FRAUD RISK ASSESSMENTS
PURPOSE, PLANNING AND EXECUTION

THE IDENTIFICATION AND EVALUATION OF RISK

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FRAUD RISK ASSESSMENTS
PURPOSE, PLANNING AND EXECUTION

- only 10% of small business, and 41% of large, conduct formal fraud risk assessments (ACFE Global Fraud Study)
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- Median loss based on presence of fraud controls. For those conducting formal fraud risk assessments, there was a 44% decrease ($94k v $168k) in the value of the median loss. (ACFE Global fraud study)
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- Median duration of loss based on presence of fraud controls. For those conducting formal fraud risk assessments, there was a 48% decrease in the duration of the loss. (ACFE Global fraud study)
• Internal Corporate Fraud (Purchase Schemes)

Ex-Texas Fruitcake Executive Sentenced for $16.6 Million Fraud - NBC News
SEP 18 2013, 1:27 AM ET
Article by NBCNews

"We were blindsided," a bakery partner, Hayden Crawford, told the Associated Press in 2013. "We were so focused on every other part of the business, and so confident in the integrity of our people, that we overlooked the elephant in the room."
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• External Corporate Fraud (Email Fraud)

“The incident involved employee impersonation and fraudulent requests targeting the company’s finance department, resulting in the transfer of $30.8 million in corporate cash to overseas accounts,” San Francisco-based Xoom said in a regulatory filing yesterday after U.S. markets closed.
Tone at the top – Financial Statement fraud

Toshiba CEO quits over $1.2 billion accounting fraud

Toshiba President Quits Over $1.2 Billion Accounting Scandal
Masashi Muromachi, incoming chairman, president and chief executive officer of Toshiba Corp., left, and Hisao Tanaka, outgoing president and chief executive officer, attend a news conference in Tokyo, Japan, on Tuesday, July 21, 2015. Photographer: Akio Kon/Bloomberg (Akio Kon)
Bloomberg News By Bloomberg News
on July 21, 2015 at 11:35 AM

Toshiba CEO quits over $1.2 billion accounting fraud

Toshiba Corp. acknowledged systematic cover-up, which began in 2004, various parts of its Japanese company operating business. Industry, computer chips and personal computers were struggling financially, but top managers set unrealistic earnings targets under the banner of "Championships," and submitted false results.

On May 5, Toshiba submitted financial statements in which it reported that it had not recorded $1.2 billion in losses from the sale of its nuclear power business. But the company later acknowledged that it had been谎报 its revenue and earnings for years, which it said "violated the market and the public's trust.

The company plans to repay the missing money and to strengthen its financial controls. It also plans to restate its financial results from 2004 to 2013.

In 2013, Toshiba Co., Ltd., issued a statement that it had discovered a "significant accounting error" in its financial statements for the fiscal year ending in March 2013. The company said it would restate its financial results for the year ending in March 2013 and for the previous four fiscal years.

The company has been under pressure from investors and regulators in Japan to improve its financial reporting and to strengthen its corporate governance after a series of accounting scandals.

The scandal has led to a loss of confidence in Toshiba's management and has raised questions about the effectiveness of the company's system for internal controls and financial reporting.
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- Alleged Financial Statement fraud, misrepresentation

Unicover hid pool's troubles, Reliance says

Reliance fired back Friday with a complaint accusing Unicover of fraud, misrepresentation and breaches of fiduciary duty. The suit seeks $800 million in compensatory damages and alleges that Unicover sought "to line its own pockets" by concealing for several months that the retrocessionaires protecting Reliance were threatening to cancel because of huge unexpected increases in premium volume.
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• Purpose of Fraud Risk Assessments:

  – Avoid these examples, and other fraud, occurring in your organization

  – Fraud risk assessments will:

    1. Act as a Fraud Deterrence
    2. Educate your staff / your organization
    3. Identify the greatest risks to your organization
HOW?
FRAUD RISK ASSESSMENTS
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Agenda

1. Purpose of Fraud Risk Assessments
   A. What is fraud risk and what factors influence fraud risk

2. Planning an the assessment of Fraud Risk at your company
   A. How to develop an effective fraud risk assessment

3. Execution of Fraud Risk Assessments
   A. Sample Frameworks
1. **Purpose** of Fraud Risk Assessments
   A. There are three interrelated elements that enable someone to commit fraud:
      - Motive or pressure
      - Opportunity
      - Rationalization
1. **Purpose** of Fraud Risk Assessments

A. **Process:**
   1) A fraud risk assessment is
      a) a process aimed at **proactively addressing** an organization's vulnerabilities to both internal and external fraud.
      b) Identification of fraud risk / prioritization of fraud risk that exist in a business.
      c) Drive results - provide education, communication, organizational alignment and action around effectively managing fraud risk and identifying new fraud risk as they emerge
1. **Purpose** of Fraud Risk Assessments

B. Compliance with professional guidance, standards and Regulators
   1) AICPA Statements on auditing standards
      a) SAS Nos. 104 - 111
   2) PCAOB has issued eight auditing standards specifically addressing the auditors assessment of and response to risk during audits
      a) AS Nos. 8 - 15
   3) COSO 2013 Principles describe four specific areas of concern for fraud risk assessments
      a) Principle 8
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1. Purpose of Fraud Risk Assessments
   A. What is fraud risk and what factors influence fraud risk

2. Planning an the assessment of Fraud Risk at your company
   A. Developing an effective fraud risk assessment

3. Execution of Fraud Risk Assessments
   A. Approach should be structured, rational and tailored to an organization
2. **Planning** of Fraud Risk Assessments

   **A. Relevance:** must be current and relevant

   1) enables procedures which will improve communication and fraud awareness
   
      a) assess compliance with professional standards and regulators

   2) identify who, and what activities put the company at greatest risk

      a) recognize what makes it most vulnerable to fraud.

   3) the process will help with the develop techniques to investigate and determine if

      fraud has occurred in high risk areas

      a) assess internal a plan to help mitigate fraud risk
2. Planning of Fraud Risk Assessments
   
   **B. Identification:** for an organization to effectively manage its fraud risks, the risks must first be identified
   
   1) fraud risk before and after management of a company respond to known risks are called inherent risk, and residual risk.
   
   2) factors that influence fraud risk include
      
      a) the nature of the business and environment in which it operates
      b) the effectiveness of internal controls
      c) ethics and values of the company and its employees
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2. Planning Fraud Risk Assessments

C. Approach: Consider a different mix of procedures:

1) picking the right method or mix of procedures to best meet the cultural fit for your organization is of utmost importance
   a) interviews can be a productive way to conduct candid one on one conversations
   b) focus groups enable to auditor to observe the interaction of the group.
   c) surveys can be anonymous or directly attributable to individuals
   d) Anonymous feedback mechanisms can be effective in an environment where people are less likely to be open and honest through other methods
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   A. Developing an effective fraud risk assessment

3. Execution of Fraud Risk Assessments
   A. Approach should be structured, rational and tailored to an organization
3. Execution of Fraud Risk Assessments

   A. Fraud risk assessments can be executed in many ways. To ensure the assessments success, the approach should be structured, rational and tailored to the organization.

   1) **Sample Framework:** it is helpful to use a "framework" for performing, evaluating and reporting the results of your work

   2) **Analysis:** fraud risk can be analyzed both qualitatively and quantitatively using consistent framework

   3) **Results and Reporting:** if the team does not use a specifically tailored fraud risk assessment approach, the team may encounter the risk of missing valuable information or obtaining unreliable or meaningless results.
3. Execution of Fraud Risk Assessments

1) Sample Fraud Risk Assessment Framework

a) **Identify potential inherent fraud risks**

b) Assess the likelihood of occurrence of the identified risks and significance to the organization

c) Evaluation of which people and departments are most likely to commit fraud and identify the methods they are likely to use
3. Execution of Fraud Risk Assessments
   1) Sample Fraud Risk Assessment Framework
      a) Identify potential inherent fraud risks
         1. Inherent fraud risks are risks that are present before management takes action
         2. The fraud risk assessment team should brainstorm to identify the fraud risks that could apply to the organization, and should include:
            i. incentives, pressures and opportunities to commit fraud
            ii. risk of management override of controls (or intervention)
            iii. population of fraud risks
            iv. risk of regulatory and legal misconduct
            v. risk to information technology
3. Execution of Fraud Risk Assessments
   1) Sample Fraud Risk Assessment Framework
      • Incentives, pressures and opportunities to commit fraud

**The Fraud Tree:**
Corruption / Asset misappropriation / fraudulent financial statements
Inventory and other assets
• misuse
• asset req. / transfers
• false sales / shipping
• purchasing / receiving
• unconcealed larceny
3. Execution of Fraud Risk Assessments
   1) Sample Fraud Risk Assessment Framework
      a) Identify potential inherent fraud risks
      b) **Assess the likelihood of occurrence of the identified risks and** its significance to the organization.
      c) Evaluation of which people and departments are most likely to commit fraud and identify the methods they are likely to use.
3. Execution of Fraud Risk Assessments
   1) Sample Fraud Risk Assessment Framework
      b) Assess the likelihood of occurrence of the identified risks and its significance to the organization.
         1. the likelihood of occurrence of each fraud risk can be classified as remote, reasonable possible, or probable
         2. the fraud risk assessment team should consider the following inherent factors in assessing the likelihood of occurrence of each of the fraud risk:
            i. prevalence of the fraud risk in the organizations industry
            ii. number of individual transactions involved / complexity of fraud risk
            iii. number of people involved in approving and reviewing the relevant process
            iv. information from fraud surveys such as ACFE report to nations
3. Execution of Fraud Risk Assessments
   1) Sample Fraud Risk Assessment Framework
      b) Assess the likelihood of occurrence of the identified risks and its significance to the organization.
      3. In addition, the team should evaluate the likelihood of identified risk based on organization specific factors such as:
         i. the organization internal control environment
         ii. management ethical standards
3. Execution of Fraud Risk Assessments
   1) Sample Fraud Risk Assessment Framework

   b) Assess the likelihood of occurrence of the identified risks and its significance to the organization.

   4. The significance of each potential fraud can be classified as immaterial, significant or material. In its analysis the fraud risk team should consider the following factors:

   i. Financial statement or monetary significance and financial condition of the organization
   ii. Value of threatened assets
   iii. Criticality of threatened assets to the organization (brand and value)
   iv. Criminal, civil and regulatory liabilities
3. Execution of Fraud Risk Assessments

1) Sample Fraud Risk Assessment Framework

   a) Identify potential inherent fraud risks

   b) Assess the likelihood of occurrence of the identified risks and its significance to the organization.

   c) Evaluation of which people and departments are most likely to commit fraud and identify the methods they are likely to use
3. Execution of Fraud Risk Assessments

1) Sample Fraud Risk Assessment Framework

c) Evaluation of which people and departments are most likely to commit fraud and identify the methods they are likely to use

1. Using the information gained during the process of identifying risk, the team should identify the individuals and departments most likely to commit fraud.
3. Execution of Fraud Risk Assessments
   A. Fraud risk assessments can be executed in many ways. To ensure the assessments success, the approach should be structured, rational and tailored to the organization.
      1) **Sample Framework:** it is helpful to use a "framework" for performing, evaluating and reporting the results of your work
      2) **Analysis:** fraud risk can be analyzed both qualitatively and quantitatively using consistent framework
      3) **Results and Reporting:** if the team does not use a specifically tailored fraud risk assessment approach, the team may encounter the risk of missing valuable information or obtaining unreliable or meaningless results.
3. Execution of Fraud Risk Assessments

2) **Analysis:** fraud risk can be analyzed both qualitatively and quantitatively using consistent framework

   a) **Identify and map existing preventative and detective controls to the relevant fraud risks**
   
   b) evaluate whether the identified controls are operating effectively and efficiently
   
   c) identify and evaluate residual fraud risks resulting from ineffective or nonexistent controls
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3. Execution of Fraud Risk Assessments
   2) Analysis: Fraud risk can be analyzed both qualitatively and quantitatively using a consistent framework
      a) Identify and map existing preventative controls to the relevant fraud risks
         1. Preventative Controls:
            i. bringing awareness to fraud risk management program
            ii. performing background checks
            iii. reviewing third party and related party transactions
            iv. segregating duties
            v. conducting exit interviews
            vi. reviewing proper alignment between an individual’s authority and his level of responsibility
3. Execution of Fraud Risk Assessments

2) **Analysis:** Fraud risk can be analyzed both qualitatively and quantitatively using a consistent framework

a) Identify and map existing **detective controls** to the relevant fraud risks

2. Detective Controls:

i. Establishing and marketing the presence of a confidential reporting system, such as a whistleblower hotline

ii. Implementing proactive controls for the fraud detection process, such as independent reconciliations, reviews, physical inspections / counts, analysis and audits

iii. Implementing proactive fraud detection procedures such as data analysis and continuous auditing techniques

iv. Performing surprise audits
3. Execution of Fraud Risk Assessments

2) **Analysis:** fraud risk can be analyzed both qualitatively and quantitatively using consistent framework

   a) Identify and map existing preventative and detective controls to the relevant fraud risks

   b) **Evaluate whether the identified controls are operating effectively and efficiently**

   c) Identify and evaluate residual fraud risks resulting from ineffective or nonexistent controls
3. Execution of Fraud Risk Assessments

2) **Analysis:** Fraud risk can be analyzed both qualitatively and quantitatively using a consistent framework.

   b) Evaluate whether the identified controls are operating effectively and efficiently, that there are adequate controls in place, that the controls are mitigating fraud as intended, and that the benefit of the controls exceeds the cost.

   1. Such an assessment requires:
      
      i. Review of the accounting policies and procedures in place
      ii. Consideration of the risk of management override of controls
      iii. Interviews with management and employees
      iv. Observation of control activities
3. Execution of Fraud Risk Assessments

2) **Analysis:** fraud risk can be analyzed both qualitatively and quantitatively using a consistent framework

   b) Evaluate whether the identified controls are operating effectively and efficiently, that there are adequate controls in place, that the controls are mitigating fraud as intended, and that the benefit of the controls exceeds the cost.

   1. such an assessment requires (continued)

       v. sample testing of controls compliance
       vi. review of previous audit reports
       vii. review of previous reports on fraud incidents, shrinkage, and unexplained shortages
3. Execution of Fraud Risk Assessments

2) **Analysis:** fraud risk can be analyzed both qualitatively and quantitatively using a consistent framework

   a) Identify and map existing preventative and detective controls to the relevant fraud risks

   b) Evaluate whether the identified controls are operating effectively and efficiently

   c) **Identify and evaluate residual fraud risks resulting from ineffective or nonexistent controls**
3. Execution of Fraud Risk Assessments

2) **Analysis:** fraud risk can be analyzed both qualitatively and quantitatively using consistent framework

c) Identify and evaluate residual fraud risks resulting from ineffective or nonexistent controls

1. Consideration of the internal control structure might reveal certain residual fraud risks, including managements override of established controls, that have not been adequately mitigated due to:

   i. lack of appropriate prevention and detection controls
   ii. noncompliance with established prevention and control measures
3. Execution of Fraud Risk Assessments

   2) **Analysis:** fraud risk can be analyzed both qualitatively and quantitatively using consistent framework

   c) Identify and evaluate residual fraud risks resulting from ineffective or nonexistent controls

   2. The likelihood and significance of occurrence of these residual fraud risks should be evaluated by the fraud risk assessment team in the development of the Fraud Risk Response
3. Execution of Fraud Risk Assessments

A. Fraud risk assessments can be executed in many ways. To ensure the assessments success, the approach should be structured, rational and tailored to the organization.

1) Sample Framework: it is helpful to use a "framework" for performing, evaluating and reporting the results of your work

2) Analysis considerations: fraud risk can be analyzed both qualitatively and quantitatively using consistent framework

3) Results and Reporting: if the team does not use a specifically tailored fraud risk assessment approach, it may encounter the risk of missing valuable information or obtaining unreliable or meaningless results.
3. Execution of Fraud Risk Assessments

3) Results and Reporting: If the team does not use a specifically tailored fraud risk assessment approach, it may encounter the risk of missing valuable information or obtaining unreliable or meaningless results.

a) Organization must establish an acceptable level of risk

b) Through ranking and prioritizing risk, an organization may better understand the cost of a risk.

i. determine its risk tolerance and cost benefit analysis
3. Execution of Fraud Risk Assessments

3) Results and Reporting: If the team does not use a specifically tailored fraud risk assessment approach, it may encounter the risk of missing valuable information or obtaining unreliable or meaningless results.

c) Estimating likely cost of a risk involves determining a quantitative value for the expected loss based on the risk's potential cost and likelihood of occurrence.
3. Execution of Fraud Risk Assessments

3) **Results** and Reporting: If the team does not use a specifically tailored fraud risk assessment approach, it may encounter the risk of missing valuable information or obtaining unreliable or meaningless results.

d) Responding to Residual Risk
   i. Avoid the risk
   ii. Transfer the risk
   iii. Mitigate the risk
   iv. Assume the risk
3. Execution of Fraud Risk Assessments
   3) Results and **Reporting**: If the team does not use a specifically tailored fraud risk assessment approach, it may encounter the risk of missing valuable information or obtaining unreliable or meaningless results.

   e) **Key considerations when communicating results**:
      i. Keep it objective
      ii. Focus on what really matters
      iii. Identify actions that are clear and measurable to drive results
      iv. Recommendations should clearly reduce the risk of fraud
3. Execution of Fraud Risk Assessments

   B. **To make an impact** with the Fraud Risk Assessment, Management should
      1) Look for fraud in high risk areas
      2) Hold responsible parties accountable for progress
      3) Keep the assessment process alive and relevant
      4) Monitor key controls
      5) Must be openly promoted by the right people and looked upon as important to
         the well being of the organization (tone at the top)
Q & A

Thank you
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