Auditors responsibility for detecting fraud

Finance

Auditor’s Responsibility for Detecting Fraud

The scandalous reports of financial frauds resulted to the implementation of the SOX-Orbanes Law in 2002. The Act hopes to establish sweeping reforms in Audit reporting in order to bring back the confidence of investors to the financial investments. This law puts great responsibility on auditors to report the true financial picture of a public company. Public traded companies have the task to prepare a timely and correct financial standing of the company. This report focuses on the responsibilities of Auditors in reporting.

Definition of terms

To put the terms in proper perspective, Arens, Beasley & Elders, (2008) stated there is an audit failure when auditors issue an incorrect audit opinion that fails to comply with the requirements of auditing standards. Audit failures, in longer term, result to business failure. Business failure occurs when a business is unable to repay its creditors or meet investors because of prevailing business conditions.

Recent fraud report

A recent fraud that shocked the financial society is the financial collapse of Lehman Brothers, a big investment firm in U. S. Reuters carried news report that the accounting firm of Ernest & Young helped to hide financial problems of Lehman Brothers that led to its downfall (McKena, Francine, 2010)

Ernest Young was motivated to commit fraud in an effort to cover up the unstable financial position of the company to prevent it from financial collapse.

How the fraud took place

Reuters reported that Ernest & Young tolerated the fraudulent transactions of Lehman Brothers that used an accounting technique known as “ Repo

105, a business model designed to hide billions in liabilities. The firm used this technique to hide as much as $50 billion in assets from the balance sheet. (McCool Grant, 2010)

Internal control failures that would have allowed the fraud to take place.

As a process, management puts internal control to be assured that operations are in place. Internal control, as Carl Haus(2014) defined, are rules designed to promote proper functioning of business. It is also designed to protect company assets, Cari suggested. In this context, Independent auditors rely on the accuracy of internal controls to form their opinions. As such, management has the responsibility of providing a reliable financial position of the company. Based on this premise, failures of internal control started with top management who failed or ignored internal controls for a dependable financial reporting. The Auditors, on their part failed or disregarded the weaknesses of financial information or errors presented so as not to disrupt the operations of Lehman Brothers.

The audit procedures that should have found the fraud, or if the procedures would not have found the fraud, explain why not

Financial statements done by Lehman Brothers were manipulated by management to make it appear that it was a sound company. However, when the collapse of Lehman was brought to public when they filed for bankruptcy on September 15, 2008, it was found that the company manipulated accounting transactions to cover up bank losses. By using Repo transactions, they were able to hide true financial situations. Ernest & Young argued that their audit procedures did not detect any fraud as it was the management who did the asset manipulations. Its audit procedures failed to check the Repo transactions that hid the asset manipulations. It failed to comply with the Auditing standards No. 5 of PCAOB that requires auditor to produce evidence that of material weaknesses in the management report.

References

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CEO and COO roles in internal control

Effective, efficient operations are a prime goal of internal control protocols. They are the responsibility of the COO, who oversees quality control of products and services as well as employee productivity. The COO implements the collection, organization and exchange of information that helps employees fulfill their responsibilities. Internal controls that are intended to insure reliable financial reporting are overseen by the chief financial officer (CFO), but the CEO and COO share in the responsibility for reliable accounting and financial reporting procedures. The CEO and COO also share the responsibility to implement and enforce internal controls with regard to compliance with laws and regulations. They create and implement policies and procedures to see that the organization complies with laws and regulations.

Apart from the oversight of accounting and financial reporting, internal control is critical in protecting a company or organization's assets, detecting fraud and in achieving its goals. The CEO assumes responsibility for fraud detection, working with the CFO. The establishment of a rigorous set of internal control procedures is the top deterrent to fraud and embezzlement within a company. The setting up and implementation of such procedures is a top priority in any business or organization.