The Role of Internal Controls in the Fight Against Fraud
A Tale of Fraud!

• Payroll manager makes $2.25MM disappear!

It must be Magic!
Fraud Statistics

- 5% of GWP lost to employee fraud & abuse
- More than $3.5 Trillion per year
- Median loss $140,000
- More than 1 in 5 losses in excess of $1 MM
- Median 18 months before detection

Source: Association of Certified Fraud Examiners' Report to the Nations.
Fraud Statistics

- Men perpetrate 65% of frauds
- Men cause losses more than twice those caused by women

Source: Association of Certified Fraud Examiners' Report to the Nations
Fraud Statistics

• Half of all frauds were committed by someone over 40
• Fraudsters 51-55 caused median losses of $600,000.
  – More than twice as much as any age group below them
  – Six times as much as employees below the age of 35

Source: Association of Certified Fraud Examiners' Report to the Nations
Fraud Statistics

• High school graduates commit 25% of all frauds
  – Median losses are $75,000
• College graduates commit 37% of all frauds
  – Median losses are $200,000
• Perpetrators with post-graduate degrees commit 17% of all frauds
  – Median losses are $300,000

Source: Association of Certified Fraud Examiners' Report to the Nations
Fraud Statistics

• Employees – 32%
  – Median loss $95K
• Managers – 46%
  – Median loss $250K
• Owners/Executives – 22%
  – Median loss $850K
• Multiple perpetrators caused median losses twice as high as perpetrators acting alone

Source: Association of Certified Fraud Examiners' Report to the Nations
Fraud Statistics

- 85% never charged or convicted for a fraud related offense

Source: Association of Certified Fraud Examiners' Report to the Nations
Why should we care?

- Fraud losses come straight out of your bottom line
To Minimize Fraud Risk, You Must Understand

- How fraud happens
- Why fraud happens
How Fraud Happens

1. Asset Misappropriation: 87%; median loss $120K
2. Corruption – Bribery, Kick-backs, illegal gratuities, conflicts of interest: 33%; median loss $250K
3. Fraudulent Statements: 8%; median loss $1 MM

Source: Association of Certified Fraud Examiners' Report to the Nations
Asset Misappropriations: Cash Is #1 Target = 85%

Billing Schemes – 25%
  • Median cost - $100,000
Skimming – 15%
  • Median cost - $58,000
Check Tampering – 12%
  • Median cost - $143,000
Expense Reimbursements – 15%
  • Median cost - $26,000
Cash on Hand – 12%
  • Median cost - $20,000

Source: Association of Certified Fraud Examiners' Report to the Nations
## Fraud Schemes by Country

<table>
<thead>
<tr>
<th>Category</th>
<th>U.S.</th>
<th>Asia</th>
<th>Europe</th>
<th>Latin America &amp; Caribbean</th>
</tr>
</thead>
<tbody>
<tr>
<td>Billing</td>
<td>26%</td>
<td>15%</td>
<td>23%</td>
<td>21%</td>
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<tr>
<td>Corruption</td>
<td>25%</td>
<td>51%</td>
<td>44%</td>
<td>47%</td>
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<tr>
<td>Check Tampering</td>
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<td>6%</td>
<td>3%</td>
<td>5%</td>
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<tr>
<td>Skimming</td>
<td>16%</td>
<td>14%</td>
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<td>13%</td>
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<tr>
<td>Non-Cash</td>
<td>15%</td>
<td>20%</td>
<td>21%</td>
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<tr>
<td>Expense Reimbursements</td>
<td>17%</td>
<td>14%</td>
<td>10%</td>
<td>8%</td>
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<td>Cash on Hand</td>
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<td>12%</td>
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<td>8%</td>
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<td>4%</td>
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<td>10%</td>
</tr>
<tr>
<td>Cash Larceny</td>
<td>11%</td>
<td>13%</td>
<td>9%</td>
<td>3%</td>
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<tr>
<td>Financial Statement Fraud</td>
<td>7%</td>
<td>9%</td>
<td>12%</td>
<td>8%</td>
</tr>
<tr>
<td>Register Disbursements</td>
<td>3%</td>
<td>3%</td>
<td>5%</td>
<td>3%</td>
</tr>
</tbody>
</table>

Source: Association of Certified Fraud Examiners' [Report to the Nations](https://www.acfe.org/)
Non-Cash Targets

Inventory/information – 17%
• Median cost - $58,000

Source: Association of Certified Fraud Examiners' Report to the Nations
Why Fraud Happens

Immediate Need

Opportunity

Rationalization
Immediate Need

Un-sharable Problem

- Living beyond one’s means
- Drugs, alcohol, gambling
- Romantic involvement
- Financial emergency
Opportunity

In the absence of trust there can be no fraud.
“Ability to Rationalize”

- “The company owes me”
- “It’s just a loan, I’ll pay it back”
- “Everybody else is doing it”
- “The rules don’t apply to me”
How Do We Find Fraud?

- Tip – 43% - $144,000
- Mgmt. Review – 15% - $123,000
- Internal Audit - 14% - $81,000
- Accident – 7% - $166,000
- External Auditors – 3% - $370,000
- Police – 3% - $1,000,000
- IT Controls - 1% - $110,000

Source: Association of Certified Fraud Examiners' Report to the Nations.
Effective Internal Controls Reduce Fraud Risk

The presence of anti-fraud controls is notably correlated with significant decreases in the cost and duration of occupational fraud schemes.

Source: Association of Certified Fraud Examiners' Report to the Nations
Obstacle #1

Ignorance
1987 COSO Model
1992 COSO Integrated Framework

Control Environment

Risk Assessment

Control Activities

Information & Communication

Monitoring

OPERATIONS

FINANCIAL REPORTING

COMPLIANCE
2004 COSO Enterprise Risk Management Model
2013 COSO Enterprise Risk Model
1987 COSO Model
Obstacle #2

“Tone at the Top”
Compliance Mentality

Effective internal controls result in compliance.

Compliance does not necessarily result in effective internal controls.
Weak Internal Controls: An Open Door to Fraud
Segregation of Duties

• One person cannot complete a transaction without involving someone else
Meaningless Approvals
Internal Controls
Preventive Controls

– What you do to ensure that the right things happen; wrong things don’t happen
Control Types

- Preventive
  - Completeness
  - Accuracy
  - Authorization
  - Segregation of Duties
  - Security
    - Physical
    - IT
IT Security

- Passwords
- User Profiles
  - Administrative Users
- Change Management
Segregation of Duties

• One person cannot initiate and complete a transaction without involving someone else

• Important:
  – “Cannot” vs. “Should Not”
  – Collusion
Detective Controls

- What you do to find the things that preventive controls didn’t prevent
Detective Controls

- Audits
- Physical Verification
- Reconciliations
- Management reviews
#1 Expect Fraud

- **Cannot** be eliminated; only managed!
- If you don't expect it
  - you won't look for it
  - you might not recognize it when you see it
#2 Assess Risk

- Know your business
  - Look at it like a fraudster would
  - What have you got that someone else would want?
  - How would you get your hands on it?
#3 Know Who You’re Hiring

- Over 30% of resumes contain false statements.
- Employers normally confirm only dates of employment.
#4 Internal Controls

- Targeted, cost-effective
- Preventive
  - Segregate duties
  - Meaningful approvals
- Detective
  - Reconciliations
  - Independent verification
  - Whistle-blower hotline
#5 Have a Plan

• You won’t have time to learn from your mistakes.

• Know what you’re going to do before you have to do it.
Questions