ABSTRACT
The major financial scandals surrounding Enron and Worldcom led to changes in legislation and standards. One of the major standard changes was Statement on Auditing Standard No. 99, “Consideration of Fraud in a Financial Audit” issued in December 2002. This research attempts to answer questions about the readiness of financial auditors to perform anti-fraud duties effectively, and the perceived effectiveness of SAS 99. Twenty-five professionals were surveyed. The results show some readiness on the part of the CPAs, and some effectiveness of SAS 99 procedures to potentially detect frauds.

INTRODUCTION
Although management has the ultimate responsibility to design and implement programs and controls to prevent, deter, and detect fraud, the public’s expectation of auditors to search for and find fraud has increased drastically over the years. The independent audit function has historically been known as the “public watchdog” with a responsibility to protect the investors, creditors, and general public from materially misstated financial statements of companies. The auditor’s responsibility is to ensure there are no material misstatements in the financials, but due to large accounting scandals over the past few years, the scope of the auditor’s job has expanded to meet the expectations of the public concerning the detection of fraud.

Even with the revamping of standards through Statement on Auditing Standard (SAS) No. 82 and its successor SAS 99, which both consider fraud in a financial statement audit, frauds continue to occur and the public’s confidence in financial audits has diminished over the years. While SAS 99 has taken a more proactive approach than its predecessors to the prevention, deterrence, and detection of fraud in a financial statement audit, measures can still be taken to further increase the effectiveness of financial audits and the public’s confidence in the public accounting profession overall.

HISTORY OF FRAUD DETECTION STANDARDS
Fraud detection standards were originally set back in 1988 through SAS 53, “The Auditor’s Responsibility to Detect and Report Errors and Irregularities.” The intent of issuing this standard was to bridge the expectations gap, distinguishing between what the independent auditor’s actual responsibilities were to detect financial statement misstatements and what the public thought these responsibilities were. By the early 1990’s though, many auditors were not clear on what their fraud detection responsibilities actually were, and the Auditing Standards Board (ASB) sought to clarify this through the release of SAS 82 [3, 42].

Issued in 1997, SAS No. 82, “Consideration of Fraud in a Financial Statement Audit,” attempted to clarify the auditor’s responsibility for detecting and reporting fraud, as well as address the public’s criticism of the audit process and audit quality.
Specifically, the standard required independent auditors at the beginning of the audit to make a specific assessment of the risk of material misstatement on financial statements, whether due to fraudulent financial reporting or asset misappropriation and keep this focus throughout the audit. They were also required to make inquiries of management concerning management’s knowledge of fraud and fraud risk factors within the entity and their responses to those risk factors. David Landsittel, the ASB fraud task force chair, expressed optimism in this new standard when he said, “I am hopeful that the standard will enhance the likelihood of detection of material misstatement due to fraud, further enabling the Certified Public Accountant (CPA) profession to serve the public interest and increase the value of our services.” [3, 43-46]

The expected results of SAS 82 did not ultimately live up to the expected benefits though. While it may have heightened awareness of fraud by both auditors and management, one of the expected benefits was an increase in the discovery of fraud, and in a research study that was conducted, almost all of the auditors said that it had not resulted in this. And while the standard meant to clarify, not increase, the auditor’s responsibility to detect fraud, the expectations gap was actually widened and auditors felt that their exposure to legal liability increased. This was due mainly to the auditor’s belief that they now had greater responsibility and the client’s belief that auditors were now doing more to uncover fraud [3, 46].

**RELEASE OF SAS NO. 99**

In 2002, the recent corporate and accounting scandals of Enron, WorldCom, and Tyco demanded that something be done quickly to restore investor and public confidence in accounting and reporting practices. The Sarbanes Oxley Act was passed in July of 2002 and shortly after, ASB issued a new fraud standard for auditors, SAS 99. This standard was actually developed prior to the scandals, but its release came in the wake of these frauds. The ASB crafted SAS No. 99, “Consideration of Fraud in a Financial Statement Audit” to fix the perceived inadequacies in its predecessor SAS 82. While both standards address the auditor’s responsibility to search for fraud, SAS 99 takes a more proactive approach to preventing and deterring fraud, than SAS 82, which focused mainly on the detection of material fraud [1, 38].

SAS 99 nonetheless makes the auditors responsibility to detect fraud very clear stating, “The auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether financial statements are free of material misstatement, whether caused by error or fraud.” (AU 316.01) In essence, SAS 99 is a “risk-based” approach to fraud detection on the part of the financial auditors, encouraging auditors to design fraud detection audit procedures to detect “significant risks” related to fraud, whether they are expected to be material or not. The determination of significant risks related to fraud is made in a brainstorming session of the audit team during the planning phase of the audit.

**KEY PROVISIONS OF SAS NO. 99**

Many debate on whether SAS 99 actually increases the auditor’s role in detecting fraud or simply restates SAS 82 in an attempt to convince the public that more is being done to detect fraud. Nonetheless, there are notable changes in SAS 99 that have affected financial statement audits in a positive way. Association of Certified Fraud Examiners (ACFE) founder and chairman, Joseph Wells, who helped draft SAS 99, recognizes that the standard is not a perfect document but does feel that the “brainstorming” feature is a good one. This feature requires that before the audit team begins the audit, they must “brainstorm” how material fraud could occur within the entity and use the information relating to these risks to design the audit [4]. Within the brainstorming process, audit team leaders must also emphasize the importance of maintaining professional skepticism throughout the audit and relay this attitude to the entire audit team (AU 316.16).
Auditors must also make inquiries to management and other appropriate personnel in the entity about the risk of fraud and whether they are aware of any fraud. Although this was previously required in SAS 82, SAS 99 goes into greater detail of what kinds of questions to ask and what areas to focus on. With that said though, the extent of questioning may vary and is ultimately up to the auditor’s judgment to whom and how many inquiries are made (AU 316.24). Another feature of SAS 99 that seems to have had a strong impact is incorporating unpredictability in substantive tests. The audit team should design tests that the clients could not predict or expect, whether that means changing testing locations, times, etc. In an article from 2005, a study was conducted regarding CPAs’ perceptions of the impact of SAS 99, and the majority of responses noted that there had been important changes in substantive testing, particularly an increase of unpredictability in testing [1, 40].

Whether or not any of the changes in SAS 99 substantially affect the chances of detecting fraud in an audit, the standard does act as a deterrent by itself. Now that companies can clearly see that auditors have a responsibility to actively search for fraud during an audit, the standard increases the perception of detection in a company, thus hopefully serving to discourage fraud in the first place [5, 66].

**DATA COLLECTION**

<table>
<thead>
<tr>
<th>Job Position</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Sr. Manager</td>
<td>4%</td>
</tr>
<tr>
<td>Manager</td>
<td>4%</td>
</tr>
<tr>
<td>Senior</td>
<td>20%</td>
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<td>Staff</td>
<td>72%</td>
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In order to gain a wider perspective on the auditor’s responsibility to detect fraud, several local CPAs were surveyed for their opinion on the subject matter. A survey was sent to various levels of auditors at a “Big Four” public accounting firm to get their thoughts on how well current auditing standards are designed to detect and prevent fraud, as well as whether the public accounting profession can do more in spite of the complexity and concealment of fraud in companies today. The positions of the 25 respondents are depicted in Figure 1. The participants were asked to self-assess their knowledge in addressing fraud issues (see Figure 2).

**CAN THE PUBLIC ACCOUNTING PROFESSION DO MORE?**

The majority of survey respondents felt that auditing standards do an adequate job in detecting fraud, as well as preventing fraud (see Figure 3). The question then arises, though, of whether an adequate job is enough? Is adequate enough for the public’s trust? Is adequate enough relating to an auditor’s job responsibility?
Fraud is often difficult to detect because it frequently involves the concealment through falsification of documents or collusion, and therefore it is more important to place emphasis on prevention and deterrence. Prevention can reduce opportunities for fraud to occur and deterrence can persuade people not to commit fraud because of the likelihood of detection and punishment [6, 2-3]. Joseph Wells particularly feels that the current auditing standards are flawed with respect to the CPA’s responsibilities to detect fraud, but says that it shouldn’t prevent the profession from turning its focus to preventing fraud in the first place. Because fraud is able to be concealed in so many ways, it is hard to determine whether transactions are actually fraud or not, and it seems almost impossible to improve standards to the degree necessary to feel confident in being able to determine that [4].
While detection may seem impossible in many circumstances, Joseph Wells focuses on prevention instead. He advocates a model organizational fraud prevention program. His idea is to develop a list of what the perfect organization does to prevent fraud and then allow the auditors to audit that “perfect organizational model.” Thus, the auditors would express an opinion on whether the company is in compliance with the model rather than that the company is free from material fraud. This would not only encourage organizations to focus on fraud prevention, but would in turn allow the investor’s confidence to strengthen because they would be assured that they are dealing with an honest and ethical organization [4].

Although standards may be flawed in detecting fraud, there are still steps auditors can take to improve the likelihood of detecting fraud, if it is not able to be prevented. To enhance the fraud detection abilities of auditors, accounting education must be expanded. For students in accounting undergraduate and graduate programs, occupational fraud remains a relatively under addressed subject [5, 67]. Auditors need to know the different types of frauds that could occur in order to be able to develop a process to detect them. Almost all occupational frauds can be classified into 11 main categories called the “fraud tree,” and it is vital that CPAs thoroughly understand these categories. In an interview with Joseph Wells, he stated that “CPA’s should be taught the most common fraud schemes so they can recognize the signs when they see them.” He also said, “If we are committed to deterring fraud, let’s begin by ensuring that every accounting student, and every CPA, receives adequate training in this area.”[4] This fraud education should start at an undergraduate level and extend all the way through continuing professional education courses (CPE) for CPAs.

While 60% of the survey respondents noted they have already had some kind of fraud-related training, an overwhelming 80% felt that receiving fraud training or attending a fraud seminar every year would be beneficial to their role as an external auditor (see Figure 4).

Another aspect of education should be proper interviewing skills. With SAS 99’s requirement to ask management as well as others in the company about the risk or prevalence of fraud within the company, interviewing skills are essential. The best clues come from people and if auditors are trained to ask appropriate probing questions, then the risks of fraud, or even the fraud itself, may be discovered at the very onset of the audit [5, 67].

After all that has been done in an effort to improve auditing standards relating to the auditor’s responsibility to detect fraud, the public continues to criticize auditors for not doing enough. People have different views on whether the public’s criticism is in fact valid. Joseph Wells seems to believe the criticism is valid to some extent and stated, “Many CPAs didn’t accept their fraud-related responsibilities willingly, and were dragged into this battle kicking and screaming. It took huge judgments against accounting firms before we started taking fraud seriously.”[4]
The responses of external auditors from the survey do not indicate the same conclusion; 76% of respondents do not think the criticism is valid (see Figure 5). Whether it is valid or not, the majority of respondents feel that the public accounting profession can do more to increase the public’s confidence (see Figure 5). When the details about the Enron and WorldCom frauds surfaced, the trust in the public accounting profession was shattered. As years have passed, the “confidence” pendulum is swinging upward again, and effort has to continue to ensure it stays up. Like previously mentioned, individual auditor’s fraud knowledge has to increase in order to increase the likelihood of detection, while at the same time the profession should shift a good amount of its focus to preventing fraud in the first place.

Overall, auditors need to take a more aggressive stance against fraud. Companies have to clearly understand the auditor’s mission to actively search for fraud. Joseph Wells gives another suggestion that goes back to the requirement of auditors to perform inquiries of management and others within the entity. He suggests that auditors ask three simple questions to the appropriate personnel:

- “You understand that part of my job as an auditor is to detect and deter fraud. Do you think that the company has any particular problem in this regard?”
- “Has anyone in the company ever asked you to do something that you thought was illegal or unethical?”
- “In the future, if you become aware of illegal or unethical conduct, will you please contact me?”

Regardless of whether the employees choose to answer honestly or not, the message becomes clear to the company that auditors are looking for fraud and are not afraid to ask the tough questions [4].

CONCLUSION

With solutions that stem from more intense fraud education, fraud prevention organizational models, and a more aggressive inquiry approach, the public accounting profession can do a better job at not only detecting and preventing fraud, but at continuing to raise the public’s confidence in financial audits. As Joseph Wells stated in an interview, “We keep trying to get it right, and I am sure we’ll continue trying to improve it.”
REFERENCES


