EURORAI

EUROPEAN ORGANIZATION OF REGIONAL AUDIT INSTITUTIONS

European Organization of Regional Audit Institutions

COUNTER FRAUD GOOD PRACTICE

Taking forward the role of EURORAI auditors in the fight against fraud

Summary of findings
of the
EURORAI working group – March 2012

Table of Contents

About EURORAI

EURORAI -the European Organisation of Regional External Public Finance Audit Institutions- is a cooperation project among public sector audit institutions in Europe. It provides an exchange of experiences and enables members to make progress in the common field of regional and local public sector financial control in order to guarantee a better use of public finances.

EURORAI's objectives are:

1. To foster and promote cooperation among audit bodies in the various sectors in which they carry out their activities.

2. To promote exchanges of knowledge and experience in public finance auditing.

3. To keep its members informed about the legislation, organization and operation of the various public sector audit bodies.

4. To promote studies relating to the audit of public finance.

5. To foster exchange programmes and training courses for the officials of the institutions which are members of EURORAI.

6. To establish a proper definition of the terminology used in each country in order to facilitate the harmonization of public finance auditing methods.

Membership

The following organisations are members of EURORAI as at March 2012:

Kärntner Landesrechnungshof (Austria)
Niederösterreichischer Landesrechnungshof (Austria)
Oberösterreichischer Landesrechnungshof (Austria)
Salzburger Landesrechnungshof (Austria)
Steiermärkischer Landesrechnungshof (Austria)
Tiroler Landesrechnungshof (Austria)
Audit Office of the Republic of Cyprus * (Cyprus)
Chambre régionale des comptes d'Alsace (France)
Chambre régionale des comptes d'Aquitaine (France)
Chambre régionale des comptes de Champagne-Ardenne (France)
Chambre régionale des comptes de Corse (France)
Chambre régionale des comptes de Franche-Comté (France)
Chambre régionale des comptes de Haute-Normandie (France)
Chambre régionale des comptes d'Ile-de-France (France)
Chambre régionale des comptes de Languedoc Roussillon (France)
Chambre régionale des comptes de Lorraine (France)
Chambre régionale des comptes de Midi-Pyrénées (France)
Chambre régionale des comptes du Nord-Pas-de Calais (France)
Chambre régionale des comptes de Provence-Alpes-Côte d'Azur (France)
Chambre régionale des comptes de Rhône-Alpes (France)
Rechnungshof Baden-Württemberg (Germany)
Landesrechnungshof Brandenburg (Germany)
Hessischer Rechnungshof (Germany)
Landesrechnungshof Mecklenburg-Vorpommern (Germany)
Rechnungshof Rheinland-Pfalz (Germany)

Sächsischer Rechnungshof (Germany)
Landesrechnungshof Sachsen-Anhalt (Germany)
Landesrechnungshof Schleswig-Holstein (Germany)
Thüringer Rechnungshof (Germany)
State Audit Office of Hungary – Major Directorate in charge of local government audit * (Hungary)
Local Government Audit Service - Department of the Environment (Ireland)
Rekenkamer Amsterdam (Netherlands)
Rekenkamer Rotterdam (Netherlands)
National Council of Regional Chambers of Audit (Poland)
Regional Chamber of Audit in Bydgoszcz * (Poland)
Regional Chamber of Audit in Katowice * (Poland)
Regional Chamber of Audit in Szczecin * (Poland)
Regional Chamber of Audit in Wrocław * (Poland)
Tribunal de Contas - Secção Regional dos Açores * (Portugal)
Tribunal de Contas - Secção Regional da Madeira * (Portugal)
Chamber of Control and Accounts of the Republic of Kabardino-Balkaria (Russia)
Chamber of Control and Accounts of Komi Republic (Russia)
Chamber of Control and Accounts of Leningrad Region (Russia)
Chamber of Control and Accounts of Moscow (Russia)
Chamber of Control and Accounts of Orenburg Region (Russia)
Chamber of Control and Accounts of Rostov Region (Russia)
Chamber of Control and Accounts of Samara Region (Russia)
Chamber of Control and Accounts of Stavropol Region (Russia)
Chamber of Control and Accounts of the Republic of Tatarstan (Russia)
Chamber of Control and Accounts of Tver Region (Russia)
Chamber of Control and Accounts of Vladimir Region (Russia)
Chamber of Control and Accounts of Tuymen Region * (Russia)
Office of the Auditor General of Kosovo (United Nations Protectorate)
Court of Audit of Slovenia – local government audit section * (Slovenia)
Cámara de Cuentas de Andalucía (Spain)
Sindicatura de Cuentas del Principado de Asturias (Spain)
Sindicatura de Comptes de les Illes Balears (Spain)
Audiencia de Cuentas de Canarias (Spain)
Sindicatura de Cuentas de Castilla-La Mancha (Spain)
Consejo de Cuentas de Castilla-León (Spain)
Sindicatura de Comptes de Catalunya (Spain)
Consello de Contas de Galicia (Spain)
Cámara de Cuentas de la Comunidad de Madrid (Spain)
Cámara de Comptos de Navarra - Nafarroako Kontuen Ganbara (Spain)
Sindicatura de Comptes de la Comunitat Valenciana (Spain)
Tribunal Vasco de Cuentas Públicas - Herri Kontuen Euskal Epaitegia (Spain)
Cour des comptes de la République et Canton de Genève (Switzerland)
Inspection des finances du canton de Genève (Switzerland)
Inspection des finances du canton du Valais (Switzerland)
Cour des comptes du canton de Vaud (Switzerland)
Finanzkontrolle des Kantons Zürich (Switzerland)
Accounts Chamber of the Supreme Rada of the Autonomous Republic of Crimea (Ukraine)
Audit Commission of England (United Kingdom)
Audit Scotland (United Kingdom)
Wales Audit Office (United Kingdom)

Tribunal de Contas do Estado do Paraná * (Brazil)
Tribunal de Contas do Estado de Santa Catarina * (Brazil)

* associated members

The following institutions/associations have observer status:

Ассоциация контрольно-счетных органов Российской Федерации (АКСОР)
(Association of Chambers of Control and Accounts of the Russian Federation)
Lietuvos Respublikos Savivaldybių kontrolierių asociacija (Association of
Comptrollers for Local Authorities in Lithuania)
Združenie hlavných kontrolórov miest a obci slovensky republike (Association of
Comptrollers for Local Authorities in Slovakia)
Auditor General of Quebec (Canada)
Canadian Council of Legislative Auditors (Canada)

Preface

In keeping with the EURORAI objectives in relation to co-operation and exchange of knowledge, the General Assembly in October 2010 agreed to funding for a pilot working group.

The idea of the working group was to identify an area of common audit interest amongst members. Research would then be undertaken with a view to producing a paper which would be of practical interest to EURORAI members. This would include sharing experiences and promoting consistency.

At the Management Committee in Salzburg in 2011, it was agreed that the initial subject would be the external audit of fraud.

The working group proposed by EURORAI members was agreed as follows:

Name	Role	RAI
Alan Bryce	Head of Counter Fraud	Audit Commission (England)
John Gilchrist	Manager-Audit Strategy	Audit Scotland
Birgit Fuchshuber	Member	Court of Audit of Upper Austria
Michel Carles	Government Commissioner	Regional Audit Chamber of Midi-Pyrenees (France)

Stephen Taylor
President of EURORAI
Southampton, England
April 2012

1. Introduction

The aim of this working group was to identify counter fraud good practice among member organisations and agree recommendations to strengthen the counter fraud arrangements and promote consistency amongst EURORAI members. In particular a survey of EURORAI members was undertaken to establish counter fraud arrangements in different countries. An analysis of the survey findings are reported in section 8 of this paper.

As this paper identifies, the different legal and operational frameworks in place for auditors in EURORAI member regions make a single, consistent approach to counter fraud impractical. However, this diversity in approaches provides the opportunity to draw on a wide range of methods and good practice in countering fraud which EURORAI members can benefit from.

2. Scope and Objectives

The scope and objectives of the working group are set out below:

1. To compare and contrast approaches to auditing fraud in different regions.
2. To recommend standard definitions for Regional Audit Institutions (RAIs) to adopt.
3. To share good practices and recommend standard approaches to be used by RAIs and promoted with audited bodies.

3. Approach

The approach to the work was to:

1. Agree a common definition to fraud including reference to current international auditing standards.
2. Agree a common approach to responsibilities for prevention of fraud in public sector organisations.
3. Compare current approaches to auditing fraud using a survey questionnaire (See Appendix A).
4. Identify and share good practices.
5. Make recommendations to promote consistency in future and help RAIs improve.

4. Summary

Prevention of fraud is a key issue for local authorities and other public bodies in Europe. As a result it features in the audit programmes of all Regional Audit Institutions (RAIs) to varying degrees.

In some regions such as those in the UK and Ireland and parts of the Netherlands, the auditor is required to certify the accounts in accordance with auditing standards. Therefore the anti fraud emphasis in the auditors work is influenced by professional accounting and auditing standards.

In other countries such as France the regional emphasis is on probity and a review of expenditure and income in delivering the budget. It is a similar situation in Russia with a lot of focus on the budget as well as the accounts. As such, the anti fraud emphasis is more based in law.

A large number of RAIs also review value for money aspects as part of the audit and this will include fraud considerations.

The approach to anti fraud audit varies between countries and regions. A number of RAIs include fraud issues within mainstream audit work whereas others devote specific time to thematic reviews of risk areas.

The significant risks and techniques used indicate a good degree of consistency across a large number of RAIs although there is variety in the reporting method depending on the approach.

This paper sets out the findings from the working group and suggests a number of recommendations for consideration by EURORAI and/or EURORAI members designed to promote consistency and share good practice.

5. Recommendations

This section brings together a range of recommendations for EURORAI and /or EURORAI members to consider.

i) Recommendations for EURORAI

No.	Recommendation
	Sharing and learning
1	Encourage member organisations to provide examples of good practice which it will make available on its website.
2	Prepare a seminar on audit of fraud for EURORAI members.
3	Offer the opportunity to facilitate training in fraud matters where requested by members or groups of members.

ii) Recommendations for Members

No.	Recommendation
	Definition
4	Review existing definition of fraud to ensure that it encompasses the key elements: • adopting a civil, rather than criminal only, basis for definition wherever practical; • reference to some form of abuse of position, false representation and failure to disclose information, within the definition; and • reference to an intention to make some form of gain or cause loss.
	Management Responsibility
5	EURORAI members should promote good practice in public authorities and ensure that each has in place as a minimum: • A Code of Conduct for Employees which reflects the issues identified in this paper (Exhibit 2); and • An anti fraud strategy which focuses on practical implementation including training (Exhibit 3).
	Auditor responsibility
6	Include time in audit programmes to monitor compliance with Code of Conduct and anti fraud strategy.
7	Ensure that audit reviews include consideration of the culture of the organisation and how anti-fraud is promoted from within the organisation.
	Audit skills and training
8	Review the skills and competencies of auditors in relation to fraud.
9	Undertake training to fill gaps as appropriate and consider the possibility of training in liaison with other interested agencies.
	Reporting
10	EURORAI members to ensure that issues arising in relation to fraud are reported annually where this isn't already in place: • Externally – to inform Regions and public; and • Internally - to ensure experiences are shared.
	Audit techniques and examples
11	Members to provide EURORAI with examples of good practice in Fraud audit that can be shared with others via the website.
12	EURORAI members to consider use of the 'Fraud Triangle' model to raise awareness of fraud potential in RAIs and also audited bodies.
13	EURORAI members should make routine enquiries of management on fraud issues each audit cycle using the suggested questionnaire in Appendix B.
14	Consider common fraud risks at each audit. As a minimum: • the risky positions held by some staff members; • the risky procedures; • the lack of transparency; • the situations of monopoly of decision making; and • risky procurement procedures.

6.   Definition of Fraud

Auditors in EURORAI regions apply a wide range of fraud definitions. This includes the International Standard on Auditing (ISA) 240 definition of fraud as constituting fraudulent financial reporting or the misappropriation of assets. However, this is a narrow definition of fraud intended to address the external auditors' responsibilities to provide an opinion on the financial statements. As such, this does not provide the basis for a EURORAI-wide definition.

In some EURORAI regions there is also no criminal definition of fraud. In England for example, there is a Fraud Act which defines specific offences of fraud but does not define fraud itself. In England the Audit Commission used the core elements of those offences to create the following definition of fraud, widely accepted across the English public sector:

"Fraud as any intentional false representation, including failure to declare information or abuse of position which is carried out to make gain, cause loss or expose another to the risk of loss. This includes cases where civil, criminal or management action such as disciplinary action has been taken".

This definition encompasses civil, criminal and disciplinary action in relation to fraud. This is an important feature of any fraud definition. In England, the vast majority of fraud committed against local government is not dealt with through criminal sanction. Thus any definition narrowly focused only on fraud as a criminal offence would have the unintended consequence of significantly underreporting and under estimating the true scale and damage caused by fraud.

Other European based public bodies have also sought to establish a definition of fraud. For example, the European Healthcare Fraud and Corruption network, based on guidance from the Swiss Institute of Comparative Law, concluded in 2005 that the following definition, based on civil case law, was applicable across Europe:

"Civil fraud is the use or presentation of false, incorrect or incomplete statements and/or documents, or the nondisclosure of information in violation of a legally enforceable obligation to disclose, having as its effect the misappropriation or wrongful retention of funds or property of others, or their misuse for purposes other than those specified".

In summary, the legal and statutory framework in different regions makes the establishment of a single acceptable definition of fraud impractical and EURORAI members have a wide range of similar definitions. A suggested generic example is shown below:

Exhibit 1

Example fraud definition for public sector body.
1. Deliberately falsifying, substituting or destroying records for personal gain;
2. Intentional breaches of financial regulations and procedures;
3. Abuse of position as employee to benefit friends, family or others;
4. Use of deception with the intention of obtaining an advantage, avoiding an obligation or causing loss to another party;
5. Theft of funds or assets from the regional/local authority or its partners.

It is **recommended** that EURORAI members review their current definitions to ensure they encompass key elements. These include:

- adopting a civil, rather than criminal only, basis for definition wherever practical;

- reference to some form of abuse of position, false representation and failure to disclose information, within the definition; and

- reference to an intention to make some form of gain or cause loss.

7. Accountability and responsibility

It is important that there is a shared understanding of the respective roles and responsibilities of auditors and audited entities in preventing and detecting fraud. Without such an understanding, there is a danger of false expectations of what auditors should or are able to do.

Management responsibility

In general, the responsibility for prevention and detection of fraud lies with management, with the oversight of those who are charged with governance. The minimum standard to counter fraud that the auditor should expect to see is:

- a Code of Conduct;
- regular training concerning the Code of Conduct;
- an anti fraud strategy;
- understanding of risks using 'Red Flags';
- use of special internal audit programmes; and
- an adequate Internal Control System.

i) Code of Conduct

The most important measure of an organisation to prevent fraud is the implementation of a Code of Conduct. It contains rules of behaviour for all employees which reflect the norms and values of the organisation. Therefore, the Code of Conduct shapes the organisational culture in a positive way. The objective of a Code of Conduct is that every employee of the organisation complies with it. Thus it is possible to prevent fraud. The sole existence of a Code of Conduct, however, is not enough, it needs to be implemented and lived by everyone.

The audited body needs to develop and implement an adequate Code of Conduct. Thereby, it is important that:

- the Code of Conduct is communicated to everyone (see training below);
- the Code of Conduct applies to every employee in the organisation, management and staff;
- all employees sign the Code of Conduct;
- sanctions for non-compliance are communicated and also executed; and
- a compliance officer is nominated who gives advice to employees, supervises the adherence to the Code of Conduct and accepts information about non-compliant activities.

Exhibit 2

Typical issues covered in a public body Code of Conduct for employees	
Issue	**Comment**
Standards expected	An emphasis on the high standards expected in public life.
Information security	To address the confidentiality of information in a public body.
Political neutrality	Staff should not display political bias.
Relationships	All employees should conduct their business with other staff, politicians, suppliers and customers in an appropriate manner.
Appointments	Staff involved in employment decisions should ensure appointments are made on the basis of merit.
Outside commitments	Outside commitments should not compromise work at the public body.
Personal interests	All financial and non-financial interests should be disclosed where there may be a potential conflict.
Procurement	Roles should be clearly separated in a tendering process.
Gifts and Hospitality	Gifts and hospitality should only be accepted if there is a genuine need related to the business of the regional/local authority. Significant personal gifts and hospitality should never be accepted. All gifts and hospitality should be declared in a register including those declined.
Whistle-blowing	An efficient whistle-blowing policy which sets out process as well as protection for the individual.

ii) Training

The audited body needs to have regular training for every employee concerning the Code of Conduct in order to strengthen its acceptance and implementation. Within such regular training the organisation's rules and norms as well as the required rules of conduct should be explained. Practical examples are very useful. The main objective of such training is to improve the ability of every employee to identify potential fraudulent activities in the organisation.

iii)   Anti fraud strategy

In addition to this, the auditor should look for detailed anti fraud arrangements at an audited body set out in an anti-fraud strategy.

Exhibit 3

Typical components of an anti-fraud strategy in a regional/local authority	
Issue	**Comment**
Definition of fraud	Each regional/local authority should publish the definition of fraud for clarity within the organisation.
Responsibilities	Specific responsibilities for various roles within the organisation. Eg: Internal audit, managers, councillors, staff.
Identification of risk	An assessment of the potential for exposure to risk.
Culture	A statement on the organisational culture and the high standards expected in public office. This should include a reference to setting the right tone in the leadership as well as publicity and training within the organisation.

Action
  1. Deter
  2. Prevent
  3. Detect
  4. Investigate
  5. Sanctions
  6. Redress
	The practical action to be taken by a regional/local authority in addressing the risk of fraud.

Monitoring	The way that the regional/local authority will monitor and report on the implementation of its fraud strategy.

iv)   Red Flag risks

To help audited bodies focus anti fraud activity, the concept of 'Red Flags' is often used. These are warning signals of possible fraud. They signal irregularities that need to be further investigated. Being able to recognize Red Flags is essential for the detection of fraud in an organisation. Therefore, the management of the audited body needs to communicate at the least the basic Red Flags to its staff in order to increase the sensibility against fraudulent activity.

Common examples for Red Flags are:

- Employee's lifestyle: living beyond their means;
- Employee's behaviour: notable changes; and
- Employee's way of working: persons who do not like to be supervised or audited by anyone, people who do not take or hardly take vacation and sick leave

v) Internal audit programmes

The audited body needs to regularly use a special audit programme which enables it to detect irregularities in the organisation, e.g. in accounting, human resources, granting of subsidies. Irregularities do not automatically mean a fraudulent activity but they need to be investigated further.

vi) Internal Control

An effective Internal Control System is another very important measure to both prevent and detect fraud. The audited body needs to have considered the risk of becoming a victim of fraudulent activities in the design of the Internal Control System. Since most organisations have not included the risk of fraud in their Internal Control System it is important to adapt the controls. The existence of controls, however, is not enough, they also need to be applied.

Research shows that the most common factor enabling a fraud to occur in the public sector is the failure to apply existing controls, rather than the absence of controls. The experience of EURORAI members is that when fraud does occur despite the existence of controls, the reason is often where the tradition, custom, practice – the culture – of the organisation is such controls can be ignored or overridden in certain circumstances. The section on Good Practice highlights a toolkit – Changing Organisational Cultures – which is designed to establish both the existence of controls and the culture of application that exists in individual organisations. Tackling a culture in which controls can be overridden has the potential to greatly enhance the fraud prevention environment.

It is **recommended** that all RAIs promote the development of a Code of Conduct and an anti fraud strategy in audited bodies where these are not already in place. This will then provide a basis for ongoing monitoring.

Evidence from the EURORAI survey suggests that most RAIs already have processes in place to routinely review plans and strategies as well as having discussions with management and those charged with governance as part of the audit. A standard questionnaire is included at Appendix B and it is **recommended** that RAIs consider using this to support the initial discussion and to promote consistency.

It is also evident that in many cases, these discussions include consideration of activities to promote an anti fraud culture. However, a number of RAIs do not currently extend audit activities to reviewing the organisational culture and it is **recommended** that this be considered.

Auditor responsibility

In considering the role and responsibility of the external auditor, it is essential to emphasise the need for independence. The auditor must be free from any personal interest in the audit engagement. The appointment of the external auditor should be made independently and the auditor should feel free to challenge on fraud and any other issues without fear of sanction. To support this, RAIs should ensure that they have a Code of Ethics understood by all staff.

The role of an auditor in a financial statements audit is to obtain reasonable assurance that the financial statements as a whole are free from material misstatement, however that is caused. This may be caused by error or fraud. An audit cannot be relied upon to detect all fraud because the requirements are to obtain reasonable assurance only. A well planned audit can be expected to have a reasonable chance of detecting frauds. However, fraud may involve sophisticated and carefully organised schemes to conceal it, so the risk of not detecting a fraud is higher than the risk of not detecting an error.

The sorts of techniques that an auditor should use in order to carry out their responsibilities are set out in section 8 below. However, the ability of the auditor to detect fraud will also be dependent on factors outside of their control, mainly:

- The skilfulness of the perpetrator;
- The seniority of those involved in the fraud;
- The degree of collusion involved; and
- The frequency and extent of the manipulation.

In view of this, it is essential that the auditor reflects on this and applies professional scepticism and a questioning mind in undertaking the audit.

In most regions, law enforcement agencies are responsible for the prosecution of fraud. Auditors should have arrangements in place to contact the relevant agencies if fraud is detected.

The Regional Court of Audit in Nord Pas-de-Calais ensures that they have effective arrangements for constant dialogue with the Regional prosecutors and other representatives.
It is also common for fraud training in France to be undertaken in partnership with other agencies.

In many jurisdictions, external auditors may not have the appropriate skills to fully investigate fraud. In such circumstances, it is essential that any work that identifies a potential fraud does not raise the suspicions of the fraudster or taint the evidence.

In all cases, it should be recognised that prevention of fraud by management should be the priority. When prevention measures are well designed, they are more likely to reduce fraud, and they are more cost effective than any fraud detection arrangements can be.

To promote consistency and awareness on the subject of auditing fraud, it is **recommended** that RAIs review skills and competencies within the organisation and assess training needs.

8.   Results of EURORAI Survey

A survey (See appendix A) was issued to all members of EURORAI to capture information on audit processes as they relate to fraud. This analysis is based on 30 completed surveys received from 10 countries. Some responses were less complete.

Exhibit 4

Country	Responses
Austria	4
France	1
Germany	8
Spain	2
Switzerland	2
UK	3
Cyprus	1
Russia	6
Hungary	1
Poland	2
Total	**30**

General

Overall, the majority (90%) of audit institutions carry out an annual assessment of fraud arrangements. This did not vary significantly between Eastern and Western Europe (80% & 95%). The principal method of conducting such reviews had greater variability.

The majority of Western European institutions (85%) routinely integrate fraud work into audit programmes. There is less evidence of this in Eastern Europe.

There was significant variance on the time taken to carry out anti fraud audit work. The average was 13% of an auditor's time with a range of 3% - 40%. The Courts of Audit in Germany and Austria are fairly consistent with inputs around 10-15%.

In 2010, the Court of Audit in Brandenburg, Germany agreed focused attention on anti fraud and corruption guidelines in 39 ministries and government institutions. This included consideration of the knowledge and training of personnel.

The UK offices in Wales, Scotland and England are similarly consistent at around 5%. The highest input into anti fraud activities was the Chamber of Control and Accounts of the Tver Region in Russia reflecting the law in the Region which is common in Russia.

The Law of Tver Region, in common with other Russian regions directs the Chamber of Control and Accounts to specifically focus on the area of fraud and corruption. In 2010 this led to a large exercise being carried out in Tver region with 40% of audit time on anti fraud and corruption.

Reporting and engagement

Only half of the institutions in the survey report specifically on fraud. The Russian Chambers of Control and Accounts, for example, have a specific focus and do tend to report on fraud. Other regions do not report specifically unless by exception and fraud matters are usually included as part of the wider audit report.

> Audit Scotland and the Audit Commission in England both produce a summary annual fraud report summarising reviews and activities from all audits.

In the majority of cases, reporting was open and transparent. RAIs consistently report to the public and to parliament as well as the local authority.

Where RAIs do not produce detailed annual reports including fraud matters, it is **recommended** that this be considered.

> To increase openness, the Accounts Chamber of Vladimir Region in Russia has part of its website available for members of the public to provide opinions and comment on matters related to audit of the Region.

Audit techniques

The survey showed a good degree of consistency already with audit techniques to address fraud. The following table sets out the techniques in the order of which is the most common:

Exhibit 5

Common audit techniques to combat fraud
1. Discussions with management
2. Review of plan and strategies
3. Data matching
4. Detailed thematic reviews
5. Review of activities undertaken to improve the anti-fraud culture of the organisation
6. Discussions with politicians/councillors

It is clear that most institutions use a mixture of the techniques. The top four techniques are all commonly used, and the majority of institutions use at least the three top techniques. Interestingly some RAIs carry out no thematic reviews.

> The Regional Court of Audit in Upper Austria adopts a high level approach to anti-fraud. Reliance is placed on review of strategy, discussions and culture rather than specific thematic reviews.

Detailed Reviews

Detailed reviews are a very common tool for investigating fraud (85% of institutions use them regularly), and the survey asked which areas had been widely reviewed.

The most common subjects for fraud related audits were procurement and payroll & expenses. These were followed by housing tenancy, social care, and abuse of position. Next were financial statements fraud and grants from the EU/ national governments.

These were all consistent across Europe. Welfare Benefits is a significant fraud risk recognised in all German Courts of Audit as well as the UK regions. This was less consistent elsewhere and not an area of analysis at all in the Russian chambers, reflecting the different welfare systems.

Both the Local Government Directorate in the Hungarian State Audit Office and the Chamber of Control in Accounts and Moscow focus on the risk of fraud in the use of public property.

It is clear from this analysis that there are some consistent fraud risk areas that will apply to many RAIs as well as some that will reflect regional circumstances. The important issue for auditors is to understand the regional environment so that each audit includes a risk assessment. This will ensure that resources are directed to the most relevant areas.

It is **recommended** that potential fraud risks are considered at each audit. This should include at least:

- the risky positions held by some staff members;
- the risky procedures;
- the lack of transparency;
- the situations of monopoly of decision making;
- risky procurement procedures (considering the field, the stakeholders, the amount, the political or economical interests); and
- other risks determined by RAIs.

Audit Scotland produces an internal annual summary for auditors of all fraud reviews and outcomes in order to raise awareness and highlight potential risks.

At a more detailed level, data interrogations are routinely carried out to identify odd transactions within financial systems.

The Geneva Court of Audit routinely uses software to systematically review odd transactions in the General Ledger.

The Regional Court of Audit in Styria (Austria) uses 'Benford's Law' as a technique to identify potentially fraudulent numerical data. Benford's Law is based on an expected distribution of 1st digits of numbers in any data set. Fraudulent entries in a data set are more likely to be random and therefore application of this law can identify these.

It is **recommended** that RAIs ensure that awareness and learning is maximised by sharing summaries of fraud reviews internally amongst auditors.

9. Good Practice examples and case studies from RAIs

The survey asked EURORAI members to share examples of good practices for the benefit of others.

Limited examples were provided by EURORAI members with the majority from the 3 large RAIs in the UK. A selection of these is set out in this section together with some suggestions from the working group. This can be added to and it is **recommended** that RAIs submit additional examples to EURORAI for sharing on the website.

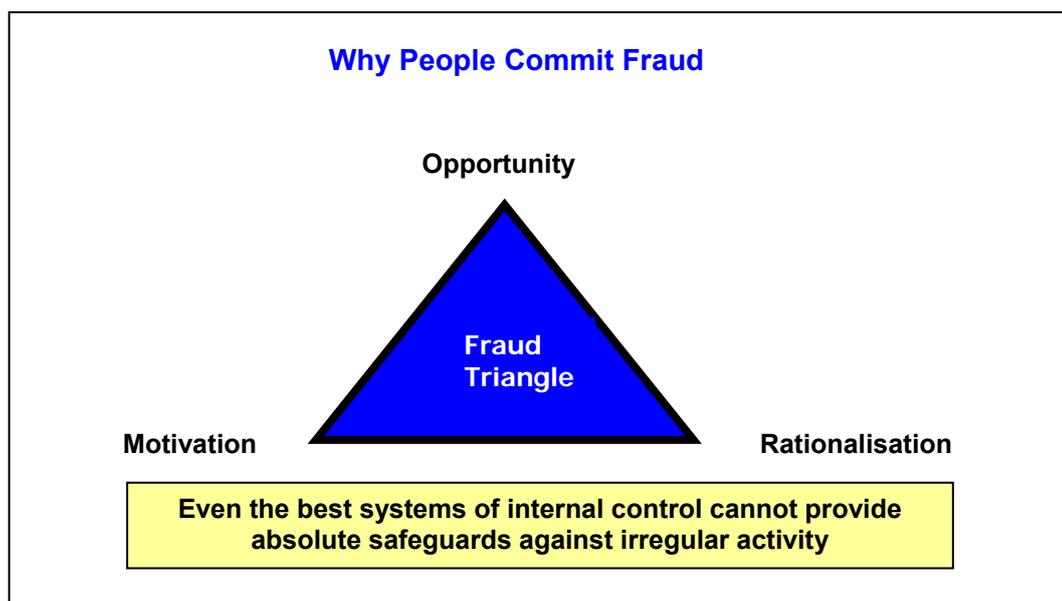### i) Fraud deterrence and The Fraud Triangle

The proactive identification and removal of the factors that cause and enable fraud is known as fraud deterrence.

Fraud deterrence reflects on the fact that fraud is not a random occurrence and it will occur where the conditions are right. By understanding this, organisations and auditors can implement practical initiatives and promote culture change to reduce the risk exposure.

To help understanding and raise awareness in RAIs and audited bodies, we **recommend** the promotion of The Fraud Triangle. This sets out three factors which will be present in every situation of fraud and it is suggested as a good model to focus training:

1. Motive (or pressure) – the need for committing fraud (need for money, etc);
2. Rationalization – the mindset of the fraudster that justifies them to commit fraud; and
3. Opportunity – the situation that enables fraud to occur (often when internal controls are weak or nonexistent).

Breaking the Fraud Triangle is the key to fraud deterrence. This will be done by removal of one element. From the perspective of the auditor, this is likely to focus on opportunity related to presence and effectiveness of internal controls.

Why People Commit Fraud

Opportunity

Fraud Triangle

Motivation   Rationalisation

Even the best systems of internal control cannot provide absolute safeguards against irregular activity

ii)   Enquiries of Management

A suggested questionnaire to be routinely used at audits is attached as Appendix B to help promote consistency. This can be modified to individual circumstances.

iii)   Organisational culture

Research shows that the most common factor enabling a fraud to occur in the public sector is the failure to apply existing controls, rather than the absence of controls. The experience of EURORAI members is that when fraud does occur despite the existence of controls, the reason is often where the tradition, custom, practice – the culture – of the organisation is such controls can be ignored or overridden in certain circumstances. Tackling a culture in which controls can be overridden has the potential to greatly enhance the fraud prevention environment.

Developing a strong counter fraud culture within organisations is increasingly recognised as one of the key elements of an effective corporate strategy to prevent fraud. In England, the Audit Commission is recognised as one of the most influential commentators on developing a strong counter fraud culture, especially in the public sector. This has been achieved through the development of a toolkit – called *Changing Organisational Cultures* – which measures and helps organisations improve their counter fraud culture. This approach has led to the establishment of a unique counter fraud culture database allowing public organisations to benchmark their counter fraud culture against similar public bodies as well as across different sectors. Where applied, the toolkit has had a significant positive impact in creating a zero tolerance approach to fraud in organisations. It has been recommended for use across the UK public sector by the UK parliamentary committee on standards, the UK government and the National Fraud Authority of the UK. More information on this toolkit can be obtained by contacting Alan Bryce, Head of Counter Fraud at the Audit Commission on a-bryce@audit-commission.gov.uk

iv)   Data matching

Data matching is an increasingly important weapon in the arsenal of fraud detection tools for auditors. When effectively implemented the results can be significant. In the UK, the Audit Commission's National Fraud Initiative (NFI) data matching activities are run every two years. This matches predominantly public sector data, and some private sector information, to provide matches which are subsequently investigated by participating organisations. Since the inception of NFI in the late 1990s, over £700 million of fraud and error has been identified. That represents a significant return on investment. There remains information sharing barriers in many EURORAI countries. These have been successfully addressed in the UK through adoption of appropriate legal safeguards to allow extension of the initiative to Audit Scotland, the Northern Ireland Audit Office and the Wales Audit Office. Further information on the NFI activities from England, Scotland and Wales can be obtained through the following links:

http://www.audit-commission.gov.uk/fraud/nfi/pages/default.aspx

http://www.audit-scotland.gov.uk/docs/central/2010/nr_100520_national_fraud_initiative.pdf

http://www.wao.gov.uk/assets/englishdocuments/NFI_08-09_eng.pdf

v)   Reporting

The public reporting of counter fraud activities creates many benefits for auditors. In addition to increased transparency of public bodies' activities, evidence indicates public reporting can enhance the public understanding of the role, responsibility and performance of public bodies in preventing and detecting fraud. This has resulted in enhanced public support for auditors' counter fraud activities, increased reporting to auditors of suspected frauds and the development of a zero tolerance approach to fraud among the general public. In England, the Audit Commission publishes an annual report, *Protecting the Public Purse*, on the detection of fraud by local government. This is a unique source of detected fraud in the UK. In addition to detected frauds, these publications identify current and emerging fraud risks, provide estimates of the likely scale of total fraud loss in areas of local government activity and a set of benchmark questions against which local government can self-assess their own counter fraud arrangements. As such the report is valuable for auditors as well as being informative for local authorities and members of the public.

As a result of increased public and government support and the re-focusing of investigative activity, local government in England detected £185 million of fraud in 2010/11. This represents a nearly 40% increase in fraud detection in just one year, against a backdrop of diminishing investigative resources. Copies of Protecting the Public Purse reports can be found at:
http://www.audit-commission.gov.uk/fraud/protecting-the-public-

[purse/pages/default.aspx](http://www.audit-commission.gov.uk/fraud/protecting-the-public-purse/pages/default.aspx)

vi)   Sharing fraud risks

The experience of EURORAI members is that fraudsters know no borders and are not limited to just one part of the public sector. Fraudsters constantly seek to exploit weakness in systems, controls and processes. To successfully prevent fraud, the auditor has to stay one step ahead of the fraudster. This can, in part, be achieved through better sharing of fraud risks and emerging fraud threats.

As noted above, we **recommend** that EURORAI seeks examples of good practice on an ongoing basis so that these can be shared with members.

Questionnaire for EURORAI Members

Working Group on Prevention of Fraud

Regional Audit Institute:	
Country:	
Completed by:	
Role:	

Questions

A.   General

No	Question	Answer
1.	Is prevention of fraud routinely incorporated into audit programmes? (Yes/No)	
2.	If yes, what percentage of time on average.	
3.	Do you undertake an annual fraud risk assessment as part of the audit?	

B.   Audit Techniques

What techniques are commonly used by external auditors?	√ (all that apply)
1. Review of plans and strategies	
2. Review of activities undertaken to improve the anti-fraud culture of the organisation	
3. Discussions with management	
4. Discussions with politicians	
5. Data matching	
6. Detailed reviews	

C.   Detailed reviews

What detailed fraud areas have been widely reviewed?	Yes/No/Not applicable	Summarise any key issues from reviews that may be of interest to others
• Financial statements fraud		
• Welfare Benefits		
• Local taxation		
• Procurement		
• Payroll and expenses		
• Housing tenancy		
• Social care		
• Grants from EU or national government		
• Abuse of Position		
• Corruption/bribery		
• Other (please specify)		

D. Reporting audits

How are results of audits of fraud reported?	√	Summarise any key issues from reports that may be of interest to others
Is there an annual report summarising anti fraud activities by the auditor?		
If so, is the report directed:		
• To the local organisation		
• To parliament		
• To the public		

E. Audit approaches

Please provide any details on approaches, checklists, techniques used by your RAI, or good practices that you think others may benefit from. Please add a link or attach files where appropriate.

Thank you for your time.

Please send form by 22 July 2011 to: e-dandy@audit-commission.gov.uk

Appendix B

Recommended standard questionnaire to assess anti-fraud measures in a local authority.

ENQUIRIES OF MANAGEMENT

Organisation	
Auditor	
Interviewee	
Date	

Generic Fraud Issues	
What are the processes for identifying and responding to risks of fraud in the organisation?	
Fraud risks	
Have you identified any specific fraud risks?	
Do you have any concerns that there are **areas** that are at risk of fraud?	
Are there particular **locations** where fraud is more likely to occur?	
Are there any high risk **jobs/posts**?	
How are the risks relating to any of the above assessed and managed?	
Internal controls	
Are you satisfied that **internal controls**, including segregation of duties, exist and work effectively?	
If not, where are the risk areas?	
What other controls are in place to help prevent, deter or detect fraud?	
Communication and culture	
How do you communicate to **those charged with governance** the processes for identifying and responding to fraud?	
How do you communicate to **employees** the policies on business practice and ethical behaviour?	
How do you encourage staff to report their concerns about fraud?	
What concerns about fraud are staff expected to report?	

Related party transactions	
Are you aware of any **related party relationships** or transactions that could give rise to instances of fraud?	
How do you mitigate the risks associated with fraud related to related party relationships and transactions?	
Instances of Fraud	
Are you aware of any **instances of fraud**, during the year of audit?	

Fraudulent financial reporting (where relevant)	
What are processes for assessing the risk that the financial statements may be materially misstated due to fraud?	
Manipulation of accounts	
Are there particular balances where fraud is more likely to occur?	
Are you aware of any assets, liabilities or transactions that you believe were improperly included or omitted from the accounts of the organisation?	
Could a false accounting entry escape detection? If so, how?	
Are there any external fraud risk factors which are high risk?	
Pressures to meet financial targets	
Are you aware of any inappropriate organisational or management pressure being applied, or incentives offered, to you or colleagues to meet financial or operating targets?	

Compliance with Laws and Regulations	
How does management gain assurance that all relevant laws and regulations have been complied with?	
Is there any potential litigation or claims that would affect the financial statements?	