

Introduction

Every year billions of dollars are lost to fraud and corruption resulting in inefficiencies, aborted projects, financial challenges, organizational failure, and, in extreme cases, humanitarian disaster. Often fraud occurs because of poorly designed controls and weak governance undermining the organization's processes.

Organizations should have robust internal control procedures to limit the risk of fraud, and internal audit's role is to assess these controls.

Fundamental Fraud Facts

Fraud can be defined as any illegal act characterized 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 organizations to obtain money, property, or services; to avoid payment or loss of services; or to secure personal or business advantage.

Fraud is not unique to any organization type. It occurs in public and privately owned businesses, not-for-profit, in organizations that seek to contribute to economic and social well-being, such as government departments, financial institutions, and public and private utilities (water, electricity, education, health care, etc.). In short, the opportunity to commit fraud exists everywhere.

How organizations deal with the risk of fraud may be influenced by legal jurisdiction and the organization's own risk assessment and appetite.

Fraud can often lead to litigation, dismissal, and recovery of assets. It is essential, therefore, that any investigation is undertaken by suitably qualified individuals to reduce the risk of compromising evidence, accusing wrongfully, or undermining prospective legal actions.

Consistent with The IIA's *International Standards for the Professional Practice of Internal Auditing* on proficiency (1210.A2), internal auditors must have sufficient knowledge to evaluate the risk of fraud and the manner in which it is managed by the organization.

KEY TAKEAWAYS

Organizations should have robust internal control procedures to limit the risk of fraud, and internal audit's role is to assess these controls.

The organization should have a suitable fraud prevention and response plan in place allowing effective limitation and swift response to the identification of fraud and management of the situation. This should include digital data.

The chief audit executive should consider how the risk of fraud is managed across the organization and assess the fraud risk exposure periodically.

The risk of fraud should be included in the audit plan and each audit assignment to evaluate the adequacy of anti-fraud controls.

Internal auditors should not investigate fraud unless they have the specific experience and expertise required to do so.

The IIA's Perspective

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. Its role includes detecting, preventing, and monitoring fraud risks and addressing those risks in audits and investigations.

It should consider where fraud risk is present within the business and respond appropriately by auditing the controls of that area, evaluating the potential for the occurrence of fraud and how the organization manages fraud risk (Standard 2120.A2) through risk assessment, and audit planning. It is not internal audit's direct responsibility to prevent fraud happening within the business. This is the responsibility of management as the first line of defense.

The internal auditor should not be expected to have the expertise of a person whose primary responsibility is to investigate fraud. Such investigations are best carried out by those experienced to undertake such assignments.

Internal audit should use its expertise to analyze data sets to identify trends and patterns that might suggest fraud and funding abuse. Where the experience is not available within the internal audit team, the organization should consider recruiting or engaging resources with sufficient knowledge or expertise.

The organization should have a suitable anti-fraud response plan outlining key policies and investigation methodologies. The plan should make clear the role of internal audit when there is suspected fraud and associated control failure.

Operationally, internal audit should have sufficient knowledge of fraud to:

- Identify red flags indicating fraud may have been committed.
- Understand the characteristics of fraud and the techniques used to commit fraud, and the various fraud schemes and scenarios.
- Evaluate the indicators of fraud and decide whether further action is necessary or whether an investigation should be recommended.
- Evaluate the effectiveness of controls to prevent or detect fraud.

Where electronic evidence is collected, internal audit should provide assurance on whether necessary access rights and legislative requirements are being met.

Where fraud has occurred, internal audit should understand how the controls failed and identify opportunities for improvement. It should consider the probability of further errors, fraud, or noncompliance across the organization and reassess the cost of assurance in relation to potential benefits.

Many factors, including available resources, influence how organizations respond to fraud. Some organizations include fraud awareness (proactive) and response (reactive) mechanisms within the internal audit activity, and some internal auditors may investigate fraud.

FIVE QUESTIONS

Managing fraud risk is something every organization faces.

Governing bodies and executive management can help clarify roles in fraud risk management, including internal audit's role.

Here are five key questions the governing body should be asking:

1.
Does the organization have a fraud response plan in place that outlines key policies and investigation methodologies?
2.
Who carries out fraud investigations within the organization?
3.
Is internal audit tasked with identifying where fraud risk is present, and does it audit controls in these areas?
4.
When fraud has occurred, does internal audit investigate to understand how the controls failed and how they can be improved?
5.
Is internal audit tasked to investigate fraud, and, if so, does it possess the proper skill sets to carry out such investigations?

If internal audit is required to investigate fraud, the internal auditor should have the necessary skills and experience to undertake the investigation and discharge their professional responsibility without jeopardizing the investigation and associated evidence.

Investigation is not typically an internal audit task; therefore, internal auditors should exercise due professional care (Standard 1220) by considering the extent of work needed to achieve the engagement's objectives and the related complexity, materiality, or significance. They should decide if they are best placed to undertake the investigation or whether to engage internal legal counsel, human resources, qualified or certified fraud examiners, digital forensics, or outside legal and investigative expertise.

Conclusion

The threat of fraud is one of the most common challenges to governance that organizations face without regard to size, industry, or location. Having proper internal control procedures in place that include an appropriate response plan is fundamental to battling fraud. Internal audit possesses intimate control knowledge of the organization. A combined assurance approach is key in this regard to understand the gaps in controls to allow for the manifestation of fraud.

Fraud investigations are best carried out by those experienced to undertake such assignments. Organizations should not expect internal audit's skill set to include fraud investigation. Instead, internal audit should support the organization's anti-fraud management efforts by providing necessary assurance services over internal controls designed to detect and prevent fraud. If circumstances require internal audit to take on an investigatory role, internal auditors should exercise due professional care.

Organizations should not expect internal audit's skill set to include fraud investigation. Instead, internal audit should support the organization's anti-fraud management efforts by providing necessary assurance services over internal controls designed to detect and prevent fraud.

About Position Papers

The IIA promulgates Position Papers on key issues of interest to stakeholders and practitioners with the aim of advocating for sound governance and educating those involved in it. The positions outlined offer insights into various aspects of the governance process and internal audit's vital role in improving governance at all levels and adding value to the organization. Position Papers are developed and reviewed through a rigorous process that solicits input and critique from practicing internal audit professionals and other IIA volunteers who serve on The IIA's Global Advocacy Committee, IIA Standards Board, and The IIA's Professional Responsibility and Ethics Committee.

About The IIA

The IIA is the internal audit profession's most widely recognized advocate, educator, and provider of standards, guidance, and certifications. Established in 1941, The IIA today serves more than 190,000 members from more than 170 countries and territories. The IIA's global headquarters are in Lake Mary, Fla. For more information, visit www.globaliia.org.

Disclaimer

The IIA publishes this document for informational and educational purposes. This material is not intended to provide definitive answers to specific individual circumstances and as such is only intended to be used as a guide. The IIA recommends seeking independent expert advice relating directly to any specific situation. The IIA accepts no responsibility for anyone placing sole reliance on this material.

Copyright

Copyright © 2019 by The Institute of Internal Auditors, Inc. All rights reserved.

January 2019



Global Headquarters

The Institute of Internal Auditors
1035 Greenwood Blvd., Suite 401
Lake Mary, FL 32746, USA
Phone: +1-407-937-1111
Fax: +1-407-937-1101
www.globaliia.org