



The Institute of
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THOUGHT LEADERSHIP

Fraud Prevention: A Proactive Approach

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Fraud poses a constant threat to organizations, causing financial losses and damaging reputations. While management has the ultimate responsibility for prevention, internal auditors play a crucial role by proactively assessing an organization's fraud risk management and governance frameworks. To be effective in this role, internal auditors need a clear understanding of the nature and characteristics of fraud, the potential for fraud risk within their organisation and effective strategies for fraud risk governance and management. This requires that the roles and responsibilities regarding fraud risk be made clear and that internal audit provide senior management and the board with an opinion on fraud risk governance and management overall.

Beyond Controls: Fostering a Culture of Ethics

When evaluating the effectiveness of an organisation's risk management process overall, the internal audit activity must evaluate the potential for the occurrence of fraud and how the organisation manages fraud risk. There are certain characteristics fraud, commonly referred to as the fraud triangle, that internal auditors need to recognise, namely: Pressure or incentive, perceived opportunity, and rationalisation. Effective internal audits go beyond simply checking the box. They promote a strong ethical environment by working with management to develop anti-fraud programs. These programs typically include a code of conduct, employee training, and confidential reporting hotlines. A strong ethical culture discourages potential fraudsters and empowers employees to report suspicious activity.

Who owns fraud?

Senior management bears primary responsibility for fraud risk management as the first line, while the second line oversees and monitors the implementation of the internal control framework. Internal audit, functioning as the third line, provides assurance to the board and senior management regarding the effectiveness of these controls in mitigating risks. While internal audit does not directly identify or detect fraud, it ensures the organization conducts comprehensive fraud risk assessments to pinpoint vulnerable areas. Internal audit also encourages managers to establish adequate controls to prevent and detect fraud and monitors their effectiveness. The specific role of internal audit in fraud prevention, detection, and investigation is typically outlined in the Internal Audit Charter, which is periodically reviewed and approved by the audit committee. Internal audit activities must align with the organization's risk appetite and fraud tolerance levels, and auditors must maintain independence and possess appropriate training and qualifications.

Fraud Management Responsibilities:

- **Senior Management:** Owns fraud risk management and sets the anti-fraud tone.
- **Internal Controls:** Mitigate risks identified by management's fraud assessment.
- **Internal Audit:** Provides independent assurance on control effectiveness.

Internal Audit's Focus:

- Reviews fraud risk assessments for thoroughness.
- Evaluates control adequacy for prevention and detection.
- Monitors control effectiveness through ongoing testing.

Alignment and Independence:

- Internal Audit activities align with the organization's risk appetite.
- Auditors maintain independence and relevant qualifications.

Where can internal audit add value?

Internal audit's role in combating fraud exceeds minimum standards and offers added value across multiple areas. Auditors proactively challenge boards and management to prioritize fraud prevention, considering factors like the fraud triangle and external pressures. They monitor the organization's environment to anticipate fraud risks and assess internal controls. Internal audit ensures employee understanding of processes and controls, fostering vigilance and curiosity. By framing fraud as a safeguarding issue, auditors challenge complacency and advocate for additional controls. Utilizing data analysis skills, they detect anomalies and investigate suspected fraud effectively, providing insights into control failures. In organizations without dedicated fraud investigation teams, internal auditors can serve as a viable alternative,

maintaining independence. Their holistic view of the business enables them to identify systemic vulnerabilities. Overall, internal audit's proactive stance and comprehensive approach are crucial in mitigating fraud risks and safeguarding the organization's interests.

- **Promote a Culture of Vigilance:** Explain controls and foster employee curiosity.
- **Detect Anomalies:** Leverage data analysis to identify potential fraud.
- **Investigate Suspected Fraud:** Provide insights for control improvements.
- **Address Systemic Vulnerabilities:** Identify and mitigate enterprise-wide weaknesses.

This holistic approach and expertise make internal audit a vital weapon against fraud.

Conclusion

In today's landscape, internal audit's role in fraud prevention is paramount. By championing integrity, fortifying controls, and fostering collaboration, auditors empower organisations to navigate fraud risks with resilience and integrity. As businesses evolve, internal audit remains a vital ally in the pursuit of fraud prevention and organisational excellence.

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