

**Instructions:** Professional standards (SAS 99) require that inquiries be made by financial statement auditors of management and others as to their knowledge of fraud, possible fraud, and fraud risk factors as they relate to material fraudulent financial reporting and misappropriation of assets. Based on the results from these inquiries and other audit procedures, risks of material misstatements resulting from fraud are assessed and appropriate audit responses are developed to limit audit risk. It is Crawford & Associates' policy to make inquiries of the following individuals at a minimum:

- Chief Executive Officer (such as City Manager or Mayor)
- Chief Financial Officer (such as Finance Director, City Clerk/Treasurer)
- Chair of Audit Committee or Equivalent ( such as Committee Chair or if no committee exists, the head of the governing body)
- Internal Auditor (if function exists)
- Any other individuals considered necessary

**Objectives:** The inquiries are to assist the auditor in identifying risks applicable to potential material fraudulent financial reporting and misappropriation of assets. In addition, the inquiries are designed to provide the auditor with knowledge of management and others of fraud that has occurred, allegations of fraud that may have occurred and information about how such frauds could be perpetrated.

**Introduction:** At the start of the inquiry or interview, you should explain the objectives of the inquiry and indicate that professional audit standards now require that such inquiries be conducted in financial statement audits. In addition, the Chief Executive Officer should be informed that similar inquiries may be made of any individuals to whom you have contact during the audit. Make sure to address any CEO concerns regarding the inquiry or interview process. Prior to asking fraud related questions of the interviewee, you should explain the types of fraud (fraudulent financial reporting and misappropriation of assets) and provide practical examples. You should also explain the concept of materiality and how it relates to the fraud risk assessment considerations. Indicate to the interviewee you are interested in any known fraud, allegations of fraud, suspicions of fraud, or potential for fraud. Also indicate that the information obtained will be kept confidential but will be followed up on and corroborate to the extent possible.

**Inquiry Questions:** The following questions are an example of the type of inquiries that should be made. These questions are intended to be a guide and not all inclusive, nor always applicable in each inquiry. *Whenever possible try to avoid phrasing questions that invite a one-word answer, such as yeas or no.* It is not necessary or desirable to document every answer provided as the interview is being conducted. It is preferable to engage the interviewee in a conversation that covers all relevant points in the list of questions.

1. Let's discuss any questions or concerns you have about the purpose of this inquiry and the type of information I am interested in learning from you related to material fraudulent financial reporting and misappropriation of assets?
2. Tell me about any known instances of financial fraud (misappropriation of assets or fraudulent reporting) within or related to the government of which you are aware? (Please explain the nature of the situation, who was involved, how it was discovered, and the current status of the matter.)
3. Tell me about any allegations of financial fraud within or related to the government of which you are aware? (Please explain the nature of the allegation, which is or was involved, if the allegation was investigated, and the current status of the matter.)
4. Tell me about any suspensions of financial fraud within or related to the government that you may have or others may have? (Please explain the nature of the suspicion, who might be involved, why you have the suspicion, and whether any follow up action has been taken related to the suspicion.)

*The next several questions relate to the potential for material fraud to occur within or related to the government.*

5. Tell me about any motives, pressures or incentives that you think are present within the entity or applicable to any employee or other individual that would contribute to material fraudulent financial reporting or misappropriation of assets?

Such motives, incentives or pressures could include:

Fraudulent Financial Reporting

Pressures to show a balanced budget and compliance with the budget?  
Pressures to show positive changes in or a specified level of fund balance?  
Financial or other incentives related to positive financial results?  
Job security pressures that may currently exist?  
Financial compliance pressures, such as meeting bond covenants?  
Pressures to report positive net income or reduced losses in business-type activities?  
Funding incentives dictated by the reporting of certain financial results?  
Grant funding and compliance pressures related to federal or state awards?

Misappropriation of Assets

Changes in lifestyle of any employees with access to material assets?

Any employees that with access to material assets that appear to be living beyond their means?

Management or employees with potential financial difficulties related to:

- Vices, such as gambling, drugs, alcohol, etc.
- Recent changes in marital status, such as divorce
- Individual or family health problems
- Personal finance problems, such as garnishments, bankruptcies, etc.

6. Tell me about any opportunities you know of for individuals to manipulate financial information or reports or to misappropriate assets. Such opportunities are normally related to the (1) inadequate design of internal controls, (2) failure to comply with designed controls, or (3) an ability to override or circumvent controls, and could include:

- Unprotected access to material assets such as cash, inventory, etc.
- Lack of segregation of duties over material assets
- Limited oversight from supervisors, key management or governing body
- Insufficient reconciliations of bank statements and other accounting records
- Management override in the handling of certain transactions or accounting entries

7. Tell me about any rationalizations you can think of that a person might use to justify a material financial fraud? Such rationalizations might include:

- Comments regarding lack of satisfaction with the job by employees
- Low or no recent employee pay increases
- Significant overtime requirements for certain employees
- Poor performance evaluations for employees with access to assets
- Recent employee demotions, reprimands, or similar disciplinary actions
- Threats of job security by governing body or management

8. If you or someone else wanted to manipulate financial information or reports within this entity, why, where and how could it be done?

9. If you or someone else wanted to misappropriate assets of this entity, why, where and how could it be done?

10. Tell me about any financial activities, transactions or types of assets, revenues or expenditures that are handled in any way outside the normal policies and procedures or just handled in a different manner than others? Examples would include:
- Certain mail directed to or only opened by a certain employee
  - Specific revenues only collected by a certain employee or collected differently than other similar revenues
  - Specific expenditures processed in a different manner than other similar
  - Certain checks written or signed differently than others
  - Certain bank accounts controlled differently than others
  - Journal entries that must be made or are made only by a certain individual
  - Adjustments to accounts that can only be made, without review, by certain individuals
11. Tell me about any employees that have access to material assets or accounting records that are not taking or have not taken extended vacations or personal leave. Tell me about you last vacation and how long you were gone from work.
12. Are you aware of any employees that have access to material assets or accounting records that are not taking or have not taken extended vacations or personal leave time?
13. Can you recall any situations in which you or anyone else were directed by a governing body member, a member of management or another employee to do anything that made you or another person feel uncomfortable or seemed suspicious? (Please describe any such incident and identify the individual making the request.)
14. How would you assess the effectiveness of the government's overall code of ethics, control environment, and disciplinary process as it relates to preventing and detecting potential fraud?
15. What is the most important thing that you can think we should know about fraud or potential fraud as it relates to this organization?
16. Are there any other concerns or issues you would like to discuss or have us address in the conduct of our audit?

*At the conclusion of the interview, thank the interviewee, give the individual your business card and contact information, and ask the following final questions:*

17. Is it okay if I contact you again in the event I need clarification of the matters we have discussed?
  
18. Would you be comfortable getting in touch with me in the future if any matters come to your attention that you think I should know about?

*Immediately following the interview, document all significant answers provided and any follow-up actions deemed necessary. (See the following page for documentation summary.)*

**Documentation of Inquiry Results:** Document below the individuals with whom fraud inquiries were conducted and any significant results that require audit responses or any follow-up action.

<b>Individual Interviewed</b>	<b>Reference to Documentation of Inquiry Results and Audit Response</b>