
The Impact of the COVID-19 Pandemic on the Increased Risk of Fraud during Auditing Activities

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Abstract: The article discusses the issues related to the increased risk of fraud in business units during the COVID-19 pandemic. The aim of the article was to point out the impact of the pandemic on areas that may be exposed to the embellishment of the presented financial data, as well as to show the increased risk during the audit of the financial statement, which must be taken into account by the statutory auditor when performing the financial audit. Possible solutions were identified, also recommended by the Polish regulator, that may help to sensitise the financial and accounting services to the emergence of fraud in enterprises, and in which areas increased caution should be exercised in the analysis of the presented financial data. It was also pointed out how important a role auditors have in building public trust as ethical leaders. The research methods used in the article were a review of source documents and materials issued by international organizations.

Keywords: financial audit, fraud, audit of financial statements, COVID-19.

1. Introduction

Currently, the world is experiencing difficulties in doing business due to the COVID-19 pandemic. Supply disruptions from global markets, job losses, problems in continuing operations, personal or organizational financial difficulties are the daily reality of people all over the world. Due to the pressures and uncertainties that shape the current reality, business units are looking for ways to continue their operations, maintain employment stability, and achieve economic growth in the long term. These actions may contribute to the search for illegal or fraudulent solutions. The circumstances created by the pandemic may give rise to new opportunities to commit fraud (Internet 1, 2020), which, given the situations, may remain undetected for

a long time and thus cause greater and more widespread financial difficulties for the victims. Yet, “severe crises can be like receding tidal waves, revealing what was hidden from view” (*Poruszanie się wśród podwyższonych ryzyk...*, 2021). This means that it is through the current crisis that such fraudulent activities that have been hidden for years can come to light.

The purpose of the article was to indicate the impact of the pandemic on various areas that may be exposed to an increased risk of fraud during auditing activities, as well as to identify possible solutions, also recommended by the Polish regulator (*Sprawozdanie finansowe w czasie pandemii COVID-19...*, 2020), that can help sensitise financial and accounting services to the emergence of fraud in a business entity. With the adoption by the National Council of Statutory Auditors (*Uchwała z dnia 25 marca...*, 2019) of a resolution to introduce a new and improved Code of Ethics for Statutory Auditors in the language of the International Code of Ethics for Professional Accountants, auditors have a tool with which they can play a guiding ethical role in minimising the extent of fraud. They can also help to signal the appearance of attempted fraud or fraud that has already taken place and to respond appropriately, seeking to reduce the impact of such actions on individual business entities.

2. Risk of fraud

One definition of ‘fraud’ states that it is an action undertaken deliberately to obtain an advantage but at a loss to third parties (Internet 8, 2020). It can occur in an enterprise at any level of employment, regardless of position. It can also be collusion between persons within an enterprise or involving a third party outside the entity (Internet 2, 2020). Procedures for estimating the risk of fraud should consider three areas that may convey information that manipulation may have occurred within an enterprise. These are called the ‘fraud triangle’ and are presented in Figure 1.

The first area shown in Figure 1 is the perception by managers or employees of real or perceived pressure or encouragement that can provide an opportunity to commit fraud. Another is justifying and explaining to oneself a fraud that has not really been committed because “nothing happened”, and “it doesn’t affect my work that much”. Then the last area, which is most strongly felt nowadays, is the emergence of circumstances that are conducive to committing a fraudulent act (Hołda, 2020, pp. 48-51).

The COVID-19 pandemic has a negative impact on many areas of life and work of individuals and whole organizations (Internet 1, 2020). Businesses are experiencing many difficulties because of it, from financial distress, to the suspension of operations during lockdown and other countermeasures implemented, to problems with business continuity and profitability (Chrostowska & Koleśnik, 2021, pp. 9-28). The desire of businesses to counter this has created both incentives and pressures to commit fraud. “In addition, the surge in demand for PPE and prescription drugs has also created incentives for actors to exploit this demand for quick and illicit financial gain” (*Poruszanie się wśród podwyższonych ryzyk...*, 2021).

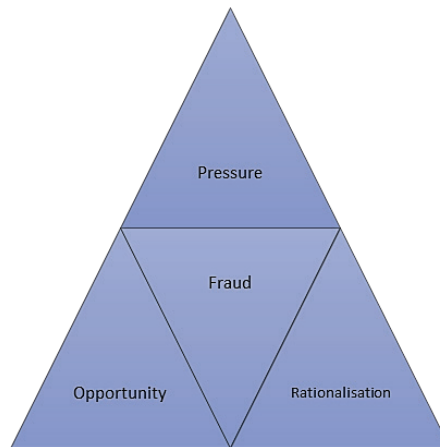


Fig. 1. The fraud triangle

Source: own elaboration based on (Wells, 2006, p. 6).

The business disruptions caused by COVID-19 and the pressures that arise under them are unprecedented. They may have affected the attitudes of management and staff operating in the business in question. There may also have been temptations to consider different ways of maintaining operations and staffing levels. However, if these ways are fraudulent, then justifying such decisions may contribute to the appearance or accumulation of unethical behaviour in the business entity (Kutera, Hołda, & Surdykowska, 2006, p. 286). This is why it is so important to realise that maintaining the highest standards of ethical behaviour nowadays is in the best interest of every company.

The COVID-19 pandemic has created circumstances that encourage the commission of fraud. The Independent Regulatory Board of Chartered Accountants (IRBCA) of South Africa examined and issued, in collaboration with the IESBA, IAASB, and the national ethics standard-setting bodies of Australia, China, Canada, the US and the UK, discerned the risks associated with the occurrence of fraud, which included the following:

- large amounts of funding are made available – all national and international organizations announced that they are making and will continue to make large financial aid packages available to offset the health and economic impact of the pandemic, which can be an attractive target for people who want to commit fraud;
- lack of focus of management operating under time pressure – the pandemic caused management to shift its efforts to crisis management, which may result in opportunities for misappropriation of assets. There was a need to make quick decisions in a short period of time, yet this may result in the neglect of the proper control and application of procedures, and in a loosening in the area of diligence and supervision;

- continuity of internal control effectiveness – management’s skills and flexibility allowed many business units to adopt alternative ways of working, such as remote working from home. However, these ways can create challenges to the effectiveness of the pre-existing, internal control environment;
- significant market opportunities – the increase in demand for personal protective equipment (PPE) and therapeutic agents created significant opportunities for unethical individuals to, among others, increase dumped prices or sell chemical agents that do not meet safety standards (*Poruszanie się wśród podwyższonych ryzyk...*, 2021).

The areas listed are not exhaustive of all the risks that emerged during the pandemic in business units. However, they do make it clear to managers and employees that a particular area may require greater attention and control. The changes that are a consequence of the current pandemic situation may affect the reliability of information, which in turn may have an impact on the conclusions to be drawn when preparing, presenting, and auditing financial statements. In the current situation, there should be all the more emphasis on auditors, together with those in the finance and accounting departments, to be inquisitive (i.e. to make reliable judgements, assess the validity and veracity of information, make informed decisions and use professional judgement) and to observe the five fundamental ethical principles set out in the Code, i.e. integrity, objectivity, professional competence and due diligence, confidentiality and professional conduct (*Uchwała z dnia 25 marca...*, 2019). This was strongly emphasised by the President of the IESBA, Dr S. Thomadakis, who stated that “now, more than ever, professional accountants must focus on the public interest and the ethical obligations incumbent on them” (*Poruszanie się wśród podwyższonych ryzyk...*, 2021).

3. Audit and increased risk of fraud

Conducting audit work in the COVID-19 environment presents unique challenges. Many business entities have shifted to working remotely, which has affected financial reporting controls and obtaining reliable audit evidence (Internet 4, 2020). Health and financial risks have made people more vulnerable and fearful of whether business units can sustain their operations and whether they will be able to cope with current circumstances (Internet 8). This also raises more opportunities for fraud, which, in turn, results, for the auditor, in an increased risk of material misstatement of the financial statements (Krajowy Standard Badania 315 (Z)..., 2019). When auditing financial statements, the auditor considers factors that can identify risks arising from fraud. Based on the data they obtain about the entity, they can develop procedures to reduce the level of these risks to one that will allow them to express an opinion on the audited area of the financial statements. For this they can also use the fraud triangle described earlier, by means of which they can make an identification in each of the three areas (Internet 8).

As IRBCA points out, the deterioration in the financial situation of business units, as well as individual employees, may have increased susceptibility to incentives or pressures to commit fraud. This may be due to new time constraints, as many employees work remotely in an attempt to reconcile home and work responsibilities, or due to downsizing, where employees have to perform additional responsibilities in addition to their duties. The pandemic raises more opportunities for incentive proposals for illicit profit (Internet 8). Employees may feel pressure from new time constraints as more workers work remotely from home and struggle to balance work with other responsibilities. “Financial difficulties may create additional pressures. Management may feel pressure to alter or distort an entity’s financial performance and position in order for it to achieve its objectives, avoid bankruptcy or foreclosure, maintain its customer base, obtain financing in the form of debt or equity, or qualify for government assistance” (*Poruszanie się wśród podwyższonych ryzyk...*, 2021). Auditors must increase their vigilance for the occurrence of such situations in business entities and focus even more strongly on the important audit area that accounting records are becoming. Similarly, they should approach the area of auditing accounting estimates because all estimates are associated with a certain degree of uncertainty, which may cause subjectivity (Internet 2). This, in turn, creates a need for judgement on the part of management, which may lead to unintentional or intentional bias on the part of management. If it is intentional, management bias is inherently deceptive (Internet 8).

In contrast, modifications to internal controls required by the pandemic situation have created more opportunities for fraudulent financial reporting or misappropriation of assets. The auditor should pay particular attention to opportunities for management to circumvent these controls (Krajowy Standard Badania 265..., 2019), if only because remote working has a significant impact of not being able to control and verify areas that were previously under control. Another possibility of fraud to emerge is changing supply chains. Other third parties emerge who are not a trusted source of supply, and as a consequence may cause an increased risk of fraud. Another area in which the auditor should look is financial assistance from government and local authorities. There may be a desire to manipulate the data shown in the financial statements in order to obtain a positive verification of an unlawful application for funding activities during a pandemic (*COVID-19: Aspekty etyczne oraz rozważania dotyczące niezależności...*, 2022). The auditor should also be aware that the audit evidence they obtain during the audit engagement may be different from what they previously obtained (Internet 1). This may be due to different sources of their acquisition, access to information, or their use, which in turn, may result in that evidence not being as useful or reliable as the evidence used previously in their work. “This may result in other challenges in relation to assessing the usefulness and reliability of information” (*COVID-19: Aspekty etyczne oraz rozważania dotyczące niezależności...*, 2022). Remote working has also increased the risk to data security as it makes business units vulnerable to *cyber-attacks* (Internet 9), and the shift of

management's attention to the more pressing needs of the business, such as financial and operational matters, rather than focusing on compliance issues, may have resulted in a weakening of internal controls. This is why it is so important for the auditor to consider significant changes that have occurred in internal control during the period, particularly in terms of fraud risk factors. Changes in control procedures may indicate an increased risk of material misstatement due to fraud, which affects the auditor's design and the conduct of further audit procedures (Internet 8). The COVID-19 pandemic has meant that fraudulent activities can be 'justified' as helping an individual survive or for personal gain due to financial deterioration. This can manifest itself in different ways and occur at different levels within the entity, from top management to rank-and-file employees. Therefore, the auditor, in performing their audit engagement, should continually review whether their procedures would allow them to identify material misstatements in this regard (Internet 6).

4. Planning and conducting the audit

When planning and performing an audit engagement, the auditor should always consider the risk that financial statements contain material misstatements due to fraud. Although the audit has been properly planned and conducted in accordance with the applicable Polish law, there is always a risk that some material misstatements will not be detected (Krajowy Standard Badania 200...). In the current situation, some risk factors for fraud may have been amplified, and while the auditor may have completed the risk identification and assessment before the audit commenced, as circumstances change, he or she should continually consider whether the previous findings remain the same or whether further redesign is needed. This may result in changes in how audit procedures are designed and performed for particular groups of transactions, account balances, or disclosures (Internet 6). During the pandemic, more often than not, the information the auditor receives may be in a different format than before. This may result in the need for additional or different procedures to determine whether the information to be used as audit evidence by the auditor is relevant and reliable and will allow the auditor to express an opinion on whether the financial statements are, in all material respects, prepared in accordance with the applicable financial reporting framework (Krajowy Standard Badania 200...).

Therefore, regular and adequate communication with management and supervisors becomes so important, as events and changes that occur are dynamic and can have a significant impact on the audit. In addition, there may be a need to modify the opinion in the auditor's report. This situation requires that the circumstances that led to such a situation be presented to those who supervise the entity (Krajowy Standard Badania 705 (Z)...).

In turn, MSB 570 Krajowy Standard Badania 570 (Z) w brzmieniu Międzynarodowego Standardu Badania 570 (Zmienionego) Kontynuacja działalności, Załącznik nr 1.24 do uchwały nr 3430/52a/2019 Krajowej Rady Biegłych Rewi-

dentów z dnia 21 marca 2019 r. sets out communication requirements when events or conditions are identified that may cast significant doubt on the entity's ability to continue as a going concern (Internet 5). In contrast, ISA 701 requires the auditor to communicate to supervisors those matters that the auditor has identified as key audit matters (Krajowy Standard Badania 701...).

To properly plan and conduct an audit of financial statements, professional scepticism becomes all the more necessary (Krajowy Standard Badania 200...). Having a critical mind, being alert to conditions that may indicate risks from fraud or contradictory audit evidence, and conducting a critical evaluation of the evidence gathered, becomes even more relevant and important (*Poruszanie się wśród podwyższonych ryzyk...*, 2021). The auditor must not forget that the current times are conducive to an increased risk of violating laws and regulations. This may be due to regulations that are often unclear and opaque, and short deadlines for submissions, but also due to accidental or intentional breaches of the law.

5. Conclusion

The impact of COVID-19 has a significant global impact on individual business entities and global markets, which are currently characterised by dynamic volatility and possible material uncertainty. In such unpredictable circumstances, auditors of affected entities should focus on the potential effects on reports used to communicate audit opinions to interested recipients (Internet 5). As the IRBCA team and its collaborating bodies rightly point out, the responsibilities caused by the COVID-19 pandemic can be overwhelming, but at the same time they can also be inspiring. This time of crisis is an opportunity for auditors to be seen and admired as ethical leaders. The skills they possess and the values they hold at work can bring about positive change. Remaining alert to threats to compliance with fundamental principles can cause a reconsideration of the safeguards and expectations of a reasonable and informed third party. Reminding others of the risks and helping to identify these areas will, in the long run, contribute to the long-term retention and success of the business units and clients that employ them (Internet 5).

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Rewizja finansowa a podwyższone ryzyko oszustwa w czasie pandemii COVID-19

Streszczenie: W artykule poruszono problematykę związaną z podwyższonym ryzykiem oszustwa w jednostkach gospodarczych w czasie pandemii COVID-19. Celem artykułu jest wskazanie wpływu pandemii na obszary, które mogą być narażone na upiększanie prezentowanych danych finansowych, a także ukazanie podwyższonego ryzyka podczas badania sprawozdania finansowego, które musi uwzględnić biegły rewident, gdy dokonuje czynności rewizji finansowej. Zaprezentowano możliwe rozwiązania, zalecane również przez polskiego regulatora, które mogą pomóc uwrażliwić służby finansowo-księgowo na pojawienie się oszustwa w jednostce gospodarczej oraz wskazać, w jakich obszarach szczególnie należy zachować wzmoczoną ostrożność w analizie przedstawionych danych finansowych. Podkreślono także, jak istotną i ważną rolę odgrywają biegli rewidenci w budowaniu zaufania społeczeństwa jako etyczni liderzy. Zastosowana w artykule metoda badawcza to przegląd dokumentów źródłowych oraz materiałów wydawanych przez międzynarodowe organizacje.

Słowa kluczowe: rewizja finansowa, oszustwo, badanie sprawozdań finansowych, COVID-19.