

What the financial statements say – or not - about fraud and corruption

There is a view that the financial statements report on fraud and corruption and that there will be a line item in the financial statements or notes saying “Fraudulent and/or corrupt activities”. There is also a view that the disclosure of items such as “irregular expenditure” always equates to fraudulent or corrupt activities.

Can financial statements aid in the fight against fraud and corruption?

To respond to the first idea that the financial statements will highlight fraud and corruption in a well labelled line item or disclosure, the answer is probably “no”. There is no specific Standard of GRAP that deals with the reporting of fraud and corrupt activities, transactions or balances.

The requirements of the Standards of GRAP are designed to report information to a wide range of users - those who provide resources to the entity, and those who rely on an entity’s services - to enable them to hold entities accountable and to make decisions. While the financial statements do not actively seek to identify fraud and corruption, the information in the financial statements can be used to identify trends and to predict certain outcomes. If there are anomalies or inconsistencies in the information based on users’ expectations, this allows users an opportunity to interrogate and investigate the underlying information. While not all inconsistencies and anomalies are related to fraud and corruption, they may warrant more attention.

It is also possible that accounting policy choices, along with the presentation and disclosure of information, can be used to hide fraud and corruption. Preparers and users should be vigilant and interrogate changes to accounting policies along with what information is disclosed and how it is presented. As an example, a person in an organisation may recommend changes to the accounting policy on provisions to reduce liabilities in the financial statements. This could be to achieve an individual/organisational performance target to reduce liabilities. Using accounting to achieve a specific outcome is always worth interrogating.

GRAP 1 on *Presentation of Financial Statements* indicates that information not specifically required by the Standards of GRAP should be disclosed to enable users to understand the impact of particular transactions, other events and conditions on the entity’s financial position and financial performance. Judgement should be exercised by preparers to assess whether or what information related to fraud and corruption is required in the financial statements, and/or whether presentation elsewhere in the annual report may be more appropriate.

Does irregular expenditure always mean fraud and corruption?

Irregular expenditure, what it means and its disclosure in the financial statements, is governed by the requirements of the Municipal Finance Management Act and the Public Finance Management Act and their respective Regulations. Irregular expenditure does not always equate to fraud and corruption as irregular expenditure relates to non-compliance with the procurement requirements, which could result for various reasons. Irregular expenditure also does not mean that the financial statements were not prepared in compliance with the Standards of GRAP.

While preparers may be well versed with what irregular expenditure means and how it arises, users of the financial statements may not. It is important to educate users each year on what irregular expenditure and other legal disclosures mean – particularly in the context of fraud and corruption.

As a professional accountant, what is your role?

Professional accountants subscribe to a Code of Ethics and Conduct. This means that when professional accountants prepare financial statements, they are required to apply the same ethical principles and conduct as with any other decision. When financial statements are prepared by professional accountants, by applying professional ethics, financial statements go a long way to producing credible, transparent information, that can aid anti-corruption and anti-fraud initiatives.

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The views expressed in this article are those of the author and are not official positions of the ASB or the Board.