How Economic Trends Affect Audit Risk:
The Important Questions to Ask Right Now

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To understand the story behind each mystery, you must be able to read the narrative correctly. Fine-tune your detective skills by taking the time to analyze each room that you walk into. Sherlock was brilliant at that. He would see what was happening, observe items around, and construct a narrative that explained what had likely happened in the past. See. Observe. Deduce.

Reading the Economic Narrative
Stock Market Value
Fed Funds Rates
Unemployment Rate

Corporate Profits
Fed Financial Stress Index
### HIGHS

- **Stock market value** at record high
- **Corporate profits** at record highs
- **Personal debt** at record highs

### LOWS

- **Interest rates** at historic lows
- **Financial stress** at 25-year low
- **Unemployment rate** near 10-year low
- **Bankruptcies** near 25-year low
Economic Investment

Understanding the Risks Fraud
Economic Risk

The risk that funding will not be adequate to cover operating costs.

This risk also includes changes in outside economic factors such as economic strength and stability of significant and partner vendors, structure, and policies outside the organization’s immediate control.

Consider employment indicators, disposable income factors, and consumer debt levels.
Investment Risk

The risk that the organization would make unfavorable investment decisions—decisions that are not aligned with approved investment strategies, or that the strategy inhibits the organization from selecting the most appropriate investments.

Includes investment selection and overall compliance with established strategy.

Consider market volatility, investment selection and management, diversification, and stock market cycles.
Fraud Risks

The risk of the occurrence of illegal acts characterized by deceit, concealment, or violation of trust.

Risks associated with dollar volume, non-conformance with ethical standards, and complexity of operations make detection more difficult.
Considering the Risks:

The Important Questions to Ask Right Now
Are controls around granting of credit to and monitoring financial positions of customers sufficient considering high national debt levels?

Have controls been established to monitor value of underlying receivables collateral for impact of market fluctuation?

Are due diligence processes adequate to measure vendors’ ability to fulfill contractual obligations considering potential economic corrections?
The Important Questions to Ask Right Now about:

**Economic Risk**

- Have controls been established to monitor vendor or supplier concentration risk?

- Has the organization established sufficient controls for identifying adverse financial and funding trends on a timely basis, and have action triggers been established?

- Do the organization’s credit and financial monitoring processes adequately consider the possibility of inflated consumer confidence indicated by low rates of financial stress combined with high rates of debt?
The Important Questions to Ask Right Now about:

Investment Risk

- Have controls been established to assure that investments made by organization are consistent with strategic objectives, policy, and regulatory parameters?

- Are controls to assure adequate diversification of organization investments sufficient?

- Are controls to prevent the undue pursuit of yield sufficient given the prolonged low interest rate cycle?
The Important Questions to Ask Right Now about:

Investment Risk

- Has the organization established controls to assure that investment decisions are made only by qualified individuals?
- Is the organization conducting “what if” modeling to consider the impact of higher interest rates or market corrections?
- Have controls been established to monitor impairment and valuation decline in a downturn?
Given record stock market value and corporate profits, are controls over financial reporting sufficient to assure that competitive pressures do not exert influence over reporting decisions?

Are underwriting controls sufficient for detecting fraudulent documentation in credit requests?

Has the organization established sufficient controls for detecting fraudulent employment documentation given low unemployment levels?
The Important Questions to Ask Right Now about:

FRAUD RISK

- Are controls at risk of being relaxed due to strong profitability?
- Are controls around the establishment of new vendors and disbursing of funds sufficient to prevent employee fraud given record debt levels?
- Has the organization established sufficient controls around employee expense reports to assure that reimbursements are made only for valid business purposes?
Discussion

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