

2.1 Roles and Responsibilities of Different Players

Session Overview

In the previous session our emphasis was on introduction of fraud and corruption, elements of fraud and corruption and factors that lead to fraud and corruption. This session encompasses INTOSAI Code of Ethics, ASOSAI Guidelines, Auditing Standards, the mandate responsibilities and general policies of SAI auditors, and responsibilities of government departments and agencies in preventing fraud and corruption.

SAI's roles and responsibilities are determined either from their constitution or created from legislation that sets out their mandate and their respective powers. SAI's of different countries usually have different mandates and authorities.

The purpose of this session is to clarify the different roles and responsibilities of auditees as well as the auditors in preventing fraud and corruption.

This session will also provide guidance on how they must discharge their responsibility.

Learning Objectives

At the end of this session participants will be able to identify, the different roles and responsibilities of the Auditee and Auditor in preventing fraud and corruption.

Basic Concepts

Internal Controls

Internal controls are management's philosophy and operating style, and all the policies and procedures adopted by the management to provide assurance to management that:

- a) The conduct of business is orderly and efficient;
- b) Irregularities are prevented as far as possible, or detected and corrected should they occur;
- c) Assets are safeguarded from unauthorised use or disposition; and
- d) Financial records and other relevant data-bases completely and accurately reflect the operational activities of the entity and permit the timely preparation of financial information.

1. Roles and Responsibilities of the Management

1.1 Rules and Regulations

Good governance is accountable, participatory, and transparent. One the principal causes of bad governance is corruption. Conversely, one of the core foundations for good governance is accountability – the obligation to account for a responsibility conferred. In government, accountability is a process that subjects ministries, departments, and agencies to a form of control, requiring them to give a general accounting for their actions. This can partly be achieved by complying with the financial and administrative laws, rules, and regulations of the government.

1.2 Internal Control System

The primary responsibility for safeguarding the assets of the entity rests with the management. It is the management's job to obtain reasonable assurance about prevention and detection of irregularities by establishing an adequate system of internal control, using such methods as controls on authorization and the segregation of duties. The controls should be designed to ensure that:

- a) The entity receives and promptly enters in the accounting records, all the income or revenue to which it is entitled, and with banking being performed promptly;
- b) Regulations governing contracts for works and for the supply of goods and services are properly enforced, and that all expenditure is properly authorized;
- c) All assets are properly recorded and provision is made for known or expected losses;
- d) All liabilities are properly recorded;
- e) The accounting records provide a reliable basis for the preparation of financial reports;
- f) Errors and irregularities in processing accounting information will become apparent;
- g) Accounting instructions and financial regulations are available to all staff and are kept up to date.

The key components of a strong internal control environment are as follows:

(a) Management Philosophy and Operating Style

Management is responsible for devising and maintaining the internal control structure. In carrying out its supervisory responsibility, management ordinarily reviews the adequacy of internal control on a regular basis to ensure that all significant controls are operating effectively. Management's philosophy and operating style will greatly influence the control environment. *The auditor should consider management's attitude toward risk-taking, financial reporting and control.*

(b) The Organizational Structure

An entity's organizational structure provides the framework within which its activities for achieving its objectives are planned, executed, controlled and monitored. Significant aspects of an organizational structure include defining key areas of responsibility and establishing appropriate lines of reporting.

(c) The Assignment of Authority and Responsibilities

The assignment of authority and responsibility should be appropriate to the entity and its operations. Authority should only be delegated to the extent required to achieve objectives.

The auditor should consider whether:

- (i) delegation of authority is appropriate;*
- (ii) risk acceptance is based on sound risk assessment;*
- (iii) all personnel understand that they are accountable for activities over which they have responsibility; and*
- (iv) there are effective procedures to monitor results.*

(d) Accounting Policies and Procedures

The existence of an up-to-date financial management practice manual, a list of accounts codes (chart of accounts) and accounting instructions for the preparation of financial reports provide effective control over the audit client's accounting function. *Auditors should assess whether the method of accounts classification is sufficiently detailed to permit effective monitoring, and the financial management practice manual is properly approved, regularly reviewed, updated and distributed to all relevant accounting personnel.*

The methods used by management to exercise control will vary between organizations to take account of the size and complexity of the operation, the volume of transactions and sophistication of management.

(e) Management Accounts and Controls

To monitor effectively the activities of the entity against budgets or plans, management must have sufficient, reliable information on a timely basis to review and evaluate its operations. As well as current budget and other management reports, these should include systems appraisals and position assessments submitted on a regular basis. *Auditors should assess their reliability and usefulness, identify features, which are likely to be particularly useful for audit purposes and consider whether it would be appropriate to examine them in more detail.*

In all but the simplest of entities there should be a strategic and operational plan which provides a clear statement of strategy and objectives in order to direct the development of the entity and to monitor its activities. The strategy which the entity pursues should be clear and based on a sound understanding and analysis of the key strategy issues which it faces, and should be properly supported by more detailed budgets and plans which indicate how the operational objectives are to be achieved.

(f) The Internal Audit Function

An effective internal audit function can significantly strengthen the control environment. The governing body of the audit client can delegate its responsibilities for reviewing the internal control structure, monitoring the operations of the information system and control procedures and recommending improvements, to the internal audit function.

In order to be effective, an internal audit function should possess adequate technical skills, knowledge and experience, integrity and objectivity. Direct reporting lines should be established between the internal audit function and the highest level of management. The internal auditors should also be able to communicate freely with the external auditor, governing body and the audit committee, where one exists.

(g) Policies Toward the Use of Information Technology

The use of information technology should be appropriate to the size and complexity of the entity's operations. The effective design, operation and control of information technology can greatly increase the auditor's confidence in the integrity of the information generated by the system. It is the responsibility of management to establish a framework of overall control over the use of information technology. *The auditor should consider whether policies and procedures have been established to ensure that:*

- (i) *appropriate segregation of incompatible functions is provided;*

- (ii) *computer systems are developed and maintained in an authorized and efficient manner to establish control over changes to application systems, testing, conversion, implementation and documentation of new or revised systems and access to systems documentation;*
- (iii) *computer systems are used only for authorized purposes and only by authorized personnel;*
- (iv) *errors are detected before, during and after processing;*
- (v) *systems software modifications are appropriately authorized, approved, tested, implemented and documented and that access to software and documentation is restricted to authorized personnel; and*
- (vi) *transactions being entered into computer systems are appropriately authorized and access to data and programs is restricted to authorized personnel.*

(h) Policies Toward Human Resources

The proper functioning of any system depends upon the competence and honesty of those operating it. The qualifications, selection and training of the personnel involved and their awareness of internal control are important features in establishing and maintaining an effective internal control structure.

The auditor should consider:

1. *standards for recruiting personnel;*
2. *training policies;*
3. *rotation of personnel and promotions driven by performance appraisals; and*
4. *effective counseling and disciplinary actions.*

(i) The Audit Committee

The existence of an audit committee can indicate a positive attitude towards control; however, its effectiveness within the business environment can be influenced by a number of factors, including:

1. its mandate and independence from management;
2. the experience of its members;
3. the extent of its involvement in the operations of the entity;
4. the appropriateness of its actions; and
5. its interaction with internal audit.

1.3 Integrated Strategic Approach to Prevent Fraud and Corruption

Management should have in place an adequate Fraud Prevention Structure. Such a structure reduces but does not eliminate the possibility of irregularities. Aspects in this scheme to which management should be encouraged to give attention in order to discharge its responsibilities for prevention of fraud should continuously seek to:

1) Improve accountability to the public

- a) *Inform and consult clients and the public in general;*
- b) *Ensure that service standards are set and that the public informed;*
- c) *Ask line managers to set standards in consultation with clients and public;*
- d) *Make service provision more transparent;*
- e) *Publicise fees or prices;*

2) Improve accountability to management

- a) *Use a Code of Conduct;*
- b) *Ensure that staff members have clear accountability for revenues, expenditures, etc;*
- c) *Give separate responsibilities to check invoices, or sign cheques;*
- d) *Ensure procedures are followed: provide training, reduce 'heavy' procedures, and simplify processing of expenditures and income;*
- e) *Establish staff appraisal patterns with training for self-appraisal to help staff identify their own strengths, weaknesses and training needs;*

3) Improve management systems

- a) *Check physical security;*
- b) *Check computer security;*
- c) *Strengthen Internal Audit;*
- d) *Pay for outputs or results;*

e) *Maintain and check inventory;*

4) Assess the risks

a) *Ask if there is any known history of corruption;*

b) *Examine new technologies;*

5) Motivate the Staff

a) *Lead by example;*

b) *Seek fair play – aim for good pay, conditions and workplace environment;*

c) *Improve awareness – help staff to recognise the threats imposed by corruption, and the damage it does to the economy, society and security;*

d) *Discuss measures to be taken – help members of staff feel involved;*

6) Clarify rules and regulations

a) *Ensure rules about gifts and entertainment are well known to staff, clients and contractors. Require reports of benefits above a chosen value;*

b) *Ensure members of staff understand they must not have, or appear to have, any conflict of interest;*

7) Ensure Compliance – increase risk that corrupt acts will be discovered

a) *Investigate delays, because delays may indicate or give rise to corruption;*

b) *Watch staff lifestyle;*

c) *Use random or spot checks to examine few contracts in great detail;*

d) *Transfer staff;*

8) Tough measures – consider when more extreme measures are justified

a) *Encourage whistleblowers;*

- b) *Choose transparency, not privacy;*
- c) *Announce 'zero Tolerance' for violations above a set limit;*
- d) *Carry out Integrity Tests;*

Brian Glicksman's reminder is appropriate at this point. "Fraud Prevention involves more than compiling anti-fraud policies. It also involves the maintenance of an ethical environment that encourages staff at all levels to actively participate in protecting public money and property." **Brian Glicksman, Treasury Officer of Accounts.**

2. Roles and Responsibilities of External Auditors

Fraud and corruption have increasingly become important issue for countries around the world. The role of audit in addressing this issue has come under critical scrutiny. There is an increasing expectation that SAIs should, through concerted action, play an effective role in promoting a culture that values honesty, responsibility, and accountability in the exercise of authority and utilization of national resources.

This expectation is embodied in the INTOSAI Auditing Standards in the following words:

...Auditors need to be alert for situations, control weaknesses, inadequacies in record keeping, errors and unusual transactions or results, which could be indicative of fraud, improper or unlawful expenditure, unauthorized operations, waste, inefficiency or lack of probity. (Paragraph 2.2.41, General Standards in Government Auditing)

In 1998, the XVI INCOSAI meeting held in Uruguay discussed "the Role of SAIs in Preventing and Detecting Fraud and Corruption" as one of its themes signifying a growing awareness of the INTOSAI to a problem that affects in varying degrees the individual member countries and collectively poses a challenge for the auditing community.

In that meeting SAI's agreed that corruption in government results in waste of resources and reduces economic growth and the quality of life, and it undermines the credibility of state institutions and reduces their effectiveness. A realization was flagged that a strong correlation apparently exists between corruption and the weakening of state institutions. An understanding emerged that corruption often links up to the socioeconomic environment of the population, like social injustice, poverty, and violence, and that a country's traditions, principles, and values influence the nature of corruption. While registering the gravity of the challenge posed by corruption, the INTOSAI community also observed that it is difficult to detect many acts of corruption and to estimate their financial impact, as the loss does not necessarily get reported in the financial statements.

In the Uruguay INCOSAI meeting adopted the following Accords:

SAIs agree that fraud and corruption are significant problems affecting all countries in varying degrees and that the SAIs can and should endeavor to create an environment that is unfavorable to fraud and corruption. As provided in the Lima Declaration adopted by INTOSAI in 1977, SAIs agreed that they should be independent and has adequate mandates that enable them to effectively contribute to the fight against fraud and corruption. It was also agreed that, where possible, SAIs should:

- 1. seek an adequate level of financial and operative independence and breadth of audit coverage;*
- 2. take a more active role in evaluating the efficiency and effectiveness of financial and internal control systems and aggressively follow up on SAIs recommendations;*
- 3. focus audit strategy more on areas and operations prone to fraud and corruption by developing effective high risk indicators for fraud;*
- 4. establish an effective means for the public dissemination of audit reports and relevant information including, establishing good relationship with the media;*
- 5. produce relevant audit reports that are understandable and user-friendly;*
- 6. consider a closer cooperation and appropriate exchange of information with other national and international bodies fighting corruption;*
- 7. intensify the exchange of experiences on fraud and corruption with other SAIs;*
- 8. encourage the establishment of a personnel management procedures for the public service that selects, retains, and motivates honest, competent employees;*
- 9. encourage the establishment of guidance for financial disclosure by public servants and monitor compliance as part of the ongoing audit process;*
- 10. use the INTOSAI Code of Ethics to promote higher ethical standards and a code of ethics for the public service;*
- 11. consider the establishment of a well publicized means to receive and process information from the public on perceived irregularities; and*
- 12. continue work regarding fraud and corruption through INTOSAI's existing committees and working groups; for example the Auditing Standards Committee will consider these issues as part of developing implementation guidance as part of a broader standard framework.“*

In the ASOSAI Guidelines for Dealing Fraud and Corruption, 30 specific audit guidelines on fraud and corruption are included. Each guideline refers to an auditing principle/ standard and guidance prescribed by the INTOSAI auditing standards. The guidelines also include a chapter dealing with understanding fraud and corruption by auditors of the member SAIs.

The ASOSAI Guidelines are expected to be used as the model for each SAI to develop its own Guidelines. Accordingly, each SAI may modify the Guidelines

applicable to each country. The Guidelines will be greatly beneficial to auditors of member SAIs when they deal with fraud and corruption cases.

Although auditors are not primarily responsible for preventing fraud and corruption, audit can be a significant influence in reducing fraud and corruption. However auditor is not relieved of his responsibility to provide a credible assurance within his SAI's audit mandate about the actions taken by the management or those that may materially affect the picture that emerges from the audited financial reports. This responsibility covers situations where the financial reports or other auditable record may be materially misrepresented and the misrepresentation may or may not have taken place with the knowledge or involvement of the management. This responsibility of the Auditor is the extension of his responsibility to provide assurance about the audited entity and its financial statements and his obligation to make the management (either in each entity individually or through reports to the legislature) aware of any weaknesses in the design or operation of the accounting and internal control systems which are reviewed by him in the discharge of his professional duties. By conducting an audit that is sensitive to the risk of fraud and corruption, the auditors can make a proactive contribution to prevent fraud and corruption.

3. Summary

It is the main responsibility of the management of any entity to prevent fraud and corruption. It is their responsibility to put in place proper control mechanism in order to prevent fraud and corruption. Internal control system is part of this mechanism and management should implement the system and devise the system. No internal control structure, however elaborate, can by itself guarantee the completeness and accuracy of accounting records; nor can it be fool proof against error or fraud. Even if this were possible it would generally be prohibitively expensive or would "slow" systems down to unacceptable levels. Management should also have in place an adequate Fraud Prevention Scheme or Plan to reduce the possibility of fraud and corruption.

Even though auditors are not primarily responsible for preventing fraud and corruption, their audits significantly help to reduce fraud and corruption. However auditor is not relieved of his responsibility to provide a reasonable assurance about the actions taken by the management or those that may materially affect the picture that emerges from the audited financial reports. If the auditor discovers any weakness in any areas he should promptly advise senior management of the entity of the matter, although due regard should be given to the possible involvement of management in irregularities or the condoning of them. By doing this auditors can help in preventing fraud and corruption.

4. References

1. INTOSAI. *INTOSAI Code of Ethics*.

2. ASOSAI, October 2003. *ASOSAI Guidelines for Dealing with Fraud and Corruption*.
3. AICPA, 2005. *Management Override of Internal Controls: The Achilles' Heel of Fraud Prevention*.
4. Asian Development Bank, OECD, 1999. *Combating Corruption in Asian and Pacific Economies*. Manila, Philippines.