

# Frequently Asked Question

## Briefing from the Internal Audit Standards Advisory Board **The Internal Audit Role in Counter Fraud**

### **Introduction**

Ensuring that an organisation has adequate counter fraud and anti-corruption arrangements is one of the requisites for good governance, particularly in a public sector body where there are responsibilities for the stewardship of public money. Like other aspects of governance, the responsibility for ensuring there are adequate arrangements lie with the Board and those charged with governance. The Public Sector Internal Audit Standards (PSIAS) highlight the role of internal audit in providing assurance on counter fraud and counter fraud related advisory and consultancy work. The aim of this guidance is to support the application of the standards in practice and reference useful resources.

The extent to which internal audit will support counter fraud activity directly will vary from organisation to organisation, as well as reflecting sector developments. For example:

- Counter fraud resources and teams are well established in some sectors: for example in the NHS there is a network of local counter fraud specialists and agencies such as NHS Protect and Counter Fraud Services in Scotland. As a result the respective roles and responsibilities of internal auditors and counter fraud specialists may be clearly defined.
- In local authorities the recent transfer of benefit investigation staff to the Department of Work and Pensions has changed the resourcing profile for counter fraud. In some organisations a corporate counter fraud team has been established. In others the responsibility for counter fraud activity has not been clearly assigned. Collaborative arrangements, known as counter fraud hubs, are also being developed in some areas.

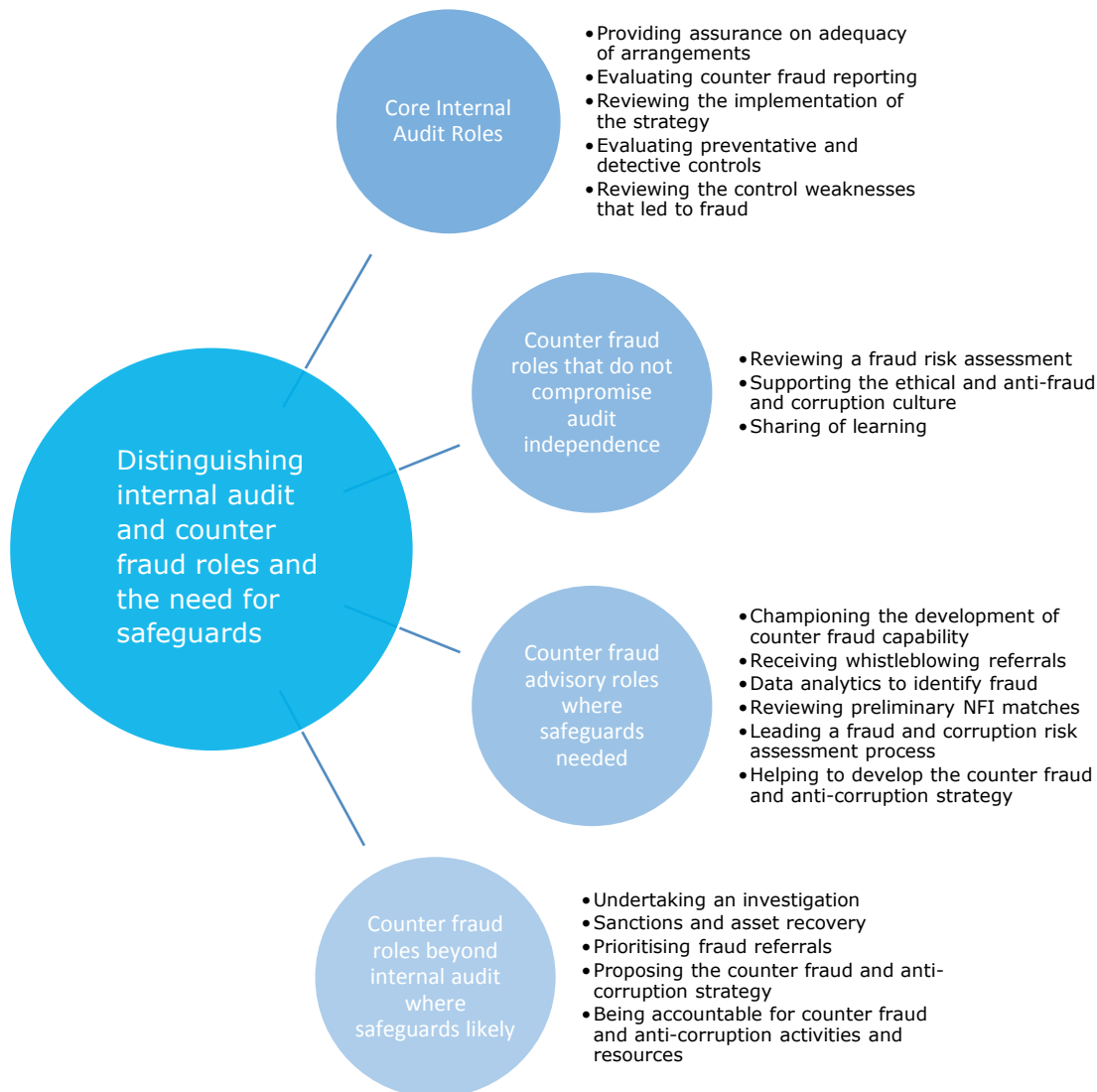
Depending on national arrangements and local circumstances, internal auditors will need to select the most appropriate approach to providing assurance and assess whether further consultancy or advice is necessary.

### **Determining internal audit's role in counter fraud**

The internal audit role and the counter fraud roles that some internal auditors are likely to be involved in are set out in the following diagram. They are broken down into four divisions:

- Core internal audit roles that all internal auditors should include in their risk-based approach
- Counter fraud roles that internal audit can undertake without compromising audit independence
- Counter fraud roles where internal audit may provide consultancy or advisory services, with safeguards
- Counter fraud activities, beyond the normal scope of internal audit which could impair the auditor's independence or objectivity, where safeguards will be required.

## The internal audit role in counter fraud



### Core internal audit role - providing assurance (segment 1)

The primary role of internal audit is to provide assurance on counter fraud arrangements and fraud risks in accordance with the standards.

Internal auditors need to evaluate the potential for the occurrence of fraud and how the organisation manages its fraud risk (2120.A2). To enable the internal audit activity to do this, individual internal auditors should have sufficient knowledge of fraud risks and fraud risk management practice (1210.A2). Further details are outlined later in this paper.

### Supporting counter fraud roles (segments 2, 3 and 4)

Some internal auditors may take on additional roles or undertake work as part of their advisory or consultancy role to support or promote the development of effective counter

fraud practice in their organisation. Both assurance and consultancy work on counter fraud may contribute to demonstrating that internal audit is operating in accordance with the *Core Principles for the Professional Practice of Internal Auditing*. For example helping the organisation to improve its management of fraud risk may evidence the following core principles:

- Aligns with the strategies, objectives, and risks of the organisation.
- Is insightful, proactive, and future-focused.
- Promotes organisational improvement.

In addition internal audit may be asked to support, advise on or manage some elements of the organisation's counter fraud activity. Internal audit may also identify opportunities to contribute to the effectiveness of counter fraud through consultancy. In these cases internal auditors need to ensure that they have adequate proficiency to undertake the activity (1210.A2) and also that they identify and manage any impairments to independence or objectivity. These should be included in the charter (Public Sector Requirement 1000).

Standard 1130 *Impairment to Independence or Objectivity* requires that details of the impairment must be disclosed and 1130.A1 requires that individual internal auditors must refrain from assessing specific operations for which they were previously responsible. 1130.A2 requires that assurance engagements for functions for which the chief audit executive has responsibility must be overseen by an outside party.

In summary therefore, where activities falling into segments three and four are in practice undertaken by internal audit, the head of internal audit needs to ensure appropriate safeguards are in place in accordance with the standards. Further details on safeguards are set out later in this guidance note.

### **Application of the standards**

#### 1210 Proficiency

The first aspect of this is ensuring there is sufficient knowledge of the types of fraud risk to which the organisation is exposed. This includes:

- Types of fraud and how they may be committed
- Past experience of fraud in the organisation
- Experience across other organisations, particularly those in the same sector
- Emerging risks
- Sectoral priorities on fraud and corruption risks
- Impact of policy changes on fraud risk. For example the creation of personal budgets as a way to better target social care funding at individual needs, also created a new area of fraud risk.

Secondly, internal auditors should understand the fraud risk management actions the organisation should have in place. Increasingly this will require them to work with others as necessary, specifically including IT security personnel whose expertise will be needed in relation to cyber-driven fraud risks. The scope of counter fraud activity that an organisation should undertake to manage its fraud risks is well defined for the public services. For example, the [CIPFA Code of Practice on Managing the Risk of Fraud and Corruption](#) (the CIPFA counter fraud code) has application across the public services. It sets out five principles:

- Acknowledge the responsibility of the governing body for countering fraud and corruption

- Identify the fraud and corruption risks
- Develop an appropriate counter fraud and corruption strategy
- Provide resources to implement the strategy
- Take action in response to fraud and corruption.

Where the organisation has adopted a structured counter fraud standard against which practice can be compared then internal audit can use this to guide their audit assurance work. The CIPFA counter fraud code will help auditors to examine the range of fraud risk management activity and to evaluate whether the organisation has a comprehensive counter fraud and anti-corruption strategy. It identifies the following elements of a counter fraud strategy:

#### Proactive

- Developing a counter-fraud culture to increase resilience to fraud.
- Preventing fraud through the implementation of appropriate and robust internal controls and security measures.
- Using techniques such as data matching to validate data.
- Deterring fraud attempts by publicising the organisation's anti-fraud and corruption stance and the actions it takes against fraudsters.

#### Responsive

- Detecting fraud through data and intelligence analysis.
- Implementing effective whistleblowing arrangements.
- Investigating fraud referrals.
- Applying sanctions, including internal disciplinary, regulatory and criminal.
- Seeking redress, including the recovery of assets and money where possible.

Other sources of guidance on fraud risk management include:

- [Managing the Business Risk of Fraud: A Practical Guide](#) (Institute of Internal Auditors, The American Institute of Certified Public Accountants and Association of Certified Fraud Examiners)
- [Counter Fraud Framework](#) (Cabinet Office)

Where internal audit is planning to rely on the evaluation work of others as part of their assurance opinion then they should have regard for PSIAS 2050 and the associated Public Sector Requirement.

Were internal auditors to take on a wider role in relation to counter fraud then their proficiency would need to extend beyond that which is required for internal audit work and which falls within the requirement of PSIAS. Internal auditors in this position are encouraged to seek guidance on the proficiency required for a counter fraud professional, but this is beyond the scope of this guidance note.

### **Safeguards when providing advice and consultancy or a counter fraud role**

It is the responsibility of the organisation's leadership to ensure that there are adequate arrangements in place to manage their fraud risks.

Internal audit may provide consultancy work or support the implementation and development of good counter fraud practice. Some of these activities, whilst beneficial to the organisation, may potentially create new impairments of independence or objectivity

with internal audit's ability to provide assurance over the management of fraud risk. Heads of internal audit should clearly identify these activities and assess their potential benefits and potential impairments at the beginning.

Where internal audit is requested to support the application of fraud risk management, there may be benefits to the organisation and to internal audit. This is most likely to be the case where internal audit are identified as the most knowledgeable and skilled team in understanding fraud risk.

#### Potential benefits of internal audit advisory and consultancy work on counter fraud

- Uses internal audit's expertise in risk and awareness of internal controls to improve fraud prevention.
- Internal audit's skills in testing and data analysis would help the organisation to improve its ability to detect fraud.
- Internal audit skills such as analysis of evidence can support an investigation.
- Advisory support will help the organisation to strengthen the control environment.
- Develops good working relationships between internal audit and counter fraud specialists and a better understanding of fraud risk and control issues amongst the audit team.

As well as benefits, internal audit should recognise that their work may result in an actual or perceived impairment to independence or objectivity.

#### Potential impairments that may arise

- Internal audit may be seen as responsible for embedding good counter fraud arrangements. This may conflict with the ability of internal audit to give assurance
- There may be a conflict with audit assurance work in the area where the fraud has occurred
- Internal audit may not be able to give independent assurance over aspects of the organisation's counter fraud arrangements if internal audit activity is significant.

Internal Audit should set out in their Charter their likely responsibilities for counter fraud activity and where there is a potential or perceived impairment to independence and identify appropriate safeguards. Similarly, any limitation of scope or apportionment of responsibility, for example in relation to cyber-driven fraud risks and the role of the body's IT security officers, should be clearly set out.

If the head of internal audit takes on responsibility for the counter fraud function of the organisation, for example managing the counter fraud team, then they must have regard for standard 1112 *Chief Audit Executive Roles Beyond Internal Auditing*. This requires reporting to the board any potential or perceived impairment and the board must approve and review any safeguards put in place. Reporting to the board provides an opportunity to highlight the value of internal audit assurance and the importance of supporting the internal audit activity and its value to the organisation alongside the importance of supporting an effective counter fraud response, so the need to report to the board should not be seen as a negative step.

Potential safeguards that might be considered appropriate, depending on the extent of impairment, include:

- arranging for internal audit of counter fraud activity to be undertaken by a third party
- identifying another senior manager to be responsible for establishing the scope of the internal audit and for reviewing the report and recommendations
- separate reporting of the audit scope and findings to the audit committee.

Establishing safeguards should enable the head of internal audit to satisfy 1130 *Impairment to Independence or Objectivity* and 1112 *Chief Audit Executive Roles Beyond Internal Auditing* whilst fulfilling the standard 2120.A2.

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**Appendix****The internal audit role in counter fraud**

Core internal audit roles that all internal auditors should include in risk-based approach.

- Providing assurance on the adequacy of the organisation's counter fraud and anti-corruption arrangements.
- Evaluating the organisation's reporting on counter fraud activities.
- Reviewing the implementation of the organisation's agreed counter fraud and corruption strategy.
- Evaluating the robustness of internal controls (including IT security controls) designed to prevent or detect fraud and corruption.
- Reviewing the control weaknesses that contributed to a case of fraud, making recommendations for improvement.

Counter fraud roles that internal audit can undertake without compromising audit independence.

- Reviewing a fraud risk assessment and proposed mitigations.
- Supporting the organisation's ethical and anti-fraud and corruption culture, for example through sharing of fraud alerts, supporting a risk awareness initiative.
- Sharing of learning on fraud and corruption risks and experiences with other organisations, such as benchmarking and fraud surveys.

Counter fraud roles where internal audit may provide consultancy or advisory services, with safeguards.

- Championing the development of counter fraud capability and activity within the organisation.
- Receiving calls from whistle blowers, for referral on to counter fraud team.
- Undertaking data analytics to identify potential matches for investigation.
- Preliminary review of matches (for example the National Fraud Initiative) for further investigation.
- Leading a fraud and corruption risk assessment process.
- Contributing to the development of the counter fraud and anti-corruption strategy.

Counter fraud activities, beyond the normal scope of internal audit which are likely to impair the auditor's independence or objectivity, where safeguards will be required.

- Undertaking a fraud or corruption investigation.
- Implementing sanctions or deciding on the recovery of assets.
- Deciding on the appropriate action to take on fraud referrals.
- Taking decisions on the counter fraud and anti-corruption strategy of the organisation.
- Being accountable for counter fraud and anti-corruption activities and resources.