

Fraud and auditing fraud

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Abstract

Fraud means deliberate steps of one or few managers, Staff of third persons that results in misrepresentation of financial statements. Fraud may include (manipulation , forging or changing documents, record transactions without supporting documents, misappropriation of assets, misrepresentation of financial written or remove them from the documents, intentional incorrect use of accounting procedures. So the main goal of this research is theoretical study of fraud and in this research we point priestly to the fraud and auditing fraud.

Keywords: fraud, auditing, fraud auditing

Introduction:

Nowadays, auditing becomes a necessary and needy profession in the world, as many evidence show the efforts for deceitful manipulation in company auditing books, in which they called (cooking books).

Some researchers in the United States ascribed the title (that dreaded year) to 2002 that was full of bad news about significance financial scandals. To the author's perspective, with confidence and without hesitation, we could divide the history of auditing into after and before this year. Something that occurred after 2002 in auditing profession of the world was a serious effort for rehabilitated a profession that may become bed reputation on (that dreaded year)

In some of the available reports, the cost of annual frauds in United States business has been reported 600 milliards dollars. What makes auditing profession into thinking is the increasing statistics from financial statements which the company managers have provided. misleading financial fraud hiding in them and

tarnish the image of reality in disclosure of company's status for external users of mentioned information, cause many damages to investors and creditors.

This is a serious warning for the future capital and credit for public companies.

Preventing, discovering and searching for fraud in the company's financial statements more than ever, have become the serious concern of formal auditors in the world. They also, more than ever, have used the formal auditors for providing prevention measures, or a reaction against fraud, either in public or private companies or in state or Semi- state companies. Almost all the organizations engage in fraud and suffer from a petty theft by its staff or fraud financial reports.

The main fraud in financial statements could have a significant adverse effect on the market value of the entity, its credit and ability to achieve its strategic goals. The interesting Point in which the author has encountered in his current studies about the fraud in financial statements ,is changing the discovered fraud in financial statements into a hot debate in Greek. Several articles have been written , try to test their suggested models for predicting fraud financial statement in the community of Athens stock Exchange member of Firms. The cause of this subject is found in the increasing numbers of the companies that join to Athens stock Exchange and their effort to attract more Capital. Also, their effort to reduce the income tax is another excuse that can justify the increase of fraud in financial statements of these companies. On the other hand, the public in Greek persist in fraud reports in financial statements and enter Condition auditing reports, as a failure in the future business. It Changes these issues in to a serious challenge for auditing profession in this country. Demand for more clarification, consistency and more information in financial statements make the burden of the profession heavier. During auditing, the auditors should asset the possibility of management fraud. The US formal auditors board for an agent that its publications is the base for auditors working not only in US but also in many other countries in the world, acknowledged expressly the auditors's responsibility in the fraud discovery.

Along with the possibility of management fraud, the auditors use analysis techniques for auditing the financial statements. This technique allows them to assess the auditing balances, without considering the transactions related to the mentioned balances one by one. In simple words, by using these analytic techniques and without prove each of transactions that finally result in reported balances in the financial Statements, the auditors can understand the current relations among the balances and assent the possible management fraud in disclosing the financial information.

The analytic methods and techniques have been classified into three classes: non quantity techniques, simple quantity techniques and advanced quantity techniques. The advanced quantity techniques include statistical complex methods and artificial intelligence, e.g. neural networks and regression analysis.

For example, in one of the most popular researches, the results from analysing regression for 75 fraud companies and 70 non- fraud companies in US show that much of the non fraud company's board, compared to the fraud companies come from the outside of organization. regression analysis of this can provide the choice of board members as a suggested method to present the fraud , and introduce this variable into his decision as one of the variables interested to the auditor for analysing the possibility of fraud in financial statements and his decisions.

In 1997, the codification board of auditing standards in US published the statement on auditing standards 99 with the title of investigation of fraud in financial statements. This standard requiring the auditors to

asset the fraud risk in every auditing encourage them in every assets about the possible fraud, consider both the internal control system of the client and the attitude of management client to the controls.

According to standard 99, the risk factors, or in other words, the (Red flags) related to the fraud financial reports could be divided into three classes : 1) the management characteristics and its effect on the control environment 2) the industry conditions , and 3) the functional features and the Client's financial Stability. The international committee of practices in auditing which is depend on the international federation of auditors, published the international auditing Statement 209, in which this standard, considered the auditor's investigations about the risk of fraud or error in financial statement and discusses explicitly the inherent limitations to discover fraud and error , especially management fraud in which the auditor encountered to them. The important point in this standard is that, there is a differentiation among the management fraud and company staff, continue discussing about the fraud financial reports. The auditing standard Statement 99 is a relative accurate manual for auditors to discover the fraud , perhaps leads auditors to perform the auditing financial statements in a way that ensure them there is not significant fraud in financial statements.

Discovering the management fraud using common auditing methods is difficult. First, because there is limited information about the features of management fraud. Second, many auditors encounter to a few cases of management fraud in their professional life and as a result, when encounter to fraud, they haven't enough necessary experiences. And the last reason and more clear is that the managers don't sit without working, they try to deceive them by elegance. About auditing these companies with the managers that understand all the weaks and limitation about each auditing, using common auditing methods is a kind of wallowing to the investors and creditors.

In this time, we as an auditor encounter to the needs for more complex methods in discovering the management fraud. We should not forget that the very focus of profession on the test and system analysis as a method to discover fraud , is in contradiction with the auditor's effort to disclose management fraud , because the largest frauds take place in high level of organization, where the controls and systems have least effectiveness and valued less.

In recent years and in the world auditing literatures, we observe the efforts to present models for predicting the management fraud. Beside the effectiveness of this models in fraud discovering of financial statements, compared to the current classic methods about the shorter time and less cost, these methods lead the auditor to discover the new frauds in financial statements. So in this study, our main goal is to analyse the theoretical issues and auditory fraud (the professional website for the Iranian expert accountants).

2) The classification of the fraud

In general, fraud performed into three following forms, in which we discuss each of them,

1) Financial Corruption: fraud comes from the financial corruption, defined as the frauders misuse their influence in a financial transaction for their personal gain or other persons.

Manen: accepting commission and an gage in the interest oppositions (bribery) , e.g kickbacks and price manipulation in auction and tender, (extortion and economic extortion) , a kind of bribery in which instead of seller agency, the corporate staff demands money from the seller.

2) Misuses of assets: includes robbery or misuses of the assets in the corporate, like:

- Cash theft tricks, product theft.

Other assets thefts: deliberate distortion in financial statements results represent a bad image of the corporate, for example high view of incomes and high view of assets – low view of robbed assets , Purianasab.

3) Fraud and embezzlement

Fraud means the deliberate distortion of realities away the others from a valuable thing or from a legal right. Embezzlement occurs when the assets grabbed fraudulent in personal consumption.

Fraud and embezzlement performed by people in or out of the organization. Incomplete revenue, costs vain, false accounting , stop operation , legal penalties, property damage and damages due to the competition, all result from fraud and embezzlement(Darabi and Abedini Sanije).

4) Fraud and administrative staff crime represents a series illegal activity which is different from the other illegal activities performed during the corporate activities.

The administrative staff crime takes place when the assets exits fraudulent from the normal process of usage or misrepresentation by a series of abnormal activities. The administrative staff crime often includes fictitious registration frauds related to the transactions in accounting system.

Three main misuses of assets tale place in administrative staff crime.

1) Employee theft includes misuses of assets by an employee for the personal interests.
2) Robbery by staff and people out of the organization includes asset's misuse by an employee and through collusion with a person from out of the organization (for example non employees) for personal interests.

3) Management fraud includes asset's misuse or misrepresentation to the staff or third persons from outside the organization or both of them. The management is responsible for control establishment in the organization .so to the extent that the other staff follow this controls, the manager is not like this.

The possibility of discovering the delinquency performed by the managers is less than discovering the delinquency of the other employees. The administrative staff crime may results in fraudulent financial reports. Fraudulent financial report is an intentional or irresponsible behaviour, and by a targeted action remove some items results in significance mislead of financial statements.

The organization staff, in every category, may do this. The fraudulent financial statement may include the following:

- the process of fictitious transactions by use of the accounting system.
- the deceitful valuation of the assets such as good inventory
- the misuse of the accounting principles (Arbab Soleimani).

5) the fraud risk evaluation in the financial statements.

The thick documents, the fraud in financial statements in 90s, make the auditing activists to look for solution.

the publication of two auditing standard statements in a short interval, was a serious response toward the prevalence of fraud in the financial statements(Valipur).

6) the fraud risk evaluation in financial statements:

The auditing standard statement 82 in 1997, with the title of << the investigation of the fraud in financial statement >> and the standard statement 99 which were published in a short time in December 2002 as a result of terrible financial scandals , was the complementary and alternative statement 82 . These two statements require the auditor to do a distinct evaluation of the risk that the employer's financial statement includes the misrepresentation. The correct evaluation of fraud risk is a key part of the program step of

each auditing because from a theoretical perspective , if the auditor evaluation from the fraud risk in financial statement was any value except zero, the auditing nature in detecting, discovering and analysing the error will change to a strategic game between auditor and the management.

The standard 99 requires the auditors during the evaluation of the fraud risk to consider the results of the primary analytical method.

Many researchers evaluate the big fraud documents in financial statement. These case studies showed that in many of the cases, the auditor could discover its frauds by use of primary analytical methods, before the publication of financial statements. But the sad story is that the auditors don't use the analytical methods effectively to evaluate the fraud risk in financial statements. In one of the researches carried out in US , 36 professional auditors were interviewed and unfortunately showed that the auditors in face of unusual process and fluctuations, instead of depend on their professional judge and prepare self explanations for the subject, depend on their employer and unfortunately it is the employer that leads the auditor programs. Also, these researchers found that the auditors in the program step of auditing use amount of useless data and information that the employer in a prejudice manner and for the purpose of influencing the auditor , give him/her this data. However the auditors perform a limit investigation data. This issue was acknowledged by a formal research in one of the agencies in the US stock exchange in 2000. This research suggest explicitly that the auditors don't acknowledge the corporate manager's remarks, and trust in the management claims is a pest for the << professional doubt>> of the auditors.

One of these researches shows that the auditors as a human have a psychological orientation to gather observation and to proof the manager claim, in such a way that manager wants. This means a dangerous trap for auditor in which he/she enters a closed loop of influences from manager's expectation and then gathering arguments just for acknowledging him/her.

First lets be interlecture in a same subject. That is in using every analytical method, the auditor should not overlook the comparative benchmarks(called benchmark) . unfortunately the industrial information or even the process of variables related to the auditioned company is the forget part of many primary analyses . remember that the auditor should use his primary analytical methods before engage in management claims and apply the results in evaluating the fraud risk.

Without complimentary, the auditors that don't develop their expectations , for example by primary analysis , with every expectations may be completely baseless and conceived and they lose simply their << professional doubt>>.

For example in using the industrial information as a benchmark and developing the expectations, the period in which the employer exists should be considered.

For instance you as a auditor may found in your recent studies about the fraud in financial information, that in a point in time,

a fraud has been more in industrial financial statements in the advanced technology to the other industries. From this observation, they concluded that in the auditing financial statements of the dynamic companies , in the industries with advanced technology , one should fear of accrual accounting and all of what has been commitment in the financial statement of these companies and in the balance sheet dates, regardless of receiving or pay for them.

These statics relates to the advanced technology industries and the fast growing of them, not necessarily true in all the times. The other point not to be forgotten is the strategic nature of fraud. Fraud in financial statements is a strategic game between managers and auditor. How the auditors be powerful in

discovering financial frauds, the managers don't sit calm and makes the fraud methods more complex. As this, the auditing fraud becomes more exciting. the developmental process of analytical methods used in auditing, from non quality analysis methods to the simple quality analysis methods and then the advanced quality analysis methods shows

The historical competition among managers and auditors in fraud and its discovering.

In 1988, the auditing standards modulation board published 9 new standards. The purpose of publishing these standards, called << expectations distance standards>> is to improve the auditors ability to cope with fraud and improve the auditing effectiveness and finally to improve the auditor relationship with external users of the corporate financial information.

The auditing standard 50 is one of these 9 << expectations distance standards>> that informed the auditors about design, use and evaluating analysis methods in auditing.

According to these standards, using analysis methods enable auditors and frauds in the fraud statements.

Some articles imply the substantial variables in which improve the fraud delayed cases, the value of capital's market, and if the financial statement is audited by an auditor except 4 big auditing companies in the world. In addition, the fraud companies, compared to the non fraud companies in the year of committing fraud, usually have high outputs and then it is said that these companies' managers committed fraud in order to overtake the publication of bad news from their declining profitability. Also, the results show how the industries information helps the auditors to evaluate the fraud risk. The fraudulent company usually have more distortion in their variables than the average industrial variable. For example, the fraudulent companies may have reasonable or inexcusable fluctuations among their received accounts and inventory and income sales. In simple words, lack of coordination among growing or declining sales and received accounts or company's inventory could be one of that red flags that analysing the financial statement and stick it to the significant summits for the auditors. The members of employer board and having or not having the auditory committee are also the other fraud risk factors which are considered in some of the students of this field. In one of the available articles in fraud auditing literatures, the time period for choosing the statistical population of studied companies, have divided into 70s, 80s and 90s. the results of fraud risk factor in financial statements in the two intervals were very interested for me. For example in 70s and 80s, the fraudulent companies compared to the non fraudulent companies had less profit and used debt as a main lever to obtain more financial supplies, while the fraudulent companies in 90s, compared to non fraudulent companies had higher profit and didn't like debt in their financial supply policies(this is where the time influences on the variables should be considered as a analysis of auditor). discuss about the analytical methods uses them for discussion about author's need to improve their ability and use analytical methods and other uses of financial statements and discovering variables that have correlation with deceiveful reports in financial statements.

7) what is fraud auditing?

From the past decades, the standards and auditing books focused on the auditor attention to the fraud possibility in registration and financial reports. But as the time passes, especially after collapsing the big companies in 2001, the fraud auditing became more attractive so in many popular universities in the world, the fraud auditing is taught we hope it happens in our national universities.

The fraud auditing is different from the financial statement auditing. The financial auditing basically doesn't discover and Searches for fraud but is an evidence and witness whether the financial statements have prepared or represented fairly or not.

But fraud auditing in an especially auditing in discovering the fraudulent financial statements.

The underlying auditing assumptions include the following:

- 1) fraud , even in accounting systems with internal, accurate and strict controls is possible.
- 2) the fraud appearance in a transaction may demonstrates inconsiderable cost, but it may have underlying considerable cost.
- 3) If the searches of fraud auditors be long and deep enough, we probably can recognize a sign of fraud.
- 4) The frauds may be related to every level of staff , management or society In addition to the necessary skills for financial auditing , the fraud auditors should have another especial skills to perform the fraud auditing. These skills include: understand by the appropriate methods for gathering and documentation the loss evidence due to fraud , the inquiry skill from the third persons, the skill to utter testify, understand the fraud nature from legal, lawful and auditing perspective, having enough skills and experience to understand the fraud related to different jobs such as bank fraud, fraud in different production industries, fraud in retails, ...

There is another kind of auditing called court auditing that is different from the fraud auditing. This auditing takes place after the fraud auditing. In this auditing, the complex financial transactions and numerical data should be translated in a language that even the common people can understand in a language that even the common people can understand it. In a addition to expert skills in accounting and auditing , the court auditors should have skills like criminal investigation, reporting, expert testify utterance, the power of teaching material, the professional behaviour and

8) Thirteen principles of fraud auditing:

About the fraud auditing, there are thirteen principles which show their differences to the financial auditing. These principles are as follow:

- 1) The main difference of fraud auditing to the financial auditing, more in the point of view and perspective than method.
- 2) The fraud auditors framework, focus on exceptions, unusual cases, accounting infractions and behavioural pattern instead of errors and drops.
- 3) The main base of teaching in auditing is to discover (experience) fraud , not the books and auditing texts. Teaching in this area is the same as an auditor think like a guilty that what is the weakest chain in the internal control system of employer.
- 4) from the financial auditing, fraud in the misrepresentation and intentional significant financial events. But in the fraud auditing perspective, fraud in the misrepresentation and intentional all the financial events , even not significant.
- 5) fraud committed by economic , arrogance, mental (Etiologic), intellectual and psychic motivations.
- 6) The fraud structural theories include motivation, opportunity and profit 7) fraud in the computer accounting may performed in any input , among , process and output.
- 8) the most common fraud areas in low class staff relates to the pays (debts, salary, claims about the costs and benefits).
- 9) The most common fraud areas in the high class managers relates to smoothing the profit.
- 10) the fraud accounting often results from lack of internal controls.

- 11) The losses due to frauds more faster than the growing (numbers) of the fraud.
- 12) accidental discovery of frauds in more than discovery of frauds by planning the audit techniques.
- 13) To prevent the fraud , as the suitable internal controls are necessary , there is a need to a working environment in which the honesty of the staff and the mutual trust among them is valuable (Adhami, khajavi)

9) There are many opportunity that make the financial statements fraud possible.

The most common of them include:

- lack of internal controls
- Failure in conducting the controls(the most common reason)
- Over trust in key employees.
- incompetent led personnel
- lack of attention to the details.
- inadequate staff (Darabi and Abedini Sayenehi).

10) The opportunities that allow staff to committee the financial statement frauds.

A) The internal controls factors

- Failure in perform/ monitor the internal controls
- The management doesn't engage in the control system.
- The management violates the controls and saturations.
- lack of attention of management , unwillingness to the details.
- The aggressive and challenging management.
- ineffective supervision by the management board.
- inadequate and low repetitions of reviews by the third persons.
- in adequate separation of licensing responsible, physical maintenance of properties and the accounting registration duties.
- over trust in key staff
- inadequate leaders
- non clear and vague devolution
- lack of the suitable process of devolution
- lack of independent controls. Governing the functions
- inadequate documents and records
- lack of adequate systems to protect the assets.
- lack of physical security or logical system.
- lack of auditory
- Failure in evaluating the professional and general records of staff.
- lack of annual holidays directions and turning the staff (Darabi and Abedini Sayenchi)

B) other factors

- big, unusual or complex transactions
- multiple adjustment registrations in a year.
- The transactions of related persons.
- The staff of accounting unit is few or works a lot
- incompetent staff
- fast turning of key staff

- long term tenure of key responsibilities.
- The organization instruction that is needless complex
- lack of behavioural regulation, Conflict of interest or unacceptable behaviour
- fast changes of auditors or legal consultants.
- activity in critical situation
- close relationship with suppliers / customer
- the assets that are vulnerable to theft.
- The accounting process that is very doubtful.
- using accounting standards, at least possible
- lack of clarity in policies and working process of company.
- Failure in teaching and focusing on organizational honesty.
- Failure in prosecution the offender staff
- low spirituality and loyalty of staff (Darabi and Abedin sayenchi).

11) increasing uses of information technology to discover the fraud.

In a few past decades, the organizations have advanced in using technology and depending on the computer based systems.

Nowadays the organizations use computer for any kind of industry, in every size and type, for ranking the business process and also for processing the accounting information.

Employees in accounting job have understand the knowledge of needs and using information technology in auditing , especially for discovering the fraud in internal auditing part and state (governmental) accounting organizations. (volonimo and et al , 2007). Usually one is more staff ware chosen to discover and monitor the staff in internal control systems. In internal auditing of big business companies, using innovative methods for discovering the fraud have been popular as a result of using preventing fraud programs and supporting of auditing committee. On the other hand, some of the general organizations have agreed about using analysis and data mining software, some others have bought software and acquired necessary instructions.

In order to use them for discovering fraud in the period of auditing financial statements. (Knetzger and muraski 2007) .

12) The importance of fraud teaching to the accounting students.

The discovered fraud cases in big companies such Anron , world com and west management, the policy makers of accounting job decided to focus on fraud teaching as an educational title in the universities of the countries. For example the formal supervisors board and (ACFE) program , have planned the fraud to hold the 5 years teaching fraud course, for half of US universities. The US formal accountants have declared their coordination and cooperation to establish the preventing fraud periods in the accounting educational program and textbooks. These courses developed to learn the main features of fraud and discovering the factors results from fraud and teach students the necessary skills and knowledge's.

Preparing students for teaching fraud will be helpful, both for students and employers because after, learning subjects like document monitoring , the community and monitoring the reports to the consultants, auditors, students become expert census that can represent very valuable services to the users. In 2003 , Bandy and ward said that.

As a result of increasing tendency to the expert legal accounting field , it is expected that the universities increase the number of fraud teaching courses and legal accounting in the primary accounting programs.

In addition to these, according to the formal accountant's evaluation of US in 2002, there are some other advantages of fraud teaching:

- Increasing the market value: according to an investigation in US, the companies can increase their market value 10-12% by changing the bad government to a good government.
- Reducing the the government penalties. According to the information in US , the companies try to use programs that prevent the law violation and reducing the penalties by 40%.
- Reducing the plan claim against the company. Keeping the business sign and its popularity.

Maybe another discussion that increases the importance of fraud teaching and demonstrates its necessity more and more, is the shocking statics released by the formal fraud supervisors organization in 2002.this organization by doing a study concluded that 7% overall incomes have been lost due to the fraud(means 600 billion dollars). On the other hand, Ernest and yang reported that just 20% of frauds discovered and reported, 40% of the frauds discovered but not reported and 40% of frauds never discovered.also, according to a small report about fraud and misuses of jobs, they are more vulnerable . from 80% asset's embezzlements, 90% of them relates to the cash income.(Royai).

B) conclusion:

In recent years, fraud in companies has resulted in millions expensive costs. Only in US and UK , the rates of fraud reported reaches to billions dollars. Thus, these reports may include only 10% of the whole frauds. Many of the frauds in companies demonstrated in the newspaper's titles and destroyed them. The managers have lost their job and many administrative managers went to the court to respond about their actions in the company. The observations show that the fraud in companies is a serious problem. These frauds, especially when committed by the major managers and staff, were discovered when the companies have a lot of serious problems. in this situations, the question is where were the auditors?

The role of independent auditors in discovering and reporting the fraud is a kind of discussion. Several investigations showed that while the policy makers, courts, financial journals and etc. Except the auditors that discover and report the frauds, the auditing profession in general reduces its responsibilities in this area. So in this study, we have reviewed theories and the history of investigations about frauds and auditing

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