

# Role of SAIs in Detecting Fraud and Corruption

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## Introduction

Corruption is a global phenomenon<sup>1</sup>. With globalization of economy pioneered by growth of finance capital and ICT revolution, the issue of fraud and corruption has emerged as a trans-boundary concern. In the absence of adequate level of control, an information technology (IT) system is more vulnerable to error than a corresponding manual system due to the automation and invisibility of transaction processing<sup>2</sup>. As per Corruption Perceptions Index (2018) published by Transparency International covering 180 countries, more than two-thirds of countries scored below 50 and vast majority of countries assessed have made little or no progress<sup>3</sup>. Corruption hurts the poor disproportionately by diverting funds intended for development, undermining a Government's ability to provide basic services, feeding inequality and injustice and discouraging foreign aid and investment<sup>4</sup>.

The primary responsibility for preventing and detecting corruption vests with the administrative or law enforcement authorities, such as, the police or anti-corruption agencies. Role of Supreme Audit Institutions (SAIs) in combating fraud and corruption broadly revolves around verification of public accounts, regulatory compliance and adherence to standards of financial integrity. It varies considerably across the countries based on SAIs' mandate and national legislations covering the issue of fraud and corruption. Studies have shown that SAIs have a notable impact on reducing corruption, especially where SAIs are entrusted with greater sanctioning powers and audits are conducted independently and professionally<sup>5</sup>. SAIs often enjoy greater levels of citizen trust than other arms of government by way of contributing to anticorruption approaches in two main ways: deterrence and detection<sup>6</sup>. Given the prevailing malaise, Strategic Plan of INTOSAI included 'fight against corruption' as one of the five priorities during the period 2011-2016.

## Fraud and Corruption

ASOSAI Guidelines (2003) for Dealing with Fraud and Corruption<sup>7</sup> define fraud and corruption (Para 1.8) "*Fraud involves deliberate misrepresentation of facts and/or significant information to obtain undue or illegal financial advantage. Corruption involves effort to influence and/or the abuse of public authority through the giving or the acceptance of inducement or illegal reward for undue personal or private advantage.*"

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<sup>1</sup>SDG (Target 16.5), Transforming Our World: The 2030 Agenda for Sustainable Development, 2015, United Nations.

<sup>2</sup> Assessing the Risk of IT Related Fraud, info IT P/26.

<sup>3</sup> Only 20 countries have made significant progress in recent years. Transparency International ranks countries on a scale of zero (highly corrupt) to 100 (very clean) in Corruption Perception Index 2018 (Source: [www.transparency.org/cpi](http://www.transparency.org/cpi)).

<sup>4</sup>United Nations Convention against Corruption (2004), P/iii.

<sup>5</sup> [The-role-of-supreme-audit-institutions-in-fighting-corruption](https://www.u4.no/publications) (August 15, 2018) P/9, Transparency International (Source: <https://www.u4.no/publications>).

<sup>6</sup>Ibid, P/8.

<sup>7</sup>Source: <https://www.scribd.com/document/254961759/ASSOSAI-Guidelines-for-Dealing-With-Fraud-and-Corruption>.

Fraud is an intentional action by one or more individuals involving the use of deception to obtain an unjust or illegal advantage, fraudulent financial reporting and misappropriation of assets is the primary consideration for an auditor in dealing with fraud.<sup>8</sup>Corruption is the abuse of public funds and/or office for private benefits and therefore affects good governance.<sup>9</sup> While the intent for fraud is false representation; obtaining or seeking reward as benefit for performance of an official act is referred to as corruption.

The ASOSAI Guidelines (para 1.10) therefore propose that while fraud and corruption should be perceived independently for their numerous implications, the auditors should be well aware of the complex correlation between the two issues. With increasing complexities of electronic transactions and accounting, proper assessments of risk of fraud<sup>10</sup> and corruption becomes critical for audit.

### **SAIs Mandate**

System of audit and the role of Supreme Audit Institutions (SAIs) are integral part of the principle of separation of powers and system of checks and balances<sup>11</sup> which are an essential prerequisites for modern democratic governments. SAIs mandate is generally derived from constitutional provisions or Acts and rules. Entrusted with the responsibility of auditing revenues and expenditures of their respective governments, SAIs act as 'watchdog' over the financial integrity, compliance with existing laws and assessing economy, efficiency and effectiveness of their operations covered under themes of financial, compliance and Performance audits. Specialized audits covering aspects such as environment, IT and other issues associated with social transformation are also increasingly becoming important for SAIs around the globe. A number of covenant and conventions against fraud and corruption<sup>12</sup> have come up in recent times in addition to the guidelines and reports of multilateral organizations and institutions. Use of computer software has helped tremendously in establishing red flags and in some cases, even quantify red flags in assessing fraud<sup>13</sup>.

### **Approach and Methodology**

INTOSAI Guidelines for the Audit of Corruption Prevention(2016) stipulate that the SAI's fight against corruption should be aimed at preventing corruption by analyzing occurrence, causes, areas and mechanisms of corruption phenomena during each audit and strengthening public institutions by identifying ways to reduce arbitrariness, simplify administrative procedures and eliminate unequal

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<sup>8</sup>International Standard on Auditing (ISA) 240 framed by International Auditing and Assurance Standards Board (IAASB) an independent standard-setting body of International Federation of Accountants (IFAC) (Source: <http://www.ifac.org/system/files/downloads/a012-2010-iaasb-handbook-isa-240.pdf> Page 157-159)

<sup>9</sup>Working definition of corruption adopted by the World Bank Group, cited in INTOSAI Guidelines for the Audit of Corruption Prevention (ISSAI 5700), September 2016.

<sup>10</sup>Assessing the Risk of IT Related Fraud, info IT P/26.

<sup>11</sup> The genesis of theory of separation of powers is traced to writing of Montesquieu in his book *The Spirit of the Laws*.

<sup>12</sup>Such as United Nations Convention, Inter-American Convention, the ICAC, of the Organization of American States, OAS, Civil and Criminal Law Conventions on Corruption by the Council of Europe, Convention on International Anti bribery of OECD, African Union Convention on Preventing and Combating Corruption.

<sup>13</sup> Assessing the Risk of IT Related Fraud, info IT,P/27.

access to information.<sup>14</sup>Some of the measures suggested in World Development Report (1997, 2002 and 2004) for combating corruption are reducing opportunities, official discretion, strengthening monitoring, increasing punishment, decentralization, effective media & civil society, greater information flow, separating policy makers from providers.<sup>15</sup>Exchange of knowledge and experiences between SAIs to combat corruption have been emphasized as means to tackle issues of fraud and corruption<sup>16</sup>.

INTOSAI Guideline for Audit of Corruption Prevention discusses seven components <sup>17</sup> viz; (1) Anti-Corruption Organizational Culture (2) Objectives/Strategy (3) Organizational responsibility (4) Risk management (5) Anti-Corruption Program/ Modules such as framework, code of ethics, internal control, e-governance tools, whistle blowing mechanism, internal audit, etc. (6) Communication - Reporting (7) Monitoring and modification.

Notwithstanding significant developments in terms of approach and methodology for combating fraud and corruption by SAIs, the mandate and exact nature of audit assignments of SAIs vary greatly as per their constitutional, legal or institutional frameworks.

### Auditing Frameworks

The Department for International Development (DFID) has broadly identified three auditing models: *Westminster* model, the *judicial* or *Napoleonic* model and the *board* or *collegiate* model<sup>18</sup>. Under *Westminster* or *Anglo-Saxon* or *Parliamentary* model, there is an Auditor General having rights and responsibilities along with safeguards to ensure independence. The ability of the SAI to challenge corruption depends on the powers and authority of the position and its independence from other national institutions<sup>19</sup>. Under *judicial* or *Napoleonic* model, SAI known as Court of Accounts is an integral part of the judicial system and normally there is also a complementary high level system of parliamentary accountability for public expenditure. The vulnerability of such a system to political influence is rather low due to indefinite tenure but there are challenges in terms of transparency, lack of parliamentary involvement and implementation of recommendations<sup>20</sup>. Under the *collegiate* system, the SAI has a number of members appointed by the parliament who form its college or governing board and take decisions jointly. Its limitations are slow decision making process and system of appointment by parliament affecting independence and impartiality<sup>21</sup>.

<sup>14</sup>INTOSAI Guidelines for the Audit of Corruption Prevention (ISSAI 5700), September 2016, p/ 14.

<sup>15</sup> Cited in Evolution of The World Bank's thinking on Governance (2018): Background Paper for World Development Report (2017): K. Sarwar Lateef, P/20 (Source: <http://pubdocs.worldbank.org/en/433301485539630301/WDRI7-BP-Evolution-of-WB-Thinking-on-Governance.pdf>).

<sup>16</sup> Lima declaration against corruption was adopted during the 8<sup>th</sup> International Conference against Corruption held in Lima, Peru from 7 - 11 September 1997 which identifies a number of actions to be taken at International and Regional as well as National and Local levels.

<sup>17</sup> INTOSAI Guidelines for the Audit of Corruption Prevention (ISSAI 5700), September 2016, P/3-4.

<sup>18</sup>Characteristics of Different External Audit Systems, DFID, 2004.

<sup>19</sup> The-role-of-supreme-audit-institutions-in-fighting-corruption P/5, Transparency International, August 15, 2018 (Source: <https://www.u4.no/publications>)

<sup>20</sup> Ibid, P/6.

<sup>21</sup> Ibid, P/6.

Country-wise position on the role of some SAIs in combating fraud and corruption are briefly highlighted in below:

S. No	SAI	Model/ Type	SAI activities and practices dealing with Fraud and Corruption
1.	Australia	Westminster	The focus of the Australian National Audit Office (ANAO) activity is on assurance and prevention. SAIs role is recommendatory rather than inquisitorial or judicial in nature <sup>22</sup> .
2	Brazil	Judicial	The <i>Tribunal de Contas da União</i> (Federal Court of Accounts or TCU) is an arm of the Legislative Branch of government which employs a highly qualified body of civil servants to prevent, investigate and sanction corruption and malpractice of public funds with national jurisdiction <sup>23</sup> .
3	Colombia	Judicial	The Office of the Comptroller General of the Republic of Colombia is an independent government institution that acts as the highest form of fiscal control in the country <sup>24</sup> .
4	Netherlands	Collegiate	The basic approach of the Netherlands Court of Audit towards fighting fraud and corruption is through promotion of integrity of the public sector as a whole and also developed IntoSAINT, a self-assessment tool to analyze their integrity risks and assess the maturity level of their integrity management systems <sup>25</sup> .
5	Sweden	Westminster	There is no explicit mandate for combating fraud and corruption <sup>26</sup> , but Swedish National Audit Office SNAO has developed three pronged approach: assessment of indications on fraud identified in audits by Special group within SNAO, involving legal unit of SNAO when rules of secrecy applies i.e. cause to believe crime has been committed and reporting to the appropriate level of management with recommendations to

<sup>22</sup> The 10<sup>th</sup> ASOSAI Research Project Report, Audit to Detect Fraud and Corruption Evaluation of the Fight against Corruption and Money Laundering (2015), P/172-173.

<sup>23</sup> [https://en.wikipedia.org/wiki/Tribunal\\_de\\_Contas\\_da\\_Uni%C3%A3o](https://en.wikipedia.org/wiki/Tribunal_de_Contas_da_Uni%C3%A3o).

<sup>24</sup> [https://en.wikipedia.org/wiki/Office\\_of\\_the\\_Comptroller\\_General\\_of\\_Colombia](https://en.wikipedia.org/wiki/Office_of_the_Comptroller_General_of_Colombia)

<sup>25</sup> A UN-INTOSAI Joint Project: Collection of Important Literature on Strengthening Capacities of Supreme Audit Institutions on the Fight against Corruption (2013), P/203 and 3

<sup>26</sup> Paper for the 15th Biennial CIGAR Conference 2015 in Valletta, Malta 4 – 5 June 2015, P/ 14

(Source: [https://www.researchgate.net/publication/281373681\\_Supreme\\_Audit\\_Institutions'\\_role\\_in\\_fighting\\_corruption-A\\_comparative\\_study\\_between\\_the\\_Norwegian\\_Danish\\_Swedish\\_Spanish\\_Italian\\_Ugandan\\_and\\_Zambian\\_SAIs](https://www.researchgate.net/publication/281373681_Supreme_Audit_Institutions'_role_in_fighting_corruption-A_comparative_study_between_the_Norwegian_Danish_Swedish_Spanish_Italian_Ugandan_and_Zambian_SAIs))

			send the information to the appointed prosecutor when indication on fraud is confirmed <sup>27</sup> .
6	Turkey	Judicial	Turkish Court of Accounts (TCA) is entrusted with the mandate of placing final judgment and plays a major role in preventing corruption and promoting a culture of openness and accountability rather than detecting corruption <sup>28</sup> . TCA has Anti-corruption Strategy and Action Plan <sup>29</sup> .
7	India	Westminster	SAI India is having a preventive role <sup>30</sup> by way of enforcing accountability, strong financial management, internal controls and use disclosure of deviations as deterrence in reference to fraud and corruption. There is very robust anti-corruption complaint mechanism and SAI is itself subjected to RTI Act. SAI India has a dedicated training institute <sup>31</sup> as Centre of Excellence in Audit of Fraud, Fraud Detection Techniques and Forensic Audit. Whistle blowing system is encouraged and Forensic audits are performed in cases where fraud is suspected/detected. Audit Quality Management Framework ensures compliance with auditing standards.
8	Indonesia	Collegiate	Audit Board of the Republic of Indonesia (BPK) can conduct investigative audit to reveal any criminal act indication and/or state loss and can also appoint its auditor/s to become an expert witness before the court regarding the state loss examination.
9	Republic of Korea	Collegiate	Board of Audit and Inspection (BAI) has inspection functions and plays more direct role of anticorruption and has a strategic plan accordingly <sup>32</sup> . It introduced a number of schemes such as citizens' audit request system that allows

<sup>27</sup> Source: <http://www.sigmaweb.org/events/roundtable-role-supreme-audit-institutions-combatting-fraud-corruption.htm>

<sup>28</sup> The 10<sup>th</sup> ASOSAI Research Project Report, Audit to Detect Fraud and Corruption Evaluation of the Fight against Corruption and Money Laundering, 2015, P/379 and 391.

<sup>29</sup> Ibid, P/101.

<sup>30</sup> SAI India Country Paper in 10<sup>th</sup> ASOSAI Research Project- "Audit to Detect Fraud and Corruption : Evaluation of the Fight against Corruption and Money Laundering", 2015, P/ 212.

<sup>31</sup> Regional Training Institute at Nagpur in Maharashtra State.

<sup>32</sup> Audit to Detect Fraud and Corruption : Evaluation of the Fight against Corruption and Money Laundering, 10<sup>th</sup> ASOSAI Research Project 2015, P/282.

			citizens to request special audits of public institutions suspected of corruption <sup>33</sup> .
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## Conclusion

Fraud and corruption have become a pernicious challenge affecting modern day governance and development. Increasing publicity and awareness about instances of fraud and corruption have brought the issue of accountability and control to the forefront of public discourse. It also casts challenges to the notions of independence and professionalism of public auditors who are called upon to perform their role in a more impartial and objective manner. Notwithstanding diversity of frameworks, global commitments such as SDGs and increasing collaboration through International Organization of Supreme Audit Institutions (INTOSAI) and similar regional organizations is likely to further reinvigorate SAIs efforts for combating fraud and corruption. A more collaborative and integrated approach by forging partnerships across other parts of government as well as civil society and maintaining its own independence and impartiality is vital for SAIs to holistically address the issue of fraud and corruption.

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<sup>33</sup> Ibid, P/13.

## Detection and Prevention of Fraud by SAIs - SAI India

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### Introduction

Fraud, whether it occurs in any form is reaching alarming proportions and is not without its costs. Businesses and government agencies worldwide suffer huge losses in lost or misused funds. The primary responsibility for detection and prevention of fraud and error rests both with those charged with governance and the management. It is the responsibility of the management to create and maintain a culture of honesty and ethics and establish appropriate controls to detect and prevent fraud and error within the entity<sup>34</sup>.

On the basis of interview of about 200 convicted embezzlers, Donald Cressey, American criminologist, formed the following hypothesis:<sup>35</sup> Trusted Persons become trust violators when they conceive of themselves as having a financial problem which is non-shareable, are aware this problem can be secretly resolved by violation of the position of financial trust, and are able to apply to their own conduct in that situation verbalizations which enable them to adjust their conceptions of themselves as trusted persons with their conceptions of themselves as users entrusted funds or property.

Donald Cressey created the concept of the fraud triangle according to which fraud can be the function of three factors- Motive, Opportunity, and Rationalization.

**Motive:** A motive is a kind of personal pressure for doing something not acceptable by the society. The person thinks, is not shareable with his/her friends and confidants. Psychotic motivation is relatively rare; but it is characterized by the "habitual criminal," who steals simply for the sake of stealing. Ego-centric motivations drive people to steal to achieve more personal prestige. Ideological motivations are held by people who think their cause is morally superior, and they are justified in making someone else a victim. However, economic motives are far more common in business frauds than the other three.

**Opportunity:** An opportunity is an open door for relieving the pressure in secret by violating trust. The violation may be a circumvention of internal control policies and procedures, or it may be simply taking advantage of an absence or lapse of control in an organization.

**Rationalizations:** Rationalization is the justification an individual uses to commit fraud. The vast majority of individuals committing frauds are first time offenders, and don't view themselves as criminals, but rather ordinary, honest people who are just the victims of unfortunate circumstances.

<sup>34</sup>INTERNATIONAL STANDARD ON AUDITING \_ 240

<sup>35</sup>Donald R. Cressey, *Other People's Money* (Montclair: Patterson Smith, 1973)

## Objectives

Audit is expected to play major role in prevention and detection of frauds through effective communication of audit findings along with the recommendations and providing reasonable assurance on integrity of financial statements. Selecting high risk areas for audit and steps to be taken for risk mitigation is first step SAI can take to utilise scarce audit resources more effectively against frauds. Risk based audit approach will help the auditors in discharge of their duties effectively.

The red flags which are pointers of fraud and the fraud detection techniques are discussed in the following paragraphs.

## Determining risk and mitigation

Detection of frauds has direct impact on prevention of the fraud as the potential fraudsters fear the possibility of their fraud being uncovered. SAI, with its available resources, can detect fraudulent practices by focusing on high risk areas. The steps to be taken by SAI in this regard can be summarized as below:<sup>36</sup>

### **1. Build a profile of auditable institutions as per risk of fraud**

Take a top-down approach to risk assessment, listing the areas in which fraud is likely to occur and the auditable institutes working in that area. The identification of the types of fraud that are possible in those areas will help in determining the risk to the institutes. Then qualify the risk based on the overall exposure to such risk to the auditable institutes. Develop fraud risk profiles as part of an overall risk assessment.

### **2. Test transactional data for possible indicators of fraud.**

While extensive audit of institutions in high risk of fraud will take place at later stage, it is always better to undertake sampling of transactions/ vouchers of such institutions in, say central audit, to detect problems at early stage. It is important to remember that fraudulent transactions, by nature, do not occur randomly. Transactions may fall within boundaries of certain standard testing and not be flagged. Further, using the sampling approach, we may not be able to fully quantify the impact of control failures and may not be able to estimate within certain populations. However, it is useful pointer to initiate full audit of such institute to confirm or dispel doubts about sanctity of the transactions.

### **3. Improve controls by implementing continuous auditing and monitoring.**

Once institute at the risk of fraud is identified it is followed by the repetitive or continuous analysis for detection of fraud. It means to undertake study of activities of the institute to identify those anomalies as they occur over a period. Patience and co-operation from the management are pre-requisites for this kind of exercise as it may take lot of time and in some cases the anomalous transactions might have proper justification or may be isolated instances of human error. It also involves audit cost as audit resources are utilized at one task/ institute only. However, this

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<sup>36</sup> PETER MILLAR at [www.corporatecomplianceinsights.com](http://www.corporatecomplianceinsights.com)

method can improve the overall efficiency, consistency and quality of fraud detection processes.

#### **4. Communicate the results of auditing activity**

A big part of fraud detection is communicating the results to fellow auditors so that they may assign appropriate risk to that area of audit. There is greater possibility of fraud in the similar transactions of other office of the same department. If there is sufficient potential, a study can be undertaken to estimate the extent of fraud, which will form a part of audit report on that activity.

#### **5. Communicate audit results to the management**

The communication of results of audit to the management helps in prevention of further damage. So it is important to make management aware of the possibility of fraud as soon as possible. While reporting on the frauds the audit can help management by providing recommendations on how to tighten controls or change processes to reduce the likelihood of recurrence of fraud.

#### **6. Actionable recommendations to guide the management**

The audit recommendations will be easily accepted by the management if they logically follow from the audit conclusions, they are specific, free from ambiguity and are actionable. This will also enable appropriate authorities to monitor the action taken by the management on recommendations of the audit.

#### **7. Fraud profile**

SAI requires updating fraud profile periodically. The updating of fraud profile after major audits or major observations is also important. No scheme or method of fraud can be overlooked in audit profiling as rare or unique schemes of fraud tend to become common after some time. Investigating relatively new frauds to understand modus operandi, environment in which it took place, damage it has caused to the institute and identity of probable perpetrators will help while determining the risk of other institutions of such fraud.

### **Auditing Fraud**

Auditing fraud involves familiarity with many elements<sup>37</sup>: the human element, organizational behavior, knowledge of common fraud schemes, evidence and its sources, standards of proof, and sensitivity to red flags. Fraud auditor requires to have a mind-set of sensitivity to the unusual. For this purpose he can focus on errors and omissions, exceptions, oddities, and patterns of conduct. A good fraud auditor considers the ways in which the controls could be subverted for fraudulent purposes by using theory of behavioral motive, opportunity, and rationalizing. The fraud auditors think of a cumulative materiality and not mere isolated impact for a particular financial year.

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<sup>37</sup> Auditing for Fraud Detection <https://www.mypescpe.com/!PDFdocs/5700BTEXT.PDF>

## **Prevention of fraud**

In every organization, employees will experience financial and other pressures from time to time. The pressures cannot be eliminated, but the facilities for sharing them can be created. The most effective long-run prevention, however, lies in the practice of management by caring for people. Managers and supervisors at all levels can exhibit a genuine concern for the personal and professional needs of their subordinates and fellow managers, and subordinates can show the same concern for each other and their managers.

## **Audit Focus**

As per 'Occupational Fraud: The Audit as Deterrent' by Mr. Joseph T. Wells published in the Journal of accountancy the majority of frauds are committed by the employees. The frauds committed by managers or executives are three-and-a-half times more costly than frauds committed by other employees. It is because of the fact that the higher employees rise in an organization, the more they are entrusted with organization assets. Males account for more losses than those for females. This trend is probably due to the "glass ceiling" phenomenon, where males generally occupy higher positions in organizations than their female contemporaries. Approximately one third of reported frauds involved two or more individuals and in such cases the median loss was six times greater than the median loss when only one person committed the fraud indicating the need for better control mechanisms that involve the separation of duties. The oldest perpetrators caused median losses 27 times greater than those of the youngest fraudsters as the older employees generally occupy more senior positions with greater access to assets. Though the study is dated and mainly concerns itself with the corporate fraud, the conclusion drawn that the fraud committed at higher level is more costly than at lower level is still valid. So, theoretically it will be appropriate to have inverted pyramidal control structure to mitigate high volume fraud risks. While control structures in all the organizations are almost invariably pyramidal. Hence, while conducting audit of fraud, audit can provide appropriate attention to all levels of functionaries of the organization.

SAI may obtain an understanding of the "control environment," of the organization being audited. Control environment relates to the overall scheme of management activity in the organization. Managements that consider and address the issue of the employee pressures in the workplace have a good control environment. The risk of fraud in such organization will be relatively low as compared to the organization where the employees with workplace pressure are left to fend for themselves.

Controls are needed to help people know the jobs they are supposed to accomplish. It also describes the accountability sphere of each employee, the system for supervision of activities and most importantly, controls provide the opportunity to management to uncover undesirable activities. Conversely, it acts as instrument for

perpetrators to get caught. Even the perception of the possibility of being caught can prevent employee theft and embezzlement. Fraudsters should be fired and, in most cases, prosecuted. They have a low rate of repeat offenses if they are prosecuted, but they have a high rate if not.

In case of compliance with applicable rules and regulations and other provisions it is important for management to lead by example. This will motivate the other employees to comply with it themselves. When the Head of the department and head of the office make themselves visible examples of compliance with the code, other people will then believe it is real. Subordinates tend to follow the boss's lead.

### Red flags

The main concern of SAI is after the fraud has been committed. The scrutiny of SAI is for a limited period of time and so the employee red flags are not very relevant to SAI. However, the employee red flags are good indicators for the managers/ high officers who are watching the employees for extended period of time. The employee red flags include the following:<sup>38</sup>

- May indulge in intoxicants too much.
- May started taking drugs.
- Become irritable easily.
- Won't be able to relax.
- Gets abnormally argumentative or becomes defensive.
- Can't look people in the eye.
- May start perspiring excessively.
- Go to confessions (e.g. priest, psychiatrist).
- Find excuses and scapegoats for mistakes.
- Works standing up.
- Works alone, works late.

During audit the SAI may encounter some oddities which might be hints of the cover-up. These generally appear in the accounting records. The key is to notice exceptions and oddities, such as transactions that are: at odd times of the day, month, season; too many or too few; in the wrong branch location; in amounts too high, too low, too consistent, too different. Exceptions and oddities like these can appear<sup>39</sup>:

- Unusual number of missing documents.
- High value of missing documents.
- Cash shortages and overages.
- Excessive voids and credit memos.
- User/ applicants complaints.

<sup>38</sup> Auditing for Fraud Detection <https://www.mypescpe.com/!PDFdocs/5700BTEXT.PDF>

<sup>39</sup> Auditing for Fraud Detection <https://www.mypescpe.com/!PDFdocs/5700BTEXT.PDF>

- Common names or addresses for wage payments/ refunds.
- Adjustments to receivables and payables.
- General ledger does not balance.
- Increased past due receivables.
- Inventory shortages.
- Increased scrap.
- Alterations on documents.
- Duplicate payments.
- Missing (Ghost) Employees.
- Second endorsements on checks.
- Payment on photocopied/ missing documents.
- Dormant accounts suddenly become active.

### Three elements of fraud

Frauds consist of the fraud act itself, the conversion of assets to the fraudster's use, and the cover-up. Catching people in the fraud act is difficult and unusual. The act of conversion is equally difficult to observe, since it typically takes place in secrecy. Many frauds are investigated by noticing signs and signals of fraud, then following the trail of missing, mutilated, or false documents that are part of the accounting records cover-up.

The actual act of theft/ fraud: Theft involves taking cash, information or other assets manually, by computer, or by telephone. Fraud can be detected by witnessing someone taking the assets, but nobody is usually around when the theft/misappropriation occurs. It is the co-workers, managers, and other employees who are present that are usually in the best position to detect fraud when it occurs.

Concealment subsequent to the theft/fraud: Concealment involves the steps taken by the perpetrator to hide the fraud from others. This includes altering financial records, miscounting assets, destroying evidence etc. Fraud can be detected at this stage by recognizing altered records or the miscounting of cash or stock in their audit samples. It is, however, other employees who are still in a better position to detect fraud at this stage.

Conversion of defrauded assets into other forms: Conversion involves selling or converting stolen assets into cash and then spending the cash. If the asset taken is cash, conversion simply involves spending the stolen funds. Fraud can be detected by focusing on lifestyle changes. Perpetrators almost inevitably make when they convert their embezzled funds. Unfortunately, there is no way that auditors can recognize lifestyle changes-they have no "start point" upon which to found suspicions. Other employees are often the best way of identifying such symptoms.

In all three elements of fraud the co-workers are in a better position to notice indication of fraud. However, there are pro-active methods that can be employed

by the auditors to detect frauds. These are inductive methods and deductive methods.

### Methods of fraud detection

Inductive Methods<sup>40</sup>: Basically includes Data Mining and Digital Analysis. Data mining is a systematic and sequential process of identifying and discovering hidden patterns and information in a large dataset. Data mining takes help of Data-Mining Software to look for anomalies. Most common uses of inductive methods include uncovering abnormal patterns; risk management; pattern classification; trend analysis; predicting future behavior and discovering relationships. The advantages of these data mining software are that they save manual efforts, easy to use and are inexpensive. The following data mining software are very popular<sup>41</sup>.

- a. Audit Command Language is a PC client-based data extraction and analysis software tool used for fraud detection & prevention, and risk management. By sampling large data sets, ACL is used to find irregularities or patterns in transactions that could indicate control weaknesses or fraud.
- b. IDEA software is a comprehensive data analysis tool that quickly analyses all the data with data integrity. It is widely used in auditing.
- c. Microsoft Excel/ Access are the traditional data analysis tools. These are used due to ready availability and familiarity of the staff with it.

However, the data mining methods suffer from difficulty in working with very large and complex databases. Further, as they provide broad symptoms and not specific frauds it may result in false fraud signals. So the user must be skilled enough to isolate false fraud signals from genuine one.

Data Analysis is a superset of Data Mining that involves extracting, cleaning, transforming, modeling and visualization of data with an intention to uncover meaningful and useful information that can help in deriving conclusion and take decisions. The advantage of Data Analysis is that it can be done on structured, semi-structured and unstructured data. Data Analysis gives insights or tests hypothesis or model from a dataset.

Deductive methods<sup>42</sup>: In these methods the auditor starts with general or common fraud types and determines whether the indicators exist for its occurrence. The auditor develops a hypothesis of a fraud that might exist and formulates the characteristics of what the data might look like if that fraud actually happened. So, deductive method of fraud detection involves starting with general fraud types and moving forward to determine whether indicators or red flags of those frauds exist in current data. Using data analysis techniques the auditor can target different types of frauds, analyze entire populations, and zero in on fraud. The advantage of this method is that it identifies specific frauds, not just symptoms. However, this

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<sup>40</sup> Ethics for accountants by William at learning.hccs.edu

<sup>41</sup> Wikipedia

<sup>42</sup> Inductive and deductive approaches to research by Deborah Gabriel

method requires extensive knowledge of entity, its business as well as frauds that can happen in such environment. This method is very expensive and so used only in specific cases.

### **Conclusion:**

The fraud detection and prevention involves multi-pronged strategy. Understanding the entity environment, motivation for fraud, system failures and approach of management towards the cases of fraud helps in determining the audit strategy in fraud investigation. To make the complex task of fraud detection easier, audit can take help of various data analytics tools and employ suitable techniques to confirm or dispel suspicion of fraud.

# THE ROLE OF THE STATE AUDIT OFFICE OF VIETNAM IN DETECTING FRAUDS AND COMBATING AGAINST CORRUPTION -

SAO Vietnam

Corruption is a negative social phenomenon that exists in all countries of the world, and in both the public and non-state sectors. Corruption not only causes serious damage to public resources and to the proper functioning of the state system but also violates social justice and fairness, lessens public trust in state institutions, and hinders national development and poverty reduction. Anti-corruption, therefore, is one of the most concerned issues of all countries; supreme audit institutions (SAI) are considered as effective tools since they play an extremely important role in preventing and combating against corruption through auditing activities.

## The role of SAIs in combating against corruption

Almost all countries set up SAIs to monitor their financial performance and work efficiency of public institutions. According to OECD (2011), SAI - an organization responsible for auditing government revenues and expenditures - acts as a supervisory body for national financial integrity by assessing whether public funds are effectively and efficiently regulated according to the rules.

Four core objectives in the Lima Declaration (INTOSAI, 1998) were adopted with high consensus, showing the relevance of audit activities with the anti-corruption issues:

- (i) Reasonable and effective use of public funds;
- (ii) Development of sound financial management;
- (iii) Reasonable management of administrative operation;
- (iv) Information and communication systems to public agencies and the public through public disclosure of objective reports.

As one of the pillars of national integrity system and the public financial supervisory body, SAIs' contribution to corruption prevention and combat is mainly referred to two ways: (i) Prevention and (ii) Detection.

Despite differences in legal frameworks, institutions, organizational models (whether Westminster, judicial or board model), functions and duties of SAIs in each countries, they generally provide the function of deterrence and prevention in the fight against corruption. SAIs are not considered as anti-corruption agencies; and the functions and duties of many SAIs do not require clear responsibility for the detection and investigation of corruption. However, besides prevention and deterrence, there has been public expectation that SAIs play an important role in detecting frauds and evidence of corruption and thus coordinating with concerned agencies. This coordination is objective and based on INTOSAI's Mexico

Declaration on independence of SAI.

In particular, the Resolution A/66/209 dated 22<sup>nd</sup> December, 2011 of General Assembly of the United Nations on "Promoting the efficiency, accountability, effectiveness and transparency of public management by strengthening the role of SAIs" recognizes the importance of SAI in promoting the efficiency, accountability, effectiveness and transparency of public management, which makes important contribution to ensure the integrity and the implementation of anti-corruption.

### **The role of the State Audit Office of Vietnam in the prevention and fight against corruption**

The Constitution in 2013 added Article 118 on the legal status of SAV and the Auditor General: "*the body established by National Assembly operates independently and only obeys the law, audits management and use of finance and public assets*", transforming the SAV from a statutory body to a constitutional authority and enhancing the position, role and responsibility of the SAV in auditing management and use of public finance and assets. By specifying the provision of Article 118 of the Constitution, the State Audit Law, approved by the National Assembly in 2015, states clearly the legal status, function and legitimate of the SAV as well as enhances the SAV's independency. The SAV, through auditing activities, detects frauds and coordinates with other concerned bodies to combat against corruption.

According to State Audit Law 2015, SAV has the function of making evaluation, conclusion and recommendation for the management and use of public finance and public assets (Article 9). Also, the SAV has the duty to transfer the auditing documents to investigation bodies, the People's Procuracy and other governmental bodies who have the function of considering and handling cases of crimes and law violations of the audited entities, organizations and individuals that are uncovered by auditing activities (Article 10).

In particular, compared to many SAIs in the world, the responsibility of the SAV in anti-corruption is also specified in the Anti-Corruption Laws.

Under the Anti-Corruption Law 2005 and the amended Laws (2007 and 2012): Within the scope of the duties and powers, the SAV is responsible for implementing audit to prevent, detect and coordinated handle corruption; In case of detecting corruption, the documents is transferred to the investigate agencies, the Procuracy or competent agencies and organizations (Article 77). The Anti-Corruption Law also stipulates the responsibilities of the SAV in coordinating with the inspection and investigation agencies, the Procuracy and the Court as the following contents: (i) Regularly exchange information, documents and experiences on anti-corruption; (ii) Transfer corruptions cases to the competent state agencies; (iii) Recapitulate, evaluate, forecast corruption and propose policies and solutions to prevent corruption (Article 80). In addition, the amended Law 2012 stipulates that the SAV

is one of the agencies have the right to request verification of assets if in the audit process there is any conclusion on the responsibility of the person who is obliged to declare assets related to corruption (Article 47a).

With the above role and legal status, the value and benefit of the SAV in the derogation detection and anti-corruption are presented through the following contents:

- Firstly, the SAV is a body working for transparency in budget finance through public audit conclusion on financial statements of organizations and budget levels. This is the basis for National Assembly deputies, People's Council deputies, state agencies, social organizations and citizens in monitoring the management and the use of public finance.

- Secondly, the SAV is an important body in detecting phenomena, signs of embezzlement, squandering, law violation in economic and financial management, inefficient use of financial resources and state asset. On that basis, the SAV suggests the competent state agencies need to promptly prevent and fight against corruption in accordance with law; proposes financial handling and thoroughly recovering the lost assets to the state; proposes solutions to improve mechanisms, policies and laws to contributions to anti-corruption. In case of detecting criminal signs, the SAV set up documents to suggest the law enforcement agencies need to handle the related subjects in accordance with the law.

- Thirdly, by its independence privilege in auditing, the SAV could put focus on and select the potential areas of gross corruption and waste, issues of public concern while developing its audit plans.

The SAV has been conducting audits in a comprehensive manner on the management and use of public finance, assets as well as the activities related to the management and use of public finance, assets. More specifically, the SAV has conducted: (i) audits of annual budget of central ministries, agencies and localities; (ii) audits of the constructions, management and use of the investment capital of projects; (iii) audit of management and use of the state capital, assets of corporations and groups; (iv) thematic audits of sensitive areas and potential issues of gross corruption and waste. Thanks to the great efforts having taken, the Office has witnessed positive and considerable results in audits of the state management of natural resources and minerals; the management and use of land; the investment of transportation infrastructure in the form of PPP. The common types of audit engagements that the SAV usually chooses include performance audit, financial audit and compliance audit.

Recognizing the role and important contributions of the SAV to the anti-corruption course, the newest-promulgated Law on Anti-Corruption which was adopted by the National Assembly in 2018 (and came into effect from the first of

July 2019) regulates that the SAV has statutory function to conduct audit with a view to eliminating, detecting corruptions, audit of cases with signs of corruption (Article 87), of which function of auditing “cases with signs of corruption” is a newly added point than the previous legislations.

In order to well discharge of its statutory responsibilities, the SAV has drawn a prime lesson that it is imperial to ensure the balance of the following factors: (i) adequate and comprehensive legal framework in support for the operation and organization of the SAV; (ii) audit standards, processes and modern audit methodologies; (iv) close coordination with other key bodies of the national integrity system; (v) enhanced cooperation with other SAIs; and (vi) the transparency, publicity and accountability of the State.