

THE FRAUD CLINIC

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Auditors and the Three Monkeys

OVER the years, I have investigated frauds in both Canada and the U.S. During the investigation of many of these frauds, it became clear that internal audit had completed audits in the areas involved and had not spotted or reacted to problem indicators.

Often, the auditors reported symptoms or red flags, but had concluded that the issues identified were control deficiencies. They had made recommendations to management to correct the control deficiencies. They had not, however, followed up with additional steps to determine if frauds were actually occurring. In some cases, they actually had seen direct evidence and had obtained information that should have alerted them immediately that fraud was involved.

Were these auditors lacking intelligence? Did they care about their companies? How could they have missed what seemed to be obvious warning flags and/or direct evidence of fraud? These questions are now being asked of internal auditors and their professional bodies by numerous regulatory bodies in Canada and the U.S.

I don't believe that these questions have been fully addressed to date by professional organizations. Because I have trained hundreds of internal auditors from departments in the U.S., Britain and Europe, I believe these questions are best answered by drawing an analogy with the three famous monkeys who professed to:

- See no evil.
- Hear no evil.
- Speak no evil.

See no evil

This internal auditor has the ability to see direct evidence of fraud and report such concerns as:

- All items have not been accounted for in the sequence control process.
- Proper authorization has not been obtained on some purchase orders.
- Orders have been split to circumvent authorization procedures.
- Required bidding practice and policy was not adhered to on a number of occasions.
- Management has not acted to correct deficiencies identified in previous audits.

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This auditor can also look at clear warning flags, such as invoices with similar company names but different mailing addresses,

unusual changes in procedure to handle certain transactions, and hundreds of other warning symptoms, without becoming alarmed or suspicious. "See no evil" has a seemingly unlimited capacity to trust and believe in the goodness of mankind.

Hear no evil

This internal auditor has the ability to interview staff and outsiders, hear the stories provided and overlook blatant clues that problems exist. Examples include:

- Staff complaining about the quality of goods or services that have been sole sourced on directions from above.
- Weak explanations of why bid procedures were not followed to obtain goods or services.
- Explanations that make no sense about why controls couldn't be followed.
- Reasons why a fraud couldn't occur that have holes big enough for trucks to drive through.
- Hearing numerous inconsistencies and half truths. "Hear no evil" has a seemingly unlimited capacity to hear lies and see red flags while continuing to believe in the goodness of mankind.

Speak no evil

"Speak no evil" is not quite as bad an internal auditor as "Hear no evil" and "See no evil". "Speak no evil" has recognized to at least some degree that a problem, or problems, exist. "Speak no evil" is reluctant, however, to report his or her concerns. Some of the reasons include:

- There is no budget to pursue the potential problem area.
- Management has promised that the issue will be addressed.
- If the matter is reported, promotion opportunities for the internal auditor will be affected.

- The issue, although clearly part of a management coverup, is not important or material enough to bring before the audit committee.
- Only circumstantial evidence exists; only absolutely sure conclusions backed by complete evidence should be raised as problem issues.
- If the audit committee were told, it might be angry with "Speak no evil" because it may already have known or suspected the problem existed, was content to remain uninformed and leave the issue alone or, worse, was a part of the problem.
- If the auditor reported his or her findings, the audit committee might ask what additional steps had been taken. The auditor is not confident of his or her ability to pursue the problem.
- Reporting the auditor's concerns might suggest that he or she didn't trust management. Indicating this distrust could be a CLM (Career Limiting Move)!

This is only a partial listing of the rationalizations and explanations I have heard from internal auditors over the years. Only "Speak no evil" has the necessary level of distrust in mankind, but he or she will not communicate the nature and extent of what that distrust discloses.

Many of us have seen members of the internal auditing profession who are examples of one or more of the three monkeys. Generally, no sanctions are imposed by any outside body when the evidence clearly points to one or more of the three deficiencies.

Litigators have started considering suing auditors who exhibit one or more of the three traits but, to date, little pursuit has taken place -- primarily, I suspect, because it has been determined that the auditor involved doesn't have enough assets to justify the effort.

Meeting the challenge

As a professional who has been an internal auditor and an internal audit manager, and who works regularly with internal auditors, I believe that it is time for internal auditors to critically assess themselves and their staff.

If your self-assessment suggests that your department has one or more of the three monkeys, I urge you to take steps to ensure that, in the long run, you retain the support and confidence of management and the audit committee. You can accomplish this by thorough planning and supervision, adequate training and encouraging adherence to high ethical standards.

In November's column, I will discuss ways to see and hear indicators of fraud, for the benefit of "See no evil" and "Hear no evil".

December's column will address how to identify and retrain auditors who prefer not to pursue or report their concerns ("Speak no evil").

At the time this article was written in 1990 Tim Leech was Managing Director of NCM Control & Security Services Limited, the Canadian subsidiary of an international consulting firm based in London, England. Tim Leech is now Principal Consultant and Chief Methodology Officer at Paisley Consulting, a world leader in business accountability software solutions. He can be reached by phone at 905 823 5518 or by email at tim.leech@paisleyconsulting.com

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