

Task Force Regarding the Auditor's Approach to Detecting Fraud

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Disclaimer

- The views expressed by each of the presenters are their own personal views and not necessarily those of the PCAOB, members of the Board, or the PCAOB staff.

Recap of November 2012 SAG Discussion

- At the November 2012 SAG Meeting, the SAG discussed whether there should be outreach or research regarding the auditor's approach to the detection of material misstatements of financial statements due to fraud ("fraud")
 - Under existing PCAOB standards, the auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Existing PCAOB standards require the auditor to, among other things, (1) perform procedures to identify fraud risks; (2) plan and perform audit procedures to address those risks, including certain specified procedures to address the risk of management override of controls; and (3) consider fraud in evaluating the results of the audit.

Recap of November 2012 SAG Discussion – (cont'd)

- Many SAG members agreed that a task force could be a useful vehicle to identify and consider ways to improve auditing practices for fraud detection and indicated that:
 - The specific scope and objectives of the task force should be clearly defined
 - Research regarding the economic consequences of fraud, trends in fraud, and how fraud is detected should be gathered and analyzed
 - The task force should consist of individuals with different areas of expertise and experience

Potential Objectives of a Fraud Task Force

- The staff is considering a two-phased approach with separate but related objectives:
 - Phase one would focus on research regarding:
 - (1) The economic consequences of fraud
 - (2) The effectiveness of audits in detecting fraud
 - (3) Potential mechanisms to improve the effectiveness of audits in detecting fraud
 - Phase 1 will be supported, in part, by the PCAOB's recently formed Center for Economic Analysis, as well as PCAOB staff in the Office of Research and Analysis
 - Phase two would focus on recommendations for specific actions (informed by phase one)

Potential Objectives of a Fraud Task Force (cont'd)

Phase One – Gather and Analyze Existing Research

- Research regarding the economic consequences of fraud:
 - Impact of fraud
 - Trends in fraud
- Research regarding the effectiveness of audits in detecting fraud:
 - Study how frauds are detected
 - Study frauds uncovered by auditors to determine how they were detected
 - Study frauds that were not detected to identify lessons learned
 - Study the role of the audit in deterring fraud

Potential Objectives of a Fraud Task Force (cont'd)

Phase One – cont'd

- Research regarding potential mechanisms to improve the effectiveness of audits in detecting fraud:
 - Improving risk assessments – characteristics or conditions that might be indicators of fraud ("red flags")
 - Impediments to fraud detection and how they can be overcome
 - How audit responses might evolve to enhance auditors' detection of fraud

Potential Objectives of a Fraud Task Force (cont'd)

Phase Two – Explore Recommendations for Specific Actions

- Examples of possible actions include:
 - Possible enhancements to PCAOB auditing standards
 - Possible issuance of PCAOB guidance
 - Processes to keep the phase one research "evergreen"
 - Implications for PCAOB oversight activities
 - Possible outreach to investors, audit committees, internal auditors, and others

Possible Structure of a Fraud Task Force

- Members of the task force would include some SAG members and others with subject-matter expertise
 - Consideration of sub-committees to address specific topics
- Engage in outreach with knowledgeable parties, which may include some of the following:
 - External and internal auditors
 - Academics
 - Analysts and short-sellers
 - Forensic accountants
 - Fraud examiners/white-collar crime experts
 - Journalists
 - Whistleblowers
- Defined life
 - Approximately 18 months

Questions

- Are the objectives, structure, and deliverables of the task force appropriate? Are there other objectives, structures, or deliverables, that the Board should consider?
- Is the two-phased approach appropriate?
- Are there other matters the Board should take into account in establishing the task force?