**Fraud Risk Factors Checklist**

**Purpose:**

The fraud risk factors identified in this checklist are examples of such factors typically faced by auditors in a broad range of situations. Although these risk factors cover a broad range of situations, they are only examples and they may not all apply to your entity.

Separately presented in Section 1 and 2 are examples relating to the two types of fraud relevant to the auditor's consideration—that is, fraudulent financial reporting and misappropriation of assets. The order of the examples of risk factors provided is not intended to reflect their relative importance or frequency of occurrence.

Fraud factors do not necessarily indicate the existence of fraud. However, they are often present when fraud has occurred. Some of these factors will be present in entities in which specific conditions do not present a risk of material misstatement. Therefore, the auditor uses professional judgment when considering fraud risk factors individually or in combination and whether there are specific controls or circumstances that mitigate or eliminate the risk.

Refer to OAG Audit 5502 for more examples of fraud risk factors.

Assess each factor by determining if they apply to your entity.

In the Comments box:

* Summarize any particular situations facing your entity; and
* When risks factors are present, conclude on whether or not there is a risk of material misstatement due to fraud for that area and describe the planned audit response.

| **Examples of risk factors** | **Ref to working papers**  **(Yes, No or N/A)** |
| --- | --- |
| **Section 1 – Are there risk factors relating to misstatements arising from fraudulent activities?** | |
| **A) Financial stability or profitability is threatened by economic, industry or entity operating conditions** | |
| 1. The entity is vulnerable to rapid changes, such as changes in technology or interest rates; |  |
| 1. The entity has recurring negative cash flows from operations or an inability to generate cash flows from operations while reporting earnings and earnings growth; |  |
| 1. The entity has new accounting, statutory or regulatory requirements that could be a threat to the financial stability or the expected profitability. |  |
| 1. The entity has weak budgetary controls. |  |
| 1. The entity has new programs, major changes to existing programs or insufficient resources and funding allocated to programs. |  |
| Comments : | |
| **B) Excessive pressure exists for management to meet the requirements or expectations of third parties** | |
| 1. Management has difficulty meeting exchange listing requirements or debt repayment or other debt covenant requirements. |  |
| 1. Excessive pressure exists for management due to perceived or real adverse effects of reporting poor financial results on significant pending transactions, such as business combinations or contract awards. |  |
| 1. Profitability expectations of investment analysts, institutional investors, significant creditors or other external parties are unduly aggressive or unrealistic. |  |
| 1. Excessive pressure exists for management due to increased public expectations and higher than normal expectations to meet budget. |  |
| 1. There is a reduction in budget without corresponding reduction in service delivery expectations. |  |
| Comments : | |
| **C) Information available indicates that the personal financial situation of management or those charged with governance is threatened by the entity’s financial performance** | |
| 1. Significant portions of compensation is comprised of pay supplement or other incentives (pay bonuses) being contingent upon achieving aggressive targets for operating results, financial position or cash flow. |  |
| 1. Management has an aggressive attitude over financial targets and forecast for operating staff. |  |
| Comments : | |
| **D) The nature of the industry or the entity’s operations provides opportunities to engage in fraudulent financial reporting** | |
| 1. The entity conducted significant related party transactions not in the ordinary course of business. |  |
| 1. Significant related party transactions are audited by another auditor. |  |
| 1. The entity has a strong financial presence that allows the entity to dictate terms or conditions to suppliers or customers, which may result in inappropriate or non-arm’s length transactions. |  |
| 1. Assets, liabilities, revenues or expenses based on significant estimates that involve subjective judgments or uncertainties that are difficult to corroborate. |  |
| 1. There are significant, unusual or highly complex transactions, especially those close to period end, that pose difficult “substance over form” questions. |  |
| 1. The entity has use of business intermediaries for which there appears to be no clear business justification. |  |
| 1. The entity engages in circuitous fund transfers among agencies making it difficult to follow the “money trail” which tend to conceal the nature of actual fund disposition. |  |
| 1. Officials in high ranking positions who may take the opportunity to misues their authority. |  |
| Comments : | |
| **E)** **There is ineffective monitoring of management responsible for governance** | |
| 1. Management of the entity is controlled by a single person or small group without compensating controls such as efficient monitoring performed by those responsible of governance. |  |
| 1. There is ineffective oversight by those charged with governance (board of directors) over the financial reporting process and internal control. |  |
| 1. The monitoring of management is ineffective due to strong political motives, ties and loyalties or due to unstable political environment. |  |
| Comments : |  |
| **F) There is a complex or unstable organizational structure** | |
| 1. The entity has an overly complex organizational structure involving unusual legal entities, or managerial lines of authority or unjustified contracts. |  |
| 1. There is high turnover of senior management, legal counsel or those charged with governance. |  |
| 1. The entity has a large number of locations with government activities. |  |
| Comments : | |
| **G)** **Internal control components are deficient** | |
| 1. Management inadequately monitors controls, including automated controls. |  |
| 1. The entity has high turnover rates or employment of ineffective accounting, internal audit or information technology staff. |  |
| 1. There are ineffective accounting and information systems, including situations involving significant weaknesses in internal control. |  |
| 1. There is a lack of sophisticated IT-software and platforms designed for public sector specific needs. |  |
| Comments : | |
| **H)** **Management does not communicate or adequately support an appropriate attitude in regard to internal control and financial processes.** | |
| 1. There is ineffective communication, implementation, support or enforcement by management of the entity’s values or ethical standards, or communication of inappropriate values or ethical standards. |  |
| 1. Management fails to correct known significant weaknesses in internal control on a timely basis. |  |
| 1. Operations are highly decentralized and management has inadequate oversight of operations. |  |
| Comments : | |
| **I)** **Management is motivated to present fraudulent financial information** | |
| 1. There is excessive interest by management in maintaining or increasing financial results with the selection of inappropriate accounting policies. |  |
| 1. Non-financial management participates excessively in or is preoccupied with the selection of accounting policies or the determination of significant estimates. |  |
| 1. There is a practice by management of committing to achieve aggressive or unrealistic forecasts. |  |
| 1. Commitment of funds are established in order to minimize the potential of losing funding for the coming fiscal year and not in context of the needs of the entity. |  |
| 1. There is an interest by management in employing inappropriate means to minimize reported earnings for budgetary reasons. |  |
| 1. There are recurring attempts by management to justify marginal or inappropriate accounting on the basis of materiality. |  |
| 1. The management shows considerable indifference to legislative authorities and regulatory issues. |  |
| Comments : | |
| **J)** **The governance structure (e.g. board of directors, audit committee) is deficient or inefficient** | |
| 1. There are reoccurring violations of authorities and regulations and there are legal actions against the entity and its management over fraud allegations. |  |
| 1. There is low morale among senior management. |  |
| 1. There are an insufficient number of independent members on the board of directors. |  |
| 1. There is no code of conduct or a similar process to define and supervise management’s and the board of director’s ethical conduct. |  |
| Comments : | |
| **K)** **The relationship between management and the current or predecessor auditor is strained** | |
| 1. Frequent disputes with the Auditor general on accounting, auditing or reporting matters. |  |
| 1. Unreasonable demands on the audit team, such as unreasonable time constraints regarding the completion of the audit or the issuance of the auditor’s report. |  |
| 1. Formal or informal restrictions on the audit team that inappropriately limit access to people or information or the ability to communicate effectively with those charged with governance, i.e. The board of directors or its equivalent. |  |
| 1. Domineering management behaviour in dealing with the audit team, especially involving attempts to influence the scope of the auditor’s work. |  |
| 1. Management is hesitant to meet with representatives from the OAG and imposes excessive delays in communicating. |  |
| 1. Management and their staff provide audit evidence that are contradictory or unsatisfying. |  |
| Comments : | |

| **Examples of risk factors** | **Ref to working papers**  **(Yes, No or N/A)** |
| --- | --- |
| **Section 2 – Are there risk factors relating to misstatements arising from misappropriation of assets?** | |
| **A) Management or employees are motivated or pressured to misappropriate assets** | |
| 1. There are indications that personal financial obligations may create pressure on management or employees with access to cash or other assets susceptible to theft to misappropriate those assets. |  |
| 1. There are indications that adverse relationships between the entity and employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets. |  |
| Comments : | |
| **B**) **The entity has assets susceptible to misappropriation (theft)** | |
| 1. The entity has several petty cash or cash accounts. |  |
| 1. The amount in petty cash is very high. |  |
| 1. Many transactions go through petty cash. |  |
| 1. There are other assets vulnerable to misappropriation, namely: |  |
| Comments : | |
| **C) Inadequate internal control over assets to detect and prevent the susceptibility of misappropriation of those assets.** | |
| 1. Inadequate segregation of duties or independent checks. |  |
| 1. Inadequate management oversight of employees responsible for assets (for example, inadequate supervision or monitoring of remote locations). |  |
| 1. Inadequate job applicant screening of employees with access to assets. |  |
| 1. Inadequate record keeping with respect to assets. |  |
| 1. An inadequate system of authorization and approval of transactions (for example, in purchasing). |  |
| 1. Inadequate physical safeguarding of cash, investments, inventory or fixed assets. |  |
| 1. A lack of complete and timely reconciliations of assets. |  |
| 1. A lack of timely and appropriate documentation of transactions. |  |
| 1. A lack of mandatory vacations for employees performing key control functions. |  |
| Comments : | |
| **D) Inadequate management understanding of information technology** | |
| 1. Inadequate management understanding of information technology, which enables information technology employees to perpetrate a misappropriation. |  |
| 1. Inadequate access controls over automated records, including controls over and review of computer systems event logs. |  |
| Comments : | |
| **E) Management does not communicate or adequately support an appropriate attitude in regard to misappropriation of assets and rationalises fraudulent activities.** | |
| 1. There is a disregard for the need for monitoring or reducing risks related to misappropriation of assets. |  |
| 1. There is a disregard for internal control over misappropriation of assets by overriding existing controls or by failing to correct known internal control deficiencies. |  |
| 1. There are changes in behaviour or lifestyle that may indicate assets have been misappropriated. |  |
| 1. There is tolerance of petty theft. |  |
| 1. There is a belief by certain public sector officials that their level of authority justifies a lifestyle similar to private sector executives, when their agreed terms of compensation are not sufficient for such lifestyle. |  |
| 1. Public sector officials make no distinction between personal and government transactions, e.g. misuse of government credit cards. |  |
| Comments : | |