Preventing and Detecting Fraud and Corruption

*Internal Audit’s Role*

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2013 Global Footprint Overview

- 187,436 members
- 190 countries
- 109 Institutes (+ US, Canada, Caribbean)
- 603 full and part-time staff
Agenda

• Introduction – Fraud & Corruption
• Preventive and Detective Controls
• Best Practices for an Effective Internal Audit Activity
• Internal Audit’s Role in Preventing and Detecting Fraud & Corruption
• The IIA Fraud/Anti-Corruption related Standards and Guidance
• Final Thoughts
Introduction
Fraud & Corruption
IIA International Professional Practices Framework (IPPF)

- Fraud - Any illegal act characterised by deceit, concealment, or violation of trust. These acts are not dependent upon the thread of violence or physical force. Frauds are perpetrated by parties and organisations to obtain money, property, or services; to avoid payment or loss of services; or to secure personal or business advantage. (The International Standards for the Professional Practice of Internal Auditing).

- Corruption – The misuse of entrusted power for private gain. (Practice Guide, Internal Auditing and Fraud)

- Bribery – The offering, giving, receiving, or soliciting of anything of value to influence an outcome. (Practice Guide, Internal Auditing and Fraud)
“A fraudulent practice is any act or omission, including a misrepresentation, that knowingly or recklessly misleads, or attempts to mislead, a party to obtain a financial or other benefit or to avoid an obligation.”

“A corrupt practice is the offering, giving, receiving or soliciting, directly or indirectly, of anything of value to influence improperly the actions of another party.”
“Everything is moving faster these days, including fraudsters.

Today, a rogue employee with a smart phone, given a weak enough control environment, could transfer significant sums of money offshore in the blink of an eye.

According to the ACFE, the average fraudster takes US $160,000 out of a company before the fraud is detected. Little of that money is ever recovered.”
“Corruption undermines democratic institutions, slows economic development and contributes to governmental instability.

Corruption attacks the foundation of democratic institutions by distorting electoral processes, perverting the rule of law and creating bureaucratic quagmires whose only reason for existing is the soliciting of bribes.”
Preventive and Detective Controls
An ounce of prevention is worth a pound of cure

Donald R. Cressey, the late criminologist, is credited with identifying the three ingredients required for fraud:

**Motive** **Opportunity** **Rationalisation**

Collectively known as The Fraud Triangle.

With appropriate risk assessment and controls, an organisation can effectively shrink the “opportunity” side of the triangle.

Today these are...
Fraud and Corruption
Risks and Controls

- Identify risk and risk indicators (red flags) which could pose serious legal, financial and reputational risks
- Determine risk mitigation strategy
  - Effective fraud and anti-corruption program
  - Tone at the top
  - Code of Conduct policies
- Investigations
Best Practices for an Effective Internal Audit Activity
Internal Audit Best Practices

• IA dual reporting lines – to the highest level of authority within the organisation, and an independent audit committee

• Proper allocation of responsibilities of prevention, detection and investigation. Coordinate efforts with other functions involved in the fraud and corruption investigation

• Reference to fraud and corruption in IA mandate

• Communication among audit committee, external audit and internal audit

• IA plays a key role in:
  – Advocating formalisation of an internal control and risk management framework going beyond purely financial controls to include wider control environment, code of ethics/conduct and F&C prevention plans
  – Educating the management and public officials on the potential risks related to operations

• Improve proficiency and professionalism to increase auditors’ ability to evaluate fraud and corruption risks and to detect fraud and corruption as swiftly as possible.
Internal Audit’s Role in Preventing and Detecting Fraud & Corruption
# Top Internal Audit Activities

<table>
<thead>
<tr>
<th>Internal Audit Activity</th>
<th>Currently</th>
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</thead>
<tbody>
<tr>
<td>Operational audits</td>
<td>88.9%</td>
</tr>
<tr>
<td>Audits of compliance with regulatory code (including privacy) requirements</td>
<td>75.1%</td>
</tr>
<tr>
<td>Auditing of financial risks</td>
<td>71.6%</td>
</tr>
<tr>
<td>Investigations of fraud and irregularities</td>
<td>71.2%</td>
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<tr>
<td>Evaluating effectiveness of control systems (using COSO, COBIT, etc., frameworks)</td>
<td>68.8%</td>
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<tr>
<td>Auditing of IT/ICT risks</td>
<td>61.7%</td>
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<tr>
<td>Auditing of information risks</td>
<td>61.4%</td>
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<tr>
<td>Audits of enterprise risk management processes</td>
<td>56.6%</td>
</tr>
<tr>
<td>Project management assurance/audits of major projects</td>
<td>55.4%</td>
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IIA 2010 Common Body of Knowledge (CBOK) Study

www.globallia.org
Internal Audit’s Role
Developing the audit plan based on risk assessment

• Assess organisation’s risks of fraud and corruption as a part of the risk assessment for audit plan

• Factors may include global spread, business environment, governance, culture, past instances, etc.
Internal Audit’s Role

Evaluating the Fraud and Anti-corruption programs:

• Support management in monitoring effectiveness of these programs by
  – Performing specific audits and/or
  – Addressing fraud and corruption in each audit
Internal Audit’s Role

Audits of specific programs and policies:
• Audit of program components may include policies, training, third-party due diligence, gift programs, charitable donations, payment processes, etc.
Internal Audit’s Role

Addressing fraud and corruption in every audit:

• Assess these risks in planning, evaluate possible scenarios, evaluate control environment
• Identify the key controls to mitigate specific risks for that audit
• Design and execute specific procedures to assess the design and execution of these key controls
Internal Audit’s Role

- **Investigations:** Tailored based on circumstances
- **Reporting:** Determine protocols based on cultural and legal landscape
- **Training:** Certain cases IA assists with trainings during their visits to locations etc.
- Coordinate with other compliance functions both internal and external (e.g., regulatory)
Summary

• Almost every organisation is exposed to fraud and corruption risks
• Awareness and legislation are on the rise
• Organisations are establishing programs to protect themselves, employees and others with which they interact
• Internal Audit should:
  − Be on the forefront, working with management to identify risks and risk mitigation strategies
  − Audit and monitor compliance with organisation programs
The International Professional Practices Framework:

Fraud-related Standards and Guidance
The IIA Fraud-related Standards

Internal auditors must:

• “….have sufficient knowledge to evaluate the risk of fraud….” (Standard 1210.A2)

• “….exercise due professional care….” (Standard 1220.A1)

• “CAE must report periodically to senior management and the board ….. on fraud risks….” (Standard 2060)
The IIA Fraud-related Standards

Internal auditors must:

• “….evaluate the potential for the occurrence of fraud and the manner in which the organisation manages fraud risk.” (Standard 2120.A2)

• “….consider the probability of significant errors, fraud, noncompliance, and other exposures when developing the engagement objectives.” (Standard 2210.A2)
The IIA Fraud-related Standards

Fraud

• Any illegal act characterised by deceit, concealment, or violation of trust.
• These acts are not dependent upon the threat of violence or physical force.
• Frauds are perpetrated by parties and organisations to obtain money, property, or services; to avoid payment or loss of services; or to secure personal or business advantage.

(Standards Glossary)
IIA Fraud Related Guidance

IPPF Practice Guides

www.globaliia.org
IIA Anti-Corruption Related Guidance
IPPF Practice Guides

Soon to be released

AUDITING ANTI-BRIBERY AND ANTI-CORRUPTION PROGRAMS
COMING SOON

www.globaliia.org
The Institute of Internal Auditors
Final thoughts:
Questions the Internal Auditors should Ask

• Does the organisation have a fraud/anti-corruption governance structure in place that assigns responsibilities for investigations?
• Does the organisation have a fraud/anti-corruption policy in place?
• Has the organisation identified laws and regulations relating to fraud/anti-corruption in jurisdictions where it does business?
• Does the organisation’s fraud/anti-corruption management program include coordination with internal auditing?
Questions