The Role of the Auditor:

Assessing and Responding to Fraud Risk

October 2024

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About the Center for Audit Quality

The Center for Audit Quality (CAQ) is a nonpartisan public policy organization serving as the voice of U.S. public company auditors and matters related to the audits of public companies. The CAQ promotes high-quality performance by U.S. public company auditors; convenes capital market stakeholders to advance the discussion of critical issues affecting audit quality, U.S. public company reporting, and investor trust in the capital markets; and using independent research and analyses, champions policies and standards that bolster and support the effectiveness and responsiveness of U.S. public company auditors and audits to dynamic market conditions.

About the Anti-Fraud Collaboration

The Anti-Fraud Collaboration, a partnership composed of the Center for Audit Quality (CAQ), Financial Executives International (FEI), The Institute of Internal Auditors (The IIA), the National Association of Corporate Directors (NACD), and the Association of Certified Fraud Examiners (ACFE) is dedicated to advancing the discussion of critical anti-fraud efforts through the development of thought leadership, awareness programs, educational opportunities, and other related resources focused on enhancing the effectiveness of financial fraud risk management.

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Executive summary

- Shifts in the economy, geopolitical landscape, and technological developments have created an environment in which companies are potentially more vulnerable to fraud. In recent years, as major corporate failures and scandals continue to be in the spotlight, fraud has become a growing area of focus. Regulators, investors, and other interested parties expect auditors to remain vigilant and to think critically about fraud.

- The mitigation of fraud risk is most effective when all participants of the financial reporting ecosystem fulfill their roles in deterring and detecting fraud. Auditors, although often the last line of defense due to the scope and timing of their engagements, are among the many stakeholders whose influence and responsibilities have a significant impact on fraud deterrence and detection.

- Auditors should continually strive to enhance their professional skepticism to effectively assess and respond to fraud risks, including considering when it may be important to elevate the basic level of skepticism that is applied throughout the process of any audit and being cognizant of biases that can impede professional skepticism.

- The auditor's fraud risk assessment is an iterative process that occurs throughout the audit and is a critical element of planning and performing an audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or by fraud. Auditors may consider the following as they plan and perform their fraud risk assessment and design procedures to address identified fraud risks:

  - **Management's fraud risk assessment:** Understanding management's fraud risk assessment, including their anti-fraud processes and controls and the operation and results of their monitoring activities, can be helpful to the auditor in considering where and how fraud could occur.

  - **Fraud brainstorming:** Effective fraud brainstorming involves active participation from audit team members of all levels of experience. Audit teams should have the mindset that fraud can occur at any organization and can be perpetrated by individuals across the organization.

  - **The fraud triangle:** Auditors may find the fraud triangle helpful to consider throughout the audit. When assessing and responding to fraud risks, auditors can leverage the fraud triangle in considering specific risks of material misstatement from fraud and in designing audit responses tailored to those risks.

  - **Fraud expertise:** To the extent fraud expertise and capabilities exist in an auditor's firm, in certain circumstances it may be beneficial to leverage such expertise to assist with fraud risk assessment procedures, including in identifying potential fraud schemes and fraud risk factors and ultimately identifying and assessing risks of material misstatement due to fraud.

  - **Training:** It is important that all auditors, including less experienced auditors, be trained in the auditor's role in assessing and responding to fraud risks and evaluating audit evidence, as well as in how to maintain a "fraud lens" throughout the audit. Creating an environment that is conducive to asking questions related to fraud can elevate less experienced auditors' fraud awareness during an audit and empower auditors to raise concerns.

Introduction

OVERVIEW OF THE FRAUD RISK LANDSCAPE

Shifts in the economy, such as ongoing inflation, global conflicts, and advancing technology, have created an environment in which companies are potentially more vulnerable to fraud. The reasons to commit fraud, the types of fraud that may reasonably be expected to be perpetrated, and/or the means of concealing fraud may be changing.

In February 2024, Paul Munter, Chief Accountant in the Office of the Chief Accountant at the U.S. Securities and Exchange Commission (SEC), released a statement, *An Investor Protection Call for a Commitment to Professional Skepticism and Audit Quality*. In this statement, he emphasized that fraud is an ever-present risk, but a higher risk of fraud may exist as companies face challenges. Munter reminded auditors that they must be aware of conditions that may create or change incentives, pressures, and opportunities, or that may facilitate rationalization for management and corporate misconduct, and in the face of heightened fraud risk, they must consider whether a proper exercise of professional skepticism requires more persuasive evidence to corroborate management's assertions.[1]

In recent years, as major corporate failures and scandals continue to be in the spotlight, fraud has become a growing area of focus for regulators whose agendas include enhancing fraud detection through standard setting and other means.

FRAUD RISK IN A FINANCIAL STATEMENT AUDIT

Fraud can cause significant losses and have consequences for an organization, investors, and many other stakeholders. In recent years, as major corporate failures and scandals continue to be in the spotlight, fraud has become a growing area of focus for regulators whose agendas include enhancing fraud detection through standard setting and other means.[2] Regulators, investors, and other interested parties expect auditors to remain vigilant and to think critically about fraud. Auditors should avoid becoming complacent or having a check-the-box mentality when it comes to their responsibilities for the consideration of fraud in a financial statement audit, which may hinder their ability to effectively identify, assess, and respond to fraud risks.

It is important to remember that even the highest-quality audits are only one component of a comprehensive anti-fraud program. In fact, external auditors are the last line of defense in many cases, due to the timing and scope of their engagements. The Association of Certified Fraud Examiners' report, *Occupational Fraud 2024: A Report to the Nations*, explores the role and effectiveness of various fraud detection mechanisms. The report's findings emphasize that active detection methods implemented by company management, internal audit, boards and audit committees—such as management reviews, account reconciliations, and surveillance/monitoring—are associated with much faster detection and much lower fraud losses than passive detection

1 Paul Munter, Office of the Chief Accountant at the SEC, *An Investor Protection Call for a Commitment to Professional Skepticism and Audit Quality*, February 2024.
2 See PCAOB Standards and Emerging Issues Advisory Group Meeting, November 2023.

methods. With active detection methods being critical to early detection, companies have invested billions of dollars in systems to support strong fraud risk management programs that include internal controls and policies to achieve that goal.[3]

Given that auditors are just one of many stakeholders whose influence and responsibilities have a significant impact on fraud deterrence and detection, the mitigation of fraud risk is most effective when all participants of the financial reporting ecosystem fulfill their roles in deterring and detecting fraud:[4]

+ **Management and those charged with governance** design and implement programs and controls to prevent, deter, and detect fraud.

+ **Boards of directors and audit committees** provide oversight of the financial reporting process and set the proper tone; create and maintain a culture of honesty and high ethical standards; and establish appropriate controls to prevent, deter, and detect fraud.

+ **Internal auditors** provide assurance and insight on the adequacy and effectiveness of governance and the management of risk (including internal control).

+ **External auditors** plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or by fraud.

For purposes of this publication, the terms "**fraud**" and "**fraud risk**" are intended to refer to material misstatement of the financial statements due to fraud and risk of material misstatement of the financial statements due to fraud, respectively.

USE AND INTENDED AUDIENCE

This publication provides insights into practices, tools, and considerations that can help auditors, especially those with less experience, enhance their professional skepticism and overall approach to assessing and responding to the risks of material misstatement resulting from fraud during the audit. It also provides clarity and understanding of the auditor's current role and responsibilities related to fraud, which may provide insights for those who are involved in evaluating and using financial reporting information as well as for policymakers and regulators.

With respect to the role of the auditor and fraud, PCAOB AS 1001: *Responsibilities and Functions of the Independent Auditor* states that "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." Examples of misstatements that are relevant to the auditor's consideration of fraud include two types of fraud: misstatements arising from fraudulent financial reporting and misstatements arising from misappropriation of assets.

3 See Fraud Detection and Prevention Market Growth Report, September 2024.
4 The Anti-Fraud Collaboration was formed by the primary participants of the financial reporting ecosystem, including Association of Certified Fraud Examiners, Center for Audit Quality, Financial Executives International, Institute of Internal Auditors, and National Association of Corporate Directors.

Assessing and responding to fraud risk

WHAT ARE THE AUDITOR'S RESPONSIBILITIES FOR ASSESSING AND RESPONDING TO FRAUD RISK?

PCAOB standards require auditors to plan and perform an audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. As described in PCAOB AS 2110: *Identifying and Assessing Risks of Material Misstatement*, "The auditor should perform risk assessment procedures that are sufficient to provide a reasonable basis for identifying and assessing the risks of material misstatement, whether due to error or fraud, and design further audit procedures."

An auditor performs the following procedures during risk assessment and throughout the audit:

+ Obtains an understanding of the company and its environment
+ Obtains an understanding of internal control over financial reporting
+ Considers information from past audits and engagements
+ Performs analytical procedures
+ Conducts a brainstorming session among the audit team and those supporting the audit (e.g., engagement quality reviewer, forensics specialists, when involved)
+ Makes inquiries with the audit committee and management about fraud risks and the risks of material misstatement

In addition to assessing fraud risk at the beginning of an audit, auditors should revisit their fraud risk assessment throughout the audit. Auditors should consider information obtained through performing audit procedures, as changes in circumstances at the entity or in the environment in which it operates that occur after initial planning may indicate the need to update preliminary risk assessments. An iterative approach to risk assessment can strengthen an audit team's ability to assess and respond to fraud risks effectively.

WHY IS PROFESSIONAL SKEPTICISM IMPORTANT IN ASSESSING AND RESPONDING TO FRAUD RISK?

In Munter's recent statement, he reminded auditors that high-quality audits depend on rigorous professional skepticism in gathering and evaluating evidence throughout the audit to support audit opinions provided.[5]

PCAOB AS 1301: *Communications with Audit Committees* requires the auditor to discuss with the audit committee the significant risks identified during the auditor's risk assessment procedures, as well as the nature and extent of specialized skill or knowledge needed to perform the planned audit procedures or evaluate the audit results related to significant risks. This includes a discussion of all fraud risks identified, as a fraud risk is a significant risk according to PCAOB AS 2110: *Identifying and Assessing Risks of Material Misstatement*.

5 Paul Munter, Office of the Chief Accountant at the SEC, *An Investor Protection Call for a Commitment to Professional Skepticism and Audit Quality*, 2024.

The PCAOB highlights the importance of performing work with due care and professional skepticism in five areas of an audit: client acceptance or continuance, audit planning, identifying and assessing risks of material misstatement, performing work with due professional care, and evaluating the audit results.[6] While exercising professional skepticism, auditors should not let a belief that management acts with integrity impede their evaluation of whether evidence is persuasive.

HOW CAN AUDITORS EXERCISE AND ELEVATE THEIR PROFESSIONAL SKEPTICISM?

Munter also stated that the auditor should "ensure that engagement teams are appropriately trained on biases that can affect auditor judgment and decision-making, and that might undermine professional skepticism."[7] Although it is difficult to eliminate bias completely, recognizing the biases that can impede professional skepticism can help minimize their impact.

The following are examples of common biases to consider:[8]

+ **Anchoring bias:** Relying too much on initial evidence when considering subsequent data and decisions
+ **Confirmation bias:** Giving greater weight to evidence that supports one's opinion while discounting facts that disagree with it
+ **Groupthink:** A group of individuals reach a decision without critical reasoning or evaluation of consequences to not upset the balance of the group
+ **Availability heuristic:** Relying on information that is easily retrieved or recalled from memory
+ **Rush to solve bias:** Needing to make a quick decision or reach consensus quickly
+ **System justification:** A failure to question existing systems and practice to support the status quo

As regulators and standard setters continue to reinforce the importance of exercising professional skepticism, audit practitioners of all levels should continually strive to enhance their skepticism to effectively assess and respond to fraud risks. Enhancing professional skepticism includes considering when it may be important to elevate the basic level of skepticism that is applied throughout the process of any audit.

HOW DO AUDITORS CONSIDER MANAGEMENT'S FRAUD RISK ASSESSMENT?

As described previously, multiple stakeholders within the financial reporting ecosystem play a role in deterring and detecting fraud. Management's role is to design and implement controls and programs to prevent, deter, and detect fraud. Along with those who have

PCAOB AS 1015: *Due Professional Care in the Performance of Work* requires the auditor to exercise and maintain professional skepticism. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence. It should be applied throughout the audit.

EXERCISING PROFESSIONAL SKEPTICISM

Research shows that the following practices support the continuing exercise of professional skepticism:[9]

+ Having leaders **set the right tone**
+ **Rewarding staff** for practicing skepticism
+ Building teams whose members **encourage deep and thoughtful fraud-related discussions**

6 PCAOB, *Professional Competence and Skepticism Are Essential to Quality Audits*, 2023.
7 Paul Munter, Office of the Chief Accountant at the SEC, *An Investor Protection Call for a Commitment to Professional Skepticism and Audit Quality*, 2024.
8 Anti-Fraud Collaboration, *Skepticism in Practice*, 2020.
9 Journal of Accountancy, *Auditing Best Practices: What Academic Fraud Research Reveals*, 2023.

responsibility for oversight of the financial reporting process (such as an audit committee), management has the responsibility to set the proper tone and to create and maintain an ethical culture. A robust fraud risk assessment process is particularly important during times of economic, political, and technological change to allow management to effectively monitor for emerging fraud risks and changes in the fraud risk environment.

As part of planning and performing an audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, auditors are required to understand management's fraud risk management programs and controls to help inform their own fraud risk assessment procedures. Audit teams should incorporate their understanding of management's fraud risk assessments, which encompasses their anti-fraud processes and controls, including the control environment, the company's risk assessment process, information and communication, control activities, and monitoring, when considering where and how fraud could occur.

Auditors also consider understanding the operation of management's monitoring activities (e.g., internal audit findings, customer complaints, policy violations, whistleblower hotlines) and the results or findings from the operation of these programs. Obtaining an understanding of management's processes, programs, and procedures related to whistleblower hotlines may be of benefit because tips from whistleblowers are one of the most common ways that frauds are initially detected.[10]

Effective fraud brainstorming involves active participation from audit team members of all levels of experience.

WHY DO AUDITORS PERFORM FRAUD BRAINSTORMING?

The purpose of fraud brainstorming is to discuss and identify fraud risk factors, fraud risks, and potential fraud schemes and to consider how and where the company's financial statements might be susceptible to material misstatement due to fraud, how management could perpetrate and conceal fraudulent financial reporting, and how assets of the company could be misappropriated.

Effective fraud brainstorming involves active participation from audit team members of all levels of experience. Audit teams should have the mindset that fraud can occur at any organization and can be perpetrated by individuals across the organization. When fraud risks are appropriately considered and discussed, audit teams are in a better position to plan responsive procedures to identify fraud and to remain alert to how fraud could be perpetrated as they execute their work.

HOW CAN AUDITORS APPLY THE FRAUD TRIANGLE?

When assessing and responding to fraud risks, auditors can leverage the fraud triangle in considering specific risks of material misstatement from fraud and in designing audit responses tailored to address those risks. Auditors may find the fraud triangle helpful to consider throughout the audit—assessing risk, designing audit responses, evaluating evidence, and forming their conclusions. Although incentives, pressures,

10 Association of Certified Fraud Examiners, *Occupational Fraud 2024: A Report to the Nations*, 2024.

and opportunity may be easier to assess and identify given that they may appear more evident on the surface (e.g., personal incentives, pressures related to company targets or key performance indicators, internal control weaknesses), rationalization may often be more difficult to understand because it can be challenging to observe and auditors cannot know what is in the mind of a fraudster.

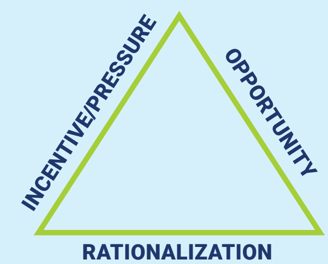
Munter emphasized the importance of contextualizing an organization's fraud risk through the lens of the fraud triangle: "Fraud is an ever-present risk, but particularly as companies face challenges, a higher risk of fraud may exist… As auditors conduct their audits, they must be aware of areas of common audit deficiencies, as well as conditions that may create or change incentives, pressures, and opportunities, or facilitate rationalization for management and corporate misconduct."[11]

PCAOB AS 2401.A2: *Risk Factors Relating to Misstatements Arising From Fraudulent Financial Reporting* lists fraud risk factors, which are classified based on the three conditions of the fraud triangle that are generally present when material misstatements due to fraud occur.

Some useful examples of fraud risk factors related to **rationalization** include the following:

+ Ineffective communication, implementation, support, or enforcement of the entity's values or ethical standards by management or the communication of inappropriate values or ethical standards
+ Nonfinancial management's excessive participation in or preoccupation with the selection of accounting principles or the determination of significant estimates
+ Known history of violations of securities laws or other laws and regulations, or claims against the entity, its senior management, or board members alleging fraud or violations of laws and regulations
+ Excessive interest by management in maintaining or increasing the entity's stock price or earnings trend
+ A practice by management of committing to analysts, creditors, and other third parties to achieve aggressive or unrealistic forecasts
+ Management failing to correct known reportable conditions on a timely basis
+ An interest by management in employing inappropriate means to minimize reported earnings for tax-motivated reasons
+ Recurring attempts by management to justify marginal or inappropriate accounting on the basis of materiality
+ The relationship between management and the current or predecessor auditor is strained, as exhibited by the following:
    - Frequent disputes with the current or predecessor auditor on accounting, auditing, or reporting matters

THE FRAUD TRIANGLE



+ **Incentive / Pressure –** Motives and factors that drive behavior to commit fraud
+ **Opportunity –** Circumstances that create an environment to perpetrate fraud
+ **Rationalization –** An attitude or set of ethical values that allows a perpetrator to knowingly and intentionally commit fraud

11 Paul Munter, Office of the Chief Accountant at the SEC, *An Investor Protection Call for a Commitment to Professional Skepticism and Audit Quality*, 2024.

- Unreasonable demands on the auditor, such as unreasonable time constraints regarding the completion of the audit or the issuance of the auditor's report

- Formal or informal restrictions on the auditor that inappropriately limit access to people or information or the ability to communicate effectively with the board of directors or audit committee

- Domineering management behavior in dealing with the auditor, especially involving attempts to influence the scope of the auditor's work or the selection or continuance of personnel assigned to or consulted on the audit engagement

Although PCAOB AS 2401 describes the three elements of the fraud triangle as conditions that are generally present when material misstatements occur due to fraud, multiple researchers have suggested consideration of other theoretical models that go beyond the three elements of the fraud triangle, including the fraud diamond and the fraud pentagon. These concepts may be helpful to auditors as they consider why and how people commit fraud when assessing and responding to fraud risks in a financial statement audit:

The ***Fraud Diamond*** places greater emphasis on the personal characteristics of the fraud perpetrator with the inclusion of a fourth element—the fraud perpetrator's capability—in order to capture the attributes and traits needed to orchestrate a fraud, such as position/function, brains, confidence/ego, coercion skills, effective lying, and immunity to stress.[12]

The ***Fraud Pentagon*** expands upon the original idea of the fraud triangle by adding competence and arrogance. Competence, in this case, is given almost the same definition as capability described in the fraud diamond—the perpetrator's ability to commit the fraud. The new element here comes in the form of arrogance—the attitude of superiority and entitlement or greed, the perpetrators' belief that the internal controls in place do not apply to them.[13]

HOW CAN AUDITORS LEVERAGE FRAUD EXPERTISE?

In his recent statement, Munter highlighted the importance of engaging and effectively integrating specialists and other experts into the audit team when auditing complex areas or where specialized knowledge is needed. He noted that doing so would help ensure that the auditor has adequate expertise to challenge management's assessments and assertions.[14]

In certain circumstances, auditors may use a professional with forensic expertise on the audit engagement as a specialist engaged or employed by the audit team. Decisions to do this would be specific to the particular facts and circumstances of the audit based on the auditor's professional judgment.

In certain circumstances, auditors may use a professional with forensic expertise on the audit engagement as a specialist engaged or employed by the audit team. Decisions to do this would be specific to the particular facts and circumstances of the audit based on the auditor's professional judgment.

12 Refer to *The Fraud Diamond: Considering the Four Elements of Fraud*, May 2024.
13 Refer to *The Shapes of Fraud: From Fraud Triangle to Pentagon*, September 2023.
14 Paul Munter, Office of the Chief Accountant at the SEC, *An Investor Protection Call for a Commitment to Professional Skepticism and Audit Quality*, February 2024.

To the extent fraud expertise and capabilities exist in an auditor's firm, tapping into such resources to gain additional knowledge and experience from forensic specialists could be beneficial to audit teams. Someone who has experience with fraud (whether they are in an official specialist role or simply have experience with uncovering frauds) can share knowledge and support auditors in their fraud risk assessment procedures, including identifying potential fraud schemes and fraud risk factors and ultimately identifying and assessing risks of material misstatement due to fraud in their engagement.

Fraud and/or forensic expertise could be leveraged by auditors in a variety of ways:

+ Staff training and learning development conducted by professionals with forensic expertise can provide practical insights into what fraud is and how fraud can be identified and can enhance the auditor's abilities to assess and respond to fraud risks.
+ Resources prepared by professionals with forensic expertise can be leveraged by the auditor when preparing for fraud brainstorming, designing questions for fraud inquiries, and more. For example, the Anti-Fraud Collaboration's report, *Mitigating the Risks of Common Fraud Schemes: Insights from SEC Enforcement Actions*, can assist auditors in understanding common fraud schemes and identifying higher risk areas that are susceptible to fraud.
+ Fraud specialists and/or others with relevant experience may be able to assist auditors in (1) preparing for and performing fraud inquiries, (2) actively engaging in fraud brainstorming, (3) designing responsive procedures to address fraud risks of material misstatement (e.g., journal entry testing), and (4) performing certain responsive audit procedures and/or reviewing the supporting audit documentation.

WHY IS TRAINING IMPORTANT FOR AUDITORS?

It is important for auditors at all levels to remain alert to facts and circumstances that may be indicative of fraud and to be empowered to raise those concerns to more experienced audit team members when they arise. Junior auditors who may have less experience remain critical to the execution of the audit. Even when they are not assigned to perform procedures directly related to fraud, it is important that they be trained on the auditor's role in assessing and responding to fraud risks and evaluating audit evidence as well as on maintaining a "fraud lens" throughout the audit. Because of their frequent interactions and communication with company management, including those outside of the financial reporting function who may have insight into business activities, less experienced auditors may have the best opportunity to identify conditions that are potentially indicative of fraud.

As such, it is important that new and less experienced auditors receive training not only on performing standard audit procedures, but also on topics related to fraud. This could include training on the types of red flags or indicators to look out for when interacting with management and performing audit procedures (e.g., what doctored evidence might look like or what a fraudster might say to "make the auditor go away"). The use of case studies may be helpful in this regard, as understanding

It is important for auditors at all levels to remain alert to facts and circumstances that may be indicative of fraud and to be empowered to raise those concerns to more experienced audit team members when they arise.

past examples of how frauds were perpetrated, initially concealed, and ultimately detected can bring concepts in the auditing standards to life and can help auditors apply them in their own audits. Forensic specialists and/or others who have experience in fraud detection could assist with formal or informal training in these areas.

Given that anomalies are not easy to identify, less experienced auditors require more guidance on assessing and responding to fraud risks and in the evaluation of evidence obtained. Senior audit team members should focus on advising less experienced staff on what questions to ask, how to ask the questions, and to whom the questions should be asked. The sooner auditors are trained to recognize fraud risk factors and assess such factors in analyzing audit evidence and during interactions with management, the better equipped and more likely they will be able to notice indicators of fraud and to assess and respond to those indicators.

Creating an environment that is conducive to asking questions related to fraud can elevate less experienced auditors' fraud awareness during an audit. Such an environment could also help all audit team members, especially those who are new to the firm and the client, understand why the procedures they are performing are pivotal to the auditing process—and their role in protecting investors.

HOW DO AUDITORS DISTINGUISH FRAUD FROM ERROR?

The primary factor that distinguishes fraud from error is intent. It is important to note, however, that such a determination cannot always be made, as the intent of an individual is difficult to ascertain and is not always verifiable. During the audit, auditors often inspect documentation and other information to support their determination of potential fraud risks and their conclusions regarding whether the financial statements are free of material misstatement due to error or fraud. Efforts by management to conceal fraudulent financial reporting schemes may include deliberate actions intended to avoid detection in the audit, such as understating expenses and omitting relevant information from documentation.[15]

Auditors should not dismiss an identified misstatement due to an omission of relevant information as simply a mistake and unintentional. It is important for auditors to maintain a heightened sense of professional skepticism when evaluating such a misstatement. Audit firms can reinforce this consideration during trainings and other internal communications to address potential tendencies to view omissions with less skepticism than misrepresentations and to reiterate that clients could use omissions to conceal fraud. Information obtained and considered in the evaluation of a misstatement may warrant the auditor revisiting decisions made during the initial risk assessment process, including the assessment of fraud risks and fraud risk factors considered. Elevating levels of professional skepticism and including audit team members of an appropriate level are important elements in allowing the auditor to effectively determine whether an action resulting in a material misstatement of the financial statements is intentional.

DISTINGUISHING FRAUD FROM ERROR

To enhance the auditor's ability to identify misstatements whether due to error or fraud, firms should reinforce and train auditors about what distinguishes fraud from error, different types of fraud, characteristics of fraud, and the impacts of fraud. This can benefit all audit team members but may be especially helpful for inexperienced auditors. Training may consist of sharing case studies and other practical examples using firm templates and tools and having less experienced auditors shadow those with more experience in performing fraud procedures.

15 Erin Hamilton and Jason L. Smith, University of Nevada, Las Vegas, *Error or Fraud? The Effect of Omissions on Management's Fraud Strategies and Auditors' Evaluations of Identified Misstatements*, April 2020.

Conclusion

As a member of the financial reporting ecosystem, auditors play a unique and important role in the detection of material fraud. As the economic and geopolitical landscape continues to change and technology continues to evolve, organizations and employees experience challenges that present new incentives, pressures, opportunities, and rationalizations to commit fraud. Auditors must continue to enhance their focus on identifying, assessing, and responding to fraud risks in financial statement audits to effectively fulfill their responsibility to plan and perform audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and to continue to support confidence in functional capital markets.

All auditors, regardless of experience level, should maintain the mindset that fraud can occur in any engagement and can be perpetrated by individuals across the organization. Auditors should exercise an appropriate level of professional skepticism and should seek to apply a fraud lens throughout the audit as they perform activities related to assessing and responding to fraud risks while remaining alert to possible red flags in interactions with company management and the evaluation of audit evidence. Communication and collaboration with fellow engagement team members and specialists (when involved) can further support the auditor's effectiveness with respect to identifying, assessing, and responding to fraud risks in a financial statement audit.

All auditors, regardless of experience level, should maintain the mindset that fraud can occur in any engagement and can be perpetrated by individuals across the organization.

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