purpose of analytical procedures is to identify unusual account balances or transactions which could indicate possible areas affected by fraud (Hopwood *et al.,* 2008:102, 111). When the auditor identifies material variances or unusual transactions during analytical procedures, the auditor has the responsibility to further investigate the matter (Zack, 2013:254). The auditor can make use of management inquiry to investigate the material differences but should still find additional evidence to support management's explanations, as it is possible for management to deceive the auditor (Zack, 2013:254, 255). Analytical procedures also involve an element of inquiry with management, as auditors are required to investigate material variances.

To make analytical procedures effective in assessing the risk of fraud, it is vital that the auditor possess knowledge on fraud to be able to identify indicators of fraud (Knapp & Knapp, 2001:28). For analytical procedures to be effective in identifying fraud, an experienced auditor is needed to perform the assessment; in other words an audit

manager, instead of an audit senior, should perform the assessment (Knapp & Knapp, 2001:34). In conclusion, analytical procedures would be effective only if the auditors performing the procedures have sufficient knowledge and experience on fraud.

The auditor must consider the following factors when designing analytical procedures (ISA 520:5):

- The suitability should be determined of the analytical procedures to assess the RMM;
- The reliability of the data used to perform the analytical procedures must be evaluated:
    - The information used in the procedures should be reliable (ISA 520:A12); and
    - Information will be reliable if it is complete, accurate, validated, comparable, relevant and the source of the information is trustworthy (ISA 520:A12).
- The auditor must be able to develop expectations of the results in order to identify misstatements causing the financial statements to be materially misstated.
    - To determine whether the expectations are adequate, the auditor can consider the following: the accuracy of the estimation, the extent to which the information can be separated and the availability of financial and non-financial information (ISA 520:A15).

It is important to keep in mind that analytical procedures do not confirm the existence of fraud; they only indicate areas where further investigation is needed (Hopwood *et al.,* 2008:227). There are three types of analytical procedures that can be used to perform the assessment of the risk of fraud; horizontal analysis, vertical analysis and operating ratio analysis. To enhance the effectiveness of horizontal analysis, vertical analysis and operating ratio analysis in detecting fraud, the auditor should group financial line items when performing the analysis (Zack, 2013:219). Financial line items can be grouped by region, location, division or manager (Zack, 2013:219).

Horizontal analysis

Horizontal analysis entails a comparison between the current years' financial statements and prior-year financial statements (Hopwood *et al.,* 2008:228). Zack (2013:210) defines horizontal analysis as the comparison of financial figures across time periods, or comparing the actual amounts of the current year with the budgeted amount of the current year. Thus, horizontal analysis can be defined as when the current year's financial figures are compared to the prior-year or budgeted financial figures or even

industry figures. When material variances are identified in comparing the data across time periods, the auditor should find reasons for the variances seeing that they can indicate a possibility of fraud within the financial statements (Zack, 2013:210).

Vertical analysis

Vertical analysis is used to analyse relationships between the various financial statement line items (Hopwood *et al.,* 2008:228). Vertical analysis can also be defined as when a single account is shown as a percentage of another account in order to analyse the relationship between the accounts (Zack, 2013:211). Hence, vertical analysis is used to analyse relationships between different financial accounts. Vertical analysis is useful in identifying fraud, because it can identify material changes in the relationship of different accounts and material changes, in turn, can indicate possible fraudulent transactions (Zack, 2013:211).

Operating ratio analysis

Ratio analysis verifies whether the financial figures have been over- or underestimated (Hopwood *et al.,* 2008:227). Of all the analytical procedures, operating ratio analysis is the most reliable method to use as a tool for detecting fraud (Zack, 2013:216). Unexplained changes in ratios can indicate the possibility of the occurrence of fraudulent transactions (Zack, 2013:216). Operating ratios can be classified into four categories, namely (Zack, 2013:217–225):

1. Liquidity ratios — Evaluate the entity's ability to comply with its short-term obligations;
2. Activity ratios — Evaluate the entity's ability to effectively utilise its assets;
3. Leverage ratios — Measure the entity's solvency and the entity's ability to survive economic recession; and
4. Profitability ratios — Measure the entity's ability to produce profit for shareholders.

When comparing all four categories, leverage ratio is the least valuable ratio for detecting fraud, whereas action ratio is the most valuable ratio for detecting fraud (Zack, 2013:224). Leverage ratio is least valuable, because it can only identify fraud relating to debt (Zack, 2013:224). Action ratio, on the other hand, has the ability to identify fraud in all of the following areas: revenue, related party transactions, accounts payable,

accounts receivable, inventory and cost of sale. The following action ratios have been proven to show direct correlation to financial statement fraud (Zack, 2013:219–225):

- *Days receivable outstanding*
  If the company records fictitious sales or overstates receivables, the effect will show in the ratio.
- *Days payable outstanding*
  If the company understates accounts payable, the ratio will show the effect.
- *Sales to total assets and sales to intangible assets*
  Failure to write off assets, improper capitalisation of expenses, or failure to record impairment losses will immediately affect the ratio. For this reason, this ratio will indicate different acts of fraud.
- *Related party sales to total assets or related party sales ratio*
  Any material increase in this ratio can indicate the possibility of fraud occurring due to related party transaction being a significant account. Related party transaction should be approached with caution, because it is a high fraud risk area.
- *Revenue composition analysis*
  Any unexplained or sudden changes in this ratio can indicate the possibility of fraud occurring. Revenue should always be treated as a significant account, because it is also a high fraud risk area.

When considering the mentioned three FRA approaches – inquiry from management; red-flag approach and analytic procedures – it can be concluded that inquiry from management can be used as a tool for identifying fraudulent transactions. It is, however, not the most reliable approach, because it is easy for management to deceive the auditors. Conversely, the red-flag questionnaire is also not the best approach. The questionnaire does not enhance the effectiveness of FRA performed by the auditor, because the auditor communicates with management to fill out the questionnaire and the questionnaire is limited to the auditor's ability to identify red flags. It is, therefore, evident that the auditor still needs to obtain additional evidence to support management's response to the questions.

In conclusion, analytical procedures are the most effective approach for assessing the risk of fraud, because they focus on the evidence without management's having an influence on the auditor. When material variances are identified, the auditor needs to find reasons for the variances by inquiring from management, but the auditor is not allowed

to accept management's explanations without sufficient evidence supporting these explanations.

4.4.3. Responding to the assessed risk of fraud

Auditors are required to respond to fraud risks that are likely to occur and to have a significant effect on their client through developing procedures to include in their overall FRA (Vona, 2008:55). Auditors can respond in four ways to address the risk of fraud:

1. Assign team members with knowledge, skills and abilities

   ISA (240:29) requires auditors to assign team members with the necessary knowledge, skills and ability. It is imperative that the audit team consists of adequate members with specialised skills and knowledge. Singleton *et al.* (2006:196) stated that people who assess the risk of fraud should think creatively, reason with logic, and have an understanding of the business and industry in which the business operates. Audit team members are vital to the success of the audit. The better the knowledge, experience and skills of the auditor performing the FRA, the better the chances of an effective FRA.

2. Exercise a high degree of professional scepticism

   Auditors have the responsibility to exercise a high degree of professional scepticism when assessing the risk of materially misstated financial statements due to fraud (Hopwood *et al.,* 2008:230). When planning and performing an audit, the auditor must maintain professional scepticism, as well as recognise the possibility of circumstances that will result in the material misstatement of the financial statements (ISA 200:15). In the context of this study, professional scepticism is a state of mind in which one is attentive to the instance of fraud (Singleton *et al.,* 2006:41). Professional scepticism can also be defined as when an individual recognises the possibility of fraud being present in the financial information by maintaining a questioning mind-set when assessing financial information (Kranacher *et al.*, 2011:182). ISA (200:A20) defines professional scepticism as the critical assessment of information by keeping a questioning mind-set. Auditors, therefore, exercise professional scepticism when they stay alert to the possibility of the presence of fraud within the financial statements throughout the audit.

3. Perform additional audit procedure to the addressed RMM due to fraud

   ISA (330:6) requires auditors to perform further audit procedures to respond to the assessed risk of fraud that causes financial statements to be materially misstated. When auditors feel there is a high risk of fraud, they have the responsibility to perform extensive testing on the areas identified (Hopwood *et al.,* 2008:230).

4. Incorporate unpredictability testing in the audit procedures by adjusting the nature, timing and extent

   Auditors need to adjust the timing, nature and extent of the audit procedures to ensure that sufficient evidence is obtained to support their conclusion on the RMM due to fraud. The nature of the audit procedures determines the types of test to be performed (Hopwood *et al.,* 2008:89). The types of test must be effective in obtaining reliable and relevant information (ISA 240:A37). The timing relates to the procedures that will be performed (Hopwood *et al.,* 2008:89) and will determine the effectiveness of said procedures. These procedures can be performed either at interim, near period end or at period end (ISA 240:A37). The extent of the audit procedures refers to how much testing needs to be performed for the specified risk (Hopwood *et al.,* 2008:89). The types of procedure performed should be appropriate to enable auditors to obtain enough evidence to support their opinion on whether the financial statements are free from material misstatements due to fraud.

Should auditors identify the possibility of fraud, they should enhance their professional scepticism and perform extensive testing on the risk area to gain sufficient evidence to be able to assess the risk of fraud. Should auditors have reason to believe that fraud has occurred or is occurring, they have a duty to report the matter to either management or the Independent Regulatory Board of Directors (IRBA).

Auditors have a duty to report fraud identified during the course of the audit in terms of the Auditing Profession Act (26 of 2005) (APA). Section 45(1) of the APA states that if a registered auditor has reason to believe that a reportable irregularity has taken place or is taking place at an entity, he/she needs to inform the IRBA. Section 1 of the APA defines a reportable irregularity as:

any unlawful act or omission committed by any person responsible for the management of an entity, which –

a. has caused or is likely to cause material financial loss to the entity or to any partner, member, shareholder, creditor or investor of the entity in respect of his, her or its dealing with that entity, or
b. is fraudulent or amount to theft; or
c. represents a material breach of any fiduciary duty owed by such person to the entity or any partner, member, shareholder, creditor, or investor of the entity under any law applying to the entity or the conduct or management thereof.

From the above definition by the APA, it can be concluded that any fraud committed by management of an entity constitutes a reportable irregularity. Therefore, auditors have the responsibility to report any fraud identified during the audit of a client, committed by management.

Should auditors have reason to believe that management is not involved in the identified fraud, they will be responsible only for contacting management timely and inform them of the findings (ISA 240:40). Auditors must use their professional judgement to determine the appropriate level of management with whom to communicate (ISA 240:A60). In conclusion, auditors are responsible only for performing additional procedures on identified risk areas and reporting susceptible fraud to:

- Management: if they have identified the possibility of fraud occurring; or
- The IRBA: if they have reason to believe that management is involved in the suspected fraud.

4.5 Summary

There are two types of FRAs: (1) FRAs performed by auditors to assess whether the controls implemented by an entity are effective in identifying, preventing and detecting fraud; and (2) FRAs performed by the management of an organisation to prevent and detect fraud and to assist in implementing controls to protect the organisation against fraud. In addition to FRAs, management should also perform FRM to identify possible risk of fraud that can affect the organisation.

The auditor's objective when performing FRA is to identify and assess the risk of fraud, to design and implement procedures to obtain evidence, and to respond to the risk of fraud. An effective FRA will identify all the fraud risks that a company is faced with and

link the fraud risks to weaknesses within internal control (Vona, 2008:38). Brainstorming sessions play a vital part in enhancing the effectiveness of an FRA, because they enable auditors to gain additional information and obtain insight into specific risk areas. In addition to brainstorming sessions, there are three procedures auditors can follow to perform FRAs, namely inquiry from management, the red-flag approach and analytical procedures. Findings regarding these three procedures can be summarised as follow:

- Inquiry from management might not be sufficient to perform an effective FRA, seeing that management has the ability to deceive auditors. Consequently, additional evidence needs to be gathered to support the facts provided by management. Moreover, inquiry limits auditors to only those fraud risk factors that they have identified during the course of the audit. Inquiry cannot be used in isolation and needs to be incorporated into other procedures;
- The red-flag approach is considered to be the most ineffective procedure to use to address the risk of fraud. The effectiveness of the red-flag approach is dependent on the auditor's knowledge and attentiveness to the possibility of fraud. The main shortcoming of the red-flag approach is the fact that it limits the auditor's knowledge to the questionnaire, meaning the auditor might overlook information outside of the questionnaire indicating the possible occurrence of fraud. The red-flag approach can also not be used in isolation and needs to be combined with the analytical procedures; and
- Analytical procedures are considered to be the most effective approach to address the risk of fraud, because they point the auditor's attention to information without the influence of management. Furthermore, it was established that operating ratio analysis is the most effective analytical procedure to use in identifying fraud, especially action ratio. Material variances in ratios indicate areas that need further investigation, because they point to the possible occurrence of fraud. Material variances are investigated by obtaining explanations from management. However, the auditor is required to request supporting documentation for these explanations.

Knapp and Knapp (2001:26) claimed that FRA will also be more effective when it is not incorporated into the overall risk assessment, but conducted as an assessment on its own. Allen *et al.* (2006:158) concur by stating that auditors can enhance the effectiveness of FRA by considering the risk of fraud independently from the assessment of error. It was concluded that fraud will result in intentional misstatements, whereas error will lead to unintentional misstatements. In conclusion, FRA should not be

incorporated into the overall risk assessment, but be performed independently from the assessment of error.

To respond to the assessed risk of fraud, auditors need to allocate team members with sufficient skills, knowledge and experience. All the team members should enhance their professional scepticism and the auditors should perform additional auditor procedures on risk areas by including unpredictability testing in their audit procedures. Auditors also have a responsibility to report fraud should they have reason to believe that fraud has occurred or is occurring. Auditors should report the matter to management in a timely manner, except when they have reason to believe that management is involve. Should this be the case, auditors should report the matter to the IRBA in terms of the APA.

As auditors are always faced with the risk of not identifying material misstatement caused by fraud, it is vital for them to gain sufficient knowledge and experience on fraud in order to enhance the effectiveness of their FRA and, ultimately, mitigate the risk. Chapter 5 will compare the external auditor and the forensic accountant to point out the difference between the two professions, as well as their characteristics and responsibilities.

CHAPTER 5

5. CHARACTERISTICS OF AUDITORS AND FORENSIC ACCOUNTANTS

5.1. Introduction

The problem statement of this research as outlined in chapter 1 (par 1.3) was whether the skills that auditors possess are sufficient to perform FRA in the most efficient way and whether the effectiveness of FRA in an audit would be enhanced if forensic accountants were to perform the assessment. In addition, the primary objective of this study was to determine the skills needed by an auditor to perform FRA.

Chapter 4 elaborated on the effectiveness of FRA used by auditors to identify fraud in terms of ISA 315 and ISA 240. This chapter will define "forensic accountant" and "external auditor," compare the auditor and forensic accountant, and discuss their skills and knowledge in order to determine who is more suitably equipped to identify and detect fraud.

5.2. Defining the auditor and forensic accountant

5.2.1. Auditor

The discipline that auditors practise is referred to as auditing. In order to gain a full understanding of the term "auditor," the discipline of auditing needs to be defined. Hopwood *et al.* (2008:82) view auditing as the process of ensuring that a company's financial statements correspond with the accounting information and are presented in line with the applicable accounting standards. Marx, Van der Walt and Bourne (2011:1–11) define auditing as providing an opinion as to whether an entity's financial statements are in accordance with the applicable financial reporting standards and statutory requirements in all material aspects. Section 1 of the APA describes auditing as examining financial information or statements in order to express an opinion on the fairness of the financial statements and whether the financial statements comply with the relevant financial reporting framework. To summarise, auditing can be defined as the process of forming and expressing an opinion on a set of financial statements as to whether the financial information is in line with the applicable financial reporting framework and statutory requirements with the ultimate aim of ensuring that the financial information fairly represents the financial state of the entity.

Auditors can be classified into two groups: internal auditors and external auditors. For purposes of this study, only “external auditor” will be defined. External auditors are third parties appointed by a company to assess whether the company’s financial statements are fairly presented in accordance with the applicable accounting standards (Hopwood *et al.,* 2008:4). Jackson and Stent (2012:1/2) describe an external auditor as an independent individual who expresses an opinion as to whether the entity’s financial statements are fairly represented in terms of the business operations and financial position. An external auditor can also be described as an independent third party responsible for examining an entity’s financial statements with the aim of ensuring that the financial information is in line with the applicable accounting standards and legal requirements and fairly represents the financial state of the entity (CIMA, 2015). An external auditor is, therefore, an independent party who expresses an opinion on a set of financial statements as to whether the financial information is in line with the applicable financial reporting framework and statutory requirements with the ultimate aim of ensuring that the financial information fairly represents the financial state of the entity. The definition of external auditor coincides with the definition of auditing provided above.

5.2.2. Forensic accountant

Forensic accounting is a term coined by Maurice E Peloubet (Crumbley, Rezaee & Ziegenfuss, 2004:472) and is the term mostly used in South Africa for relating terms such as fraud examiner, forensic auditor, fraud auditor and forensic investigator (Du Plessis, 2005:1–11). Eiya and Otalor (2013:19) and Singleton and Singleton (2010:12) mentioned that fraud/forensic auditing and fraud/forensic investigation are terminology used to describe forensic accounting. The term “forensic accounting” will be used throughout this study in lieu of the mentioned terms.

It is important to explain the terms “forensic” and “accounting” separately to gain a better understanding of the term “forensic accounting”. “Forensic” pertains to information presented in court and information obtained during an investigation (Van Romburgh, 2008:23). The Oxford Advance Learner’s Dictionary (2010:10) defines the term as a test used to solve a crime and which can be used in court. The term can also be described as linking financial evidence to legal matters (Singleton & Singleton, 2010:12). The term “forensic,” therefore, pertains to obtaining information by investigating the occurrence of a legal matter and presenting the information in court.

“Accounting” can be explained as the process during which financial events are recorded, classified and summarised with the aim of presenting the information to formulate decisions (Hopwood *et al.,* 2008:4). The term can also be defined as the expression of business transactions that are presented in a set of financial statements (Van Romburgh, 2008:24). The Oxford Advance Learner’s Dictionary (2010:10) defines accounting as the process in which financial information is retained. According to Hopwood *et al.* (2008:4), accounting consists of financial accounting, managerial accounting, information systems, taxation, auditing and forensic accounting. Accounting can, therefore, be described as recording, classifying and summarising business transactions and presenting the transactions in a set of financial statements with the aim to assist with business decisions.

Forensic and investigative accounting is defined by Du Plessis (2001:2–6) as:

> the application of financial skills and investigative mentality to unresolved issues, conducted within the rules of evidence. As a discipline it encompasses financial expertise, fraud knowledge and a strong knowledge and understanding of business reality and the working of the legal system.

Forensic accounting is also described as the application of skills to resolve financial discrepancies in a manner that can be used in the court of law (Hopwood *et al.,* 2008:3), as well as when an independent entity gathers evidence in order to investigate fraud, theft or misconduct (Jackson & Stent, 2012:1/3). Van Romburgh (2008:32) best describes a forensic accountant in South Africa as an individual with legal, accounting, auditing and investigative skills who have the ability to investigate and prevent fraud and commercial crime, act as an expert witness in court, apply accounting and auditing, provide support with litigation matters and, finally, analyse human behaviour.

Together with providing a definition for a South African forensic accountant, Van Romburgh created a Venn diagram to illustrate the definition.

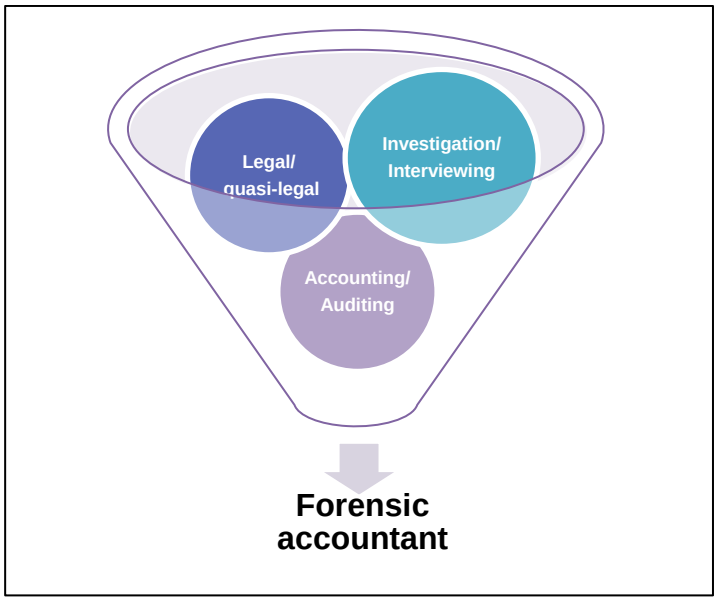

Figure 5.1. South African forensic accountant defined

(Source: Adjusted from Van Romburgh, 2008:33).

Figure 5.1 illustrates the overlapping of the skills of accounting/auditing, legal/quasi-legal skills and investigation/interviewing, and supports the definition of a forensic accountant as provided by Van Romburgh (2008:33).

In light of the above, a forensic accountant can be viewed as an independent expert in the fields of auditing, accounting, investigation, and the legal system, who is appointed by third parties to investigate and resolve commercial crime, assist with financial disputes and act as an expert witness in the court of law by performing his/her duties in accordance with the law to ensure the evidence obtained will be admissible in court. It is vital to remember that forensic accountants' main focus is to apply their accounting/auditing knowledge as they use their investigative and legal skills only to assist them in their investigations (Van Romburgh, 2008:33). However, forensic accountants still need the skills and knowledge of all three disciplines (accounting/auditing, legal/quasi-legal and investigating/interviewing) to effectively carry out their investigations.

5.3. Characteristics of the auditor and forensic accountant

5.3.1. Ethical requirements

The ethical requirements of both the auditor and forensic accountant are critical in assessing the risk of fraud as their ethics will determine their perception of actions as being right or wrong and their conduct when performing an FRA. In addition, auditors and forensic accountants should always maintain a level of professional scepticism when performing their duties. Professional scepticism was defined in chapter 4 (par 4.4.3) as being alert to the possibility of the presence of fraud in the financial statements. Professional scepticism plays a vital role in performing FRAs as it ensures that the auditor and forensic accountant maintain a questioning mind-set, enabling them to critically assess information while being attentive to the instance of fraud.

Both the forensic accountant and auditor need to adhere to strict ethical requirements when performing their work. Registered auditors (CAs) need to adhere to the Code of Professional Conduct (CPC) of the South African Institute of Chartered Accountants (SAICA) and the IRBA (Marx *et al.,* 2011:1–3). The CPC (2010:100.5) states that CAs must apply and uphold the following fundamental principles:

- *Integrity*: always being honest and open in a professional setting;
- *Objectivity:* refraining from being bias and not allowing financial interest or the influence of others to cloud professional judgement;
- *Professional competence and due care:* providing proficient work to clients by staying informed about developments in practice and legislation and applying the required skills and knowledge;
- *Confidentiality:* not disclosing confidential information to third parties without the proper authority; and
- *Professional behaviour:* complying with laws and regulations and refraining from behaviour that discredits the profession of chartered accountancy.

The fundamental principles that a forensic accountant must adhere to have been established by the Institute of Commercial Forensic Practitioners (ICFP) in an extensive Code of Ethics and Rules of Conduct (McIntyre, Van Graan, Van Romburgh & Van Zyl, 2014:143). Only members to the ICFP are bound by the Code of Ethics and Rules of Conduct; however, forensic accountants not registered with the ICFP can use the principles as a guideline (McIntyre *et al.,* 2014:143). There are five fundamental principles for forensic practitioners (ICFP, 2015a):

- *Integrity:* earning the client's trust in order for the client to rely on the forensic accountant's services and advice;
- *Objectivity:* refraining from being bias when gathering evidence and not allowing financial interest or the influence of others to cloud professional judgement;
- *Confidentiality:* not disclosing private and valuable information without the proper authority;
- *Competency:* providing proficient work to clients by applying the required skills and knowledge; and
- *Legality:* respecting the rights of all and adhering to all laws applicable to the profession.

The ACFE SA (2015b) prescribes a Code of Professional Ethics with the following fundamental principles to which a certified fraud examiner (CFE) needs to adhere:

- *Integrity and objectivity:* refraining from engaging in illegal or unethical activities resulting in conflict of interest, assessing conflict of interest prior to accepting a fraud examination, and always being truthful when testifying in a court of law;
- *Professional competence:* always performing professional services effectively, and rejecting assignments in which the fraud examiner's competency is threatened;
- *Due professional care:* remaining diligent and keeping professional scepticism when performing professional responsibilities, and basing conclusions on relevant, competent and sufficient evidence;
- *Understanding with client or employer:* obtaining an understanding of the scope and limitations of the fraud examination;
- *Communication with client or employer:* communicating significant findings to those who appointed him/her; and
- *Confidentiality:* not allowing information to be disclosed without proper authority.

Objectivity and integrity are two of the most important characteristics a forensic accountant should have (Singleton *et al.,* 2006:44). A forensic accountant who is a commercial forensic practitioner and CFE will be required to adhere to the ethical requirements prescribed by the ICFP and ACFE SA. Forensic accountants registered as CAs with SAICA should take into account the fundamental principles set out in the CPC when performing their duties.

It is clear from the above that both the auditor and forensic accountant have strict ethical principles they need to abide by when performing their duties. When comparing the ethical requirements of the auditor with those of the forensic accountant, the conclusion can be drawn that the forensic accountant needs to adhere to all the ethical requirements that an auditor has to. However, the forensic accountant has legality, understanding with client and communication with client in addition to the auditor's ethical requirements.

The skills and knowledge that the auditor and forensic accountant possess play a critical role in determining who is more suited to perform FRA, as their skills and knowledge enables them to effectively and efficiently perform their duties.

5.3.2. Skills and knowledge

5.3.2.1. Auditor

The Institute of Chartered Accountants in Australia (ICAA) (2012) provides the following list of key attributes that they believe each well-rounded CA needs to have:

- Up to date with accounting, auditing and taxation developments;
- Problem solving skills;
- Analytical ability;
- Ability to be open minded;
- Thinking ahead;
- Proficiency in information technology (IT);
- Ability to communicate effectively;
- Strong ethical principles;
- Leadership qualities;
- Team work skills;
- Ability to show empathy;
- Compliance with laws and regulations;
- Negotiation skills if needed;
- Ability to respond to change;
- Understanding of client needs;
- Interpersonal skills;
- Strong technical skills;
- Ability to apply self-learning.

SAICA (2010) states that all CAs of South Africa (CA(SA)) should have strong technical knowledge and competence in order to be leaders in their profession. Competence needed by a CA(SA) can be divided into four categories (SAICA, 2010):

- *Interpersonal and communication skills:*
  Conflict management and negotiation skills; teamwork ability; ability to present views; listening skills and reading skills.

- *Organisational and management skills:*
  Project and people management skills; ability to delegate; ability to plan; leadership skills; ability to mentor and train others; knowledge on global and economic issues.
- *Intellectual skills:*
  Ability to understand, obtain and analyse information; ability to identify and solve problems.
- *Personal skills:*
  Self-management and self-learning skills; ability to prioritise deadlines and adapt to change.

The Institute of Chartered Accountants of Scotland (ICAS) (2015) states that a CA needs technical abilities in the following areas: business law; business management; finance; financial accounting; auditing and reporting principles and taxation. Singleton and Singleton (2010:13) concur by adding that the auditor is an expert in accounting and financial reporting.

In conclusion, it can be said that auditors require a wide set of skills to effectively perform their duties. When combining the above information, the skills and knowledge that auditors need to possess are as follow:

Knowledge	Business law; business management; finance; financial accounting; auditing and reporting principles and taxation; global and economic matters; relevant legislation and regulations; staying up to date with accounting, auditing and taxation developments.
Skills	Negotiation; listening; reading; communication; management; leadership; problem solving; analytical; IT; interpersonal skills; and being open minded and thinking ahead.
Abilities	Manage conflict; work in a team; present and defend their views; delegate; plan; train and mentor others; analyse information; adapt to change; prioritise deadlines; life-long learner; understand and gather information; and show empathy.

5.3.2.2. Skills and knowledge of the forensic accountant

As seen from the definition in paragraph 5.2.2, the forensic accountant has sufficient knowledge on auditing, accounting, legal systems, interviewing, investigation, and fraud. Forensic accountants who are also CAs should also possess the skills mentioned above.

Singleton *et al.* (2006:46–52) suggested an effective forensic accountant need to possess the following skills, abilities and knowledge:

- Extensive fraud knowledge
- Ability to identify and detect fraud
- Ability to quickly identify financial issues
- Compliance with laws and regulations
- Being independent and objective when representing evidence to the court to ensure evidence is admissible in court
- Well rounded
- Remaining independent
- Street smart
- Quick to act
- Approachable
- Attentive to detail
- Precise
- Verbal and written communication skills
- Accounting knowledge
- Investigative techniques, skills and mentality
- Interviewing skills
- Ability to act as an expert witness
- Thinking outside the box
- Business sense
- Understand business operations
- Confidence
- Perseverance
- Curious mind-set
- Fair
- Prioritising tasks
- Listening skills

Hopwood *et al.* (2008:7) add the following skills and knowledge that a forensic accountant needs to possess: auditing skills; ability to collect and analyse information; investigative knowledge and skills; interviewing and interrogation skills; accounting knowledge; knowledge of law and court procedures; IT skills; communication skills and skills in examining human behaviour. Because forensic accountants can also act as expert witnesses on the evidence they present in their report, it is vital that they have the ability to analyse, interpret, summarise and present complex information in an understandable manner to support their facts (Eiya & Otalor, 2013:22). The core skills that a forensic accountant needs can also be summarised as: report writing skills; investigative skills; questioning skills; interviewing skills; ability to think critically and logically; understanding information quickly (Fitzgerald, 2011:13).

Van Romburgh (2008:30–31) views the following skills and knowledge as essential to a successful forensic accountant in South Africa:

- Accounting knowledge
- Business knowledge
- Auditing knowledge
- Investigative skills
- Interviewing skills
- Knowledge on civil and criminal legal proceeding
- Data analysis skills
- Ability to apply IT skills
- Ability to provide expert testimony

In conclusion, it can be said that forensic accountants need a wide set of skills to effectively perform their duties and ensure that their investigation is in line with legal proceedings. When combining the above information, the knowledge, skills and abilities that a forensic accountant need to possess are as follows:

Knowledge Fraud; accounting; auditing; investigations; law and court procedures; business and business operations; civil and criminal proceedings; and having business sense and being street smart.

Skills Communication; report writing; investigative; listening; interviewing; collecting and analysing data; interrogation; IT; listening; having a questioning mind-set; confidence; perseverance; and being precise; independent; and approachable.

Abilities Identify and detect fraud; quickly identify issues and understand information; comply with laws and regulations; provide expert testimony; keep an investigative mentality; examine human behaviour; simplify complicated information and think logically; think outside the box; keep a curious mind-set; fair; pay attention to detail and prioritise effectively.

5.3.2.3. Skills needed for identifying fraud

Singleton *et al.* (2006:43) explain that, in order to be able to successfully and effectively detect and identify fraud, one needs the following: a mind-set that has been trained to identify fraud indicators; the necessary experience; the ability to question the substance of a transaction, the ability to think creatively and logically; the natural instinct to solve problems; the necessary detective skills; determination and persistence; and self-confidence. The following can be added: knowledge on fraud schemes, applicable laws and regulations; and communication and interviewing skills (Zikmund, 2008:21). Kranacher and Stern (2004:67) provided the following list of essential skills an auditor

needs to be able to uncover fraud: interviewing skills; ability to think critically; knowledge on criminology and psychology, or the ability to analyse people; writing skills; investigative skills; and analytical skills. From the above three authors, it can be concluded that in order to effectively and sufficiently identify fraud the following skills set is required:

- Mind-set to identify fraud
- Experience
- Questioning mind-set
- Analytical skills
- Interviewing skills
- Detective/investigative skills
- Communication skills
- Knowledge on psychology and criminology
- Knowledge on laws and regulations
- Writing skills
- Self-confidence
- Knowledge on fraud
- Logical/critical thinking
- Ability to solve problems
- Determination and perseverance

In order to determine, between the forensic accountant and auditor, whose skills set is more appropriate to perform an effective FRA within an audit programme, their skills sets are compared to the list provided above. The comparison is shown in table 5.1 below.

Table 5.1. Skills set needed to effectively identify fraud in comparison with the skills of an auditor and forensic accountant

Skills to identify fraud	Auditor	Forensic accountant
• Mind-set to identify fraud	✔	✔
• Experience		✔
• Questioning mind-set	✔	✔
• Analytical skills	✔	✔
• Interviewing skills		✔
• Detective/investigative skills		✔
• Knowledge on laws and regulations	✔	✔
• Knowledge on psychology and criminology		✔
• Self-confidence	✔	✔
• Knowledge on fraud		✔
• Logical/critical thinking	✔	✔
• Ability to solve problems	✔	✔
• Communication skills	✔	✔
• Determination and perseverance		✔
• Writing skills	✔	✔

Table 5.1 proves undoubtedly that a forensic accountant's skills set is more in line with what is needed to identify fraud effectively. The auditor lacks the most important skills, namely experience, interviewing skills, investigative skills and knowledge on fraud, in spite of having all the other skills. Zikmund (2008:21) concurs by adding that auditors cannot be expected to have the necessary skills to identify fraud on the level of fraud examiners; however, auditors can train themselves to develop the skills needed to identify fraud. Based on all of the above, it appears that the forensic accountant's skills, knowledge and abilities are in line with what is needed to identify fraud and, ultimately, perform an effective FRA.

5.4. Comparison between auditors and forensic accountants

5.4.1. Objective

The objective of both the auditor and forensic accountant determines how much focus on fraud they will place in performing FRAs. The objective of auditors is to ensure an entity's financial statements are presented in all material aspects in accordance with the applicable reporting standards (Chui & Pike, 2013:221) and that the financial statements are free from material misstatements caused by error or fraud, and to report their findings by providing an opinion (ISA 200:11).

The auditor's objective towards fraud in terms of ISA (240:10) is to identify and assess the risk of fraud causing the financial statements to be materially misstated. Even though auditors are responsible for assessing the possibility of fraud, it is not their primary task (Taylor, 2011:35), and it is not their responsibility to design procedures to detect fraud (Kranacher *et al.,* 2011:9). Furthermore, auditors will only provide reasonable assurance that the financial statements are free from material misstatements due to fraud, because they apply their judgement when performing an audit (Marx *et al.,* 2011:1–4). Taylor (2011:34) argues that auditors are not always precise, because they use assumptions and estimates when gathering evidence. As stated before, there is always an unavoidable risk that auditors might not identify the risk of fraud, because they use their judgement and make estimates, and their primary focus is not to identify fraud.

In contrast, forensic accountants' responsibilities and objectives vary depending on what type of service they are required to offer. Overall, forensic accountants aim to obtain complete, reliable and relevant information to support their opinion in their report to the client (ACFE, 2015). In addition, forensic accountants' objective with their investigation is to obtain evidence to determine what, why, when, how and by whom the suspected misconduct might have occurred (Golden *et al.,* 2006:109).

The objective of forensic accountants with regard to fraud is to investigate financial and non-financial information to find enough evidence to support their conclusion on whether fraud has occurred (Golden *et al.,* 2006:20). According to Chui and Pike (2013:221), it is the forensic accountant's responsibility to investigate fraud with the objective of determining whether fraud exists and, if so, the extent of the fraud. The conclusion is drawn that, when appointed to investigate fraud, forensic accountants' main objective is to determine whether fraud has occurred and to report their findings to the client. It is, thus, clear that forensic accountants place all their focus on identifying fraud.

The forensic accountant's report and opinion are required to be based only on facts, conclusions and recommendations (ACFE, 2015). Golden *et al.* (2006:266) mentioned that forensic accountants are fact finders, they are not hired to form opinions. It is evident that forensic accountants, similar to auditors, need to obtain sufficient evidence to support their opinion in their report. As forensic accountants base their opinion only on facts, and not on their judgement, these opinions will provide absolute assurance as to whether fraud has occurred.

When comparing the forensic accountant with the auditor and linking their responsibilities to fraud, the following can be said: The conclusion drawn by auditors regarding their assessment of the risk of fraud would provide only reasonable assurance, because of the unavoidable risk that auditors might not identify material misstatement due to fraud. However, the conclusion drawn by the forensic accountant regarding the occurrence of fraud will always provide absolute assurance, because the conclusion is based on facts. Moreover, the auditor pays less attention to the risk of fraud than the forensic accountant seeing that it is not the former's primary objective.

5.4.2. Regulatory bodies

Auditors and forensic accountants both have regulatory bodies where they can be accredited; for the auditor it is compulsory, but for the forensic accountant it is voluntary. A regulatory body usually establishes the members' ethical standards, outlines the technical abilities of members, offers advice and support to members, and prescribes a set of disciplinary codes (Taylor, 2011:34).

The recognised regulatory bodies for auditors are:

- *South African Institute of Chartered Accountants (SAICA)*
  SAICA is the accountancy body in South Africa that promotes and leads the CA profession in South Africa and strives to create sustainable value for its members and other stakeholders (SAICA, 2015:6).
- *Independent Regulatory Board of Auditors (IRBA)*
  IRBA has been established in terms of Section 3 of the APA (IRBA, 2013:7). IRBA's main focus is to ensure that only qualified individuals are permitted to the auditing profession, that all auditors deliver high quality services in accordance with internationally recognised standards and that they adhere to the ethical standards at all times (IRBA, 2013:6).

The professional bodies with which a forensic accountant can register are:

- *Institute of Commercial Forensic Practitioners (ICFP)*
  The ICFP is a self-regulatory body who regulates the commercial forensic profession in South Africa (ICFP, 2015b).
- *Association of Certified Fraud Examiner SA (ACFE SA)*
  The ACFE SA is the only recognised professional body for CFEs in South Africa and aims to reduce fraud and white-collar crime (ACFE SA, 2015a).

From the above, it can be seen that there are four regulatory bodies that are of importance. An auditor is required to be a CA and registered auditor in order to perform an FRA and express an opinion. Forensic accountants, on the other hand, are required only to be a commercial forensic practitioner to perform their duty in South Africa and they have the option to also become a CFE. A forensic accountant who is also a CA can also register with SAICA and IRBA.

5.4.3. Laws and regulations

There are several laws and regulations applicable to the auditor and forensic accountant which determine how they need to go about in assessing the risk of fraud and gathering their evidence. Auditors carry out their activities in accordance with the ISA and the standards that are of relevance for this study are:

- ISA 200 (Chapter 1, 3, 4, 5): Overall objectives of the independent auditor and the conduct of an audit in accordance with ISA;
- ISA 240 (Chapter 1, 3, 4, 5): The auditor's responsibilities relating to fraud in an audit of financial statements;
- ISA 315 (Chapter 1, 4, 5): Identifying and assessing the RMM through understanding the entity and its environment;
- ISA 320 (Chapter 3): Materiality in planning and performing an audit;
- ISA 330 (Chapter 4): The auditor's responses to assessed risks;
- ISA 500 (Chapter 5): Audit evidence; and
- ISA 520: (Chapter 4): Analytical procedures.

In addition, the auditor needs to adhere to the following legislation and regulations when performing an audit (Jackson & Stent, 2012:1/16). These legislation and regulations are of relevance to enable the auditor to assess the risk of fraud:

- The Auditing Profession Act No 26 of 2005 (APA);
- The Companies Act No 71 of 2008;
- The constitution and by-laws of SAICA;
- The SAICA Code of Professional Conduct of 2011 (CPC);
- International Standards on Auditing (ISA);
- International Auditing Practice Statements (IAPS); and
- South African Auditing Practice Statements (SAAPS).

Section 45 of the APA (26 of 2005) determines how to respond when management is involved in the alleged fraud (refer to chapter 4, par 4.4.3). Sections 28 to 30 of the Companies Act (71 of 2008) determine when an entity should be audited; this is of relevance, seeing that auditors are compelled only to perform an FRA on an audit. The CPC sets out the ethical requirements to which auditors need to adhere, as mentioned in paragraph 5.3.1, and the ISA sets out the procedures auditors need to follow when performing an FRA.

Forensic accountants are also required to adhere to laws and regulations that form part of the South African common law when assisting third parties with misconduct (Van Romburgh, 2008:15–17). A forensic accountant needs strong knowledge on the rules of court, legal systems, and how to gather relevant, material and competent evidence in a lawful manner in order to effectively investigate fraud and to ensure the evidence is accepted in court (Singleton *et al.,* 2006:299–300). Hopwood *et al.* (2008:7) affirm that forensic accountants need the necessary legal knowledge to ensure they follow the correct procedures when collecting evidence and information and, furthermore, to ensure they have all the relevant information needed to prove the perpetration. According to Van Romburgh (2008:15–17), the forensic accountant needs to comply with the following rules and regulations:

- The Financial Intelligence Centre Act No 38 of 2001 (FICA);
- Prevention of Organised Crime Act No 121 of 1998 (POCA);
- Prevention and Combatting of Corrupt Activities Act No 12 of 2004 (PRECCA); and
- Criminal Procedures Act No 51 of 1977.

Owing to their involvement in different types of commercial crime, it is mandatory that forensic accountants also comply with the specific laws and regulations that deal with the different types of crime. All offences relating to corruption are dealt with under PRECCA (12 of 2004), whereas FICA (38 of 2001) deals with money laundering and

terrorist financing. In addition, POCA (121 of 1998) deals with money laundering, as well as organised crime (racketeering). The Criminal Procedures Act (51 of 1977) deals with offences relating to fraud, theft and forgery.

The above-mentioned emphasises the importance for the forensic accountant to adhere to laws and regulations at all times. In order to do so, the forensic accountant is required to have legal knowledge of various matters to a certain extent. In summary, auditors use ISAs to perform FRAs, whereas forensic accountants use the South Africa common law to guide them in their investigation.

5.4.4. Sources of evidence used to gather evidence

Both auditors and forensic accountants have specific sources they use to gather sufficient evidence to support their opinion on the risk of fraud. Auditors follow different procedures to ensure they obtain sufficient evidence to express an opinion on the financial statements. The following sources of evidence can be used by the auditor to gain sufficient evidence (ISA 500:A14–A22):

- *Inspection*: examining internal and external information (hard copy and soft copy); and physically inspecting an asset, for example, confirming its existence;
- *Observation*: assessing the employees' procedures or examining an entity's business processes while they are being performed;
- *External confirmation:* using third parties to provide information on hard or soft copy to verify information;
- *Recalculation:* testing the mathematical accuracy of information;
- *Reperformance:* performing a task that has been performed by the entity to test the internal controls;
- *Analytical procedures:* comparing financial information; and
- *Inquiry:* seeking financial and non-financial information from internal or external parties if the information needed cannot be found on paper.

When performing their procedures, auditors use assertions to identify potential misstatements as management use assertions to recognise, measure, present and disclose financial information (ISA 315:A123–A124). The following assertions are used by the auditor (ISA 315:A123–A124):

- *Existence/occurrence:* transactions recorded have indeed transpired;
- *Completeness:* all transactions have been recorded;
- *Accuracy:* transactions have been recorded appropriately;
- *Cut-off*: transactions have been recorded in the correct period;
- *Classification:* transactions have been recorded in the proper account;
- *Right and obligations:* the item recorded belongs to the entity;
- *Valuation:* the amounts included in the financial statements are appropriate; and
- *Presentation/disclosure:* all transactions have been presented fairly and all relevant information disclosed.

Because forensic accountants are involved in different types of investigations, which are all unique, they adopt different procedures to address a specific investigation (Eiya & Otalor, 2013:21, 23). Van Romburgh (2008:15–17) concurs by adding that forensic accountants do not have specific procedures they need to follow when providing services to a client. However, there are different sources of evidence that forensic accountants can use to gather sufficient evidence to conclude on whether fraud has occurred. The following sources of evidence can be used by forensic accountants during their investigation (Golden *et al.*, 2006:20):

- *Review:* financial and non-financial information can be reviewed;
- *Search:* public records can be searched to obtain external information;
- *Perform:* several interviews can be conducted with the aim of finding facts and in search of confessions; and
- *Inquiries:* inquiries can be made from third parties through the course of their investigation.

To summarise, auditors use the ISAs to assist them in determining how to gather evidence, whereas for forensic accountants there is no law or standard that outlines specific procedures they need to follow. Procedures need to be identified and applied by the forensic accountants themselves.

5.4.5. Services offered

There is a wide variety of services that can be offered by the forensic accountant and auditor. The Big 4 accounting firms were consulted to provide a list of services that can be offered, seeing that they are highly recognised and also participated in the survey. The services offered by the Big 4 accounting firms (KPMG, EY, PwC and Deloitte) are set out in figures 5.1 and 5.2.

EY (2015b) refers to "Assurance Services" and offers the following:

- Accounting compliance and reporting;
- Sustainability services;
- Advisory services; and
- Financial statement audit.

KPMG's (2015a) audit department renders the following services:

- Attestation services;
- Financial statement audit;
- Technical accounting advisory services;
- Financial reporting services;
- Technical accounting training services; and
- Audit data and analytics.

PwC's (2015a) assurance department renders the following services:

- Risk assurance;
- Financial statement audit;
- Actuarial and insurance management solutions;
- Consulting services;
- Integrated reporting; and
- IFRS reporting.

Deloitte (2015a) offers the following audit and assurance services:

- Financial statement audit;
- Financial statement preparation;
- Project management support;
- Assessing management services; and
- Assisting in describing controls, policies and procedures.

Figure 5.2. Auditing services

EY (2015a) refers to "Fraud Investigation and Dispute Services" and offer the following services:

- Discovering electronic evidence;
- Reviewing financial information;
- Anti-fraud; services
- Corporate compliance;
- Dispute services, forensic technology and discovery services; and
- Fraud investigations.

KPMG (2015b) offers the following forensic services:

- Corporate intelligence;
- Dispute advisory services;
- Forensic technology;
- Fraud risk management;
- Investigation of bribery, corruption, fraud and misconduct;
- Ethics and fraud hotline; and
- Regulatory compliance and monitoring.

PwC (2015b) refers to "Forensic Investigation and Dispute Resolution" and offers the following services:

- Investigations;
- Forensic accounting, financial analysis, advanced technology and regulatory knowledge;
- Dispute resolution;
- Forensic technology solutions;
- Anti-money laundering, counter terrorist financing and sanctions;
- Risk management and regulatory compliance; and
- Litigation support.

Deloitte's (2015b) forensic department renders the following services:

- Assistance with crises, investigations and disputes;
- Responses to cyber-attacks;
- Risk management;
- Forensic investigations; and
- Compliance with regulations.

Figure 5.3. Forensic accounting services

As seen from figures 5.2 and 5.3, there is a wide variety of services that both the forensic accountants and auditors can offer. The services offered by the Big 4 accounting firms in the different departments appear to be similar in nature. In conclusion, when comparing the Big 4 accounting firms, the services that the forensic accountant and auditor can offer are:

Auditing services	Forensic accounting services
• Financial statement audit; • Advisory services; • Financial reporting; • Technical accounting training; • Audit data and analytics; • Accounting compliance and reporting; • Sustainability; • Attestation, actuarial and insurance services; • Risk assurance; and • Integrated reporting.	• Forensic technology; • Financial analysis; • Litigation support; • Advisory services; • Dispute resolution; • Anti-money laundering services; • Fraud risk management; • Corporate intelligence; • Fraud investigations; and • Regulatory compliance and monitoring.

Figure 5.4. Overall services offered

The services rendered by both the auditors and forensic accountants which are relevant to this study are financial statement audit and fraud investigations.

5.5. Summary

Chapter 5 elaborated on the objectives of the forensic accountant and auditor; laws, regulations and regulatory bodies applicable to the forensic accountant and auditor; services offered by them; and, most importantly, their skills and knowledge.

Both the forensic accountant and auditor have a wide variety of services they can offer. To effectively render these services, they need a set of skills, knowledge and abilities and adhere to strong ethical requirements. The ethical requirements of auditors and forensic accountants are very similar, except that the latter has additional requirements that they need to adhere to. It was further concluded that the skills, knowledge and abilities possessed by forensic accountants are more in line with what is needed to effectively identify fraud. The auditors have the majority of skills needed to identify fraud; however, they lack the most important skills set, namely knowledge on fraud, investigative skills and interviewing skills.

Even though forensic accounting and auditing offer different services, they are both professions regulated by a professional body. Auditors are registered as CAs and Registered Auditors, whereas forensic accountants can be registered as CAs, Commercial Forensic Practitioners and CFEs. It is important to remember that registering with a professional body is mandatory for auditors, but only voluntary for forensic accountants.

It was established that auditors follow specific procedures outlined in the ISAs to perform their audits and, ultimately, FRAs. In addition, auditors use assertions to identify misstatements due to fraud. Forensic accountants, on the contrary, do not have specific procedures stipulated; they follow civil and criminal proceedings to guide them in their investigations and use the evidence obtained to prove or disprove the occurrence of fraud.

In conclusion, auditors' main objective in performing an audit is not to identify fraud, even though they are required to perform FRA. Auditors use assertions, assumptions, judgement and estimates to gather evidence and form an opinion. Consequently, there is always the risk that auditors might not identify fraud, seeing that their procedures are not designed to identify the act. Forensic accountants' main focus, on the other hand, is to design procedures that will obtain sufficient evidence to prove whether fraud has occurred. Forensic accountants base their opinion on facts and evidence obtained, and never use assumptions or own judgement. Consequently, auditors can only provide reasonable assurance that the financial statements are free from fraud, whereas forensic accountants can provide absolute assurance.

Chapter 6 will present, discuss and analyse the findings of the survey that was conducted with the Big 4 accounting firms and honours students in forensic accountancy and chartered accountancy.

CHAPTER 6

6. RESULTS: EMPIRICAL STUDY

6.1. Introduction

The main objective of this study, as set out in chapter 1 (par 1.4.1), was to determine the skills needed by an auditor to perform FRAs. The purpose was to conclude whether the skills set of a forensic accountant is more suited to perform an FRA than the skills set of an auditor. The main objective was to be achieved by the secondary objectives listed below:

- Understand the concept “fraud” to determine the characteristics that a person needs to perform an FRA (as discussed in chapter 3); and
- Determine the objective of an FRA so as to identify the skills set needed to perform an effective FRA (as discussed in chapter 4).

This chapter will present the evidence from the empirical study. The aim of the empirical study, as mentioned in chapter 1 (par 1.5.2), was to prove that a forensic accountant has more knowledge and experience on fraud and is, therefore, more suitably equipped to perform FRAs than an auditor. To achieve the objective, a questionnaire was distributed, as provided in Annexure 2, with the aim of gaining more knowledge on auditors and forensic accountants regarding:

- Their experience and knowledge on fraud;
- Their capability of identifying fraudulent transactions; and
- How they go about in assessing the risk of fraud.

6.2. Method of questionnaire

A questionnaire was distributed to the forensic accounting/investigation and auditing departments of KPMG, PwC, Deloitte and EY. The questionnaire was also distributed to the CTA and forensic accountancy honours students of University X. As mentioned in chapter 2 (par 2.6.1), the criterion used to select University X was exclusivity – this university offers a degree in forensic accountancy. The criteria of being the most influential auditing firms in South Africa and having both forensic accountancy and auditing departments were followed in selecting the Big 4 accounting firms.

The data were collected by means of a web-based cross-sectional questionnaire, using Fluid Survey, and took 10 to 15 minutes to complete. Participation in the survey was entirely voluntary and anonymous.

To be able to conclude on the knowledge and experience of the auditor and forensic accountant, the questions were formulated to cover four topics:

- *Experience and knowledge on fraud (questions 1–11)*
  It was important to obtain background information on the respondents' knowledge and experience on fraud, because they would need knowledge and experience to have the ability to identify fraud. Therefore, if the respondents did not have knowledge or experience on fraud, the expectation would be that they would not be able to perform an effective FRA. With these questions, a conclusion could be drawn as to which of the two groups, auditors or forensic accountants, signified to have more knowledge on fraud when comparing the results to the findings of chapter 3.

- *Capability of identifying fraudulent transactions (questions 12–18)*
  To effectively perform an FRA, one has to have the ability to identify fraud. Hence, these questions aimed to determine who are more capable in identifying fraud; the forensic accountant or the auditor.

- *Fraud risk assessment (questions 19–25)*
  The study aimed to assess the relevance of auditors and forensic accountants in performing FRAs. Questions 19–25, thus, attempted to prove which of the two possesses sufficient knowledge on FRAs when compared to the findings in chapter 4.

- *Profile of respondents (questions 26–28)*
  Lastly, it was important to obtain an understanding of the respondents' position and education, because these aspects contribute to their skills and knowledge and, in effect, influence their responses to the questions.

A profile of the respondents will follow next and will be used to compare the results to the respondents, professions and positions.

6.3. Data analysis

6.3.1. Profile of the respondents

The respondents' profiles were determined by means of questions 26–28. There were 183 respondents in total of which 123 were audit practitioners, 24 forensic accounting practitioners, five other practitioners, 15 CTA students and 16 forensic accountancy honours students. Figure 6.1 illustrates the distribution.

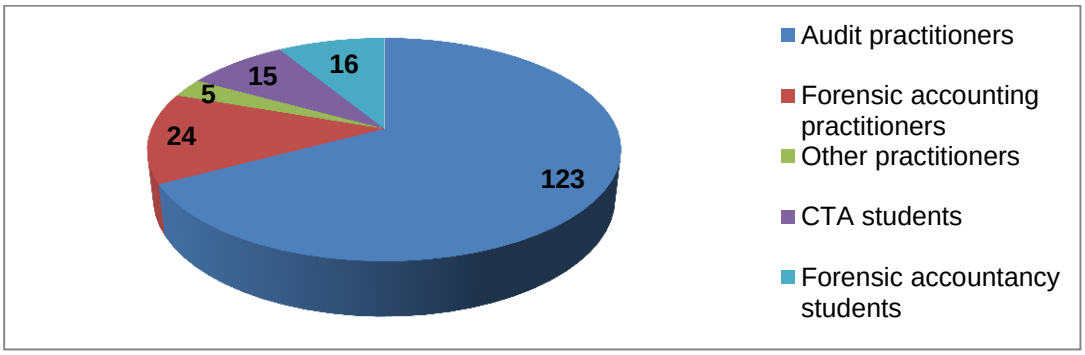

Figure 6.1. Number of respondents

6.3.1.1. Practitioners

The data of "other" were excluded when the information of all the questions was analysed, because this study only focused on the forensic accountant and the auditor. Forensic departments in comparison with the auditing departments in the Big 4 accounting firms are fairly small; this is the reason why auditors make up 81% and forensic accountants only 16%, as reflected in figure 6.2 below.

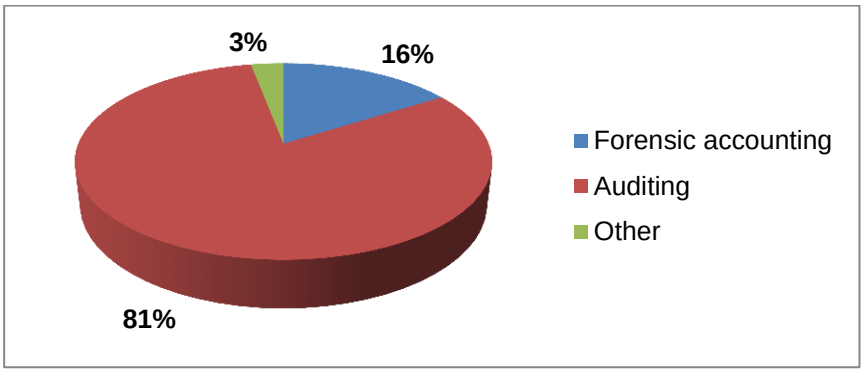

Figure 6.2. Profession

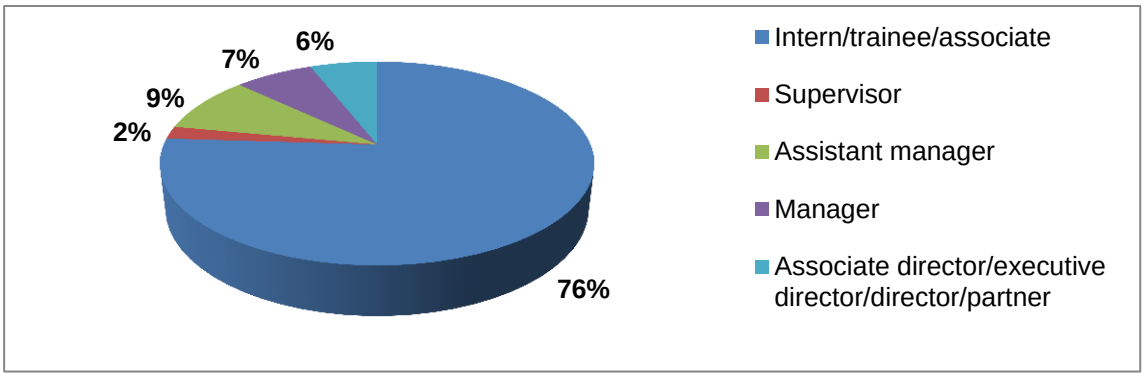

Figure 6.3. Position of audit practitioners

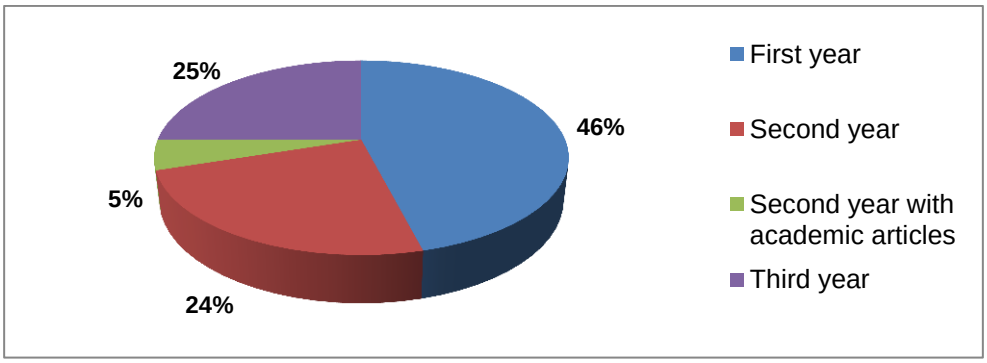

Figure 6.4. Audit intern/trainee/associate level

Figure 6.3 illustrates that the majority of audit respondents were interns, trainees and associates. Figure 6.4 shows that the majority of respondents from the audit departments were individuals who had recently graduated from university and were, therefore, technically sound.

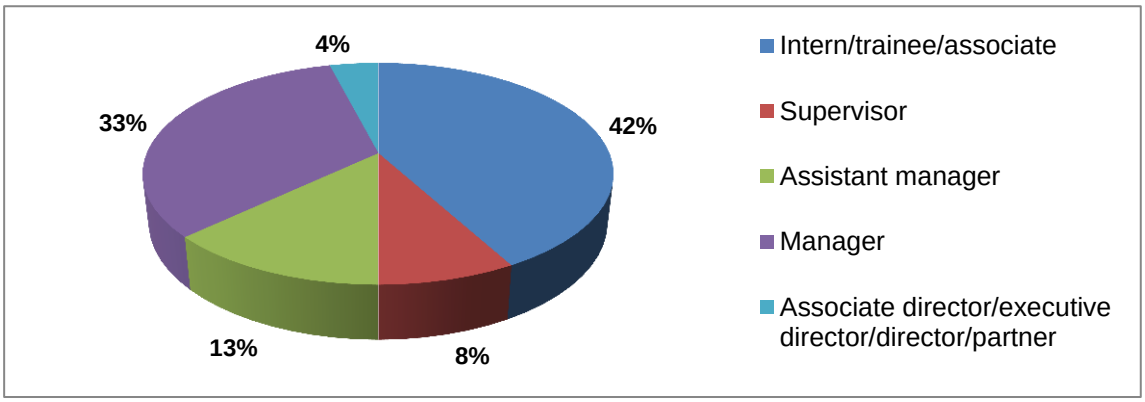

Figure 6.5. Position of forensic accounting practitioners

The majority of forensic accountants who responded also consisted of interns, trainees and associates; and it was noted that more assistant managers and managers from the forensic accounting field responded than from the auditing field. Figure 6.6 also illustrates that more senior interns/trainees/associates from the forensic accounting field participated in the survey.

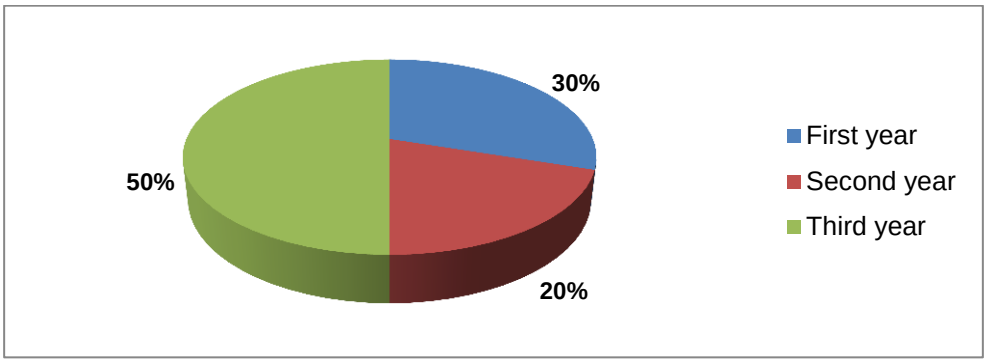

Figure 6.6. Forensic accountant intern/trainee/associate level

6.3.1.2. Students

Students were asked to provide their highest degree obtained. As seen from figure 6.7, the percentages of highest degrees by the student respondents were 57% students with a BCom (Forensic Accountancy) degree and 43% with a BCom (Accounting) degree.

This question supports the study's assumption that the students should have the necessary theoretical knowledge needed to perform an effective FRA, even though they lack the necessary skills, which are developed only when knowledge can be applied to practical situations and more experience is gained, for example, in traineeships.

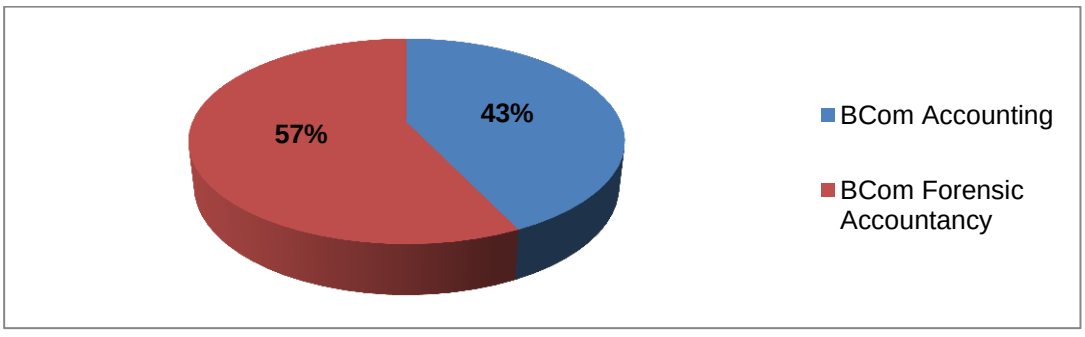

Figure 6.7. Degrees of honours students

Paragraph 6.3.2 will elaborate on the fraud experience and knowledge of the auditors and practitioners in this study.

6.3.2. Experience and knowledge on fraud

6.3.2.1. Knowledge/education on fraud

Taylor (2011:39) stated that auditors should have the ability to uncover and reveal misappropriation of assets and financial statement fraud. Forensic accountants are known to be experienced, trained and knowledgeable on fraud, according to Singleton *et al.* (2006:4). It can, therefore, be concluded that both the forensic accountants and auditors should have sufficient knowledge on fraud. Questions 1–3 indicated whether the forensic accountants and auditors have the mentioned sufficient theoretical knowledge on fraud.

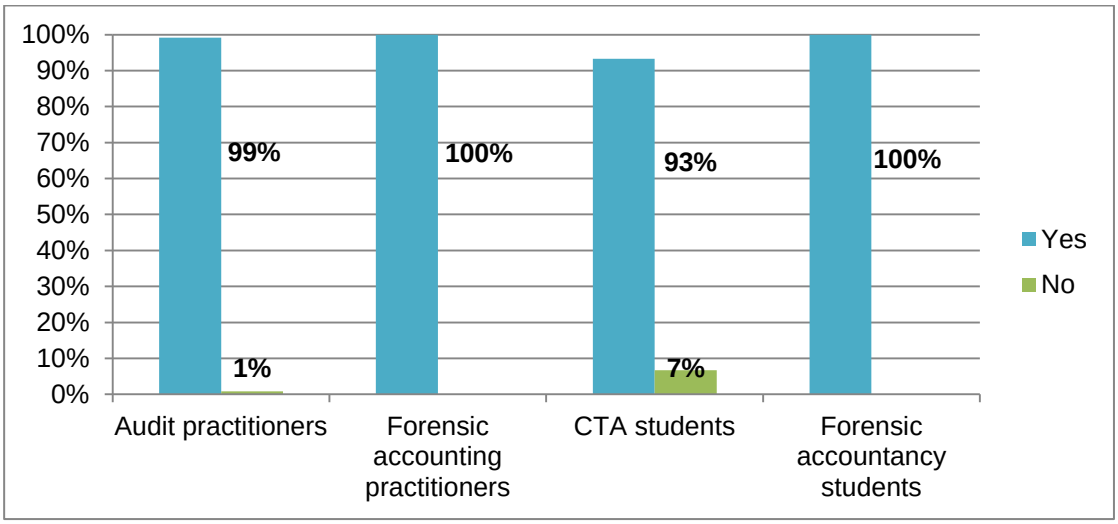

Figure 6.8. Have the respondents received education on fraud?

From figure 6.8, it is evident that 100% of the forensic accounting practitioners and forensic accountancy students indicated having been educated on fraud, while 99% of the audit practitioners and 93% of the CTA students responded in the same manner.

A criminal offence needs to have four elements for it to be classified as fraud. The South African Criminal Law provides the four elements in the definition of fraud as (Snyman, 2006:523):

- Intent to deceive;
- Misrepresentation;
- Actual prejudice or potential prejudice; and
- Unlawfulness.

One can only understand the elements of fraud (in a South African perspective) if one have been educated on fraud. As pointed out in figure 6.8, both forensic accountants and auditors have been educated on fraud; however, the auditors have been educated on fraud based on the information provided in ISA 240, whereas the forensic accountants have been educated on the legal concepts of fraud. This affirms Vona's (2008:191) claim that auditors refer to auditing standards and accounting principles, whereas forensic accountants refer to criminal and civil procedures.

Singleton and Singleton (2010:114) stated that one needs to have an understanding of fraud concepts to perform an effective FRA. In conclusion, two things can be expected:

- Only the forensic accountants would be able to identify the elements of fraud because they have the relevant legal knowledge (option a; c; f and g of question 2); and
- The auditors would recognise the definition of fraud as provided by ISA 240 (option a of question 3) and the forensic accountants would recognise the legal definition of fraud (option e of question 3).

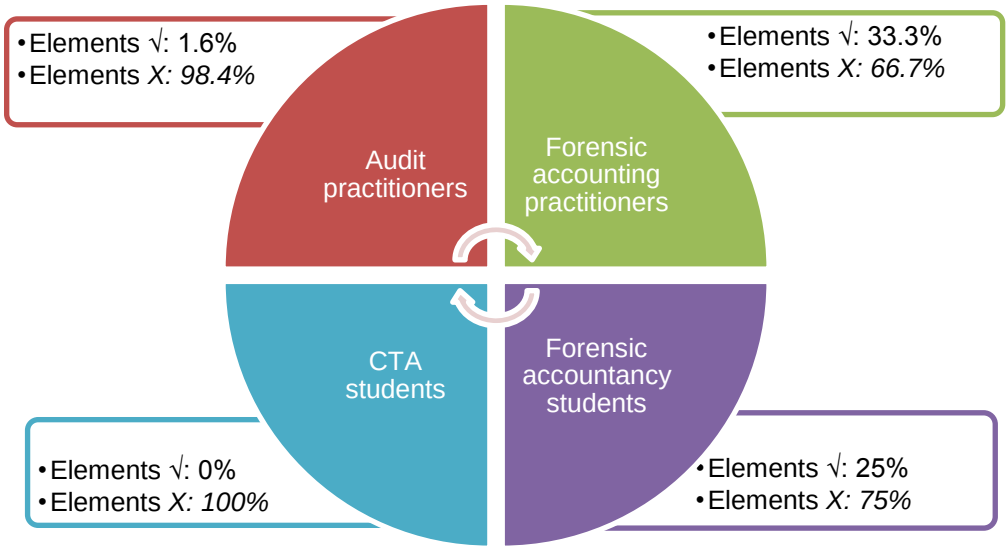

Figure 6.9. Elements of fraud

Figure 6.9 illustrates that, although more forensic accountants than auditors had the ability to identify the elements correctly, neither of the two could do so in full. As auditors are required to assess the risk of fraud in terms of ISA 240 and forensic accountants

should have the ability to investigate fraud, it can be assumed that both should be capable of identifying fraud.

According to Vona (2008:5), the first step in effectively performing an FRA is to have knowledge on the definition of fraud. Question 3 was included to determine, between the forensic accountant and auditor, who has more knowledge on fraud. Figure 6.10 below indicates that the majority of forensic accountants were able to identify the correct definition of fraud containing all four elements: "**Unlawful** and **intentional** making of a **misrepresentation** which causes **actual prejudice** or which is **potentially prejudicial** to another".

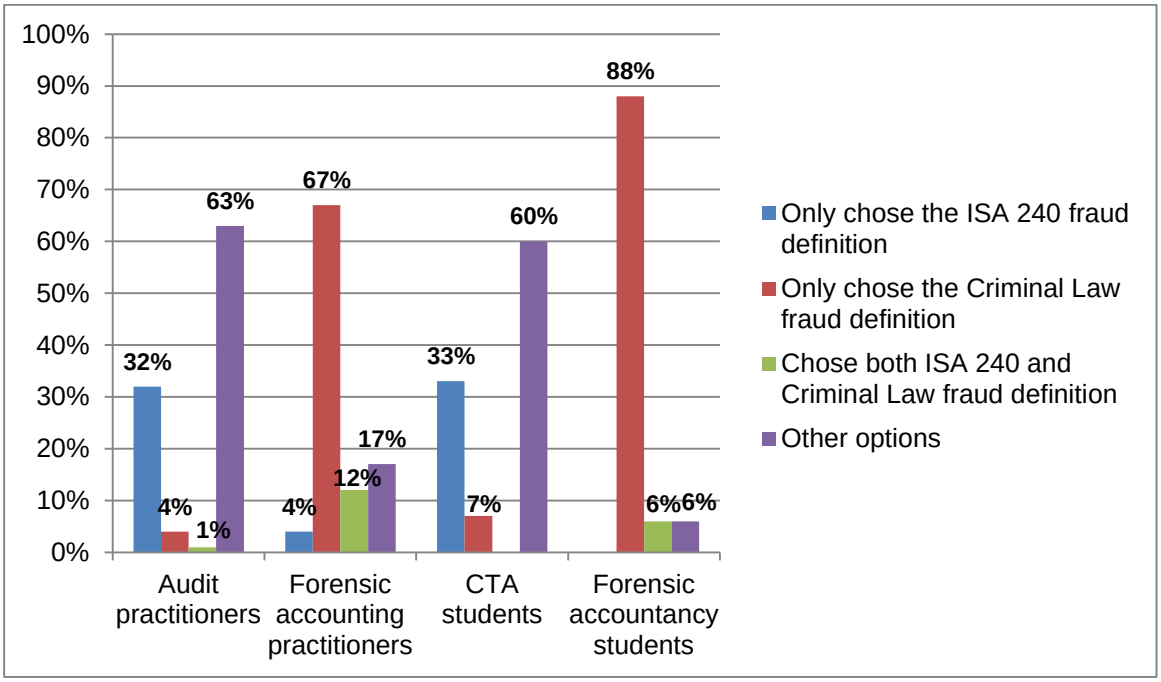

Figure 6.10. Definition of fraud (specific responses)

Figure 6.10 clearly indicates that the forensic accountants had better knowledge on the definition of fraud, whereas the majority of auditors did not know what the definition of fraud is, neither in terms of ISA 240 nor the criminal law. The "other options" represent the auditors and forensic accountants who selected more than one option that includes option b and/or option c and/or option d as a definition of fraud. The options provided were as follows:

- Option a: Definition of fraud in terms of ISA 240;
- Option b: Definition of embezzlement;
- Option c: Definition of corruption;
- Option d: Definition of theft; or
- Option e: Definition of fraud in terms of the South African Criminal Law.

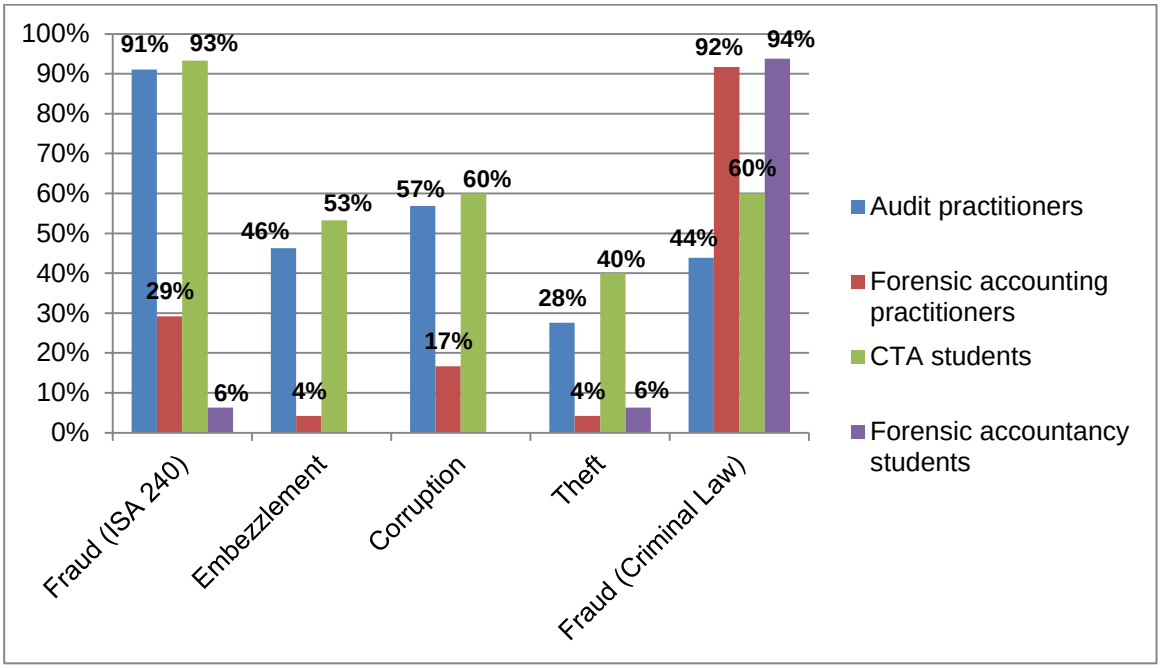

Figure 6.11. Definition of fraud (total responses)

The fact that the majority of auditors chose more than one option proves the statement made by Labuschagne (2006:30) in chapter 3 (par 3.4) that auditors use fraud as a generic term to refer to any dishonest act. The majority of auditors (57% professionals and 60% of students), as derived from figure 6.11, selected the definition of corruption as a definition of fraud. This is significant, because corruption and fraud are considered to be two different types of offences in South Africa. ISA 240 refers only to fraud and not corruption, meaning that auditors are not responsible for identifying corrupt activities. The auditors in this study did not have knowledge on the definition of fraud, neither in terms of ISA 240 nor the South African Criminal Law, and they were not able to distinguish the definition of fraud from the definition of other offences.

The majority of forensic accountants (67% professionals and 88% students) were able to select the criminal law definition as the only definition for fraud. This indicates that the forensic accountants were able to separate fraud from other offences. The forensic accountants were also able to better, although only slightly, identify the elements of

fraud than the auditors. The information mentioned above seems to signify that forensic accountants have more knowledge on fraud than auditors.

6.3.2.2. Experience

Experience plays a vital role in one's ability to perform an FRA, because both experience and knowledge on fraud are needed to identify fraud. For this component, only the practitioners were taken into account, because the students will only encounter actual fraud once they have entered practice.

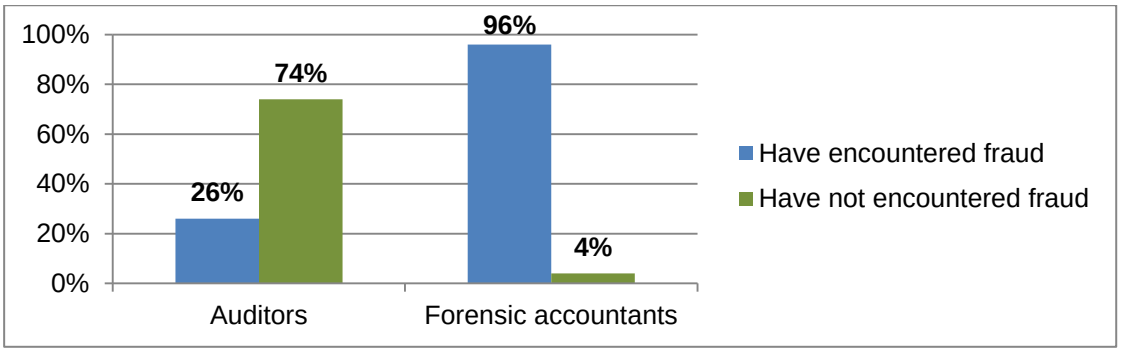

Figure 6.12. Encounters with fraud

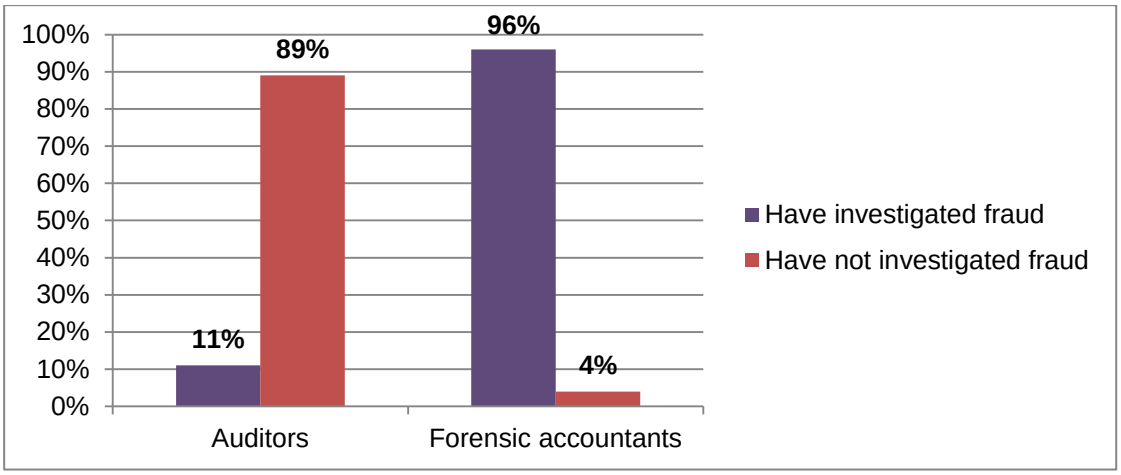

Figure 6.13. Previous investigation of fraud

Figures 6.12 and 6.13 illustrate that the forensic accountants had more experience on fraud than the auditors. A total of 96% of the forensic accountants have encountered fraud and 96% have investigated fraud before. It was expected that the majority of auditors would not have encountered fraud in their career yet, because the majority of auditors had less than three years' practical experience. It can, therefore, be concluded

that the auditors in this study lacked the necessary experience on fraud to identify the act.

Paragraph 6.3.2.3 will elaborate on the auditors' and forensic accountants' responsibility to report fraud and determine their opinions on who they felt are responsible for investigating the act.

6.3.2.3. Reporting of fraud

The majority of forensic accountants responded that they have a responsibility to report fraudulent transactions. The question that needed to be answered was whether they know at what point in time and to whom the fraudulent transaction should be reported.

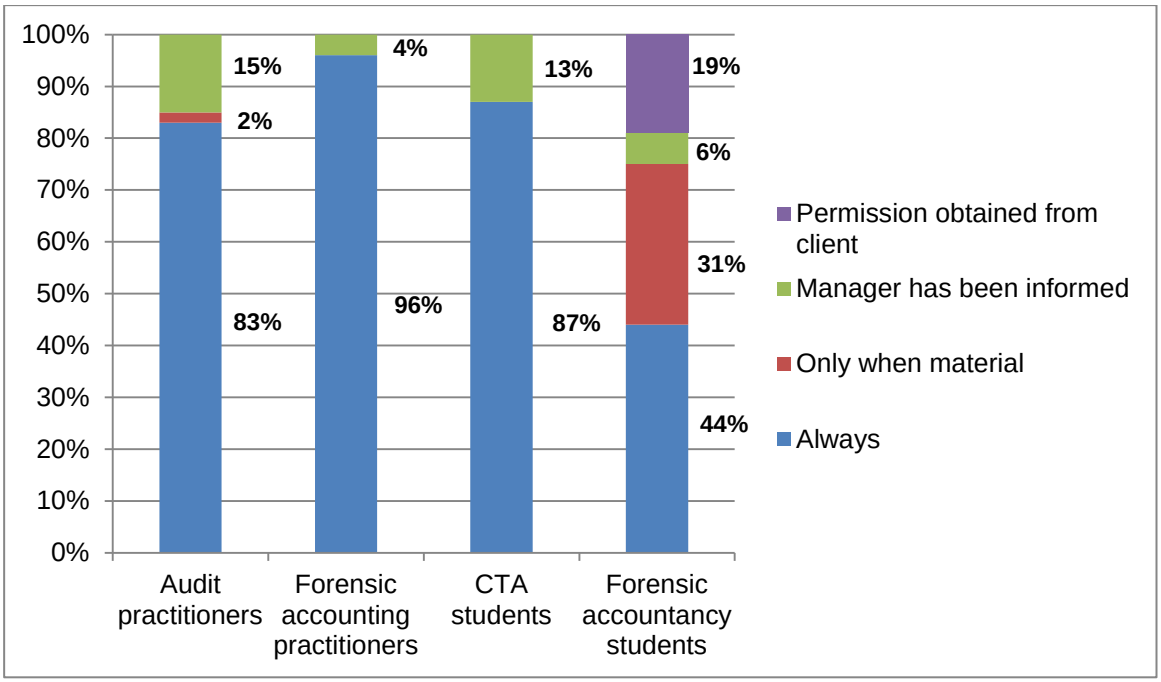

Figure 6.14. When should fraudulent transactions be reported?

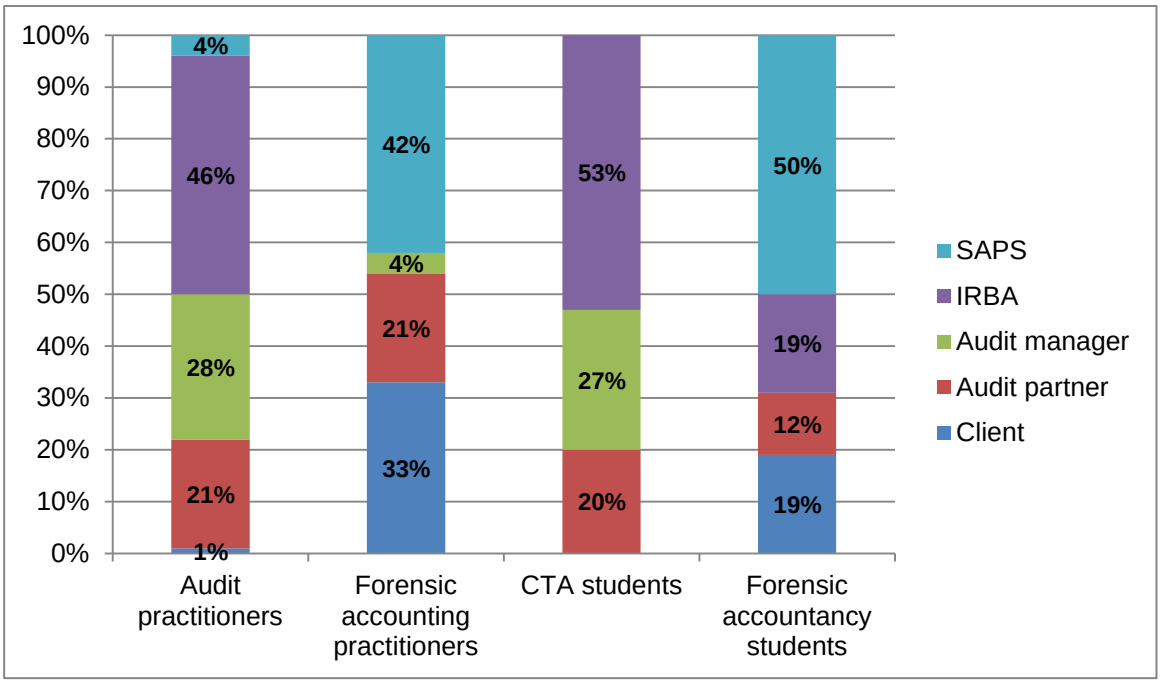

Figure 6.15. To whom should fraudulent transactions be reported?

The forensic accountants and auditors were overall mostly in agreement that fraud should always be reported, as shown in figure 6.14. Furthermore, there is no single correct answer for question 6 (illustrated in figure 6.15), as all five options are plausible, depending on the circumstances:

- *SAPS (South African Police Services):*

  Section 34 of PRECCA requires a person who holds a position of authority to report fraud involving an amount exceeding R100 000 to any police official. Section 34(4) of PRECCA stipulates that managers, secretaries, and boards of directors as defined in the Companies Act, CEOs and partners of an institution or organisation hold a position of authority. According to this stipulation, neither the forensic accountant nor the auditor holds a position of authority. Therefore, individuals responsible for the overall management and control of the client are responsible for reporting fraudulent transactions to the SAPS should the monetary amount exceed R100 000.

- *IRBA:*

  As mentioned in chapter 4 (par 4.4.3), the auditor is required to report fraudulent transactions to the IRBA only when the auditor has reason to believe that management committed fraud.

- *Audit manager/Audit Partner:*

  Interns/trainees/associates within a firm are required to report any risk of fraud identified during the course of their audit to their audit manager. The audit manager will then report the matter to the audit partner. The audit partner will take the necessary steps to report the matter to management or to the IRBA depending on the situation. When analysing the responses to question 6, it was noted that only audit interns/trainees/associates and CTA students selected the audit manager as the person to whom fraudulent transactions should be reported. It was further noted that the majority of respondents who indicated the audit partner as the person to whom fraudulent transactions should be reported are: interns/trainees/associates, assistant managers and managers.

- *The client:*

  ISA 240 requires an auditor to inform management when actual or possible fraud has been identified and the auditor has reason to believe management is not involved. As mentioned in chapter 5 (par 5.4.1), it was concluded that forensic accountants report their evidence to the client to prove or disprove the occurrence of fraud.

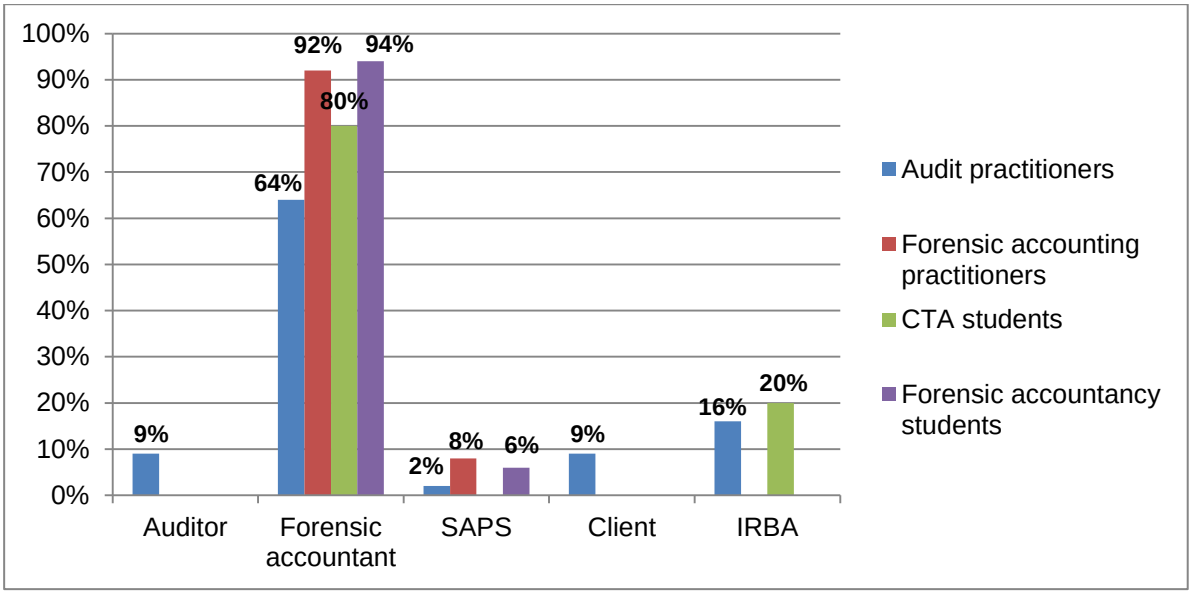

Figure 6.16. Who should investigate fraudulent transactions?

It is evident from figure 6.16 that the majority of auditors and forensic accountants selected the forensic accountant as the person they believed should investigate fraud.

Based on the information provided in chapter 5, it was concluded that the forensic accountant has the necessary skills and knowledge to investigate fraud:

- Forensic accounting is the integration between auditing, accounting, investigating, interviewing and legal concepts, as mentioned in paragraph 5.2.2;
- Fraud investigation is one of the services provided by the Big 4 accounting firms' forensic departments (par 5.4.5);
- Paragraph 5.5 concluded that forensic accountants use the civil and criminal law to guide them in their investigations in order to prove or disprove the occurrence of fraud.

Thus, the conclusion can be drawn that forensic accountants are considered skilled in detecting fraud and are suitably equipped to perform fraud investigations. This is in line with the conclusion by Ojo (2012) and Singleton *et al.* (2006:4) in chapter 1 (par 1.2) that forensic accountants are trained to detect fraud and possess the skills needed to identify fraud. Section 6.3.3 will determine who is more capable of identifying fraudulent transactions between the auditor and forensic accountant.

6.3.3. Capability of identifying fraudulent transactions

In questions 8 and 9 the respondents indicated whether they felt they had the ability to identify fraud and whether they considered themselves experts in identifying fraud. Questions 12–18 aimed at proving that forensic accountants are more capable of identifying fraudulent transactions, because they have the necessary knowledge on fraud.

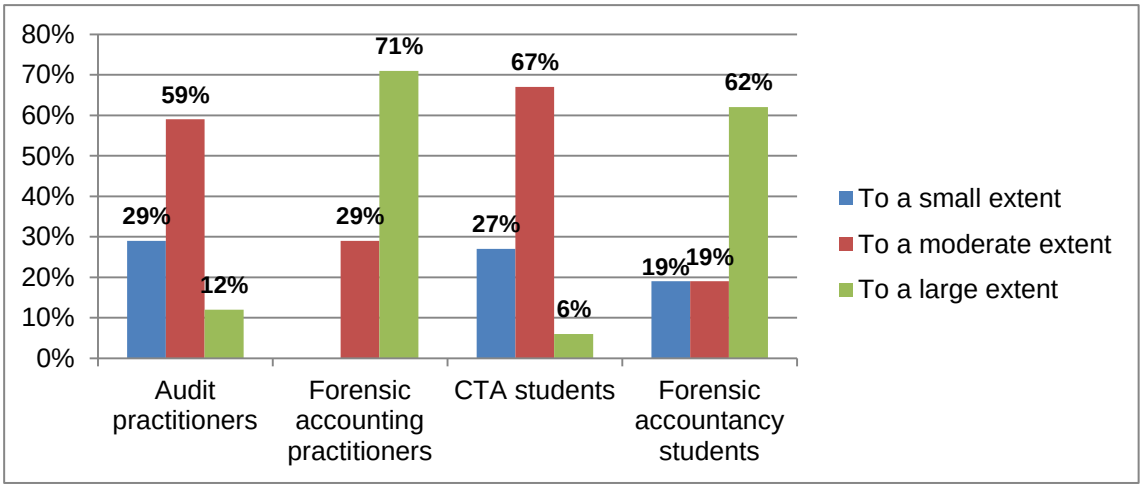

Figure 6.17. Respondents' perception of own ability to identify fraudulent transactions

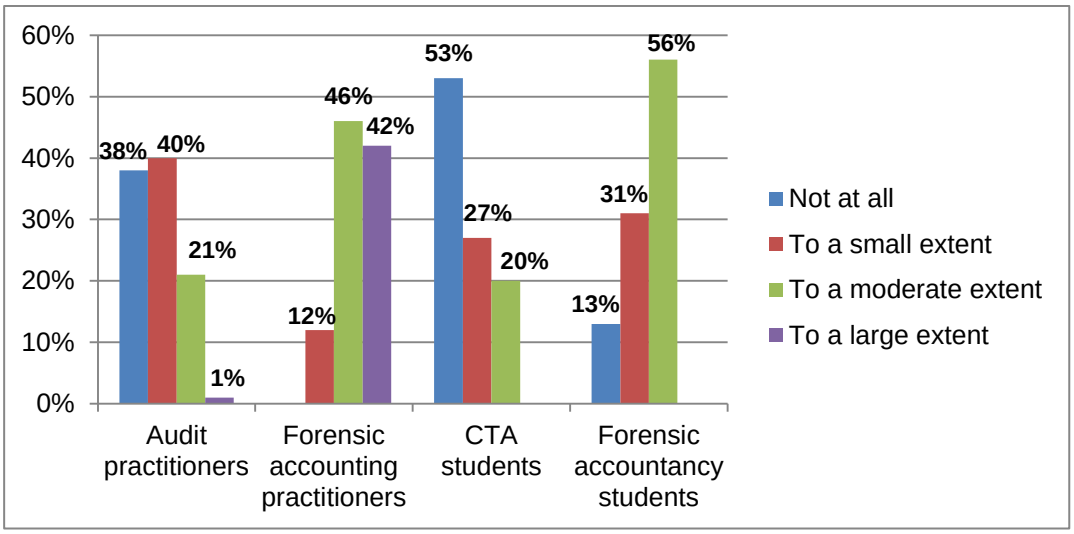

Figure 6.18. Respondents' perception of themselves as experts in identifying fraudulent transactions

Figures 6.17 and 6.18 show that the majority of auditors and forensic accountants felt they had the ability to identify fraud to a moderate and large extent. A total of 42% of forensic accountants considered themselves as experts in identifying fraud, whereas none of the auditors considered themselves as experts. Paragraphs 6.3.3.1 and 6.3.3.2 will determine whether the auditors and forensic accountants had the capability of identifying fraudulent transactions.

6.3.3.1. Identifying circumstances indicating fraud

Fraud risk assessment was defined in chapter 4 (par 4.2) as the action of identifying the possibility of fraudulent transactions occurring, as well as assessing the impact the occurrence of fraud has on the organisation. It was shown that the ability to identify fraud is critical in effectively performing an FRA.

In question 12, the respondents were provided with three scenarios requiring them to indicate the scenario that points to fraud:

- Option a is an act fraud;
- Option b is an act of theft; and
- Option c is an act of corruption.

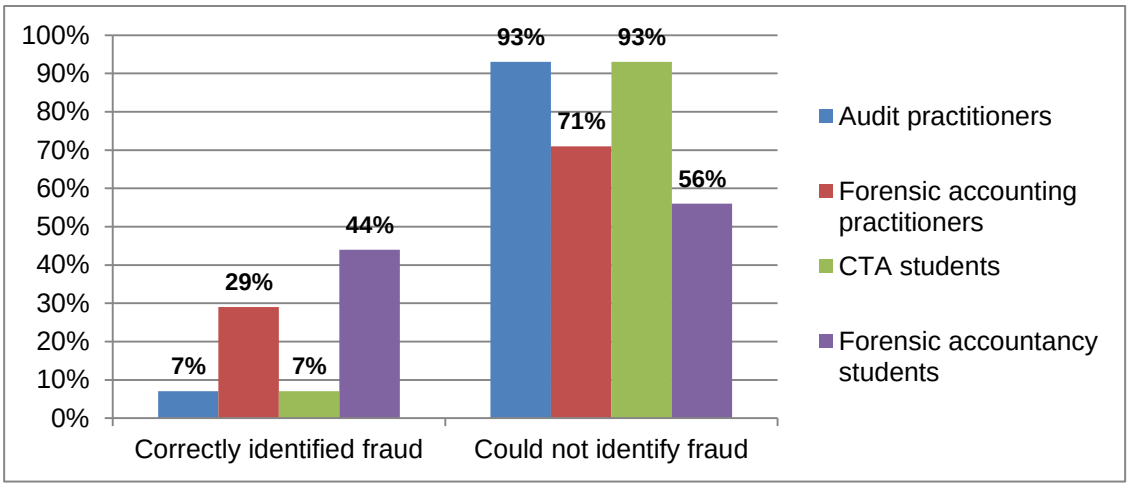

Figure 6.19. Ability to correctly identify fraud

Figure 6.19 proves that the majority of forensic accountants and auditors could not correctly identify option a as an act of fraud. Nonetheless, when comparing the forensic accountants to the auditors, 44% of the forensic accountancy students and 29% of the forensic accounting practitioners were able to correctly identify the fraudulent transaction as opposed to 7% and 7% respectively.

Auditors and forensic accountants need to be aware of fraud risk indicators, because these indicators can be used to identify fraudulent transactions. Question 13 provided the respondents with four possible indicators of fraud. Both forensic accountants and auditors have to maintain a mind-set of professional scepticism and, therefore, be vigilant to the possibility of fraud. ISA 240 provides fraud risk indicators to guide auditors in identifying fraudulent transactions, whereas forensic accountants are trained to detect fraud. Thus, both the forensic accountant and auditor have knowledge on fraud risk indicators and should be able to identify circumstances indicating the possibility of fraud occurrence.

Figure 6.20 aims to prove whether forensic accountants and auditors have the ability to identify fraud risk indicators.

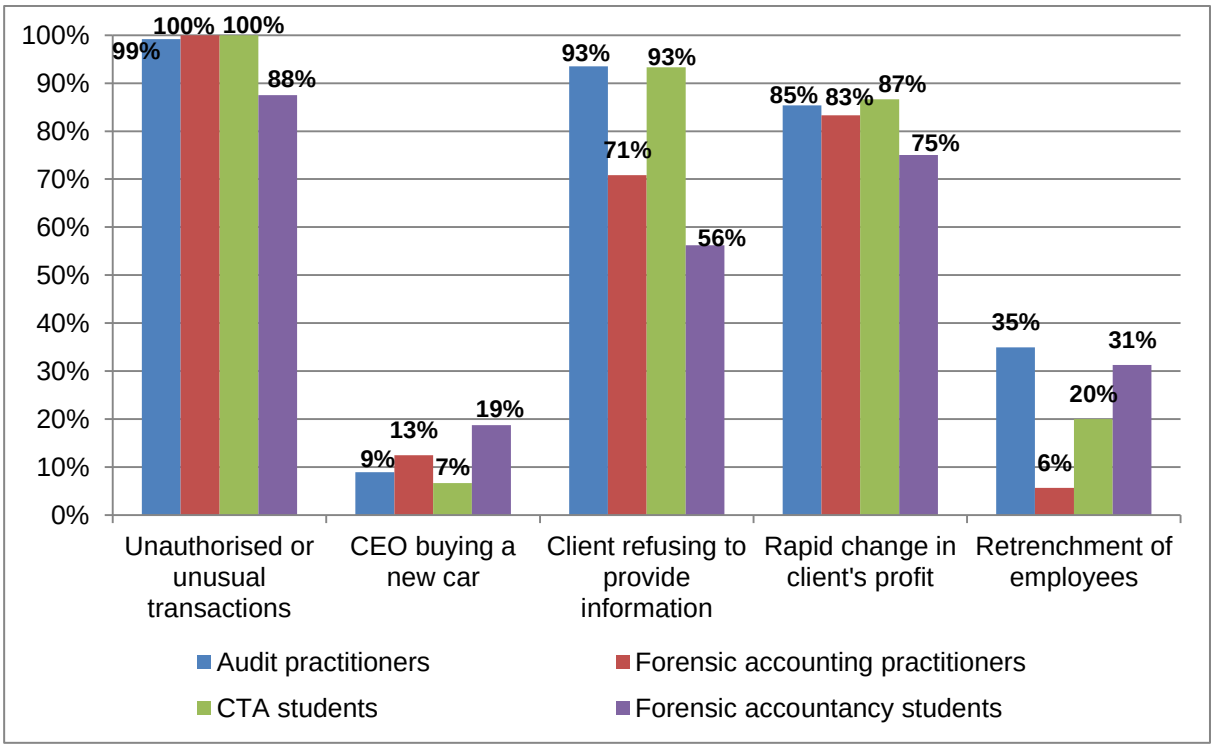

Figure 6.20. Ability to correctly identify indicators of fraud

The indicators that are more likely to indicate the occurrence of fraud in question 13 are: unauthorised or unusual transactions, client refusing to provide information and rapid change in a client's profit. Figure 6.20 illustrates that both the forensic accountants and auditors were equally competent in identifying fraud risk indicators.

6.3.3.2. Separating fraud from other instances

Questions 14–18 addressed the forensic accountant's and auditor's ability to separate fraud from other criminal offences. In the scenario provided, fraud was divided into financial statement fraud and misappropriation of assets. As mentioned in chapter 3 (par 3.4), auditors need to assess only the possibility of financial statement fraud and the misappropriation of assets. ISA 240 specifically addresses financial statement fraud and misappropriation of assets, therefore, the expectation was that the auditors would be competent in identifying these two types of fraud.

The correct answers to questions 14–18 were as follows:

- Question 14: Financial statement fraud;
- Question 15: Misappropriation of assets;
- Question 16: Financial statement fraud;
- Question 17: Financial statement fraud; and
- Question 18: Misappropriation of assets.

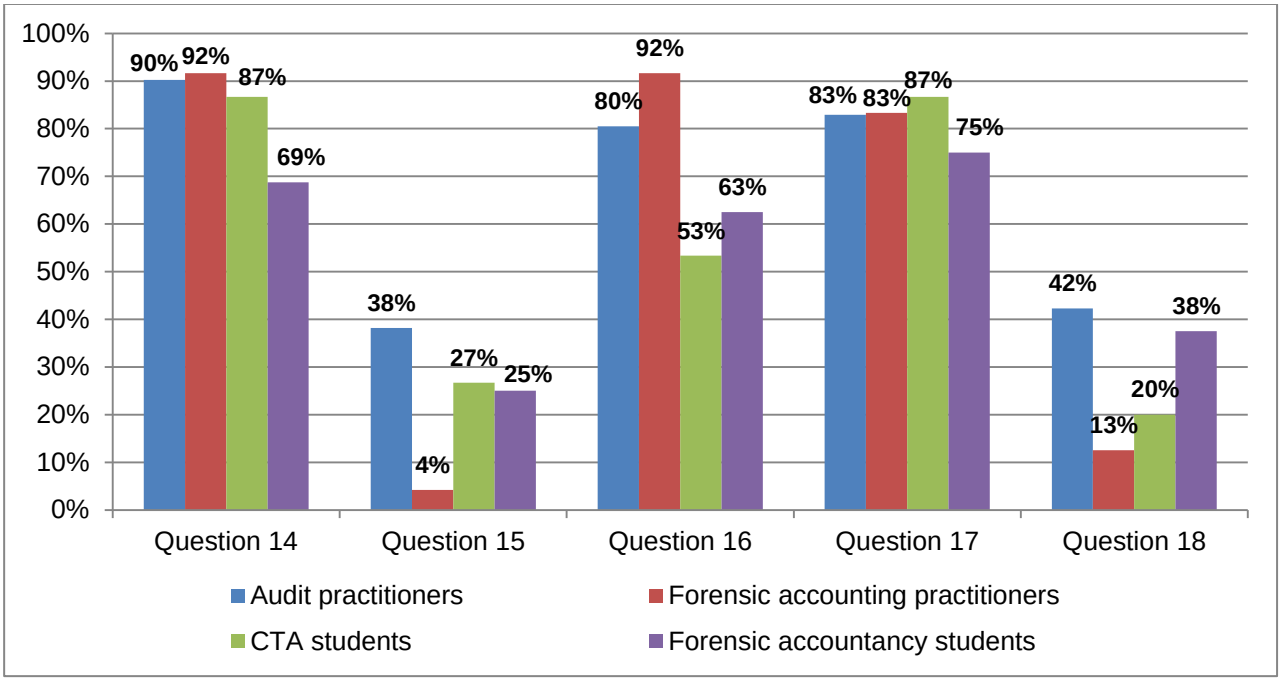

Figure 6.21. Ability to correctly identify the criminal offence

The forensic accountants and auditors seemed to be consistent in their responses. The majority of the forensic accountants and auditors had the ability to correctly identify questions 14, 16 and 17. The forensic accountants and auditors seemed to have correctly identified the criminal offences relating to financial statements fraud, but were unable to correctly identify the offences relating to misappropriation of assets. It does, however, seem that the auditors were more effective in identifying misappropriation of assets than the forensic accountants. As both the auditors and forensic accountants were unable to correctly identify misappropriation of assets, the responses to questions 15 and 18 will be analysed in more detail. The aim is to identify which of the incorrect offences the auditors and forensic accountants selected and to determine whether there are any similarities between their responses. The responses for questions 15 and 18 were:

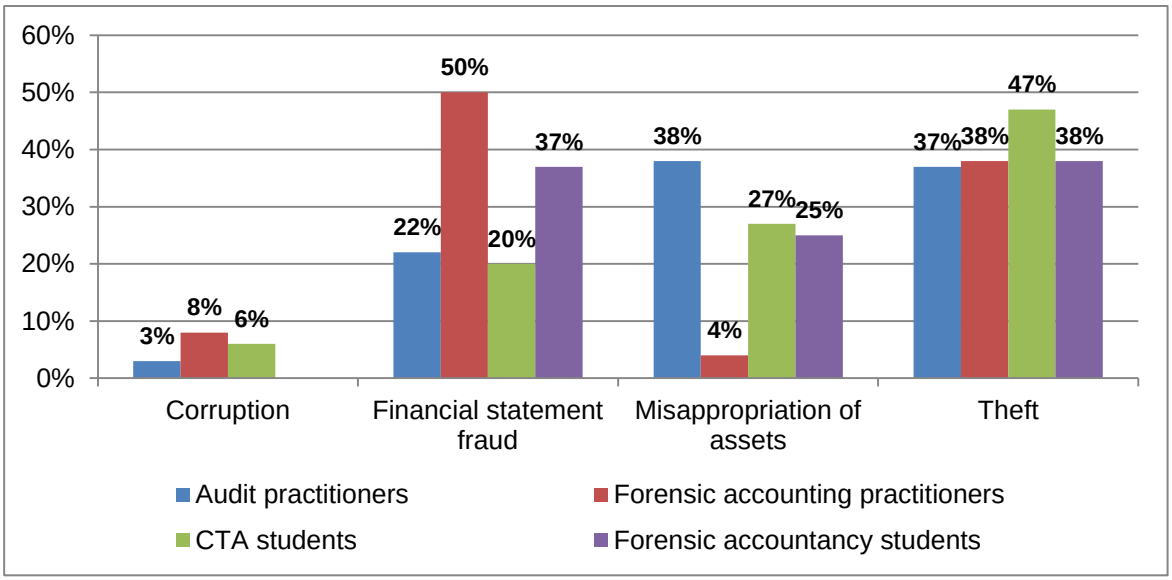

Figure 6.22. Overall responses to question 15

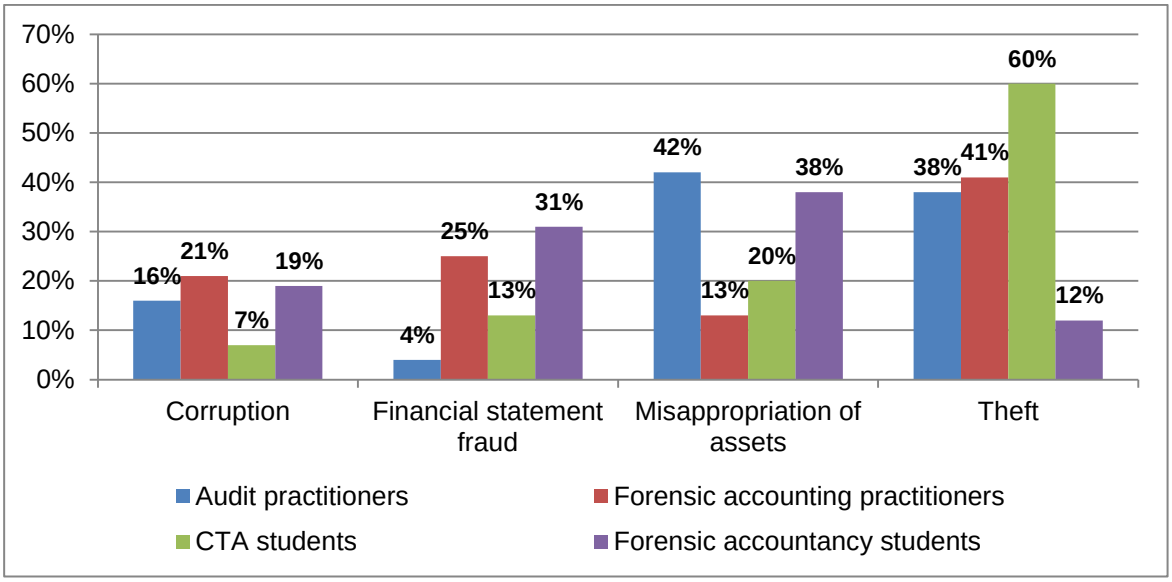

Figure 6.23. Overall responses to question 18

Figures 6.22 and 6.23 clearly indicate that both the auditors and forensic accountants misinterpreted misappropriation of assets as theft. It can, therefore, be determined that the auditors and forensic accountants might not understand the difference between misappropriation of assets and theft. The misappropriation of assets in the scenario in questions 15 and 18 was assets (cash) being taken from the entity, and the employee's concealing the act by force balancing the bank reconciliation and including personal expenses on monthly expense claims for the business trips. The difference between fraud and theft lies in the phrase "intention to deceive". Theft can be defined as "the

unlawful and intentional appropriation of a movable corporeal property" in terms of the South African Criminal Law (Snyman, 2006:523). Hence, theft does not involve the intent to deceive, whereas intent to deceive is one of the elements of fraud. In conclusion, the responses to questions 15 and 18 reveal that the auditors were more capable than the forensic accountants to identify misappropriation of assets as the correct offence.

In figure 6.17, the majority of forensic accountants and auditors indicated that they felt they had the ability to identify fraud to a moderate and large extent. In addition, the forensic accountants considered themselves experts in identifying fraud. From all the information provided in paragraph 6.3.3, the following can be established:

- The forensic accountants were more capable than the auditors to correctly identify fraudulent transactions from other offences (figure 6.19);
- The auditors and forensic accountants were equally capable of identifying fraud risk indicators (figure 6.20); and
- The auditors and forensic accountants were equally capable of identifying financial statement fraud, but the auditors were more capable of identifying misappropriation of assets in comparison to the forensic accountants (figure 6.21–6.23). However, both the auditors and forensic accountants confused misappropriation of assets with theft and financial statement fraud.

6.3.4. Fraud risk assessment

6.3.4.1. Experience on fraud risk assessment

Questions 19–25 addressed the auditors' and forensic accountants' knowledge on FRA and the approach the respondents would follow to address FRA. The results from the responses will also be compared to the information provided in chapter 4. Only practitioners were taken into account in this component, because the students would perform FRA only once they have finished their studies and gained adequate experience.

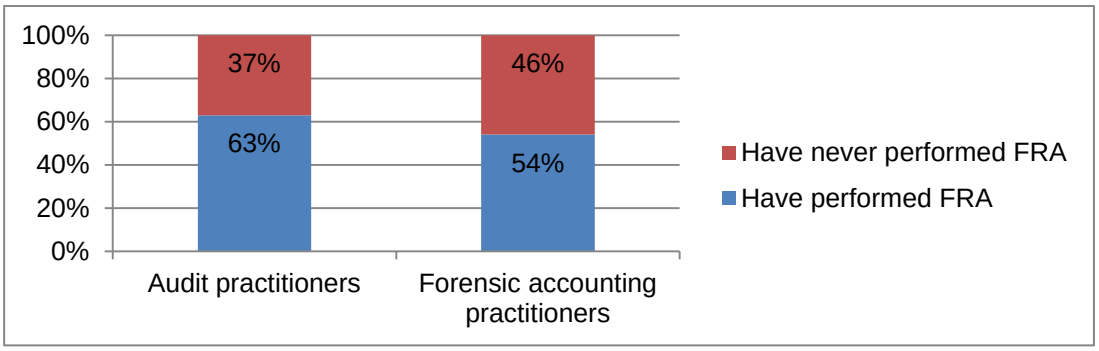

Figure 6.24. Have they ever performed a fraud risk assessment?

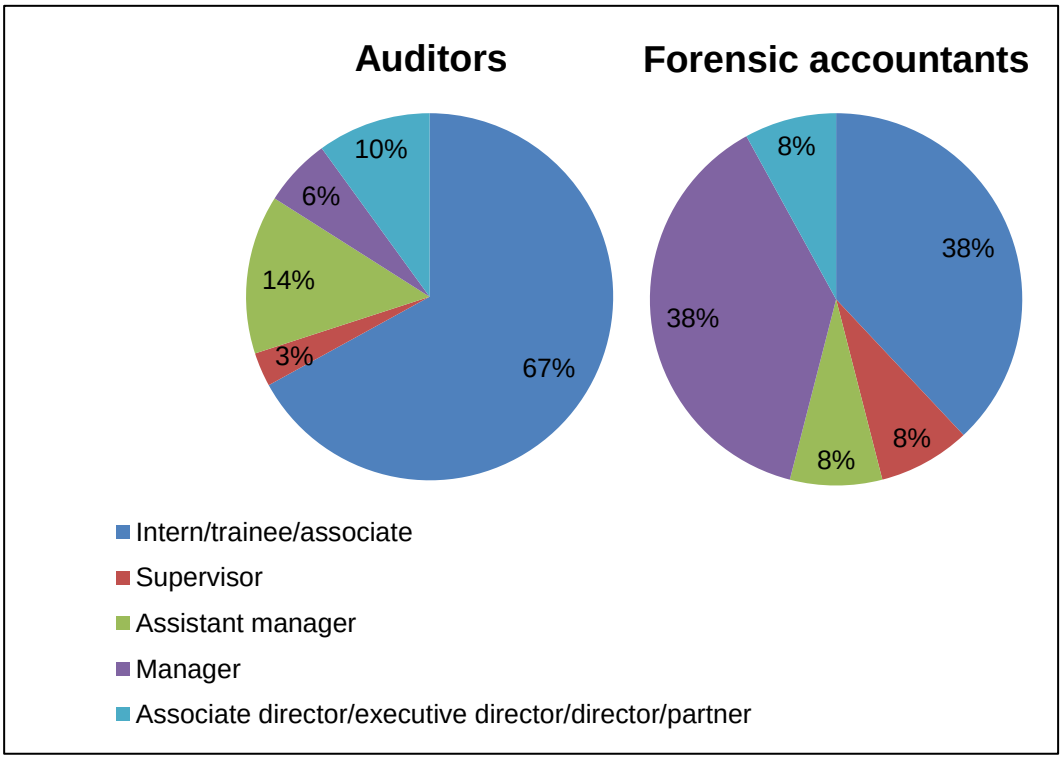

Figure 6.25. Position of respondent who performed FRA

As the majority of auditors and forensic accountants have performed FRA in the past, the presumption was that both the auditors and forensic accountants should have an understanding on how to perform FRA in order to reach the objective of this assessment. Figure 6.12 indicates that 74% of auditors have never encountered fraud in their career; however, 63% of auditors have performed FRAs before. In chapter 4 (par 4.4), Allen *et al.* (2006:161) and Beasley and Jenkins (2003:32) mentioned that auditors who have never encountered fraud during their career find it difficult to assess the risk of fraud. In addition, figure 6.25 illustrates that the majority of auditors who have performed FRA before were interns/trainees/associates. Furthermore, it was determined that most of

these interns/trainees/associates had less than one year practical experience. In chapter 4 (par 4.5), it was concluded that someone with experience should perform FRA and, as a result, auditing firms should reconsider the allocation of this task to junior team members.

Figure 6.25 also indicates that more forensic accountant managers have performed FRA. Even though 42% of the forensic accountant respondents were interns/trainees/associates, the majority of them were seniors, as seen in figure 6.6. Figures 6.12 and 6.13 show that the majority of forensic accountants have encountered fraud in their career and have investigated fraud. It was concluded in chapter 4 (par 4.4.2.3) that managers instead of seniors should perform FRA in order to enhance the effectiveness thereof, seeing that the former has more knowledge and experience on fraud.

Questions can be raised as to the effectiveness of the FRAs that were performed by the above interns/trainees/associates, seeing that they lack the knowledge and experience on fraud that managers have.

6.3.4.2. Purpose of a fraud risk assessment

Question 20 was included to gain an understanding of the auditors' and forensic accountants' knowledge of FRA when performing an audit. To be able to effectively perform an FRA, it is important to understand the purpose of an FRA.

Question 20 required the respondents to select the options describing the purpose of FRA in an audit. The options were as follows:

a. To detect fraudulent transactions;
b. To determine whether the company's internal controls have the ability to reduce the risk of fraud to an acceptable level;
c. To evaluate whether the fraud identified could cause the financial statements to be materially misstated;
d. To prevent fraudulent transactions; and
e. To confirm the existence of fraudulent transactions.

Figure 6.26 displays the responses received.

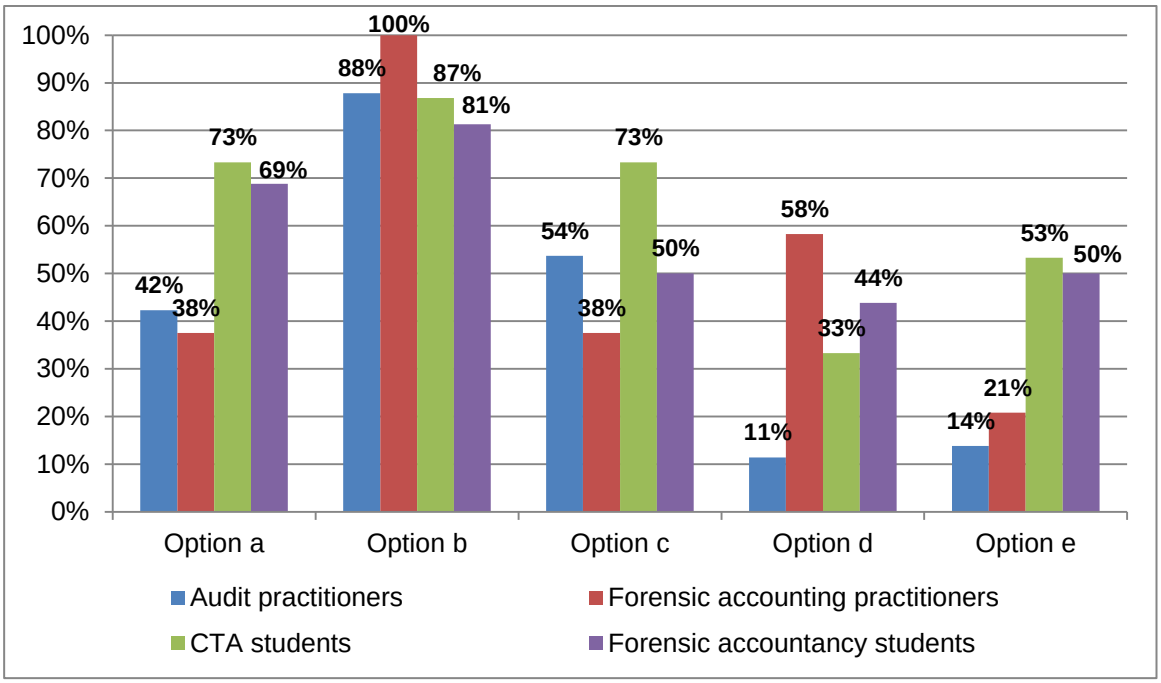

Figure 6.26. Purpose of a fraud risk assessment

The respondents were given the choice to select more than one option in order to test their understanding of the purpose of FRA. As concluded in chapter 4 (par 4.3), the purpose of performing FRA is to assess, firstly, whether the client's controls are effective in identifying, preventing and detecting fraud together and, secondly, the fraud risk that the entity is facing. Option b of question 20, therefore, represents the purpose of FRA. Figure 6.26 shows that the majority of auditors and forensic accountants selected option b; however, it was not the only option chosen by the respondents. ISA (315:4) adds that FRA is performed to identify and assess the RMM due to fraud. In chapter 4 (par 4.4), it was determined that ISA (240:3) expects auditors to only identify fraud that causes the financial statements to be materially misstated. For this reason, it can be argued that option c could also have been selected as an option together with option b, although it could not be selected as the only purpose of FRA.

Figure 6.27 provides the number of respondents who correctly identified the purpose of FRA.

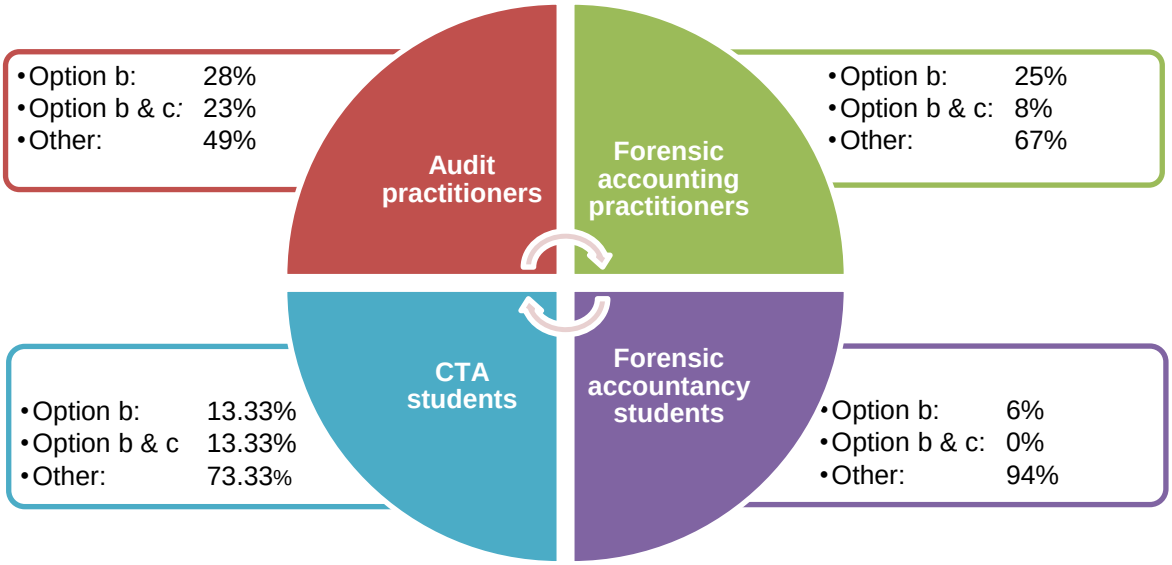

Figure 6.27. Ability to correctly identify purpose of fraud risk assessment

In the above figure, the "other options" represent the auditors and forensic accountants who selected option a and/or option d and/or option e as the purpose of an FRA.

The remark can be made that neither the forensic accountants nor the auditors understand the purpose of FRA in terms of an audit. It does, however, seem as if the professionals have a better understanding than the students, seeing that they have experience on FRA. When comparing the forensic accountants with the auditors, it can be concluded that the latter has a better understanding of the purpose of FRA. A few forensic accountants and auditors indicated that the purpose of FRA is to prevent and detect fraud. Even though this can also be the purpose of FRA, it is not the purpose of FRA in an audit – it refers to the purpose of FRA when performed by management.

6.3.4.3. Performing fraud risk assessment

Chapter 4 (par 4.4) discussed how FRA should be performed in an audit context. Questions 21–24 were formulated by using the information in chapter 4 to determine whether the forensic accountants and auditors had the ability to select the most appropriate procedures to perform FRA. As with question 20, the respondents had the choice to select more than one option. Figure 6.28 displays the respondents' view on how FRA should be addressed.

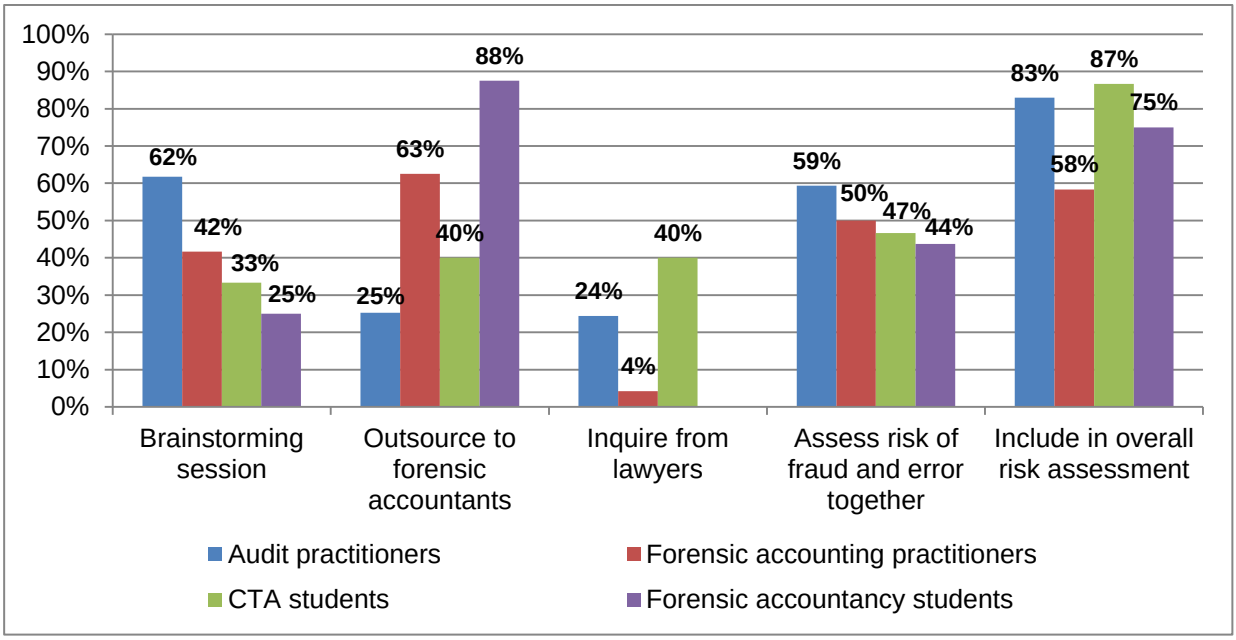

Figure 6.28. How fraud risk assessment should be addressed

Question 21 was compiled based on the information obtained in chapter 4. The following conclusions were reached in chapter 4 (par 4.5) on how to address the risk of fraud:

- Brainstorming sessions between the audit team members are vital to the success of an FRA and will enhance the auditors' sensitivity to the risk of fraud;
- FRAs are more effective when they are not incorporated in the overall risk assessment;
- Assessing the risk of fraud and risk of error separately enhances the effectiveness of an FRA.

The above indicates that the majority of auditors would use brainstorming; assess the risk of fraud and error together; and include the FRA in the overall risk assessment to address the risk of fraud. The forensic accountants were in agreement with the auditors, except they also added that the FRA should be outsourced to the forensic department.

Both the auditors and forensic accountants were correct in selecting brainstorming sessions to address FRA. However, consideration should be given to separate FRA from the overall risk assessment and the risk assessment of error, seeing that fraud involves the intention to deceive, whereas error is merely the result of a mistake, as stated in chapter 4 (par 4.4). It will be harder for auditors and forensic accountants to identify fraud than error due to fact that fraud perpetrators conceal the act from the auditors and financial statement users. Consequently, the procedures designed to identify an error

will not necessarily be effective in identifying fraud. It is recommended that auditors and forensic accountants apply a higher level of professional scepticism when assessing the risk of fraud and design a distinct approach to assess the risk of fraud.

Figure 6.29 identifies who has the ability to select the most appropriate procedure to perform an FRA: auditors or forensic accountants.

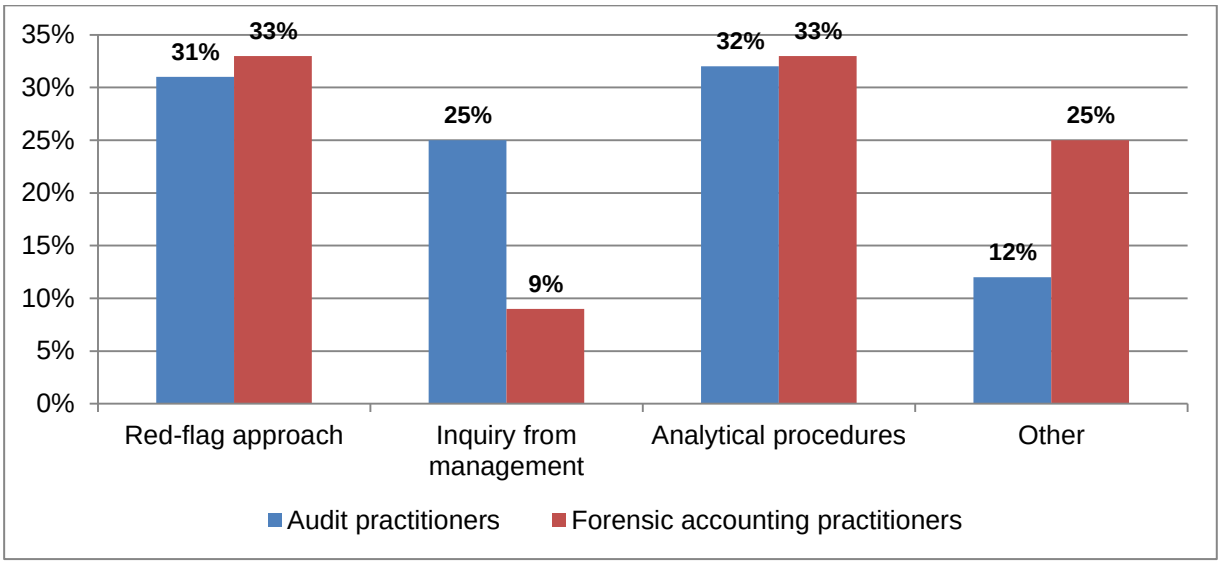

Figure 6.29. Ability to select the most appropriate procedure for fraud risk assessment

The majority of responses received from “other” can be summarised to three responses: use a combination of inquiry, red-flag approach and analytical procedures; perform journals testing; and inquire from others within the entity.

The responses from the students were not taken into account, because they did not have practical experience on FRA and were, therefore, not in a position to identify the most effective approach to perform FRA.

Figure 6.29 demonstrates that the majority of audit practitioners feel the red-flag approach, inquiry from management and analytical procedures are the best approaches to be used, while the forensic accounting practitioners felt the red-flag approach, analytical procedures and a combination of the three are the best approach to perform FRA. Question 22 was derived from the information covered by chapter 4 (par 4.4.2) of which the findings can be summarised as follow:

- Inquiry from management should be used with caution, because management have the ability to deceive the auditor and limit the auditor's focus to specific types of fraud. However, management can indeed be helpful in identifying information that cannot be found on paper. If inquiry from management is used, it should never be used in isolation;
- The red-flag approach is the most ineffective approach to address the risk of fraud, because the approach limits the auditor's knowledge, resulting in the risk of overlooking information outside of the questionnaire which could indicate the possible occurrence of fraud; and
- Analytical procedures are the most effective approach to use to address the risk of fraud, because they focus on the type of information with which management cannot influence the auditor. Should material variances be identified, the auditor would be required to request an explanation from management. Nonetheless, the auditor is to request supporting documentation for all explanations provided by management.

In conclusion, analytical procedures are the best approach in performing FRA. Analytical procedures also involve an element that requires auditors to inquire from management. Therefore, it can be concluded that a combination between inquiry from management and analytical procedures is the best approach to assess the risk of fraud.

According to figure 6.29, 32% auditors and 33% forensic accountants chose the most effective approach (analytical procedures) and 31% auditors and 33% forensic accountants chose the most ineffective approach (red-flag questionnaire). Thus, the auditors and forensic accountants were equally successful in selecting the most effective procedures to perform an FRA. In chapter 4 (par 4.4.2.2), it was determined that the red-flag approach would be effective if used in combination with analytical procedures. It can be concluded that the auditors and forensic accountants would be able to use inquiry and the red-flag approach to effectively perform FRAs; however, these approaches will be effective only if they are used in combination with analytical procedures.

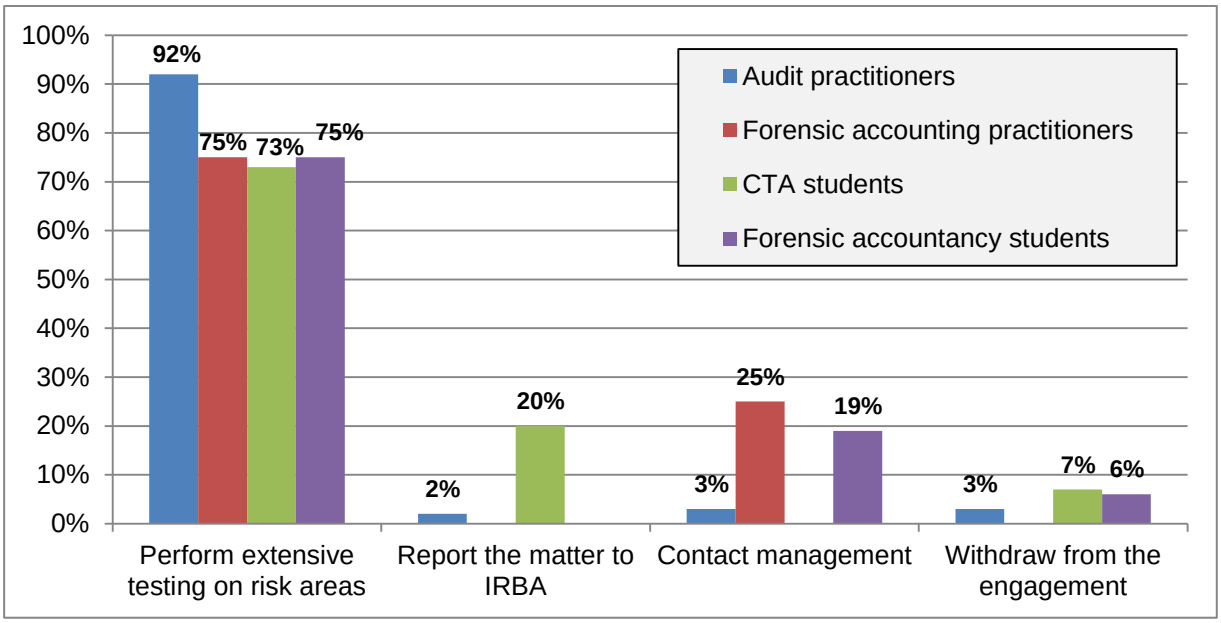

Figure 6.30. How to respond to the risk of fraud

Question 23 was derived from the information included in chapter 4 (par 4.4.3). Figure 6.30 clearly illustrates that the majority of forensic accountants and auditors chose to perform extensive testing on risk areas to respond to the risk of fraud. There were, however, 20% of CTA students who chose to report the matter to the IRBA and a small number of forensic accountants (25% practitioners and 19% students) who chose to contact management. There is no definite answer for question 23, as all four options are plausible responses to the risk of fraud.

The following conclusion can be drawn from the information provided in chapter 4 (par 4.4.3):

- Auditors should perform extensive testing on high risk areas of fraud;
- When identifying possible fraud, auditors should inform management in a timely manner; and
- Should the auditor believe management is involved, the auditor should report the matter to a third party (IRBA).

In addition, auditors are allowed to withdraw from an engagement should they feel they are no longer able to continue their audit of financial statements due to misstatements resulting from fraud (ISA 240:38), for example, when management is involved and in cases of possible reputational damages to the auditor and the audit firm (ISA 240:A55).

Forensic accountants are required to perform extensive testing on risk areas, seeing that they are required to investigate fraud and gather enough evidence to conclude on whether fraud has occurred. Forensic accountants are also required to communicate to management their conclusion by way of a report. In conclusion, performing extensive testing is the first step in order to gain sufficient evidence to be able to communicate the matter to the relevant parties (management or IRBA).

Question 24 was included to establish who the respondents believed to be best suited to perform an FRA. Figure 6.31 displays the responses to question 24.

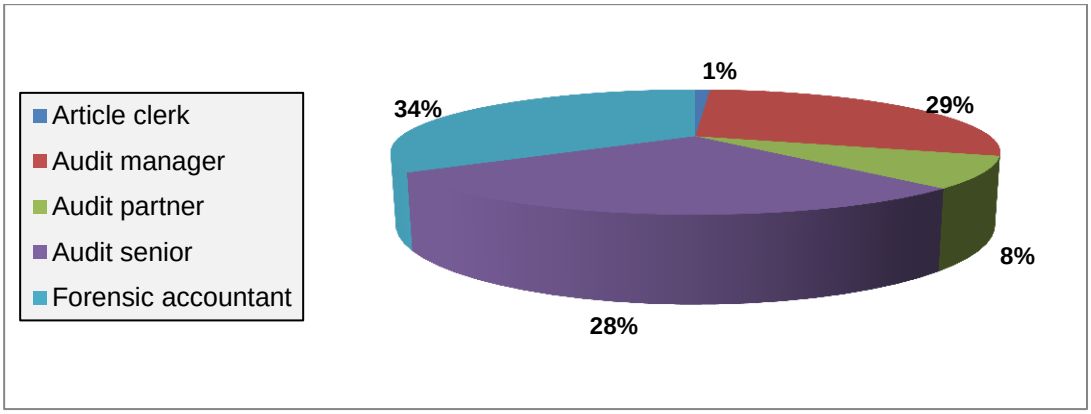

Figure 6.31. Who is best suited to perform fraud risk assessment?

From the responses, it was noted that the majority of forensic accountants felt they were more suited to perform an FRA, while the majority of auditors believed that audit managers and audit seniors were best suited. As mentioned in chapter 4 (par 4.4.2.3), assigning the FRA to managers instead of audit seniors would enhance the effectiveness of the assessment, because managers have more knowledge and experience on fraud than audit seniors. It is, therefore, vital that auditors and forensic accountants assign the responsibility to perform FRA to individuals with the necessary knowledge, skills and experience.

6.4. Summary

The summary can be divided into three sections:

1. *Experience and knowledge on fraud*

   As mentioned in chapter 4 (par 4.4), it is critical that auditors have knowledge on fraud to supplement their limited experience on fraud. From all the information provided in paragraph 6.3.2, the conclusion can be drawn that the forensic accountant has more knowledge and experience on fraud than the auditor. The conclusion is supported by the following findings from the study:

   - Forensic accountants were found to be more suitably equipped to identify the four elements of fraud;
   - Forensic accountants had the ability to correctly identify the legal definition for fraud, whereas the auditors were not capable of identifying the fraud definition neither in terms of ISA 240 nor in terms of the criminal law;
   - Auditors were not able to separate the definition of fraud from the definition of other offences, confirming the fact that auditors use the term “fraud” to refer to any dishonest act;
   - Forensic accountants had more experience on fraud than auditors, seeing that they have encountered fraud and performed fraud investigations in the past; and
   - The skills needed to effectively detect fraud are all skills possessed by forensic accountants.

2. *Capability to identify fraudulent transactions*

   The following conclusions were drawn from the responses as discussed in paragraph 6.3.3:

   - Forensic accountants were found to be more capable of identifying fraudulent transactions than auditors;
   - The auditors and forensic accountants were equally capable of identifying fraud risk indicators; and
   - Both auditors and forensic accountants were capable of identifying offences relating to financial statement fraud. In addition, auditors were more capable

than forensic accountants of identifying offences relating to misappropriation of assets.

It is, therefore, difficult to determine, between the forensic accountant and auditor, who is more capable of identifying fraud. Based on the three points provided above, it can be said that auditors and forensic accountants seem equally capable of identifying fraudulent transactions.

3. *Assessing the risk of fraud*

The auditors and forensic accountants both showed the ability to determine the correct approach, procedures and responses to address FRA. The conclusion is supported by the responses derived from figures 6.24–6.31:

- The majority of auditors and forensic accountants indicated that they have performed FRA in the past, despite the fact that the auditors lacked the necessary knowledge and experience;
- Auditors indicated a better understanding of the purpose of FRA when compared to the forensic accountants;
- When comparing the forensic accountants with the auditors, it can be confirmed that both were equally capable of identifying the correct approach to address FRA, procedures to perform FRA and responses to address the risk of fraud; and
- The majority of auditors felt that audit seniors and audit managers were best suited to perform FRA. In order to enhance the effectiveness of an FRA, managers instead of audit seniors should perform an FRA, because they have more knowledge and experience, as concluded in chapter 4 (par 4.4.2.3). This being said, the majority of the respondents were in their first and second year of articles and have already performed FRA. This indicates that the respondents also believed that they, as first- and second-year trainees/interns/associates, were not suited to perform FRAs. Furthermore, it was concluded that the auditors did not have the necessary knowledge and experience on fraud, even though they have performed FRA in the past.

Based on all the conclusions from paragraph 6.4, an overall conclusion can be reached, namely that forensic accountants and auditors have strengths and weaknesses with regard to performing FRA. The forensic accountants and auditors in this study seem to be equally capable of identifying fraudulent transactions and equally competent in

selecting an approach for an FRA, procedures to perform an FRA and responses to address the risk of fraud. However, the forensic accountants proved to have more knowledge and experience of fraud.

The objective of the self-compilation questionnaire (empirical study) was to obtain evidence that forensic accountants have more knowledge and experience on acts of fraud and, therefore, are more suitably equipped to perform FRA, as stated in chapter 1 (par 1.5.2). Chapter 7 will return to the objective of the study to determine whether it has been achieved and to, ultimately, conclude as to who is more suitably equipped to perform FRA based on knowledge, experience and skills on fraud.

CHAPTER 7

7. CONCLUSION AND RECOMMENDATIONS

7.1. Introduction

This chapter will revisit the research objectives as set out in chapter 1 (par 1.4). The main objective of this study was to determine the skills needed by an auditor to perform an FRA in terms of ISA 240. The purpose was to determine whether a forensic accountant might be more suited for such a task.

The secondary objectives (par 1.4.2) for this study were:

- To achieve an understanding of the concept “fraud” in order to determine the characteristics that a person should possess to be able to perform FRA; and
- To understand the objectives of FRA in order to determine the skills set necessary to perform an effective FRA.

The aim of this chapter is to conclude on whether the objectives as set out in chapter 1 have been achieved. The conclusion will be based on the research findings of both the literature study (chapters 3, 4 and 5) and the empirical study (chapter 6). Recommendations will be made based on these findings in order to enhance the effectiveness of the assessment. The limitations to the study will be discussed, as well as areas where further research can be performed. The conclusion of this chapter will address the main objective of this study and conclude on the contribution of the study.

7.2. Conclusion on secondary objectives

The secondary objectives of this study was to obtain an understanding of the concept “fraud” and the objective of an FRA in order to identify the characteristics needed to perform an effective FRA.

7.2.1. Understanding the concept “fraud”

As seen from chapter 1 (par 1.1), extensive knowledge on fraud is required to be able to perform an effective FRA and identify fraud. Fraud is defined as an act by a person with the intention of misrepresenting the truth and concealing a deed in order to persuade another person to part from their possessions and/or cause them potential or definite harm which could, ultimately, lead to legal action.

There are four elements that need to be present in order for an act to be classified as fraud as per the South African Criminal Law:

- Intent to deceive;
- Misrepresentation;
- Actual or potential prejudice; and
- Unlawfulness.

The definition of fraud provided by ISA 240 was established to be ineffective, because it does not contain all the elements of fraud in terms of the South African Criminal Law. The definition of fraud in ISA 240 makes no reference to misrepresentation or actual/potential prejudice. As a result, ISA 240 limits the auditor's understanding of exactly what fraud entails. This statement was proved by the responses received from the survey, which indicated that auditors were not capable of identifying the fraud definition neither in terms of ISA 240 nor in terms of the South African Criminal Law. Auditors also found it difficult to separate the definition of fraud from other offences and to identify the fraud elements as mentioned above (chapter 6, par 6.3.2.1). In addition, the results showed that the majority of auditors have never encountered fraud in their career and, therefore, did not have the necessary experience to identify fraudulent transactions. It was determined in chapter 4 (par 4.4) that, in light of their limited experience, auditors should gain the necessary knowledge on fraud to be able to identify fraud and perform an effective FRA. It can, therefore, be argued that auditors would find it difficult to identify fraud and perform an effective FRA.

In chapter 1 (par 1.2), it was stated that forensic accountants are trained to detect fraud and have the necessary skills, knowledge and experience to identify the act. This statement was proved by the responses received from the survey, as the results showed that the forensic accountants fully understood the definition of fraud in terms of the South African Criminal Law. They were also capable of separating the definition of fraud from other offences, as illustrated in figure 6.11 (chapter 6, par 6.3.2.1). Furthermore, they indicated to have the necessary experience, as the majority indicated in figures 6.12 and 6.13 (chapter 6, par 6.3.2.2) that they have encountered fraud in their career and have investigated fraud in the past. It was concluded that the forensic accountants have the necessary knowledge and experience to enable them to perform an effective FRA.

In order to gain a full understanding of fraud, it was also necessary to grasp the different types of fraud models. Six fraud models were discussed, namely the fraud triangle, MICE, the fraud diamond, the fraud scale model, the reasoning process and Crowe's

fraud pentagon, as seen in chapter 3 (par 3.3). The well-known fraud model used by ISA 240, namely the fraud triangle, was considered to be ineffective in identifying fraud, because it excludes the fraudster's capabilities, integrity and a lack of conscience. It was proposed that a combination of all six models could be the most sufficient fraud model to deter, prevent and detect fraud and, ultimately, enable the auditor to perform the most effective FRA. The fraud combination model was provided to reflect the combined elements, illustrating the motivation and reasoning behind committing fraud. The distinguishable elements as reflected in the fraud combination model are:

- Pressure/motivation;
- Opportunity;
- Capabilities/competence;
- Integrity or a lack of conscience; and
- Rationalisation.

It was shown that two more elements, beyond the fraud triangle, needed to be considered in order to determine how someone will go about committing fraud. The model included in ISA 240 is clearly not the most effective model to assist an auditor in determining the reason for someone to commit fraud and, in effect, in identifying fraud.

In addition to the fraud definition and fraud models, auditors and forensic accountants need to have the ability identify red flags to be successful in identifying fraud. For this reason, auditors and forensic accountants are required to be aware of red flags to enable them to effectively identify fraud and perform an effective FRA. It was concluded in chapter 3 (par 3.5) that the red flags provided by ISA 240 are not sufficient to enable the auditor to identify the possibility of fraud occurring. ISA 240 focuses only on events that can be found within the financial statements, whereas other authors placed focus on both financial statement events and management behaviour. Management behaviour plays a vital role in this regard, as it is considered to be the best indicator of fraud, as stated by Koornhof and Du Plessis (2000:84).

Thus, ISA 240 might be ineffective to assist the auditor in performing the most effective FRA. In addition, ISA 240 excludes the South African Criminal Law definition of fraud, includes an ineffective fraud model to identify fraud and, lastly, contains an incomplete list of fraud risk indicators. These inadequacies limit auditors' knowledge and understanding of fraud, making it more challenging for them to identify fraud during an FRA.

Nonetheless, from the survey it was determined that the auditors were just as capable as forensic accountants to correctly identify indicators of fraud, as seen in figure 6.20 (chapter 6, par 6.3.3.1). Forensic accountants, however, seemed to be more capable of identifying fraudulent transactions from other offences, as seen in chapter 6 (par 6.3.3.1). This finding is in line with forensic accountants' ability to distinguish the definition of fraud from the definition of other offences. It was further determined, based on the responses from the survey, that the auditors and forensic accountants had the ability to correctly identify financial statement fraud in the different scenarios. The auditors, however, proved that they were more capable than forensic accountants of identifying misappropriation of assets within the different scenarios. As a result, even though ISA 240 limits auditors' knowledge on fraud, auditors proved that they did have the ability to identify fraud risk indicators, financial statement fraud and misappropriation of assets. The only part where auditors seemed to fall short was separating fraud from other offences.

Paragraph 7.2.2 will elaborate on the auditors and forensic accountants' ability to identify the objective of FRA and to select the most appropriate procedures to address FRA.

7.2.2. Objective of a fraud risk assessment

The objective of an FRA in an audit context is assessing whether the controls implemented by the client are effective in identifying, preventing and detecting fraud, as well as assessing the risk of fraud faced by the company, as concluded in chapter 4 (par 4.3). According to ISA (315:25), the auditor's objective with an FRA is to identify and assess the risk of the financial statements being materially misstated due to fraud. It was noted in chapter 6 (par 6.3.4.2) that neither the auditors nor the forensic accountants were able to identify the objective of an FRA. However, when comparing the auditors with the forensic accountants, the former indicated a better understanding of the purpose of an FRA. It was, however, expected that the auditors would have a better understanding of the objective of FRA, seeing that these assessments are the responsibility of auditors and not forensic accountants.

In addition, the majority of auditing and forensic accounting practitioners who participated in the survey have performed FRA in the past (chapter 6, par 6.3.4.1) and, thus, have the necessary experience to assess the risk of fraud. For this reason, it can be argued that they should have the necessary knowledge on FRA. This was confirmed by the responses from the survey indicating that the practitioners had a better

understanding of the purpose of an FRA than the students, as seen from figure 6.27 (chapter 6, par 6.3.4.2). This finding affirms that experience enhances one's understanding of the objective of FRA.

In chapter 4 (par 4.4.2), three approaches to addressing an FRA were explained. Table 7.1 below depicts the three FRA approaches:

Table 7.1. Fraud risk assessment approaches

Inquiry from management	Red-flag questionnaire	Analytical procedures
Inquiry is a useful procedure to gain information that cannot be found on paper. The procedure should, however, be used with caution because management are in the best position to deceive auditors. Inquiry also limits auditors' knowledge to those fraud risk factors that have been identified during the audit. Inquiry should never be used in isolation, but be incorporated into other procedures instead.	The red-flag questionnaire was considered to be the most ineffective procedure to use and the procedure is dependent on the auditors' knowledge on fraud. As mentioned in par 7.2.1, auditors lack such knowledge. The red-flag questionnaire limits the auditor to the questionnaire, resulting in a risk of overlooking information outside the questionnaire.	Analytical procedures have proved to be the most effective procedure to identify and assess fraud, as well as address the risk of fraud, because they focus on financial information that cannot be influenced by management. Because analytical procedures involve an element of inquiry, it was concluded in chapter 6 (par 6.3.4.3) that a combination of inquiry from management and analytical procedures is the best approach towards assessing the risk of fraud.

It was concluded in chapter 6 (par 6.4) that both the auditors and forensic accountants were equally capable of selecting the most effective procedure to perform FRA, namely analytical procedures. Together with selecting the most effective approach, the auditors and forensic accountants, however, also selected the most ineffective approach, namely the red-flag questionnaire. Auditors and forensic accountant will be able to use the red-flag questionnaire to assist them in identifying fraud, but this approach will be effective only if it used in combination with the analytical procedures, as concluded in chapter 6 (par 6.3.4.3).

In chapter 4 (par 4.5), the study indicated that brainstorming sessions are vital to the success of an FRA, because they enhance the auditor's sensitivity to the risk of fraud. This was confirmed in chapter 6 (par 6.3.4.3): the results indicated that both auditors and forensic accountants would select brainstorming sessions to address the risk of fraud. Auditors and forensic accountants seem, therefore, equally capable of selecting the correct approach to address and perform an FRA and seem to have an understanding on how to perform an FRA. Paragraph 7.3 will elaborate on the main objective of this study.

7.3. Conclusion on the main research objective

The main objective of this study was to determine whether the skills possessed by auditors are sufficient to perform FRA in the most efficient way and whether the effectiveness of FRA within an audit programme would be enhanced if forensic accountants were to perform the assessment.

It was established that, in order to perform an FRA, one needs to have the ability to identify the risk of fraud and to assess whether the risk could cause the financial statements to be materially misstated. Apart from the fact that knowledge on fraud is needed to effectively identify the offence, one also needs the ability to identify such an offence. As mentioned in 7.2.1 and 7.2.2, the auditors and forensic accountants in the study were equally capable of identifying fraudulent transactions and selecting approaches to assess the risk of fraud. The only factors that would make forensic accountants more suitably equipped to perform FRA than auditors are their knowledge, experience and skills set. As paragraph 7.2.1 has addressed the auditors' and forensic accountants' knowledge and experience, a discussion on their skills sets follows.

In chapter 5 (par 5.3.2) it was determined that auditors and forensic accountants need to possess a wide variety of skills, knowledge and abilities to effectively execute their work. However, only certain skills, knowledge and abilities will enable them to effectively identify fraud. The question then becomes: whose skills set is more in line with the requirements for effectively identifying fraud and, ultimately, performing an effective FRA? The auditor's or the forensic accountant's? The skills set possessed by the auditor and forensic accountant that will enhance their ability to effectively identify fraud were identified as follows:

Table 7.2. Skills set to identify fraud

Auditor	Forensic accountant
Mind-set to identify fraud	Mind-set to identify fraud
Questioning mind-set	Questioning mind-set
Analytical skills	Analytical skills
Knowledge on laws and regulations	Knowledge on laws and regulations
Self-confidence	Self-confidence
Ability to solve problems	Ability to solve problems
Communication skills	Communication skills
Writing skills	Writing skills
Logical/critical thinking	Logical/critical thinking
	Knowledge on fraud
	Knowledge on psychology and criminology
	Determination and perseverance
	Experience
	Interviewing skills
	Detective/investigative skills

It was concluded in chapter 5 (par 5.5) that the skills set possessed by forensic accountants is more in line with what is required to effectively identify fraud. Auditors, on the other hand, possess the majority of the skills needed to identify fraud; however, they lack the most important ones. Auditors seem to lack experience – the majority of auditors in this study have not encountered fraud in their career (figure 6.12) even though they have performed FRA. Auditors also seem to lack the necessary knowledge on fraud, as proved by paragraph 7.2.1. Even though auditors lack the necessary skills to effectively identify fraud, paragraph 7.2.1 indicated that they seem just as capable as forensic accountants in identifying fraudulent transactions. In addition, auditors lack interviewing and investigative skills. It cannot be expected from auditors to have the skills possessed by forensic accountants, seeing that the latter is acknowledged as experts in investigating and detecting fraud. That being said, it is possible for auditors to develop the skills needed to effectively identify fraud.

To conclude, the skills possessed by auditors might not be sufficient to perform the most effective and efficient FRA. Forensic accountants, on the other hand, have the necessary knowledge, skills and experience to effectively identify fraud. Therefore, the

effectiveness of FRA within an audit programme could be enhanced if forensic accountants were to perform the assessment. Based on the literature provided in chapter 5, FRA could be enhanced in the following manner if the forensic accountant were to perform the assessment:

Table 7.3. Auditors' approach to fraud risk assessment versus forensic accountants' approach

	Auditors' approach	Forensic accountants' approach
Primary focus	Primary focus is to conclude on the fairness of financial statements	Primary focus is to conclude on whether fraud has occurred
Procedures used	ISA 240 is used to perform FRA Specific procedures are not designed to identify fraud	Criminal and civil procedures are used to assess the risk of fraud Specific procedures are designed to detect fraud
Assurance provided	Reasonable assurance is provided that the financial statements are free from fraud	Absolute assurance is provided that the financial statements are free from fraud
Opinion	Opinion is based on assumptions and estimates	Opinion is based on facts
Skills	Knowledge on fraud, experience, interviewing/ investigative skills are lacking	All attributes needed to effectively identify fraud are present

7.4. Limitations and shortcomings

The limitations and shortcomings of this study can be summarised as follows:

- The survey of the Big 4 accounting firms (PwC, Deloitte, Ernst & young and KPMG) and the honours students was conducted via a web-based cross-sectional questionnaire and participation was entirely voluntary. Therefore, the responses were limited to participants who made the time to complete the survey.
- There were a few responses that could not be used, because some of the participants did not complete the whole survey.

- A few participants were neither auditors nor forensic accountants and their responses could, therefore, not be used, reducing the number of responses.
- The practitioners who responded had limited practical experience, because the majority were interns/trainees/associates. The majority of audit practitioners were in their first year of article and the majority of forensic accounting practitioners were in their third year.

7.5. Recommendations for future research

The following recommendations for future research are specifically aimed at enhancing the auditing/forensic accounting practice:

- Outsourcing the task of assessing the risk of fraud to forensic accountants to enhance the effectiveness and efficiency of FRA;
- Educating auditors on fraud beyond ISA 240 by expanding their curriculum and training them on how to identify fraud and how to separate fraud from other offences;
- Including corruption as a fraud offence in ISA 240;
- Expanding ISA 240 to include all six models and the definition of fraud in terms of the South African Criminal Law; and
- Training opportunities for auditors to develop the necessary skills set needed to identify fraud.

7.6. Summary

The study investigated the possibility of transferring the task of performing fraud risk assessment to the forensic accountant. To explore the possibility, the study aimed to determine the skills needed by an auditor to perform FRA in terms of ISA 240. The main objective was to determine the skills needed by an auditor to perform FRA in terms of ISA 240. The purpose was to ascertain whether a forensic accountant might be more suited for such a task.

It was concluded that ISA 240 limits the auditor's knowledge on fraud, because it excludes the South African Criminal Law definition of fraud, does not address a fraudster's capability or integrity/lack of conscience, and contains an incomplete list of fraud risk indicators. The findings from the survey proved that auditors do not have the necessary knowledge and experience on fraud that will enable them to effectively identify fraud. As a result, their ability to perform an effective FRA is limited. This finding

is in line with Chui and Pike's (2013:205) claim that auditors are not fraud examiners and to expect auditors to identify fraud by only being aware of the possibility of fraud, is not enough.

The study proved that forensic accountants have all the attributes, experience and knowledge required to effectively and successfully identify fraud and, ultimately, perform an effective FRA. Forensic accountants were proven to be more suitably equipped than auditors to perform an effective and efficient FRA based on their skills, knowledge and experience.

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ANNEXURE 1: LETTER ACCOMPANYING QUESTIONNAIRE

NORTH-WEST UNIVERSITY
YUNIBESITI YA BOKONE-BOPHIRIMA
NOORDWES-UNIVERSITEIT
POTCHEFSTROOM CAMPUS

Dear potential participant

I am conducting a research study as part of the requirements of my Master's Degree in Forensic Accountancy at the North-West University. I would like to invite you to participate. The aim of the research is to assess the relevance of external auditors and forensic accountants when performing fraud risk assessments. The aim of the questionnaire is to gain more knowledge on auditors and forensic accountants regarding their experience and knowledge of fraud, their capability of identifying fraudulent transactions and how they will go about in assessing the risk of fraud.

The intended participants are Big 4 accounting firms' forensic accounting and auditing departments the CTA and forensic accountancy honours students. Data will be collected by means of a web-based cross-sectional questionnaire and should not take longer than 10 - 15 minutes to complete.

Kindly note that participation in the study is entirely voluntarily and your anonymity will be maintained at all times, meaning that the researcher is not able to make a link between information provided by you as participant.

I sincerely hope that you will be able to assist in this study. Thank you for taking the time to consider my request.

Please refer to the link below to access the questionnaire.
http://fluidsurveys.com/s/alicia2015/

Kindly note, this is an approved request.
I hereby quote the ethical clearance reference number: EMS14/08/19-01/02

Yours sincerely

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ANNEXURE 2: QUESTIONNAIRE

Assessing the relevance of external auditors and forensic accountants when performing fraud risk assessments

Question 1

Have you ever been educated on fraud?

a. Yes
b. No

Question 2

What are the elements of fraud?
(Select all applicable answers)

a. Intent to deceive
b. Personal gain
c. Misrepresentation
d. Dishonesty
e. Illegally obtaining money
f. Actual prejudice or potential prejudice
g. Unlawfulness

Question 3

What is the definition of fraud?
(Select all applicable answers)

a. An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.
b. Someone misusing their employment or position of trust, to lawfully take or convert another's money or property, with the intention to use as one's own.
c. Someone who misuses their position of power within a company, with the aim of acquiring a direct or indirect benefit in an illegal or deceitful manner.
d. When a person obtains or attempts to obtain the property of another with the intention to deprive the owner of the said property.

e. Unlawful and intentional making of a misrepresentation which causes actual prejudice or which is potentially prejudicial to another.

Question 4

Do you think you have a responsibility to report fraudulent transactions?

a. Yes
b. No

Question 5

When should fraudulent transactions be reported?

a. Always
b. Only when it is material
c. When the manager has been informed
d. When permission is obtained from the client

Question 6

To whom should fraudulent transactions be reported?

a. The client
b. Audit partner
c. Audit manager
d. IRBA
e. SAPS

Question 7

Who do you feel should investigate fraudulent transactions?

a. Auditor
b. Forensic Accountant / Forensic Auditor
c. SAPS
d. Client
e. CCMA
f. IRBA

Question 8

Do you feel you will be able to identify fraud?

a. Not at all
b. To a small extent
c. To a moderate extent
d. To a large extent

Question 9

Would you consider yourself an expert in identifying fraudulent transactions?

a. Not at all
b. To a small extent
c. To a moderate extent
d. To a large extent

Question 10

Have you ever encountered fraudulent transactions in your career?

a. Yes
b. No
c. N/A (student)

Question 11

Have you ever investigated fraud?

a. Yes
b. No
c. N/A (student)

Question 12

Which of the following scenarios will you describe as an act of fraud?
(Select all applicable answers)

a. Miss Pixie works at Lucky's car parts and is in charge of buying inventory. Every weekend Miss Pixie buys parts on the black market and allocates the difference between the amount she paid and the amount she would have paid for the original parts to

herself. On Mondays she prepares an invoice to Lucky's for the price of the original parts, and records the parts at the price per the invoice.

b. Mr Tastic works at a rice factory, "Ricey". All the rice is kept in air-free containers. Mr Tastic is a security guard for Ricey who works the night shift. Mr Tastic decided to run his own business called "Help Yourself". At night when he is on duty and all the factory workers are taking their "on duty nap" he helps himself to a cup of rice from the containers. After work, Mr Tastic takes his well "earned" cup of rice home and sells it to his loyal customers.
c. Mr Heuer is a financial manager who works at "Sissy Watches". Sissy watches is a company known for its exclusive and high quality watches. Mr Heuer made a deal with Mr Fakey to buy watches from Mr Fakey at an increased price for his company, in exchange for a share in the profit on all the watches sold to Mr Heuer.

Question 13

Which of the following indicate the possibility of fraud occurring?
(Select all applicable answers)

a. Unauthorised or unusual transactions
b. The CEO buying a new car
c. Client refusing to provide information
d. Rapid changes in the client's profits
e. Sudden retrenchment of employees

Question 14

Miss Dyer is the CFO of a cosmetic company. Her annual bonus is calculated as a percentage of net profit after tax. Just before year-end, Miss Dyer posted fictitious transactions to the revenue account to increase her bonus.

What kind of act is described above?

a. Theft
b. Financial statement fraud
c. Misappropriation of assets
d. Corruption

Question 15

Miss Abby is a senior accountant of Dixies. She is solely responsible for receiving payments of customer accounts. Sometimes Miss Abby takes some of the payments for herself by misadding the transactions. To hide the transactions, Miss Abby would force the bank reconciliation to balance.

What kind of act is described above?

a. Theft
b. Financial statement fraud
c. Misappropriation of assets
d. Corruption

Question 16

Mr Ngcobo is the owner of Express Appliances with a 28 February year end. To boost sales Mr Ngcobo advertised the following special deal at the end of January:

> *"Take a dishwasher home during this month (February). If satisfied, pay the bill in 30 days, if not, return the dishwasher!"*

The dishwashers taken by clients were intentionally recorded as sales in February.

What kind of act is described above?

a. Theft
b. Financial statement fraud
c. Misappropriation of assets
d. Corruption

Question 17

To decrease the tax liability, Miss Precious, the CFO of Tech Inc., expenses the payment on a finance lease.

What kind of act is described above?

a. Theft
b. Financial statement fraud
c. Misappropriation of assets
d. Corruption

Question 18

Mr Oxford often takes business trips. On these trips he likes to entertain women he meets at a local bar. The women accompany him for dinner and drinks. When completing his monthly expense claim, he includes these entertainment expenses.

What kind of act is described above?

a. Theft
b. Financial statement fraud
c. Misappropriation of assets
d. Corruption

Question 19

Have you ever performed a fraud risk assessment?

(i.e. assess the risk of material misstatement due to fraud)

a. Yes
b. No
c. N/A (student)

Question 20

What is the purpose of a fraud risk assessment in an audit?
(Select all applicable answers)

a. To detect fraudulent transactions.
b. To determine if the company's internal controls have the ability to reduce the risk of fraud to an acceptable level.
c. To evaluate if the fraud identified can cause the financial statements to be materially misstated.
d. To prevent fraudulent transactions.
e. To confirm the existence of fraudulent transactions.

Question 21

How would you address a fraud risk assessment?
(Select all applicable answers)

a. Brainstorming session between audit team members.

b. Outsource the fraud risk assessment to the forensic accounting department
c. Inquire from lawyers
d. Assess the risk of fraud and the risk of error together
e. Include the fraud risk assessment in the overall risk assessment

Question 22

How would you perform a fraud risk assessment?

a. Red flag approach (Questionnaire)
b. Inquiry from management
c. Analytical procedures
d. Other

Question 23

Once the risk of fraud has been assessed as high, how will you respond?

a. Perform extensive testing on the areas containing the high risk
b. Report the matter to IRBA
c. Contact management
d. Withdraw from the engagement

Question 24

Who is best suited to perform a fraud risk assessment?

a. Article clerk
b. Audit senior
c. Audit Manager
d. Audit Partner
e. Forensic accountant

Question 25

Are you a Practitioner or Student?

a. Practitioner
b. Student

PRACTITIONER

Question 26

In which department do you work?

a. Forensic / FIDS / Advisory / Investigator / Analyst
b. Auditing / Assurance / Accountant
c. Other

Question 27

What is your current position?

a. Intern / Trainee / Associate
b. Supervisor
c. Assistant Manager
d. Manager
e. Associate Director / Executive Director / Director / Partner

Question 27.1

If Intern / Trainee / Associate

At what level are you?

a. First year
b. Second year
c. Second year academic clerk
d. Third year
e. Senior

Question 27.2

Other positions

How long have you been in your position?

a. Less than one year
b. Between one and three years
c. Between three and five years
d. Longer than five years

Question 28

What is your highest qualification?
(Select highest)

a. Grade 12
b. B.Com Accounting / B. Accounting
c. B.Com Forensic Accountancy
d. B.Com (Other)
e. Honours B.Com Accounting (CTA) / Honours B. Accounting (CTA)
f. Honours B.Com Financial Accounting (SAIPA)
g. Honours B.Com Management Accounting (CIMA)
h. Honours B.Com Accounting (CTA) & Honours B.Com Forensic Accountancy
i. CA (SA)
j. M.Com
k. Other

If “other” please provide more details _____

STUDENT

Question 26

What are you currently studying?

a. CTA
b. Forensic Accountancy

Question 27

Do you have any other degrees?
(Select Highest)

a. B.Com Accounting / B. Accounting
b. B.Com Forensic Accountancy
c. Honours B.Com Financial Accountancy (SAIPA)
d. Honours B.Com Forensic Accountancy