confidence swiss — Auditing builds confidence

The role of auditing in the fight against corruption

The auditor's role is to deliver an opinion as to whether the audited financial statements comply with the applicable financial reporting standards. Financial statement audits are not an anti-corruption tool, however. It is nevertheless important for the public to know that – by virtue of their independence, objectivity and professional scepticism – members of the audit profession will address any misconduct of which they become aware in the course of an ordinary audit with the board of directors and, if necessary, the general meeting. Throughout the audit process, auditors must maintain professional scepticism and consider the possibility of a management override of controls. In a limited audit, however, the auditor does not consider the risk of fraud in the company, focusing instead on the direct business risks affecting the annual financial statements.

Take-Outs 1/2

1. It is the responsibility of the board of directors and senior management to ensure that a company acts ethically.
2. In contrast, the aim of the audit of financial statements is to assess whether the annual financial statements prepared by the board of directors and senior management comply with the relevant accounting standards and correctly reflect the company's financial position.
3. An ordinary audit of annual financial statements also involves the auditor taking into account the risk of misrepresentations in the annual financial statements due to non-compliance (balance sheet manipulation, asset misappropriation etc.).

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www.confidence.swiss
www.expertsuisse.ch

Contact
info@confidence.swiss

Take-Outs 2/2

4. However, while the auditor maintains appropriate professional scepticism, a forensic approach is not taken; thus, the statutory auditor cannot be expected to identify all instances of fraud.
5. The fight against corruption in companies can only succeed through a combination of various measures. These include having:
   a. an ethical board of directors;
   b. clear control and reporting structures (including internal audit, where applicable);
   c. an ethical corporate culture;
   d. an auditor who has the full support of the board of directors and unrestricted access within the company.
6. Over and above this, the board of directors has the power to engage an external audit firm to perform additional audit tasks and identify any instances of internal fraud at the company at any time.

Intentional and unintentional errors in annual financial statements

The purpose of an audit of financial statements in the form of an "ordinary" audit is to enhance the degree of confidence among the financial statements' stakeholders. This is achieved by the auditor expressing an audit opinion stating whether the financial statements have been prepared, in all material respects, in accordance with the applicable accounting requirements. To do so, the auditor must obtain reasonable assurance that the financial statements as a whole are free of material misstatements, whether intentional or unintentional. Intentional misstatements are falsifications due to balance sheet manipulation or asset misappropriation – "wilful" actions. Unintentional errors are general mistakes, such as in the application of financial reporting standards.

Wilful actions are less likely to be identified than unintentional errors. This is due to the fact that wilful actions may involve a well thought-through and carefully organised process of concealment. This may include forgery, deliberate non-recognition of transactions or embezzlement.

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Uncovering fraud at company

Responsibility for preventing and uncovering wilful actions lies with the board member responsible for supervising the unit in question as well as the senior management. What can auditing contribute to uncovering fraudulent conduct? Although they maintain a high degree of professional scepticism, auditors do not take a forensic approach, which means that they do not start from the assumption that fraud has been committed and that evidence of irregular conduct must therefore be sought out.

In order to obtain reasonable assurance during an ordinary audit, auditors must take care to maintain professional scepticism throughout the entire audit and consider the possibility of a management override of controls.

If the auditor finds indications of breaches of the law or legal requirements, these must be addressed with the management and/or the board of directors. The auditor of the financial statements may even be obliged to report material cases to the general meeting as part of its statutory audit report. However, under the audit and professional confidentiality requirements in Switzerland, auditors are not permitted to involve law enforcement authorities.

It is not the case that every instance of corruption represents a material violation of the law with a direct impact on the annual financial statements that must therefore be reported to the general meeting. Where management reacts quickly and appropriately to corruption, it may be judged that subsequent reporting to the general meeting is not necessary.

Responsibility of the board of directors and management

Auditors cannot be expected to identify all instances of fraud in the execution of their statutory duties. The fight against corruption in companies can only succeed through a combination of various measures. These include having:

- an ethical board of directors;
- clear control and reporting structures and – depending on the company's size – an internal audit function that reports directly to the board of directors;
- an ethical corporate culture;
- an auditor who has the full support of the board of directors and unrestricted access within the company.

The bigger and more complex a company, the greater the prudential risk for the board of directors, for which reason the board would be well advised to engage an external audit firm to perform additional audit tasks to identify any instances of internal fraud at the company.

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The media is increasingly reporting cases where the points noted above do not fully apply. Auditors do not have a separate duty to uncover such misconduct. However, it is important for the public to know that – by virtue of their independence, objectivity and professional scepticism and an ethical sense of responsibility – members of the audit profession will address any misconduct of which they become aware in the course of their activities with the board of directors and, if necessary, the general meeting.

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