**Engagement Team-Based Learning (ETBL) for American Life Insurance Company Limited (MetLife Bangladesh)**

Discussion on Fraud by team members, to challenge the status quo, and to embed the changes introduced.

**Attendees of the session:**

1. Mr. Md. Faruk Uddin Ahammed, Engagement Partner
2. Mr. Shamsur Rahman, EQCR Partner
3. Ms. Israt Jahan, Engagement Manager
4. Mr. Ranti Saha, Engagement In-charge
5. Mr. Enamul Haq Rudro, Executive
6. Mr. Hasan Shahriar Khan, Audit Senior
7. Mr. Rayhan Mahmud Khan, Senior Associate
8. Mr. Saklayen Ahmed, Associate

Date: 22 March 2022

Place: Nurul Faruk Hasan & Co., Chartered Accountants

Vertex Prominent (1st Floor), GA-16/1 Mohakhali, Dhaka-1212, Bangladesh

**Discussion# 1: Fraud theory**

**Question 1: What are the Engagement Teams’ responsibilities as auditor in relation to fraud and what key areas should we focus on to fulfil our responsibilities?**

Objectives of the ISA 240: identification of fraud

The overall objectives in relation to fraud are described as follows:

* To obtain reasonable assurance about whether the financial statements are free from material misstatement due to fraud, including:
  1. identifying and assessing the risks of material misstatement of the financial statements due to fraud;
  2. obtaining sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and
* To respond appropriately to fraud or suspected fraud identified during the audit.

To meet our fraud responsibilities, we focus on but not limited to the following areas:

1. **Exercise professional skepticism**

We must maintain professional skepticism throughout the audit and remember when performing our procedures that we are responding to the risk of fraud.

1. **Importance of the fraud briefing**

The fraud briefing is critical in terms of setting the tone for our fraud work. A well-organized and informative briefing session will help the engagement team to assess and identify risk of material misstatement area of a Company. This briefing need leadership from the partner and senior members of the engagement team. In addition, consider whether it is necessary to invite specialists and component auditors to attend the fraud briefing.

1. **Control environment**

We have to consider how seriously management and those charged with governance take their responsibility in relation to fraud. Consider the processes and controls to prevent and detect fraud and whether any deficiencies have been identified in those areas.

1. **Focus on motivations and incentives**

Our fraud work needs to focus on the motivations and incentives to commit fraud and how this would impact the financial statements. In particular, we should be thinking about how fraud might occur and how would it be committed and how could it be concealed. Those are the areas that we should focus our audit work on.

1. **Look for contradictory evidence**

Throughout the audit, we should be monitoring results and looking at analyst reports or other industry data, focusing on signs of stress (covenants, tight financing, bonus levels) and how the entity is performing compared to industry peers. If we find something in the financial statements that doesn’t make sense, we should explicitly investigate that matter. Also review whistle blowing reports and any correspondence with regulators for any relevant matters.

1. **EQCR**

Fraud should be a key area of focus for the EQCR given the engagement team’s assessment of, and response to, the risk of fraud as a significant judgement. Any fraud risks identified are significant risks.

1. **Revisit the risk assessment at the end of the audit**

As we conclude our audit, consider the need to revisit the original fraud risk assessment performed as part of planning. This is to determine whether it remains appropriate or not and whether we have identified any other matters indicating we may need to extend our audit work in relation to fraud.

1. **Reporting to management and those charged with governance**

Our audit committee report templates set out our responsibilities to fraud and the work that we have performed to meet our responsibilities. They also remind management and those charged with governance of their own responsibilities in relation to fraud.

**Question 2: What are the mandatory consultation requirements in relation to fraud?**

1. When a fraud has been identified or suspected
2. If management does not provide satisfactory information that, in fact, there is no fraud
3. We are not satisfied with legal counsel’s opinion.
4. Report to the NPPD/ARL where a fraud has been identified or suspected.

**Question 3: How do we respond to the risk of management override of controls?**

1. Test the appropriateness of manual or automated journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements, including consolidation adjustments in the preparation of group financial statements. In designing and performing audit procedures for such tests, we shall:

* Make inquiries of individuals with different levels of responsibility involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;
* Select journal entries and other adjustments made at the end of a reporting period and post-closing entries; and
* Consider the need to test journal entries and other adjustments throughout the period.

1. Review accounting estimates for biases and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud. In performing this review, the auditor shall:

* Evaluate whether the judgments and decisions made by management in making the accounting estimates included in the financial statements (even if they are individually reasonable) indicate a possible bias on the part of the entity’s management that may represent a risk of material misstatement due to fraud. If so, the auditor shall re-evaluate the accounting estimates taken as a whole; and
* Perform a retrospective review of management judgments and assumptions related to significant accounting estimates reflected in the financial statements of the prior year.

1. For significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual given the auditor’s understanding of the entity and its environment and other information obtained during the audit, the auditor shall evaluate whether the business rationale (or the lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets.

**Question 4: Why do we test journals as part of our fraud work?**

A keyway in which management could manipulate the financial statements is through the use of fraudulent journal entries and other adjustments.

Management may override controls using such techniques which include amongst others:

* Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives;
* Omitting, advancing, or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period.

As such we need to be satisfied that there is no evidence of this, hence we look for journals’ indicative of fraud.

We also need to consider other entries and adjustments made in preparing the financial statements for example:

* Adjustments recorded directly to the financial statements (“top-side entries”)
* Consolidating and eliminating adjustments
* Closing journal entries recorded at or near the end of the period (e.g., reclassifications)

Note: We may also perform work on journals as part of understanding the business processes (e.g. test of controls over journal entries/ performing D&I work), however that work is separate to our testing of journals in response to the risk of fraud.

**Question 5: How do we identify which fraud characteristics are relevant for the Company?**

Considering fraud characteristics are generic to the entity i.e., Premium collection and its recognition, Management Override which need to be considered.

During the discussion, Mr Faruk Uddin Ahammed-Engagement Partner indicates how and where the financial statements may be susceptible to fraud perpetrated and concealed by management, particularly those facilitated by fraudulent journal entries.

The key here is to consider how management could manipulate the financial statements and what pressures are they under? How is management incentivized and remunerated?

Also consider the culture of the entity. What is the tone from the top? Is there an emphasis on compliance and controls or an overriding focus on management objectives?

We would want to also consider the pressures from an industry perspective, so we also consider what pressures have been identified at other similar entities and how the entity compares to its peers. Is it performing strongly or struggling? We also need to consider the impact of COVID-19.

As part of our risk assessment procedures, we may identify fraud risk factors, such as significant pressure on management to achieve KPIs, which may indicate the accounts which are more susceptible to manipulation. Analytical procedures may also reveal unusual and unexpected relationships we may plan to include as part of our journal entry testing objectives.

As a result, we then need to consider how management would be able to manipulate the financial statements so that they could achieve the desired result i.e. what adjustments would they need to make and where.

**Question 6: What are some of the common global practice review findings in relation to fraud?**

To think about the common global practice review findings so that we have an awareness of these and can make the necessary updates on our engagement files.

Findings in relation to fraud are:

**Management’s fraud risk assessment**

* Often teams do not obtain a copy. Some teams will find that management does not prepare this document and if so then they should report this as a finding to those charged with governance.
* When this document is produced it often hasn’t been updated to include the impact of COVID-19.
* When we obtain this document, it is often filed but we do not document the impact on the risk assessment and audit plan.

**Fraud brainstorming sessions**

* The session is often too generic and not tailored to the risks of the entity.
* There is little mention of the different types of fraud schemes.
* Whilst good points may be raised in the discussion there is not the follow up to demonstrate how this links to our planned audit procedures.

**Journals testing**

* Lack of evidence for how the journal was tested for fraud. We shouldn’t reference out to other areas of testing as whilst we might have seen support for the journal, we will not have specifically considered it for fraud risk. For example, if a journal test identifies a fixed asset addition that was tested as part of our work on fixed assets, we still need to consider why the journal was selected. If we say, “the journal was selected because the credit was to an unusual balance”, we cannot presume that the fraud aspect was covered in our additions testing as the likelihood is that we wouldn’t have looked at the other side of the entry when testing additions.
* Insufficient testing on financial statement level journals that are posted after the initial trial balance.
* Rationale for why certain fraud tests were selected/excluded is not clearly documented and linked to planning conclusions. For example, the entity may have a cash sweeping arrangement which means that large round numbers of cash are transferred regularly. We may determine that the ‘round numbers’ parameter doesn’t apply to such movements, but we should clearly document our rationale and still consider it for other transactions.

**Discussion# 2: Practical application**

The purpose of this session is to follow on from the theory covered in the Discussion# 1: Fraud theory and to practically apply this theory to the company.

**Question 1:** Who do we currently hold fraud discussions with and who are we going speak with (both inside and outside of the finance function) that we haven’t spoken with previously?

We have planned to discuss with Risk and Compliance department and Deputy Managing Director (CFO) since those charged with governance are centrally situated in USA.

As this is an insurance company, so we must hold discussion with outside the finance team like claims, reinsurance, and underwriting team, etc. Other than these teams, we will hold discussion with IT department as the entity is trying to establish its IT sector.

We will make inquiries with the members relating to financial reporting process with Chief Financial Officer (CFO) and Executive Vice President–Accounts & Finance.

**Question 2:** What drives management remuneration and how would this influence their incentives to manipulate the financial statements?

The purpose of this question is for the team to consider the fraud risks specific to the entity and how fraud could be perpetrated.

While discussing with Management of the company, we tried to understand what incentives are allowed to the management (e.g., what bonus targets are based on) where management may be more likely to post fraudulent journals to meet those targets. From our review, we did not find anything like this. There is no incentive for management to manipulate Financial statements. Some finance people are assessed on the basis timely reporting and timely closure of external audit. But the company usually get relaxed timeline to close the audit.

We considered the impact of COVID-19 at the entity. Has this had a significant impact on results which may incentivize fraudulent entries to meet these targets? Are there any other COVID-19 related impacts that you are aware of at the entity which may influence journal entries?

We discussed with the management on the impact of COVID19 and did not find any activities that were related to getting incentives.

**Question 3:** What KPIs are we already aware of and what sources of information will we use this year to identify other potential KPIs?

We are aware of that marketing employees and agents are getting incentive bonus based on premium collection and new policy underwritten by them. This is governed by policy. We have checked the bonus payment and find the transactions are within normal course of business. This year we will inquire HR and Risk Dept. about other KPIs of the company.

**Question 4:** What are the key dates within the financial close and reporting process over which we will track KPIs?

The company usually needs to close their books of accounts by January and within six months, financial statements need to be finalized. We need to review the closing FS for the purpose of KPIs.

**Question 5:** Using the prior year fraud brainstorming agenda, how can we tailor this session for the current year and ensure participation from all team members?

Last year ET also a dialogue for fraud brainstorming session which was led by Engagement Partner and 3 of the team members were involved with the discussion. Last year it was well enough. For the current year, we arranged a robust brainstorming session at the beginning of the audit.

**Question 6:** Are there any changes to the fraud risk factors of the entity, our understanding of KPIs or journal selection criteria we should consider for the fraud briefing / brainstorming?

This is a reminder that the fraud risk factors, and our understanding of the entity should be driving our journal entry selection criteria. There was no change in fraud risk factors in the current year. Hence our JE testing was similar like last year.

**Closing**

We have planned to perform fraud inquiry this year with Internal Audit dept. and Risk & Compliance dept. We have also nominated one ET member for including the ‘ETBL’ files and documentation within the audit files.

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