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The Responsibility of the External Auditor under International Standard on Auditing 240: A Comparison between Professional Ethics and Legal Obligations

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Abstract:

The role of the external auditor in preventing financial fraud under ISA 240 is examined in this essay. The auditor's ethical and legal responsibilities are balanced through the use of a descriptive-analytical technique. The results demonstrate that in order to prevent sophisticated fraud, ISA 240 necessitates a strong ethical commitment and appropriate legal settings. In the end, auditor effectiveness hinges on striking a balance between regulatory restrictions and professional freedom. The report suggests improving ethical education, harmonizing domestic legislation with global norms, and publishing useful manuals. Additionally, it suggests future study that focuses on real-world case studies and global comparative studies.

Keywords: External auditing, financial fraud, professional ethics, legal obligations, International Standard on Auditing 240.
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1. INTRODUCTION

The external auditing profession has become a fundamental pillar of the modern economy, with its function extending beyond merely verifying the accuracy of numbers to include building trust among the various parties dealing with an institution. Investors, shareholders, and regulatory bodies rely heavily on the external auditor's opinion to make their financial and economic decisions. However, this trust is not derived solely from the auditor's technical competence but also from their commitment to a set of stringent ethical rules that form the core of professional practice.

Nevertheless, the history of auditing is rife with cases of financial collapses linked to the failure of auditors to detect fraud or manipulation. This has led to a widespread debate about the limits of the external auditor's responsibility: Is their role limited to providing reasonable assurance according to professional standards, or are they also required to assume broader responsibilities of a legal and ethical nature? Here, the crucial role of International Standard on Auditing (ISA) 240 emerges, which defines the auditor's responsibility concerning fraud. Auditors must proactively design and perform audit procedures to secure sufficient, appropriate evidence. This is essential to their duty of providing reasonable assurance that the financial statements are free of material misstatements, regardless of whether they stem from fraud or unintentional error.

This issue presents intertwined dimensions between professional ethics, which require the auditor to be characterized by integrity, independence, and objectivity, and the legal obligations imposed by the regulatory environment, which may differ from one country to another. Consequently, the discussion around ISA 240 is not just a technical debate but also a philosophical, legal, and ethical one concerning the boundaries of the auditing profession in a world witnessing increasing complexity in financial fraud schemes.

Research Problem: The main research problem is:

How can the external auditor balance the requirements of professional ethics and legal obligations in the context of applying International

Standard on Auditing 240, and what are the actual limits of their responsibility in confronting cases of financial fraud?

1.1. Research Hypotheses:

- ✓ ISA 240 establishes a theoretical framework for the auditor's responsibility towards financial fraud, but it does not resolve the debate on the balance between ethical and legal obligations.
- ✓ The practical application of the standard is more influenced by the legal and regulatory environment of the profession than by its theoretical texts.
- ✓ An auditor's effectiveness is directly linked to their commitment to professional ethics and independence, as well as their adherence to all legal requirements.

1.2. Research Methodology:

This study adopts a descriptive-analytical and critical approach, based on analyzing the theoretical texts of ISA 240 and comparing them with the ethical and legal framework of the auditing profession, with reference to previous literature and studies to highlight the gap between the theoretical and practical aspects.

1.3. Objectives of the Study:

This study aims to clarify the specific responsibilities of the external auditor as defined by (ISA) 240. Additionally, the research will:

- ✓ Analyze the interrelationship between professional ethics and legal obligations in the practice of external auditing.
- ✓ Highlight the practical challenges auditors encounter when applying the standard across diverse regulatory environments.
- ✓ Provide a critical analysis to define the boundaries of the external auditor’s professional responsibility.
- ✓ Enrich the academic discourse on the future of the auditing profession, given the increasing complexity of financial fraud.

1.4. Significance of the Study:

The significance of this study lies in its shedding light on a sensitive issue related to the responsibility of the external auditor, a matter with professional, legal, and ethical dimensions. On one hand, it contributes to

enriching the theoretical literature related to ISA 240. On the other hand, it offers practical value to external auditors by clarifying the challenges associated with their work in different regulatory environments. It is also particularly important for regulatory bodies and policymakers, as its recommendations may contribute to the development of professional and legislative frameworks that enhance user confidence in financial reports and promote transparency in the markets.

2. International Standard on Auditing (ISA 240): The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

ISA 240 addresses the external auditor's responsibilities regarding fraud and deception, clarifying the difference between fraud and error so that the auditor can perform their duties. The responsibility of management and those charged with governance in an entity is to prevent and detect fraud. The auditor's responsibility is to detect material misstatements due to fraud by adopting an attitude of professional skepticism throughout the audit process. The standard starts from the important point that there is a possibility of material misstatements due to fraud and management override of controls. It also clarifies the various situations of fraud risks and how the auditor should handle each case. (Meziani, 2021, p. 83) ISA 240 mandates that auditors assess risk factors for material misstatement that signal a potential for fraud. These factors are commonly categorized into three conditions: (Al-Sabbagh & Dahdouh, 2016, p. 377)

- ✓ The presence of an incentive or pressure to commit fraud.
- ✓ The existence of a perceived opportunity to commit fraud.
- ✓ The capacity to rationalize the fraudulent behavior.

The core objectives for an auditor under ISA 240 are to: ((IAASB), 2020, p. 166)

- ✓ Identify and evaluate the risks of material misstatement in the financial statements that arise from fraud.
- ✓ Design and execute appropriate responses to obtain sufficient, suitable audit evidence for the assessed risks of fraud-related material misstatement.

- ✓ Respond effectively to any fraud or suspected fraud discovered during the course of the audit.

3. Requirements of International Standard on Auditing 240

ISA 240 focused on several procedures that the auditor must follow in assessing the risks of material misstatement resulting from fraud and responding to these risks, as well as how to report these risks to those charged with governance. These requirements are as follows:

3.1 Professional Skepticism:

ISA 200 emphasized that the auditor must plan and perform the audit with professional skepticism, taking into account the possibility that the financial statements may contain material errors or misstatements. ((IAASB), 2020, p. 87) Professional skepticism is a necessity in the auditing profession, and its absence is often a cause for the failure to detect material misstatements resulting from fraud. (Raïs & Zaibet, 2020, p. 454)

3.2 Discussion among the Engagement Team:

A discussion must be conducted among the members of the team assigned to the audit engagement at the firm, which is referred to as brainstorming. (Maddah & Saidi, 2017, p. 179)

3.3 Risk Assessment Procedures and Related Activities:

The importance of assessing the risks of material misstatement arising from fraud stems from any inadequate risk assessment process that could lead to an insufficient or ineffective allocation of audit resources. (Al-Sabbagh & Dahdouh, 2016, p. 383)

3.4 Identification and Assessment of the Risks of Material Misstatement Due to Fraud:

In accordance with ISA 315, the auditor is required to identify and assess the risks of material misstatement resulting from fraud at both the financial statement and assertion levels. This process involves the following steps: ((IAASB), 2020, p. 282)

- ✓ Assessing Fraud-Related Risks: The auditor must evaluate which types of revenue, revenue transactions, or specific assertions present risks of

fraud. This evaluation is based on the presumption that risks of fraud exist in revenue recognition.

- ✓ Treating Risks as Significant: The auditor must treat all assessed risks of material misstatement due to fraud as significant risks.

3.5 Responses to the Assessed Risks of Material Misstatement Due to Fraud: (Saudi Organization for Certified Public Accountants (SOCPA), 2020, p. 269)

When auditing, an auditor must design and perform additional procedures that directly respond to the assessed risks of material misstatement at the assertion level. The nature, timing, and extent of these procedures should be determined by the specific risks identified.

The auditor's considerations should include:

- ✓ The reasons for assessing the risk of material misstatement at both the financial statement level and the individual account balance level.
- ✓ The need to obtain more compelling or persuasive audit evidence as the auditor's risk assessment increases.

3.6 Evaluation of Audit Evidence:

If the auditor identifies a misstatement, whether material or immaterial, and has reason to believe that it is or may be the result of fraud and that management is involved, the auditor must re-evaluate the assessment of the risks of material misstatement due to fraud and its effect on the nature, timing, and extent of audit procedures to respond to the assessed risks. The auditor must consider whether circumstances or conditions indicate the possibility of collusion among employees or management when reconsidering the reliability of previously obtained evidence. (Saudi Organization for Certified Public Accountants (SOCPA), 2020, p. 146)

3.7 The Auditor's Inability to Continue the Engagement:

If the auditor concludes that it is not possible to continue performing the audit as a result of a misstatement resulting from fraud or suspected fraud, the auditor must: (Bin Moufki, 2019, p. 80)

- ✓ Assess Professional and Legal Obligations: The auditor must first consider their professional and legal duties in the given situation. This

includes determining if they are required to report to the party that appointed them, and in certain cases, to regulatory bodies.

- ✓ Evaluate Engagement Withdrawal: The auditor must then consider the possibility of withdrawing from the audit engagement.

If the auditor withdraws:

- ✓ Communicate with Leadership: The auditor is required to discuss their withdrawal and the reasons for it with the appropriate levels of management and those charged with governance (such as the board of directors or audit committee).
- ✓ Fulfill Reporting Requirements: The auditor must determine if there is a professional or legal obligation to report their withdrawal and the reasons for it to the appointing party and, potentially, to regulatory authorities.

3.8 Written Representations:

The auditor must assess the implications of fraud and material error on all aspects of the audit, with a particular focus on the reliability of representations provided by management. As noted in paragraph 39, the auditor should obtain a formal written representation from management confirming the following: (Houli, 2017, p. 344)

- ✓ cknowledgement of responsibility: Management acknowledges its responsibility for establishing, implementing, and maintaining the internal controls designed to prevent and detect fraud.
- ✓ Disclosure of risk assessment: Management has disclosed to the auditor the results of its own assessment of the risk that the financial statements could contain material misstatements due to fraud.
- ✓ Disclosure of known fraud: Management has disclosed to the auditor its knowledge of any known or suspected fraud affecting the entity, particularly involving management, employees in key internal control roles, or any other individuals whose actions could materially affect the financial statements.

3.9 Communication to Management and with Those Charged with Governance:

According to ISA 260, the external auditor is required to communicate with those charged with governance. This communication must include an overview of the planned scope and timing of the audit, as well as a discussion of the significant risks identified by the auditor. (Saudi Organization for Certified Public Accountants (SOCPA), 2020, p. 177)

3.10 Communication of Fraud to an Authority Outside the Entity:

When an auditor identifies or suspects fraud, they must determine whether law, regulation, or ethical requirements obligate them to report it to an external authority. Specifically, the auditor must assess if these rules either: ((IAASB), 2020, p. 175)

- ✓ Require the auditor to report to an appropriate authority outside of the company.
- ✓ Establish responsibilities under which reporting to an external authority is appropriate given the circumstances.

3.11 Documentation:

The auditor's documentation must include the procedures for assessing and responding to the assessed risks of material misstatement from fraud. This should also specify the nature, timing, and extent of the audit procedures and demonstrate their relationship to the identified fraud risks. (Arab & Zidane, 2018, p. 495)

4. Auditor's Procedures Upon Discovering Material Errors and Irregularities According to Algerian Legislation

Article 715 bis 13 of the Commercial Code and Article 61 of Law 10/01 state that the statutory auditor must present to the next general assembly the irregularities and errors they have noted during the performance of their duties. Additionally, the statutory auditor must report to the Public Prosecutor all discovered irregularities, transgressions, and cases of fraud in the course of performing the audit mission to clear their responsibility. It is not within their scope or jurisdiction to classify the crime or fraud committed; this falls under the jurisdiction of the Public Prosecutor, and reporting is part of the duties assigned to the statutory auditor. (Aiad, 2014, p. 4)

Accordingly, the procedures of the statutory auditor upon discovering errors

and irregularities during the performance of their duties are as follows: (Hajjaj, 2016, pp. 187-188)

4.1. Procedures Followed by the Auditor in Case of Suspicion:

The statutory auditor does not operate on verbal or written grounds that are not part of proper work procedures, as reporting pertains to actual situations that are considered evidence that can be relied upon by the court. It is not their duty to search for transgressions, but if they receive a tip or find irregularities while performing their duties, they must assess, under their own responsibility, whether to take them into account and whether they could lead to an additional audit procedure. Therefore, the statutory auditor determines the stages and procedures to be followed.

4.2. Auditor's Procedures Taking into Account Intent:

The statutory auditor must take into account the mental element, i.e., intent or its absence, and be convinced that the violation was committed intentionally or unintentionally. Given the difficulty of this matter, and in order to assess the intent of fraud, they must know whether it is an error due to inaccuracy or non-compliance with laws, or if it is a transgression that must be reported. They can also seek further procedures from the judicial authorities.

4.3. The Necessary Timing for Reporting:

There is no specific time limit; it depends on the facts. Complex and difficult-to-determine facts may take more time to assess than simple ones.

4.4. Auditor's Procedures if the Concerned Authorities Fail to Take Necessary Action on the Report:

A statutory auditor who has reported transgressions and fraud as required by law generally has no further obligation to take action if the relevant state authorities fail to follow up. The auditor's role is to identify and report such issues to the appropriate bodies, not to act as a law enforcement or judicial authority. The legal responsibility for investigating and prosecuting fraud rests with the state's judicial and regulatory authorities.

4.5. Auditor's Procedures When Informing the Audited Entity's Bodies of the Discovered Irregularities:

This does not mean they are not required to report to the Public Prosecutor. Law 10/01, under Article 61, imposes a duty on them to report all transgressions to the Public Prosecutor, in addition to informing the board of directors of the discovered transgressions. If these are not remedied, they must report them to the general assembly at its next meeting.

5. External Auditor's Responsibility and Corresponding Penalties in Algerian Legislation

The responsibility of the statutory auditor stems from the objective that led owners to contract with them. All laws and standards in the field of auditing and accounting aim to arrive at sound financial statements that reflect the true financial reality of the institution, opening the way for owners to make correct future decisions. To protect owners from the abuse or deception that some statutory auditors might resort to in collusion with the board of directors, the state has issued laws and regulations that define their responsibility. The following table summarizes the various responsibilities that the statutory auditor is subject to.

Table 01. The External Auditor's Responsibility and the Resulting Penalties

Type of Responsibility	Resulting Penalties	Legal Reference
Civil	Financial compensation for the damage caused by the auditor to the client, unless it is proven that they performed their duties with the necessary professional care.	The contract between the statutory auditor and the client; Law 10/01, Articles 61, 62.
Criminal	- Practicing the profession without being registered, or during temporary suspension: a fine of 500,000 to 2,000,000 DZD, and in case of a repeat offense, imprisonment from six months to one year and double the	Commercial Code, especially Articles 825 to 831; Law 10/01, especially Articles 62, 73, and 74; Penal Code,

	fine. - Knowingly approving incorrect information to abolish pre-emptive rights in a share subscription: imprisonment from 6 months to two years, and a fine of 20,000 to 500,000 DZD, or one of these two penalties. - Maintaining the practice of the profession despite legal incompatibility: imprisonment from two to 6 months, and a fine of 20,000 to 200,000 DZD, or one of these two penalties. - Disclosure of professional secrets: imprisonment from one to 6 months, and a fine of 500 to 5,000 DZD.	especially the amended Article 301.
Disciplinary	Warning, reprimand, temporary suspension for a maximum period of 6 months, removal from the roll.	Law 10/01, especially Article 63.

Source: (Gritli & Bouaza, 2021, p. 638)

6. Challenges and Shortcomings in the Application of International Standard on Auditing 240

Based on what we have concluded in the theoretical framework, as well as what previous studies in the field have highlighted, it is clear that International Standard on Auditing 240. despite its significant importance in guiding the external auditor towards their responsibilities in detecting fraud and financial manipulation, has remained a subject of wide debate and discussion among researchers and practitioners alike. The standard—as a reference tool—has not been immune to criticism, which has primarily focused on the limits of its practical application and its inability to encompass all forms of sophisticated financial fraud in contemporary business environments. This makes it necessary to approach the standard with a critical perspective, based on an analytical reading of what is stated

in the theoretical literature on one hand, and the outputs of applied research on the other, which is what we have sought to do in this article.

We also noted in our review of scientific texts and previous studies on the subject that the shortcomings associated with standard 240 are not limited to technical or professional aspects, but also extend to the conceptual and organizational dimensions surrounding the auditor's work. Several studies have revealed a clear gap between what the standard stipulates in its theoretical texts and what auditors face in practice when examining evidence and detecting indicators of fraud. This gap between the "required" and the "possible" has been a central theme in many academic critiques, which has prompted us to review it in detail in this part of the article, in order to contribute to shaping a more comprehensive vision of the weaknesses that hinder the effectiveness of the standard in practice.

6.1. Ambiguity in Defining the Limits of Responsibility

The standard states that the auditor must plan and perform procedures that provide them with "reasonable assurance" that the financial statements are free from material misstatement due to fraud or error. However, it does not draw clear legal boundaries for the auditor's liability in cases of failure to detect material fraud. This ambiguity creates wide room for interpretation among practitioners, judges, and the public, leading to an "expectation gap." That is, users of financial statements may believe that the auditor has a much greater ability or obligation than what the texts actually define. In practice, this results in audit firms facing extensive and inconsistent liability lawsuits across different legal systems. To mitigate this, the standard and the texts of professional bodies need clearer language that explicitly defines the scope of the obligation (what is legally and professionally expected versus what is not), and educational guidance for report users about the limits of an audit.

6.2. Procedural Focus on Detection, Not Prevention

The requirements of ISA 240 are formulated with a focus on subsequent audit procedures (substantive tests, risk assessment, etc.) rather than providing clear preventive guidance on the auditor's role in strengthening internal control systems or influencing the governance

environment to prevent fraud. The result is that the auditor often appears as a "discoverer" rather than a "deterrent factor," whereas prevention requires broader interventions that include risk management and governance. In several cases, systemic loopholes or a company's culture were a primary cause of fraud, and the auditor lacked the tools or authority to correct them. Suggestion: The standard's guidance should be enhanced to link fraud risk assessment with practical recommendations to strengthen controls, and to make communication with audit and follow-up committees more binding and clear.

6.3. Inability to Keep Pace with the Complexity of Modern Fraud Schemes

Financial fraud schemes have evolved to include the use of complex corporate structures, related-party transactions, derivative financial instruments, or manipulation of provisions and detailed accounting. The texts of the standard often remain general and do not provide advanced examples or procedures to deal with these complexities. In practice, auditors face scenarios they have not previously encountered and do not find sufficient guidance to deal with them, which increases the likelihood of failure to detect sophisticated fraud. For treatment: The standard needs application supplements or practice aids that cover modern scenarios, and the use of forensic experts or data analysis specialists as part of the audit procedure should be facilitated.

6.4. Over-reliance on Individual Professional Judgment and Inconsistency in Application

The standard grants considerable latitude for the auditor's judgment in assessing the level of risk and selecting appropriate procedures, which is inherently necessary as each engagement is unique. However, the wide margin for judgment leads to significant variations in the quality of work between different firms or even between auditors within the same firm, resulting in inconsistencies in the level of protection provided to users. This inconsistency weakens uniformity and makes it difficult for professional bodies to monitor quality. Practical recommendation: The variation should

be reduced by developing more specific implementation standards (such as standardized checklists), mandatory training programs on fraud risk assessment, and more rigorous internal and external quality reviews.

6.5. Inadequacy in Addressing the Ethical and Professional Pressures Faced by Auditors

The standard largely ignores the psychological and social dimensions of audit work: pressure to retain clients, threats of economic loss to the firm, or business relationships that may weaken independence. These pressures sometimes lead to compromises in the level of professional integrity or a reduction in the scope of testing. Without clear mechanisms to help auditors resist these pressures (whistleblower protection, policies for rotating engagement teams, etc.), the standard remains theoretical. Possible solutions include encouraging institutional professional policies to limit conflicts of interest, internal protection mechanisms for difficult decisions, and mandatory internal reports documenting pressure situations and how they were handled.

6.6. Weak Compatibility and Alignment with National Legal and Regulatory Contexts

Since ISA 240 is an international standard, it is drafted in general terms to be applicable across borders. However, the legislative reality varies significantly between countries—in terms of disclosure duties, criminal liability, the role of regulatory bodies, or the level of penalties. This creates a gap between "what the standard directs" and "what local law requires," making practical application fragmented and inconsistent. The result: auditors in countries with weak legal frameworks may find themselves without sufficient protection when taking decisive action, or vice versa. Therefore, it is essential for national accounting and auditing bodies to translate the standard into legally adapted application guidance and to coordinate with legislative authorities to ensure the alignment of roles and responsibilities.

6.7. Academic and Professional Criticisms Related to Public Expectations and the Role of Audit Committees

Researchers and professional bodies have argued that ISA 240 has contributed—unintentionally—to deepening the "expectation gap" because its wording leads the public to read it as if auditors have a stronger role in detecting and preventing fraud than is actually assigned. The standard also does not give sufficient role to the relationship between the auditor and the audit committee (or does not clearly define the duties of both parties) in fraud prevention, while audit committees can be influential bodies in preventing or detecting fraud. Furthermore, the standard's wording is criticized for not sufficiently encouraging transparency through clearer audit reports about fraud risk and the actions taken. Suggested reform: Give a broader and more specific role to the audit committee within the standard's framework, and encourage an enhanced reporting model that shows the auditor's positions on fraud risks without breaching the confidentiality of sensitive information.

6.8. Failure to Keep Pace with Technological Developments and Modern Analytical Tools

The texts of the standard have not given sufficient weight to modern tools (big data analytics, artificial intelligence, chronological record examination techniques) that have proven effective in detecting unusual patterns that may suggest fraud. Many practitioners lack methodological guidance on when and how these tools should be employed.

These tools as part of fraud testing. As a result, the audit misses the opportunity to leverage the exploratory capabilities of these technologies. Recommendation: Update the guidelines to include requirements and practices for using data analytics, and train future auditors to integrate these tools in assessing fraud risks.

7. Suggested Workable Methods for Algeria to Implement International Standard 240:

Researchers created this model in an effort to offer a workable solution to the issues related to the Algerian application of International Standard on Auditing (ISA) 240. This vision was created to offer workable and implementable mechanisms that allow Algerian institutions to adjust to

the standards' requirements and activate their role in reducing financial fraud and malpractice, taking into account the actual challenges faced by auditors, including inadequate training, weak internal control systems, organizational and legal gaps, and the field of fraud auditing.

With its many elements, this model is a potential practical study that aims to create a more rigorous and successful auditing culture based on internal reporting systems, data analysis tools, and improved collaboration between auditors and regulatory agencies. In order to improve the quality of auditing in Algeria and boost investors' and economic operators' trust in the reliability of financial statements, the researchers hope to start a professional and scientific dialogue about how to move from the theoretical part of ISA 240 to a practical reality through this suggested framework.

7.1 Creating an Institutional Fraud Detection Unit

Goal: To evaluate fraud risks, identify indicators, carry out preliminary investigations, and collaborate with the audit committee and external auditor, this specialist unit within the organization was established.

7.1.1 Structure and Function of Units

- ✓ Head of Unit/Fraud Officer: An employee with full functional independence who answers directly to the Audit Committee or the Board of Directors.
- ✓ Core Members: A data analyst or analytical specialist, and an internal auditor with forensic or criminal experience. a human resources representative and, if necessary, an internal or external legal advisor.
- ✓ Independence: To maintain objectivity, the unit does not provide reports to the financial operations division.

7.1.2 Daily/Periodic Operational Tasks

- ✓ Conduct fraud risk assessment annually or when significant changes occur in operations.
- ✓ Monitor red flags such as repeated payments to the same vendor, manual daily entries, sudden changes in vendor data.
- ✓ Coordinate with the information systems department to obtain secure access to financial databases.

- ✓ Conduct preliminary investigations (triage) and refer major cases to the external auditor or judicial authorities as needed.
- ✓ Follow up on the implementation of corrective measures and investigation recommendations.

7.1.3 Supporting Materials and Tools

- ✓ Case Management system for recording reports, observations, and procedures, and maintaining records.
- ✓ Official forms: Investigation plan, evidence log (Chain of Custody), investigation report, preliminary investigation report.

7.1.4 Detailed Implementation Manual

- ✓ Accept the Board of Directors' decision to create the unit and specify its authority. Assign a capable leader with a well-defined job description.
- ✓ Provide the unit with IT infrastructure, such as specialized access accounts and analytical tools.
- ✓ Create Standard Operating Procedures (SOPs) for reporting, preserving evidence, and conducting investigations.
- ✓ To safeguard whistleblowers and clarify the unit's mission, launch an internal awareness campaign.

7.1.5 KPIs, or key performance indicators

- ✓ The monthly total of open and closed cases.
- ✓ The initial response time for investigations (for example, 48 hours; however, this can be modified in accordance with institutional policy).
- ✓ The proportion of suggestions that were put into practice.

7.2 Implementing a System for Internal Whistleblowing

Goal: To provide legal protection against retaliation for employees or outside parties who disclose fraudulent activities.

7.2.1 Components of the System

- ✓ Reporting Channels: Secure email, encrypted electronic portal, independent phone line (if possible, third-party), and the option to send a paper report to a member of the audit committee. * Triage/Verification Mechanism: A reception team that assesses and ranks reports according to priority.

- ✓ Whistleblower Protection: A regulation that makes protection protocols clear and forbids reprisals or termination.
- ✓ Confidentiality of Processing: Only designated persons have access to reports.

7.2.2 Steps in the Process

- ✓ Issue a formal whistleblower policy that has been approved by management. Create a report reception form that has the following information: the incident's description, the evidence that is available, the persons involved, and the necessary degree of confidentiality.
- ✓ If at all possible, use a status indication to confirm that the whistleblower received the report.
- ✓ Contact the appropriate authority or arrange for an initial investigation.
- ✓ To prevent retaliation, provide the whistleblower a broad update on the investigation's progress without sharing specifics.

An example of a straightforward wording clause protecting whistleblowers would be: "No employee who reports fraudulent activities in good faith will be disciplined or fired. Retaliation of any kind will be viewed as a disciplinary infraction that could result in legal action.

7.2.3 Requirements for Technology and Security

- ✓ Encryption of messages and stored data; * Archiving/deletion policy following investigations, in accordance with data laws.
- ✓ Logs (audit trail) are accessible to report viewers.

7.2.4 Measures of Performance

- ✓ The quantity of reports per year.
- ✓ The proportion of reports that resulted in a formal inquiry.
- ✓ The degree of satisfaction of whistleblowers (if quantifiable by an anonymous survey).

7.3 Teaching Auditors How to Conduct Fraud Audits

The goal is to improve auditors' ability to identify and stop fraud by imparting both theoretical and practical skills.

7.3.1 Content of the Proposed Training Program:

- ✓ Fraud Concepts: Types of Fraud, Financial, Administrative, and External Fraud.

- ✓ ISA 240 Framework: Roles of auditors, reporting requirements, and real-world examples.
- ✓ Data Analysis Techniques: Hands-on instruction with sophisticated Excel, IDEA, and ACL tools.
- ✓ Cut-off tests and journal entries: how they are administered, with real-world examples.
- ✓ Investigative and Interviewing Skills: Managing delicate interviews, interviewing witnesses, and recording statements.
- ✓ Preparing actionable reports and chain of custody for use in criminal proceedings: Evidence Preservation and Forensic File Preparation.
- ✓ Ethics and Professional Conduct.

7.3.2 Methods of Training

- ✓ Hands-on workshops that are practical and include simulation cases (red-team activities).
- ✓ Taking part in workshops with forensic and criminal professionals and earning professional certifications (CPD).
- ✓ Training is done gradually, with a practical test at the conclusion of each level (beginner, intermediate, and advanced).

7.3.3 Monitoring and Assessment

A theoretical and practical analysis;

- ✓ A final project that involves creating a report and simulating a dishonest investigation.
- ✓ Every year, the curriculum is improved, and errors are tracked.

7.4 Creating a National Standard 240 Practical Guide

The goal is to establish a single national reference that makes it easier to use ISA 240 in accordance with Algerian specifics (in Arabic and French).

7.4.1 Suggested Content for the Guide

- ✓ Introduction of the law and local adaption of ISA 240 principles.
- ✓ A step-by-step methodology for assessing fraud risk using local examples.

- ✓ Pre-made checklists for the planning, carrying out, testing, and documenting phases of an audit.
- ✓ Auditor report templates (fraud risk report, preliminary investigation report).
- ✓ A guide to investigation procedures: how to gather evidence, how to handle staff, and when to call in legal authorities.
- ✓ Anonymized real-world case examples for examining typical mistakes and lessons discovered.
- ✓ Templates for regulations and policies protecting whistleblowers.
- ✓ Excel and SQL templates for standard analytical tests are included in the technical appendix.

7.4.2 The Process of Adoption and Preparation

- ✓ Create a nationwide committee with representatives from the Ministry of Finance, the accounting profession, the accounting council, customs, tax authorities, external auditors, accounting specialists, and bank representatives.
- ✓ Consult the public and private sectors through governmental institutions.
- ✓ Start a pilot guide with ten businesses, then make changes and expand it.
- ✓ Courses for application awareness and official issuance.

7.5 Making a Fraud Risk Report Required

7.5.1 What ought to include in the report?

- ✓ Executive Summary: Important conclusions and risk factors.
- ✓ The management's evaluation of the risks of fraud.
- ✓ Particular hazards identified by testing and review findings.
- ✓ Important control flaws and possible consequences.
- ✓ Recommendations for correction along with a schedule and accountability for execution.
- ✓ The reaction of management to every discovery.
- ✓ Appendices: Data analysis snippets, transaction samples, and supporting documentation.

7.5.2 Recipient of the Report:

- ✓ The Board of Directors;
- ✓ The Audit Committee;

- ✓ The relevant regulatory body, if required by law.

7.5.3 Submission Style and Format

- ✓ An Executive Summary, a brief paper with comprehensive technical appendices.
- ✓ The signature of an external auditor with clear boundaries and scope.

7.5.4 Mechanism for Regulation and Enforcement

- ✓ Including the report's requirement in an organizational policy or administrative board decision.
- ✓ Applying fines or refusing to accept financial statements if the fraud risk report is not included where it is necessary for legally subject businesses (such as public shareholding corporations and significant institutions).

7.6 Strengthening Regulatory Bodies' and Auditors' Collaboration

7.6.1 Selected Parties:

- ✓ The Central Bank of Algeria, the court and public prosecution, customs, tax administration, and other regulatory agencies, such as the Financial Regulatory Authority or National Council of Accounting.

7.6.2 Frameworks for Cooperation

- ✓ Memoranda of Understanding (MoUs) with explicit terms for data protection and confidentiality that allow information sharing when serious concerns exist Alerts and suspicions can be sent via secure methods (official contact information, encrypted web portal).
- ✓ Formal referral mechanism: A referral form that contains the desired criminal and investigative procedures, preliminary evidence, and a case narrative.

7.6.3 Suggested Collaborative Tasks

- ✓ Quarterly or annual meetings to discuss cases and trends.
- ✓ The establishment of working groups for significant fraud cases requiring criminal or cross-border processes; * Cooperative training workshops between tax/customs inspectors and auditors to identify trends of contemporary fraud.

7.6.4 Principles of Law and Operations

- ✓ Adherence to criminal processes (not interfering with evidence) during referral.
- ✓ Preserving privacy and individual liberties until verdicts are rendered.
- ✓ Data sharing rules that comply with national laws (data protection).

8. Conclusion

The external auditing profession today is no longer just a technical activity aimed at verifying the integrity of financial statements; it has become a social, legal, and ethical responsibility of utmost importance in a complex economic environment where the risks of financial fraud are increasing. The external auditor acts as the link between the institution and its environment, and a primary source of trust upon which investors, shareholders, and policymakers rely. In this context, International Standard on Auditing 240 has emerged as a professional benchmark that defines the auditor's responsibility towards fraud, emphasizing the necessity of planning and execution that provides a reasonable degree of assurance that the financial statements are free from material misstatements.

However, the debate raised by this study transcends the technical aspects, extending to the inevitable overlap between the professional ethics of the auditor and the legal obligations imposed by the regulatory environment. Herein lies the added value of this research topic, as it poses a central question about how to reconcile the theoretical texts of the standard with the practical application that is affected by legal, market, and ethical pressures.

8.1. Results and Interpretation of Hypotheses

- ✓ **Regarding the first hypothesis:** The study showed that ISA 240 does indeed provide a clear theoretical framework for the external auditor's responsibility concerning fraud, but it does not fully address the practical issues related to the balance between professional, ethical, and legal obligations. This makes the standard a necessary but insufficient reference on its own.
- ✓ **Regarding the second hypothesis:** It was found that the practical application of the standard's requirements is more significantly

influenced by the legal and regulatory environment in which the auditor operates. They may find themselves constrained by local laws or institutional pressures that limit their freedom to apply the standard's texts. This explains the significant variation among countries in the level of actual compliance with the provisions of standard 240.

- ✓ **Regarding the third hypothesis:** The study confirmed that the effectiveness of the standard in managing fraud risks is contingent on the auditor's commitment to professional ethics, especially independence, integrity, and objectivity, alongside compliance with the legal framework. This means that the standard alone is not sufficient if it is not supported by firm professional conduct on the part of the auditor.

8.2. Recommendations

- ✓ It is necessary to enhance the training of external auditors in the field of professional ethics alongside technical aspects, so they are better able to reconcile between texts, standards, and practical reality.
- ✓ Develop national legislative frameworks to be more consistent with the requirements of international auditing standards, especially standard 240, which would raise the level of confidence in the auditing profession.
- ✓ Encourage professional bodies to issue procedural guidelines that clarify how to apply standard 240 in different environments, highlighting the ethical and legal dimensions in professional practice.
- ✓ Strengthen the role of oversight over audit firms to ensure their commitment to the standards of independence and integrity when performing their tasks.

8.3. Avenues for Future Research: This research opens the door for more in-depth future studies that address:

- ✓ International comparisons on the extent of the effectiveness of applying standard 240 in different legal and regulatory environments.

- ✓ Applied studies that adopt a case study methodology for known financial scandals to analyze the role of the external auditor and the extent of their compliance with the standard.
- ✓ Theoretical-philosophical research that studies the relationship of the auditing profession with social justice and the broader ethical dimensions of auditing standards.
- ✓ Integrative research between accounting, law, and sociology to understand the multiple factors affecting the external auditor's responsibility.

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