Globalization has increased the scale and complexity of today’s business environment. The velocity of change has created significant pressures on management to effectively maintain oversight of all operations. These challenging scenarios create various vulnerabilities in systems, procedures and frameworks for manipulation and frauds. The incentives and pressures to commit frauds viz. financial gain, meeting target etc have always existed. However, frauds happen when fraudsters get an opportunity to execute their intentions. The opportunity arises when they spot a weak link in the oversight process, inadequate controls, lack of proper accountability, unrestrained power to certain individuals, inadequate segregation and rotation of duties, excessive trust etc. Some of these are simplistic internal control failures.

According to KPMG in India’s Fraud survey report 2012, 55 percent of the organizations surveyed had experienced fraud in the last 2 years. Executive management who are responsible for establishing a robust control environment and audit committees who responsible for effective oversight are increasingly depending on the audit functions (internal and external) and various other assurance providers to provide them with the necessary information to gain insights and assurance on the control environment. Though the audit functions are not primarily responsible for identifying frauds within an organization, they have an implicit responsibility to identify fraud. Internal auditors and external auditors are the third line of defense. However, they are the only independent line of defense for various stakeholders. According to KPMG’s survey, internal audit review was considered by stakeholders as the second most reliant method to detect fraud.

While managing these challenges, internal audit teams should ensure that they stay relevant in today’s times and equip themselves with the necessary skills, knowledge and tools to enhance their ability to identify frauds and discharge their responsibilities. Internal audit functions need to evaluate how vulnerable are their internal procedures and abilities to discharge this role effectively and take measures to strengthen their approach.

This paper defines certain key focus areas for internal audit teams to assist them in enhancing their role towards identifying vulnerabilities in the system for manipulation and fraud.
Internal audit plan is the fundamental document which is the basis for driving the assurance program within an organization. The audit plan is normally focused on critical areas that matter the most. This is identified based on critical risks, inputs from various stakeholders, past experiences etc. The plans are mainly geared to review the operational processes and the emphasis on strategic and cultural areas is often not included in the plans. To make them more holistic internal audit plans should include the following:

**Assessing organization culture and governance structure**

The starting point of a robust fraud risk management framework is the organization’s governance structure. The audit of governance structure should include audit of budgeting process, ethics policies and its implementation, quality of organizational teams, amount of work pressure for individuals, effectiveness of monitoring procedures by senior management, rotation procedures, alignment of schedule of authority matrix, compliance framework, governance practices, performance incentives evaluation, segregation of duties etc. Any weaknesses in these areas will create vulnerability for frauds and hence it is important for internal auditors as part of their internal audit plan to focus on these areas as well. This should be done by conducting independent interviews with several senior and middle level management team members.

As organizations expand into various geographies and countries, they are exposed to different cultures and value systems. Some cultures are inherently more democratic, have relatively flat hierarchies, their work relationships are relatively more formal etc. Some cultures, on the other hand, encourage respecting authority, informal/familial relationships at work etc. These cultural beliefs are deep seated. This could make certain cultures more conducive for/tolerant of frauds by superiors, authoritative figures etc. Hence, it is important for internal audit teams also to assess the culture within various business organizations. This can be done through various risk culture surveys among employees. The outcomes and findings of these surveys can be used as inputs to strengthen the business and operating culture.

**Benchmark processes to industry practices**

One of Internal Audit's primary responsibilities is to review all key processes followed in an organization and provide assurance on their effectiveness. Internal Audit teams should not only focus on evaluating processes based on the information they have within the organization but also continuously benchmark the processes/practices followed by leading companies within and outside their sectors. This will give them the ability to challenge various practices followed by the company to identify vulnerabilities and complacency within processes. Constructive challenge of areas will throw up vulnerabilities in existing processes which may have been lying undetected under the garb of industry practices.
Assess adequacy of Rotation Policy

According to Association of Certified Fraud Examiners 2012, the amount of fraud losses is positively correlated with the number of years the perpetrator has worked for the organization. Median losses caused by perpetrators in the first year of their job amounted to USD 25,000 while those caused by perpetrators with more than ten years of experience at the organization caused a median loss of USD 229,000.

This finding underlines the importance of employee rotation. Internal auditors should also evaluate assessing the quality of the company personnel performing certain roles and evaluate their skillsets to perform the job roles/description assigned to them. Employees with low level of skill-sets (especially those who are performing the role of a checker) create vulnerabilities in the system for frauds being undetected or create vulnerability in the system for others to misuse. These assessments can be done by the internal auditors through discussions with process owners and understanding the manner in which they discharge their responsibilities. Internal auditors should also evaluate the time period since when an individual is performing the defined role. In the past, frauds have been highlighted mainly when there has been a rotation in the employee performing a specified role. Periodic rotation and mandatory leaves should be encouraged.

Ensuring seamless audit policy across entities

Internal Audit teams also play an important role after new acquisitions, big outsourcing deals, large scale expansion, formation of subsidiaries etc. Internal Audit should make sure that the company’s policies are consistent in all subsidiaries and business units. Internal Audit functions should do dip-stick reviews of the acquired entity or newly formed joint venture to assess the organizational culture, governance levels and also the strength of its internal control environment. Such a practice should be followed both for domestic as well as international acquisitions.

The global acquisitions should not be ignored on account of cost implications as the impact of any vulnerability may be severe and may not be recovered from the seller post a particular time period as per the purchase/JV agreement.

Building competencies and enhancing domain knowledge

Internal audit functions need to also focus on enhancing their team skillsets and technology enablers to align them with the business requirements. Internal Audit team members need to have the necessary domain knowledge and also has skill sets in IT applications being used by the organization. Many internal audit functions have separate forensic experts who complement the internal audit teams in reviewing processes to assess fraud vulnerabilities. The Chief Internal Auditor should ensure that personnel from their team undergo the necessary certifications courses like Certified Fraud Examiner to enhance their skillsets etc.
Internal Audit teams should have sufficient domain knowledge in the relevant industry / area. Each industry has its unique characteristics. Sound understanding of these characteristics, seasonality in industry performance, the role played by technology, competition etc will help the Internal Audit team detect unusual / suspicious activity better. Hence, Internal Audit should have the requisite domain expertise on the business processes namely technical processes, manufacturing, utility cost management, treasury, specialized procurement e.g. cotton procurement, fuel procurement, e-procurement, logistics and distribution which are prone to frauds. They may need to seek assistance from third party experts in areas of specialization e.g. Treasury reviews, IT security reviews, Commodity Hedging reviews, etc.

**Data analytics**

Considering the current geographic spread and also the segmental spread of companies across business, internal audit functions cannot function effectively without technology. The volume of data and information to be validated/ reviewed requires automated control dashboards / System GRC tools and data analytics to evaluate information. Internal audit functions need to invest in these technologies and tools to drive efficiencies and value. Adequate business analytical skills to relate information across various databases and also interpret data and what should be analyzed. This requires Internal Audit functions to have personnel who are experienced in data modeling and data analysis.

Internal Audit teams should leverage on tools such as MIS, customized tools and softwares to prevent and detect frauds.

**Whistleblower Policy**

Whistleblower is arguably the most important channel of capturing employee or partner feedback on suspicious or potentially fraudulent behavior. According to KPMG in India Fraud Survey 2012, whistleblower was the most effective mode of fraud detection. An anonymous hotline or whistleblower should be available to all employees, vendors and partners across geographies and around the clock. This will encourage reporting or flagging of potentially fraudulent activity. An anonymous call should be followed by an initial investigation by internal auditors or an external consultant. If the investigators find any merit in the complaint, they should escalate the matter to the management. The Companies Bill 2012 mandates listed companies to establish a vigil mechanism or a whistleblower for directors and employees.

Considering significant pressures on margins due to intense competition, organizations have increasing expectations that internal audit function costs need to be recovered and hence may also tend to evaluate internal audit function based on cost saving noted and process improvements identified. It is important for organizations to note that the internal audit function has an onerous and primary responsibility to ensure that the control environment within an organization is robust to protect stakeholder interests and hence they should mainly focus on risk and control evaluation and cost reduction opportunities should only be by-product where necessary and not a driving factor.

Organizations and management should also take cognizance of the various internal audit findings and implement measures even if they are vulnerabilities at a particular date. E.g. in the rouge trading case in a financial institution, it was later discovered that the financial institution's data analytics center had detected and warned the management about various irregularities. However, the management did not act promptly on the warning. Hence organizations should take segregation of duties, access control violations, rotation of employees, absence of maker – checker controls, unlimited value based limits in systems, etc issues very seriously even if there have been no anomalies identified or immediate impact noted.
Conclusion

As the past has shown, tight controls and stringent penalties are not adequate in preventing frauds. Internal Audit professionals need to do much more in today’s dynamic environment. Given the significant role Internal Audit plays in an organization’s fraud risk management, it can no longer afford to take a back seat. It will have to be at the forefront in assisting management in setting up processes to prevent frauds in an organization.