



ORGANIZATIONS ARE LOSING
5

Workshop on Audit Risk Assessment

Day 1

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THE INSTITUTE OF
**CHARTERED
ACCOUNTANTS**
OF BANGLADESH

About the Presenter

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THE GLOBAL COST OF FRAUD



1,921
CASES

from



138
COUNTRIES and
TERRITORIES

Causing total
losses of more than

\$3.1 BILLION



\$1,662,000

Average loss per case



22% of cases had losses of
\$1 million+

CFEs estimate that
organizations **LOSE**



5% of revenue
to **FRAUD**
each year

Projected against
2022 GWP*
(\$101 TRILLION)

that's more than
\$5 TRILLION
LOST TO FRAUD
GLOBALLY

*<https://databank.worldbank.org/data/download/GDP.pdf>

FINANCIAL STATEMENT FRAUDS
are the least common but most costly

5%
of cases

\$766,000
median loss

CFEs estimate that
organizations **LOSE**



MEDIAN LOSS
PER CASE:
\$145,000

AVERAGE LOSS
PER CASE
\$1.7 MILLION

Perpetrators of financial statement
fraud schemes more commonly **FACED**
EXCESSIVE PRESSURE TO PERFORM
FROM WITHIN the organization.

Association of Certified Fraud Examiners
Occupational Fraud 2024: A Report to the Nations

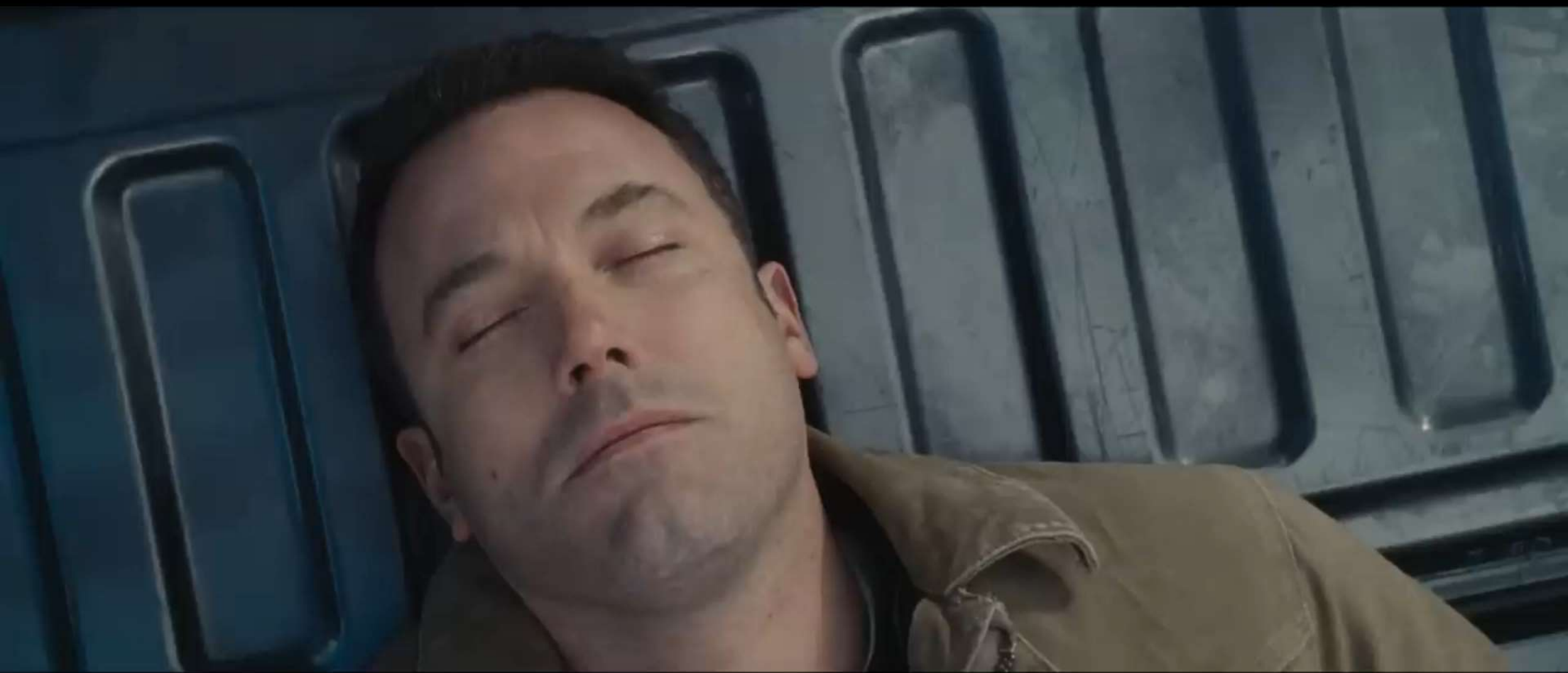
SCHEMES					
Category	Cases	25 th percentile	Median (50 th percentile)	75 th percentile	Mean*
Asset misappropriation	1,309	\$22,000	\$120,000	\$500,000	\$1,116,000
Noncash	246	\$10,000	\$66,000	\$250,000	\$537,000
Billing	207	\$25,000	\$100,000	\$448,000	\$624,000
Cash on hand	143	\$10,000	\$50,000	\$200,000	\$357,000
Skimming	130	\$10,000	\$43,000	\$200,000	\$205,000
Expense reimbursements	127	\$5,000	\$50,000	\$150,000	\$251,000
Check and payment tampering	109	\$26,000	\$155,000	\$510,000	\$787,000
Cash larceny	95	\$10,000	\$50,000	\$300,000	\$561,000
Payroll	74	\$10,000	\$50,000	\$250,000	\$383,000
Register disbursements	21	\$4,000	\$50,000	\$94,000	\$95,000
Corruption	662	\$50,000	\$200,000	\$1,000,000	\$2,738,000
Financial statement fraud	61	\$100,000	\$766,000	\$4,815,000	\$6,045,000

**Mean amounts were calculated using loss data that was winsorized at 5% (i.e., assigned all cases in the top 2.5% and bottom 2.5% the same value as the 97.5th percentile and 2.5th percentile, respectively).*



solution?





WHAT ANTI-FRAUD CONTROLS ARE MOST COMMON?



HOW DOES THE PRESENCE OF ANTI-FRAUD CONTROLS RELATE TO MEDIAN LOSS?

Control	Percent of cases	Control in place	Control not in place	Percent reduction
External audit of financial statements	84%	\$121,000	\$250,000	52%
Code of conduct	85%	\$121,000	\$200,000	40%
Internal audit department	80%	\$120,000	\$210,000	43%

Outline

- fraud risk
- business/operational processes and controls
- audit materiality
- interactive audit materiality calculations
- interactive preliminary audit analytics
- financial statements level risks with examples
- assertions level risks with examples
- general it controls



shall we begin?

Interactive scenario

Background

TechNova PLC is a publicly traded technology company specializing in consumer electronics. Over the past two years, the company has reported impressive revenue growth, attracting significant investor attention. However, recent rumors of aggressive accounting practices and internal control weaknesses have raised concern among stakeholders. You are part of the audit team assigned to review TechNova's financial statements for the year ending December 31, 2022.

Interactive scenario

Financial Data

Metric	2022	2021	2020
Revenue	BDT 250M	BDT 180M	BDT 150M
Net Income	BDT 30M	BDT 20M	BDT 15M
Accounts Receivable	BDT 90M	BDT 60M	BDT 50M
Inventory	BDT 40M	BDT 30M	BDT 25M
Cash Flow from Operations	BDT 10M	BDT 15M	BDT 12M

Interactive scenario

Accounts Receivable Aging Schedule (December 31, 2022)

Customer	0-30 Days	31-60 Days	61-90 Days	>90 Days	Total
Customer A	BDT 10M	BDT 5M	BDT 2M	BDT 1M	BDT 18M
Customer B	BDT 8M	BDT 4M	BDT 3M	BDT 2M	BDT 17M
Customer C	BDT 12M	BDT 6M	BDT 4M	BDT 3M	BDT 25M
Customer D	BDT 5M	BDT 3M	BDT 2M	BDT 1M	BDT 11M
Customer E	BDT 7M	BDT 4M	BDT 3M	BDT 2M	BDT 16M
Total	BDT 42M	BDT 22M	BDT 14M	BDT 9M	BDT 87M

Interactive scenario

Sales Contracts (Sample)

- Contract 1: A BDT 10M sale to Customer A recorded on December 30, 2022, with delivery scheduled for January 15, 2023.
- Contract 2: A BDT 15M sale to Customer B recorded on December 31, 2022, with payment terms of 180 days.
- Contract 3: A BDT 5M sale to a related party (TechNova Display Technologies LLC) recorded on December 31, 2022.

Interactive scenario

Inventory Summary

Total Inventory: BDT 40 million

Obsolete Inventory: BDT 8 million (20% of total inventory)

Inventory Turnover Ratio: 4.5 (down from 6.0 in 2021)

Interactive scenario

Inventory Summary

Total Inventory: BDT 40 million

Obsolete Inventory: BDT 8 million (20% of total inventory)

Inventory Turnover Ratio: 4.5 (down from 6.0 in 2021)

Internal Control (Weaknesses)

The company lacks a formal policy for approving sales to related parties.

There is no segregation of duties between the sales and accounting departments.

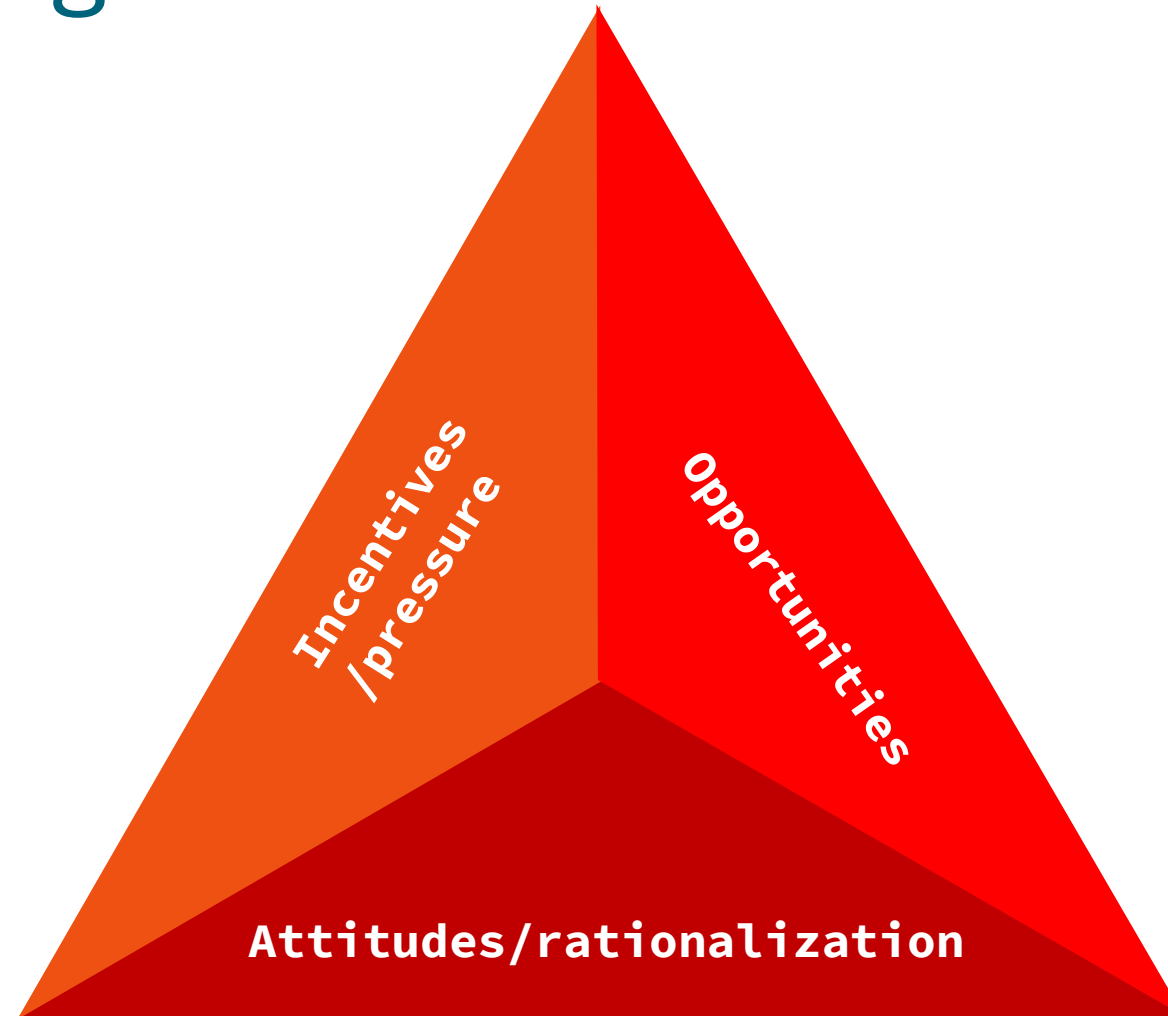
Management override of controls is common, with limited oversight from the board of directors.

Interactive scenario

Tasks for Participants:

1. Analyze the Financial Data
2. Review the Additional Information
3. Identify the Fraud Indicators
4. Propose Next Steps

Fraud Triangle



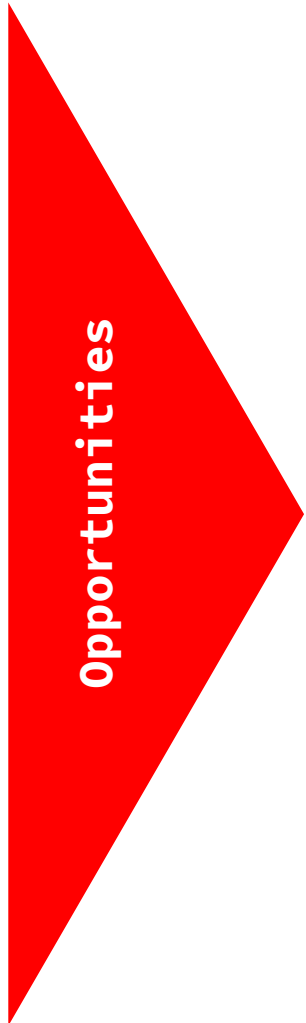
Fraud triangle



Incentive
/pressure

- Financial stability or profitability is threatened by economic, industry, or entity operating conditions
- Excessive pressure exists for management to meet the requirements or expectations of third parties
- personal financial situation of management or those charged with governance is threatened by the entity's financial performance
- There is excessive pressure on management or operating personnel to meet financial targets established by those charged with governance, including sales or profitability incentive goals.

Fraud triangle



- The nature of the industry or the entity's operations provides opportunities to engage in fraudulent financial reporting
- The monitoring of management is not effective
- There is a complex or unstable organizational structure
- Deficiencies in internal control

Fraud triangle



- Ineffective or inappropriate communication, implementation, support, or enforcement of entity values & ethical standards
- Non financial management participates in selection of account policies or determination of significant estimates
- Known history of violations of securities laws or other laws and regulations
- Low morale among senior management
- The relationship between management and the current or predecessor auditor is strained
- Failing to remedy know deficiency in internal control

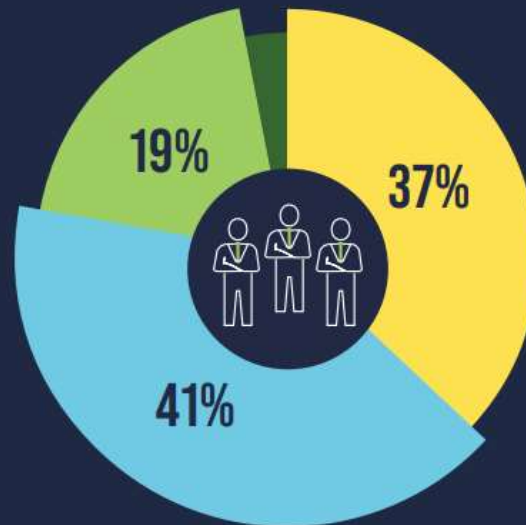
PROFILE OF A FRAUDSTER

LEVEL OF AUTHORITY



Most fraudsters were employees or managers, but **FRAUDS PERPETRATED BY OWNERS AND EXECUTIVES WERE THE COSTLIEST.**

PERCENT OF CASES



Employee Manager Owner/Executive



Fraudster

Ideal Controls Over Revenue

1. Segregation of Duties
2. Authorization and Approval
3. Documentation and Record-Keeping
4. Reconciliation and Monitoring
5. Automated Controls
6. Independent Reviews



Interactive discussion

- What could have been done differently?
- If you were the chairman of the audit committee, what would you do?



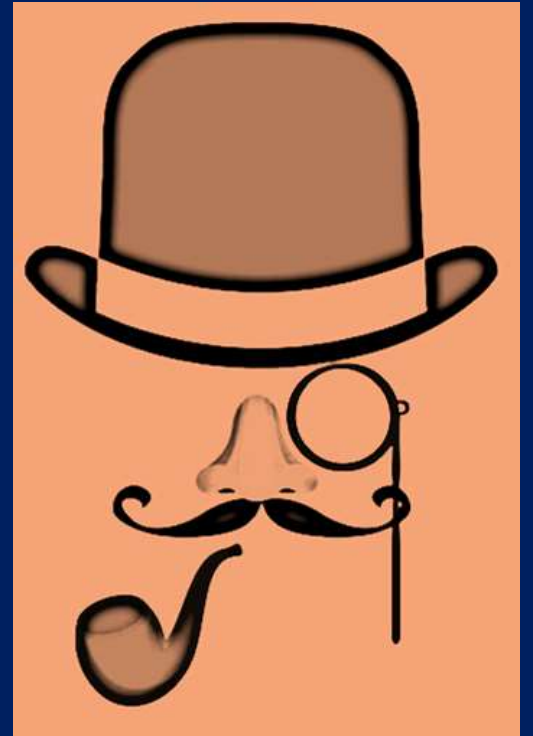
Internal Control

Ideal Controls Over Revenue

1. Segregation of Duties
2. Authorization and Approval
3. Documentation and Record-Keeping
4. Reconciliation and Monitoring
5. Automated Controls
6. Independent Reviews



Sherlock Holmes!



Audit Procedures

Understand the revenue process:

1. Customer Order Received

Control: Verify customer creditworthiness and order details.

2. Sales Order Approved

Control: Multi-level approval for large or unusual orders.

3. Goods Shipped

Control: Match shipping documents with sales orders.

4. Invoice Generated

Control: Automatically generate invoices based on shipping documents.

5. Revenue Recognized

Control: Ensure revenue is recognized only when goods are delivered and accepted by the customer.

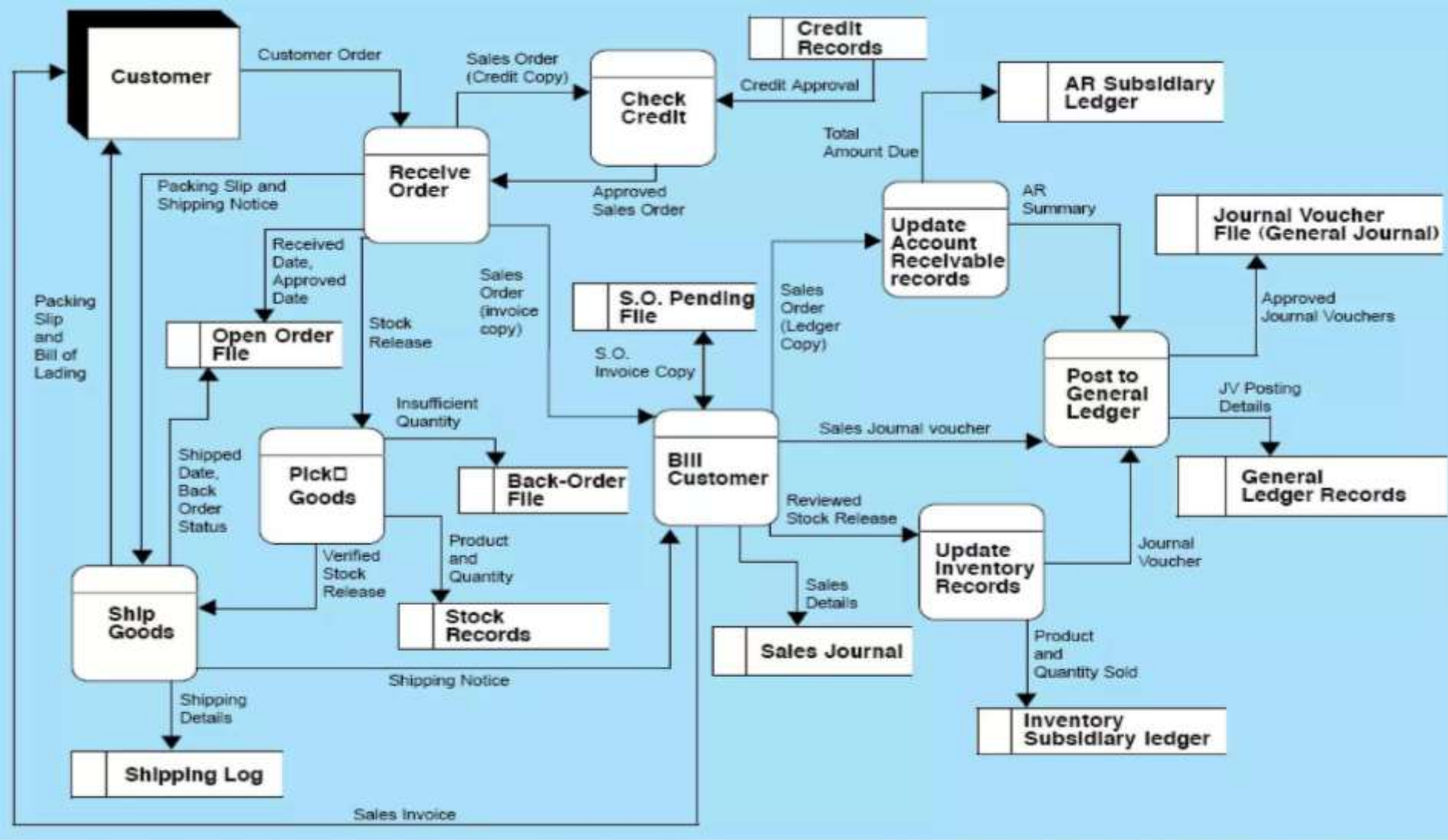
6. Payment Received

1. Control: Reconcile payments with invoices and accounts receivable.

7. Periodic Reconciliation

Control: Regularly reconcile accounts receivable with supporting documentation.

DFD of sales order process





Worst-case Scenario

Qualified Opinion

Basis for Qualified Opinion

During our audit, we identified material misstatements in the Company's revenue recognition practices. Specifically:

1. **Premature Revenue Recognition:** The Company recognized revenue of BDT25 million from sales transactions where delivery of goods had not yet occurred as of the reporting date. This practice is not in compliance with IFRS 15 (Revenue from Contracts with Customers), which requires revenue to be recognized only when control of goods is transferred to the customer.

2. **Fictitious Sales:** We identified BDT10 million in sales transactions that could not be substantiated with supporting documentation, such as signed contracts or shipping records. These transactions appear to be fictitious and were improperly recorded as revenue.

The Company has not adjusted the financial statements to correct these misstatements. Had these adjustments been made, revenue for the year ended December 31, 2022, would have been reduced by 35million and net income would have been reduced by 7 million (after tax effects).

Adverse Opinion

Basis for Adverse Opinion

During our audit, we identified material and pervasive misstatements in the Company's revenue recognition practices. Specifically:

1. **Premature Revenue Recognition:** The Company recognized revenue of BDT50 million from sales transactions where delivery of goods had not yet occurred as of the reporting date. This practice is not in compliance with IFRS 15 (Revenue from Contracts with Customers), which requires revenue to be recognized only when control of goods is transferred to the customer.
2. **Fictitious Sales:** We identified BDT20 million in sales transactions that could not be substantiated with supporting documentation, such as signed contracts or shipping records. These transactions appear to be fictitious and were improperly recorded as revenue.
3. **Related-Party Transactions:** The Company recorded BDT15 million in revenue from sales to related parties at inflated prices, which were not conducted at arm's length and do not reflect fair market value.

The cumulative effect of these misstatements is pervasive to the financial statements. Had these adjustments been made:

- Revenue for the year ended December 31, 2022, would have been reduced by BDT85 million.
- Net income would have been reduced by BDT17 million (after tax effects).
- Accounts receivable would have been reduced by BDT50 million.



What if...

Summary of Identified Misstatements - TCWG

Premature Revenue Recognition: The Company recognized revenue of BDT 0.5 million from sales transactions where delivery of goods had not yet occurred as of the reporting date. This practice is not in compliance with IFRS 15 (Revenue from Contracts with Customers), which requires revenue to be recognized only when control of goods is transferred to the customer.

Opinion

We have audited the financial statements of TechNova Inc. (the "Company"), which comprise the balance sheet as of December 31, 2022, and the related statements of income, changes in equity, and cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2022, and the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).



Materiality

“

Information is MATERIAL if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

”

The changes are effective from 1 January 2020

Key audit terms

- RMM
- Significant Risk
- Audit Assertions
- SCOT
- Audit Risk

Key financial information

Financial Data

Metric	2022	2021	2020
Revenue	BDT 250M	BDT 180M	BDT 150M
Net Income	BDT 30M	BDT 20M	BDT 15M
Total Assets	BDT 200M	BDT 160M	BDT 137M
Total Liabilities	BDT 90M	BDT 75M	BDT 60M
Total Equity	BDT 110M	BDT 85M	BDT 77M

Application of Materiality

- Planning and performing the audit
- Evaluating the effect of any identified misstatements (corrected and uncorrected) on the audit
- Evaluating the effect of any uncorrected misstatements on the financial statements
- Forming an opinion on the financial statements as a whole. [ISA 320.5, ISA 320.8, ISA 320.A1]

Determining Materiality

- Applying a reasonable measurement percentage to an appropriate benchmark
- Determining the materiality amount and evaluating the appropriateness of the amount considering the firm's parameters related to appropriate benchmarks and reasonable measurement percentages.

Professional judgement

Selecting an appropriate benchmark and determining a reasonable measurement percentage is a matter of **PROFESSIONAL JUDGEMENT.**

Determined Amount

- Determined Amount 1,000,000
- Evaluate against appropriate benchmarks

Benchmark	Percentage	Amount
Revenue	3%	300,000
Net Income	10%	1,000,000

Documentation

More extensive audit

DOCUMENTATION may also be included when determining the materiality amount and evaluating the appropriateness of the amount.



Benchmarks and measurement percentages

The following factors may affect the selection of the appropriate benchmark or measurement percentage:

- The financial statement elements and items that financial statement users focus on
- The nature of the entity, where the entity is in its life cycle, and its industry, economic, and regulatory environment
- The entity's ownership structure and the way it is financed
- The relative volatility of the benchmark. [ISA 320.A4]

Benchmarks and measurement percentages some examples

Indicative Benchmark	Indicative Measurement percentage
Profit before tax	Up to 10%
Equity/net assets (except employee benefit plans)	Up to 10%
Gross profit	Up to 4%
Earnings before interest, tax, depreciation, and amortization (EBITDA)	Up to 5%
Total revenues	Up to 3%
Total expenses	Up to 3%
Total assets	Up to 2%

The above benchmarks and respective percentages are for indicative purpose only. It is the responsibility of the firm to select and apply the benchmarks and percentages appropriately.

Selecting an appropriate benchmark

- Depends on the nature of the entity
- Depends on changing circumstances
- Not always static/ may change year to year

Selecting a reasonable measurement percentage

- Concentration of ownership or management
- Level of debt and debt arrangements
- Business environment
- the percentage will often decrease as the size and complexity of the entity increases.

Factors to consider

Factors to consider when selecting an appropriate benchmark or measurement percentage:

- financial statement elements and whether there are items on which financial statement users focus
- nature of the entity, where the entity is in its life cycle, and its industry and economic environment
- entity's ownership structure and the way it is financed
- relative volatility of the benchmark

Performance Materiality

- **LESS** than materiality
- **REDUCE PROBABILITY** of aggregate uncorrected and undetected misstatement
- a matter of **PROFESSIONAL JUDGMENT**
- should **Not Exceed 75%** of materiality

New developments

Cutting-Edge Wearable Ring Development - NovaRing

Description: NovaRing is a revolutionary wearable ring designed to monitor health data, including heart rate, blood oxygen levels, sleep patterns, and stress levels. It uses advanced AI algorithms to provide personalized health insights.

Stage of Development: The product is in the late stages of R&D but has not yet reached full maturity. Key challenges remain in miniaturizing the technology and ensuring regulatory compliance.

Market Expectations: Analysts predict that NovaRing could capture a 10% market share in the wearable health tech industry within two years of launch.

The global wearable health tech market is projected to grow to USD7.5 billion by 2025, making NovaRing a potential game-changer for TechNova.

New developments

Financial Implications

R&D Costs: TechNova has invested BDT 5 million in NovaRing over the past three years including BDT 1 million during 2022, with an additional BDT 2 million budgeted for 2023.

Revenue Projections: If successful, NovaRing could generate BDT 20 million in annual revenue by 2025.

Investor Pressure: Shareholders and venture capital partners are eager to see a return on their investment, creating significant pressure on management to deliver results.

Specific materiality!

The materiality level or levels for one or more particular classes of transactions, account balances, or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of the users taken on the basis of the financial statements.

Materiality for particular classes of transactions, account balances, or disclosures

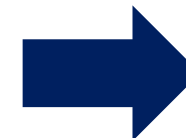
IF...

Transactions, account balances, or disclosures for which misstatements could reasonably be expected to influence the economic decisions of the financial statement users



Then...

The engagement team determines the materiality level or levels to be applied to those classes of transactions, account balances, or disclosures



This is referred to as materiality for a particular class of transactions, account balances, or disclosures

Lower Performance Materiality

- To address **RISK** within a particular class of transactions, account balance or disclosure.
- Risk material misstatement due to **FRAUD**

Recap

- **LOWER MATERIALITY** for particular classes of transactions, account balances, or disclosures
- If lower materiality is determined, it's required to calculate lower performance materiality
- **LOWER PERFORMANCE MATERIALITY** to address specific risk

Knowledge check

In which scenario is it likely that a misstatement less than materiality in each of the classes of transactions, account balances, or disclosures would influence the economic decisions of a user? Assuming that materiality is 500,000.

- The entity has an asset retirement obligation for 300,000 and if it is not fully satisfied within the terms of the executed contract, the entity could be subjected to penalties up to 2,000,000
- Management has just completed the acquisition of an entity for an amount less than 500,000, but this transaction will need to be disclosed separately in the financial statements
- The entity entered into an arrangement with a sister entity for 400,000 worth of management services

Audit Observation

The calculated depreciation charge for fixed assets during the year is Tk. 1,294,569, whereas the draft accounts show a depreciation value of Tk. 1,298,116. This results in a discrepancy of Tk. 3,547 (see Annexure A);

What would we do?

Trivial amount

- clearly inconsequential, whether taken individually or in aggregate

Check! Check!! Check again!!!

- Revision as the audit progresses
- Reassessment prior to evaluating uncorrected misstatements

Get your facts straight!

- Can we determine separate materiality amounts for different statements (for example, the statement of financial position and statement of comprehensive income)?
- Is there a threshold whereby actual financial results differ from the anticipated results resulting in a need to revise materiality?
- Why is it important to reassess materiality prior to evaluating the effect of uncorrected misstatements?
- When we have a lower materiality amount for a particular class of transactions, account balance, or disclosure, do we need a lower trivial amount?
- Can materiality for a particular class of transactions, account balance, or disclosure be higher than materiality for the financial statements as a whole?



**Practice makes
perfect**



Pause & Think

What do you think?





Wrap-up



Thank you