

# BANK OF UGANDA

OFFICE OF  
THE EXECUTIVE DIRECTOR  
SUPERVISION



37-45 KAMPALA ROAD,  
P.O. BOX 7120,  
KAMPALA

DIRECT LINE 256-414- 230051  
GENERAL LINE 256-414- 258441  
Ext 2403  
FAX LINE 256-414- 258515  
TELEX 256-414-61059

CABLES UGABANK  
Email info@bou.or.ug  
Web site www.bou.or.ug

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cc Division Heads

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*Circular to all Chief Executive Officers of Commercial Banks, Credit Institutions and Microfinance Deposit-taking Institutions*

## Guidance on the Role of Internal Audit Department in Fraud Risk Management

Bank of Uganda (BOU) has noted that fraud investigations in Supervised Financial Institutions (SFIs) have predominantly been conducted by Internal Audit departments/units irrespective of the complexity of these frauds. This practice is the result of differing interpretations and understanding of the role of the internal audit function in fraud risk management. Accordingly, BOU advises as follows:

- 1) Standard 1210.A2 of the Standards for the Professional Practice of Internal Auditing provides that, *"The internal auditor should have sufficient knowledge to identify the indicators of fraud but is not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud"*. Accordingly, the internal auditor should not, by default, be expected to have the expertise to investigate every fraud. Rather, internal audit should support an SFIs' fraud risk management efforts by providing the necessary assurance services over internal controls designed to detect and prevent fraud.
- 2) It is essential that fraud investigations are undertaken by individuals or entities suitably qualified and experienced in conducting such assignments. This minimizes the risks of compromising evidence; prevalence of unfounded accusations; and inadvertent undermining of courses of action with a high likelihood of favorable outcomes. In the event that circumstances require internal audit to undertake an investigation, due professional care should be exercised in the execution of such an investigative assignment. It is critical that the internal auditor self-assess whether or not they possess the requisite skills and have adequate resources, to conduct the requested investigation. The SFI should consider engaging subject matter experts (internal/external) if the self-assessment indicates significant or material gaps or inadequacies in the Internal Audit capacity to conduct a specific fraud investigation.

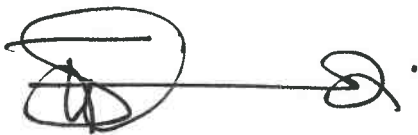


3) Internal Audit is an independent, objective, assurance and consulting activity designed to add value and improve an SFI's operations. Its chief role includes detecting, preventing, and monitoring fraud risks. This means that the internal audit function must at the minimum, have sufficient capacity to:

- a) Identify and flag potential fraud incidents,
- b) Evaluate the identified fraud red flags and decide whether or not, further action is necessary, and if so, the kind of action it should be,
- c) Understand the nature, types and characteristics of fraud,
- d) Understand techniques used to commit fraud, including an understanding of various fraud schemes and scenarios.
- e) Evaluate the effectiveness of controls to prevent or detect fraud.

It is not internal audit's responsibility to prevent fraud happening within the SFI. This is the organizational responsibility of the business line (management) as the first line of defense. SFIs should have suitable anti-fraud response plans outlining key policies and investigation methodologies. The plans should clearly specify the role of internal audit when there is suspected fraud. Internal audit function therefore provides assurance on the management of fraud risk in the SFI through risk assessment, and audit planning.

The purpose of this Circular is to clarify the role of internal audit in fraud risk management and urge SFIs to take into account this guidance in designing their fraud risk management frameworks.



Tumubweinee Twinemanzi (Dr.)  
**Executive Director Supervision**

Copy: Governor  
Deputy Governor  
**Director, Commercial Banking**  
Director, NBF