

AUDITOR'S RESPONSIBILITIES IN REVIEWING FRAUD AND ERRORS

Yuldasheva Saodat Khalmurzaevna

*PhD and associate professor at International School of Finance
Technology and Science, department of "Accounting"*

Abstract: The article is devoted to current issues, the auditor's responsibility when considering fraud and errors related to the organization and the industry. The auditor should get an idea of the subject's compliance with these regulations. Particular attention should be paid to laws and regulations that may affect the organization's activities.

Key words: risk assessment, ethical standards, compliance with legal requirements, economic entity, auditor's responsibility, internal standards, controls, inherent risk.

Introduction

International practice permits the current auditor of an entity to inform the auditor who has been invited to perform the audit that there are professional reasons why the auditor who has received an offer to perform the audit should decline to accept it. In doing so, the ethical standards and legal restrictions existing in each individual country should be taken into account. In addition, the current auditor should obtain the client's permission to discuss the client's affairs with the auditor who has received an offer to perform the audit.

Procedure for considering cases of fraud and error.

International Standard 240 "The Auditor's Responsibilities for Considering Fraud and Error During an Audit of Financial Statements" regulates the responsibilities of the auditor. The standard includes the following sections: introduction, limitations inherent in an audit, procedures performed when there is an indication of fraud or error, reporting the fact of fraud or error, refusing to conduct an audit.

The term "**fraud**" means an intentional act committed by one or more persons, whether officers or employees, of an organization or by third parties, that results in the incorrect presentation of financial statements. The following acts are considered to be fraud:

- manipulation, falsification, alteration of records or documents;
- misappropriation of assets;
- concealment or omission of transactions in records or documents;
- recording non-existent transactions;
- improper application of accounting policies.

The term "**error**" refers to unintentional errors in financial reporting. The following actions are considered to be errors:

- mathematical errors or typographical errors in accounting records or data;
- omissions of facts or their incorrect interpretation;
- incorrect application of accounting policies.

The standard distinguishes between the responsibilities of management and the auditor in preventing and detecting fraud and error.

The responsibility for preventing and detecting fraud and errors rests with the management of the organization. The management of the organization is obliged to organize and ensure the effective operation of accounting and internal control systems. However, these systems cannot completely eliminate the possibility of fraud and errors.

The auditor is not responsible for preventing fraud and errors. However, conducting an annual audit helps prevent such facts.

In the process of planning and conducting an audit, the auditor must assess the risk of material misstatement of the financial statements as a result of fraud or error. For this purpose, he must request information from the management of the organization about all previously discovered fraud and errors.

There are a number of conditions and events that may increase the risk of fraud and errors:

- doubts about the integrity and/or competence of the organization's management;
- unusual internal and external pressures;
- unusual transactions;
- problems with obtaining sufficient and appropriate audit evidence, etc.

Examples of conditions and events that increase the risk of fraud and errors are provided in Table 1.1.

Table 1.1.

Examples of conditions or events that increase the risk of fraud or error

Type of condition or event	Characteristic of a condition or event
Doubts about the integrity and/or competence of the organization's management	<ul style="list-style-type: none"> • The organization is managed by one person, there is no board or oversight committee • The organization has a complex, ineffective corporate structure • There are significant deficiencies in the internal control system that are not being addressed • There is a high turnover of accountants, financiers, legal advisers and auditors • The accounting department is understaffed
Unusual internal and external pressure	<ul style="list-style-type: none"> • There is a decline in the industry and an increase in bankruptcies • Insufficient working capital due to a decrease in profits or rapid expansion of production • Investment in the development of the industry or expansion of the product range • Dependence of the organization on one or more types of products or customers • Financial pressure on the organization's managers or pressure on the accounting staff in connection with the preparation of financial statements in a short time

End of table. 1.1

Type of condition or event	Characteristic of a condition or event
Unusual operations	<ul style="list-style-type: none"> • Unusual transactions that have a material effect on revenues • Complex transactions or accounting methods • Related party transactions • Excessive fees for legal, advisory or agent services compared to the services rendered
Problems in obtaining sufficient and appropriate audit evidence	<ul style="list-style-type: none"> • Irregular accounting entries, large number of adjustments and corrections in accounting, off-balance sheet accounts • Insufficient documentary evidence of transactions • Inconsistencies in accounting records and third-party confirmations • Evasive or unreasonable responses from management to auditor's questions

Problems with the use of computer systems	<ul style="list-style-type: none"> • Lack of necessary information due to lack of documents or outdated programs • Changes in programs that are not documented, approved or verified • Inconsistency between computer operations and databases and financial statement figures
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The auditor's actions should be aimed at providing reasonable assurance that fraud and errors have generally been detected. To this end, appropriate audit procedures should be designed. The result of these procedures should be the collection of sufficient and appropriate audit evidence confirming:

- the absence of fraud and errors;
- the effects of fraud are properly reflected in the financial statements;
- the correction of errors.

Experience shows that the probability of detecting facts of errors is higher than the probability of detecting cases of fraud. This is due to the actions of the organization's management, which, as a rule, are aimed at concealing facts of fraud. Such actions include:

- collusion;
- forgery of documents;
- deliberate failure to reflect transactions;
- deliberate submission of incorrect information to the auditor.

When considering fraud and error, the limitations inherent in an audit apply: there is an inherent risk of not detecting a material misstatement of the financial statements arising from fraud. This also applies to errors, but to a lesser extent. Detection risk is not related to compliance with audit policies and procedures. Compliance with the policies and procedures is evidenced by the adequacy of the audit procedures and the conformity of the auditor's report with the established requirements.

In general, the auditor should plan and perform the audit with a attitude of professional skepticism. This means that conditions and events may be identified that indicate the presence of fraud and error.

Having well-functioning accounting and internal control systems reduces the likelihood of fraud and errors. However, internal control systems are not always effective. Moreover, accounting and internal control systems may not be effective against fraud committed by the organization's management or by collusion between employees. Sometimes, managers at a certain level deliberately ignore control procedures that could prevent fraud by other employees of the organization. For example, they may order subordinates to incorrectly record transactions, hide them, or conceal information.

To detect fraud or errors that have a material effect on the financial statements, the auditor must perform appropriate modified or additional procedures. The extent of such procedures depends on:

- the type of fraud or error;
- the likelihood of their existence;
- the degree of significance of the impact of fraud or error on the financial statements.

Modified or additional procedures may enable the auditor to confirm or refute fraud or error. If the auditor's suspicions of such facts have not been refuted, the auditor should discuss the matter with the organization's management. In addition, the auditor should analyze the fraud and error facts from the point of view of their reflection and correction in the financial statements, and assess the possible consequences for the auditor's report.

The implications of fraud and error for the reliability of management representations should also be considered. The auditor should review the risk assessment and reliability of management representations in the following cases:

- if the internal control system does not detect fraud or error;
- if fraud or error is not reflected in management representations.

The auditor may report fraud and error:

- the organization's management;
- users of the auditor's report on the financial statements;
- regulatory authorities and law enforcement agencies.

The auditor must report fraud and errors to the organization's management in two cases:

- if there is a suspicion that fraud has been committed, even if its consequences are not material to the financial statements;
- if fraud or a material error exists.

The standard specifies that it is appropriate for the auditor to inform the managers occupying a higher position in the organizational structure of the economic entity. If persons responsible for the general management of the entity's activities are involved in the commission of fraud, the auditor seeks advice from a lawyer to coordinate his actions.

The auditor must express a conditionally positive or negative opinion to users of financial statements. The auditor's report reflects:

- the materiality of the effect of fraud or error on the financial statements;
- the improper recognition or correction of fraud or error in the financial statements.

If the auditor is limited in obtaining sufficient and appropriate audit evidence, the auditor should express a qualified opinion or disclaim an opinion on the financial statements based on a scope limitation.

The auditor may report fraud or error to regulators and law enforcement agencies under certain circumstances. These circumstances relate to compliance with law and court orders. In such situations, the auditor may consult with legal counsel.

The auditor may decide to disengage from the audit if the entity fails to take the corrective action for the fraud that the auditor believes is necessary in the circumstances, even if the effects of the fraud are not material to the financial statements. One reason that may influence the auditor's decision is if the entity's senior management is suspected of engaging in fraud, which may cast doubt on the reliability of management's representations and, accordingly, cause the auditor to decline to continue to engage with the entity.

Conclusion

The application of this standard to public sector entities has its own particularities. The nature and extent of the audit may be affected by various laws and regulations concerning the detection of fraud and error, which may limit the auditor's own professional judgment. Moreover, the use of public funds implies that fraud issues should be given greater attention. In doing so, the auditor must be more careful and consider public expectations regarding the detection of fraud.

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