Fraud Risk Management

22nd July – Abu Dhabi
Fraud Risk Management at a Glance

Agenda

1. Case Studies – Corporate Fraud
2. Key findings from recent surveys
3. What is Fraud?
4. Types of Fraud
5. Why do people commit Fraud?
6. How Fraud can effect you and your organisation
7. Warning Signs
8. What can you do?
9. Typical Anti-Fraud Techniques
Case Studies – Corporate Fraud
Deutsche Bank was fined a record $2.5 billion by US and UK authorities for its role in an interest scam between 2003 and 2007. The bank's London subsidiary pleaded guilty to counts of criminal wire fraud, after it was accused of fixing interest rates like the London Interbank Offered Rate (Libor), used to price a hefty amount of loans and contracts across the world. Deutsche Bank and other large Banks had profited from transactions made using the fixed interest rates.

Wells Fargo & Company, an American multinational financial services company, was fined USD 185 million including a penalty of USD 100 million from the United States Consumer Financial Protection Bureau for engaging in improper activities by opening/applying for over 3.5 million bank accounts and credit cards without the customers knowledge or approval. The company has faced and faces additional civil and criminal suits reaching an estimated $2.7 billion by the end of 2018.

A Toys R Us Employee of 23 years, seen as steady and reliable, was able to secretly siphon off almost £3.7 million from the children's retailer to buy homes and luxury cars. The "accounts payable manager" at the retailer, diverted regular instalments of £300,000 to an account of a fictitious toy manufacturer which he controlled. He was finally caught following an investigation into the companies and sentenced to eight years in prison, plus repayment of the funds stolen.
Key findings from recent surveys
Key Findings From Recent Surveys

2,690 real cases of occupational fraud

$7 BILLION+ in total losses

$130,000 median loss per case

16 months median duration of a fraud scheme

22% of cases caused losses of $1 million or more

Corruption was the most common scheme in every region.

125 countries

23 industry categories

TIPS are by far the most common initial detection method

$800,000 median loss

$14,000 median loss from Insider Activity

Financial statement fraud schemes are the most common and most costly

60% of cases

Small businesses lost almost twice as much as the median loss from fraud

$104,000 Median loss

$200,000 Median loss

$850,000

Fraudsters who had been with their company longer stole twice as much

85% of fraudsters

45% of companies

10% of companies

Over the past 10 years, occupational fraud referrals to prosecution declined 16%

Fraud conviction only 4%

A majority of the victims recovered nothing

Source: Report to the Nations 2018 - ACFE
Key Findings From Recent Surveys

Source: Report to the Nations 2018 - ACFE
What is Fraud?
In the broadest sense, fraud can encompass any crime for gain that uses deception as its principal modus operandi. More specifically, fraud is defined by Black’s Law Dictionary as:

*A knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment.*

Consequently, fraud includes any intentional or deliberate act to deprive another of property or money by guile, deception, or other unfair means.

**Association of Certified Fraud Examiners (ACFE) – Fraud 101**
Types of Fraud
Types of Fraud

Fraud may be attempted in all organizations notwithstanding its size, industry or country and having valuable property including cash, goods, information or services.

<table>
<thead>
<tr>
<th>Internal Fraud</th>
<th>External Fraud</th>
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<tr>
<td>• Internal Fraud is also known as Occupational Fraud.</td>
<td>• Committed by customers, vendors and other parties.</td>
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<tr>
<td>• Committed by Employees, Managers, Officers or Owners of the company.</td>
<td>• External Fraud includes hacking, theft of proprietary information, tax fraud, bankruptcy fraud, insurance fraud, healthcare fraud, and loan fraud</td>
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<td>• Asset Misappropriation (theft, false invoicing, payroll fraud etc.), fraudulent statements (financial statements), corruption (bribes, kickbacks).</td>
<td>• Procurement related Fraud.</td>
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Asset Misappropriation

Schemes in which the employee steals or misuses an organization’s assets. Below are some examples:

• Skimming cash receipts
• Falsifying refunds
• Fraudulent Disbursements
  • Cheque Tampering
  • Expense Reimbursement
  • Payroll
• Inventory Fraud Schemes
Corruption

Schemes in which a fraudster wrongfully uses his influence in a business transaction for the purpose of obtaining a benefit for himself or another person

- Bribery
- Conflict of interests
- Illegal gratuities
Fraudulent statements

Fraud schemes involving the intentional misreporting of an organization’s financial/non-financial information with the intent to mislead others. Such as:

• Creating fictitious revenue

• Concealing liabilities or revenue
Other common types of Fraud

- Abuse of company time and resources
- Unauthorized computer access to restricted areas
- Divulging corporate information
- Giving friends of relatives unauthorized discounts on company merchandise or services
Common Fraud by Vendors

- Bid-rigging
- Price-fixing
- Overbilling
- Kickbacks
- Shell companies
Why do people commit Fraud?
The Fraud triangle is a framework designed to explain the reasoning behind a person’s decision to commit fraud.

**Opportunity:**
A weak internal control system, poor security over company property, little fear of exposure and likelihood of detection, or unclear behavioural policies.

**Pressure:**
Generally based on greed or need.

**Rationalization:**
Certain people rationalise fraudulent actions based as necessary; harmless or justified.
Why do people commit Fraud?

**Pressure**
- Personal debt or poor credit
- Pressure of targets
- A significant financial loss
- A gambling or drug habit
- Peer or family pressure to succeed

**Rationalisation**
- The company will benefit.
- I had to make the targets that I had been given.
- I’ve been working with the company for 15 years. They owe it to me.
- I deserve this after the way the company has treated me.
- The impact to the company is small, so it won’t make an impact.

**Opportunity**
- Poor internal controls
- Lack of supervision
- Poor record keeping
- Extreme trust in a single individual
- Lack of disciplinary action for previous fraud
How Fraud can affect you and your organisation
How Fraud can affect you and your organisation

- Company goes out of business
- Negative publicity for the company and damage to reputation
- Fines and imprisonment
- Loss of business/customers
- Loss of trust – which can often never be regained
- Fewer pay increases
- Increased layoffs
- Further increased pressure to increase sales and revenue
- Decreases in employee benefits
- Low employee morale
Warning signs
Warning signs of Fraud – Gaps in your Organisation

How robust are the controls & policies in the organization?

Has the organization identified the potential frauds & mitigated / treated them via suitable means?

How well do you know vendors, employees & other organizational participants?

Are there functions / processes that have a key bearing on the organization that I don’t have any visibility of?

Are the procedures of statutory & internal auditors focused towards identifying potential frauds?

Do I have adequate procedural documentation in place to act as deterrent and aid detection and cure of frauds?

Is my organization compliant under Foreign Corrupt Practices Act (FCPA), UK Bribery and other relevant laws?

Are the entity level policies in place and has related training been imparted to all organizational participants?
Warning signs of Fraud – Red Flags

- Employees living beyond their means
- A close personal relationship with vendors or customers
- An unwillingness to share duties
- A refusal to take vacations
- Complaints about low pay
- Family problems
- Excessive pressure within the company
- Rule breakers
What can you do?
What can you do?

**Fraud Risk Management Program**

Risk Management is defined as a process of understanding and managing risks that organizations are subjected to in endeavouring to achieve its objectives. A constructive business driven fraud risk management framework and approach including anti-fraud initiatives provides an organization tools to manage the risk in a manner consistent with regulatory requirements as well as the entity’s business needs and market place expectation.
The Fraud Risk Management Principles correlates with the 2013 COSO Frameworks 17 internal control principles and 5 internal control components which COSO established in 1992.
Anti-Fraud Strategy

An effective Anti-Fraud Strategy has four key components – prevention, detection, deterrence and response, which are closely interlinked and play a significant role in combating fraud.
Anti-Fraud Strategy Components

Fraud Deterrence

Prevention
- Fraud Policy and Framework
- A sound ethical culture
- Effective internal controls

Detection
- Detection methods
- Indicators and warning signs
- Tools and techniques

Response
- Fraud Response Plan
- Responsibility for Action
- Approach to be taken
Typical Anti-Fraud Techniques
Typical Techniques being considered by companies

**Cost Benchmarking**
Validate costs incurred to other Companies and assess potential for Company’s cost saving & profitability increase

**ERM (end to end risk management)**
Control process with change in model & scale of operations via identifying, measuring, managing & monitoring risk

**Tracing (Capex, stock & labor)**
Surprise verification of assets etc. and complete tracing to reported details with gap identification

**Internal Audit**
Risk based periodical check of business based on existing policies & control framework

**E-discovery (Hard disks & emails)**
Identify fraudulent activities by employees with or without collusion with vendors via review of Hard disk, email data & paper records

**Market Intelligence**
Identify vendor & employee relations | Identify fair market price of Company expenses | Cost saving & control

**Whistleblower Program**
Whistleblower policy framework | Whistleblower hotline & with complaints response & action plan
Case 1 – Real Estate Co.

Owners Expectation

- Standard Operating Procedures to ensure better internal controls over the operations and financial reporting.
- Recommended to carry out a Gap Analysis, support with drafting of SOP's

Execution Strategy

- Walkthrough with stakeholders for the leasing process, maintenance process, inventory process and finance process
- Perform Financial Analytics
- Perform Substantive test
- Perform Tracing and mystery checks on properties

Key Findings

- Commissions paid out to leasing agents without documentary proof (agent, unit, etc.)
- Units handed over without maintenance, however maintenance supplies being used for respective unit
- Units shown vacant in the system but occupied at time surprise check.

Success

- Reduction in commission payout to leasing agents of AED 1 Million
- Reduction in overall maintenance cost of AED 3.5 Million
- Increase in revenue from units that were fraudulently leased out by certain employees.
Case 1 – Key Findings

Mystery checking of apartments:
Case 2 – Trading Co. for Organic Products

Owners Expectation
- Co. commenced operations in 2017, owner never received any reports from management
- Management blamed one another and owner wanted to resolve and put proper practices in place
- Assignment to perform Process Re-engineering and control analysis

Execution Strategy
- Walkthrough with stakeholders for inventory and finance
- Perform Financial Analytics
- Perform Substantive test
- Perform surprise checks in warehouse

Key Findings
- No controls over inventory management in warehouse, such as following the FIFO process or ailing of stock - resulting in huge quantity expiry of products
- Huge Stock variations as per physical stock and books
- Stocks were repacked and sold in the market

Success
- Storekeeper hired to maintain stock and proper systems put in place
- Inventory that was repacked was called back from all Merchandisers and destroyed, Loss of AED 1.25 Million
Case 2 – Key Findings

Surprise check of warehouse:
Case 3 – Man Power Supply Company

Owners Expectation

- The company provides man power to various construction company’s with over 6,000 employees on the payroll
- The assignment was to carry out an Internal Audit

Execution Strategy

- Performing a walkthrough with the HR department to understand the process
- Performing Financial Analytics
- Performing Substantive tests on Salary payouts

Key Findings

- The laborers were paid food allowances irrespective of Attendance resulting into excess payments ; and
- Few employees having duplicate Employee code were discovered
- In absence of written policies for Bonus, many decisions were at the discretion of payroll in charge.

Success

- The excess amount of AED 600K paid is being recovered from employee salary’s.
- Implemented controls to mitigate SOD deviation.
- Implemented written standard HR and Payroll policies to strengthen the way of workings.
Case 4 – Ice Cream Distribution Co.

Owners Expectation

- Analysis to understand the wastage in distribution of Ice creams
- Recommended to carry out a Analytical Review of entire process along with benchmarking with the industry

Execution Strategy

- Walkthrough with stakeholders for distribution process, inventory and finance
- Perform Financial Analytics
- Perform Substantive test
- Perform Mystery checks in warehouse, Food trucks and Kiosks

Key Findings

- Commissions paid to Schools without contract / agreement or documentary proof
- Huge Stock variations as per physical stock and books
- Stocks adjusted as wastage by Finance Manager and Store keeper
- External Serving cups and other brand ice creams were found at the time of surprise checks of the Food trucks.

Success

- Agreements made to formalize commission payments
- Wastages on account of fraudulent activities by the employees and reduction in was 3%
- Reduction in overall wastage
Case 4 – Key Findings

Surprise check of Food Trucks:
Case 5 – Hotel based in Sharjah

**Owners Expectation**

- Analysis to understand expenses incurred in the pre-opening phase due to delay of Opening Date of Hotel.
- Review of the complex arrangement made between two hotels.
- Assignment to perform pre-opening review and carry out an Internal Audit.

**Execution Strategy**

- Walkthrough with stakeholders of all critical departments of the Hotel
- Perform Financial Analytics
- Perform Substantive test
- Perform Mystery checks in Rooms and Kitchen Inventory

**Key Findings**

- Salary paid to Complex Spa & Recreation employee even though the Hotel does not have a Spa & Recreation department.
- Complex expenses paid to the Complex General Manager not recorded in books.
- Accounting entries with unclear line descriptions.
- No Inventory maintained for Housekeeping supplies.

**Success**

- Spa & Recreation employee removed from the Complex payroll
- Complex expenses paid to Complex Manager recorded in the books of accounts of the Hotel
- Verification of Accounting entries on a weekly basis
- Inventory log for housekeeping supplies provided to Hotel associates
Thank you