The Institute of
Internal Auditors
Australia

Factsheet:
Fraud and Corruption

What is fraud and corruption?

Fraud can be defined as:

Misuse of entrusted power for personal gain including bribery, conflict of interest, extortion, embezzlement and fraud.

Corruption can be defined as:

Acts in which individuals wrongfully use their position or influence to procure benefit for themselves or another person, contrary to their duty to their employer or the rights of others, for example kickbacks, self-dealing or conflicts of interest – corruption typically involves bribery.

A well-known anti-corruption organisation is Transparency International. Each year Transparency International produces its 'Corruption Perceptions Index' ranking nations from least to most corrupt. In 2020 New Zealand and Denmark were ranked equal least corrupt countries (number 1) in the world. Australia was ranked equal number 11 but could improve transparency and potentially its international corruption ranking if the Australian Government established a strong federal integrity commission. Australian States and Territories have their own government anti-corruption bodies.

Why is fraud and corruption a problem?

The ACFE study 'Report to the Nations – 2020 Global Study on Occupational Fraud and Abuse' reported that from 2,504 cases studied from 125 countries:

› Total fraud losses were more than USD 3.6 billion.

› Average loss per fraud case was USD 1.5 million.

› Estimates are that organisations lose 5% of revenue to fraud each year.

› A typical fraud case lasts for 14 months before detection.

› Smaller organisations tend to suffer disproportionately large losses.

Studies in Australia have shown a belief among suppliers that government procurement is prone to corruption.

The International Monetary Fund (IMF) reports that corruption results in:

› Increased income inequality and poverty through lower economic growth.

› Biased tax systems favouring the rich and well-connected.

› Poor targeting of social programs.

› Use of wealth by the well-to-do to lobby government for favourable policies perpetuating inequality in asset ownership.

› Lower social spending.

› Unequal access to education.

› Higher risk in investment decisions of the poor.

What is the fraud triangle?

The fraud triangle is a model for explaining the factors that cause someone to commit occupational fraud. It consists of three components which together lead to fraudulent behavior:

› Perceived unshareable financial need.

› Perceived opportunity.

› Rationalisation.

What are red flags of fraud?

The ACFE says there are six behavioural red flags of fraud that have been the most common in every one of their studies dating back to 2008, with a remarkably consistent distribution:

› Living beyond one's means.

› Financial difficulties.

› Unusually close association with a vendor or customer.

› Excessive control issues or unwillingness to share duties.

› Recent divorce or family problems.

› A general 'wheeler-dealer' attitude involving shrewd or unscrupulous behaviour.

While the presence of these red flags does not imply fraud is being committed, understanding and recognising behavioural red flags displayed by fraud perpetrators can help organisations detect fraud and mitigate losses.

Transaction related red flags of fraud may include:

› Undeclared or inadequately managed conflicts of interest.

› Excessive discretion in decision-making and providing advice.

› Excessive autonomy.

› Inadequate segregation of duties.

› Inventory shrinkage.

› Missing documents.

› Multiple payments.

› Split payments.

› Increase in volume of invoices.

› Frequent complaints.

› Excessive financial or inventory adjustment entries.

How is fraud uncovered?

ACFE research says fraud is detected by:

Tip-offs	43%
Internal audit	15%
Management review	12%
Other	6%
By accident	5%
Account reconciliation	4%
External audit	4%
Document examination	3%
Surveillance and monitoring	3%
Notified by law enforcement	2%
IT controls	2%
Confession	1%
	100%

What are benefits of active fraud control measures?

› Financial savings.

› Proactive rather than reactive management.

› Fewer surprises.

› Enhanced ethics.

› Enhanced reputation.

› Better accountability, assurance and governance.

› Improved information for decision-making.

› Insurance cost reduction

› Improved morale because people prefer to work in an ethical environment.

› Avoiding risks as it is not uncommon for organisations to be wiped out by fraud.

› Regulatory support and avoiding regulatory sanction.

› Stakeholder support.

11 Action Steps – what organisations can do about fraud and corruption

Step 1 – Implement a fraud and corruption control policy

› Organisations should implement a formal documented fraud and corruption control policy to:

› Enhance integrity.

› Reduce risk of fraud.

› Detail the organisation's approach to fraud prevention.

› Help people understand their roles and accountabilities.

Step 2 – Have 'zero tolerance' for fraud – and mean it

› Organisations should have a 'zero tolerance' approach to fraud and be committed to:

› Actively preventing, detecting and investigating fraud.

› Protecting and promoting proper use of the organisation's property.

› Maintaining and improving fraud prevention controls.

› Detecting and investigating unlawful use of assets such as computers, vehicles, telephones and other property or services.

› Detecting and investigating bribery, corruption or abuse of office.

› Referring offenders for criminal prosecution where there is sufficient evidence.

› Seeking civil, administrative or disciplinary sanctions where a case of fraud has been proven.

> › Recovering proceeds of fraud.

› Organisations should follow through with prosecution where warranted rather than quietly dismissing an employee and leaving them free to do it again elsewhere - this is unconscionable behaviour especially where a reference is provided to the perpetrator.

Step 3 – Assign fraud control responsibilities

› Develop a fraud control responsibility assignment matrix (RACI) to identify who in the organisation needs to be Responsible / Accountable / Consulted / Informed about fraud control.

› Make sure people know where they fit in the RACI and what their obligations are.

› Ensure all staff, supervisors, managers and suppliers understand their roles and accountabilities.

Step 4 – Perform regular fraud risk assessment

› Develop a fraud risk universe of areas where there may be potential for fraud and corruption.

› Prepare an assurance map showing the various fraud assurance capabilities and rate their effectiveness and gaps.

› Implement a plan to address the gaps.

› Perform regular fraud risk assessments.

› Make sure there is a dynamic process that can be quickly applied to new fraud risk areas for example to large programs, projects and procurements.

Some fraud control frameworks suggest integrating fraud and corruption risk assessment into an organisation's enterprise risk management framework and general risk assessments – the main point is that fraud risk needs to be captured and remediation strategies devised however it is done.

Step 5 – Develop a fraud control plan

› Develop a formal documented fraud control plan based on identified fraud and corruption risk.

› The plan should incorporate all action steps shown in this fact sheet with a focus on awareness / prevention / detection / investigation / reporting.

Step 6 – Implement fraud awareness

› It is generally accepted the most cost-effective means of preventing, detecting and deterring fraud in any organisation is through establishment and reinforcement of a sound ethical tone, together with a high level of employee awareness of fraud risk and the impact that fraud has on organisation sustainability.

› Fraud awareness training is an essential part of the overall process of fraud prevention.

› It needs to cover people within the organisation and also external stakeholders such as suppliers.

› For people in operational and risk areas, it is essential they are trained on how to identify suspect transactions and there is a culture of following-up on these.

› Set standards on integrity issues such as conflict of interest, gifts and benefits, use of resources, bullying and harassment, etc.

› Ensure people understand the standards and there is a culture of complying with them.

Step 7 – Ensure there is adequate fraud detection capability in place

› Ensure all assurance activities within the organisation have focus on fraud prevention and detection for example risk management, compliance, internal audit, etc.

› Consider continuous control monitoring of technology systems to interrogate whole populations of data to detect fraud.

› Ensure fraud detection capability also covers external stakeholders such as suppliers.

› A major cause of fraud and corruption is organisations outsourcing activities and relying purely on a written contract, with organisations (a) failing to assess and ensure the supplier has an adequate control framework in place (b) failing to require the supplier provide evidence the framework is operating properly (c) the organisation failing to conduct their own checks on suppliers instead of relying on trust the supplier will do the right thing (d) not looking at supply chains – not only the immediate supplier – as fraud at subcontractor level can be a major risk.

Step 8 – Ensure there is adequate fraud investigative capability

› Ensure all fraud allegations are logged and tracked.

› Ensure all fraud allegations are promptly investigated.

› Investigations should be undertaken by people with appropriate training and experience – these may include in-house and trusted contracted resources.

Step 9 – Establish fraud reporting mechanisms

› Have clear and simple fraud reporting mechanisms for people to report suspected fraud.

› Make sure this covers people who want to report fraud from (a) inside the organisation (b) outside the organisation (c) suppliers.

› Ensure it covers protected interest disclosure (whistleblowing).

› Go to your organisation's website right now and see how someone from outside the organisation can report possible fraud – this mechanism often does not exist or is difficult to locate.

> › Require suppliers and the supply chain to report suspected fraud and corruption – and make sure supplier staff involved with the contract know where to report allegations.

Step 10 – Schedule annual reporting about fraud including performance measures

› Implement a set of fit-for-purpose fraud control performance measures (KPIs).

› Periodically report KPI results to senior management and the audit committee.

› Prepare a fraud control annual report for senior management and the audit committee.

Step 11 – Commission periodic independent review of organisation culture, fraud control and investigative capability

› Ensure internal audit actively considers opportunity for fraud and corruption in every internal audit engagement performed - and also conducts audits of organisation culture.

› Periodically engage an independent expert to independently review organisation culture, fraud control and investigative capability.

› Report review results to senior management and the audit committee

Internal Audit's Role in Fighting Fraud

The 'International Professional Practices Framework' issued by the IIA states in Internal Audit Standard 1210.A2 that:

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

This is contrary to what many people think, which is that internal auditors have a primary focus on fraud and its detection. 'Report to the Nations – 2020 Global Study on Occupational Fraud and Abuse' by the ACFE reported that internal audit detects 15% of fraud.

Conclusion

Organisations need to have a fit-for-purpose co-ordinated approach to fraud and corruption control that needs to focus on awareness / prevention / detection / investigation / reporting.

Management has responsibility to ensure fraud risk assessments are conducted and fraud prevention strategies are implemented.

The key question to be answered is – How does management, the audit committee and board clearly know that ethics and culture are strong, and fraud and corruption prevention arrangements are operating effectively?

Connect › Support › Advance

Useful references

'The 20 Critical Questions Series – What Directors should ask about Ethics and Fraud Control', IIA-Australia

Factsheet 'Conflicts of Interest', IIA-Australia

Factsheet 'Procurement Integrity (Probity)', IIA-Australia

Factsheet 'Tender Transparency', IIA-Australia

White Paper 'Auditing Transparency', IIA-Australia

White Paper 'Auditing Tender Evaluation Reports', IIA-Australia

White Paper 'Auditing Tender Specifications and Assessment Criteria', IIA-Australia

White Paper 'Conducting Fraud and Corruption Investigations', IIA-Australia

White Paper 'Conflicts of Interest in the Award of Contracts', IIA-Australia

White Paper 'Conflicts of Interest – A Framework', IIA-Australia

White Paper 'Corruption Indicators in Internal Audit', IIA-Australia

White Paper 'Corruption Related Risk in Decision-making', IIA-Australia

White Paper 'Fraud and Corruption Risk Assessments', IIA-Australia

White Paper 'Fraud Prevention: 10 Action Steps', IIA-Australia

White Paper 'Fraud Risk Indicators', IIA-Australia

White Paper 'Procurement Integrity (Probity)', IIA-Australia

White Paper 'Public Sector Procurement', IIA-Australia

White Paper 'Procurement Integrity (Probity)', IIA-Australia

White Paper 'Whistleblowing Program', IIA-Australia

'Fraud Examiners Manual', Association of Certified Fraud Examiners

Australian Standard AS 8001–2008 'Fraud and Corruption Control', Standards Australia

Transparency International website, www.transparency.org

The Australian Government Commonwealth Fraud Prevention Centre has guidance on how to counter fraud.

Australian State and Territory Governments have anti-corruption bodies that produce relevant guidance.

Many Australian State and Territory Auditors—General have issued fraud and corruption guidance.

Acknowledgement

This factsheet has drawn upon information from the Association of Certified Fraud Examiners.

The Institute of Internal Auditors Australia