
FRAUD PROTOCOL

WHAT CAN YOU EXPECT
FROM AUDITORS WHEN
IT COMES TO FRAUD?

Royal Netherlands
Institute of Chartered
Accountants

NBA

DECEMBER 2018

PUBLIC INTEREST STEERING COMMITTEE

Marco van der Vegte (chairman NBA)

Bert Albers (Deloitte)

Anja Bast (Accon avm)

Marcel Baks (Grant Thornton)

Paul Dinkgreve (SRA)

Egbert Eeftink (KPMG)

Peter Hopstaken (Mazars)

Marcel Huisman (Baker Tilly Berk)

Agnes Koops (PwC)

Rob Lelieveld (EY)

Roland Ogink (non-PIE work group)

Hans Renckens (BDO)

Berry Wammes (NBA)



CONTENT

INTRODUCTION 4

FRAUD PROTOCOL: WHAT AUDITORS DO 7



INTRODUCTION

Financial and economic crime is a serious social issue that harms the finances of civilians, companies and the government. Fraud is defined as ‘deliberate deception in an attempt to gain an unfair advantage’. Fraud disrupts economic transactions between civilians and undermines confidence in the government. It also damages the integrity of certain structures, like financial markets and the healthcare system.

Auditors play an important role in the financial system because they audit financial information and compile reports about their findings. Auditing engagements are aimed at making sure financial information - like financial statements - does not contain material deviations that have been caused by fraud or errors. The audit process thus involves identifying the risk of material fraud (fraud risks), performing the accompanying auditing activities and taking action if fraud is suspected. Having said that, it is sometimes difficult for auditors to identify actual fraud: this is because fraud goes hand-in-hand with actions aimed at concealing fraud, like falsifying documents, deliberately failing to register transactions or deliberately misrepresenting data to the auditor. This issue is further complicated if collusion is encountered within organisations or with third parties.

Users of financial statements have high expectations of the role played by auditors when discovering fraud. And auditors are not always able to meet these expectations. Irrespective of whether these expectations are justified or too high, the mere existence of such wide-ranging expectations could be problematic.

We must actively express what the public can expect from us. As also mentioned in the Audit Change Agenda, we will converse with fellow professionals and stakeholders about what is needed to live up to these expectations. We are also preparing to share our knowledge and instruments, and will provide a clear insight into our progress via the Accountancy Dashboard, which will be published by the NBA's Public Interest Steering Committee in January 2019.

This will not be based on the limitations and risks inherent to our profession, but on the concerns of the public and our strengths and capabilities. We have further emphasised this by creating a ‘fraud protocol’: *“What can you expect from auditors....when it comes to fraud”*. This protocol has been compiled by the Fraud Work group, under assignment from the Public Interest Steering Committee.

Users of financial statements can expect us to do everything in our power to identify and monitor fraud-related risks. We do not turn a blind eye to fraud, corruption¹ or other irregular transactions, and take our responsibility towards clients and authorities. We do this using the following three steps:

¹ For example, please refer to NBA Practice Note 1137 ‘Corruption, procedures of the auditor’, which was published in december 2016.

1. ISSUING A FRAUD PROTOCOL

The fraud protocol clarifies the role of auditors under existing laws and regulations. It clearly highlights the steps that auditors and their organisations can be expected to take. That is why it is called the fraud protocol: it summarises a way of working which will be embraced by auditing firms and their auditors. This 'way of working' has not always been defined in detail within the fraud protocol; this framework has already been provided by Auditing standards, NBA Guidelines and the resulting (internal) procedures. If necessary, the NBA will release Best Practices for several components, which will be added to the Fraud protocol as an appendix. For instance, about information which can and cannot be shared when consulting with fellow professionals; about the evaluation of Soft Controls or about text in the (comprehensive) auditor's report.

However, this does not mean public auditors that perform other engagements (like reporting engagements or other assurance engagements) cannot implement the protocol accordingly. When it comes to auditors in business and internal auditors, the protocol offers good advice about how fraud should be dealt with. The Work group will investigate whether modified protocols are needed for other types of activities and/or member groups other than public auditors.

Auditing firms are expected to perform a periodic analysis, in order to identify aspects where organisations may still not (fully) comply with the protocol, and take appropriate measures.

2. ACKNOWLEDGING DILEMMAS AND CONVERSING WITH STAKEHOLDERS

In practice, auditors are confronted with a number of dilemmas. For example, because - unlike fraud - auditors can only play a limited role when it comes to compliance with laws and regulation, unless there are indications that laws and regulations have been breached. This distinction in the auditor's role is rarely made in the public debate, and is barely of interest to users. Nonetheless, breaches of laws and regulations can have just as big an impact on companies as fraud. Another dilemma is encountered when clients are not serious about the risk of fraud. What must auditors do in such cases? Should they (be required to) mention this, for example, in the auditor's report? The fraud protocol serves as a launch pad for discussing expectations and dilemmas with stakeholders as well as fellow professionals. To facilitate this, the NBA will be organising a number of meetings in the future.

Auditors are one link in the whole financial reporting process, and are not solely responsible for addressing and combating fraud; in this case, the primary responsibility lies with directors and internal supervisory bodies. The overall objective is to create a covenant together with other stakeholders, such as investors (VEB, Eumedion), directors (VNO-NCW, VEUO) and supervisory bodies (RvC's, AFM), which means we can work together to play an effective role in the battle against fraud.

3. TAKING ADDITIONAL MEASURES

Discussions with stakeholders could highlight the need to do more when it comes to fraud. This is something the covenant will clarify. These additional measures can affect the whole professional group, auditing firms and/or individual auditors. But it could also demand more from the firms themselves and their supervisory bodies. If necessary, this third and last step will also lead to changes in existing laws and regulations.

But it is clear that auditors and the NBA want to maintain continuous dialogue with stakeholders about expectations and new developments. Do you have questions or comments about this fraud protocol, or any other suggestions? Then please feel free to send an e-mail to fraudebeleid@nba.nl.



FRAUD PROTOCOL: WHAT AUDITORS DO

WHEN ACCEPTING AN ENGAGEMENT

1. The client's reliability and integrity is investigated before accepting an engagement. For example, information is collected about the owners (UBO), board, commercial activities and past integrity issues involving the organisation and/or directors; this includes information from the company itself as well as external information.
2. The preceding auditor is contacted. This involves exchanging relevant information and performing a file review if cause has been given to do so. Transition files from preceding auditors to succeeding auditors are encountered when dealing with public interest entities (PIE's, including listed companies).
3. Auditors only accept assignments under certain conditions if integrity-related risks are anticipated. These conditions can relate to the client, like improving internal control for fraud risks and terminating certain activities. But audit firms can also implement their own additional quality measures, like using a 2nd external auditor, an engagement-related quality assessment, another type of review, or a forensic specialist. Auditors will not accept clients in certain situations.



DURING RISK ANALYSIS

4. Every audit includes identifying fraud risk factors for the client in question. This includes fraud risk factors mentioned in (the appendix of) audit standards as well as specific fraud risk factors for the concerned sector or company. The auditor then determines whether information obtained from risk assessment activities points to the presence of one or more fraud risks. The auditor also examines the internal control measures introduced by the client.
5. The auditor examines fraud risks identified by the client and uses them for/compares them with his or her own fraud risk analysis. The process behind the fraud risk analysis is discussed with the internal supervisory body.

6. The auditor communicates with management and/or internal supervisory bodies about issues relevant to fraud and risks of fraud. This also applies if the client does not have its own insight into fraud risks, or if this insight is insufficient. After all, management and internal supervisory bodies continue to be responsible for setting up, implementing and operating an internal control system that can prevent, detect and/or correct abnormalities in financial overviews.

DURING THE AUDIT

7. The auditor determines appropriate auditing activities, which are aimed at overcoming fraud risks. A fraud risk is always regarded as an important risk by the auditor (a so-called 'significant risk'). The auditor ensures an element of surprise in his/her audit activities each year. Activities are part of the audit plan, which is coordinated with the client at an appropriate level (directors and/or internal supervisory bodies).
8. The auditor is alert for potential signs of fraud. For example, the auditor discusses reports received via a whistle-blower arrangement, discusses internal investigations carried out in relation to fraud risks and/or uses specific data analyses to identify abnormalities that could be attributed to fraud. When performing activities, the auditor ensures - with support from the auditing firm - an appropriate team, possibly involving the use of forensic expertise.
9. The auditor always performs auditing activities bearing in mind that company management could breach internal control measures (which is also a fraud risk).


IN CASE OF INDICATIONS

10. The auditor takes specific action if there are indications of potential fraud - irrespective of materiality. An investigation is then carried out to see if there has been an incident. A blind eye is not turned or attempts are not made to find excuses. In this case, auditors do not allow themselves to be restricted by time and budget constraints, repercussions or emotions. Also if the fraud appears to date back over an extended period or if management may have been involved in the fraud.
11. If indicators of fraud are encountered, the auditor consults colleagues within his or her professional practice, compliance colleagues and/or contacts the NBA help-desk and/or counsellor. Audit firms make sure their helpdesk or consultation services are very easy to access.

12. All indications of fraud are discussed with the client's directors and/or internal supervisory body. Auditors mention which (minimum) actions the client must implement. The client is personally responsible for investigating the nature and magnitude of the fraud.


IN CASE OF FRAUD

13. Auditors continue to be involved in the investigation into the nature and magnitude of the fraud. This is important because the investigation could unearth information that the auditor needs to assess impact on the financial statement and recovery plan, and his or her ability to complete the audit. Auditors agree in advance that results of such investigations will be shared with them and are able to access the underlying files; if this is insufficient, they evaluate what impact this could have on the auditor's report.
14. The client then provides a plan of approach if fraud is actually encountered. This means: ensuring recovery from fraud (correction) and implementing measures for preventing repeat. Auditors mention the (minimum) requirements such recovery plans must comply with.

- 
15. For each case, auditors evaluate whether the recovery plan is sufficient and whether other (extra) actions are needed. If the client refuses to investigate an indication of fraud and/or if the recovery plan is insufficient, auditors report cases of material fraud to the concerned detection service (for statutory audits) and the engagement is terminated prematurely.
 16. In all cases (thus also if the fraud is insignificant and/or if the recovery plan is sufficient), auditors will consider which consequences the signalled integrity risks have on their engagement.

REPORTING

17. Auditors must always report irregular transactions as soon as possible to the Financial Intelligence Unit-Netherlands (FIU-NL). The reporting obligation is easy to execute: underlying evidence is not necessary and the audit client need not be notified. Auditors must explain, in as much detail as possible, why they have notified FIU-NL. If fraud has been encountered, it is almost always accompanied by irregular transactions.

- 
18. Incidents and prematurely terminated engagements are reported to the AFM. Auditors also immediately notify the AFM about potential integrity risks that could damage the company or financial markets.

TRANSPARENCY

19. If needed in the public interest, auditors make sure that relevant fraud-related information is shared with the outside world by way of transparent reporting. In this case, auditors urge the client to include information about fraud (risks) and accompanying control measures in its management report. If necessary, auditors place extra emphasis on these matters in their (comprehensive) auditor's report.
20. The auditor is and will continue to be responsible for auditing financial statements - so they remain (with a reasonable degree of certainty) free of material abnormalities due to fraud or errors - and the resulting auditor's report.
21. Auditors must be open about fraud risks when consulting with the succeeding auditor. The succeeding auditor will also investigate the reliability and integrity of the client. Naturally, this means the preceding auditor plays a key role during effective fraud prevention and abatement.

Royal Netherlands
Institute of Chartered
Accountants


NBA

Antonio Vivaldistraat 2 - 8
1083 HP Amsterdam
P.O. Box 7984
1008 AD Amsterdam
The Netherlands

T +31 20 301 03 01
E nba@nba.nl
I www.nba.nl

