

Internal audit function and Fraud prevention and investigation system

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When these solutions are applicable

- **Fraud Prevention & Investigation System Implementation**

A Company considers to create and formalize working system that enables to identify and estimates possible indicators and facts of fraud and response adequately on them in timely manner.

- **Internal Audit Function Set-up**

A Company considers to initiate a process of setting-up and development of a modern and effective internal audit function. Management is demanding that internal audit to deliver value through ideas that generate cost savings, revenue enhancements and process improvements, while at the same time monitoring the effectiveness of internal controls, especially internal controls over fraud and abuse.

Internal audit and fraud issues

■ What Is Fraud?

Fraud encompasses an array of irregularities and illegal acts characterized by intentional deception. It can be perpetrated for the benefit of or to the detriment of the organization and by persons outside as well as inside the organization.

■ What Is Internal Audit?

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

Internal audit and fraud issues

Role of Internal Audit With Respect To Fraud

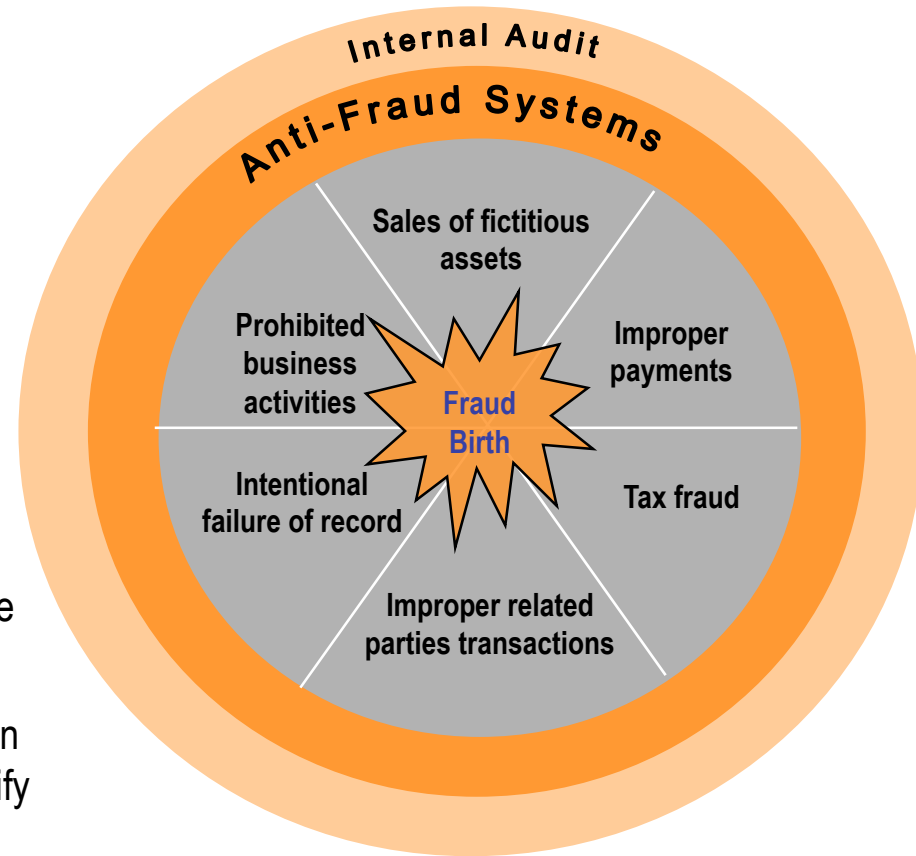
Internal auditors are responsible for assisting in the deterrence of fraud by examining and evaluating the adequacy and the effectiveness of the system of internal control, commensurate with the extent of the potential exposure/risk in the various segments of the company's operations.

Role of Internal Audit When Fraud Investigation Is Concluded

To determine if controls need to be implemented or strengthened to reduce future vulnerability.

To design engagement tests to help disclose the existence of similar frauds in the future.

To help meet the internal auditors responsibility to maintain sufficient knowledge of fraud and thereby be able to identify future indicators of fraud.



Fraud birth

Incentive / Pressure



Opportunity

Rationalization

Adapted from Occupational Fraud and Abuse, Joseph T. Wells, Obsidian Publishing Company, 1997

Anti-fraud system: 4 lines of defense

1st Line

Code of conduct and business ethics policies and procedures, and other primers of entity-level controls

2nd Line

Internal control and corporate risk management – process-level

3rd Line

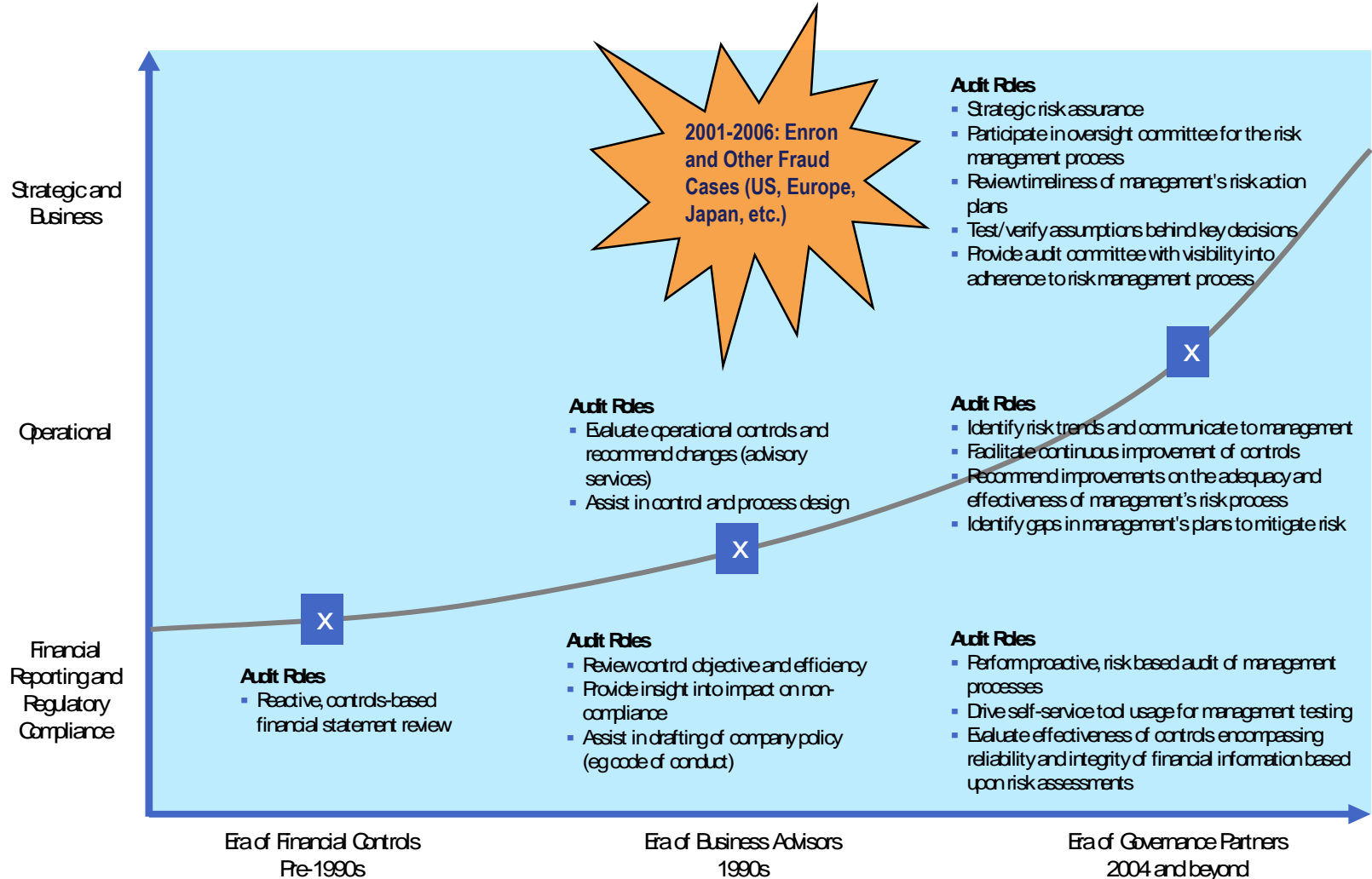
Risk-based internal audit function

4th Line

Fraud investigation efforts

Evolution of internal audit

Risk Types covered by Internal Audit



Solution to meet these needs

The solution is to concentrate first efforts on foundation of the 3rd and 4th lines of defence – internal audit function and fraud investigation. They are basic to continue with the 1st and 2nd lines in the future and can save company's money.

Equip a Specialty Team with the Fraud Investigation Tool

Develop & Implement Fraud Investigation Procedures

Equip the IA Function With the Fraud Identification Tool

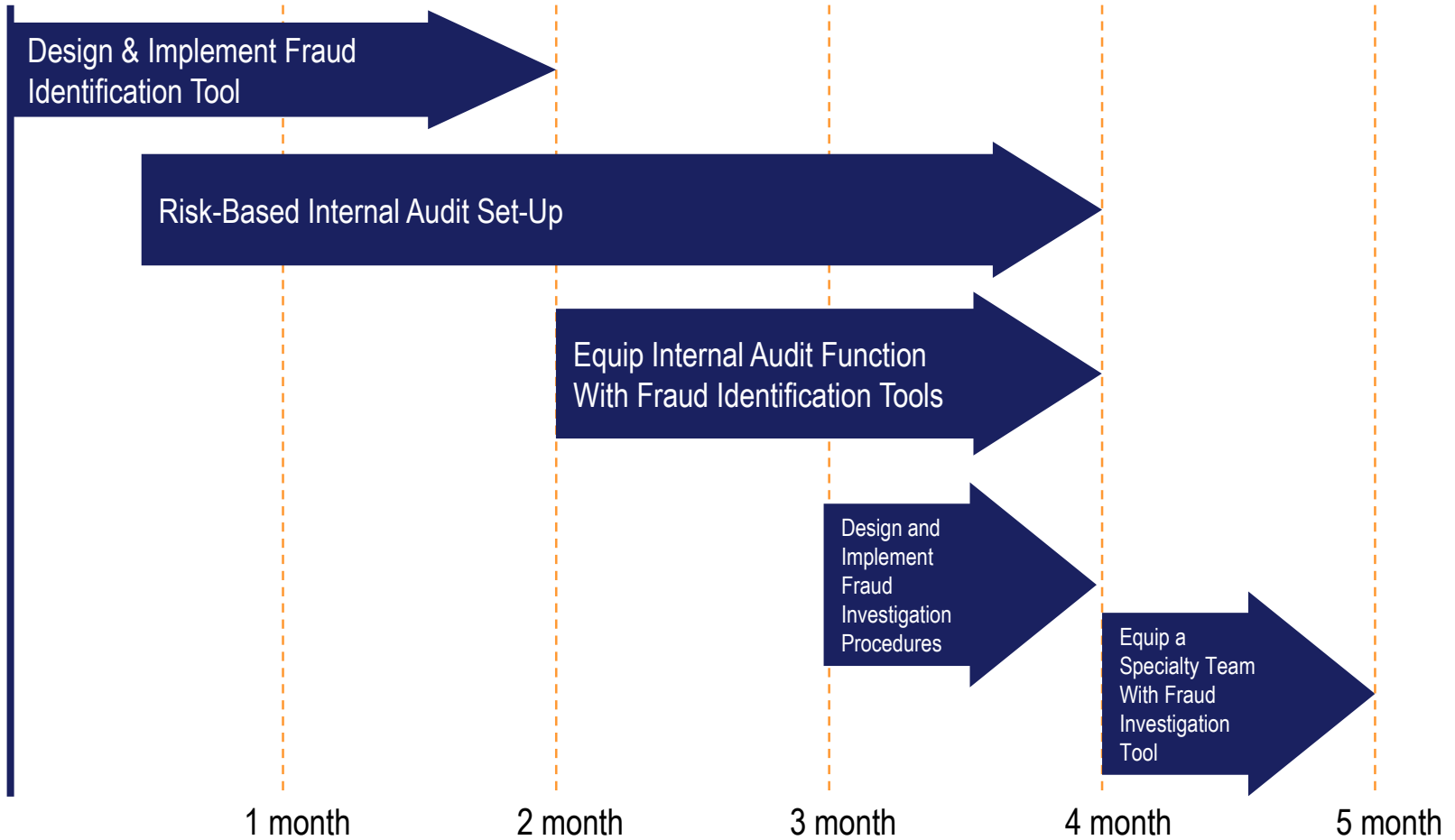
Launch Risk-Based Internal Audit Functions

Design & Implement Fraud Indicators and Fraud Identification Procedures

Integrated approach

| Design & Implement Fraud Identification Tool | Risk-Based Internal Audit Set-up | Equip Internal Audit Function With Fraud Identification Tools | Design and Implement Fraud Investigation Procedures | Equip a Specialty Team With Fraud Investigation Tool |
|--|---|--|--|--|
| <ul style="list-style-type: none"> ▪ Fraud Risks Register ▪ Fraud Indicators for value-chain and supporting processes ▪ Fraud Identification Procedures | <ul style="list-style-type: none"> ▪ Assess Company-Level Risk ▪ Evaluate of Company-Level Controls ▪ Plan Audit ▪ Execute Pilot Audit ▪ Reporting Findings ▪ Basic and Work IA Methodology | <ul style="list-style-type: none"> ▪ Embed of Fraud Identification into IA Function's Methodology and Plan ▪ Monitor Pilot Engagements | <ul style="list-style-type: none"> ▪ Fraud Investigation Procedures | <ul style="list-style-type: none"> ▪ Plan Fraud Investigations ▪ Monitor Pilot Engagements |
| Co-Develop Expectations, Communicate Interim Results | | | | Communicate Final Results |

Timeline of the approach



Attachment. Internal Audit: Vision

Concerns:

Absence of internal assurance function

- Lack of ability to add value
- Concerns of fraud and unstable environment causing errors
- Work is independent of management's business objectives
- Lack of breadth and depth of specialist skills
- Lack of ability to deter real fraud

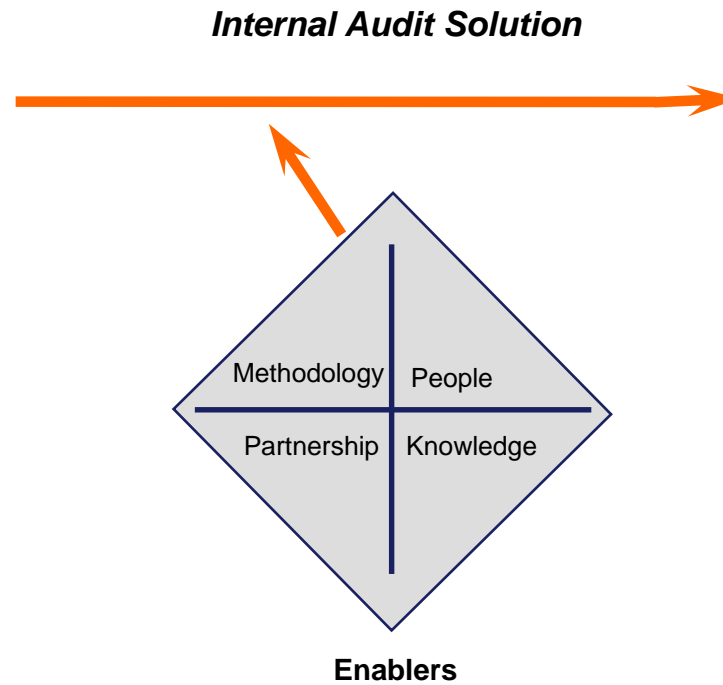
Weak internal control environment and system

Solutions:

Modern internal audit

- Clear communication and agreement of objectives
- Working in partnership with management
- Focused on risks (especially fraud risks) to the organization
- Specialist knowledge
- Technology-enabled
- Providing recommendations for process and control improvement
- Motivated, high-quality staff

Value-driven internal audit, triggering improvements in internal control system



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