

# Internal Audit in Financial Services: Consideration of Fraud – An Empirical Analysis and Assessment

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The present study sought to research procedural and technological means to consider the risk of internal and external fraud implemented in large financial service providers (excluding insurance business). The study includes a theoretical foundation section providing an outline of the key drivers underlying the present work, together with a brief description of a selected relevant guidance and standards issued by supranational opinion leaders, professional organisations, and national supervisors. The sub-section on fraud and internal control includes a short presentation of the most common internal control frameworks COSO and COCO due to their relevance in establishing controls that prevent the occurrence of fraud in the first place. The main part of the study is represented by a survey that has been addressed to internal audit representatives from 20 large and one small internationally active financial service provider. The survey attempts at capturing (i) the methodological framework adopted by the respondents, (ii) the existence of technological support for the identification of patterns potentially indicative of fraud (red flags), and (iii) the existence of technological support for conducting assignments to investigate fraud cases. The survey also included a supplementary set of questions designed to highlight possible challenges to the execution of fraud investigations resulting from the “legal privilege”. This can be applied to specific work performed in

the course of an investigation and subject its documentation to be concealed to a limited number of persons aware of the situation. Responses were ultimately received from five of the 21 institutions, representing a feeble 24 % completion ratio.

The study found that processes and systems in place to support the internal audit function of the surveyed institutions in the execution of their fraud detection or investigation mandates were in general little developed, apart from one of the institution that asserted to possess a leading edge in this area. This relative immature development was surprising in the light of the challenges posed by the continual presence of fraud cases through all industries, with special emphasis on the financial industry. The fact that senior financial institutions have developed tools used for monitoring transactions, albeit for other purposes (anti-money laundering, combating terrorism financing), and yet do not dispose from tools susceptible to provide recognition of patterns potentially indicative of fraud adds to the surprise. Further, while fraud investigations absorb an estimated 10 % of resources dedicated to audit, there are little signs that would indicate the presence of automated workflow tools to support the process.