Conducting Fraud Risk Assessments Successfully

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Course Agenda

One  Principals for Managing Fraud Risk in an Organization

Two  Fraud Risk Assessment Basics

Three  Fraud Basics

Four  Conducting a Fraud Risk Assessment

Five  Prevention and Detection

Six  Applicable tools – Examples of Templates and Documentation
Learning Objectives

✓ Learn how to conduct a fraud risk assessment
✓ Understanding basic fraud concepts
✓ Learning to identify and assess risks
✓ Identifying best practices in fraud risk assessment
✓ Understanding the parts of a fraud risk assessment program
✓ Learn to utilize appropriate frameworks for assessing fraud risks
✓ Commonly used framework, scorecards and reporting templates
✓ Familiarization with best practices
FRAUD MANAGEMENT PRINCIPALS
What is a Fraud Risk Assessment?

- Systematically identify where and how fraud may occur.
- Identify who may be in a position to commit fraud.
- Creates a structured process that identifies fraud risk schemes and respective controls that may prevent or detect these schemes.
- Measures detective and preventative controls to ensure they are designed and operating effectively.
What is a Fraud Risk Assessment? (2)

- Crucial part of an entity’s Enterprise Risk Assessment (ERM) process.
- Key element to any Anti-fraud Framework.
- Strengthens an organization’s ability to evaluate, mitigate and monitor risks arising from fraud, corruption and misconduct.
What is a Fraud Risk Assessment? (3)

☑ Proactively identifying and addressing fraud in an organization.
☑ Considers both internal and external threats.
☑ It is tailored to the organization and industry.
☑ Part art, part science.
☑ It is an ongoing continuous process that never ends.
Corporate Governance Structure
Fraud Risk Environment

Fraud Risk Management Program

Regular Assessment of Fraud Risk

Fraud Prevention Techniques

Fraud Detection Techniques

Formal Investigation and Reporting

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As part of an organization’s governance structure, a fraud risk management program should be in place, including a written policy (or policies) to convey the expectations of the board of directors and senior management regarding managing fraud risk.
Fraud risk exposure should be assessed periodically by the organization to identify specific potential schemes and events that the organization needs to mitigate.
Prevention techniques to avoid potential key fraud risk events should be established, where feasible, to mitigate possible impacts on the organization.
Detection techniques should be established to uncover fraud events when preventive measures fail or unmitigated risks are realized.
A reporting process should be in place to solicit input on potential fraud, and a coordinated approach to investigation and corrective action should be used to help ensure potential fraud is addressed appropriately and timely.
Only through diligent and ongoing effort can an organization protect itself against significant acts of fraud.
FRAUD RISK GOVERNANCE
Fraud Governance Components

- Documented Fraud Risk Program
- Ethics Programs
- Defined Roles & Responsibilities
Fraud Risk Program

✓ Formally documented.
  • Policy, strategy, outline, etc.

✓ Should communicate:
  • Commitment – by board & management
  • Fraud Awareness – assessment, training, communication
  • Affirmation process – Code of Conduct, Fraud Program,
  • Conflict Disclosure – Conflict of interest for board, management, employees, contractors
Fraud Risk Program (2)

✓ (con’t) Should communicate:
  • **Fraud Risk Assessment** – performed on a systematic & reoccurring basis
  • **Reporting Procedures & Whistleblower Protection** – Articulate zero tolerance for fraud
  • **Investigation Process**
  • **Corrective Action** – termination, arrest, prosecution, report to regulatory agency
  • **Quality Assurance** – periodic review of effectiveness of fraud program
  • **Continuous Monitoring**
Ethics Programs

An effective ethics programs will create and environment in which making the right decision is implicit.

It will serve as the foundation for preventing, detecting and deterring fraud.

Often part of Code of Conduct.
Roles & Responsibilities

✓ Board of Directors
  • Tone at the Top
  • Understand Fraud Risks
  • Maintain oversight of Fraud Risk Assessment
  • Monitor Management’s reports on fraud
  • Oversee Internal Controls
  • Engage outside parties regarding fraud when needed – External Audit, Experts

✓ Audit Committee
  • Proactive involvement
Roles & Responsibilities (2)

✓ Management
  • Responsible for design & implementation
  • Create anti-fraud culture
  • Implement adequate controls
  • Ongoing reporting on instances & effectiveness of program

✓ Employees / Staff
  • Understand fraud and fraud red flags
  • Understand their roles in controls
  • Report suspicions or instances of fraud
  • Cooperate in investigations
Roles & Responsibilities (3)

✓ Internal Audit

• Objective assurance that fraud program is in place, effective and sufficient.
• Fraud risk assessment should be part of annual audit plan considerations
• Participate / conduct fraud risk assessment
• Understand fraud schemes, scenarios and red flags
• Dependent on organization, conduct / participate in fraud investigations
3 Part Fraud Protection

![Diagram showing 3 part fraud protection: Prevent, Detect, Deter]
Exercise #1 – A Little History

FRAUD HIT PARADE
We all know that Bernie will spend the rest of his life in prison for orchestrating perhaps the biggest investment scam of all time, but his accountants and aides helped him do the dirty work. David Friehling, Madoff's accountant, plead guilty last year to a number of charges that he issued "rubber stamp" audits. Madoff's right-hand man, Frank DiPascali plead guilty to creating fake trade orders for Madoff and is facing up to 125 years in prison.

Lehman Brothers - $50 Billion in Disguised Loans

A bankruptcy examiner's report released last week revealed that Lehman Brothers hid more than $50 billion in loans by classifying them as sales. Execs and auditor, Ernst & Young, allegedly manipulated the firm's balance sheets using an accounting trick called "Repo 105".

HealthSouth - $2.7 Billion Accounting Fraud

The rehabilitation provider's former CEO, Richard Scrushy, was convicted of host of criminal and civil charges -- including bribery -- related to a massive accounting fraud that is believed to have lasted seven years. Scrushy is currently serving a seven-year prison sentence.

Tyco’s former CEO Dennis Kozlowski and former CFO Mark Swartz were convicted of misappropriating hundreds of millions of dollars in company funds. On top of that, the two ex-Tyco execs were involved in a scheme to inflate Tyco's income by more than $500 million.

Satyam - $1 Billion Accounting Fraud

In just one quarter, execs at the Indian outsourcing firm Satyam magically boosted revenue by 20 percent -- or $1.04 billion -- by falsifying loans, the New York Times reported last year. Ironically, Satyam maintained back-office accounting functions for several high-profile companies including, General Electric and General Motors.

AIG - $1.7 Billion in Improper Accounting

Long before AIG became a maligned bailout recipient, the behemoth insurance company was embroiled in a $1.7 billion accounting scandal involving loans that were improperly booked as revenue. Ex-CEO Hank Greenberg was ousted over the controversy -- and ultimately paid $15 million to settle fraud charges with the SEC.

While hauling away America's refuse in 1998, Waste Management execs were busy reworking the company's earnings from the previous 5 years to the tune of $1.9 billion. This marked the biggest accounting scandal before Enron took the title in 2001. WM settled the lawsuit with a mere $26.8 million on behalf of its "trashy" execs.

Freddie Mac - $5 Billion in Misstated Earnings

A four-year lapse in proper accounting cost Freddie Mac $50 million in fines back in 2007. To keep up with Wall Street expectations, this mortgage financing giant misstated $5 billion in earnings. Then-president David Glenn along with other top executives were removed and fined.

Worldcom - $103.9 Billion Bankruptcy

In a scandal that likely cost about 30,000 jobs, WorldCom execs devised an $11 billion accounting fraud, which included former CEO Bernie Ebbers helping himself to hundreds of millions of dollars in personal loans.

The total cost to investors: $180 billion.

Enron – Shareholders lose $74 Billion

Once America’s seventh largest company, Enron collapsed in 2001. Executives used special purpose entities – which went by names like ‘Whitewing’ and ‘Raptor’-- to keep huge debts off the firm’s balance sheet. During an infamous 2001 conference call, then CEO Jeff Skilling attacked an analyst who questioned the firm’s creative accounting by calling him an "asshole." Ken Lay, Enron's former CEO, and Jeff Skilling were later convicted of a host of criminal charges. (Lay died in 2006 before he could serve time. Skilling was convicted in 2006, and is currently appealing.)

List as many common issues as you can think of.

1. Pressure to perform – Wall Street.
2. Tone at the Top - Arrogance & Greed.
3. Lack of appropriate controls.
4. External Auditors not exhibiting professional skepticism and due care.
5. Where was Internal Audit?
FRAUD RISK ASSESSMENT BASICS
Why Conduct a Fraud Risk Assessment?

A Fraud Risk Assessment helps Management understand risks that are unique to its business activities, identify gaps, weaknesses in controls and priorities of controls to manage those risks and develop a realistic plan for targeting the right resources and controls to reduce fraud risks.
Why Conduct a Fraud Risk Assessment?

✓ Improve communication and awareness about fraud.
✓ Identify where the company is most vulnerable to fraud and what activities put it at the greatest risk.
✓ Develop plans to mitigate fraud risk.
✓ Develop techniques to monitor and investigate high-risk areas.
✓ Assess internal controls.
Why Conduct a Fraud Risk Assessment? (2)

✓ Fraud exists in **EVERY** organization.
✓ Fraudsters are becoming more and more sophisticated.
✓ And estimated 95% of fraud goes unnoticed unless you are actively looking for it.
✓ Should be a component of larger ERM.
✓ Comply with regulations and professional standards
✓ COSO 2013 – Principal 8
COSO 2013 – Principal 8

The organization considers the potential for fraud in assessing risks to the achievement of objectives.
Fraud Risk

• 45% of all US Organizations reported suffering a financial crime in the last two years.

• 67% of organizations currently, or plan to have, operations in high risk markets.

• 71% believe organizational fraud is increasing.

PWC’s 2014 Global Economic Crime Survey
Benefits of a Fraud Risk Assessment

✔ Prevent, deter and detect fraud.
✔ Prevent financial losses.
✔ Prevent potential damage to reputation.
✔ Protect Share price.
✔ Provide tangible evidence for a culture of integrity.
✔ Best Practice
Pitfalls & Obstacles

- “No Fraud here” mentality.
- “He / She would never.” Believing an individual is a control.
- Assessment is not risk-based.
- FRA is too broad, not focused.
- Approach isn’t aligned with corporate culture.
- Organization does not have appropriate skill sets to perform assessment properly
- Not systematic and reoccurring.
FRAUD BASICS
Mary’s Fraud Cases

- Lima, Peru
  - $7 million Inventory and Asset Misappropriation fraud - collusion

- Bamako, Mali
  - Finance Director “steals” legal entity and all subsequent profits. False employees hired to build his house. $8 Million.

- Brussels, Belgium
  - Export Fraud – Shipping to embargoed countries under falsified sales orders. $5 million +

- Perth, Australia

- Salt Lake City, Utah
  - Asset theft. Fleet management auction scheme. $1.8 million.
Foreign Subsidiary of Texas Oil Firm Pledges Guilty to Illegally Exporting Drilling Equipment to Syria

Sat, Oct 4, '14
Targeted News Service

The U.S. Department of Commerce's Bureau of Industry and Security issued the following news release:


The guilty plea stemmed from actions by Robbins & Myers Belgium that, in 2006, caused four illegal exports, reexports and/or transshipments of stators—important components of oil extraction equipment—that had made from steel that had been milled in the United States to a customer operating oil fields in Syria.

As part of its plea agreement Robbins & Myers Belgium agreed to pay a total of $1 million in criminal fines ($250,000 for each violation) and to serve a term of corporate probation. The gross proceeds received by Robbins & Myers Belgium for these four illegal exports was $31,716. As part of its plea agreement, Robbins & Myers Belgium has forfeited the entire $31,716 to the government. Robbins & Myers Belgium has also entered into a civil settlement with the Department of Commerce requiring the company to pay $600,000 in civil penalties.

Robbins & Myers Belgium entered the guilty plea this afternoon and was sentenced this afternoon in accordance with the terms of the plea agreement by the Honorable Judge Beryl A. Howell in U.S. District Court for the District of Columbia.

"This case shows that the United States will vigorously enforce its export laws against companies doing business with Syria, a state-sponsor of terrorism and home to one of the most brutal regimes on earth," said U.S. Attorney Machen. "The Department of Justice will hit companies that do business with Syria where it hurts most: the bottom line. This company will pay fines, penalties, and forfeitures more than 50 times greater than the proceeds of its sales."

"The significant civil and criminal penalties in this case show our resolve to pursue and prosecute those who flout our export control laws," said Under Secretary of Commerce Hirschhorn. "We will continue to work in concert with our partner agencies to ensure that U.S. technology stays out of the wrong hands."

According to court documents, in or about May 2006 an internal auditor with Robbins & Myers Inc. (the U.S. parent


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