
Using Internal Audit as a Catalyst to Help Mitigate Fraud Risk

Presented by:

- Chris Jeffrey
- Mumta Taneja



HERE WITH YOU TODAY

Introductions



Chris Jeffrey, CPA
Partner
Baker Tilly

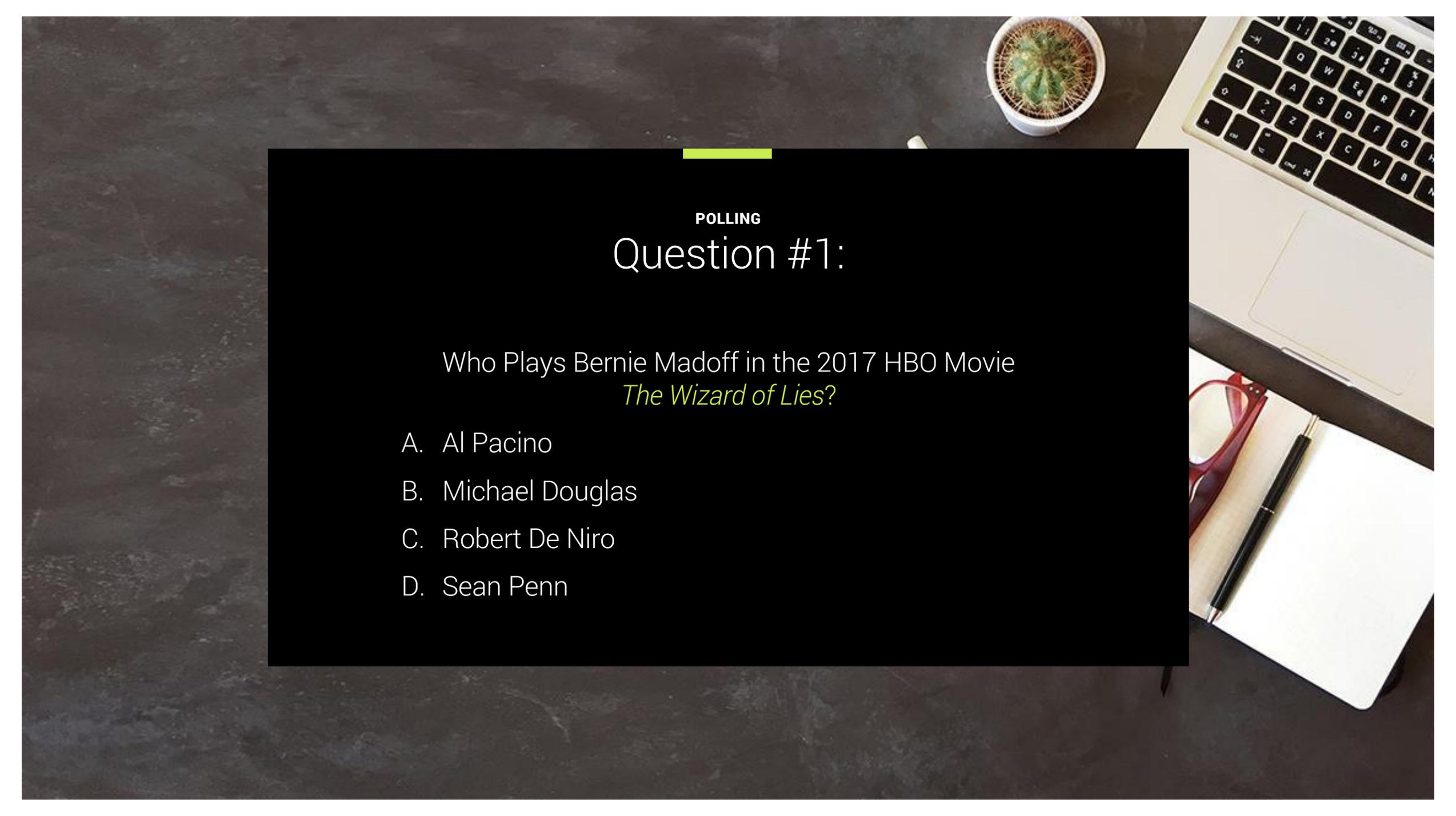


Mumta Taneja, CRMA
Senior Manager
Baker Tilly



Agenda

- Embedding fraud risk in your organization's risk assessments
- Requirements and leading practices for including fraud risk in your organization's assessments
- How to collaborate with internal audit to help your organization mitigate fraud risk

A top-down view of a dark grey desk. In the top right corner, there is a small white pot with a green cactus. Below it is a silver laptop with a black keyboard. In the bottom right corner, there is a pair of red-rimmed glasses and a black pen resting on a white notepad.

POLLING

Question #1:

Who Plays Bernie Madoff in the 2017 HBO Movie
The Wizard of Lies?

- A. Al Pacino
- B. Michael Douglas
- C. Robert De Niro
- D. Sean Penn

FRAUD RISK

Why should organizations embed fraud risk into its assessments?

Improve communication

Identify the most vulnerable activities

Develop plans to mitigate fraud risk

Understand if fraud has occurred

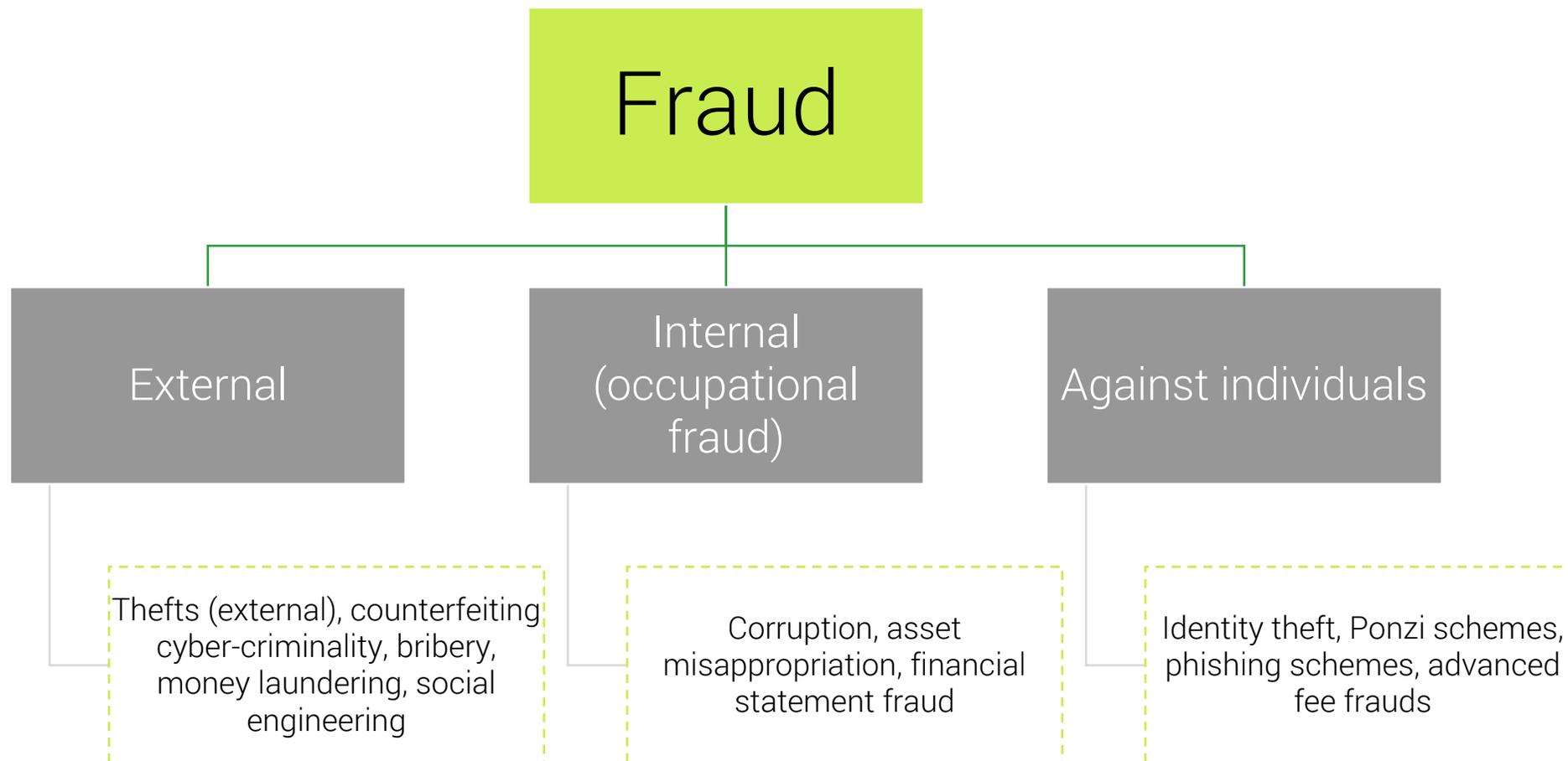
Assess internal controls

Comply with regulations and professional standards

Understand the potential for significant fraud risk

TAKING A STEP BACK

Types of fraud



FRAUD RISK ASSESSMENT

Assessing the risk of fraud

Objective: proactively identify and understand potential fraud risks and schemes impacting the organization



Key Activities

- Identify fraud risks and scenarios
- Measure fraud risk schemes by impact and likelihood
- Rank how each risk should be addressed
- Audit responses to each identified risk (implement controls, test controls, or conduct specific procedures)

FRAUD RISK ASSESSMENT

Opportunities and common pitfalls when conducting a fraud risk assessment

Plan ahead and allow adequate time	▶	Understand the businesses/processes in scope and time needed for completion
Involve Relevant Stakeholders	▶	Across functions, levels, senior management, etc.
Disregard the control environment when identifying schemes	▶	Ignore the “that could never happen”
Be specific when identifying fraud schemes	▶	Ask for details – how, who, when, systems involved, accounts impacted, \$ amount
Utilize a risk-based approach	▶	Analyze controls and processes for the highest risk scenarios
Consider emerging risks	▶	New markets, technologies, acquisitions, recent attacks, etc.
Document the fraud risk assessment outcomes thoroughly		

ENTERPRISE RISK

Enterprise Risk Management

Designed to provide an organization's board and senior leaders a top-down, strategic perspective of risks on the horizon so that those risks can be managed proactively to increase the likelihood the organization will achieve its core objectives

- Identification and management of enterprise risks
- Alignment of risk appetite and strategy
- Loss minimization
- Risk response improvement



Fraud risk can be an input to the enterprise risk assessment or an output.

ORGANIZATIONS ARE FALLING VICTIM TO CYBER ATTACKS EVERY DAY

Cybersecurity risk assessment

Involves identifying organizational risks and vulnerabilities and applying administrative actions and comprehensive solutions to make sure your organization is adequately protected.

Objectives:

- Improves transparency in decision making because criteria are made explicit
- Reduces costly surprises, since undesirable risks are identified and managed
- Establishes a more rigorous basis for strategic planning as a result of a structured consideration of the key elements of risk
- Allows for better identification and exploitation of opportunities
- Improves effectiveness and efficiency in compliance with applicable statutory, regulatory and contractual requirements

The NIST Cybersecurity Framework originated from an Executive Order by former President Obama in 2013:

"it is the Policy of the United States to enhance the security and resilience of the Nation's critical infrastructure and to maintain a cyber environment that encourages efficiency, innovation, and economic prosperity while promoting safety, security, business confidentiality, privacy, and civil liberties."

Former President Obama,
Executive Order 13636

COSO CONSIDERATIONS

COSO

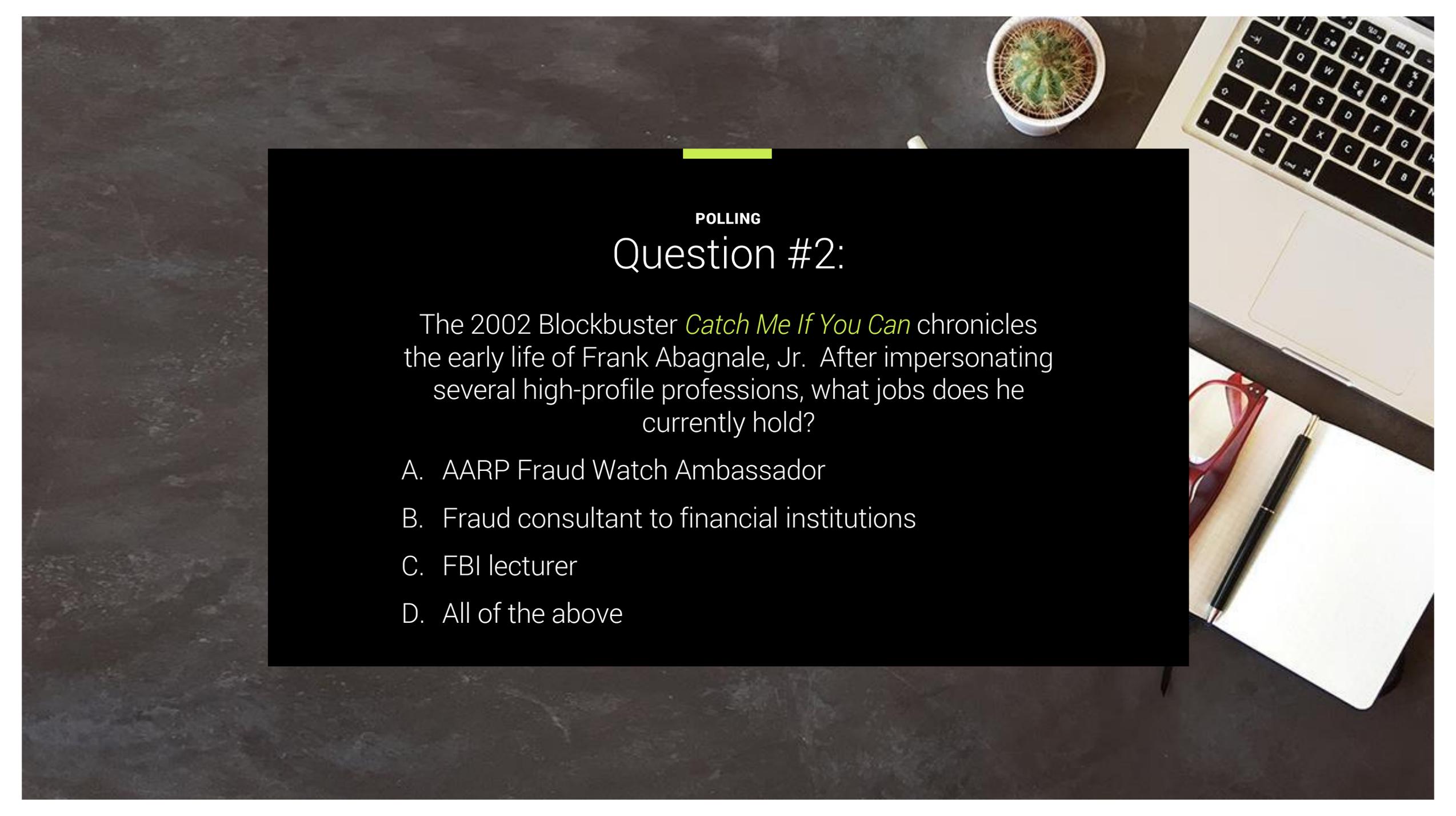
The Committee of Sponsoring Organizations of the Treadway Commission (COSO)'s original internal control framework considered fraud, although the discussion of anti-fraud expectations and the relationship between fraud and internal control was less prominent. **The updated framework, published in May 2013, contains considerably more discussion on fraud and also considers the potential of fraud as a principle of internal control.**

Risk Assessment (COSO 2013 Principles 6-9):

6. The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives
7. The organization identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed
8. **The organization considers the potential for fraud in assessing risks to the achievement of objectives**
9. The organization identifies and assesses changes that could significantly impact the system of internal control



COSO 2013 Framework

A top-down view of a dark grey desk. In the upper right, a silver laptop is partially visible. To its left is a small white pot containing a green cactus. Below the laptop, a pair of red-rimmed glasses and a black pen are resting on a white notebook. A black rectangular box with a thin yellow horizontal line at the top is centered on the desk, containing white text.

POLLING

Question #2:

The 2002 Blockbuster *Catch Me If You Can* chronicles the early life of Frank Abagnale, Jr. After impersonating several high-profile professions, what jobs does he currently hold?

- A. AARP Fraud Watch Ambassador
- B. Fraud consultant to financial institutions
- C. FBI lecturer
- D. All of the above

FRAUD RISK MANAGEMENT

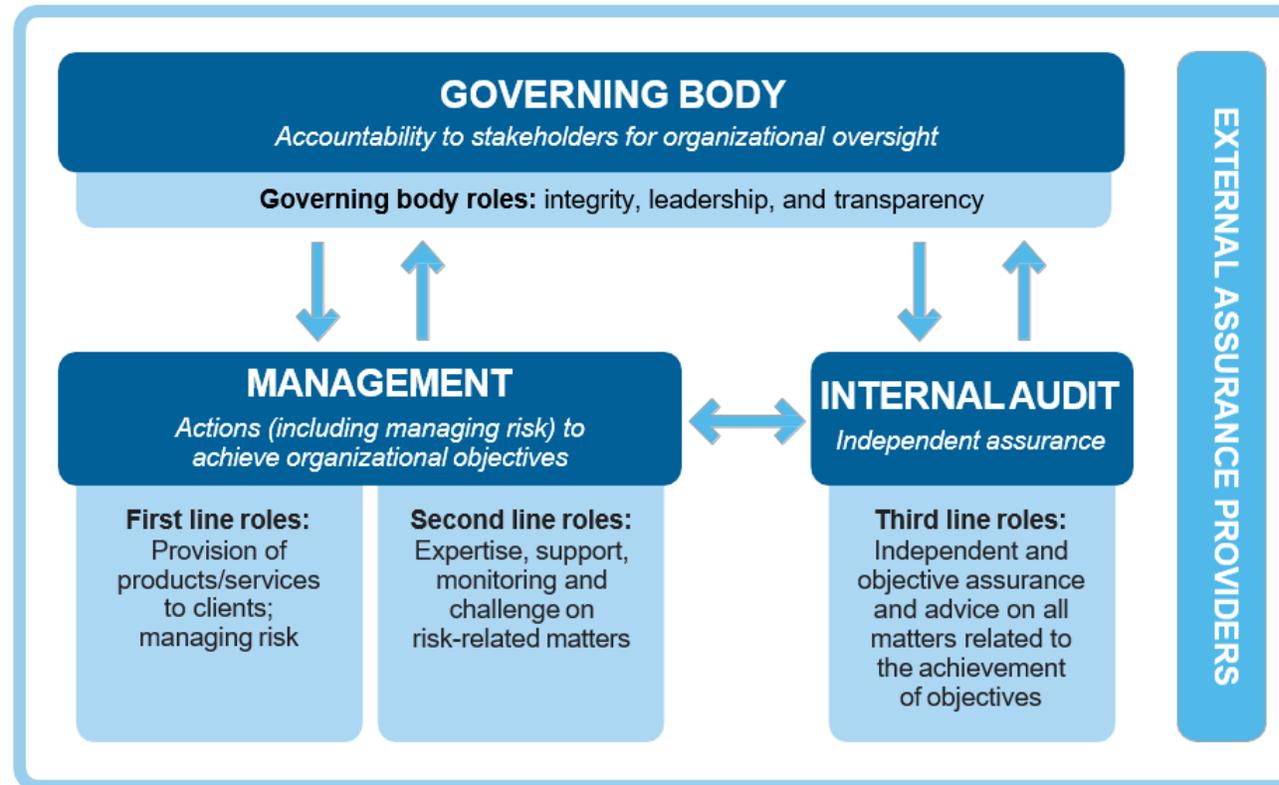
Roles and responsibilities



The role of internal audit in fraud risk management can vary by organization

ROLES & RESPONSIBILITIES

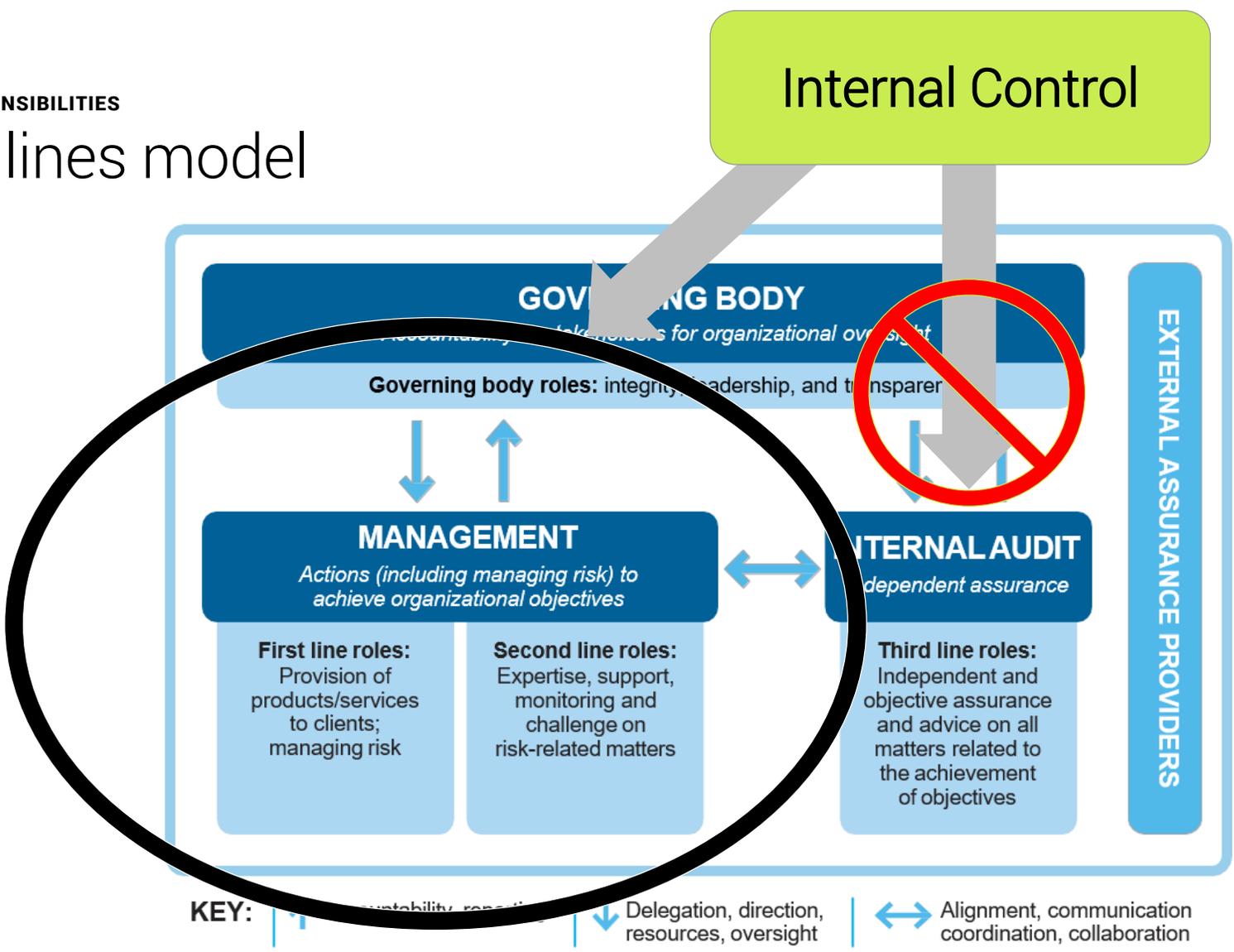
Three lines model



KEY: | ↑ Accountability, reporting | ↓ Delegation, direction, resources, oversight | ↔ Alignment, communication coordination, collaboration

ROLES & RESPONSIBILITIES

Three lines model



FRAUD CONSIDERATIONS IN INTERNAL AUDIT

Guidance and mandates

IPPF

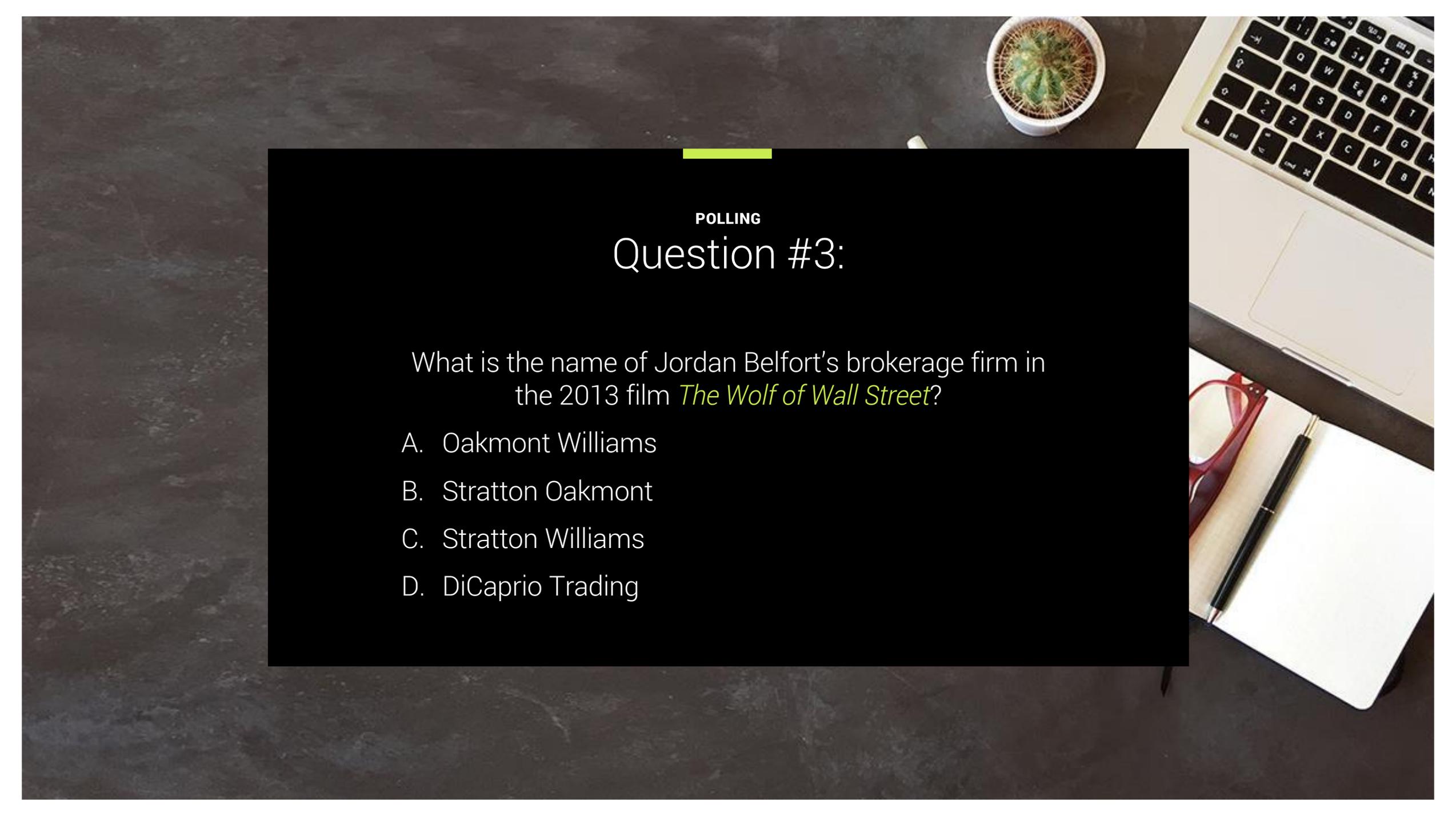
The International Professional Practices Framework (IPPF) outlines the following International Standards for the Professional Practice of Internal Auditing (Standards) pertaining to fraud and the internal auditor's role in detecting, preventing, and monitoring fraud risks and addressing those risks in audits and investigations

- **IIA Standard 1200:** Proficiency and Due Professional Care
- **IIA Standard 1220:** Due Professional Care
- **IIA Standard 2060:** Reporting to Senior Management and the Board
- **IIA Standard 2120:** Risk Management
- **IIA Standard 2210:** Engagement Objectives

Others:

- **COSO 2013 Framework**
- **SOX Compliance**
- **AICPA**
- **PCAOB**



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POLLING

Question #3:

What is the name of Jordan Belfort's brokerage firm in the 2013 film *The Wolf of Wall Street*?

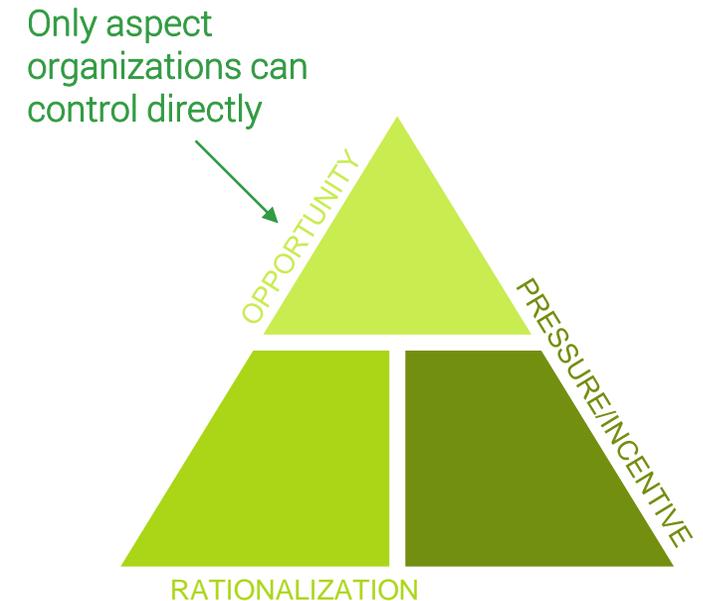
- A. Oakmont Williams
- B. Stratton Oakmont
- C. Stratton Williams
- D. DiCaprio Trading

FRAUD CONSIDERATIONS IN INTERNAL AUDIT

Engagement planning

Gathering Information

- To identify fraud risks in the area/process under review, internal auditors should understand the organization and the larger context in which it operates
- Seek information from a variety of sources:
 1. Prior assessments and investigations
 2. Formal reporting mechanisms and interviews
 3. A preliminary review of the control environment
 4. External research and specialists



FRAUD CONSIDERATIONS IN INTERNAL AUDIT

Engagement planning



Brainstorming fraud scenarios...

...is an effective way to determine the characteristics and circumstances unique to the specific area or process under review that may produce opportunities and incentives for fraud

- Consider potential pressures and opportunities to commit fraud in the area or process under review
- This process may affect the audit approach or scope
- Be mindful of audit objectives when brainstorming fraud scenarios

Fraud scenario	Fraud risk
Fictitious personnel expenses	Corporate cards are intentionally issued inappropriately, resulting in fraudulent expenses
	Expenses submitted for services or goods are not actually provided to the organization
	Multiple expense reimbursements are submitted for the same expense
Fraudulent disbursements	Fictitious vendors are set up in the system, resulting in fraudulent payments
	False refunds and/or voids are processed
Concealed liabilities and expenses	Bad debt expense is intentionally omitted
	Expenses are capitalized
Related party transactions	One party receives some benefit not obtainable in an arm's-length transaction
Embezzlement	Personnel pay expenses with the organization's funds and falsify financial records to cover it up

FRAUD CONSIDERATIONS IN INTERNAL AUDIT

Execution and fieldwork

In conducting audit engagements, the internal auditor should:

- Consider fraud risks in the assessment of internal control design
- Have sufficient knowledge of fraud to identify red flags
- Be alert to opportunities that could allow fraud, such as control deficiencies
- Evaluate oversight of the fraud risk management program
- Assess the indicators of fraud and decide whether any further action is necessary
- Recommend investigation when appropriate
- Take an active role in support of the organization's ethical culture
- Exercise professional skepticism when reviewing activities

"Internal auditors must have sufficient knowledge to evaluate the risk of fraud and the manner in which it is managed by the organization, but are not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud."

- IIA Standard 1210.A2

FRAUD CONSIDERATIONS IN INTERNAL AUDIT

Potential red flags

Certain phrases used by interviewees may indicate potential control deficiencies and/or fraud risks:

- “As a work around...”
- “Just this one time...”
- “I have always done it this way”
- “Once in awhile we...”
- “Off the record...”
- “There are no policies or procedures for this process”
- “Someone told me to do it this way, however I am not sure why”
- “This is *really* how it’s done”
- “The way it is *supposed* to work is...”

Management issues:

- Lack of area expertise
- Lack of supervision
- History of legal violations

Personnel issues:

- Lack of background checks
- Dissatisfied employees
- Unwillingness to share duties

Process issues:

- Duties not segregated
- Poor physical security
- Poor access controls

FRAUD CONSIDERATIONS IN INTERNAL AUDIT

Data analytics in fraud identification

Proactive data monitoring / analysis is one of the most effective anti-fraud controls in terms of reducing median fraud losses and duration

“Internal audit departments need to create a smart database that includes all fraud incidents which have happened over the years. This database should be searchable, and from there, you can analyze trends and gain useful insights into fraud hotspots and the circumstances which led to committing fraud.” – Dr. Al Faddagh

Continuous monitoring allows for early detection of fraud and control deficiencies

Identifies higher risk records, transactions, or activities for further review

Insight about how internal controls are operating and identify anomalies in patterns/trends

Embedding data analytics into the business is likely to result in operational efficiencies and improved fraud detection

FRAUD CONSIDERATIONS IN INTERNAL AUDIT

Root cause analysis

A research-based approach to identifying the bottom line reason of a problem or an issue



Approaches:

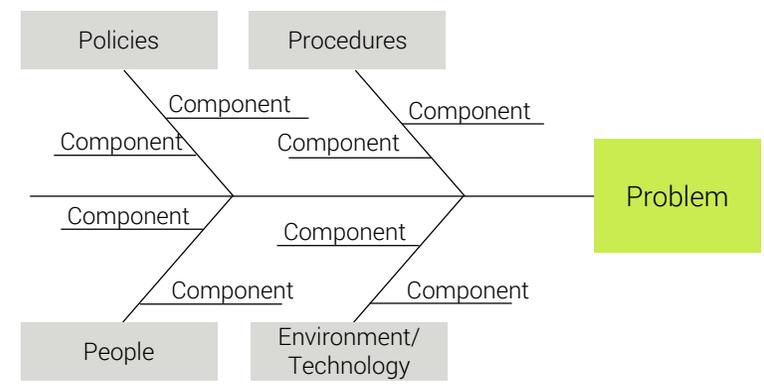
Six Sigma: The 5 Whys

If you do not ask the right question, you will not get the right answer.



By the fifth "why," the internal auditor should have identified or be close to identifying the root cause.

Fishbone diagram



FRAUD CONSIDERATIONS IN INTERNAL AUDIT

Conducting an investigation

Organizations should not necessarily expect internal audit's skill set to include fraud investigation

- The role of the internal audit activity needs to be defined in the internal audit charter, as well as in the fraud policies/procedures
- Investigation is not typically an internal audit task, but if necessary, exercise due professional care by considering the extent of work needed to achieve the engagement's objectives and the related complexity, materiality or significance
- Investigations require experience with specialized techniques and approaches
 - ✓ Most internal auditors have a skills gap when it comes to fraud investigations
 - ✓ Consider engaging legal counsel, HR or a qualified fraud examiner with appropriate expertise

FRAUD CONSIDERATIONS IN INTERNAL AUDIT

Communicating audit results

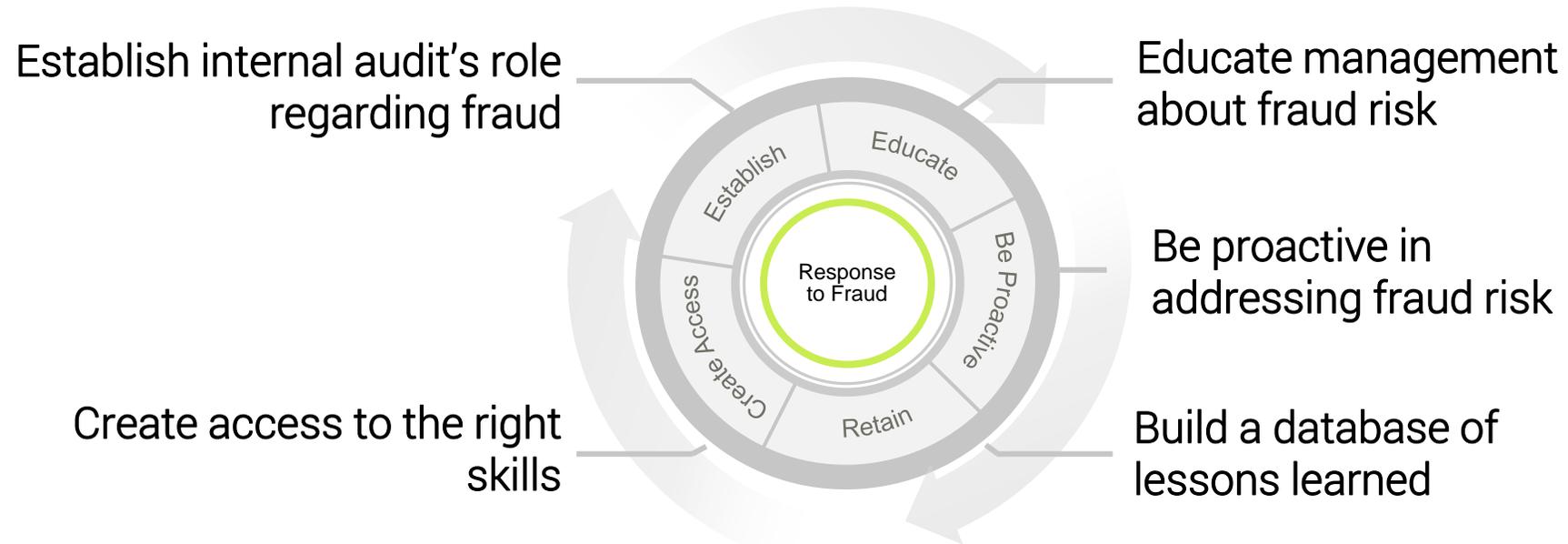
If you see something, say something!

- Notify appropriate level of management timely when there is evidence that fraud may exist
 - If fraud is suspected at the senior management/executive level then notify the audit committee as soon as possible
- Where potential or confirmed fraud has occurred, internal audit should understand how the controls failed and identify opportunities for improvement
 - Consider the probability of further errors, fraud or noncompliance across the organization
- The auditor should evaluate whether the absence of or deficiencies in controls that address fraud risks or otherwise help prevent, deter or detect fraud
- **IIA Standard 2400: Communicating Results** provides specific expectations for communicating audit results

Source: PCAOB AU Section 316, IIA Standards

FRAUD CONSIDERATIONS IN INTERNAL AUDIT

Five ways to improve internal audit's approach to fraud risk



TAKEAWAYS

Summary

Embed fraud risk considerations

Collaborate with internal audit

Assess the fraud risk exposure periodically

Include the risk of fraud in the audit plan

Specific experience and expertise is required to perform investigations

THANK YOU FOR LISTENING

Contact information



Chris Jeffrey, CPA
Partner
Baker Tilly
Chris.Jeffrey@bakertilly.com
312-729-8184



Mumta Taneja, CRMA
Senior Manager
Baker Tilly
Mumta.Taneja@bakertilly.com
312-729-8349



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