

Fraud Risk Assessment 2012/13 - Methodology

Introduction

It is clear that while there will always be the incentive for some people to commit fraud and no more so than in times of pay cuts and economic uncertainty, there is also concern that fewer resources and cost-cutting may result in any gaps in a control framework being breached.

In light of the above, the Council has re-evaluated its fraud risks for 2012/13 so that Internal Audit resources continue to focus on those areas most susceptible to fraud. A fluid fraud risk management process is one of the Council's key weapons in its fight against fraud and is essential for identifying potential fraud threats and weaknesses in controls to prevent fraud.

Methodology

In establishing a structured fraud risk assessment, the following methodology was applied:-

- a full list of potential inherent fraud risks was identified through:-
 - gathering external information from regulatory bodies such as CIPFA, the Audit Commission and the Institute of Internal Auditors (IIA);
 - past experience/occurrence of fraud;
 - reference to other Local Authorities.
- Pre-existing preventative and detective controls were then identified and mapped to each inherent fraud risk.
- An assessment of the effectiveness of the pre-existing preventative and detective controls was carried out based upon past internal audit experience. After consideration of the pre-existing internal control environment, any residual fraud risks were identified i.e. where controls do not mitigate the fraud risk adequately due to factors such as (a) system controls are not properly designed to address the fraud risk and/or (b) controls identified are not operating effectively.
- An assessment of the likelihood and impact of each potential inherent fraud residual risk was carried out:-

Likelihood was assessed based upon historical information of known frauds, as well as other factors such as number of individual transactions, complexity of process and the number of people involved in reviewing and approving the process. In line with our risk assessment approach, five categories have been used in assessing the likelihood of a fraud risk:

- rare (1),
- possible (2),
- likely (3)
- almost certain (4) and
- certain (5).

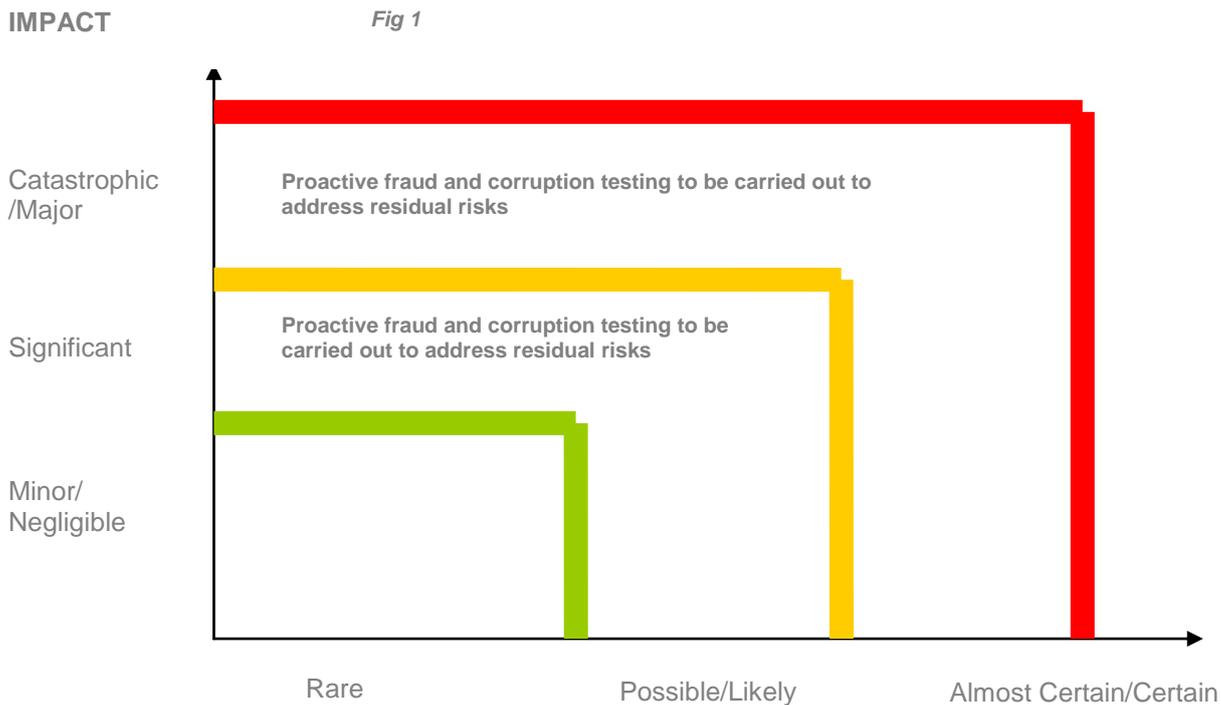
Impact was assessed based upon quantitative (financial) and qualitative (reputational) factors. Five categories have been used in assessing the significance of a fraud risk:

- negligible (1),
- minor (2),
- significant (3),
- major (4) and

catastrophic (5).

- Residual fraud risks identified are responded to by way of
 - (a) system reviews,
 - (b) targeted proactive fraud and corruption testing and
 - (c) other compliance reviews.
- The Council will respond to as a minimum those residual fraud risks which are assessed as the impact is “significant or higher” and where the likelihood is “possible or higher”.

Figure 1 below illustrates the assessment of the likelihood of fraud and its impact.



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- The proactive fraud and corruption testing planned for 2012/13, in response to the residual fraud risks is detailed in the report. Where available, test programmes will be based upon best practice checklists produced by the Audit Commission, Institute of Internal Auditors and CIPFA.

Review and Reporting

- The Fraud Risk Assessment is reviewed on an annual basis by management and updated to adapt to the changing needs of the organisation.

Sources of Information Used to Compile Risk Assessment

- Internal Audit Plan 2012-13
- List of Audit Commission Fraud and Corruption Modules
- Protecting the Public Purse 2012
- Managing the Business Risk of Fraud: A Practical Guide (IIA Publication)
- Cutting Costs and Cutting Fraud (PwC Publication)
- Other Local Authorities Fraud Risk Assessments