

Auditor's Mission in Preventing and Fighting against Fraud

Mihai DEJU

Vasile Alecsandri University of Bacău, ROMANIA

dejumihai@yahoo.com

Petrică STOICA

Alexandru Ioan Cuza University of Iași, ROMANIA

Abstract: *Fraud as a phenomenon is most commonly found in the economic area, manifesting in various forms. Within an entity, the auditor must inform the management, those responsible with the governance, regulatory and implementation authorities, on any significant gaps existing at the level of the internal control associated with preventing or detecting fraud and errors, which were reported as a result of carrying out the audit activity.*

Key words: *fraud, audit, prevention, management*

Introduction

Fraud is a scam. There are several definitions of fraud. According to The American Heritage Dictionary of the English Language (Fifth Edition), fraud is defined as “*a deception deliberately practiced in order to obtain unfair or unlawful gain*”.

Various specialized dictionaries have defined the concept of fraud as a misleading, an act of bad faith committed by person interested in getting a material profit, an asset, prejudicial to the rights of any other person.

In short, fraud always involves one or more persons who wilfully act in a hidden way, to deprive anyone else of a property or a value with the purpose of becoming wealthy. Specialists in combating this phenomenon considered deception as the pivot of fraud.

1. The Prevention, Detection and Investigation of Fraud

The forms of fraud suggest that it can have a vast field of action, and there is not a clear dividing line between irregularities that are intentional/ unintentional, and fraud, which is carried out with intent.

The identification of the presence of fraud in practice is a problem both for managers and auditors, the phenomenon being treated with maximum seriousness.

Considering that the fraud appear in different areas of the auditable fields, but also that it is a distinct objective of the audit activity, it is a question of the degree of auditors' involvement in the prevention, detection and investigation of fraud as well as to in what degree their involvement is recommended, so as to be able to keep their independence and objectivity which are essential features of any profession. For a long time it was considered that the prevention of fraud is not an objective of an entity's internal control system. The action of identifying and combating fraud was seen as a general objective, generally without being given due attention as a structured program with clear and explicit goals.

The change of view on fraud has been achieved due to numerous cases of fraud discovered in some of the most prestigious international companies, which has led to a reconsideration of priorities towards this phenomenon. The risk of fraud sensitized investors because, in some cases, companies have suffered collateral losses caused by the presence of this phenomenon, such as negative publicity or loss of confidence in the management team, more significant in value than the financial losses generated directly by fraud. For fighting against this phenomenon, investors turned to the development of mechanisms designed to prevent, detect and combat the appearance of fraud. Considerable attention has been given to internal control and audit as basic elements of this mechanism.

Professional audit bodies have taken a stand against the occurrence of fraud, defining the term in the internal audit Rules, as an illegal act characterized by deception or betrayal of trust, dissimulation, being committed by individuals and organizations in order to obtain money, goods or services, in order to avoid payment or loss of services or to provide a business or personal advantage for themselves. [1]. When we talk of fraud, we consider four aspects, namely prevention, detection, investigation and correction, the internal audit being responsible for the pressure on an entity in order to prevent fraud.

The responsibilities to prevent fraud in an entity are divided between the internal audit, the audit committee and the Executive. The executive is the one that gives explanations for the identification of cases of fraud, while the audit committee oversees the risk management, monitoring the anti-fraud measures decided by the Executive. Internal audit is a tool used by the audit committee in evaluating the risk of fraud and the measures implemented by the Executive.

The auditor's mission is to provide advice and draw conclusions on the effectiveness of approach initiated by the management in managing the risk of fraud within the entity. This role requires the following actions carried out by the auditor:

- to investigate cases of fraud, recommending appropriate control tools that can be used in the future;
- to examine the instruments of control to prevent fraud and detection processes implemented with the management;
- to make recommendations necessary to improve these processes;
- to provide counselling for the audit Committee;
- to provide specialist knowledge and specific skills required for an investigation;
- to have the necessary knowledge to detect fraud indicators.

In the detection of fraud, the auditor does not play the most important role, this role belonging to the entity's management to implement control detecting tools, which will identify the potential deliberate fraudulent actions. The audit's mission is to analyse the test the control tools, being mindful to the indicators that may indicate the presence of this phenomenon.

The investigation of fraud is the area where the audit identifies with the greatest responsibility of action carried out on the basis of written procedures.

2. The Correction of Fraud

The correction of fraud involves the intervention of management, on the one hand, to deal, in a first phase, with those who had committed fraud and the consequences of fraud in an attempt to engage in legal proceedings and to minimize losses and, on the other hand, of the audit, to review the conditions which allowed the emergence of fraud and to prevent the repetition of them.

In Romania, according to the law [2], the resolution of frauds at the moment of their appearance, is one of the management responsibilities, regardless of whether the frauds come from the internal control, internal audit, external audit, or from other sources.

Also, managers have the responsibility of ensuring the legality and public entity patrimony by law [3], and their non interference in such cases even attract criminal liability.

When the General Management becomes aware of the signals of a possible fraud, immediately investigates its causes, using their own control or inspection structures.

Even in the situation of unsafe signals, the management must create a team for the investigation and determination of possible fraud or even a decision-based commission, in order to investigate and decides how it will proceed according to the results of the investigation.

When the general manager is possibly involved in fraud, then he/she submits the file to the superior hierarchical level, for investigation, taking into consideration the obligation established by law, to valorise the probative documents in the possession of which he/she entered when carrying out the

current activities. Also, the management informs the internal audit structure on the results of investigations.

The police and the prosecution bodies, even if they have been applied by management, not having the necessary tools for investigating fraud in the public entities, will appeal to all of them to complete the research. Please note that this system was adopted in Romania after the harmonization of the “community acquis” with the national legislation in the field in order to make the top management more responsible.

The International Internal Auditing Standard number 1210.A2, related to fraud, stipulates: “*The internal auditor should, with the help of knowledge held, identify fraud signals, but he/she is not expected to have the same experience as a person whose main responsibility is to detect and investigate fraud*” [4].

We have to admit that, in practice, there are internal auditors who wish to amplify very much their activities when they detect a fraud, coming usually from the category of staff that carried out control or inspection activities. These specialists are trying to provide management with the necessary tools or a convincing quantity of information, but there are more practices in the field of investigating fraud, being difficult to set a limit by which they must engage the internal auditor.

From the carried out documentation there has resulted that international practice, as well, is quite different and, in many cases, the activity of investigating fraud, is related to the national culture in this area.

In the United Kingdom, the internal auditor should consult his/her lawyer before giving the signals of fraud, for not risking being sued for violating the professional interests of those involved. At the same time, *internal audit, which has a special qualification in fraud investigation*, may, if it is conclusive, to carry out preventive detention; however, if it is wrong, the responsibility is entirely its, which is why, in such situations, it frequently calls to advice offered by lawyers.

The contribution of internal auditors to the diminution of risks, which lead to the appearance of fraud, is carried out in connection with the conduct of internal audit missions, but especially in the process of risk analysis, specific to each audited area. By carrying out the internal audit plan and implicitly through the application of and compliance with the internal audit procedures there can not be given an assurance that all cases were detected, but rather a reasonable assurance on the functionality of the management control system.

We believe that, in the case of identifying a potential fraud, it is recommended to draw up a separate report containing evidence of fraud and the express recommendation of establishing additional investigations.

Internal auditors of public entities with major fraud risk, based on a grounded analysis, may recommend the organization of an inspection/control structure permanently or temporarily, which will be an auditable objective in the sphere of activity of the internal audit department.

Within current activities, internal auditors must possess sufficient knowledge to identify the signs of fraud, but this does not mean that it is necessary to have the competence of a person whose primary responsibility is to identify fraud [5].

The phenomenon of fraud can be associated with serious criminal activities that occur outside the entity, including money laundering. There is no clear dividing line between this term and the errors/irregularities which can be carried out intentionally or unintentionally.

In an entity’s practice, the elements linked to irregularities or fraud represents a problem to solve for both managers and internal or external auditors.

The professional qualifications of auditors, in accordance with International Audit Standards (I.S.A) do not require the experience and expertise necessary to investigate fraud. The auditor's contact with fraud occurs when evaluating the internal control system, moment when the auditor identifies the control non functional mechanisms generating malfunctions.

The auditor's mission is inform the management on the risks faced by the entity and that sufficient and the most appropriate measures have been taken so that their effect does not interfere or influence the carried out activity. From this perspective, the auditor's role is not to investigate but to provide professional advice.

There are opinions and even requests from users of financial statements according to which auditors should investigate fraud.

In this regard professional bodies have agreed that the role of the auditor is not to investigate fraud but to provide recommendations based on the conclusions concerning the effectiveness of the management process in order to manage the risk of fraud.

Since the first signs of fraud, the entity's management needs to be informed in order to carry out research with respect to fraud and the debate of its own investigations, to the persons who were involved in the production of fraud, the size of fraud, the auditor supervising and supporting the management throughout the process.

The first reactions of the management, in the case of detecting fraud, consist in the creation of a Commission with powers of investigation and establishing the existence of possible cases of fraud, and, depending on the conclusions reached, this commission will proceed accordingly. A particular situation is when the management is involved in generating the phenomenon of fraud.

The management of organizational structures of public entities are tasked to take all measures in regard to the risk of fraud by establishing its own procedures, necessary for the prevention and the fight against fraud, the application of appropriate control tools for detecting and preventing fraud, readiness in solving the problems signalled by the staff and the involvement of the competent judicial organs when it is considered necessary.

In preventing and combating fraud, the staff must show discipline, in terms of compliance with the entity's internal regulations in relation to the protection of assets, the operational hierarchical information whenever there is detected or suspected a fraud, informing the competent authorities when the staff becomes aware of an offence when carrying out its duties.

The external auditors' contribution in the prevention of and the fight against fraud is manifested through audits which verify the functionality of the control system management, implementation methods and its efficiency in risk management.

Although the quality of auditor does not require the possession of the experience necessary for the detection and investigation of fraud, this not being a responsibility, it has as characteristic the examination of the control instruments and identification procedures applied by the management, offering assurance on the functionality of the fraud management system.

Although they are not required to possess the necessary expertise to detect fraud, auditors have a number of compulsory responsibilities in order to contribute to the prevention of and fight against fraud, concerning:

- knowledge of the types of fraud specific to auditable areas;
- having the necessary and sufficient knowledge to identify the defining elements of fraud and the techniques used for investigation;
- the development of additional activities in the case of identification of weaknesses in the internal control system in order to identify signs of fraud (in the case of non-compliance with procedures, carrying out unauthorized operations, making no checks, the derogation from the

- laid down rules without any explanations, etc) whereas the identification of several clues in the same place or moment indicates a larger probability of committing fraud;
- the evaluation of clues, the sufficiency of presumptions to commit fraud in order to recommend further investigations through a separate action.

At the end of the investigation of fraud the auditor can continue his/her own specific evaluations in order to formulate recommendations on the implementation and development of internal control instruments for reducing future risks, the elaboration of audit tests to detect future risks of fraud and identify the necessary additional knowledge for risk identification and fraud mechanisms which might occur in the future.

The importance given to combating this phenomenon has determined the creation, in some entities, of fraud investigation departments based on their own methodologies, operating independently of the internal audit. The mission of these departments may be to take cases initially identified by audit structures, which does not exclude the fact that internal audit may be involved in investigating fraud. It depends on the strategy specific to each entity in terms of the internal audit's involvement in carrying out the investigation of fraud.

The role of internal audit is limited, on the one hand, by the level of technical knowledge and, on the other hand, by the professional experience acquired within the audit structure.

We should also take into consideration the fact that the audit, by the mission it needs to carry out, must also cover other aspects of an entity, such as: the efficiency and effectiveness of operations, financial reporting, and compliance with legal requirements.

By failing to provide a balance in the auditor's activities, directing its activity mainly to missions of investigating fraud, certain relevant aspects may be ignored, decreasing the added value that the audit function must bring to an entity.

Conclusions

The work carried out by auditors is generally based on survey techniques, which makes the identification of fraud often accidental, as the documentary control is seldom used. Moreover, the professional training itself and further specializations show that the auditor may not be, from this point of view, on the same level with a financial auditor-inspector who has acquired specific skills to identify and eradicate cases of fraud in the State sector.

The identification of cases of fraud is more noticeable since internal audit works with external audit. The two types of activities may cooperate with regard to the assessment of the internal control system, the use of unitary documents for repetitive transactions, the participation in physical inventorying, actual documenting at subsidiaries, evaluations etc.

The benefits of this bilateral cooperation refer to the reduction of the duration and nature of the expenditure necessary to achieve the common goals, the mutual exchange of knowledge and experience and the recovery of independence by internal auditors.

We believe that in order to standardise the internal auditors' way of acting in the field of fraud and to set the level of their involvement in the prevention, detection and investigation of fraud, it is necessary to supplement the existing regulatory framework.

The final conclusion is that auditing cannot prevent all cases of fraud, but it can contribute to the identification of causes, accurately interpreting the clues that indicate the presence of fraud.

References

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