



<b>OPERATIONAL PROCEDURES</b>	Procedure No.	<b>280.00 FRAUD CONSIDERATIONS</b> <b>LAST REVISED: JULY 1, 2019</b>	<b>PAGE 1 OF 4</b>

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## **CONSIDERATION OF FRAUD, WASTE AND/OR ABUSE**

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### **DEFINITION –**

**FRAUD** – a type of illegal act involving the obtaining of something of value through willful misrepresentation. Final determination of fraud is to be made through the judicial or other adjunctive system and is beyond the auditors' professional responsibility.

**WASTE** – the act of using or expending resources carelessly, extravagantly, or to no purpose. It can include activities that do not include abuse and does not necessarily involve a violation of law. Waste relates primarily to mismanagement, inappropriate actions, and inadequate oversight. (7.23)

**ABUSE** – behavior that is deficient or improper and also includes misuse of authority or position for personal financial interest or those of an immediate or close family member or business associate. (NOTE: Abuse does not necessarily involve Fraud)

Consideration of fraud, waste and/or abuse (FWA) is the conscious and deliberate awareness by auditors of the potential for fraud throughout the ERA, ARA, and the audit/engagement process.

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### **PURPOSE –**

- Research and identify risks associated with fraud, waste and/or abuse;
- Evaluate the adequacy of the City's processes/methods for managing risks of fraud, waste and/or abuse;
- Assure that AD staff's proficiency and competency is at a sufficient level of knowledge to evaluate risk of fraud, waste and/or abuse and assess the manner in which the City addresses the management of that risk;
- Assure that AD staff take risk of fraud, waste and/or abuse into consideration during the development of engagement objectives and program steps;
- Assure that the AD keeps the CC (and ultimately the Mayor and City Council) informed as to risks of fraud, waste and/or abuse; and
- Provide and promote method by which employees, citizens, and other interested parties can inform the AD of potential occurrences of fraud, waste and/or abuse without the fear of retribution (e.g. Fraud Hotline, Fraud Reporting link via the City Controller's Website, etc.).
- Report indicators of Fraud, Waste and/or Abuse through appropriate channels

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### **APPROACH AND METHODOLOGY –**

Consideration of fraud, waste and/or abuse is an element of the ERA, and ARA, in that the risk of occurrence and the management of that risk is assessed. However, consideration of fraud, waste and/or abuse is addressed separately in this manual due to the potential illegal nature of the activity.

The opportunity, significance, and likelihood of fraud, waste and/or abuse occurring should be considered during audit/engagement planning (an activity that continues throughout the audit/engagement process).



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The AD performs and documents annual ERA. The results of enterprise level assessments can be an indicator of management's position related to risk management and the consequences for committing fraud, waste and/or abuse.

As part of planning, engagement teams will conduct a brainstorming session to identify potential risks of fraud, waste and/or abuse that are significant within the context of the audit/engagement objectives, which can include input from other staff. The output of this process will be a workpaper which lists the fraud, waste and/or abuse risk areas identified, the perceived significance/impact of the fraud, waste and/or abuse should it occur, and the perceived likelihood of occurrence.

Once the significant risks have been identified, the audit/engagement Lead Auditor, will, in connection with preparing the audit/engagement program, develop steps to assess the internal controls (if applicable) in place to manage the identified risks associated with fraud, waste and/or abuse. In addition, the Lead Auditor will develop program steps to test the effectiveness of internal controls and other procedures deemed necessary to detail test to identify potential fraud, waste and/or abuse. Auditors will document testing procedures in compliance with audit/engagement documentation policy and procedures ([Policy No. 140.00](#) and [Procedure No. 240.00](#) respectively), identifying findings that may surface and their related conclusions.

The following are examples of fraud indicators (not all inclusive). The existence of one or more of these indicators is not evidence that fraud has been or is occurring, but rather serves as an alert to auditors that a more in depth look at an activity may be necessary.

- Lack of segregation of duties;
- Lack of written policies and standard operating procedures;
- Management override of key controls;
- Rigged specifications;
- Co-mingling (lack of clear delineation where possible);
- Conflict of Interest situations;
- Split purchases;
- Contractor complaints of late payment;
- Duplicate payments;
- Frequent complaints by users of supplies or services;
- Equipment charged to contract but cannot be located;
- Downgrading serviceable property to scrap; and
- Poor physical security.

To effectively address risk of fraud, waste and/or abuse, auditors must possess a certain level of knowledge of the activity under review and must develop appropriate audit/engagement program steps. Therefore, in addition to brainstorming to identify potential risks, team members should research relevant information available from various sources. Sources include, the CC Fraud Hotline, the Fraud Reporting Link via the CC's Website, the *Fraud Indicators* publication and the *Handbook on Fraud Indicators for Contract Auditors* prepared by the U.S. Federal Office of the Inspector General's Office of Investigations (OIG) and U.S. Department of Defense (DoD), respectively.

  
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IIA Standard 1210.A2 states that, “*Internal auditors must have sufficient knowledge to evaluate the risk of fraud and the manner in which it is managed by the organization, but are not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud.*” To adhere to The Standards, the AD will centrally maintain Continuing Professional Education (CPE) records for each internal auditor, specifically identifying the CPE’s related to fraud training.

The AD also monitors the CC’s Fraud Hotline, whose number is posted on the City’s website. Issues reported through the hotline are reviewed, documented and forwarded to other City/State/Federal investigative bodies as deemed necessary, which includes communications with the City’s OIG as outlined in EO 1-39 (Establishment of Office of Inspector General for Investigation of Employee Misconduct), section 5.7. A summary report is prepared and reviewed by the CA and the auditor who monitors and is the first responder to reported FWA activity.

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**RELEVANT PROFESSIONAL STANDARDS AND GUIDANCE**

**GAGAS**

FINANCIAL AUDITS	6.09, 6.12 – 6.15, 6.41 – 6.53
ATTESTATION ENGAGEMENTS	7.05, 7.11, 7.14 – 7.15, 7.22 – 7.25, 7.40 – 7.47, 7.74 – 7.81
PERFORMANCE AUDITS	8.05, 8.25, 8.28 – 8.29, 8.71 – 8.76, 8.122
PROFESSIONAL JUDGMENT	3.117
FRAUD	8.71 – 8.76

**IIA STANDARDS**

- 1210 – PROFICIENCY
  - 1210.A
- 1220 – DUE PROFESSIONAL CARE
  - 1220.A1
- 2060 – REPORTING TO SENIOR MANAGEMENT AND THE BOARD
- 2120 – RISK MANAGEMENT
  - 2120.A2
- 2210 – ENGAGEMENT OBJECTIVES
  - 2210.A2

**IIA IMPLEMENTATION GUIDANCE**

- 1210 – PROFICIENCY
- 1220 – DUE PROFESSIONAL CARE
- 2060 – REPORTING TO SENIOR MANAGEMENT AND THE BOARD
- 2120 – RISK MANAGEMENT
- 2210 – ENGAGEMENT OBJECTIVES

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**CHANGE HISTORY**

<b>CHG #</b>	<b>DATE</b>	<b>SECTION</b>	<b>DESCRIPTION/REASON</b>
1	7/1/2019	Relevant Professional Standards	Updated to reflect updates to Professional Standards