

Fraud and whistle-blowing

Audit Committee Questions
Audit Committee Institute

The increasing complexity of global organisations – technologies, financial transactions and processes, global supply chains and third party relationships – continue to expand the opportunities for fraud in a variety of areas. Audit committees have to address the various fraud risks head-on ensuring that appropriate safeguards are in place and that whistle-blowing channels are fit for purpose and working as intended.

**Employee fraud
and misconduct**

**Missappropriation
of assets
and theft**

**Accounting
manipulation to
meet budgets**

**Effectiveness of
whistle-blowing
channels**

Audit committee oversight essentials ...

While the ultimate responsibility rests with the board as a whole, audit committees are typically tasked with the principal oversight of fraud, misappropriation and whistleblowing systems, with the direct responsibility for antifraud efforts generally residing with management including internal audit.

As an important first step to its fraud risk oversight, the audit committee should make sure management has fraud risk management right. The audit committee must be properly informed and actively engaged in overseeing the process while avoiding taking on the role or responsibilities of management. To this end, it should seek input from the legal counsel, internal and/or external audit.

The audit committee should seek to ensure that management has considered all risks that are likely to have a significant financial, reputational or regulatory impact on the organisation. For any such risks, a rigorous assessment of the relevant internal controls – including their ability to detect or prevent fraud – should be made. Effective monitoring of these internal controls and periodic re-assessments of their effectiveness are key elements to stay abreast, together with management's active engagement in the process.

The audit committee should consider whether effective fraud awareness programs are in

place, updated as appropriate and effectively communicated to all employees. Also, the need for periodic fraud awareness training for all employees should be stressed.

Importantly, the audit committee must be equipped to assess, monitor and influence the tone at the top to aim at enforcing a zero-tolerance approach to fraud.

The audit committee should be sensitive to the various business pressures on management – to meet earnings estimates and budget targets, meeting incentive compensation targets, hiding bad news, etc. – and how small adjustments can snowball into bigger problems.

The audit committee's objective should be to ensure that arrangements are in place for the receipt and proportionate independent investigation of alleged or suspected fraudulent actions and for appropriate follow-up action. Whistle-blowing procedures are a major line of defence against fraud and audit committees have a role in ensuring such procedures are effective.

By focusing on fraud risk management and whistle-blowing channels – and considering it within the context of the organisation's overall approach to enterprise risk management – the audit committee can help strengthen internal controls, financial reporting and corporate governance.

Symptoms of potential fraud

- Overly dominant senior executives with unfettered powers and highly leveraged reward schemes.
- Frequent changes in finance, other key personnel or auditors.
- Individuals with lifestyles or habits potentially at variance with the remuneration they receive.
- Implausible explanations as to surpluses, or projections that are "too good to be true".
- Organisations "bucking the trend" or significantly outperforming the competition.
- Aggressive accounting policies and frequent changes thereto.
- Overly complex and / or opaque corporate structures

Barriers to effective whistle blowing

- Operational – Is the whistle blowing process fully embedded within the organisation? Do all staff members know what to do, what to look for? Do the hotlines and reporting lines actually work?
- Emotional and cultural – Whistle blowers are commonly viewed as snitches, sneaks, grasses and gossips. This perception can make it difficult to blow the whistle even though individuals recognise that it is good for the company, employees, shareholders and other stakeholders.
- Fear – Potential whistle blowers often fear reporting incidents to management. Areas such as legal protection, fear of trouble and potential dismissal all play a part when an individual is considering whistle blowing.

Key questions for audit committees to consider:

Fraud risk oversight

- Is management taking sufficient responsibility for the fight against fraud and misappropriation? Is the tone from the top unequivocal in insisting on an anti-fraud culture throughout the organisation?
- Do record-keeping policies and procedures minimise the risk of fraud?
- Are appropriate diagnostic assessments of fraud risks performed and updated periodically?
- Are all significant fraud risks properly included in the enterprise risk management approach, linked to relevant internal controls and monitored?
- Do codes of conduct contain adequate, user-friendly and upto-date behavioural guidelines in respect of fraud and other misconduct? Are they adopted across the organisation and do they apply evenly to business partners and subcontractors?
- What is the level of assurance gained related to the effectiveness of anti-fraud controls by management, internal and/or external audit and is it appropriate in the circumstances?
- Are anti-fraud controls designed to detect or prevent financial reporting fraud from the early stage (i.e. before small adjustments snowball into bigger issues)?
- Are fraud-tracking and -monitoring systems and fraud response plans in place and are they fit for purpose?
- Do staff members at all levels have appropriate skills to identify the signs of fraud and do they receive fraud awareness training relevant to their role?

Whistle-blowing responsibilities

- Are whistle-blowing policies and procedures documented and communicated across the organisation?
- Does the whistle-blowing policy ensure that it is both safe and acceptable for employees to raise concerns about wrongdoing?
- Were the whistle-blowing procedures arrived at through a consultative process? Do management and employees "buy into" the process? Are success stories publicised?
- Are concerns raised by employees (and others) responded to within a reasonable time frame?
- Are procedures in place to ensure that all reasonable steps are taken to prevent the victimisation of whistle-blowers and to keep the identity of whistle-blowers confidential?
- Has a dedicated person been identified to whom confidential concerns can be disclosed? Does this person have the authority and statute to act if concerns are not raised with, or properly dealt with, by line management and other responsible individuals?
- Does management understand how to act if a concern is raised? Do they understand that employees (and others) have the right to blow the whistle?
- Has consideration been given to the use of an independent advice centre as part of the whistle-blowing procedures?
- In cases where no instances are being reported through the whistle-blowing channel, did management re-assess the effectiveness of the procedures?

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