Assessing and Managing Fraud Risk

Dave Cotton, CPA, CFE, CGFM
Cotton & Company, LLP
Alexandria, Virginia
dcotton@cottoncpa.com

Plan for This Session …

- Fraud Happens
- ACFE Fraud Statistics
- Anti-Fraud Guidance
- Managing the Business Risk of Fraud
- COSO Update and Assessing Fraud Risk
- COSO-ACFE Task Force
- GAO Green Book and Assessing Fraud Risk
- GAO’s Fraud Risk Management Framework

Fraud Happens …
Raise Your Hand If You Want to Find Fraud

Ponder This …

Would you rather:
A. Find the fraud if it’s there?
B. Explain why you failed to find the fraud?

Billy-Bob …

- Is fantastic …
- Has been with us for years …
- Does ALL of the accounting stuff so that we can focus on more important things …
- Works long hours and many weekends …
- Never takes a vacation …
- Works for very modest pay and never asks for a raise (we think he inherited some money/retired after a successful career in some other field) …
- Has turned down offers to work elsewhere for more money because he believes in our mission …
Raise your hand if you know Billy Bob or someone just like him

Mary-Lou …
- Is fantastic and totally dedicated to our mission …
- Has been our executive director since our founding …
- We wouldn't be where we are today without her …
- Is a “hands-on” and “no nonsense” executive and makes all of the important decisions …
- Works long hours and most weekends …
- Never takes a vacation …
- Knows everyone on the board and personally recommended each one …
- Makes board service easy, because she really runs the organization with an iron hand …

Raise your hand if you know Mary-Lou or someone just like her
Fraud Happens ...

Four words precede EVERY fraud:
“It can't happen here.”

Eight words follow EVERY fraud:
“We didn’t think it could happen to us.”

Fraud Happens … And Not Just to Others

Four words precede EVERY fraud:
“It can't happen here.”

Eight words follow EVERY fraud:
“We didn’t think it could happen to us.”

The Case of the Trusted Treasurer
Rita Crundwell

- Born Jan 10, 1953
- Grew up on a family farm near Dixon, Illinois (population ~15,000; boyhood home of Ronald Reagan)
- Appointed treasurer/comptroller of Dixon in 1983
- Embezzled ~$53 million from the city from 1990 to 2012
  - 1991—$181,000;
  - 2008—$5.8 million
- Arrested April 17, 2012
- Pled guilty on November 14, 2012
- Sentenced to 19 years and 7 months in prison on February 14, 2013

Dixon’s 2012 budget was ~$17 million
How Did She Do It?

- Opened a bank account called Reserve Sewer Capital Development Account (RSCDA) with herself as the only signatory
- Moved City funds into a legitimate City account—Capital Development Account (CDA)
- Created phony invoices that she paid with CDA checks payable to “Treasurer”
- Deposited checks into the RSCDA
- Used funds to run her thoroughbred horse farm and business and on “prize-winning horses, expensive jewelry, luxury cars and even birthday bashes in Venice Beach, Fla.”

*Source: [http://www.huffingtonpost.com/2013/02/06/rita-crundwell-sentencing_o_2613714.html](http://www.huffingtonpost.com/2013/02/06/rita-crundwell-sentencing_o_2613714.html)

Rita’s $2.1 Million Motor Coach

How Did She Get Caught?

- While Rita was away at a horse show, another city employee stumbled upon the secret account.
Psychopath or Sociopath?

... prosecutors noted that while Crundwell was stealing from the city, she repeatedly argued for painful spending cuts at budget meetings. She claimed the shortfalls were the result of an economic downturn and late payments from Illinois' state government, according to prosecutors.

"Day after day, for more than 20 years, (the) defendant would work with employees of the city of Dixon and interact with citizens in her capacity as comptroller while lying about the reason the city of Dixon lacked funds," U.S. Attorney Gary Shapiro wrote.

"... the impact of the theft: Police could not afford to upgrade squad car radios or make new hires, streets could not be resurfaced, a waste water treatment facility had to be delayed and the city had to issue $3 million in bonds to cover financial obligations.

"... prosecutors included a news article about Crundwell’s 2010 birthday party in Venice Beach. Paid for with the help of stolen money, the party had live music, prime rib and jumbo shrimp cocktails.

"Rita was gorgeous as always in one of her trademark ‘must have’ coats," said the article in GoHorseShow.com.

Source: [http://www.huffingtonpost.com/2013/02/06/rita-crundwell-sentencing_a_2633791.html](http://www.huffingtonpost.com/2013/02/06/rita-crundwell-sentencing_a_2633791.html)

http://www.nbcnews.com/video/rock-center/49113424#49113424

“Trust, but verify.”

--Ronald W. Reagan

Dixon, IL – Outcomes

- Attorneys fees for investigating the fraud and negotiating settlements with accounting firms and the bank totaled $10 million
- Settlement with the CPA firm that assisted Dixon with accounting and financial management: $35.15 million
- Settlement with the CPA firm that performed Dixon’s annual audit since 2006: $1 million
- Settlement with the bank where Dixon’s accounts were maintained and where Crundwell set up the bogus account: $3.85 million

Dixon, IL – Outcomes

**Bottom Line:**

- Amount misappropriated by Crundwell: ~$54 million
- Attorneys fees: ~$10 million
- Loss to Dixon: ~$64 million
- Recovery from sale of Crundwell assets: ~$10 million
- Settlement with accounting firm: ~$35 million
- Settlement with audit firm: ~$1 million
- Settlement with bank: ~$4 million
- Dixon’s net monetary loss: ~$14 million
What control procedure(s) would have thwarted Rita’s fraud?

March 5, 2030
The Case of the Trusted Executive Director

William Aramony and the United Way

- Aramony was CEO of the United Way of America from 1970 to 1992.
- Aramony grew revenues from $787 million in 1970 to more than $1 billion in 1990.
- In 1992, Aramony, and two other United Way executives were indicted on 53 counts.
- In 1995, Aramony was convicted on 23 counts including conspiracy to defraud, mail fraud, wire fraud, transportation of fraudulently acquired property, engaging in monetary transactions in unlawful activity, filing false tax returns, and aiding in the filing of false tax returns.
- Sentenced to 8 years in prison; released in 2001.
- Died in 2011.

Case Study
The United Way of the National Capital Area Ran this Full-Page Ad on April 3, 1992

“We take our stewardship seriously.”
In other words ...

“It can’t happen to us.”
May 15, 2004

Ex-Chief Of Local United Way Sentenced

“… pleaded guilty in March to defrauding the charity of almost $500,000.”

“He admitted charging the organization for personal expenses such as bowling equipment and trips to Las Vegas, paying himself $333,000 for annual leave he had already used and siphoning $94,000 more than his share from the charity's pension plan.”

May 1, 2004

Ex-Chief Of Local United Way Sentenced

Former Chief of Area United Way Sentenced to 27 Months for Fraud

Oral Suer pleaded guilty to defrauding the United Way of almost $500,000 over a 6-7 year period

He was caught in 2002

UWNCA 2001 revenue: $90,000,000

Not material, the auditors said; “only” about $80,000 per year

UWNCA 2002 revenue: $19,000,000
Case Study

The United Way of the National Capital Area Ran this Full-Page Ad on April 3, 1992

About that “90 cents of every donated dollar” promise …

The Suer investigation revealed another scheme: Round-Tripping Receipts

DC Area Donors

United Way of the National Capital Area: Takes 10%
The Suer investigation revealed another scheme: Round-Tripping Receipts

DC Area Donors

United Way of the National Capital Area:
Takes 10%

90%

Neighboring United Way: takes 10% of the 90%

Takes 10%

81%

Neighboring United Way: takes 10% of the 90%

Charities get 72.9%
Strong Governance Can Make a Big Difference

Case Study

Mr. Travel Voucher

William John Burns

- Supervisor of USAID’s Fiscal Services Office
- FSO was part of USAID’s Office of Financial Management, Washington Accounting Operations Division
- FSO disbursed about $74 million per year of USAID’s $6.5 billion budget
- FSO disbursed about $4 million per year for travel expense reimbursements
William John Burns

- USAID bureau chiefs authorized obligations for travel expenses
- They tended to estimate high when deciding how much to obligate
  - This allowed them to avoid having to add to an obligation; and also tended to ‘support’ future year budget requests
- Bureau chiefs were usually careful to de-obligate and reprogram unspent funds in the current year

William John Burns

- But, obligated amounts were often spent in subsequent years rather than in the current year
- De-obligated prior-year money reverts to the US Treasury and cannot be reprogrammed for agency use; hence, bureau chiefs did not track it or care about it
- FSO’s top priority was de-obligating current-year funds

William John Burns

- FSO had high turnover--about 40% per year
- Burns trained and supervised all FSO employees
- There had been concerns about USAID’s accounting and internal control systems for some time
- During the past few years, the Office of Financial Management had grown in personnel and responsibility--some thought it was too large for a single manager to handle
The USAID director appointed a task force to conduct a major review of the Office of Financial Management “in order to strengthen areas identified as potentially vulnerable.”

The task force’s review did not look at FSO, but expressed concern that OFM “was too extensive” and had “lax accounting practices.”

USAID’s IG also expressed concerns about OFM’s “untimely payment of bills” and “inadequate and untimely reviews” of voucher records.

The IG did not do any audits within FSO, because “relatively speaking there was less money and less chance of corruption there.”

“We cannot audit everything if it is not of monetary significance” [Deputy IG]

A new computer system was being installed, but the installation was plagued by “high error rates.”

Due to these installation problems, some offices (including FSO) did not use the new system.

Burns began his crime spree in 1982; it ended in 1988; he stole more than $1.2 million.

Burns took upon himself the accounting chore no one else wanted—reconciling prior year unliquidated obligations.

Burns established a false identity—Vincent Kauffman—and diverted unexpended travel money to ‘Kauffman’s’ bank account.
Case Study

William John Burns

- Burns’ salary at the time of his arrest was $35,108 per year
- He lived in a 3-garage, $335,000 home and had 5 expensive cars
- He had attended 3 Super Bowls
- He told a neighbor that his hobby was “shopping for major appliances”
- He told co-workers that he inherited money when his mother died in 1982

Case Study

William John Burns

- Burns plead guilty to embezzlement, fraud, and evading taxes on August 11, 1988
- He forfeited nearly all of his assets and agreed to repay the balance of his estimated $1.2 million theft
- On October 11, 1988, Burns was sentenced to 6 years in prison

Case Study

William John Burns

- Despite the longstanding concerns by USAID management and its IG about weak accounting controls, Burns’ crimes were not discovered by the special task force or any IG audits or reviews
- During a routine security check for renewing Burns’ clearance, the low-level investigator decided to drive by Burns’ home
- He found the home and expensive cars to be inconsistent with Burns’ salary
Case Study

Mr. Travel Voucher

**OPPORTUNITY**

**MOTIVE**

**PRESSURE**

**RATIONALIZATION**

---

**Fraud Risk Factors/Indicators**

- Inadequate duties segregation
- High turnover
- Weak accounting controls
- Inadequate reconciliations
- Computer accounting system with high error rates
- Some offices not using new system

---

ACFE Fraud Statistics
The Magnitude of Fraud

- The typical organization loses 5% of its revenues to fraud each year [global loss to fraud ~$3.7 trillion]
- Median loss caused by fraud in the cases studied was ~ $145,000
- Frauds lasted a median of 18 months before being detected
- Asset misappropriation:
  - 85% of cases; median loss ~$130,000
- Financial statement (managerial) fraud:
  - 9% of cases; median loss of ~$1 million
- Corruption schemes:
  - 37% of cases; median loss of $200,000

This is where most of the fraud action is.
The Magnitude of Fraud

- The typical organization loses 5% of its revenues to fraud each year (global loss: $3.7 trillion)
- Median loss caused by fraud in the cases studied was ~ $145,000
- Frauds lasted a median of 18 months before being detected
- Asset misappropriation: 85% of cases; median loss ~ $130,000
- Financial statement (managerial) fraud: 
  - 9% of cases; median loss of ~ $1 million
- Corruption schemes: 
  - 37% of cases; median loss of $200,000

Most common means of detection: tips from employees of the victim organization --> 40% of cases

But, these frauds can be and often are catastrophic.
Most common means of detection: tips from employees of the victim organization— > 40% of cases
Organizations should make it as easy as possible for employees to report concerns
Fraud hotlines used to be expensive; and sometimes distrusted
New web-based hotline systems are inexpensive; and provide greater trust by employees; and allow follow-up contact with whistleblowers
CAUTION: before engaging a third-party hotline provider, perform due diligence regarding information security
C&C list of providers available on request
The Magnitude of Fraud
- Most common means of detection: tips from employees of the victim organization-- > 40% of cases
- Corruption and billing schemes pose the greatest risk
- Fraud is a significant threat to small businesses, with disproportionate losses
- Most commonly victimized industries:
  - Banking and financial services
  - Government and public administration
  - Manufacturing
- Presence of anti-fraud controls notably correlated with decreases in the cost and duration of frauds
- Perpetrators with higher levels of authority tend to cause much larger losses
- The longer a perpetrator has been with an organization, fraud losses tend to be higher

77% of frauds committed by individuals in one of seven departments:
- Accounting
- Operations
- Sales
- Executive/upper management
- Customer service
- Purchasing
- Finance

Collusion results in higher losses: 1 perp, median loss $80,000; 2 perps, $200,000; 3 perps, $355,000; 4 or more perps, > $500,000
The Magnitude of Fraud

- Organizations with hotlines are MUCH more likely to detect fraud by tips
- Organizations with hotlines had frauds that were 41% less costly
- Organizations with hotlines detected frauds 50% more quickly

In 92% of cases, the perpetrator displayed one or more red flags:
- Living beyond means—43.8% of cases
- Financial problems—33.0% of cases
- Unusually close association with vendors/customers—21.8% of cases
- Excessive control issues—21.1% of cases
- “Wheeler-Dealer” attitude—18.4% of cases
In 92% of cases, the perpetrator displayed one or more red flags:

- Living beyond means—43.8% of cases
- Financial problems—33.0% of cases
- Unusually close association with vendors/customers—21.8% of cases
- Excessive control issues—21.1% of cases
- "Wheeler-Dealer" attitude—18.4% of cases

58.4% of victim organizations do not recover ANY losses suffered.
Fraud is universal

Fraud reporting mechanisms—hotlines—are critical to effective anti-fraud programs

External audits are useful in deterrence, but detect very few (~3%) frauds

Fraud awareness training is critical to preventing and detecting fraud

Small businesses are particularly vulnerable

Most fraudsters exhibit behavioral red flags

The cost of fraud—financially and reputationally—can be devastating

ACFE Conclusions

The Magnitude of Fraud

http://www.acfe.com/rttn.aspx
Anti-Fraud Guidance

Historical Perspective on Anti-Fraud Guidance

2000-2002 were traumatic years for the accountability profession

- Enron, WorldCom, Tyco, Global Crossing, Waste Management, Baptist Foundation of America, Peregrine, AOL/Time Warner, HealthSouth, Adelphia, IMClone
- Demise of Arthur Andersen

"Being an accountant gives him that extra aura of danger."
Historical Perspective on Anti-Fraud Guidance

2000-2002 were traumatic years for the accountability profession
- Enron, WorldCom, Tyco, Global Crossing, Waste Management, Baptist Foundation of America, Peregrine, AOL/Time Warner, HealthSouth, Adelphia, IMClone
- Demise of Arthur Andersen

In 2002, the AICPA, ACFE, and IIA formed a task force: The Antifraud Programs and Controls Task Force

Antifraud Programs and Controls Task Force

- Ronald L. Durham, Chair
- KPMO LLP
- Dan L. Goldwasser
- Veler, Price, Kaufman, & Kannibuc, PC
- Audit Committee member
- Mark Bessley
- North Carolina State University
- Ronald B. Nonis
- The Citicorp Change Companies Inc.
- Toby J.F. Bishop
- Association of Certified Fraud Examiners
- Zoe-Verna Palmaa
- University of Southern California
- David Cotton
- Cotton & Company LLP
- Thomas M. Stander
- Arthur Andersen LLP (retired)
- Audit Committee member
- Georgia P. Fritz
- PricewaterhouseCoopers LLP (retired)
- Accounting & Auditing Consultants LLC
- AICPA Staff
- Charles E. Landen
- Michael P. Olsen
- Director
- Technical Manager
- Audit and Attest Standards
- Audit and Attest Standards

Historical Perspective on Anti-Fraud Guidance

- The Task Force’s Mandate: develop “attestable criteria” for an organization to follow in implementing anti-fraud programs and controls
- The Task Force rebelled against that mandate
  - More immediately important guidance was needed
  - Recent catastrophic frauds (Enron, WorldCom, Tyco, Global Crossing, Waste Management, Baptist Foundation of America, Peregrine, AOL/Time Warner, HealthSouth, Adelphia, IMClone) ALL caused by management override of internal control
New Guidance for Audit Committees

Management Override: The Achilles’ Heel of Internal Control

TARGET AUDIENCE:
Those Charged with Governance
Management Override: The Achilles’ Heel of Internal Control

The Audit Committee’s Responsibilities

Actions to Address the Risk of Management Override of Internal Controls

- Maintaining Skepticism
- Strengthening Committee Understanding of the Business
- Brainstorming to Identify Fraud Risks
- Using the Code of Conduct to Assess Financial Reporting Culture
- Cultivating a Vigorous Whistleblower Program
- Developing a Broad Information and Feedback Network

Appendix: Suggested Audit Committee Procedures:
Strengthening Knowledge of the Business and Related Financial Statement Risks

- Incentives or Pressures on Management
- Opportunities Management Can Exploit

A Restructured Task Force then Went Back to the Future

Under IIA leadership (President Dave Richards), a reconstituted task force returned to the original (attestable criteria) mandate.
Is your organization fully committed to protecting stakeholder assets?


Published in 2007

Managing the Business Risk of Fraud: A Practical Guide

- Introduction ................................................................. 5
- Section 1: Fraud Risk Governance .................................. 10
- Section 2: Fraud Risk Assessment .................................. 19
- Section 3: Fraud Prevention ........................................... 20
- Section 4: Fraud Detection ............................................. 24
- Section 5: Fraud Investigation and Corrective Action ......... 29
Managing the Business Risk of Fraud: A Practical Guide

APPENDICES:
- APPENDIX A: REFERENCE MATERIAL .......................................................... 65
- APPENDIX B: SAMPLE FRAMEWORK FOR A FRAUD CONTROL POLICY .................. 67
- APPENDIX C: SAMPLE FRAUD POLICY ...................................................... 70
- APPENDIX D: FRAUD RISK ASSESSMENT FRAMEWORK EXAMPLE .................. 75
- APPENDIX E: FRAUD RISK EXPOSURES ................................................... 77
- APPENDIX F: FRAUD PREVENTION SCORECARD ........................................... 81
- APPENDIX G: FRAUD DETECTION SCORECARD ........................................... 85
- APPENDIX H: OECD FOUNDATION PRINCIPLES THAT RELATE TO FRAUD .......... 99
- APPENDIX I: COSO INTERNAL CONTROL INTEGRATED FRAMEWORK ............... 79

Anti-Fraud Principles

Principle 1: 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.

Principle 2: Fraud risk exposure should be assessed periodically by the organization to identify specific potential schemes and events that the organization needs to mitigate.

Anti-Fraud Principles

Principle 3: Prevention techniques to avoid potential key fraud risk events should be established, where feasible, to mitigate possible impacts on the organization.

Principle 4: Detection techniques should be established to uncover fraud events when preventive measures fail or unmitigated risks are realized.

Principle 5: 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.
FLASH UPDATE

- The 2013 Updated COSO Internal Control Framework added 17 Principles
- Principle #8: “The organization considers the potential for fraud in assessing risks to the achievement of objectives.”
Joint COSO-ACFE Task Force

- COSO Principle #8 (Assess Fraud Risk) resulted in a need for more specific guidance on assessing fraud risk
- Task Force is updating Managing the Business Risk of Fraud: A Practical Guide (originally published in 2007)
- Update was completed by the end of 2015
- Currently undergoing production processing by COSO
- Should be issued in early spring 2016
**Joint COSO-ACFE Task Force**

<table>
<thead>
<tr>
<th>Name</th>
<th>Affiliation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Barbara Andrews</td>
<td>AICPA</td>
</tr>
<tr>
<td>Michael Birdsall</td>
<td>Comcast Corporation</td>
</tr>
<tr>
<td>Toby Bishop</td>
<td>Formerly ACFE, Deloitte</td>
</tr>
<tr>
<td>Margot Cella</td>
<td>Center for Audit Quality</td>
</tr>
<tr>
<td>David Codrict</td>
<td>Comcast Wholesale Services</td>
</tr>
<tr>
<td>Dave Cotton</td>
<td>Cotton &amp; Company LLP</td>
</tr>
<tr>
<td>James Dalkin</td>
<td>GAO</td>
</tr>
<tr>
<td>Rex Durkin</td>
<td>And MultiTech</td>
</tr>
<tr>
<td>Bert Edwards</td>
<td>Formerly State Department</td>
</tr>
<tr>
<td>Frank Fusti</td>
<td>General Electric</td>
</tr>
<tr>
<td>Time Warner Cable</td>
<td>Comcast Rose Falikight</td>
</tr>
<tr>
<td>Eric Feldman</td>
<td>Formerly QMRR/OD, DOD</td>
</tr>
<tr>
<td>J. Michael Peppers</td>
<td>University of Texas</td>
</tr>
<tr>
<td>Kelly Richardson Pope</td>
<td>Def Hampton University</td>
</tr>
<tr>
<td>Carolina DaPonte</td>
<td>Naval Academy</td>
</tr>
<tr>
<td>William Tiberio</td>
<td>Formerly NY</td>
</tr>
<tr>
<td>Michael Jetteri</td>
<td>Uhlhorn &amp; Company</td>
</tr>
<tr>
<td>Private Sector</td>
<td>Practit</td>
</tr>
<tr>
<td>Vincent Walden</td>
<td>EY</td>
</tr>
<tr>
<td>BB Warren</td>
<td>PwC</td>
</tr>
<tr>
<td>Richard Woodard</td>
<td>DRS-IGS</td>
</tr>
<tr>
<td>J. Michael Peppers</td>
<td>University of Texas</td>
</tr>
<tr>
<td>J. Michael Peppers</td>
<td>Def Hampton University</td>
</tr>
<tr>
<td>Carolina DaPonte</td>
<td>Naval Academy</td>
</tr>
<tr>
<td>William Tiberio</td>
<td>Formerly NY</td>
</tr>
<tr>
<td>Michael Jetteri</td>
<td>Uhlhorn &amp; Company</td>
</tr>
<tr>
<td>Private Sector</td>
<td>Practit</td>
</tr>
<tr>
<td>Vincent Walden</td>
<td>EY</td>
</tr>
<tr>
<td>BB Warren</td>
<td>PwC</td>
</tr>
<tr>
<td>Richard Woodard</td>
<td>DRS-IGS</td>
</tr>
</tbody>
</table>

**FREE at:**


Published in 2007

**Updated Guide**

- Similar to MBRF; more up-to-date
- More emphasis on data analytics
- 5 Principles (slightly different than MBRF) and many Points of Focus
- 5 Fraud Risk Management Principles correlate with the COSO Components and Principles
- More robust appendices
Updated Guide Can Be Used:

- For developing and implementing a comprehensive fraud risk management program, or
- Just for complying with Principle #8—performing a fraud risk assessment
Establish the fraud risk assessment team, considering:
- Appropriate management levels
- All organizational components

Identify all fraud schemes and fraud risks, considering:
- Internal and external factors
- Various types of fraud
- Risk of management override
Establish the fraud risk assessment team, considering:
- Appropriate management levels
- All organizational components

Identify all fraud schemes and fraud risks, considering:
- Internal and external factors
- Various types of fraud
- Risk of management override

Estimate likelihood and significance of each fraud scheme and risk.
Establish the fraud risk assessment team, considering appropriate management levels and all organizational components.

Identify all fraud schemes and fraud risks, considering internal and external factors, various types of fraud, and risk of management override.

Estimate likelihood and significance of each fraud scheme and risk.

Determine all personnel and departments potentially involved, considering the fraud triangle.

Identify existing controls and assess their effectiveness.
Establish the fraud risk assessment team, considering:
- Appropriate management levels
- All organizational components

Identify all fraud schemes and fraud risks, considering:
- Internal and external factors
- Various types of fraud
- Risk of management override

Estimate likelihood and significance of each fraud scheme and risk

Determine all personnel and departments potentially involved, considering the fraud triangle

Identify existing controls and assess their effectiveness

Assess and respond to residual risks that need to be mitigated:
- Strengthen existing control activities
- Add control activities
- Consider data analyses

Document the fraud risk assessment

<table>
<thead>
<tr>
<th>Fraud Risk Assessment Documentation</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Identified fraud risks and schemes</td>
</tr>
</tbody>
</table>
Establish the fraud risk assessment team, considering:
- Appropriate management levels
- All organizational components

Identify all fraud schemes and fraud risks, considering:
- Internal and external factors
- Various types of fraud
- Risk of management override

Estimate likelihood and significance of each fraud scheme and risk

Determine all personnel and departments potentially involved considering the fraud triangle

Identify existing controls and assess their effectiveness

Assess and respond to residual risks that need to be mitigated:
- Strengthen existing control activities
- Add control activities
- Consider data analytics

Document the risk assessment

Reassess risk periodically, considering changes:
- Internal to the organization
- Operational Leadership

Appendices

A: GLOSSARY
B: ROLES AND RESPONSIBILITIES
C: CONSIDERATIONS FOR SMALLER ENTITIES
D: REFERENCE MATERIAL
E: DATA ANALYTICS
F: SAMPLE MATERIALS RELATED TO FRAUD RISK GOVERNANCE
   F1: FRAUD CONTROL POLICY FRAMEWORK
   F2: FRAUD RISK MANAGEMENT HIGH-LEVEL ASSESSMENT
   F3: FRAUD POLICY RESPONSIBILITY MATRIX
   F4: FRAUD RISK MANAGEMENT POLICY
   F5: FRAUD RISK MANAGEMENT ANNUAL EMPLOYEE SURVEY

G: LIST OF FRAUD RISK EXPOSURES
H: MANAGEMENT OVERRIDE: THE ACHEILLES’ HEEL OF FRAUD PREVENTION
I: SAMPLE FRAUD RISK ASSESSMENT
J: FRAUD RISK MANAGEMENT ASSESSMENT SCORECARDS
   J1: FRAUD RISK GOVERNANCE
   J2: FRAUD RISK ASSESSMENT
   J3: FRAUD CONTROL ACTIVITIES
   J4: FRAUD INVESTIGATION AND FOLLOWUP
   J5: FRAUD RISK MANAGEMENT MONITORING
K: HYPERLINKS TO ADDITIONAL TOOLS
L: MANAGING THE RISK OF FRAUD IN GOVERNMENT
HYPERLINKS TO ADDITIONAL TOOLS

- Points of Focus Documentation Templates
- Risk Assessment and Follow-up Actions Template
HYPERLINKS TO ADDITIONAL TOOLS

- Points of Focus Documentation Templates
- Risk Assessment and Follow-up Actions Template
- Log for allegations of fraud and investigation results

HYPERLINKS TO ADDITIONAL TOOLS

- Points of Focus Documentation Templates
- Risk Assessment and Follow-up Actions Template
- Log for allegations of fraud and investigation results
- Interactive Scorecards
**HYPERLINKS TO ADDITIONAL TOOLS**

- Points of Focus Documentation Templates
- Risk Assessment and Follow-up Actions Template
- Log for allegations of fraud and investigation results
- Interactive Scorecards
- Library of Data Analytics Tests
### AREA

#### 1. Test

<table>
<thead>
<tr>
<th>Test</th>
<th>Test</th>
</tr>
</thead>
<tbody>
<tr>
<td>Test</td>
<td>Test</td>
</tr>
</tbody>
</table>

#### 2. Test

<table>
<thead>
<tr>
<th>Test</th>
<th>Test</th>
</tr>
</thead>
<tbody>
<tr>
<td>Test</td>
<td>Test</td>
</tr>
</tbody>
</table>

#### 3. Test

<table>
<thead>
<tr>
<th>Test</th>
<th>Test</th>
</tr>
</thead>
<tbody>
<tr>
<td>Test</td>
<td>Test</td>
</tr>
</tbody>
</table>

#### 4. Test

<table>
<thead>
<tr>
<th>Test</th>
<th>Test</th>
</tr>
</thead>
<tbody>
<tr>
<td>Test</td>
<td>Test</td>
</tr>
</tbody>
</table>
The Plan for the Guide

- Completed and issued as COSO “guidance” in 2016
- COSO will then vet the Guide by exposing it for public comment
- COSO will re-issue the vetted product as a 3rd COSO Framework

COSO Frameworks
COSO Frameworks

FLASH UPDATE

- GAO’s Green Book, Standards for Internal Control in the Federal Government, was updated in 2014 to mirror the 2013 updated COSO Framework.
- Green Book Principle #8: “Management should consider the potential for fraud when identifying, analyzing, and responding to risks.”
COSO Framework vs GAO Green Book

- COSO Framework
  - Principles and Points of Focus
  - Best Practices (i.e. no “shoulds” or “musts”)

- GAO Green Book
  - Principles and Attributes
  - Mandatory Standards (i.e. contains “shoulds” and “musts”)

FLASH UPDATE—GAO

- GAO recently published A Framework for Managing Fraud Risks in Federal Programs
- Available at: http://www.gao.gov/products/GAO-15-593SP
GAO Framework Structure

- Overarching Concepts
- Leading Practices

GAO Framework Structure

- Principles
- Areas of Focus
- Overarching Concepts
- Leading Practices
**Costs versus Benefits????**

- This sounds like a lot of work …
- It IS a comprehensive process if done correctly
- But, there are benefits
  - You WILL learn things about your organization that you did not know
  - Your employees WILL feel empowered, involved, committed to enhancing operations, and dedicated to improved accountability
  - You WILL reduce your risk due to fraud
- If we were to ask Dixon, Illinois, United Way of America, United Way of the National Capital Area, and USAID if they wished that they had taken more proactive Fraud Risk Management steps, what do you think THEY would say?
What Does FRM Mean for External Auditors?

- External auditors are required to assess fraud risk
- Audits are risk-based: higher risk = more audit work needed = higher audit fees
- If you tell your auditors that you have implemented rigorous fraud risk management processes, their assessment of fraud risk should go down ...

Prediction:

- Auditing standards will be revised to REQUIRE auditors to evaluate and test management’s fraud risk management system and processes
- Similar to the existing requirement that auditors must evaluate and test management’s system of internal control

Not Quite Sure You Need to Implement a Fraud Risk Management Program in Your Organization?

- I will send you the 5 Scorecards or you can download them at (http://www.cottoncpa.com/outreach/thought-leadership/)
- Print them and get some red, yellow, and green dots (at Office Depot or Staples)
- Self-assess at your next senior staff or governing board meeting (45-60 minutes)
- See how much RED there is in your organization ...
- Then decide ...
Concluding Comments

- Fraud is not a subject that any organization wants to deal with, but the reality is most organizations experience fraud to some degree.
- Dealing with fraud can be constructive, and forward-thinking, and can position an organization in a leadership role within its industry or business segment.
- Strong, effective, and well-run organizations exist because management takes proactive steps to anticipate issues before they occur and to take action to prevent undesired results.
- Implementation of this guide should help establish a climate where positive and constructive steps are taken to protect employees and ensure a positive culture.
- The dynamics of any organization require an ongoing reassessment of fraud exposures and responses in light of the changing environment the organization encounters.

My Final Thought

Live Long and Prevent Fraud.

R.I.P.
Assessing and Managing Fraud Risk

Dave Cotton, CPA, CFE, CGFM
Cotton & Company, LLP
Alexandria, Virginia
dvcotton@cottoncpa.com