

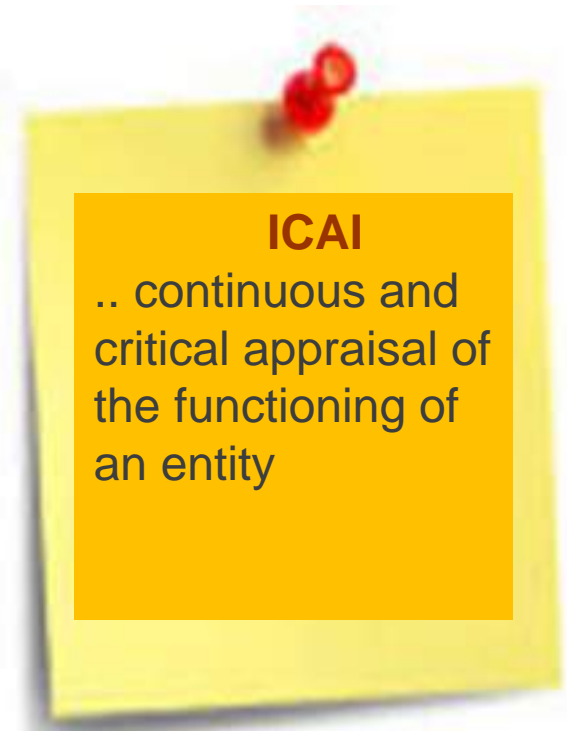
FRAUD – WHERE IS INTERNAL AUDIT ?



Ashish Jain

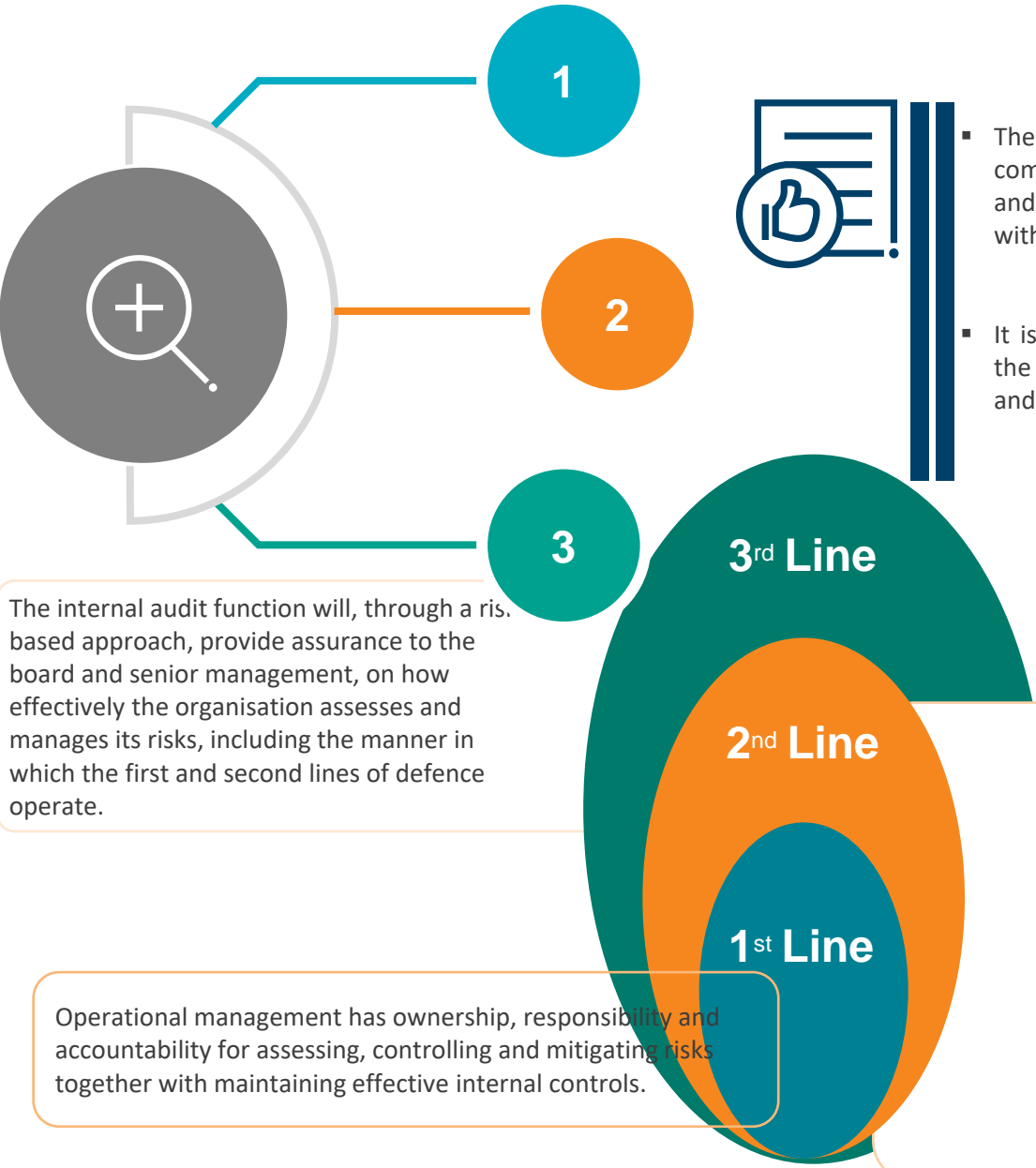
IS INTERNAL AUDIT A FRAUD INVESTIGATION ?

Do you
read
Fraud
anywhere ?



Fraud is defined as a **deliberate deception** to secure, or attempt to secure, unfair or unlawful benefit or gain from an organization or its third party. This may include embezzlement of company funds or the misappropriation of company assets in the form of money, property, data or intellectual property

3 LINES ...WHO JOINS THE DOTS ?



- The 3 Lines model is an organisational model to manage risks and compliance obligations and specifically defining the related roles and responsibilities of the particular bodies/ groups involved within the respective organization
- It is putting particular emphasis on risk management throughout the organization and assurance over its effective implementation and execution

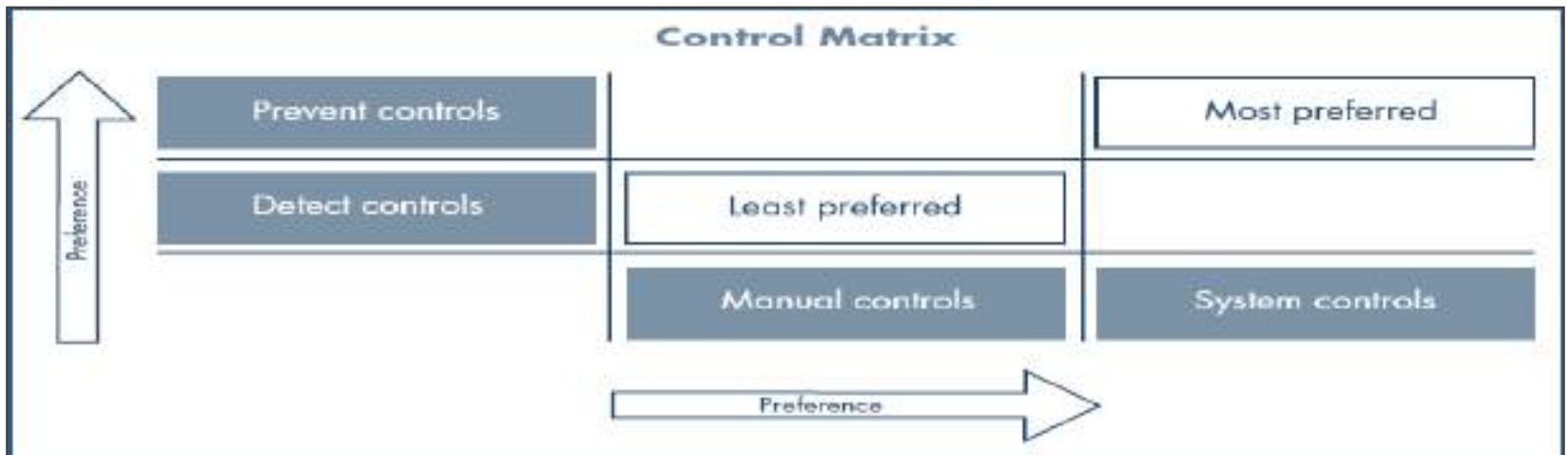
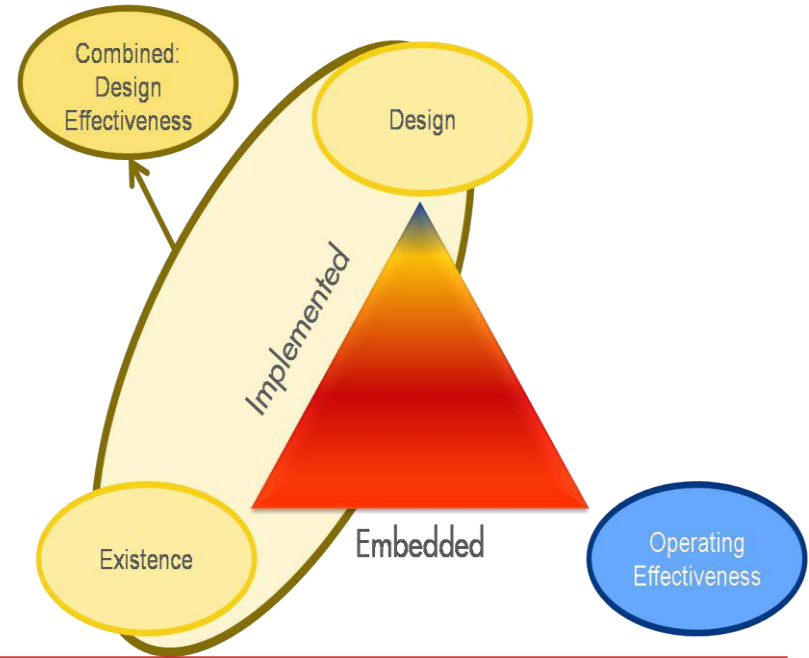
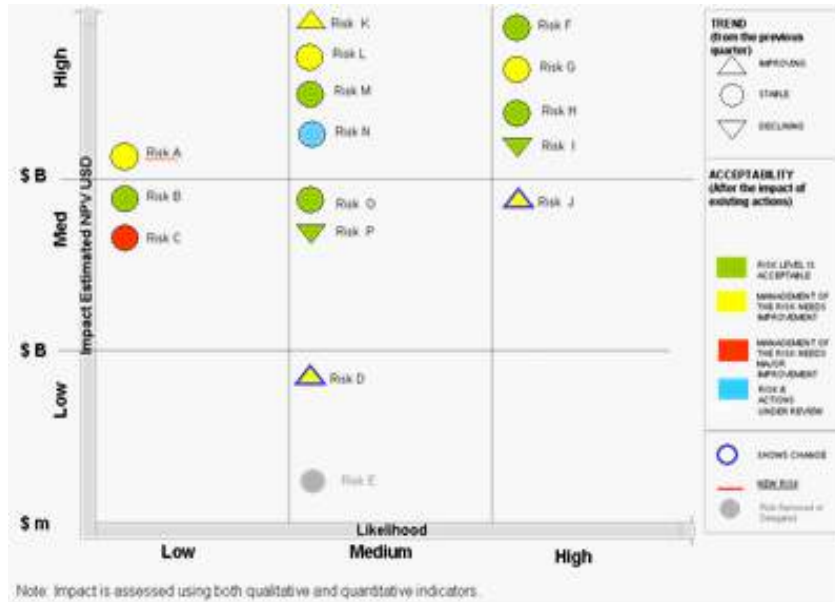
The internal audit function will, through a risk-based approach, provide assurance to the board and senior management, on how effectively the organisation assesses and manages its risks, including the manner in which the first and second lines of defence operate.

Operational management has ownership, responsibility and accountability for assessing, controlling and mitigating risks together with maintaining effective internal controls.

The risk management function facilitates and monitors the implementation of effective risk management practices and assists the risk owners in defining the target risk exposure and reporting adequate risk related information through the organisation.

In addition to the risk management function, and as part of this second line of defence, some organisations have established a separate compliance function to monitor compliance risks, i.e. risks of non-conformity with applicable laws and regulations as well as internal regulations (including fraud). In this capacity, the compliance function reports directly to senior management. Other specific monitoring functions may include health & safety, supply chain, environmental and quality functions.

RISK AND CONTROL EFFECTIVENESS – WHAT DOES THAT MEAN



AUDIT PLANNING - OBJECTIVE & SCOPE

DOES INTERNAL AUDIT LOOK AT THE RIGHT PLACE ?



Financial Risks

- Financial Control Assurance
- *Credit*
- *Interest*
- *Forex*
- *Taxation*
- *Reporting & Accounting*
- *Delegation of Authorities*



Operational Risks

- Business Planning & Performance
- *People*
- *Process*
- *Control Framework*
- *Asset Integrity*
- *Governance*
- *Assurance*
- *Compliance*



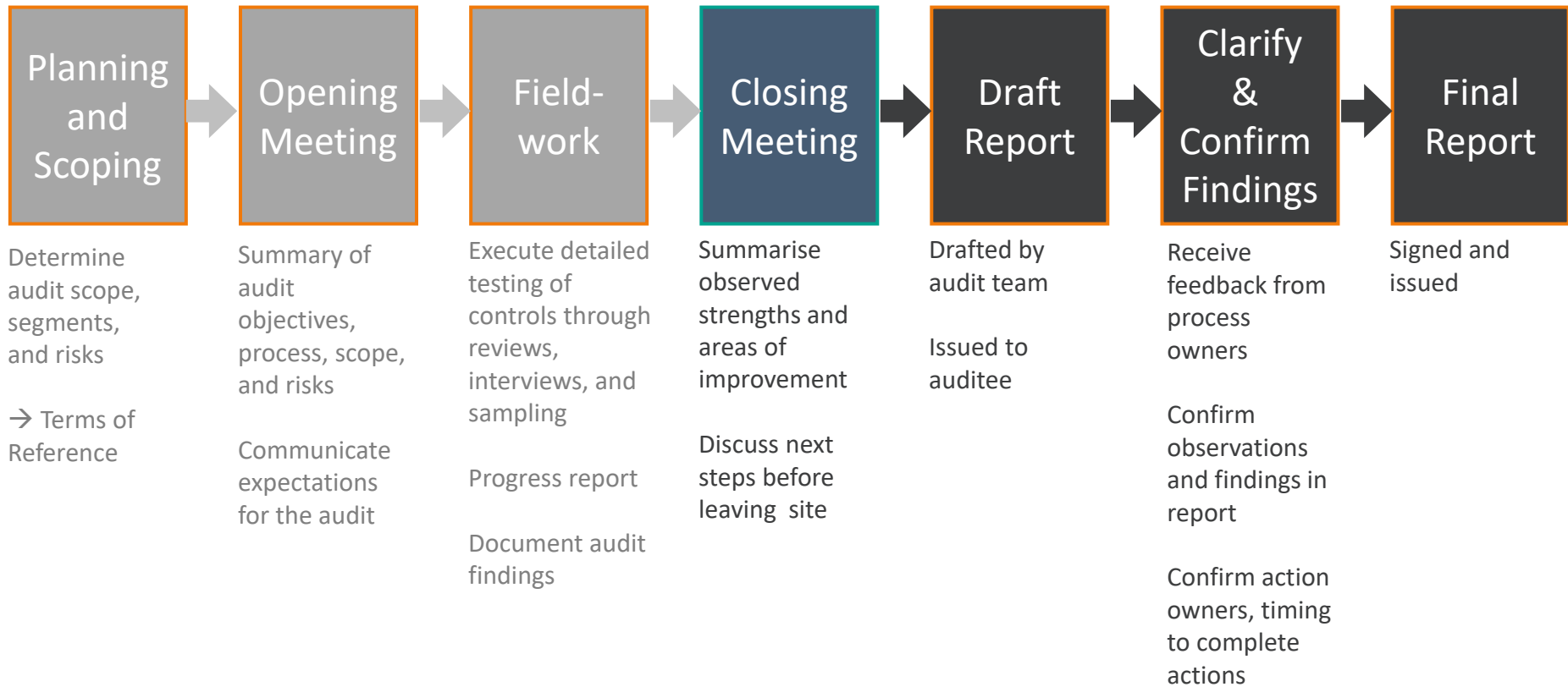
Fraud Risks

- Fraud Risk management Response
- *Ethical Conduct*
- *Due diligence*
- *ABC*
- *AML*
- *Conflict of Interest*
- *Gifts & Hospitality*



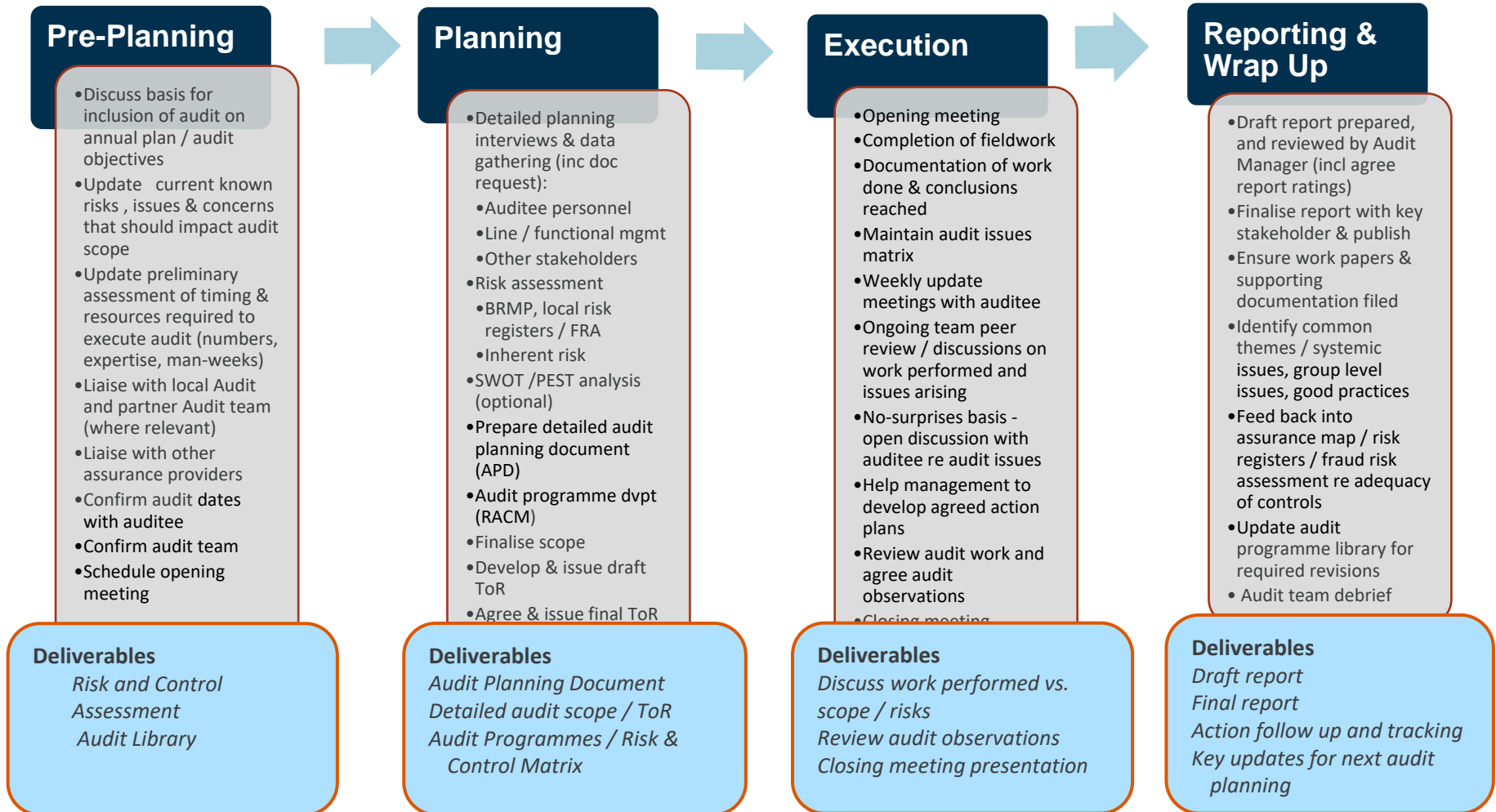
- Audit reviews management's approach to mitigate a number of risks relevant to the core business objectives
- Audit Plan considers all relevant risks

PROCESS FLOWS BUT WHERE ?



The quality of outcome is directly dependent on the methodology and execution approach of IA

WHAT ARE THE DELIVERABLES - OUTCOMES OR THE APPROACH ?



The success factors are not visible, risk of outcomes disproportionately forms basis to evaluate performance

WHERE DOES THE DIFFERENCE LIE...

VALUE DRIVERS FOR INTERNAL AUDIT VS INVESTIGATION

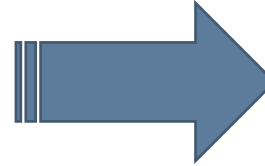
Internal Audit

Investigation

Scope



- Objective is to provide assurance on meeting of organizations plan
- Very broad covering all major risks and controls



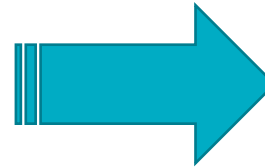
Objective is to confirm wrong doing or breach

Scope restricted to the area of impact

Execution



- Moderate to High emphasis on authenticity of evidence
- Personal conduct is not specifically reviewed
- Interviews are more open ended and focused on operations



Very high emphasis on authenticity of evidence

Personal conduct is examined – including forensic examination
Interviews are close ended, focused on consequence management

Market Intelligence



Secondary sources

Benchmarking, Information in public domain, regulatory filings, industry publications



Primary Sources

Contracting of specialists, source / target selection, specific intelligence, due diligence, corroboration of information

Engagement



- Open engagement with process owners
- No surprise approach
- Feedback on required mitigations
- Impact on company's operations



Restricted engagement, Legal privileges in case of external counsels, consequence management on individuals, impact on reputation, loss containment

DO YOU IDENTIFY THE CAUSE OF RISK EVENT ?



PROBLEM:

The Taj Mahal is requiring excessive power washes – very expensive and damaging to the stone

FOR IDENTIFYING THE CAUSE...GO TO THE ROOT



Why?

Because pigeons are swarming to the monument and depositing large amounts of droppings

Why?

Because the pigeons are feeding on an unusually large number of spiders living under the roof line

Why?

Because the spiders are feeding on an unusually high number of lacewing moths and midge flies (mosquitoes)

Why?

Because the moths and midge flies are attracted to lights illuminating the Memorial at night (for mating)

Why?

Because the lights remain on throughout the night
(ideal condition for mating)



~~Stop washing?~~



~~Remove the birds?~~



~~Remove the spiders?~~



~~Remove the moths & mosquitoes?~~



~~Remove the lights?~~



Minimize time for lights to be on

BOW TIE - Compliance with laws and regulations and ethical conduct

Operations not in compliance with Law or Regulation

Failure of partners to maintain effective ABC programmes

Failure to anticipate changes in Regulation

Failure to appreciate regulatory risk

Ambiguity in interpretation of Law or Regulation

Cost of compliance leads to non-compliance

Failure to follow legal advice / guidance

Fraud and corruption

Management over-ride of Legal advice/guidance

Failure to adequately document compliance procedures

Legal risks not recognized in BP or BRMP

Failure to discover intentional breaches of controls

Incomplete, ineffective, unenforceable documentation

CAUSES

BUSINESS PRINCIPLES & ORGANISATIONAL RISK BEHAVIOURS

PREVENTATIVE CONTROLS

CONTAINMENT CONTROLS

- *Legal & Regulatory Framework*
 - *monitoring of external environment*
 - *monitoring of compliance*
- *External legal Counsel, including law firm panel arrangements*
- *Ongoing internal legal education and training*
- *Regulatory Compliance systems*
- *Legal Function Role & Responsibility*
- *Audit*
- *Lawyer's Handbook*
- *Legal Standards adopted Organization wide*
- *Quarterly Due Diligence*
- *Escalation procedures*
- *'Speak-up'*
- *Disciplinary Procedures*
- *Legal Function monitoring*
- *Business Planning / forecasting*
- *BRMP*
- *Director Training*
- *ABC programmes*
- *Independent reporting line of Legal function*
- *Legal function participation in planning, forecasting, risk processes*

RISK EVENT

Breach of applicable laws and regulations by a staff member, a contractor and/or someone acting on company's behalf. Perceived or actual ethical misconduct, bribery, or fraud by a staff member, an associated party and/or someone acting on company's behalf.

Investigations

- *Stakeholder management by Investor Relations, PCA*
- *Litigation management*
- *Outside counsel*
- *Ability to demonstrate robust procedures and adequate controls*

Loss of License to Operate

Reputation damage

Debarment from award / loss of government contracts and licences

Unforeseen liabilities e.g. decommissioning

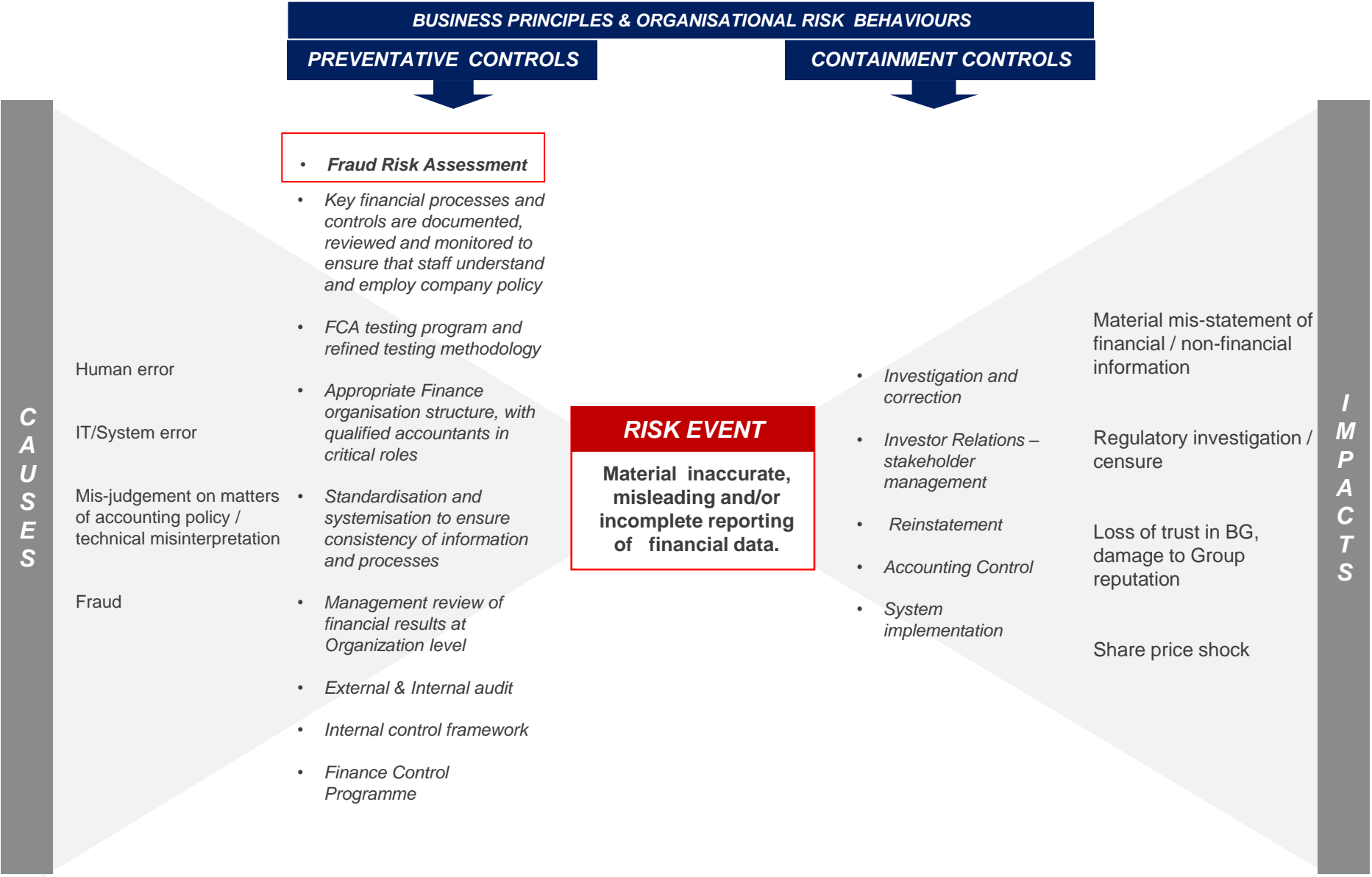
Regulatory censure, fines or penalties

Increased costs

Litigation from industry partner, contractor, sovereign entity

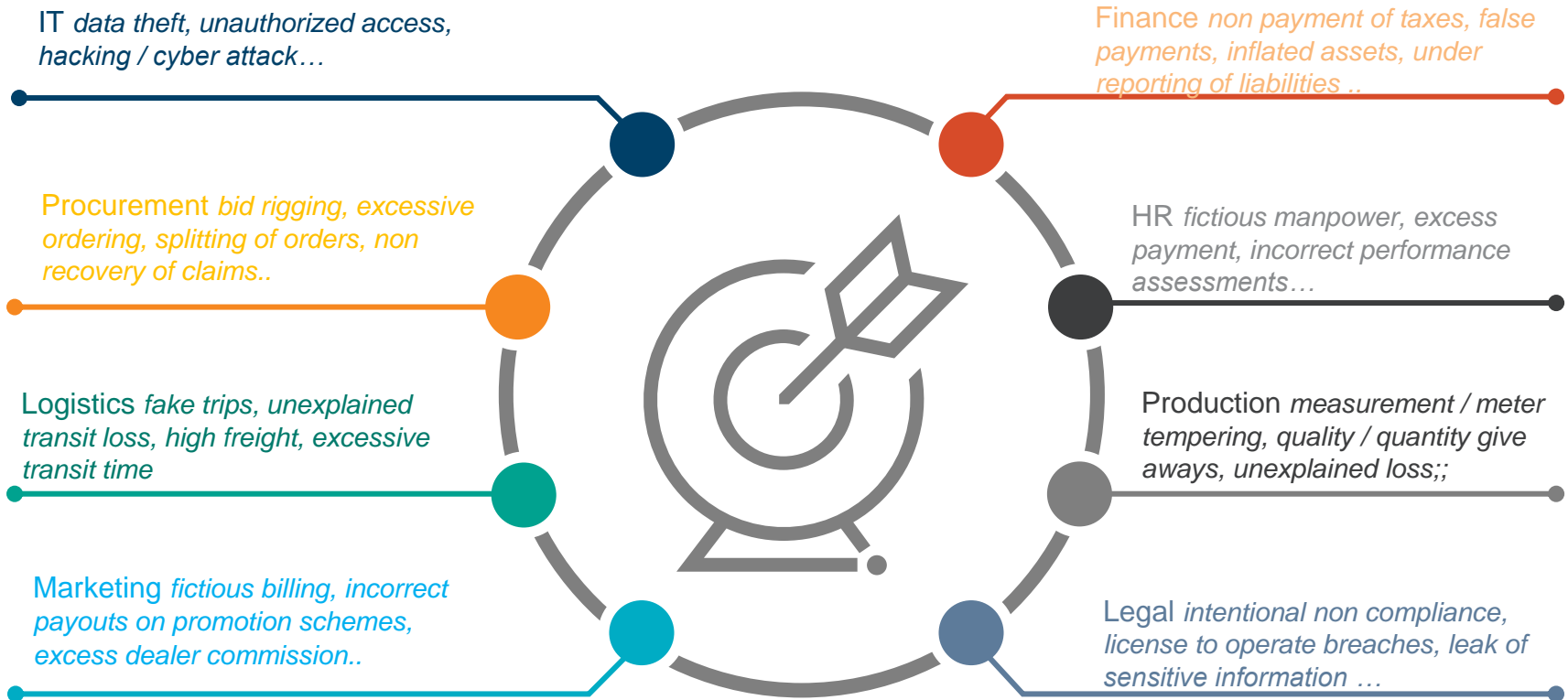
IMPACTS

BOW TIE - Financial accounting and reporting



WHERE IS YOUR FRAUD RISK LIBRARY ?

Does the organization have an adequate level of fraud awareness, are appropriate controls in place to minimize fraud risk ?



THE FRAUD TRIANGLE

What's the Tone at the Top ?

Opportunity

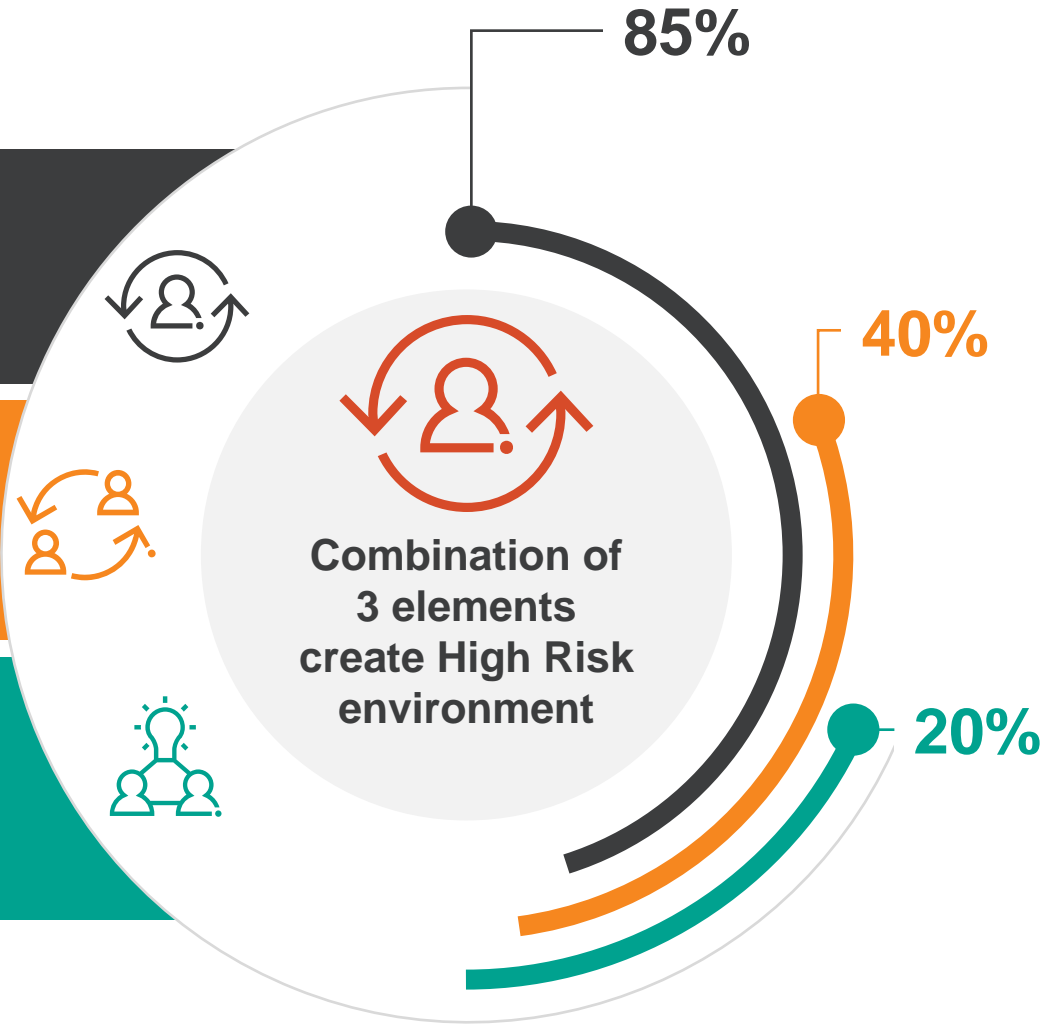
Poor controls, Abuse of authority, Lack of segregation of duties, complex transaction..

Rationalization

It's a small amount, They do not pay me enough, They can afford it, I'll never get caught, I'am the boss...

Pressure

Debts, Revenge, Coercion or Blackmail, Addiction, Peer / Family pressure...



FRAUD RISK ASSESSMENTS – SET THE CRITERIA

Risk Criteria Definitions

Rating	Likelihood		Impact	Reputational impact
	Level	Description	Level	
1	Low <10%	Highly unlikely <10% chance of occurrence in the next 12 months	Very Low <\$300K	Failure is deemed to be technical or of minor importance. Items that will cause embarrassment/dissatisfaction visible within a business unit. Results in minimal customer/ stakeholder reaction
2	Marginal 10%-35%	Not expected to occur/no history 10%-35% chance of occurrence in the next 12 months	Low \$300K-\$1m	Failure is deemed to be not material to the business unit Minor legal issues Negative publicity within the business
3	Moderate 35%-65%	Possible 35%-65% chance of occurrence in the next 12 months	Moderate \$1m-\$5m	Failure is deemed local to individual business unit Confidence in the business unit management is damaged Publicity has some impact on confidence of customers Items that will cause substantial private embarrassment/ dissatisfaction, visible across the company
4	High 65%-90%	Expected to occur/history of past similar events 65%-90% chance of occurrence in next 12 months	High \$5m-\$10m	Failure is deemed not systemic across all businesses Items that will inevitably emerge into the public domain because of their size and importance causing substantial public embarrassment/ dissatisfaction Significant adverse customer/stakeholder reaction
5	Very high >90%	Expected to occur/frequent history of past similar events >90% chance of occurrence in next 12 months	Very high >\$10m	Failure is deemed systemic Sustained national adverse media coverage/stakeholder reaction which has a hugely significant impact on the Asset Shareholder/market notification necessary Causes damage to the organisation but can be endured with proper management

Control Assessment Definitions

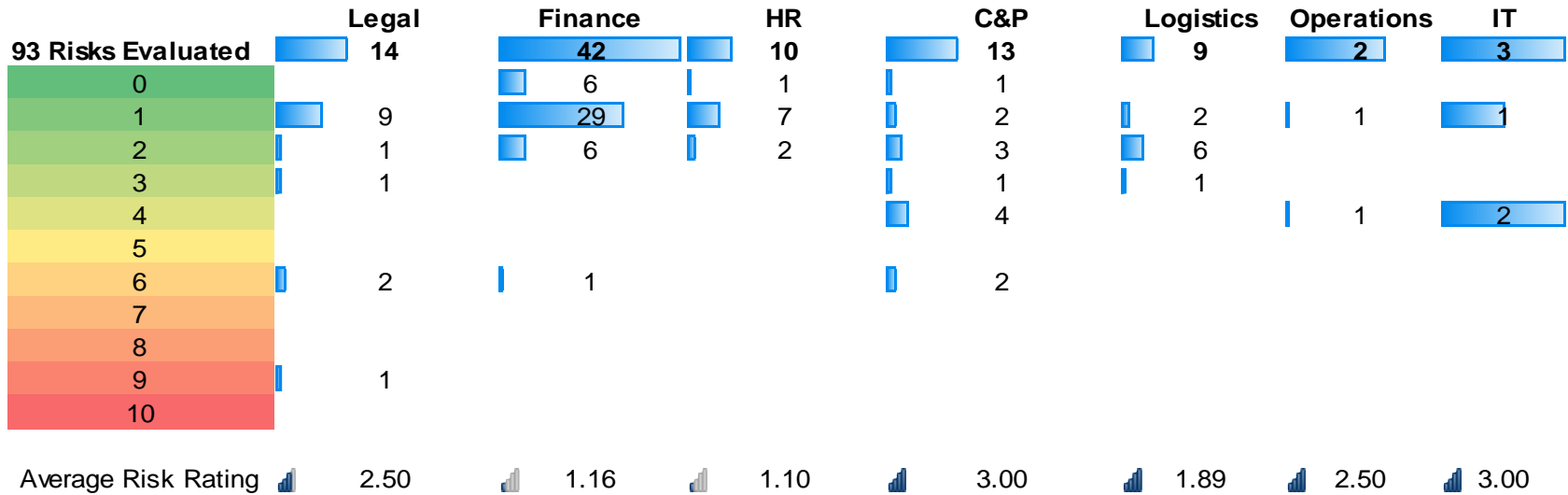
Highly Effective	Processes and controls are both designed and operating in a, substantially, sound and cost effective way, providing an appropriate control environment to manage risk. They meet the expectations, policies and standards of the Group. There may be some minor weaknesses or opportunities for best practice or efficiency enhancements
Partially Effective	There are some weaknesses in the design or operation of the processes and controls such that they may not be fully effective or reliable in managing the risk, and/or there are instances of non-compliance with Group policies or standards. Action needs to be taken in a timely manner to address these weaknesses and/or non-compliances. There may also be significant opportunities to make processes and controls more efficient, cost effective or aligned with best practice.
Ineffective	Weaknesses [and/or failure in core controls contained within Group Standards] are important or widespread and there are, therefore, substantial flaws in the design and/or operation of the controls in the management of the risk reviewed. Immediate steps need to be initiated to address these weaknesses.

FRAUD RISK ASSESSMENTS – TEMPLATE

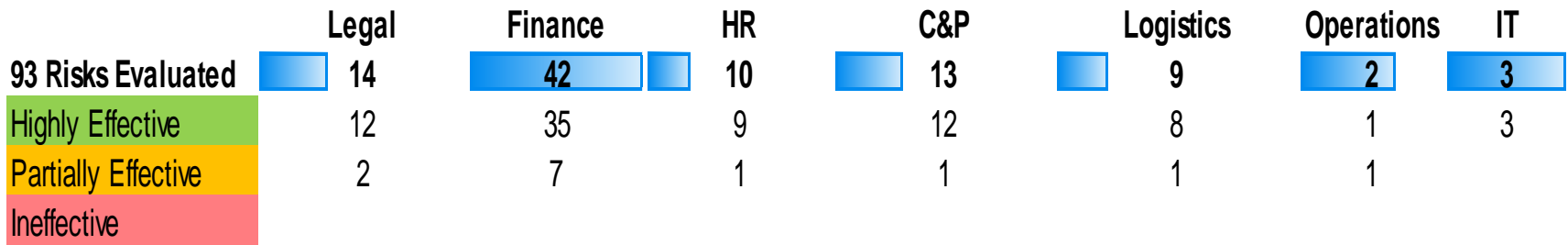
Function	Risk	Likelihood (a)	Impact (b)	a x b	Control Assessment
Legal	Employee, or Other Personnel, offers and/or makes a bribe (including a facilitation payment) to a public official	3	3	9	Highly Effective
Legal	A third party offers an employee, or other personnel, a bribe in order to get the employee (or other personnel) to manipulate a process or decision to gain business, or to gain a business advantage	3	2	6	Partially Effective <i>Mitigation Action - Enhanced awareness and communication</i>
Finance	Assets or inventory written off as scrap but diverted for personal gain / re-sale	3	2	6	Partially Effective <i>Mitigation Action - Guidelines for expected safe keeping / physical control of written off assets to be included in control manual</i>
C&P	Information brokering – collusion between staff and tenderers to influence tender evaluations and contractor selection	2	3	6	Highly Effective
C&P	Collusion between Business Users and Sourcing Managers to influence contractor selection	2	3	6	Highly Effective

FRAUD RISK ASSESSMENTS – DASHBOARDING

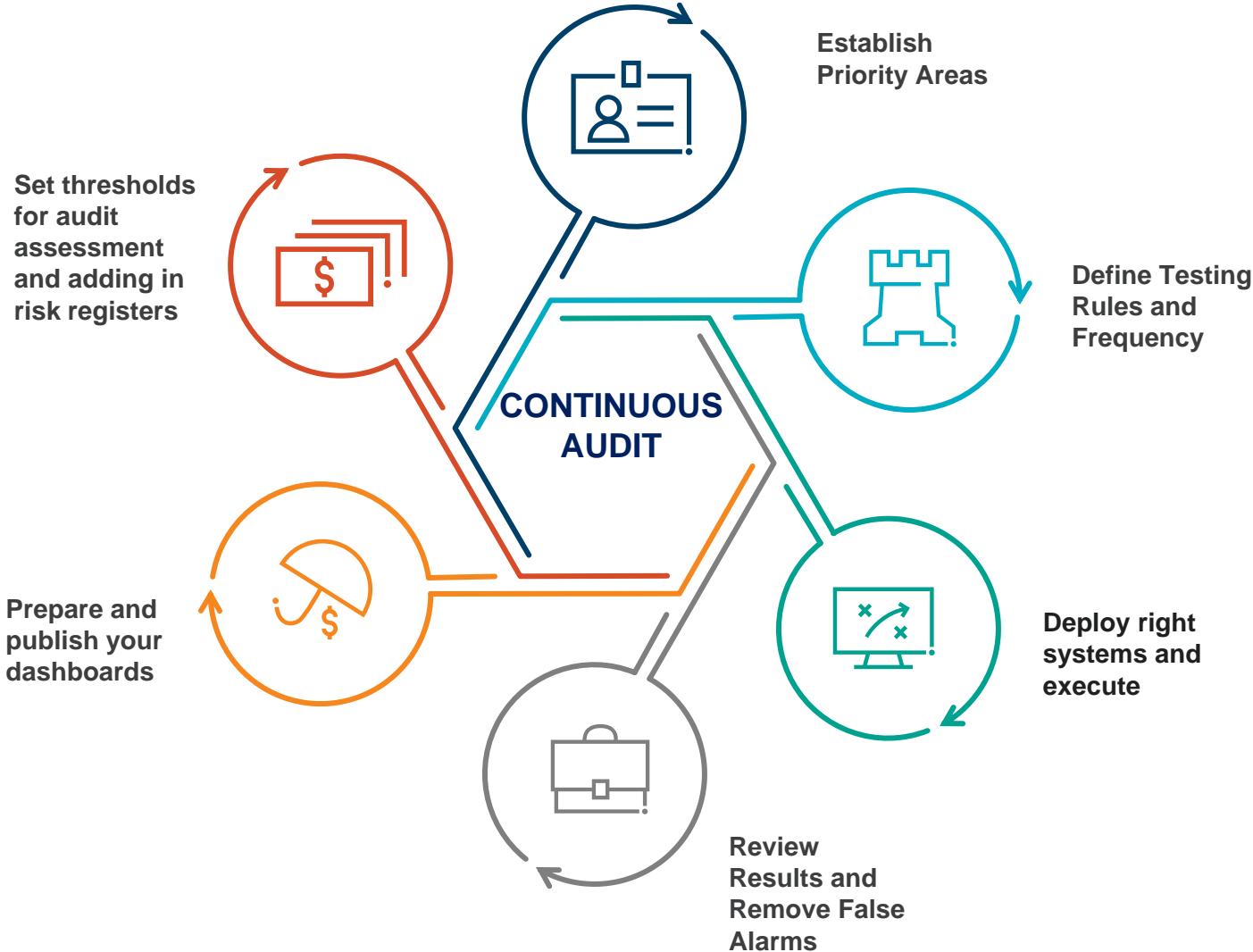
Inherent Risks



Control Assessment



WHAT MORE CAN INTERNAL AUDIT DO ?



DATA ANALYTICS USE FOR EFFECTIVE MONITORING AND ASSESSMENTS

Compliance

- Evaluate expense reports and purchase card usage for all transactions.
- Perform supplier audits by utilising line-item billing data to identify anomalies and trends to investigate.
- Assess regulatory requirements.
- Identify poor data quality and integrity around various data systems that are key drivers to non-compliance risks.

Fraud Risk Assessment, Detection and Investigation

- Identify areas at high risk of fraud and assess controls.
- Identify ghost employees, potential false suppliers, and related parties or employee-supplier relationships.
- Highlight data anomalies that pose the greatest financial and/or reputational risk to the organisation.
- Investigate the symptoms of an asset misappropriation scheme to answer the “who, what, when, where” questions.

Operational Performance

- Isolate key metrics around spend analysis e.g. payment timing, forgone early-payment discounts and payment efficiency.
- Perform duplicate payment analysis and recovery.
- Perform revenue-assurance analysis.
- Perform slow-moving inventory analysis.
- Identify key performance and key risk indicators across industries and business lines.

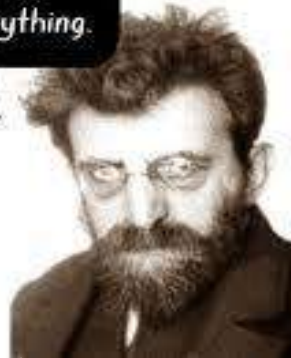
Internal Controls

- Anticipatory e.g. business continuity plan.
- Detective and corrective e.g. control account reconciliations.
- Directive e.g. code of conduct.
- Preventative e.g. passwords, access controls.
- Perform segregation of duties analysis, user access analysis.
- Assess control performance.
- Exception reporting e.g. identify potential outliers that would indicate

AUDITOR OR INVESTIGATOR ?

Where
do you
stand ?

*A generalist
knows less and
less about more
and more until
eventually he
knows nothing
about everything.*



PonderAbout.com



*A specialist
knows more and
more about less
and less until
eventually he
knows everything
about nothing.*



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Thank you