

# Shadow Investigations

SCCE

São Paulo - Regional Compliance & Ethics Conference

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## Agenda

- What is auditing?
- What is expected from the company?
- What is the role of the auditor?
- Independence
- Fraud Allegations: What is expected from the Company?
- Fraud impacts on the financial statements
- Shadow Investigation

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## What is auditing?

- It is an exam of the company's financial statements in order to determine its accuracy and compliance with applicable rules (IFRS, GAAP, etc);
- An audit is a *reasonable* not absolute assurance on the reliability of the financial statements;
- In order to achieve this, an audit plan is created and executed considering, among others, the company profile and industry, risks, internal controls;
- The audit report is an opinion on the accuracy and compliance of the financial statements presented by the company.

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## What is expected from the company?

- The company should prepare financial statements;
- The financial statements reflects the company's financial status and performance;
- Management should adopt sound accounting policies;
- Management should establish and maintain an internal control environment that will support the accuracy of their statements;
- Management should make a **fair** presentation about the accuracy and quality of the financial statement and the internal controls surrounding it.

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## What is the role of the auditor?

- Plan and perform the audit to obtain an assurance about the financial statements;
- Given the nature of the audit evidence and the characteristics of fraud, the auditor is expected to obtain a reasonable not absolute assurance that material misstatements were detected;
- The auditor is not expected to have a reasonable plan to identify misstatements which are not material to the financial statements;
- Express an opinion on the financial statements that were audited.

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## Independence

- Independence in mental attitude is expected to be maintained during the audit;
- Maintaining an appearance of independence is as important as being independent;
- This means that no bias with respect to the client should exist, this includes, but it is not limited to:
  - Financial independence;
  - No personal or professional ties with the company and relevant employees;
  - Financial interests;
  - Other conflicts of interests.

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## Fraud Allegations: What is expected from the Company?

- It is the responsibility of the company to perform an *independent* investigation to identify the validity of the allegations.
- The purpose of the investigation is to allow the company to understand what happened and take appropriate managerial actions;
- The independent investigation team should have the technical skills necessary to define an appropriate investigation plan and to execute it;
- The investigation plan should be comprehensive, covering all the allegations and exhausting the information sources;
- The investigation results should be factual and should aim to identify at least the following:
  - Who did it?
  - How it was done?
  - What is the financial impact?
  - When did it happened?

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## Fraud Impacts on Financial Statements

The main areas of impact in the financial statements are the following:

- **People:** Who from management and the certifiers for the audit process were involved in the fraud?
- **Books and Records:** How the facts uncovered in the investigation affects the amounts booked in the financial statements?
- **Internal Controls:** Is there any failure or need for improvement in the design and effectiveness of the controls supporting the financial statements?

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## Shadow Investigation

- The external auditor expect to be made by the company of any investigation that can affect the financial statements;
- The auditor will engage its Forensics team so it can assess, at a minimum the following:
  - Allegations;
  - Scope of the investigation;
  - Independence of the Investigation Team;
  - Capabilities of the Investigation Team.
- The Shadow Process is usually not included in the audit budget and additional fees will be required.

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## Shadow Investigation (cont.)

- The results of this assessment will be a Shadow plan that will be followed by the Shadow team.
- The Shadow Plan is not usually shared with the company or the Investigation Team as it is part of the audit procedure;
- The Shadow Team does not execute investigation activities;
- Recommendations can made by the Shadow Team to the Investigation Team during the shadow process.

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## Shadow Investigation (cont.)

- In addition to the initial assessment, the Shadow Plan can contain the following activities (not an exhaustive list):
  - Custodian list;
  - Keyword list;
  - e-Discovery;
  - Computer Forensics;
  - Financial Analysis;
  - Document Review;
  - Background Checks
- The main goal of those activities is to (i) verify the accuracy of the procedure and (ii) understand the results and how they impact the audit;
- Finally, the analysis of the Shadow team will be documented in a audit memorandum which will be used by the audit partner to issue its audit opinion.

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Questions?

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