FRAUD, A GROWING PROBLEM - CAN WE MITIGATE IT?

Victoria STANCIU
Academy of Economic Studies of Bucharest
Bucharest, Romania
stanciuvictoria58@hotmail.com

Abstract

Over the past few years the companies had to face a difficult economic climate. In this instable and sometimes unpredictable environment, organizations have changed their strategies, building and applying new business models based on globalization and new technologies, understanding that traditional business approaches may not be effective in the new economic circumstances. The complexity of the activities performed determined the emergence of new risks. A particular characteristic for the crisis years is also a higher potential risk of fraud and fraudulent financial reporting. Fraud is a risk that should not be ignored and many companies have recognized that the impact of fraud is increased in the past years. Senior managers have become more concerned on fraud risk and try to understand how their companies might be vulnerable to fraud.

The objective of this paper is to examine the fraud phenomenon and fraud vectors aiming at identifying appropriate prevention actions. The author focuses on the internal audit role in fraud prevention, identification and investigation. Our research results conclude on means of improving fraud risk monitor and prevention, providing suggestions for proactive approaches in control processes’ improvement.

Keywords: fraud, fraudulent financial reporting, red flags, internal audit
JEL classification: M42, G34

1. INTRODUCTION

Studies on accounting field have showed the seriousness of fraud problem and its increasing trends. Researches within this area have emphasized the fraud models and suggested how to prevent, detect and investigate frauds. Strong corporate governance and a solid corporate culture are important pillars for fraud prevention. The companies are facing this challenge being aware that the key stays in a robust fraud risk management culture and senior management endorsement for a strong approach to fraud management and ethical culture within the organization. Companies have to put in place robust systems and controls in order to prevent and detect fraud. Failure in fraud detection exposes companies to significant reputational and financial damage.

In crisis years, fraudulent financial reporting represents another growing risk. The accounting and financial audit professional literature have analyzed in detail the well known cases such as Enron, WorldCom, Xerox in US and the European fraudulent reporting cases as for example Vivendi and Parmalat. The researches in accounting and forensic accounting
have emphasized the nature of frauds and the causes that have facilitated them. The final objective of all those studies was to draw the professional framework for fraud prevention, detection and investigation and recommend how to recognize and react when alert signs arise.

Important results in the fraud research were published by Donald Cressey. Cressey explains the necessary frame for fraud: opportunity, pressure/incentive and rationalization. If any one of the three elements is missing, fraud may not occur. To succeed, the fraudster has to prove his ability and knowledge to commit fraud. Incentive (also called “pressure”) can take various forms; but any of these determine the perpetrator to seek gains via financial fraud. It should be noticed that opportunity and incentive only exist or they don’t or, in other words, exists or they potential exists. In opposite, rationalization depends on the individual and the circumstances he/she is facing.

In periods with difficult financial and economic climate, the fraud risk is increasing and there is also a higher potential risk for registering fraudulent financial statements. Since 1950s professionals and academicians have offered important insights that have gone beyond Cressey’s theory of fraud triangle. Their research had as objective to define effective ways to prevent, detect, investigate, and remediate fraud. Even so, it appears that fraud in all its various forms remains a growing problem (fraud is increasing in frequency and severity). The most recent surveys confirm the ascendant trend of fraud, in all its various forms. Everybody is aware that it is impossible to detect and/or prevent all the frauds but it is essential to design and implement an effective fraud risk management process aiming at significantly mitigate the fraud phenomenon.

The present paper aim at emphasizing the characteristics of fraud and present the author’s research results regarding means of improvement fraud risk management process. The author opted for an empiric study. In this respect our research started with a preliminary screening of the professional literature on fraud phenomenon, fraud models, fraudulent financial reporting and means of mitigate fraud risk. In a second phase, our documentation focused on surveys and studies on fraud topic, surveys issued by international professional bodies and international organizations. The conclusions retain from the accounting and fraud forensic literature, the opinion of recognized specialists in the field and the author’s personal practical experience have been evaluated in the deductive and inductive methodological process in order to identify the aspects that can be considered flag alerts for possible fraudulent financial reporting and means for fraud prevention in its various forms.

2. FRAUD PREMISE

To understand why people commit fraud, our research started from the Cassey’s theory of the “fraud triangle” aiming at emphasizing the basic elements determining fraud:

**Opportunity** is the ability to commit fraud. The perpetrator believes that he/she can conceive and commit acts of fraud without being detected. It should be noticed that opportunities must be perceived as real by the perpetrator, meaning that opportunity is not implicitly real. The perpetrator’s conviction is based on identified weaknesses in the internal control, poor management oversight, inadequate external oversight and monitoring (performed by external auditors, supervision entities, and governmental units), the management failure to implement adequate fraud mitigation and monitor processes, lack of a formalized policy on conflicts of interest, lack of prosecution of perpetrators, weak ethical culture etc. Studies on frauds have emphasized that opportunity is provided also by the position and au-
Fraud, a Growing Problem - Can We Mitigate It?

Authority of the individuals within the company. A top position in the company confers power and the ability to attract co-perpetrators by inducing fear of punishment or promising rewards.

Opportunity is the element over which business owners have the most control. Limiting opportunities for fraud is one, and very important, way a company can mitigate fraud.

The pressure, the second element in the fraud triangle, has financial and non-financial nature. Pressure takes different forms as for example: high financial needs, need to report better results due to the pressure to meet (unrealistic sometimes) targets (especially in austere times), frustrations related to work environment, professional aspiration and the desire to reach it sooner, the competitive professional environment and sometimes just the person’s desire to prove he/she can defeat the system, the inadequate incentive systems etc. Professionals in fraud forensic concluded that pressure is generally nonobservable.

In crisis years, the potential of fraudulent financial reporting is higher as a result of pressure registered by the executive management to fulfill the business objectives, so that their own financial position or even professional status in the company not to be affected. In such context, the adoption of a more “aggressive accounting” can create the perception of solid financial statements. This pressure is higher in the case of the companies rated on the market.

In difficult economic climate, management is focused more on business objectives and costs’ decreasing as a result of tighter budgets. Consequently, companies register cost cuts in their control environment. The possible consequence is the postponing or even omission of updating the risk management process according with the existing conditions.

Rationalization is considered by many specialists to be a crucial component in most frauds. In many cases, persons that had proved in time ethical and professional integrity are the initiators of frauds or fraudulent financial reporting. As the fraudster profile shows, the most frequent cases involve senior management as for example CEOs and CFOs, individuals highly respected and recognized for their professionalism. Cressey noticed that a morally acceptable rationalization is necessary before the crime takes place. By rationalization the fraudster is preserving his self-image as a trustworthy person. The fraudsters’ justification for their actions can take different forms:

- the action is, in fact, benefic for the company,
- there is no other option, for the moment, and this situation will be changed as soon as possible,
- she/he will payback the money, the fraud being considered a “loan” etc.

All the above mentioned justifications are linked to the pressure registered and the perceived opportunity identified by the perpetrator. Like pressure, rationalization is not a readily observable characteristic, and for the auditor (internal or external) it’s not possible to identify it.

Fraudulent financial reporting involves in many cases top management, head of accounting, individuals with internal control attributions and simple accountants. The “fraud triangle” theory can explain the fraudulent financial action itself but it can’t provide explanations for the perpetrators’ success in attracting other persons in the criminal act. The experts in fraud, recognizing the importance of Cressey’s theory, demonstrated that the triangle alone is an inadequate tool for preventing and detecting fraud as a result of pressure and rationalization that cannot be observed. In this respect, the research effort continued aiming at developing appropriate tools in fraud deterrence, prevention, and detection.
An important contribution to the fraud research is provided by David T. Wolfe and Dana R. Hermanson, authors’ of the “fraud diamond” concept. The “fraud diamond” concept adds the fourth component to “fraud triangle”: the individual’s capability. They started from the premise that fraudulent financial statement involves large amounts, solid accounting knowledge and specific abilities. Wolfe and Hermanson have selected four observable characteristics that can be identified in case of frauds involving large amounts (Wolfe et. al, 2004, p3):

- "Authoritative position or function within the organization;
- Capacity to understand and exploit accounting systems and internal control weaknesses, possibly leveraging responsibility and abusing authority to complete and conceal the fraud;
- Confidence (ego) that she will not be detected, or, if caught, that she will talk herself out of trouble;
- Capability to deal with the stress created within an otherwise good person when she commits bad acts”.

The fraud diamond highlights the fact that the capabilities to commit fraud are explicitly and separately considered in the assessment of fraud risk. As a result, the fraud diamond moves beyond viewing fraud opportunity largely in terms of environmental or situational factors. The capabilities are generated by the person’s position or function within the organization that may offer the ability to create or exploit an opportunity for fraud not available to others. The fraudster is trained person that understands and exploits internal control weaknesses and uses his position in his advantage. Wolfe and Hermanson’s arguments are confirmed by different surveys, all emphasizing that most cases had as initiators CEOs and CFOs. In this respect, the conclusions of the Association of Certified Fraud Examiners’ survey in 2010 are very relevant: 51% of the perpetrators of occupational fraud had at least a bachelor’s degree, 49% of the fraudsters were over 40 years, 46% of the frauds were committed by managers or executives (ACFE, 2010). Similar conclusions are revealed by KPMG’s survey issued in 2011: most people, involved in committing fraud, work in the finance function, in the chief executive’s/managing director’s office or in operations and sales (KPMG, 2011, p.4).

The fraudster has a strong ego and great confidence that he will not be detected and has a very persuasive personality, this explaining how he/she succeeds to convince others to go along with a fraud. In his article “The Human Face of Fraud”, Allan Roddy retains that the perpetrator “makes unusual and significant demands of those who work for him or her, cultivates fear rather than respect … and consequently avoids being subject to the same rules and procedures as others.” Many financial reporting frauds are committed by subordinates reacting to an edict from above to “make your numbers at all costs, or else…” (Allan, 2003).

The fraud literature review has revealed the MICE fraud model (MICE is the acronym from money, ideology, coercion, and ego/entitlement). Jason Thomas defined the model taking into consideration that in financial reporting fraud, the motivating elements are monetary incentives, bonuses or stock options. In this respect, top executives feel the pressure to provide solid financial results and crises’ causes revealed by numerous surveys have emphasized this aspect (OECD, 2009).
3. PERPETRATORS’ PROFILE

The author’s literature review on fraud and forensic accounting reveals the existence of a two defined types of perpetrators: the “predator” and the “accidental fraudster”. In their work, Forensic Accounting and Fraud Examination, Kranacher, Riley, and Wells characterize “accidental fraudster” by the following characteristics: first-time offender; middle-aged; well-educated; trusted employee; in a position of responsibility; and considered a good citizen through service works at the office, in the community, or at a charitable organization (Dorminey, 2010). This profile fits with Cressey’s “fraud triangle” considerations.

In opposition with the accidental fraudster, the specialists have defined a new profile specific for the predator, represented by an individuals or an organization (Dorminey, 2010, p.5):

- “Predators seek out organizations where they can start to scheme almost immediately upon being hired.
- At some point, many accidental fraudsters, if not caught beforehand, will move from the behavior characteristic of an accidental fraudster to that of a predator.
- Financial statement fraud perpetrators often appear to start as accidental fraudsters, or even just as earnings managers, and sooner or later become predators”.

A recent study issued by KPMG provides the following fraudster profile (KPMG, 2011, p. 6):

- male (the smaller percentage of female fraudster can be explained by the under-representation of females in senior management positions);
- 35-45 years old: the survey emphasize that senior management is more frequently implicated in fraud than junior staff;
- works in finance or in finance-related role and holds a senior management position. COSO’s study, issued in 2010, has placed CEOs and CFOs in the top of positions that committed frauds. The explanation stays in their access and responsibilities on company’s assets and financial reporting and, in this respect CEO and CFO positions offers opportunity and temptation to commit fraud. It should be noticed that, individuals on such positions have access to sensitive information, detailed information on the company’s internal control system and they have the knowledge and ability to avoid controls;
- commits fraud against his/her own employer;
- employed by the company for more than ten years;
- works in collusion with another perpetrator. The losses caused by individual fraudster can be substantial, but, in case of collusion, losses can increase dramatically. Big frauds with sophisticated schemas are conceived, in general, under conditions of collusion.

The antifraud professionals concluded that the perpetrators are better organized, have better concealment schemes, and are better prepared to deal with auditors and other oversight mechanisms or entities. As a result, the recommended ways for exposing them are professional skepticism, brainstorming and critical thinking.

The fraudster has a strong personality, a good self control and deals also very well with stress: the fraudster lies convincingly and possesses the skill to keep track of his/her lies (in most cases parallel records of transactions). In this respect, for internal and external auditors it is more difficult to detect fraud cases being known the fact that fraudsters are covering
their criminal actions by altering or hiding documents, raising restrictions and making pressure on auditors mainly in cases where he has senior executive positions.

4. REVIEWING THE STATISTICS

Fraudulent financial reporting can have significant consequences for the confidence in capital markets. In this respect, COSO publishes its periodically surveys on US public corporations’ fraudulent financial statements aiming at emphasize the characteristics of the companies and management involved in instances of financial statement fraud and provide recommendations to improve the corporate financial reporting environment. The key findings of the surveys provide useful information facilitating the understanding of the profile that characterizes management and companies involved in such cases.

The COSO survey for 2010 reveals that fraudulent financial reporting instances were registered in all industries and in companies with different size. Even new companies were identified as fraudulent. Big companies have registered less fraud or fraudulent reporting cases, but the implied amounts were significant more important. The explanation for the frauds in small firms stays in the fact that they are more exposed to fraud because of lack of controls or the inadequate internal control system.

The survey reveals (COSO, 2010) important findings in regard with the control environment (top management and the Board):

- 11% of the board members had knowledge in accounting and finance, having a higher weight comparing with non fraudulent companies. The fraudulent companies scheduled more board meetings. This fact can be explained by the possible existing financial pressure at the top.
- There were no differences between fraud and no-fraud firms in the number of directors who left the Board during the first fraud year. A large majority of both fraud and no-fraud firms had compensation committees and were registered relatively few differences in their characteristics.
- 95% of the companies registering fraudulent financial reporting had the audit committee composed by three members, many of them (comparing with the companies having correct financial reporting) having knowledge and experience in accounting and finance. More than that, the survey emphasize that 26% of the companies registering fraudulent financial reporting have changed the auditors in the period between the last correct financial statement and the first fraudulent one; 60% of the them have changed the auditor in the period when they registered the fraud and the rest of 40% have changed the auditors in the previous fiscal period they registered frauds. This can be explained by the fact that the new auditor needs time to understand the specificity of the company’s activity and its internal control system. In this respect, it should be noticed the audit committee attributions in regard with the relation with external auditor. Another important aspect points out the audit committee attributions in internal audit (IA) monitor and assessment, being known IA’s important role in fraud risk detection, prevention and investigation.

On the nature of frauds, the survey emphasizes that:

- Most frauds were registered in more that 1 year, the average period being 24 months.
• Financial statement fraud techniques involved the overstatement of revenues and assets. These are “classic” techniques emphasized by all surveys all over the world. Deloitte’s 2010 survey states that the top three types of fraud were: misappropriation of assets, improper expenditure and procurement fraud” (Deloitte, 2010, p. 9).

The fraud remains undetected in many cases. Everybody is aware that it is impossible to prevent and detect all frauds. Frauds are run based on predefined schemes aiming to hide the criminal act and traces. The red flags can appear in relation with a limited number of transactions or cannot appear if the charging transactions are not selected in the audit sample. That is why, IA has to promote techniques that facilitate analyzes on large samples, IT tools being appropriate for this tasks.

Studies have emphasized that the fraud was detected as a result of: information provided by the employees, clients, providers, anonym sources or accidentally. A document issued by ACFE (Association of Certified Fraud Examiners) underlines that, “The inherently clandestine nature of fraud means that many cases will never be revealed, and, of those that are, the full amount of losses might not be uncovered, quantified or reported” (ACFE, 2010). The ACFE study retains that individuals having high position in the organization, and implicitly having experience and high education level, register the highest rate of fraud. As a result, the study brings up the problem of trust given to the employees. Individuals who work for an organization a longer period of time engender more trust from their co-workers. They may also acquire higher level of authority; they succeed to consolidate professional relation inside and outside the company and get better understanding of procedures and means to avoid internal controls. Their skills, abilities, experience, authority and position will permit them to conceive and perform sophisticated fraud schemes. As a result the losses increase and it is more difficult to identify the criminal act. For higher positions in the organization operate less standard controls and the individuals on these position, based on their expertise and knowledge, have the ability to avoid the existing controls. Their position inside the company can provide the needed authority over the control units, making more difficult the fraud identification as a result of the constraints arisen by the fraudster. As we already stated in a previous chapter, they have the power to attract other individuals in the fraud actions; in case of collusion the fraud is more difficult to be detected.

5. HOW TO MITIGATE FRAUD?

Based on the analysis on fraud cases the auditing profession (financial audit) has adopted more rigorous auditing standards and procedures underling the importance of professional skepticism, promoting discussions in the audit team regarding moments or activities that can provide opportunities for fraud, adequate tests considering fraud when conducting a financial statement audit etc. Regulators have issued more severe rules and legislation. Complex teams formed from fraud forensic specialists and software developers have developed dedicated software aiming at adding continuous monitoring features to back-office systems. But the continuous increasing trend of frauds imposes more efforts aiming at mitigate the fraud phenomenon.

Knowing the factors that contribute to the fraud, it is more easily to find ways to mitigate the phenomenon. In this respect, the most important factors that contribute to fraud success can be considered the followings:

1. Inadequate leadership at the top;
2. Ineffective internal controls, including inadequate monitor or individuals’ work review;
3. Management override of internal controls;
4. Autocratic senior management;
5. Aggressive accounting policies;
6. Collusion between employees and/or collusion between employees and third parties;
7. Management less focus on ethical values and culture;
8. Insufficient external and internal oversight.

It should be mentioned that, in cases of collusion, internal controls centered on segregation of duties are generally ineffective in preventing fraud and other financial crimes. Many companies have recognized that the frauds could be prevented by implementing more effective controls. In this respect, organizations are reviewing their internal control systems by implementing more powerful and adequate controls and state the management role to perform broader oversight. The management is more aware that fraud prevention and detection processes must be design, implemented and periodically tested and improved. Their measures must focus on controls that diminish the opportunity to commit fraud. In this respect, organizations must design and implement processes, procedures and controls that effectively detect fraudulent activity if it occurs. An important role plays the organization culture and ethical values. The employees must be aware that the fraud phenomenon must be revealed and that they are the first to report the events even if it is a suspicion of fraud. The poor message sent by the management regarding the intolerance at fraud correlated with poor effort in ethical work environment implementation determines individuals’ inadequate response when fraud appears. The fear not to lose the job, especially when the management is involved in the fraudulent act, determines the employee not to signal the suspicion of fraud. The employees can easily identify red flags as for example changes in the behavior and life standards of theirs co-workers or possible unethical actions. As a consequence, formal frameworks providing whistleblowing instruments are extremely usefulness, the identity of the tip-off sender being ensured.

Fraud and misstatement of result can be signaled by alert flags as:

- increases in profitability fail to lead to increased cash flows, unusually rapid revenue and/or profit growth;
- accounting anomalies (transactions not recorded in a complete or timely manner or improperly recorded), last minute client adjustments that significantly affect financial results, changes in accounting policies or the methods without valid arguments/fundaments;
- contraire evolution of the company comparing with competitors/substantial growth beyond the industry: when other companies are registering sales and/or profit decrease and another business is “on the wave” and is reporting increasing trends of sales/profits the suspicion has to arise;
- large bonuses for the senior management as reward for the targets’ achievement. It is significant to notice that one of the crisis causes was the inadequate remunerations systems and inappropriate incentive structures. These weaknesses together with the high pressure on achieving target conduct to misreporting results;
- complex/unusual payment methods, duplicate payments;
- extremely complex and unstable organizational structure of the company, with a lot of subsidiaries and business transactions between them (e.g. Enron case)
- Complex business structure, in general;
- multiple banking arrangements reducing the transparency over the company’s finance and transactions;
- level of performance and skills of new entry staff are not in consonance with their past experience revealed by the CVs;
- no mandatory vacations/avoiding vacations, no periodic rotations on certain positions or unexpected transfers of key employees;
- inadequate personnel-screening policies when hiring new employees, especially for senior position and/or positions of trust;
- numerous or high value year-end and/or unusual transactions;
- employee motivation and job satisfaction levels that are low (as general picture).

Distinct red flags can be established for employees and management. The fraud forensic literature provides examples of red flags that may indicate the fraud risk in case of the employees:
- uncomfortable being reviewed their work or uncomfortable to share responsibilities with another colleague;
- strong desire for personal gain or higher gains;
- showing a “beat the system” attitude or frustrations;
- live beyond their means, evident changes in individuals’ lifestyle and behavior;
- significant personal debt and credit problems;
- too close relationship with customers or vendors;
- refusal to take vacation or sick leave;
- high employee turnover, especially in those areas which are more vulnerable to fraud;
- lack of segregation of duties in the vulnerable area.

For the management part, red flags can be considered:
- difficult relationships and possible lack of trust between the business and internal/external auditor: refuse to provide information to auditors, engaging in frequent disputes with auditors, making pressure on the auditors (see Enron case for example), the management is not facilitating the auditor’s access to the electronic files to perform tests using CAATs;
- management decisions are dominated by an individual or small group;
- rules or the actions taken to combat fraud are not communicated to the staff;
- authoritative and aggressive behavior aiming at intimidate colleagues and subordinates;
- weak internal control environment;
- inexperienced accounting personnel;
- ineffectve internal audit staff;
- decentralization without adequate monitoring;
- management changes often the external auditors or legal counsels;
- management does not prosecute or punish identified embezzlers;
- management has no clear position about conflicts of interest and is not preoccupied to issue formalized policies regarding conflict of interests;
- company assets sold under market value (DiNapoli);
- high employee turnover rate;
- unexpected overdrafts or declines in cash balances;
- financial transaction that doesn’t make sense;
- service contracts result in no product;
- conflicting or missing/photocopied documents, questionable handwriting on documents; delays in offering information and documents.

Companies are failing to read and react on the warning signs. It is important to notice that in the fraud detection process, it is important to recognize the difference between error and fraud and remember that responsibility for follow-up investigation of a red flag should be assign to the most experienced, skilled and responsible person. It should be noticed the audit findings, that are sometimes appreciated to be errors and/or irregularities and, by consequence, considered immaterial and not alert signs for fraud.

The success of the fraud management process stays also in the ethical work environment based on a robust code of ethics (or code of business conduct). Continuous communication and training are critical to enforce a solid ethical culture and building a positive work environment and encouraging self-reporting of unethical actions and/or compliance violations. In order to mitigate the fraud, the organization must understand the unique nature of its workforce and the vectors that motivate this workforce.

6. INTERNAL AUDIT ROLE

Internal auditors acknowledge their important role in fraud prevention, detection and investigation. More than that, as a result of economic uncertainty, IA’s concern and activities on this area have increased. All internal audit planning activities and work are based on risk assessment. In this respect, fraud risk is assessed and a major importance has the identification of the risk area. Despite the declared acknowledge and assumed responsibilities in risk fraud area, the practice reveals that there is not always a corresponding enhancement in IA’s activity. Deloitte’s study on internal audit status - 2011 reveals alarming facts: just 39% of the respondents declared that they perform regular fraud risk assessment exercise to consider, identify, and prioritize fraud risk (Deloitte, 2011,p.10). In order to get the answer why this percentage is so low we had to look for the determinant factors:

1. The engagement of senior management and Board: does internal audit get the appropriate mandate to deal with fraud? In this respect, there are some aspects that need more attention:
   - the most debated “tone at the top” and management responsibility in ensuring an appropriate organizational ethical culture: in fraud mitigation a culture of zero tolerance to fraud is essential. Code of conduct has to be part of day-to-day activity and unprofessional and unethical behavior must be penalized;
   - documented fraud policy: management has to understand how the business could be impacted by fraud and how it might be vulnerable. Based on these assessments a formal fraud policy has to be prepared and implemented;
   - management has to be aware on its increasing dependency on IA to monitor, detect and investigate incidents of fraud when they arise and provide the support IA is needing in achieving its role;
   - the importance of annual fraud risk assessment cannot be underestimated. Being aware of this, senior management and Board have to discuss and analyze the company’s
exposure to fraud risk and have to enhance risk fraud monitoring. Audit committee as well has to focus on these issues. Periodical meetings on fraud risk, risk management in general, imply the IA, risk management and compliance chiefs officers’ participation;

- the management has to sustain the implementation of formal whistleblowing mechanisms and be aware that this implementation should not be considered as principal detection tool or the single mechanism to be put in place;
- internal audit plan approval: the annual internal plan is approved by the Board, based on the audit committee’ recommendation. The plan has to reflect increased focus on fraud detection and monitor.

2. The IA’s appetite and ability to fulfill its role. IA response to the increasing expectation on fraud risk implies adequate resources in terms of people, skill and tools. There are known the constraints IA is facing with in most of organizations: under-resourced and significant gaps in skill sets. In this respect, it should be noticed that there are several enablers ensuring IA success in fraud detection and monitor:

- ensuring adequate resources for IA: experienced and trained staff;
- extended use of IT to prevent, detect and investigate fraud: data mining tools, tools for continuous audit;
- trainings ensuring for IA staff skills and knowledge in areas like: interview techniques, data analysis, fraud schemes, skills for fraud detection and investigation, use of dedicated software applications. The survey performed by Deloitte in 2010 reveals that only 44% of respondents declared that IA teams have adequate skills and knowledge in data analysis (Deloitte, 2010, p.8). 50% of the auditors mentioned that they never receive training in gathering and handling evidence and investigative interviews. Other topics “omitted” in training sessions registering significant percentages of the respondents were: regulatory investigation, identifying and evaluating fraud schemes, bribery and corruption (Deloitte, 2011, p.8). In crisis years, the cut costs impacts areas like training in significant way. As a consequence, the skills gaps increases and the internal auditors’ tasks on risk detection become hard to be fulfilled.
- consider using IT experts and other external resources. Cut costs or even the reticence to use external resources (in this sensitive domain) limit the chance to benefit from external expertise.

Drivers that could potentate IA performance in fraud risk and fraudulent financial reporting are:

- including increased coverage on fraud, in all forms that fraud might impact the company – fraudulent financial reporting inclusively - in IA’s annual plan;
- periodic fraud-oriented ratio analysis—focusing in particular on long-term trends and on comparisons between business units/competitor companies in the industry;
- including fraud risk /fraudulent reporting in scope reviews; Internal audit is consistently engaged in substantive anti-fraud activities and performs surprise audits and/or cash counts;
- placing IA in the frontline of the general effort of strengthen the fraud controls. IA has responsibilities in control systems’ assessment and detailed analysis and evaluation of the companies’ processes. In this respect, IA’s recommendations can offer solutions for controls’ improvement, fraud controls inclusively.
IA staff received training in specific areas as for example identification and evaluation of fraud schemes, forensic accounting, gathering and handling evidence, usage of IT instruments etc.

PwC’s survey on internal audit places risk fraud assessment on the fifth’s place between the factors driving greatest projected increases in IA’s responsibility. The same survey emphasize that the most important skills set for 2012 are considered, in order: data mining and analysis, risk assessment, information technology, risk management and fraud detection. (PwC, 2007). All those skills mentioned above are interrelated from fraud risk perspective.

In difficult economic climate, the targets are difficult to achieve especially when shareholders impose too onerous ones. Managers are facing two challenges: managing the company in unstable and sometimes unpredictable conditions and working on an excessive pressure to achieve the targets. The pressure to meet budgets and targets determines the risk of misreporting of results. One of the most frequent causes of fraudulent financial reporting is the pressure placed on management to achieve targets. As fraudulent financial reporting exposes the company to significant risk, an important role plays the audit committee oversight on financial reporting process and controls. In this respect, AICPA recommended six key actions that the audit committee should consider in performing his duties related to financial reporting oversight:

- "Maintaining skepticism,
- Strengthening committee understanding of the business,
- Brainstorming to identify fraud risks,
- Using the code of conduct to assess the financial reporting culture,
- Ensuring the entity cultivates a vigorous whistleblower program, and
- Developing a broad information and feedback network”.

The above mentioned recommendations are included in AIPA’s guide "Management Override of Internal Controls: The Achilles’ Heel of Fraud Prevention - The Audit Committee and Oversight of Financial Reporting”.

In the article, "Preventing and Detecting Collusive Management Fraud" (The CPA Journal, October 2008), Stephen E. Silver, Arron Scott Fleming, and Richard A. Riley, Jr., suggest that, beyond the review of management's fraud risk assessment, an audit committee should consider the following questions:

- "Do the internal auditors and the audit committee have the knowledge, education, and awareness of the various fraudulent management override and collusive schemes that may be perpetrated by management?
- Has the audit committee reviewed a comprehensive fraud risk assessment, including how collusive fraud and management override schemes are mitigated and detected?
- Have audit committee members participated in continuing education programs that can prepare them for appraising management's fraud risk assessment?
- Did the audit committee assist in the collusive and management override fraud risk assessment process, or did it rely solely on the internal or external audit group?
- Does the audit committee have direct oversight of the internal audit or do the internal auditors report to management?”

We appreciate that the above questions are essential in understanding the skills, knowledge and implication of internal auditors and audit committee’s members on fraud topic. The audit committee’s members should focus on the personality and skills of top ex-
ecutives and others responsible for high-risk areas when assessing fraud risk or seeking to prevent or detect fraud (Wolf, 2004).

It should be noticed that mitigating fraud risk implies a joint effort of board, executive management, audit committee, ethic committee (if it exist), remuneration committee and units ensuring compliance, internal audit and risk management functions. External auditors must take part to this effort too. The main actors remain the Board’s members and the audit committee’s members. The “tone” is provided by the Board that has to fully adhere and respect its responsibilities related to the overall risk management, fraud risk being imbedded in the overall risk management process. The top management must give a clear signal insight and outsight of the company that fraud risk tolerance is zero. Robust corporate governance determines the implementation of strong ethical principles and an organizational culture promoting those ethic principles and values. The top management must prove its ability and desire to make all the employees understand and adhere to the ethical values stated by the company. At his turn, the Board has to oversee the antifraud process implemented by the executive management and assess its effectiveness. Non executive members of the Board are also members in the audit committee and they must become the catalysts in the overseen process. They are an important vector implementing the Board requirements in the audit (internal and external), compliance and risk areas and ensuring the feedback from the audit committee to the Board regarding the conclusions of AC’s evaluation over the financial reporting, internal control and risk management processes. The author believes that the role of audit committee increases as a result of the new requirements in the risk management and compliance area. From the fraud management perspective the audit committee must ensure a proactive approach in fraud risk monitor and prevention process.

In order to mitigate fraud, the implemented process must be tailored on the company’s characteristics. For the fraud mitigation program success, it is compulsory to be identified the critical areas that can be subject of fraud actions and the potential schemas that can be used. A periodical internal control system assessment will emphasize the week controls or the ones that can be avoided by different executive and managerial positions. The analysis of all those information will emphasize the real fraud exposure and the prevention actions to be put in place.

As the author has emphasized in a previous chapter, it is impossible to prevent all risks and the companies must be aware that frauds can remain undetected or their real extent is not possible to be always establish. In this respect, it is realistic to determine an acceptable fraud loss (exposure). All the control systems will be then calibrated to maintain fraud risk exposure under this accepted level. The fraud detection controls will be added to the prevention ones.

The audit committee is asked to oversee the internal audit activities. In this respect, the audit committee’s members are asked to understand how internal audit is strategically address fraud and how internal audit work is performed aiming at fraud detection.

The audit committee must allocate time for assessing the executive management actions and monitor on fraud area and analyze litigations, fraud tips and fraud events. Being a communication bridge between board, on one hand, and, on the other hand, internal and external auditors, executive managers and supervision entities, the audit committee dispose of all the information related to the risk exposure and control and can provide its assessment and conclusions to the board so that the most adequate risk-related decision to be taken.

The audit committee in its continuous monitor over the internal audit function must ensure audit improvement. Risk oriented approach in internal audit work is essential. Internal
audit is asked to adjust its work to the identified risks and adapt its procedures and techniques to fraud detection. More than ever, today is necessary to put in practice continuous audit approach. The software tools can ensure the extension of the transaction analysis so that sampling concept to achieve a new perception. Another important role of internal audit is to ensure its support in the company’s ethical culture assimilation. Internal audit is not just a control entity; it has also the role to make everybody aware of risk and ethical values. In the author’s opinion, for the effectiveness of the control activities in general and internal audit in particular, is not enough to identify unconformities and determine their impact, maybe is more important to make aware the one that has generated the unconformity about the risk the company is exposed as a result of its action (Stanciu et al., 2011).

7. CONCLUSIONS

The fraud problem, in all its forms – corruption, asset misappropriation, fraudulent reporting, registers a continuous upward trend. Fraud is a growing problem affecting public organizations and private companies as well in all the countries, and all the industries/sectors. The governments and regulatory bodies issued regulations aiming at strengthen the control over the fraud risk and limit its likelihood and impact. The response to the fraud problem stands not just in the regulatory environment and the supervision bodies’ monitor, but first of all in the companies’ awareness that fraud does happen and there is a stringent need to proactively manage risk fraud. In some industries as for example the financial and insurances, a major fraud might cause significant losses and unforeseeable affectation of the company’s reputation.

The key of the fraud problem stays in the organizations’ senior executive decisions to design and implement tailored fraud prevention, detection and monitor processes. There is no common and predefined solution for the fraud risk management. Being part of the overall risk management process, it has to be tailored based on the company’s size, profile and characteristics.

The ethical aspects and the organization’s culture are extremely important for the fraud prevention and detection process. The “tone at the top” and concrete actions of the management have to reveal that the code of ethic is not just a written document but an attitude and way of conduct in day-to-day activities.

The fraud exists whether or not it is detected or recognized and in order to limit this phenomenon it is compulsory to know its specific characteristics and how to identify the most vulnerable areas and recognize the red flags and properly react to them. Internal audit role in preventing, detecting and investigating fraud and fraudulent reporting has increased for most organizations in the difficult economic climate characterizing the last years. Management is depending on IA to monitor, detect and investigate frauds. In this regard, IA’s approach, resources and skills have to be permanently improved aiming at increasing its effectiveness. The audit committee and management must understand that investment return in internal audit function will align IA to their expectations and needs, fraud mitigation inclusively.
References


