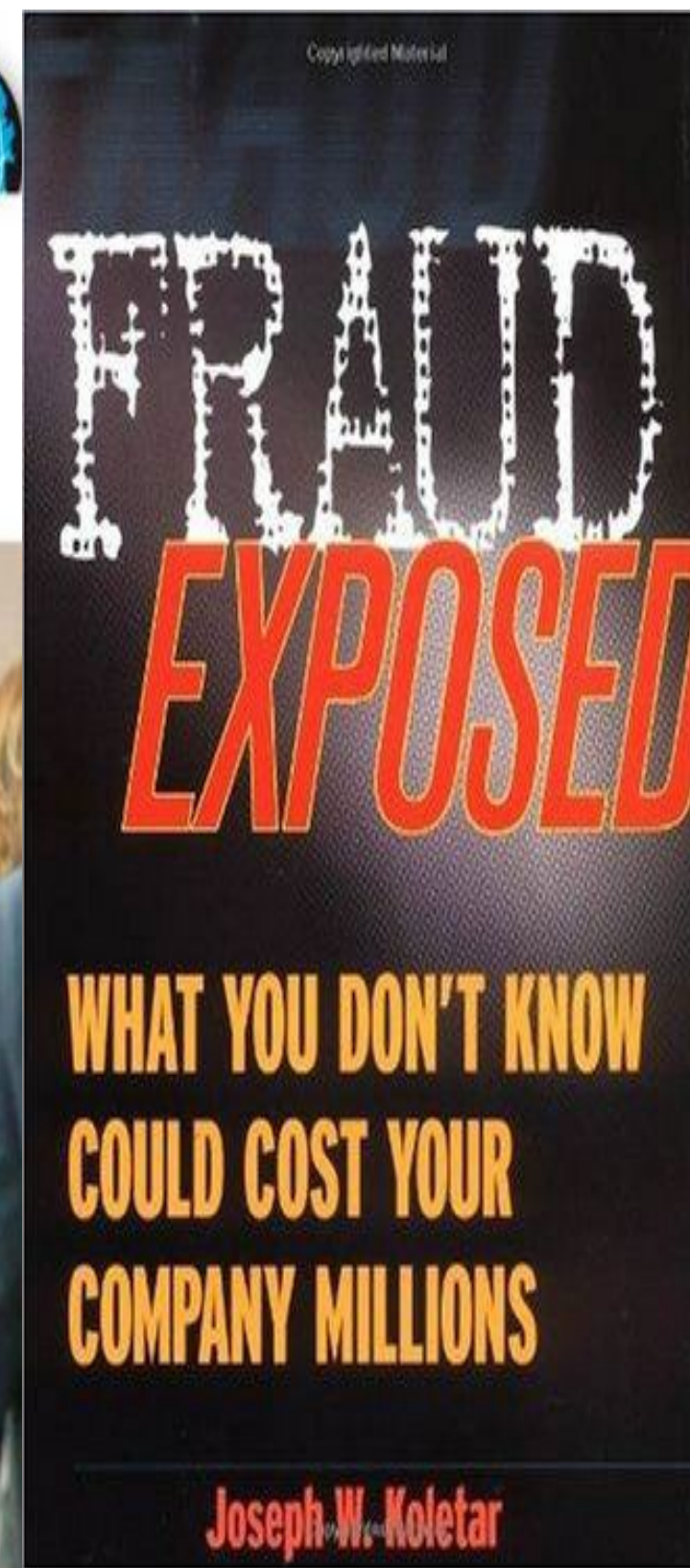
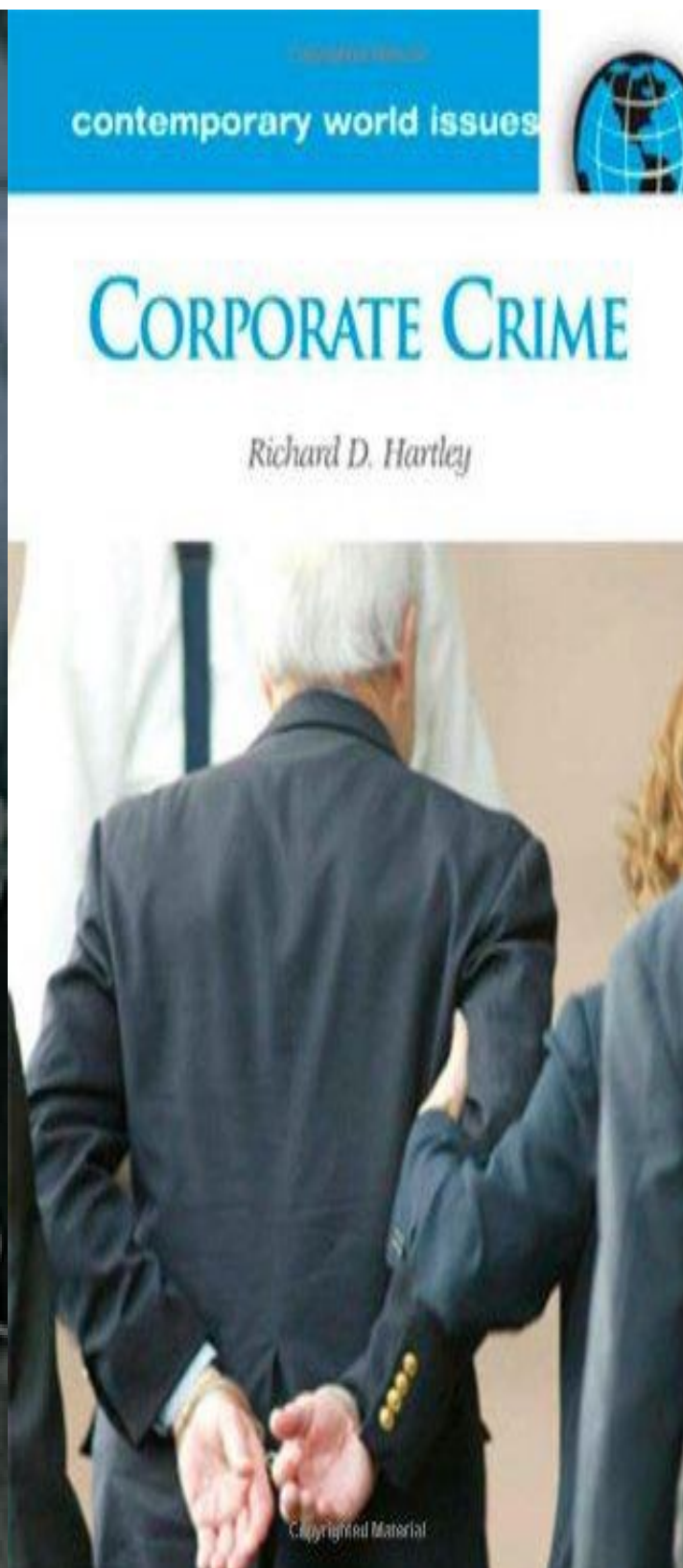
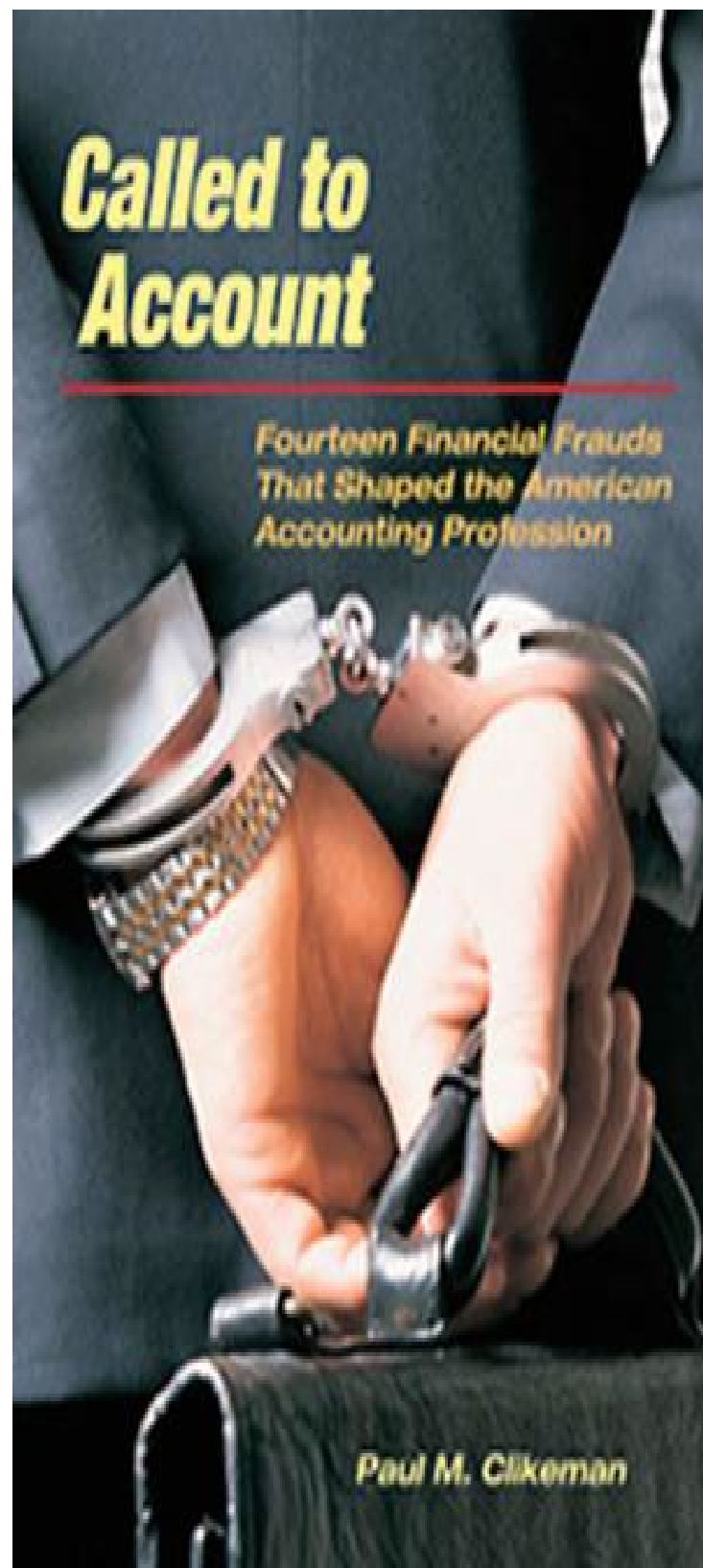
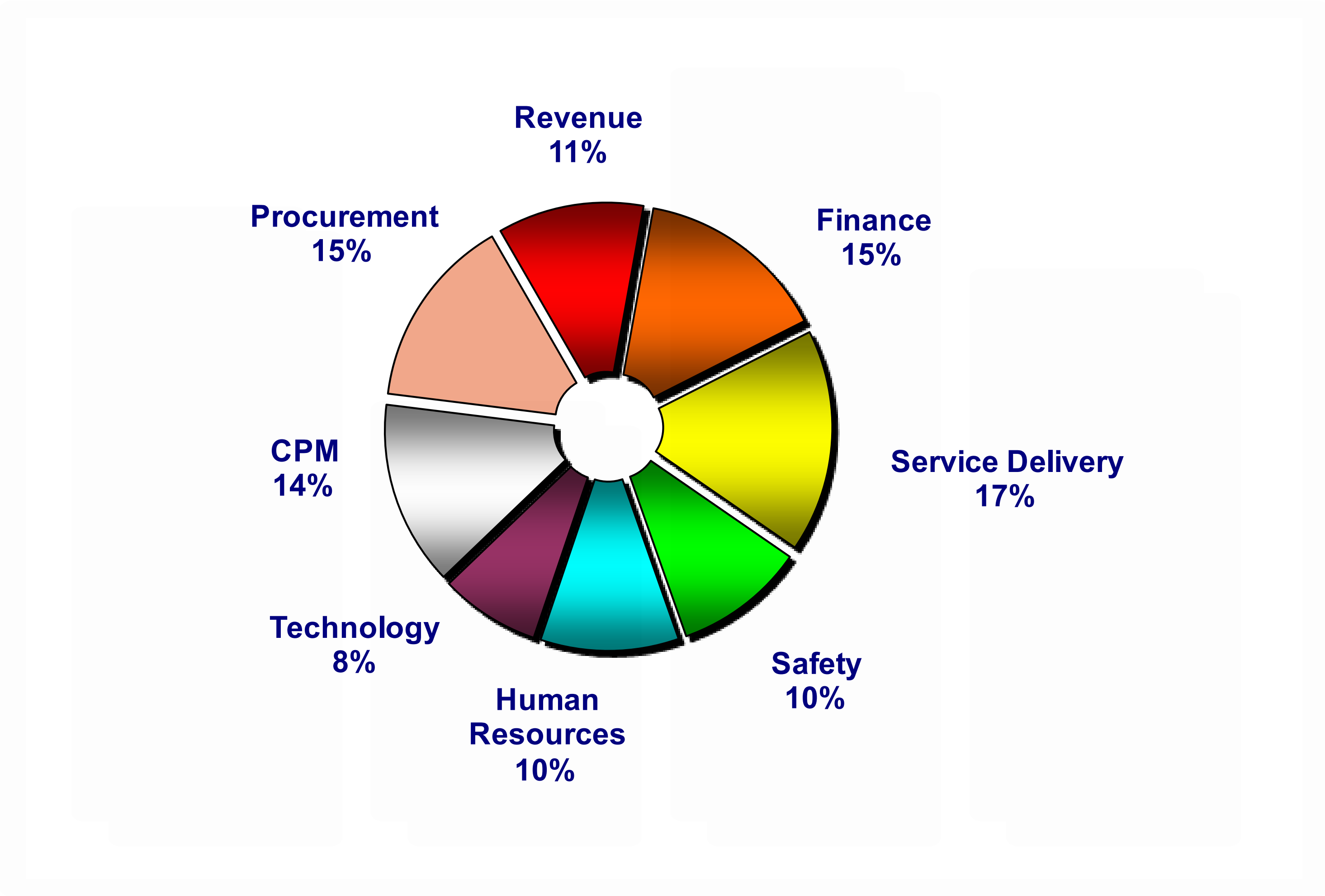


# FRAUD DETECTION THROUGH THE EYES OF COSO



# Where is Ethics and Fraud?



# COSO & ERM



# What We Are Up Against

- 47% of CFO's say they could justify unethical behavior to help their organization survive the economic downturn
- Nearly half of those survey stated they would be willing to cut ethical corners to meet performance targets, particularly in the last 4 years
- 40% surveys stated that their companies do business in countries in which bribery and fraud occur frequently

# REMEMBER: FRAUD IS PERPETRATED FOR TWO REASONS

- **Profit or Performance**
- **We focus on Employee fraud**
- **Focus on Corporate Fraud**

**Top California high-speed rail executive under investigation in ethics probe**

11 years behind schedule and billions in the red



**According to Grant Thornton fraud and corruption remains commonplace in the UK construction industry.**

- Kroll's Global Fraud Report cites the construction industry as having the highest incidence of management conflict of interest at 34%.
- The sector was also quoted as having the second highest rate of corruption at 18%, and market collusion at 13%.
- Fraud was identified as a strategic risk for the Crossrail Project;



# Hong Kong-Macau-Zhuhai Bridge

- **Jail time for Jacobs China technicians who faked safety test results**





# AND THE MOST TERRIBLE.....

**The Parmesan Cheese You Sprinkle on Your Pasta Could Be Wood.**

Some brands promising 100 percent purity contained no Parmesan at all.



# Why COSO?

- Management Override of Controls
- Conflict of Interest
- Lack of Segregation of Duties
- Poor transparency
- Siloed Risk Management
- Ineffective Board Oversight
- Dysfunctional/Irresponsible Behavior

# RISK: THAT WILL NEVER HAPPEN – YES IT WILL



**Can this Cause Fraud?**

**YOUR COMPANY'S MISSION**

**How can you help Your Company  
accomplish its' Mission**

# CAN THIS CAUSE FRAUD?

To be the number one  
bank of choice in the  
USA.



# Must Dos

- Know Your Company Strategy
- Lead a debrief at meetings on poor governance issues around the world
- Gauge employees perceptions of Organizational culture
- Review the misconduct reporting process
- Look outside the box for risk information
- Reevaluate incentive structure
- Update Ethics training

# Unethical behavior still tolerated

- Companies must be prepared for the challenges posed by greater regulatory scrutiny. A large proportion remains tolerant of unethical conduct across all levels of organizations
- Almost 1 in 5 company employees, regardless of grade, consider it acceptable to pay bribes to win or retain business.
- This is not new. Companies are not making progress in strengthening their ethical culture.

# Unethical behavior still tolerated

- Many ways Ethics and Culture is not an easy area to audit because assessment techniques are less defined than in more traditional audit areas.
- CAEs often find it is an area for which they do not have prior experience, cannot use traditional audit approaches,
- **“Not the Auditor’s Job to Detect Fraud”** The reality is: Internal audit is a natural resource for Fraud Risk Assessment

• **What does Fraud Look like on your desk?**





# 17 Principles of the Updated ICIF

## Control Environment

1. Demonstrates commitment to integrity and ethical values
2. Exercises oversight responsibility
3. Establishes structure, authority and responsibility
4. Demonstrates commitment to competence
5. Enforces accountability

## Risk Assessment

6. Specifies suitable objectives
7. Identifies and analyzes risk
8. Assesses fraud risk
9. Identifies and analyzes significant change

## Control Activities

10. Selects and develops control activities
11. Selects and develops general controls over technology
12. Deploys through policies and procedures

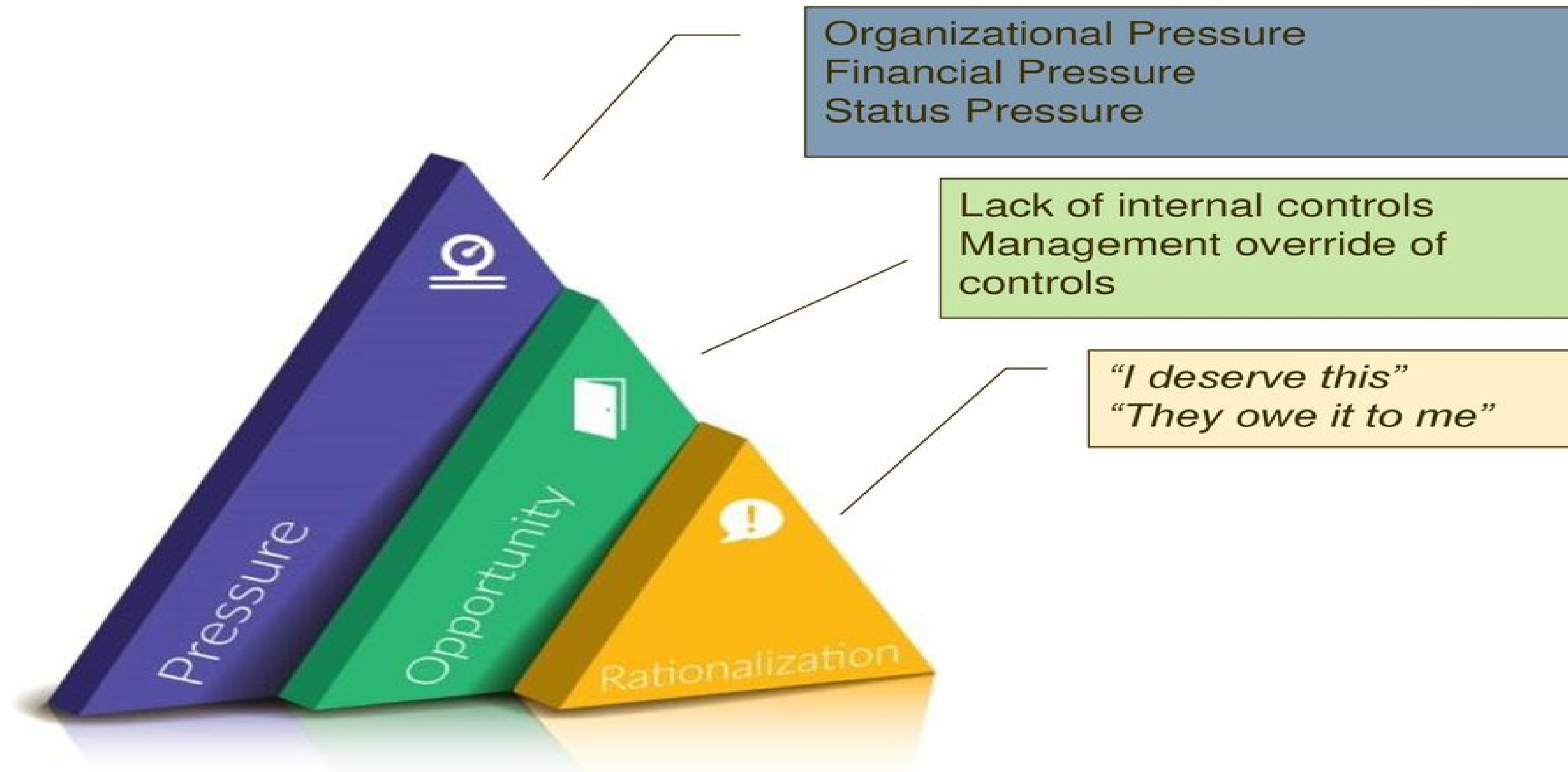
## Information & Communication

13. Uses relevant information
14. Communicates internally
15. Communicates externally

## Monitoring Activities

16. Conducts ongoing and/or separate evaluations
17. Evaluates and communicates deficiencies

# Fraud Triangle



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# HOW MUCH HAS 70 YEARS OF LEGISLATION IMPACTED FRAUD?

*“Greed is smarter and faster than regulation.”*

- **The Board is generally surprised**
- **The Audit Committee is shocked**
- **Yet People know about the fraud**

# Qualities of a Healthy Organizational Ethics

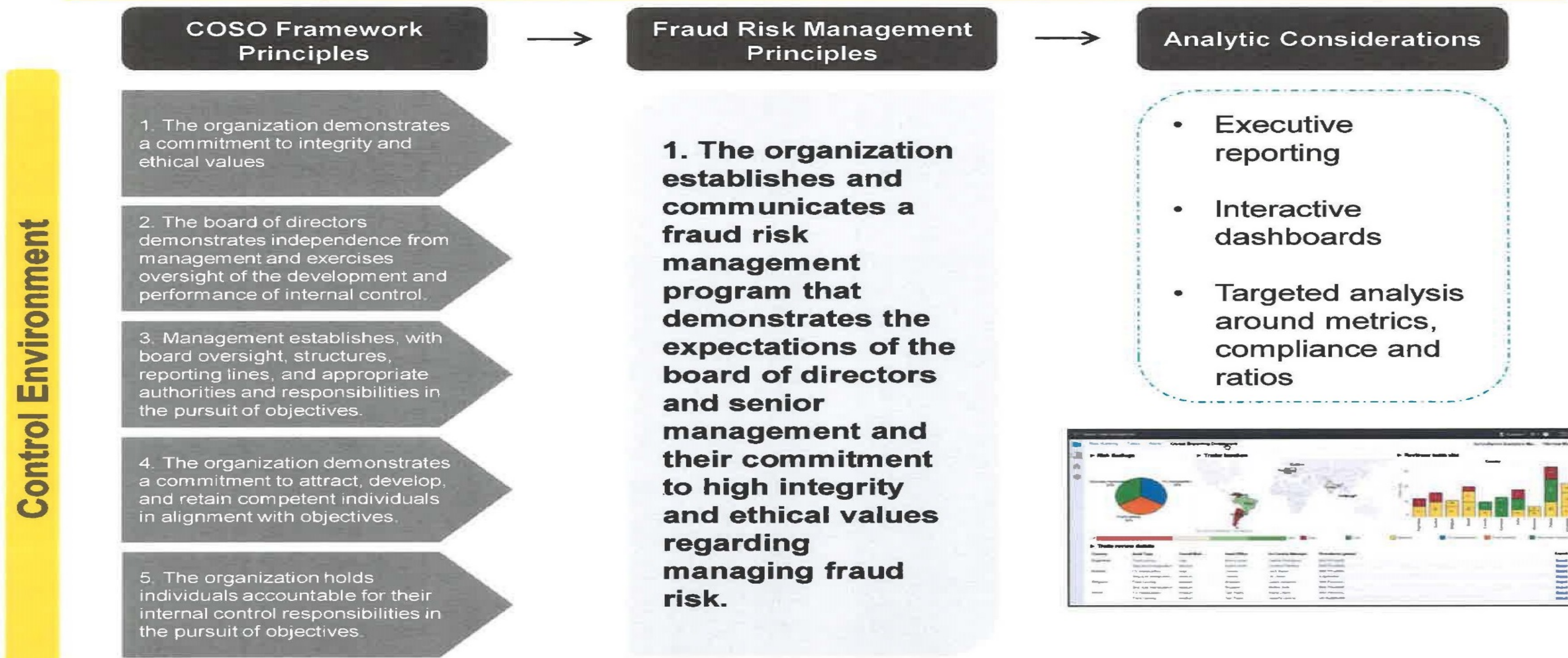
- Strong governance with clear policy and procedures.
- Communication of policy and procedures throughout the organization.
- Clear and consistent “tone at the top” communication from senior management regarding their expectations around control and appropriate behavior.
- Consistent application of policy and procedures to all levels of management without exception.
- Alignment of rewards to the right behaviors.

## Good News! *Integrity delivers business benefits*

- Real business benefits can be achieved by companies that act with integrity.
- Two-thirds of our respondents agree that there are commercial advantages for companies with strong reputations for ethical behavior.
- 45% would be unwilling to work for a company involved in a major bribery or corruption scandal.
- 53% of respondents state that they would be unwilling to hire suppliers or agents involved in a major bribery or corruption case

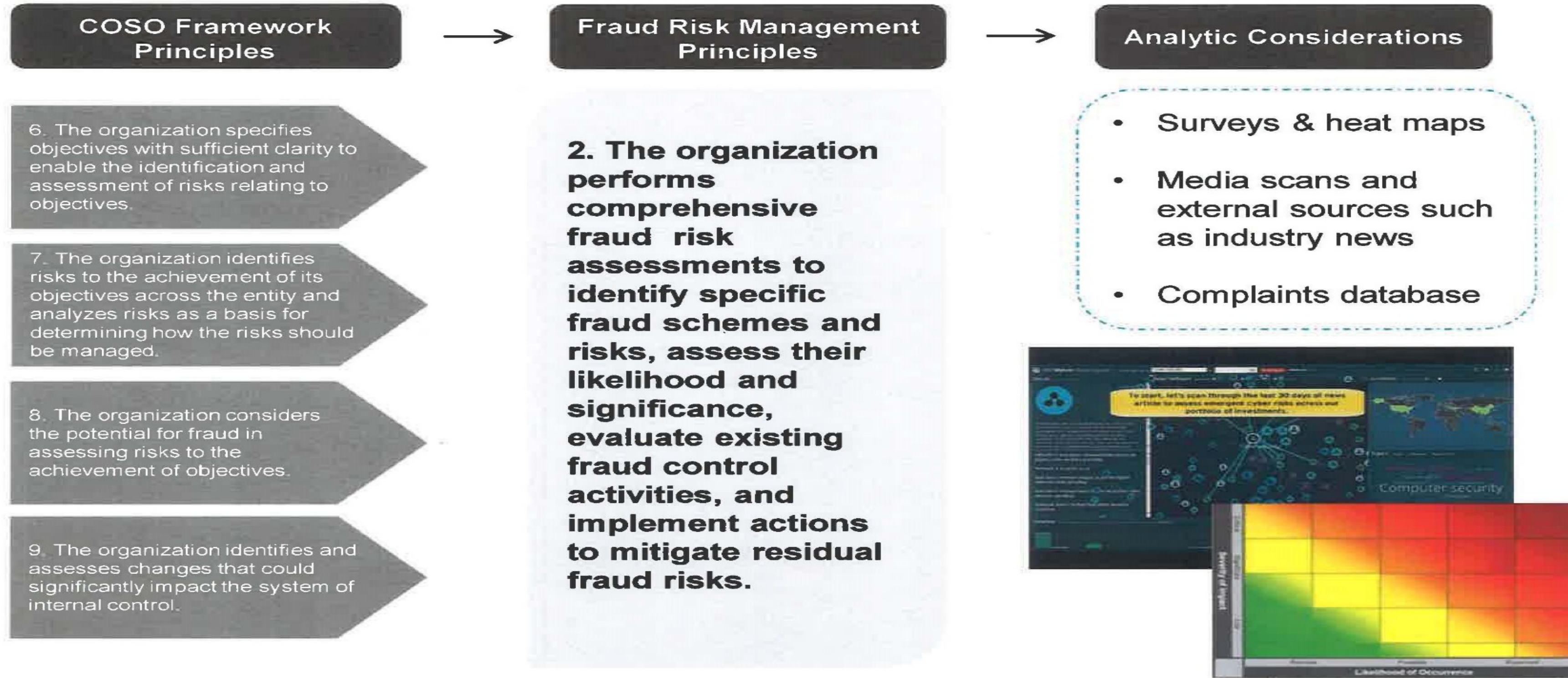
# COSO 2013 Internal Controls Framework

## Principles 1 through 5



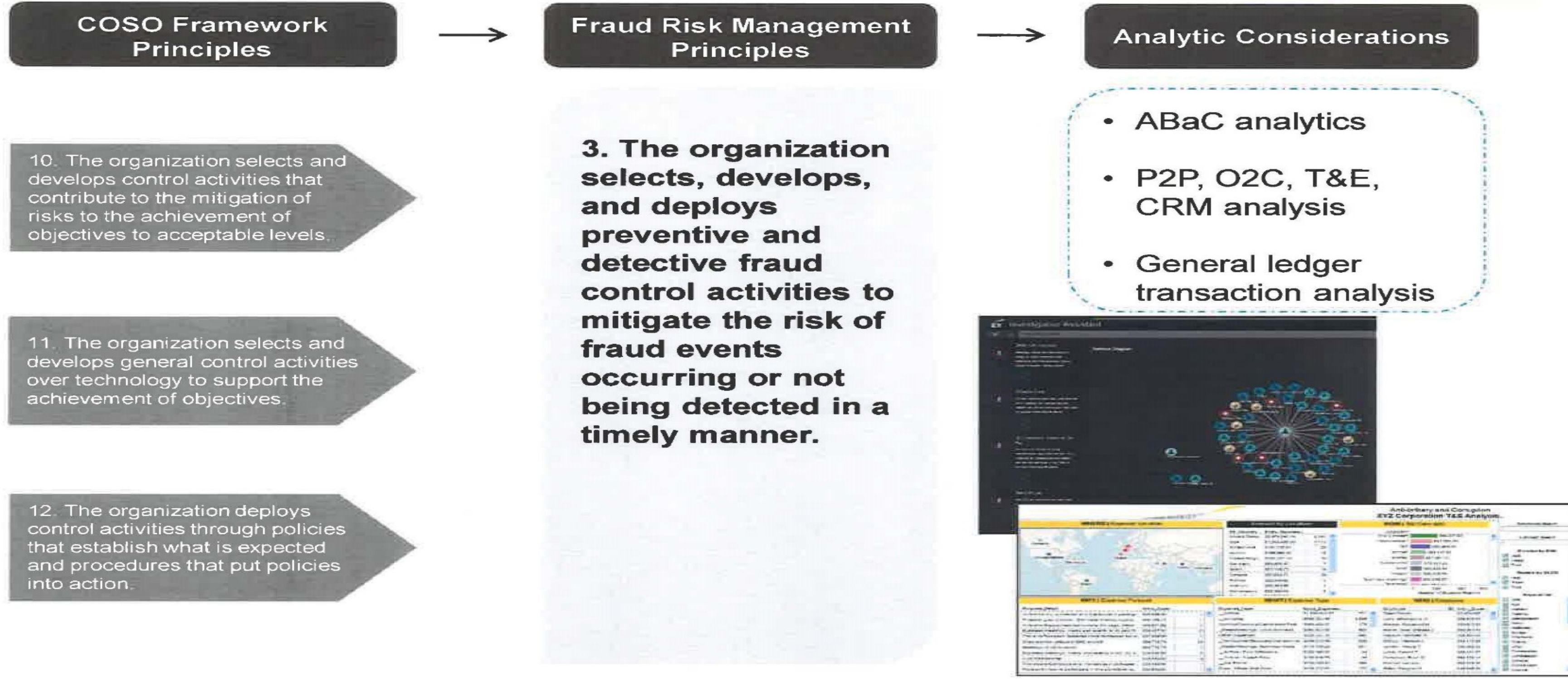
# COSO Framework Principles 6 through 9

Risk Assessment



# COSO Framework Principles 10 through 12

## Control Activities





# COSO Framework Principles 13 through 15

## Information & Communication

### COSO Framework Principles

13. The organization obtains or generates and uses relevant, quality information to support the functioning of other components of internal control.

14. The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control.

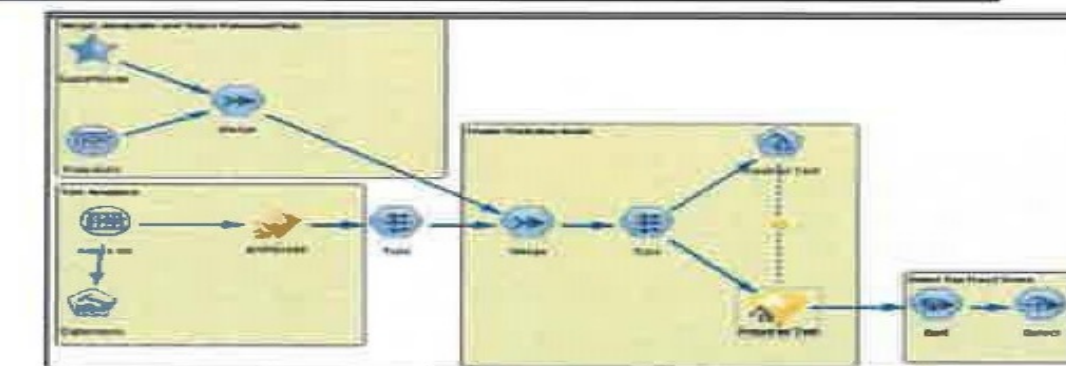
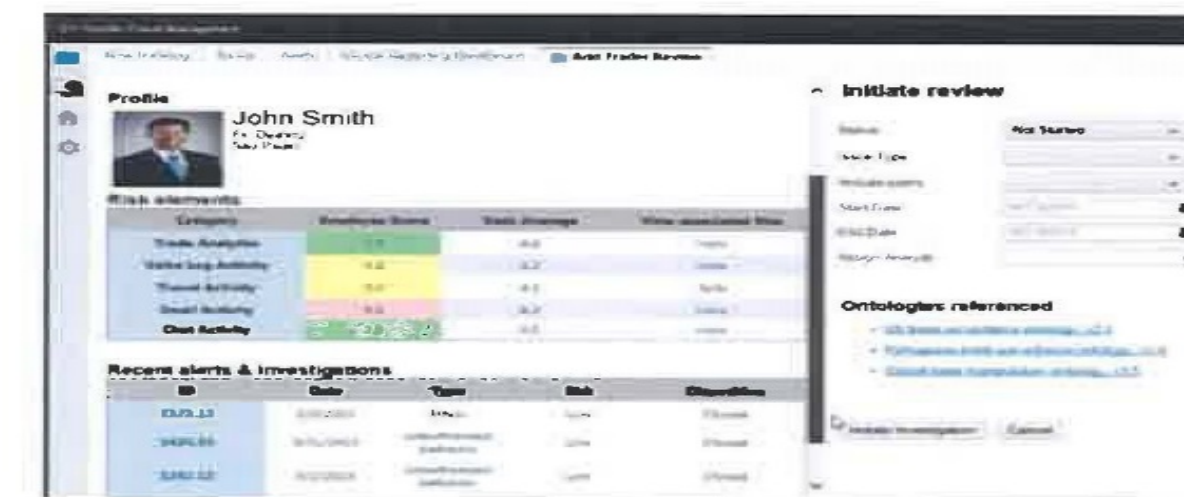
15. The organization communicates with external parties regarding matters affecting the functioning of other components of internal control.

### Fraud Risk Management Principles

**4. The organization establishes a communication process to obtain information about potential fraud and deploys a coordinated approach to investigation and corrective action to address fraud appropriately and in a timely manner.**

### Analytic Considerations

- Case management
- Escalation and triage
- Review workflow management



# COSO Framework Principles 16 & 17

Monitoring Activities

### COSO Framework Principles

16. The organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning.

17. The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate.



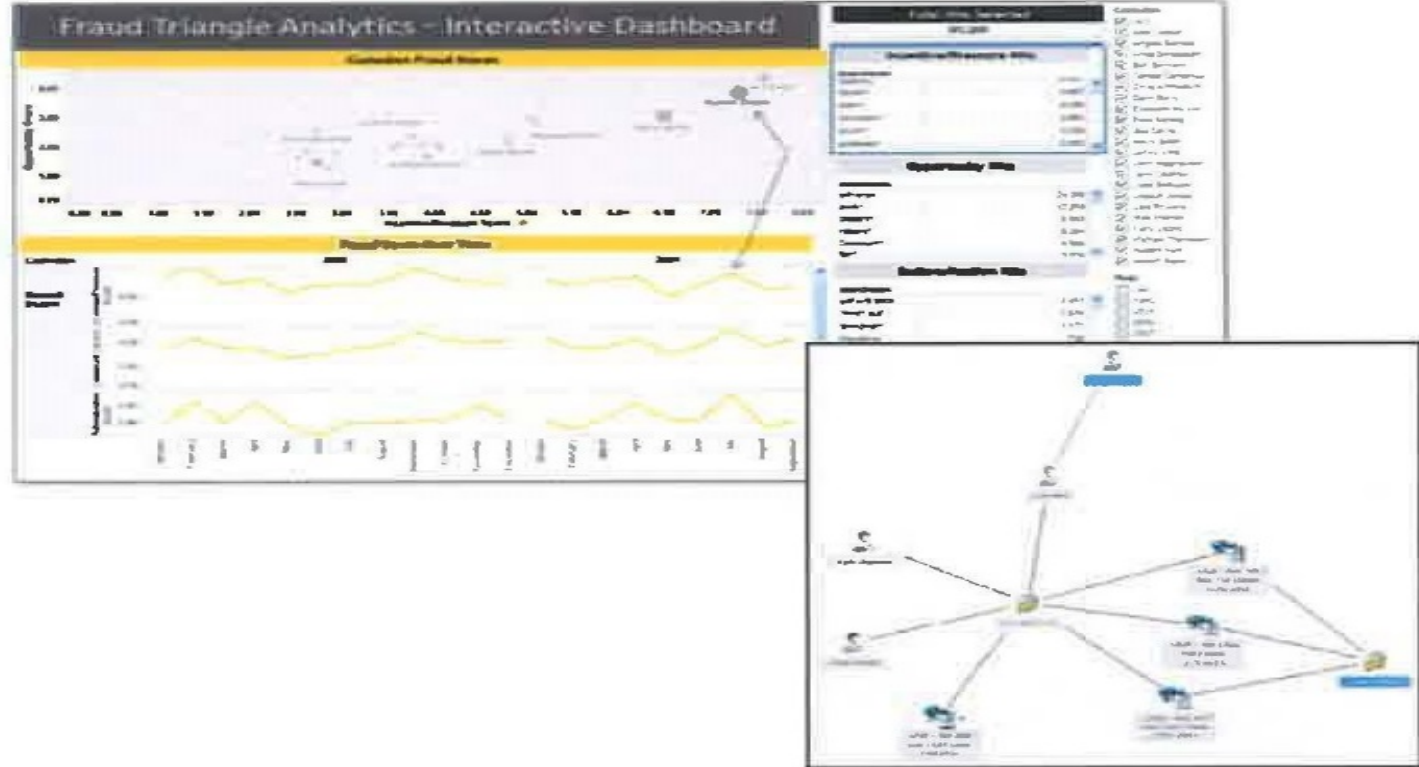
### Fraud Risk Management Principles

**5. The organization selects, develops, and performs ongoing evaluations to ascertain whether each of the five principles of fraud risk management is present and functioning and communicates fraud risk management program deficiencies in a timely manner to parties responsible for taking corrective action, including senior management and the board of directors.**

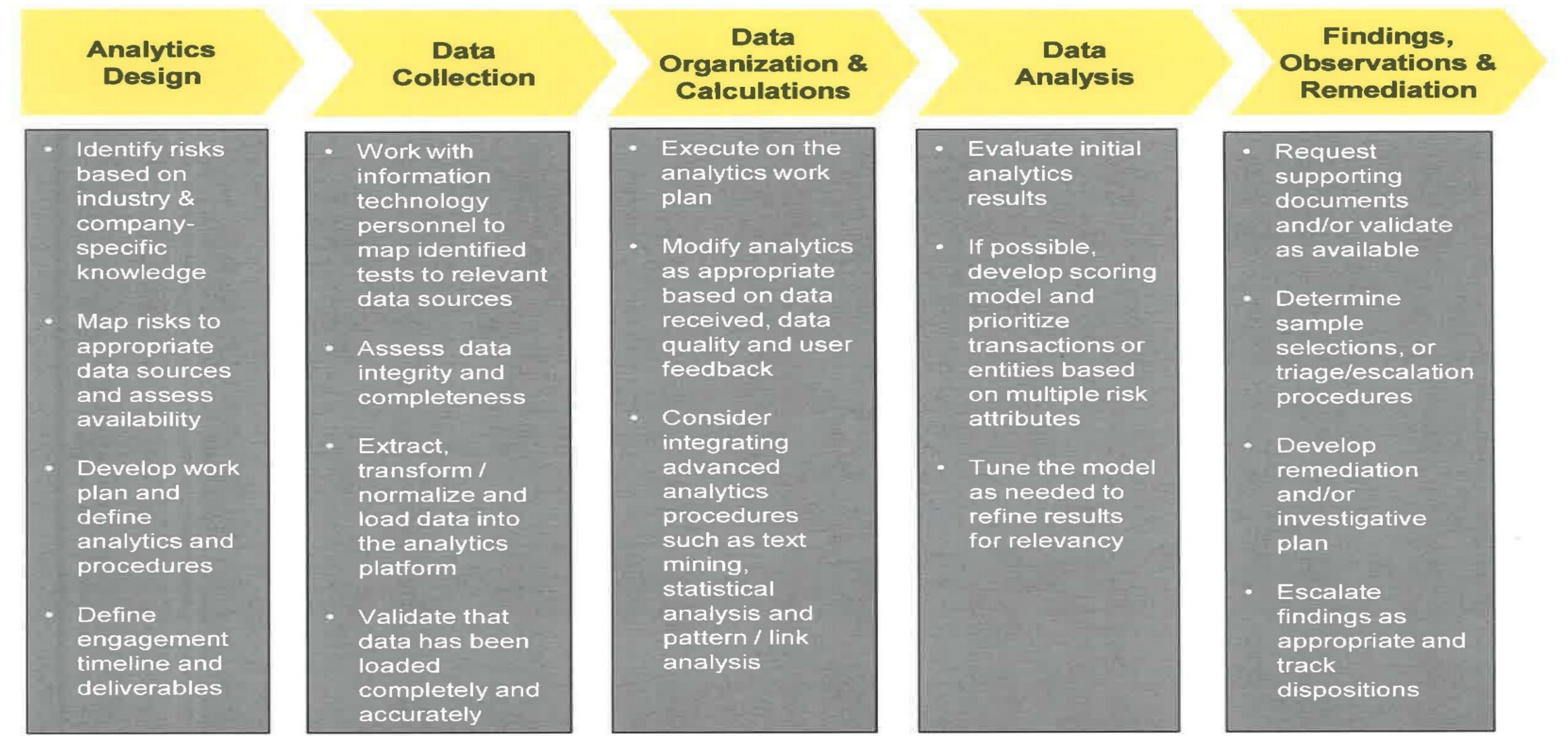


### Analytic Considerations

- Investigative procedures
- Deep dive analysis
- Email and communications review



# Graphic 1: Forensic Data Analytics Process used in COSO guidance



# These are the Big Three

**Figure 59: Median Loss Based on Presence of Anti-Fraud Controls**

Control	Percent of Cases	Control in Place	Control Not in Place	Percent Reduction
Proactive Data Monitoring/Analysis	36.7%	\$92,000	\$200,000	54.0%
Management Review	64.7%	\$100,000	\$200,000	50.0%
Hotline	60.1%	\$100,000	\$200,000	50.0%
Management Certification of Financial Statements	71.9%	\$104,000	\$205,000	49.3%
Surprise Audits	37.8%	\$100,000	\$195,000	48.7%
Dedicated Fraud Department, Function, or Team	41.2%	\$100,000	\$192,000	47.9%
Job Rotation/Mandatory Vacation	19.4%	\$89,000	\$170,000	47.6%
External Audit of Internal Controls over Financial Reporting	67.6%	\$105,000	\$200,000	47.5%
Fraud Training for Managers/Executives	51.3%	\$100,000	\$190,000	47.4%
Fraud Training for Employees	51.6%	\$100,000	\$188,000	46.8%
Formal Fraud Risk Assessments	39.3%	\$100,000	\$187,000	46.5%
Employee Support Programs	56.1%	\$100,000	\$183,000	45.4%
Anti-Fraud Policy	49.6%	\$100,000	\$175,000	42.9%
Internal Audit Department	73.7%	\$123,000	\$215,000	42.8%
Code of Conduct	81.1%	\$120,000	\$200,000	40.0%
Rewards for Whistleblowers	12.1%	\$100,000	\$163,000	38.7%
Independent Audit Committee	62.5%	\$114,000	\$180,000	36.7%
External Audit of Financial Statements	81.7%	\$150,000	\$175,000	14.3%

# MORE THAN JUST A FRAUD RISK ASSESSMENT

**Guidance on establishing an overall fraud risk management program includes:**

- ▶ **Establishing fraud risk governance policies**
- ▶ **Performing a fraud risk assessment**
- ▶ **Designing and deploying fraud prevention and detect control activities**
- ▶ **Conducting investigations**
- ▶ **Monitoring activities**

# Developing a Best in Class Fraud Risk Assessment

Category	High Fraud Potential	Lower Fraud Potential
Management Style	Autocratic	Participative
Management Orientation	Power-Driven	Achievement-Driven
Distribution of Authority	Centralized (Reserved by top)	Decentralized (Dispersed to all levels,delegated)
Planning	Centralized (short range)	Decentralized (long range)
Performance Measures	Quantitatively and on a short term basis	Measured both quantitatively and subjectively
Business Focus	Profit-Focused	Customer-Focused
Management Strategy	Management by Crisis	Management by Objectives
Reporting	Reporting by Exception	Reporting by Routine
Policies and Rules	Rigid and Inflexible (Strongly Policed)	Reasonable (Fairly Enforced)
Customer Satisfaction	Many Complaints	Few Complaints

- Is fraud increasing, decreasing, or staying the same?
- How would you classify the global mood? Optimistic or pessimistic?
- What is fraud?
- Do we audit?
- Values?
- Is it really a mistake?
- If legal says that it is okay, is it okay?

- Find a way to take part in executive- and board-level discussions of strategic risks and strategic risk management.
- As risk management experts, auditors can help not only identify areas of strategic risks, but also recommend how to keep these risks at bay, mitigate them, and take advantage of the opportunities they present.



# Developing a Best in Class Fraud Risk Assessment

- Step 1 - Evaluate Fraud Risk Factors
- > Step 2 - Identify Possible Fraud Schemes and Scenarios
- > Step 3 – Analyze / Prioritize Identified Fraud Risks
- > Step 4 – Evaluate Mitigating Controls

***Auditors have to align risk management practices with anti-fraud measures to maximize protection to the company.***

# FRAUD WORKSHEET

- **Area / Types of Fraud**
- **Fraud / Risk Likelihood**
- **Risk Impact**
- **Perpetrators**
- **Method used to perpetrate**
- **Control Prevent**
- **Control / Detect**
- **Override / Control**
- **Audit Program Step**

# Questions to ask

1. Do your employees, partners and third parties know what constitutes bribery and corruption in your specific organization and industry?
2. Are they familiar with the anti-bribery provisions that apply in the countries and regions where you do business?
3. Can they spot the warning signs and red flags of fraud— both the obvious and subtle ones — they may encounter in their work?

## MORE THAN JUST A FRAUD RISK ASSESSMENT

Guidance on establishing an overall fraud risk management program includes:

- ▶ Establishing fraud risk governance policies
- ▶ Performing a fraud risk assessment
- ▶ Designing and deploying fraud prevention and detect control activities
- ▶ Conducting investigations
- ▶ Monitoring activities

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**THANK YOU**