Fraud risk in difficult economies

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Welcome

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Agenda

– Fraud statistics
– Fraud risk in difficult economies
– Fraud risk management
– Response and moving forward
Findings from the 2016 ACFE Report to the Nations
ACFE Fraud study

2016 Report to the Nations

The Costs of Fraud

– Estimates that organizations lose 5% of annual revenue to fraud
– Median losses are $150,000 ($154,000 in Canada)
– More than 23% of cases caused losses greater than $1M
– The frauds reported lasted a median of 18 months before being detected
– 58% of victim organizations had not recovered any losses that they suffered, and only 12% had made full recovery
– 8.4% of victim organizations also received fines from authorities

Source: 2016 Report to the Nations on Occupational Fraud and Abuse. © 2016 by the Association of Certified Fraud Examiners, Inc.
Most common red flags

- Living beyond one’s means (46%)
- Financial difficulties (30%)
- Unusually close relationships with vendors/customers (20%)
- Control issues, unwilling to share duties (15%)

Organizations that had anti-fraud controls in place had significantly lower losses and time-to-detection than organizations without such controls

Source: 2016 Report to the Nations on Occupational Fraud and Abuse. © 2016 by the Association of Certified Fraud Examiners, Inc.
ACFE Fraud study

Frequency and Median Loss of Victims

Figure 38: Type of Victim Organization—Frequency and Median Loss

Source: 2016 Report to the Nations on Occupational Fraud and Abuse. © 2016 by the Association of Certified Fraud Examiners, Inc.
ACFE Fraud study

Frequency of Fraud Schemes by Industry

Source: 2016 Report to the Nations on Occupational Fraud and Abuse. © 2016 by the Association of Certified Fraud Examiners, Inc.
Fraud risk in difficult economies
The Fraud Triangle

Lack of effective oversight

Poor controls

Opportunity

Lack of segregation of duties

Motive

“Others do it and no one seems to care”

“I’ll never get caught”

“They can afford it”

“I am just “borrowing” the money, I will pay it back later”

Family pressures

Revenge

Debts

“Results at any cost”

Poor corporate governance

Debts

Family pressures

“Results at any cost”
The fraud prevention balancing act

Preventative Measures
- Internal Controls
- Audits and Testing

Pressures
- Staff Reductions
- Conservation & Reduced Capacity
- Financial Results and Covenants
Financial pressure is a powerful motive

- Results-based compensation
- External forces, like a spouse being laid off and family income being reduced
- Such individual pressures can lead to:
  - Fraudulent financial reporting (because of threat to personal compensation)
  - Asset misappropriation
Fraud increases during difficult economies

Change in Number of Frauds Observed During Last Year

- Significant increase: 18.1%
- Slight increase: 37.3%
- Approximately the same: 28.8%
- Slight decrease: 4.7%
- Significant decrease: 2.8%

ACFE 2009 Survey

Employee fraud is the greatest threat

Layoffs can leave holes in internal control systems

Effect of Layoffs on Internal Controls

- Increased controls: 3.2%
- No effect on controls: 44.2%
- Eliminated some controls: 34.4%

Fraud risk management
**FRM objectives**

**Prevention**
- Reduce the risk of fraud and misconduct from occurring
- Internal controls prevent and deter

**Detection**
- Discover fraud and misconduct when it occurs
- Testing and oversight are key

**Response**
- Take corrective action and remedy the harm caused by fraud or misconduct
Preventative controls are designed to deter fraud from occurring in the first place

- Leadership and governance
- Fraud risk assessment
- Code of conduct
- Communication and training
- Process-specific fraud risk controls
- Employee and third party due diligence

- Sets the tone for overall control culture
- Raises awareness of Management’s commitment to integrity
- Resources available to help employees achieve Management’s compliance goals
- CPA Canada 20 Questions Series

- Scope and depth varies based on risk and function
- Especially important for those having financial responsibility
A well designed hotline provides:

- Confidentiality and anonymity
- Organization-wide availability
- "Real time" assistance
- Classification of concerns
- Audit Committee notification
- Follow-up
- Prominent communication
Internal control considerations

**Did the former staff member perform important control functions?**
- Ensure that mitigating controls are put in place

**Is there sufficient and compensating management oversight?**
- Consider the need for increased management review of critical control areas

**Can electronic tools be used to compensate for reduced human-based controls?**
- Explore the use of active data analytics and proactive data monitoring/analysis
### Impact of anti-fraud controls

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

<table>
<thead>
<tr>
<th>Control</th>
<th>Percent of Cases</th>
<th>Control in Place</th>
<th>Control Not in Place</th>
<th>Percent Reduction</th>
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</thead>
<tbody>
<tr>
<td>Proactive Data Monitoring/Analysis</td>
<td>36.7%</td>
<td>$92,000</td>
<td>$200,000</td>
<td>54.0%</td>
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<td>Management Review</td>
<td>64.7%</td>
<td>$100,000</td>
<td>$200,000</td>
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<td>Hotline</td>
<td>60.1%</td>
<td>$100,000</td>
<td>$200,000</td>
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<tr>
<td>Management Certification of Financial Statements</td>
<td>71.9%</td>
<td>$104,000</td>
<td>$205,000</td>
<td>49.3%</td>
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<tr>
<td>Surprise Audits</td>
<td>37.0%</td>
<td>$100,000</td>
<td>$195,000</td>
<td>48.7%</td>
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<td>Dedicated Fraud Department, Function, or Team</td>
<td>41.2%</td>
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<td>$192,000</td>
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<td>Job Rotation/Mandatory Vacation</td>
<td>19.4%</td>
<td>$82,000</td>
<td>$170,000</td>
<td>47.6%</td>
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<tr>
<td>External Audit of Internal Controls over Financial Reporting</td>
<td>67.6%</td>
<td>$105,000</td>
<td>$200,000</td>
<td>47.5%</td>
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<tr>
<td>Fraud Training for Managers/Executives</td>
<td>51.3%</td>
<td>$100,000</td>
<td>$190,000</td>
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<tr>
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<td>$100,000</td>
<td>$188,000</td>
<td>46.8%</td>
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<td>Formal Fraud Risk Assessments</td>
<td>39.3%</td>
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<td>$187,000</td>
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<td>Employee Support Programs</td>
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<td>$100,000</td>
<td>$183,000</td>
<td>45.4%</td>
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<tr>
<td>Anti-Fraud Policy</td>
<td>49.8%</td>
<td>$100,000</td>
<td>$175,000</td>
<td>42.9%</td>
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<tr>
<td>Internal Audit Department</td>
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<td>Code of Conduct</td>
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<td>$200,000</td>
<td>40.0%</td>
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<td>Rewards for Whistleblowers</td>
<td>12.1%</td>
<td>$100,000</td>
<td>$163,000</td>
<td>38.7%</td>
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<td>Independent Audit Committee</td>
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<td>$114,000</td>
<td>$180,000</td>
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<td>External Audit of Financial Statements</td>
<td>81.7%</td>
<td>$150,000</td>
<td>$275,000</td>
<td>44.3%</td>
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Impact of anti-fraud controls

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Response and moving forward
Response

Investigations
- Comprehensive and objective
- Determine your goals

Enforcement and accountability
- Consistent and credible discipline is a key deterrence control

Corrective action
- Learn from the experience
What to do when fraud is suspected

- Get qualified and experienced advice before you do anything
- Consult legal counsel
- Get appropriate investigative assistance
- Take steps with professionals to secure relevant records (hard copy and electronic)
- Handle the matter with discretion until the facts are clear
- Decide on objectives
- Develop and investigation plan and strategy
- Consider removing the employee (after consulting legal and investigative team first) if an employee is suspected
- Notify insurer
What not to do!

– Do not confront the suspected employee
– Do not start rummaging around and “investigating”
– Do not copy or attempt to access emails or computer data without the assistance of qualified experts and advice
– Do not start conducting interviews without a plan of action and advice
– Do not terminate or suspend the employee
Closing thoughts

- Fraud risk increases in difficult economies
- Be proactive and take steps to understand and mitigate the risk of fraud
- Be aware of and respond to red flags (trust your own intuition)
- Be diligent when you are reviewing and approving invoices, payments, expense reports, time cards, payroll (don’t be the “rubber stamp”)
- Understand the information being provided in management and financial reports and take the time to review and question that information
- Understand the policies and controls in place and avoid steps that circumvent those controls (don’t be an unsuspecting contributor to fraud)
- If you suspect fraud, a well planned response is critical
Questions?
Contact us

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Thank you

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