Seattle IIA Fraud Conference

Reducing Fraud Risk: Tips from the Trenches

March 24, 2021
Polling Question

What is your role?

A. Chief audit executive/lead internal auditor
B. Internal audit staff
C. Compliance
D. Fraud/forensics examiner
E. Consultant (e.g., I support customers/clients)
F. Other (explain)
### Background

- Most 10K’s note that a company has adopted an internal control framework, such as COSO, to define the process for internal control.

<table>
<thead>
<tr>
<th>Principle</th>
<th>Description</th>
<th>Points of Focus</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principle 8: Assess fraud risk</td>
<td>The organization considers the potential for fraud in assessing the risks to achievement of objectives.</td>
<td>Considers various types of fraud.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Assesses incentives and pressures</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Assesses Opportunities</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Assesses Attitudes and Rationalizations</td>
</tr>
</tbody>
</table>

- COSO Principle 8 has Points of Focus regarding Fraud.

- What, if anything, is your organization doing to address COSO Principle 8?
Background

- Does your organization’s process include a customized fraud brainstorming session to move from the theoretical to the real risks inside the company?

- This presentation is designed to stimulate your thinking about Fraud, and steps you can take to reduce the risk of fraud at your organization.

- The Association of Certified Fraud Examiners publishes a biannual study based on fraud reports worldwide, as submitted by thousands of ACFE members worldwide.

- 2020 Global Study on occupational fraud is the latest study on costs and effects of fraud, and steps companies are taking to reduce the risk.
Background Continued:

Key questions to ask:

• What is your company doing to address Principle 8?

• Does your organization’s process include a customized fraud brainstorming session to move from the theoretical to the real risks inside the company?
What is Fraud?

• Fraud is the “knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment”

• Fraud includes intentional or deliberate acts that deprive another of property or money by deception or other unfair means
Definitions:

What is a Fraud Risk Assessment?

• As the business model changes, the company’s ability to proactively recognize, measure, prevent and even respond to incidents will need to be enhanced in order to minimize the risk and consequences of potential fraudulent events.

• This exercise is part of a healthy company’s ongoing effort to identify the most likely risks of fraud within our current environment in order to: Assess whether we have processes and internal controls currently in place to mitigate the risks.

• Implement or enhance procedures and/or processes to provide Management with additional comfort.
Occupational Fraud Schemes: Select Industries

FIG. 20 What are the most common occupational fraud schemes in various industries?

<table>
<thead>
<tr>
<th>INDUSTRY</th>
<th>Cases</th>
<th>Billing</th>
<th>Cash fraud</th>
<th>Cash on hand</th>
<th>Check and payment tampering</th>
<th>Corruption</th>
<th>Expense reimbursements</th>
<th>Financial statement fraud</th>
<th>Noncash</th>
<th>Payroll</th>
<th>Register disbursements</th>
<th>Skimming</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking and financial services</td>
<td>364</td>
<td>8%</td>
<td>10%</td>
<td>18%</td>
<td>9%</td>
<td>40%</td>
<td>8%</td>
<td>10%</td>
<td>10%</td>
<td>2%</td>
<td>2%</td>
<td>10%</td>
</tr>
<tr>
<td>Government and public administration</td>
<td>189</td>
<td>18%</td>
<td>5%</td>
<td>9%</td>
<td>4%</td>
<td>48%</td>
<td>17%</td>
<td>4%</td>
<td>17%</td>
<td>17%</td>
<td>0%</td>
<td>7%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>177</td>
<td>23%</td>
<td>5%</td>
<td>6%</td>
<td>8%</td>
<td>50%</td>
<td>20%</td>
<td>18%</td>
<td>23%</td>
<td>10%</td>
<td>2%</td>
<td>8%</td>
</tr>
<tr>
<td>Health care</td>
<td>145</td>
<td>33%</td>
<td>10%</td>
<td>10%</td>
<td>14%</td>
<td>40%</td>
<td>22%</td>
<td>14%</td>
<td>24%</td>
<td>15%</td>
<td>6%</td>
<td>10%</td>
</tr>
</tbody>
</table>

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Primary Internal Control Weaknesses Contributing to Occupational Fraud

FIG. 5 What asset misappropriation schemes present the greatest risk?

Check and payment tampering
Billing
Cash larceny
Noncash
Payroll
Skimming
Expense reimbursements
Cash on hand
Register disbursements

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# Occupational Fraud Schemes in High-Risk Departments

<table>
<thead>
<tr>
<th>DEPARTMENT</th>
<th>Cases</th>
<th>Billing</th>
<th>Cash Liquidity</th>
<th>Cash on Hand</th>
<th>Check and Payment Tampering</th>
<th>Corruption</th>
<th>Expense Reimbursement</th>
<th>Financial Statement Fraud</th>
<th>Noncash</th>
<th>Payroll</th>
<th>Register Disbursements</th>
<th>Skimming</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operations</td>
<td>288</td>
<td>15%</td>
<td>5%</td>
<td>10%</td>
<td>5%</td>
<td>44%</td>
<td>12%</td>
<td>7%</td>
<td>15%</td>
<td>8%</td>
<td>3%</td>
<td>9%</td>
</tr>
<tr>
<td>Accounting</td>
<td>277</td>
<td>32%</td>
<td>14%</td>
<td>12%</td>
<td>27%</td>
<td>24%</td>
<td>18%</td>
<td>15%</td>
<td>11%</td>
<td>21%</td>
<td>5%</td>
<td>19%</td>
</tr>
<tr>
<td>Executive/Upper management</td>
<td>234</td>
<td>26%</td>
<td>11%</td>
<td>12%</td>
<td>11%</td>
<td>62%</td>
<td>26%</td>
<td>30%</td>
<td>18%</td>
<td>12%</td>
<td>3%</td>
<td>10%</td>
</tr>
<tr>
<td>Sales</td>
<td>225</td>
<td>10%</td>
<td>6%</td>
<td>10%</td>
<td>5%</td>
<td>39%</td>
<td>14%</td>
<td>8%</td>
<td>21%</td>
<td>2%</td>
<td>4%</td>
<td>10%</td>
</tr>
<tr>
<td>Customer service</td>
<td>175</td>
<td>5%</td>
<td>8%</td>
<td>11%</td>
<td>8%</td>
<td>33%</td>
<td>6%</td>
<td>1%</td>
<td>9%</td>
<td>2%</td>
<td>2%</td>
<td>17%</td>
</tr>
<tr>
<td>Administrative support</td>
<td>116</td>
<td>31%</td>
<td>8%</td>
<td>18%</td>
<td>12%</td>
<td>29%</td>
<td>14%</td>
<td>8%</td>
<td>12%</td>
<td>9%</td>
<td>3%</td>
<td>12%</td>
</tr>
<tr>
<td>Finance</td>
<td>101</td>
<td>20%</td>
<td>10%</td>
<td>12%</td>
<td>9%</td>
<td>35%</td>
<td>14%</td>
<td>14%</td>
<td>12%</td>
<td>9%</td>
<td>3%</td>
<td>8%</td>
</tr>
<tr>
<td>Purchasing</td>
<td>96</td>
<td>22%</td>
<td>4%</td>
<td>4%</td>
<td>2%</td>
<td>81%</td>
<td>7%</td>
<td>7%</td>
<td>18%</td>
<td>2%</td>
<td>0%</td>
<td>4%</td>
</tr>
</tbody>
</table>

MORE THAN HALF of all occupational frauds came from these four departments:

- **Operations**: 15%
- **Accounting**: 14%
- **Executive/Upper Management**: 12%
- **Sales**: 11%

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Polling Question

How are most occupational frauds initially detected?

A. External auditors inform the company
B. Internal auditors
C. Internal controls (e.g., management review, IT controls)
D. By accident
E. Police notify the company
F. Tips
Polling Question

According to the ACFE’s 2020 Report to the Nations, what percent of frauds are detected by tips?

A. 73%
B. 54%
C. 43%
D. 33%
E. Don’t know / unable to answer
How are Frauds Detected?

**FIG. 9** How is occupational fraud initially detected?

- **Tip** 43%
- Internal audit 15%
- Management review 12%
- Other 6%
- By accident 5%
- Account reconciliation 4%
- External audit 4%
- Document examination 3%
- Surveillance/monitoring 3%
- Notified by law enforcement 2%

**FIG. 10** Who reports occupational fraud?

- Employee 50%
- Customer 22%
- Anonymous 15%
- Vendor 11%
- Other 6%
How are Frauds Detected?

Organizations with FRAUD AWARENESS TRAINING for employees were more likely to gather tips through FORMAL REPORTING MECHANISMS. 43% of schemes were detected by TIP, and half of those tips came from employees.

56% of tips with training 37% of tips without training

TELEPHONE HOTLINE and EMAIL were each used by whistleblowers in 33% of cases.

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How are Occupational Frauds Concealed?

**TOP 4 CONCEALMENT METHODS USED BY FRAUDSTERS**

- **40%** Created fraudulent physical documents
- **36%** Altered physical documents
- **27%** Altered electronic documents or files
- **26%** Created fraudulent electronic documents or files

12% did not involve any attempts to conceal the fraud

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COVID-19 Impacts on Fraud

Key Findings

79% of respondents observed an increase in fraud as of November 2020.

90% of respondents expect an increase in fraud over the next 12 months.

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COVID-19 Impacts on Fraud

TOP 5 FRAUD SCHEMES CURRENTLY OBSERVED DUE TO THE CORONAVIRUS

- **Cyberfraud**: 85% overall increase, 52% significant increase
- **Identity Theft**: 73% overall increase, 35% significant increase
- **Payment Fraud**: 72% overall increase, 35% significant increase
- **Unemployment Fraud**: 69% overall increase, 40% significant increase
- **Fraud by Vendors and Sellers**: 67% overall increase, 33% significant increase

TOP 5 FRAUD SCHEMES PREDICTED INCREASE OVER 12 MONTHS DUE TO THE CORONAVIRUS

- **Cyberfraud**: 88% overall increase, 57% significant increase
- **Payment Fraud**: 82% overall increase, 43% significant increase
- **Unemployment Fraud**: 81% overall increase, 46% significant increase
- **Fraud by Vendors and Sellers**: 80% overall increase, 38% significant increase
- **Health Care Fraud**: 79% overall increase, 42% significant increase

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Think Like a Fraudster!

FRAUD BRAINSTORMING SESSION

• Spend 3-4 minutes jotting down notes on potential fraud scenarios

• Enhance the list of potential fraud risks
  How could a fraud perpetrate itself?

• Breakout Groups to enable broad discussion—20 minutes, then come together to share key risks with broader group
Fraud Brainstorming Exercise

What new risks associated with remote work in the Covid-19 environment need to be considered?

Other Key Considerations:
- Remote team management?
- Third party changes
- Trial impact
- Manufacturers
- Change in competency?
- Data analytics?
Discussion Questions

• What were the key takeaways from utilizing a fraud brainstorming session to supplement the company’s annual fraud risk assessment?

• Tell us about the preplanning for the brainstorm session.

• What can be done with the results of the FRA?

• Is there an optimal time of year to conduct the FRA?

• What value did the company receive?

• Has the company made any changes as a result of things learned within the FRA?

• What other recommendations do you have for companies that have not conducted brainstorming as a part of their FRA?
Where do we go from here?
Tone at the Top is Primary Risk Factor in Financial Statement Frauds

POOR TONE AT THE TOP
was the primary risk factor in 22% of all financial statement frauds.

- Asset misappropriation: 8%
- Corruption: 15%
- Financial statement fraud: 22%
Fraud Controls

• What are the most common fraud controls?
• Proactive controls play a key role in the reduction of fraud risk.
• The presence of controls does not ensure that fraud will be prevented.
• Fraud controls demonstrate management’s commitment to and investment in targeted prevention and detection measures...and sends a clear message to employees.

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Corruption Perception Index

Your organization may benefit from identifying and assessing fraud risk within the organization’s international operations:

- Source: Transparency International
- The primary countries where Company A conducts business (noted in capital letters) are fairly clean (Canada 82, United Kingdom 81, United States 74, Japan 72 and France 69.)
- China and Russia represent the greatest potential corruption risk.
Next Steps

Plan and schedule your FY2021 Fraud Risk Assessment and Brainstorming Session

Learn more: RGP Internal Audit & Compliance

Recent RGP articles:

• Don’t Miss This Critical Last Step in Your SOX Process
• Agile Audit: Delivering Real-time Insights & Value
• Is It Time to Revisit Your Business Continuity Plan?
• How to Flatten Tomorrow’s Risk Curve with Strong Internal Controls
Final Polling Question

Please let us know what next steps you plan to take to reduce the organization’s fraud risk (multiple answers ok)

A. Educate executives/management on the best tools to reduce fraud risk
B. Start a fraud risk assessment program within the organization
C. Enhance the FRA program to include fraud brainstorming
D. I could use some help in moving this along within my organization
E. Not sure/don’t know
F. Let’s chat: Please drop in your contact information to be contacted—or contact us.
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Thank You, Fellow Human!