FRAUD RISK FACTORS CHECKLIST
(Source: New AU Section 240, Appendix A)

RECOGNIZING RISK FACTORS THAT SHOULD GET YOUR ATTENTION

How to use the checklist:

1. Review this checklist towards end on an engagement with all profession staff that worked on engagement.
2. Each "Yes" answer identifies an area that may require attention.

PART 1
RISK FACTORS RELATING TO MISSTATEMENTS ARISING FROM FRAUDULENT FINANCIAL REPORTING

		Does Risk Factor Exist?		
Ref.	**Question (Note: each "yes" answer identifies a potential problem!)**	Yes	No	N/A
INCENTIVES AND PRESSURES				
Is financial stability or profitability threatened by economic, industry, or entity operating conditions, such as (or as indicated by) the following:				
1.	High degree of competition or market saturation, accompanied by declining margins?			
2.	High vulnerability to rapid changes, such as changes in technology, product obsolescence, or interest rates?			
3.	Significant declines in customer demand and increasing business failures in either the industry or overall economy?			
4.	Operating losses making the threat of bankruptcy, foreclosure, or hostile takeover imminent?			
5.	Recurring negative cash flows from operations or an inability to generate cash flows from operations while reporting earnings and earnings growth?			
6.	Rapid growth or unusual profitability especially compared to that of other companies in the same industry?			
7.	New accounting, statutory, or regulatory requirements?			
Does excessive pressure exist for management to meet the requirements or expectations of third parties due to the following:				
8.	Profitability or trend level expectations of investment analysts, institutional investors, significant creditors, or other external parties (particularly expectations that are unduly aggressive or unrealistic), including expectations created by management in, for example, overly optimistic press releases or annual report messages?			
9.	Need to obtain additional debt or equity financing to stay competitive—including financing of major research and development or capital expenditures?			
10.	Need to meet exchange listing requirements or debt repayment or other debt covenant requirements			
11.	Need to avoid reporting poor financial results because of significant pending transactions, such as business combinations or contract awards?			
12.	A need to achieve financial targets required in bond covenants?			
13.	Pressure for management to meet the expectations of legislative or oversight bodies or to achieve political outcomes, or both?			
Does available information indicate that the personal financial situation of management or those charged with governance is threatened by the entity's financial performance arising from the following:				
14.	Significant financial interests in the entity?			
15.	Significant portions of their compensation (for example, bonuses, stock options, and earn-out arrangements) being contingent upon achieving aggressive targets for stock price, operating results, financial position, or cash flow?			
16.	Personal guarantees of debts of the entity?			
17.	Management or operating personnel are under excessive pressure to meet financial targets established by those charged with governance, including sales or profitability incentive goals?			

Ref.	Question (Note: each “yes” answer identifies a potential problem!)	Does Risk Factor Exist? Yes	No	N/A
OPPORTUNITIES				
Does the nature of the industry or the entity’s operations provides opportunities to engage in fraudulent financial reporting that can arise from the following:				
18.	Significant related-party transactions not in the ordinary course of business or with related entities not audited or audited by another firm?			
19.	A strong financial presence or ability to dominate a certain industry sector that allows the entity to dictate terms or conditions to suppliers or customers that may result in inappropriate or non-arm’s-length transactions?			
20.	Assets, liabilities, revenues, or expenses based on significant estimates that involve subjective judgments or uncertainties that are difficult to corroborate?			
21.	Significant, unusual, or highly complex transactions, especially those close to period end that pose difficult “substance over form” questions?			
22.	Significant operations located or conducted across jurisdictional borders where differing business environments and regulations exist?			
23.	Use of business intermediaries for which there appears to be no clear business justification?			
24.	Significant bank accounts or subsidiary or branch operations in tax-haven jurisdictions for which there appears to be no clear business justification?			
Is the monitoring of management not effective as a result of the following:				
25.	Domination of management by a single person or small group (in a nonowner-managed business) without compensating controls?			
26.	Oversight by those charged with governance over the financial reporting process and internal control is not effective?			
Is the organizational structure complex or unstable, as evidenced by the following:				
27.	Difficulty in determining the organization or individuals that have controlling interest in the entity?			
28.	Overly complex organizational structure involving unusual legal entities or managerial lines of authority?			
29.	High turnover of senior management, legal counsel, or those charged with governance?			
Are the internal control components deficient as a result of the following:				
30.	Inadequate monitoring of controls, including automated controls and controls over interim financial reporting (when external reporting is required)?			
31.	High turnover rates or employment of accounting, internal audit, or IT staff who are not effective?			
32.	Weak controls over budget preparation and development and compliance with law or regulation?			
ATTITUDES AND RATIONALIZATIONS				
33.	Is the communication, implementation, support, or enforcement of the entity’s values or ethical standards by management not effective or is there a communication of inappropriate values or ethical standards?			
34.	Is there excessive participation in or preoccupation with the selection of accounting policies or the determination of significant estimates by “non-financial management”?			
35.	Is there a known history of violations of securities laws or other law or regulation, or claims against the entity, its senior management, or those charged with governance alleging fraud or violations of law or regulation?			
36.	Is there excessive interest by management in maintaining or increasing the entity’s stock price or earnings trend?			
37.	Is there a practice by management of committing to analysts, creditors, and other third parties the ability to achieve aggressive or unrealistic forecasts?			

		Does Risk Factor Exist?		
Ref.	**Question (Note: each “yes” answer identifies a potential problem!)**	Yes	No	N/A
ATTITUDES AND RATIONALIZATIONS				
38.	Is management failing to remedy known significant deficiencies or material weaknesses in internal control on a timely basis?			
39.	Is there an interest by management in employing inappropriate means to minimize reported earnings for tax-motivated reasons?			
40.	Is there low morale among senior management?			
41.	Is there a dispute between shareholders in a closely held entity?			
42.	Are there recurring attempts by management to justify marginal or inappropriate accounting on the basis of materiality?			
A strained relationship between management and the current or predecessor auditor, as exhibited by the following:				
43.	Are there frequent disputes with the current or predecessor auditor on accounting, auditing, or reporting matters?			
44.	Are there unreasonable demands on the auditor, such as unrealistic time constraints regarding the completion of the audit or the issuance of the auditor’s report?			
45.	Are there restrictions on the auditor that inappropriately limit access to people or information or the ability to communicate effectively with those charged with governance?			
46.	Is there a domineering management behavior in dealing with the auditor, especially involving attempts to influence the scope of the auditor’s work or the selection or continuance of personnel assigned to or consulted on the audit engagement?			

PART 2
RISK FACTORS ARISING FROM MISSTATEMENTS ARISING FROM MISAPPROPRIATION OF ASSETS

Risk factors that relate to misstatements arising from misappropriation of assets are also classified according to the three conditions generally present when fraud exists: incentives and pressures, opportunities, and attitudes and rationalization. Some of the risk factors related to misstatements arising from fraudulent financial reporting also may be present when misstatements arising from misappropriation of assets occur. For example, ineffective monitoring of management and other deficiencies in internal control that are not effective may be present when misstatements due to either fraudulent financial reporting or misappropriation of assets exist.

		Does Risk Factor Exist?		
Ref.	**Question (Note: each "yes" answer identifies a potential problem!)**	Yes	No	N/A
INCENTIVES AND PRESSURES				
1.	Personal financial obligations may create pressure on management or employees with access to cash or other assets susceptible to theft to misappropriate those assets. Have any such personal financial obligations come to light?			
Adverse relationships between the entity and employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets. Do any of the following situations that could create adverse relationships exist:				
2.	Known or anticipated future employee layoffs?			
3.	Recent or anticipated changes to employee compensation or benefit plans?			
4.	Promotions, compensation, or other rewards inconsistent with expectations?			
OPPORTUNITIES				
Certain characteristics or circumstances may increase the susceptibility of assets to misappropriation. For example, opportunities to misappropriate assets increase when the following exist				
5.	Large amounts of cash on hand or processed?			
6.	Inventory items that are small in size, of high value, or in high demand?			
7.	Easily convertible assets, such as bearer bonds, diamonds, or computer chips?			
8.	Fixed assets that are small in size, marketable, or lack observable identification of ownership?			
Inadequate internal control over assets may increase the susceptibility of misappropriation of t hose assets. For example, misappropriation of assets may occur because the following exist:				
9.	Inadequate segregation of duties or independent checks?			
10.	Inadequate oversight of senior management expenditures, such as travel and other reimbursements?			
11.	Inadequate management oversight of employees responsible for assets (for example, inadequate supervision or monitoring of remote locations)?			
12.	Inadequate job applicant screening of employees with access to assets?			
13.	Inadequate record keeping with respect to assets?			
14.	Inadequate system of authorization and approval of transactions (for example, in purchasing)?			
15.	Inadequate physical safeguards over cash, investments, inventory, or fixed assets?			
16.	Lack of complete and timely reconciliations of assets?			
17.	Lack of timely and appropriate documentation of transactions (for example, credits for merchandise returns)?			
18.	Lack of mandatory vacations for employees performing key control functions?			
19.	Inadequate management understanding of IT, which enables IT employees to perpetrate a misappropriation?			
20	Inadequate access controls over automated records, including controls over and review of computer systems event logs?			

		Does Risk Factor Exist?		
Ref.	**Question (Note: each “yes” answer identifies a potential problem!)**	Yes	No	N/A
ATTITUDES AND RATIONALIZATIONS				
21.	Is there a disregard for the need for monitoring or reducing risks related to misappropriations of assets?			
22.	Is there a disregard for internal control over misappropriation of assets by overriding existing controls or by failing to take appropriate remedial action on known deficiencies in internal control?			
23.	Is there behavior indicating displeasure or dissatisfaction with the entity or its treatment of the employee?			
24.	Is there changes in behavior or lifestyle that may indicate assets have been misappropriated?			
25.	The belief by management that their level of authority justifies a certain level of compensation and personal privileges?			
26.	Is there a tolerance of petty theft?			