

The Internal Audit fraud challenge
Prevention, protection, detection



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Introduction to survey

Economic uncertainty and changes to the regulatory landscape in the past two years have continued to push fraud risk to the forefront of company agendas.

Since our last Internal Audit Fraud Survey in 2010, the mandate and role of Internal Audit functions have continued to evolve, in respect of both fraud risk management and investigation responsibility. Management are still dependent on Internal Audit to provide them with assurance over the anti-fraud controls in place across their businesses, together with the ability to detect and investigate fraud, should it occur.

So, in light of increased pressures and demands on the Internal Audit function, this survey has covered a range of issues including whether continuing changes in the regulatory environment have had a significant impact on the role of Internal Audit; whether the complexity of data-gathering and transaction monitoring within organisations has affected the role of Internal Audit; and if Internal Audit functions are sufficiently equipped to respond to increased pressures.

In addition, the survey has looked to see how businesses have actually been impacted by fraud, and how the role and remit of Internal Audit might have changed since our last survey. We also examine the role of Internal Audit in preventing and detecting fraud, and senior management's expectations of their Internal Audit function.

The results of this cross-industry survey are based on responses to a number of quantitative questions answered by Heads of Internal Audit during March and April 2012.

Key findings

At a time where organisations are perceived to have an increased vulnerability to fraud, and with many of them having experienced actual fraud within their organisations, it appears that Internal Audit are increasingly focusing on fraud risk. Not only is there boardroom discussion on the topic, but steps are being taken to increase the coverage of fraud risk within the remit of Internal Audit.

One of the key findings to emerge from Deloitte's second biannual Internal Audit survey is the disparate approach to the use of data analytics in the prevention, detection and investigation of fraud. When asked whether data analysis is used by Internal Audit in their fraud prevention, detection or investigation activities, 40% of our respondents said 'no'. 38% also said they were not adequately resourced to perform data analysis. When asked what would help Internal Audit be more effective in providing assurance over fraud risk, 47% said an increased use of data analytics would help the most. This is echoed by 28% who indicated that they planned to implement data mining tools in the next 12 months.

Whilst ongoing economic uncertainty has focused attention on fraud risk within organisations, such uncertainty does not appear to have translated fully into the regular performance of fraud risk assessments. 49% of the Internal Audit teams surveyed said they are performing regular fraud risk assessments, but 40% said they were not (2010: 57%). The absence of such an assessment can make it difficult for Internal Audit functions to determine how to effectively focus sometimes limited resources on the areas of highest fraud risk.

Nearly half (43%) of our respondents indicated their organisations' fraud vulnerability had increased in the last 12 months; 44% and 36% reported an increase in external and internal fraud incidents respectively.

58% of respondents said the new regulatory environment, including the new UK Bribery Act 2010, had increased their focus on fraud risk management while the majority of respondents said senior management continued to strongly support fraud risk management.

In our last survey we found over half (51%) of the Internal Audit functions surveyed considered themselves to be under-resourced to respond effectively to fraud risk within their organisation; this has now reduced to 28%. Despite this apparent increase in resourcing, a training and capability skills gap still remains. If investigations arise, not all Internal Audit teams are adequately resourced both in terms of staffing levels and, for instance, in the areas of investigative interviewing and evidence handling skills. Attention is still required in these areas if they fall within the remit of the Internal Audit function.

What are the views of senior management?

On the face of it, it seems a robust anti-fraud culture is being promoted by senior management with 98% of respondents stating senior management endorse and offer some, or extensive encouragement of a strong approach to fraud risk management (see Figure 1). Similarly, there is some or extensive encouragement (98%) of an ethical culture (2010: 96%) (see Figure 2).

Promotion of a robust anti-fraud and ethical culture would typically be evidenced by having both a defined fraud policy and clear code of ethics that have been communicated effectively across an organisation. Our results show only 19% (2010: 20%) do not have a documented fraud policy (see Figure 3) while only 24% (2010: 30%) do not communicate their fraud policy (see Figure 4); this is similar to the results of the last survey.

Figure 1. In your organisation, do you see senior management encouraging and endorsing a strong approach to fraud risk management?

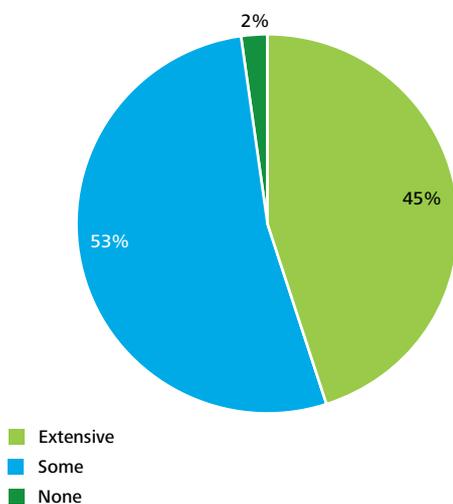


Figure 2. In your organisation, do you see senior management encouraging and endorsing a strong approach to an ethical culture?

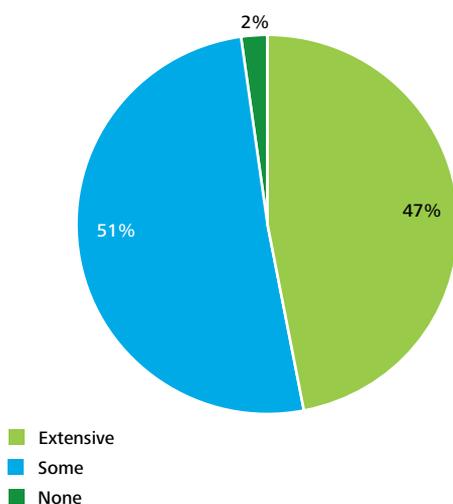


Figure 3. Does your company have a documented fraud policy?

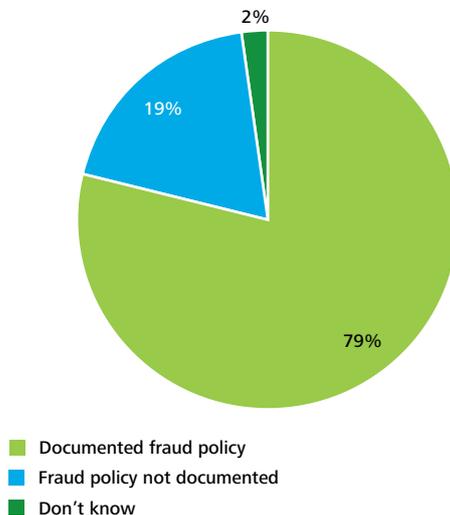
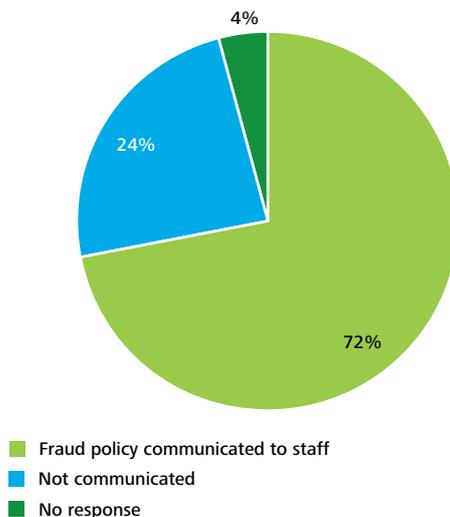


Figure 4. Is the fraud policy regularly referred to in employee communications?



76% (2010: 77%) of respondents said economic uncertainty had generated Board level discussion on either introducing and/or enhancing fraud risk monitoring (see Figure 5) and, 64% (2010: 80%) said the economic uncertainty had increased or significantly increased the level of Internal Audit coverage of fraud risks (see Figure 6). When asked specifically about changes in legislation, 58% of respondents said the new regulatory environment had increased their focus on fraud risk management in the last 12 months (see Figure 7).

Figure 5. To what extent has economic uncertainty generated Board level discussion on either introducing and/or enhancing fraud risk monitoring?

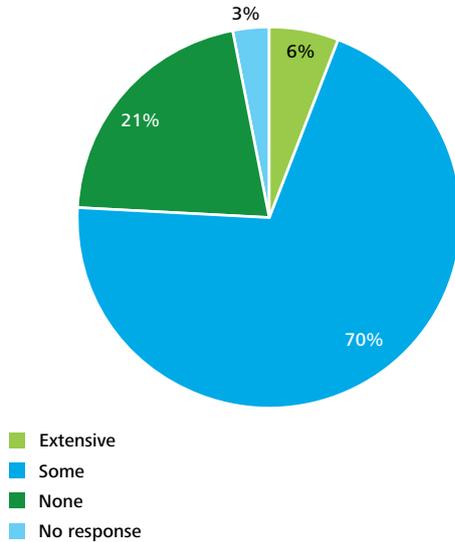
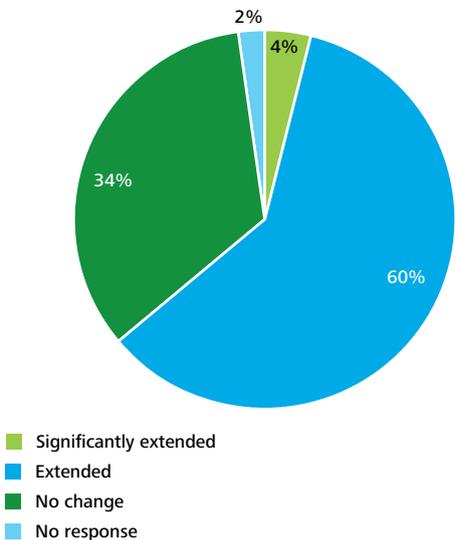


Figure 6. To what extent has continuing economic uncertainty changed the level of Internal Audit coverage of fraud risk in your organisation?



Despite the increase in discussion and coverage of fraud risk, there are still a number of organisations where regular fraud risk assessments are not performed (see Figure 8). 49% of organisations said they were performing these regularly, but there were still 40% who were not doing so (2010: 57%). This has reduced from the prior year though, which is encouraging.

Figure 7. To what extent has changing regulation and legislation changed the focus on fraud risk management in the last 12 months?

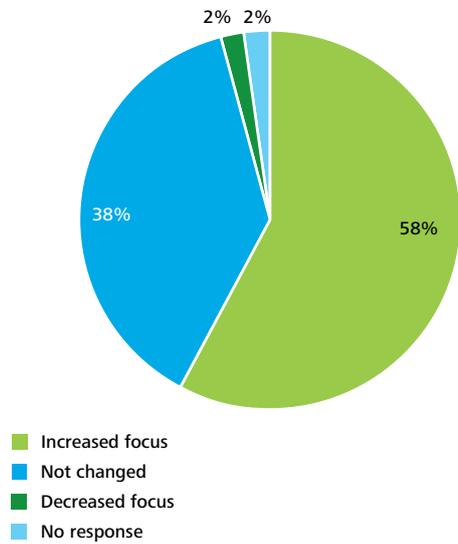
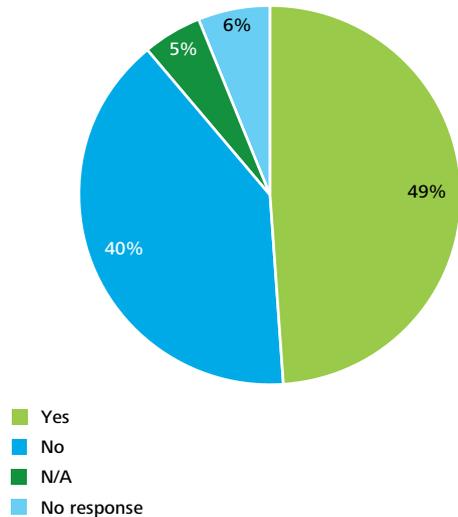


Figure 8. Does IA perform a regular fraud risk assessment exercise to consider, identify and prioritise risks of fraud?



Interestingly, when survey respondents were asked what they believe senior management perceived the role of Internal Audit to be, the majority of responses were that Internal Audit would supplement others across the prevention, detection and investigation of fraud. We note a difference in the perception of who is responsible for running investigations; 51% of Internal Audit functions said they were responsible, whereas only 19% thought senior management perceived Internal Audit to be responsible.

Our perspective

“We are witnessing an improvement in the quality of the discussion around fraud risk; however there is an apparent weakness in turning such discussions into actual, tangible activity. The fact that a significant minority of organisations are still not performing regular fraud risk assessments is an area of weakness. Winning the battle with fraud requires relentless focus on controls in this area and ensuring that the easy steps of having a clear fraud policy and performing risk assessments are taken” says Kirsty Searles, Fraud Controls Partner at Deloitte.

Adequately resourced?

Figure 9. Do you consider your IA team to be adequately resourced to perform fraud investigations within the organisation?

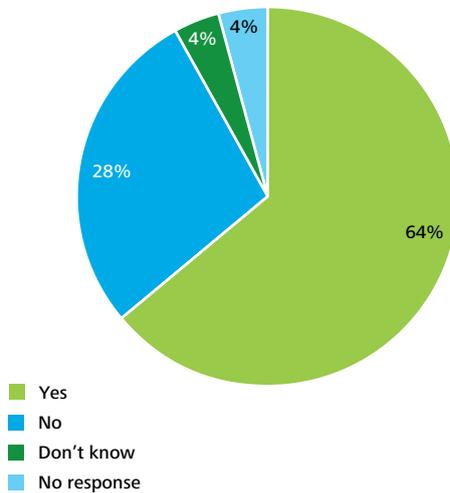
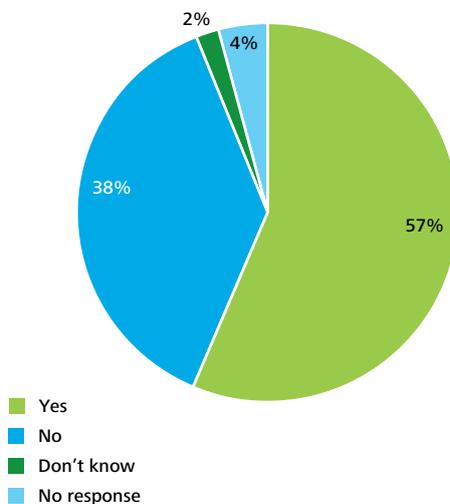


Figure 10. Do you consider the IA team to have adequate skills and knowledge in the area of data analysis?



Reassuringly, 91% (2010: 83%) of respondents indicated that they consider themselves to have the right skills and knowledge in the area of fraud risk awareness, and 89% (2010: 85%) think they are adequately resourced in fraud control awareness. 28% of organisations said that they are not adequately resourced to perform fraud investigations (see Figure 9), a figure that has decreased markedly from 51% in the last survey, which is positive. However, the current economic environment means organisations need to be able to react quickly and they can only do this if they are adequately resourced in this key area.

51% (2010: 65%) of respondents say they are responsible for running investigations, but despite this there are still some key investigation competencies where the training, appropriate skills, or knowledge are somewhat lacking. In particular, the handling of evidence, interview techniques and data analytics were areas where both the skills and training could be improved. Specifically, 47% (2010: 37%) of respondents consider themselves inadequately resourced to handle evidence; 42% (2010: 43%) consider themselves unable to conduct effective interviews; and 30% (2010: 38%) say they receive inadequate training to identify and evaluate fraud schemes.

Although 55% (2010: 52%) have used data analytics to prevent, detect, and investigate fraud (primarily with regard to transactions (93%) and the monitoring of system access (41%)); 38% (2010: 55%) said they lack resources in the area of data analysis (see Figures 10 and 11). Being able to manage and analyse large volumes of data in an efficient, useful, and meaningful manner can be very effective in identifying potential issues and testing the control environment generally. As well as being applied to fraud prevention, data analytics can also be deployed in the investigation of frauds. For example, the identification of patterns in financial data which may assist in quantifying the scale and scope of frauds suffered, as well as the identification of potential suspects. 47% of respondents say data analytics would help them be more effective.

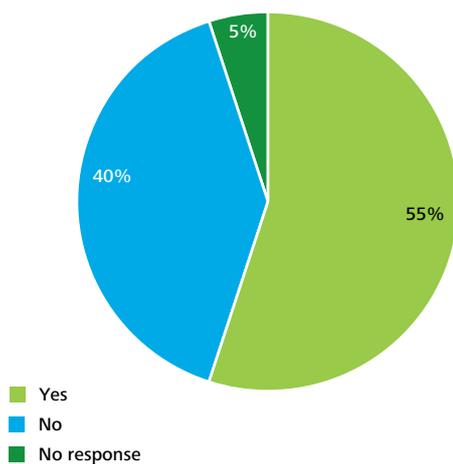
As expected (and consistent with the previous survey), the use of external parties in assisting the Internal Audit function is also more common in the investigation stages, with IT experts (42%), the Police (45%), External Counsel (34%) and Forensic Accountants (42%) being used; figures which correlate to the apparent shortage of skills in these key investigative areas.

Our perspective

“Analysing our findings, it seems that organisations have resolved to do more in the fields of preventing and detecting fraud, yet many of the same organisations still have gaps in their resourcing and investigation capabilities which need to be addressed if Internal Audit have responsibility for this area. One area in particular is that of data analytics” says Nic Carrington, Forensic Investigations Partner.

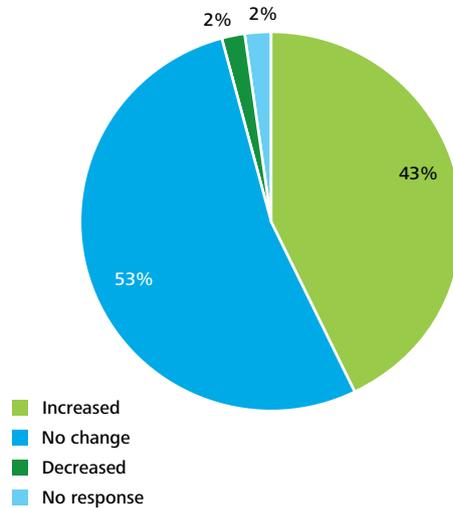
Jarrod Haggerty of Deloitte Forensic Technology, comments: “Leaders in fraud prevention are taking advantage of new data analytic tools and technologies to harness their data. Gathering and storing relevant data and mining it for patterns, discrepancies and anomalies can help bring insights that allow a company to manage potential threats before they occur. These data analytic techniques are helping companies develop a proactive fraud and bribery detection environment.”

Figure 11. Does IA use data analytics/mining in the prevention, detection or investigation of fraud?



Current trends and what the future holds

Figure 12. Has your organisation's vulnerability to fraud risk changed in the last 12 months?



43% (2010: 63%) of survey respondents stated that their organisation's vulnerability to fraud risk has increased in the last 12 months (see Figure 12). Of those, 57% and 74% (2010: 62% and 60%) said there had been an increase in internal and external fraud respectively. Across all respondents, 44% and 36% said they had seen an increase in external and internal fraud, respectively.

In the last 12 months, the most common types of fraud were misappropriation of assets, identity fraud and procurement fraud.

The main opportunities and motives for fraud in the past year were similar to those given in the previous survey. Disgruntled employees (51%) and collusion between employees and third parties (49%) were the top responses, followed by other external pressure on individuals (43%) and inadequate or ineffective internal controls (42%) (see Figure 13).

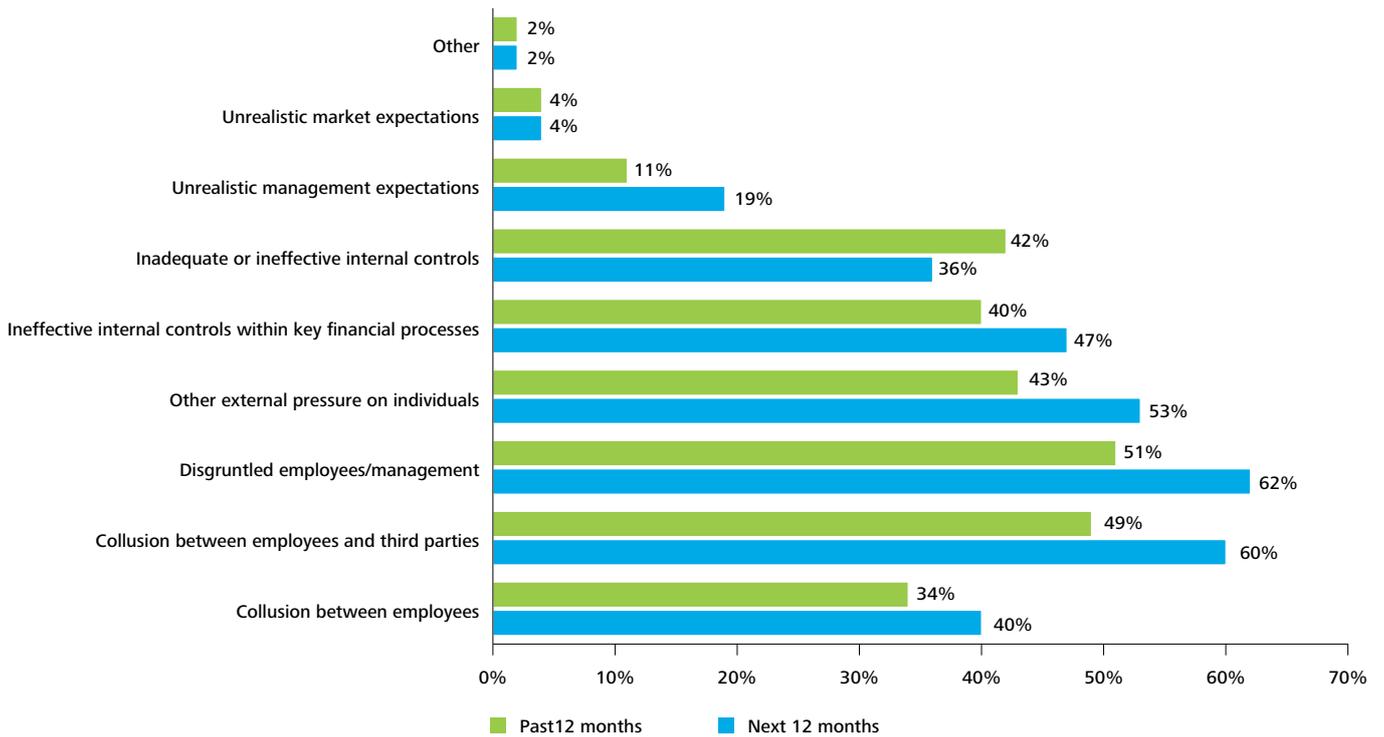
It should be noted that these motives are always affected by external factors, such as the general economic environment, and are not limited to just those within an organisation. When looking at the next 12 months, little difference is predicted in the opportunities and motivational factors behind fraud risk (see Figure 13).

In our current survey we asked whether the frauds identified in the organisations could be attributed to particular geographies or areas of operation. Unsurprisingly in a UK survey, the responses indicated mainly UK-based frauds being reported. But other geographical regions – namely Africa (6%) and Asia (8%), South America (8%) and the USA (4%) were also noted.

We also asked respondents to indicate all the ways in which fraud is typically identified in their organisations. 72% identified the 'whistle-blowing' hotline; 72% the internal control environment; 45% Internal Audit and compliance testing; and 15% through the use of data analytics.

Internal Audit's top priorities from a fraud risk perspective over the past 12 months were: basic operational controls (77%), basic financial controls (74%) and new legislation (55%).

Figure 13. Which areas have been and will be the main opportunities and motives for fraud risk within your organisation?



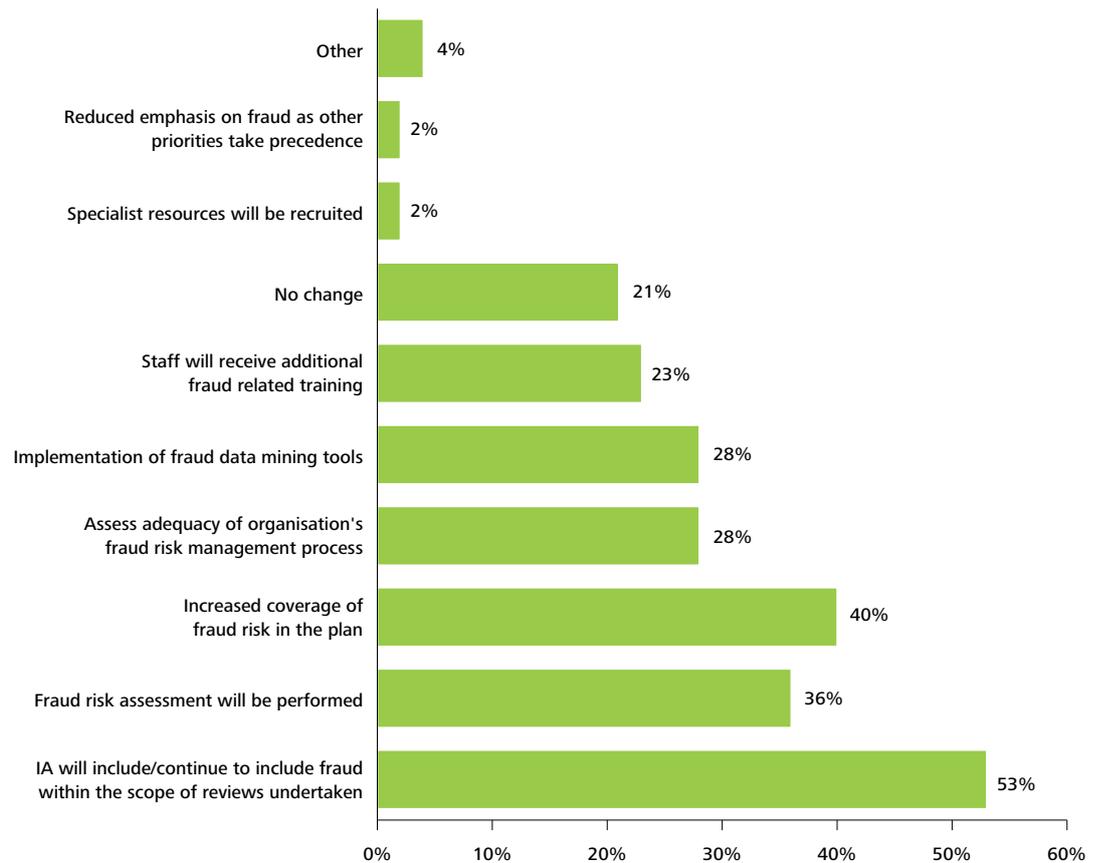
What needs to change?

When we asked Internal Audit departments how they thought their role or focus on fraud had changed over the past 12 months, the top three responses were: 1) fraud has been included in the scope of reviews undertaken; 2) there has been increased coverage of fraud risk within the plan; and 3) there have been assessments of the adequacy of the organisation's fraud risk management process.

This seems to indicate that organisations are bringing their fraud risks into focus. However, a significant 40% (2010: 57%) said their Internal Audit department did not perform regular fraud risk assessment exercises to consider, identify, and prioritise the risks of fraud (see Figure 8).

Over the next 12 months, the three key areas of focus in Internal Audit were predicted to be firstly the inclusion (or continued inclusion) of fraud in the scope of reviews undertaken (53%), secondly the increased coverage of fraud risk in the audit plan (40%), and thirdly performing fraud risk assessments (36%) (see Figure 14). Figure 14 also indicates that 28% of respondents anticipate the implementation of fraud data mining tools.

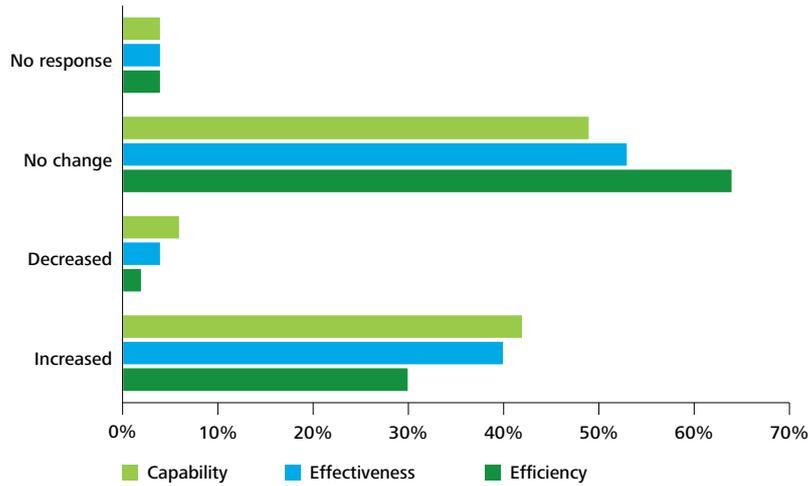
Figure 14. How do you see IA's role/focus on fraud changing over the next 12 months?



While almost two-thirds of respondents (64%) said their organisations had seen no real change in their efficiency in preventing, monitoring and detecting fraud in the past 12 months, 42% said the capability of their Internal Audit function had increased (see Figure 15).

When asked what would help their Internal Audit department be more effective in providing assurance over fraud risk, a variety of responses were given. The top three responses were: 1) an increased use of data analytics (47%); 2) fraud awareness training for all staff (38%); and 3) more resources and skills (26%) (see Figure 16). Interestingly, data analytics is identified as the most common way organisations believe they can improve their performance in the current environment, which reflects the skills gap and focus in this area.

Figure 15. How has the capability, effectiveness and efficiency of your organisation to prevent, monitor and detect fraud changed in the last 12 months?

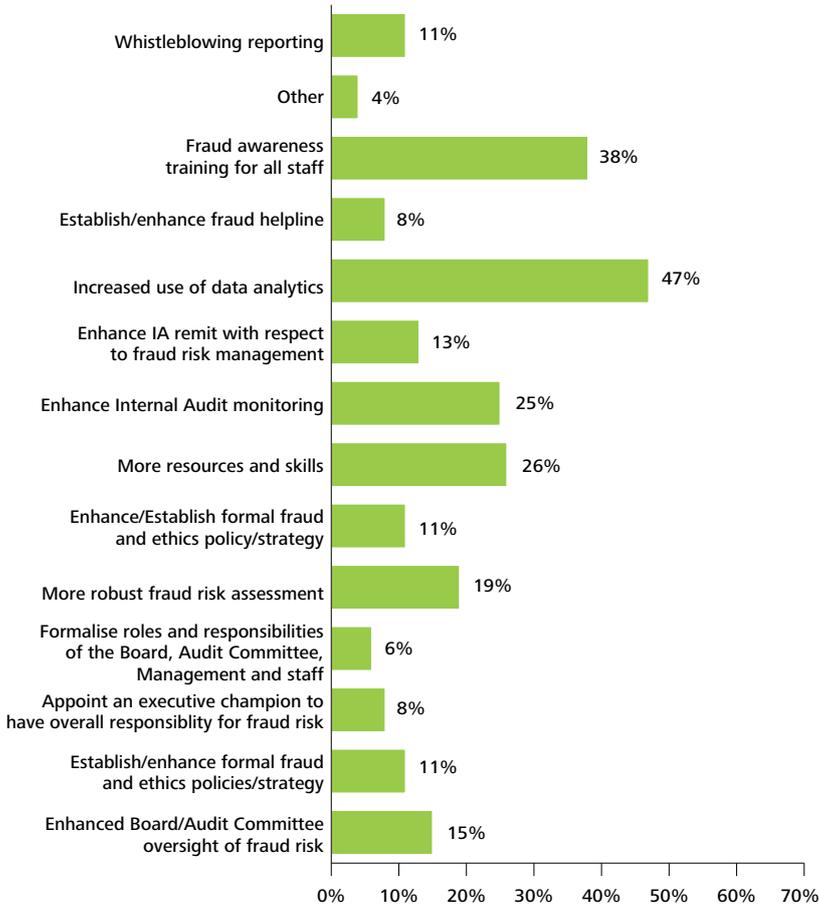


Our perspective

“While it is true that one size does not fit all, it is interesting to see the sheer variety of responses on how to improve fraud assurance; this is not a straight forward topic” says Kirsty Searles.

“The good news is that a significant number of Internal Audit functions have increased their coverage of fraud risks over the last 12 months and increased their resources – a genuinely positive indicator that some action has been taken. But there is more work that can be done by Internal Audit departments and management, around training and data analytics” adds Nic Carrington.

Figure 16. Which of the following would most help IA be more effective in providing assurance over fraud risk in the organisation?



Key contacts



Nic Carrington
Partner
020 7303 2139
ncarrington@deloitte.co.uk



Jarrod Haggerty
Partner
020 7007 8227
jahaggerty@deloitte.co.uk



Michael Jones
Partner
0121 695 5826
mxjones@deloitte.co.uk



Kirsty Searles
Partner
020 7007 2823
kasearles@deloitte.co.uk

Survey respondents' key demographics

- The top three industries represented in the survey sample are Public Sector (34%), Financial Services (26%), and Telecommunications, Media and Technology (11%).
- The majority are employed by organisations with 1,001 – 5,000 employees, 40%; 10,000+ people, 38%; and 5,001 – 10,000 staff, 11%.
- Nearly three-quarters of our respondents (72%) work for an organisation with an annual turnover of more than £500m.
- 47% work for an organisation listed on a stock exchange; 36% for a government/public sector organisation.
- 6% of respondents outsource internal audit to an external provider; 17% co-source with an external provider; 49% use some external specialist resources to support their internal audit function; 28% have an in-house function with no external support.
- Most respondents have an Internal Audit team of 25 or less (5-25 staff at 49%, and 32% at less than 5 staff).



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