

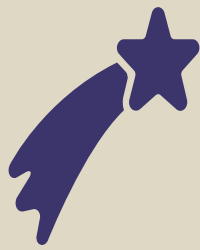


IDENTIFYING FRAUD RISK

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Course Objectives

- **Defining Occupational Fraud**
- **Fraud Fast Facts**
- **Conducting a Fraud Risk Assessment**



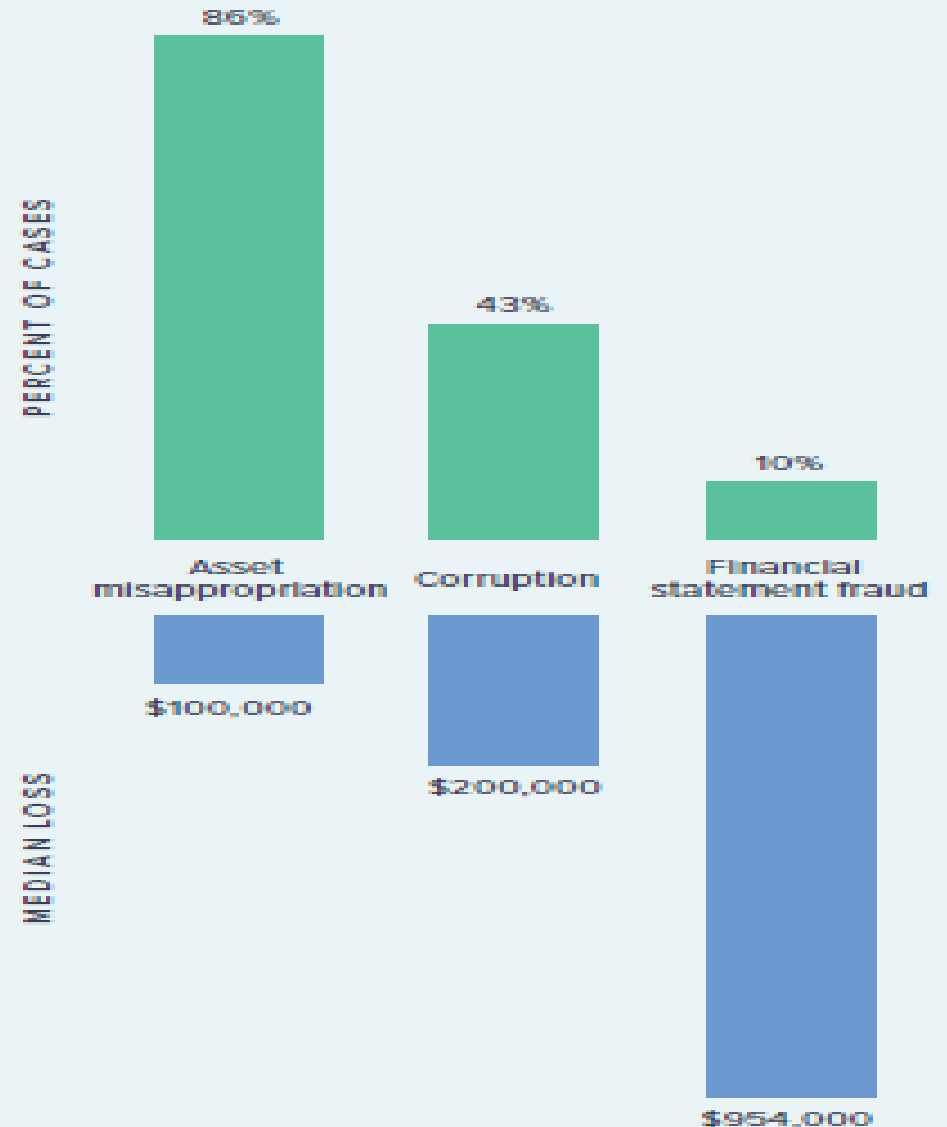
OCCUPATIONAL FRAUD DEFINED

Occupational fraud is formally defined as the use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets.

The three essential categories of occupational fraud are:

- Asset misappropriation
- Corruption / Illegal Acts
- Financial Statement Fraud

FIG. 2 How is occupational fraud committed?



Asset Misappropriation

Theft of Cash on Hand

Fraudulent Disbursement

- Billing schemes
- Payroll schemes

Misuse of Inventory

- Personal Use of Company Property, tangible or intangible

Corruption / Illegal Acts

Conflicts of Interest

Bribery

Illegal Gratuities

Economic Extortion

Financial Statement Fraud

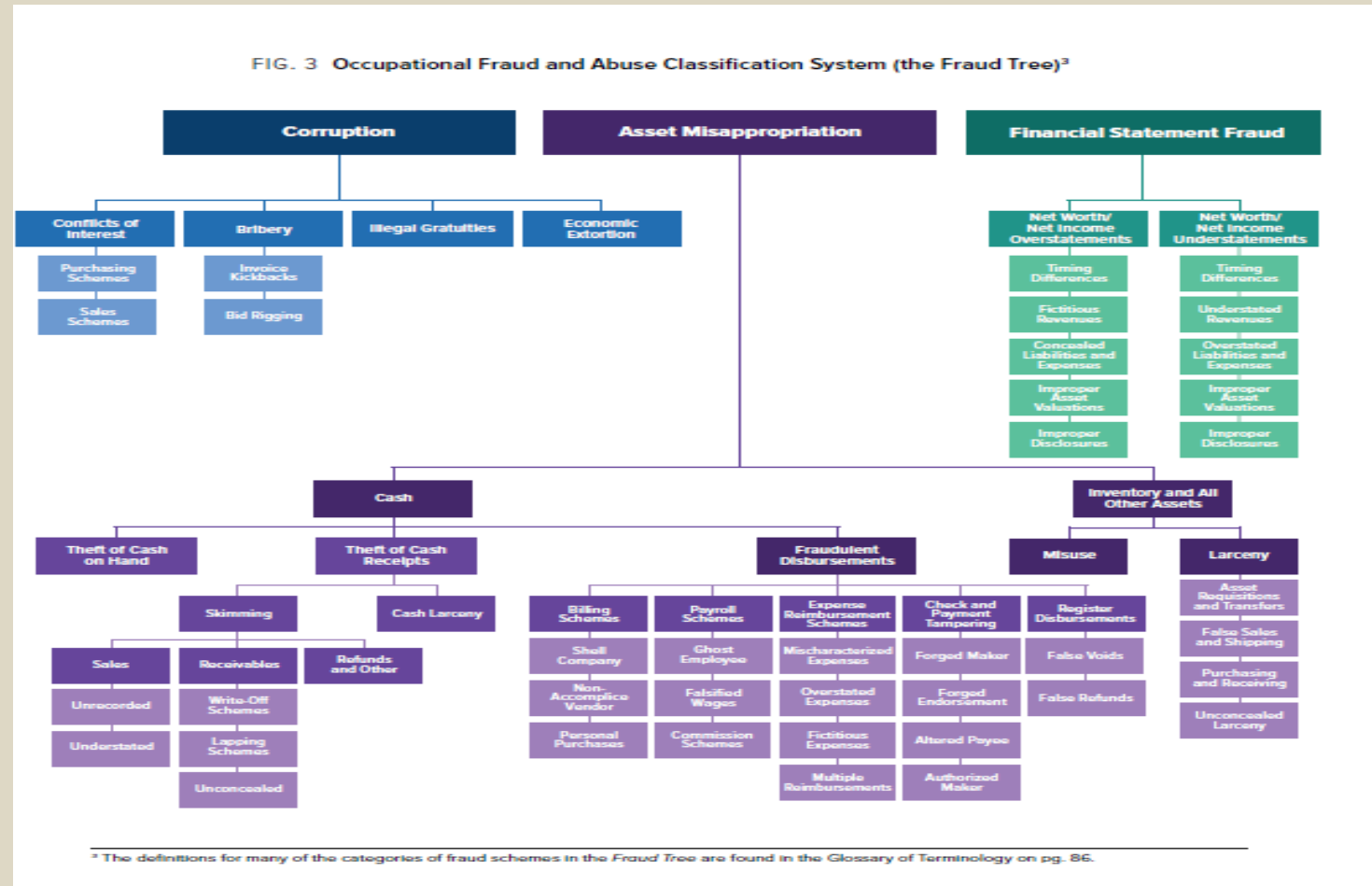
Net worth / Net income
overstatements

- Timing Differences
- Fictitious Revenues
- Concealed Liabilities and Expenses

Net worth / Net income
understatements

- Timing Differences
- Understated Revenues
- Overstated Liabilities and Expenses

Occupational Fraud Classification System

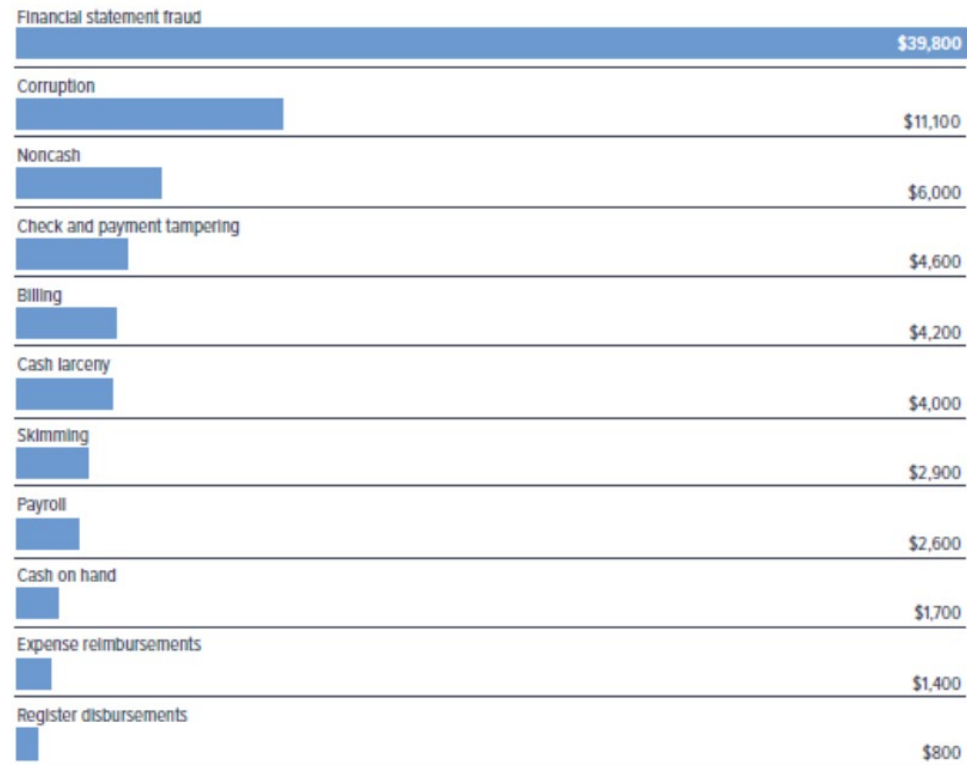


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FIG. 8 What is the typical velocity (median loss per month) of different occupational fraud schemes?



How Occupational Fraud Is Concealed

Understanding the methods fraudsters use to conceal their crimes can assist organizations in more effectively detecting and preventing similar schemes in the future.

TOP 4 CONCEALMENT METHODS USED BY FRAUDSTERS



40%

Created fraudulent physical documents



36%

Altered physical documents



27%

Altered electronic documents or files



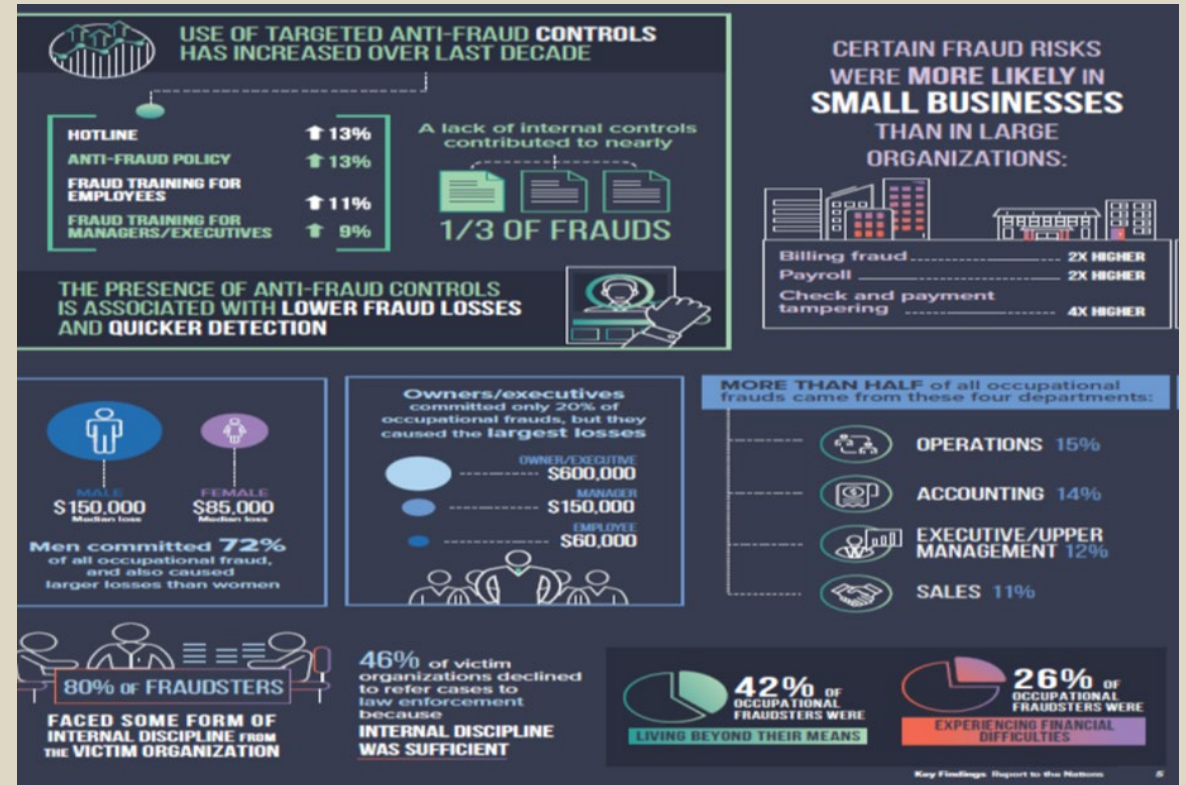
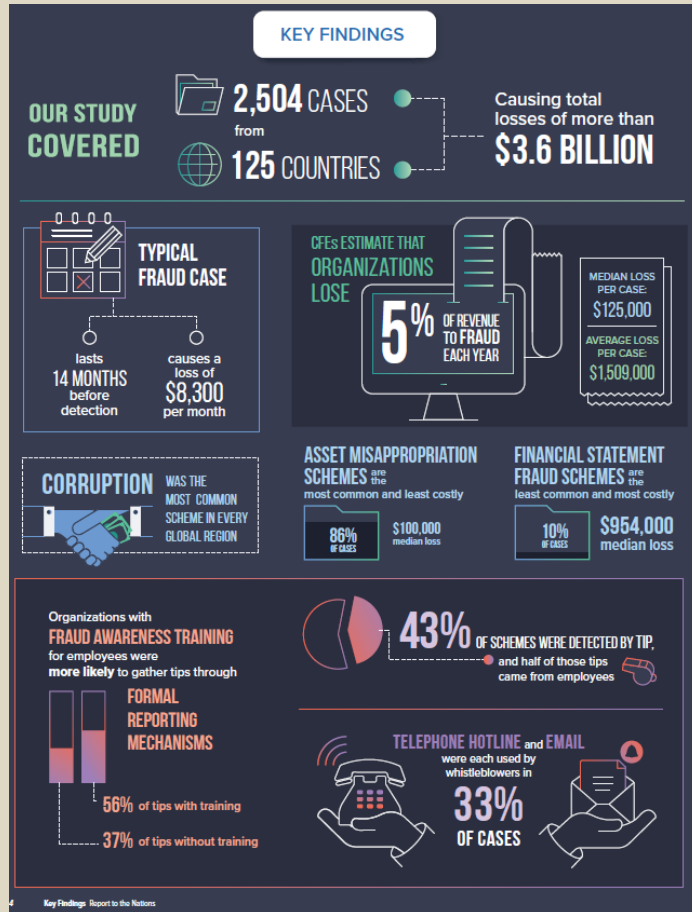
26%

Created fraudulent electronic documents or files



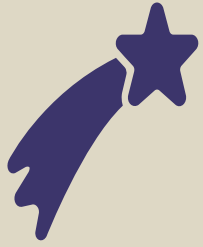
12% did not involve any attempts to conceal the fraud

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FRAUD RISK ASSESSMENT

A key tool to identifying fraud risk

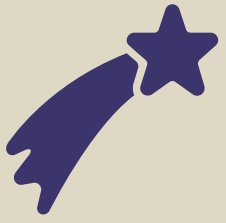


FRAUD RISK ASSESSMENT

A fraud risk assessment is aimed at proactively addressing a business's vulnerabilities to internal and external fraud.

Though types of fraud vary by business line, internal frauds include embezzlement and misappropriation of assets, while external frauds include hacking and theft of proprietary information.

Commonly, perpetrators commit fraud due to weaknesses in internal controls.



How Does a Fraud Risk Assessment Work?

A fraud risk assessment should be tailored to an organization's unique industry and operations.

Management and managers responsible for each department should perform a risk assessment by examining the organization's exposure to fraud risk events. Because changes in the internal and external environment are certain, the assessment should be refreshed regularly to mitigate risks to an acceptable level.

The fraud risk assessment can take many forms:

Matrix

Narrative

Survey

The assessment should be shared with the Board of Directors and other applicable Agency Stakeholders, and jointly, all parties should implement anti-fraud controls based on the likelihood and impact each risk will have on the organization.

Why Is a Fraud Risk Assessment Important?

A fraud risk assessment is essential in helping businesses proactively identify external and internal risks that can have a significant impact on their reputation, exposure to criminal or civil liability, and assets.

Once these fraud risks have been identified, companies can develop a mitigation strategy.

While it's impossible to eliminate all fraud risks, a fraud risk assessment is a powerful tool in reducing the probability and severity of those risks.

What Should a Fraud Risk Assessment Address?

The fraud risk assessment should address four key areas:

- Asset misappropriation
- Corruption / illegal acts
- Financial and nonfinancial reporting
- Regulatory compliance areas

What Should a Fraud Risk Assessment Address?

Asset Misappropriation

- In general, cash, inventory, and company assets are subject to misappropriation and must be examined for potential skimming, larceny, and fraudulent disbursements. Asset misappropriation is also more than theft or embezzlement — employees who use company equipment, such as computers, for their personal benefit are engaging in misappropriation.

Corruption / Illegal Acts

- Fraud is fundamentally an illegal act, and auditors should maintain sufficient knowledge of the characteristics and indicators of fraud, techniques used to commit fraud, and types of fraud associated with the activities being audited. The fraud risk assessment is an excellent tool in helping audit, risk, and compliance professionals provide reasonable assurance in preventing and detecting fraud.

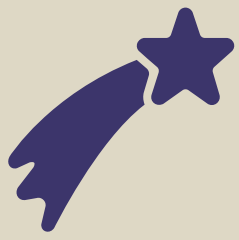
What Should a Fraud Risk Assessment Address, Cont'd?

Financial and Non-financial Reporting

- Inconsistency between financial and nonfinancial information can reflect internal fraud. Commonly carried out by management by overriding internal controls, fraud in the financial statements can include overstating revenues, profits, and assets; and understating expenses, losses, and liabilities. Auditors should analyze such as the number of facilities/stores, the number of customer accounts, and the number of employees.

Regulatory Compliance Areas

- As business risk becomes increasingly complex due to external risks like the coronavirus crisis, auditors must maintain a watchful eye on the relationship between a company's risk of fraud and their compliance efforts. A recent report by Ernst & Young found that the risk of fraud can spike during global events like the pandemic, leading to decreases in compliance activity. Investigate the compliance activities of the organization — is compliance merely a “check-the-box” exercise, or is it a genuine effort at creating a culture of integrity?



5 Simple Steps to Conduct a Fraud Risk Assessment

Step 1: Identify Risks

- Identifying risks most relevant to the organization is a key first step in conducting a fraud risk assessment. Factors that influence fraud risk include:
 - The nature of the business and environment in which it operates.
 - The effectiveness of internal controls.
 - The ethics and values of the company and its employees.
- It's important to evaluate which people and departments are most likely to commit fraud and identify the methods they are likely to use. Examine incentives, pressures, and opportunities to commit fraud; antifraud controls already in place; risk of management to override controls; risk of regulatory and legal misconduct; and risk to information technology. Identifying these factors will enable you to create a successful risk management plan.

Step 2: Quantify Risks

- Assess the likelihood of occurrence of the identified risks and significance to the organization. A risk assessment matrix, also known as a probability and severity matrix, can be a helpful tool in quantifying risks and evaluating their impact.
- When assessing likelihood, you should consider:
 - Prevalence of the fraud risk in the organization's industry.
 - Number of individual transactions involved and complexity of the fraud risk.
 - Number of people involved in approving and reviewing the relevant process.
- When assessing significance, be sure to consider:
 - Financial condition of the organization.
 - Value and criticality of threatened assets.
 - Criminal, civil, and regulatory liabilities.



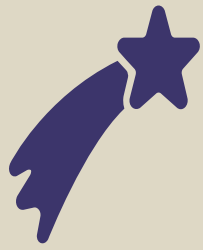
5 Simple Steps to Conduct a Fraud Risk Assessment, Cont'd.

Step 3: Respond to Risks

- Once risks have been quantified, decide on a mitigation strategy and who will be responsible for its implementation. Every organization must establish an acceptable level of risk based on a thorough cost benefit analysis.
- When deciding on how to respond to risks, an organization may choose to:
 - **Avoid the risk** by terminating the activity.
 - **Transfer the risk** and its financial consequences to a third party.
 - **Mitigate the risk** by reducing its likelihood and impact.
 - **Assume the risk** because the cost of mitigating it isn't worth it.
- Remember that putting internal controls in place is one of the most effective mitigation strategies an organization can use. The risk of asset misappropriation is a lot easier to reduce when a company is rigorous about segregation of duties, for example.

Step 4: Monitor and Review Risks

- As with any risk management strategy, there is no such thing as a one-and-done approach to fraud risk assessment. A process that requires ongoing monitoring and review, the fraud risk assessment must be refreshed to respond to the changing risk environment. Not only can new fraud risks appear due to changes in the risk universe, but their impact can change also.



5 Simple Steps to Conduct a Fraud Risk Assessment, Cont'd.

Step 5: Report Risks

- By using a tailored and comprehensive fraud risk assessment approach, an organization will be able to avoid another important risk: missing valuable information and obtaining unreliable results. When communicating the results of a fraud risk assessment, stay objective, identify actions that are clear and measurable to drive results, and recommend control activities that reduce the risk of fraud.

How Can I Strengthen My Fraud Risk Assessment Process?

Whether your company has instituted an enterprise-wide fraud risk assessment or started in one business area and built out the program over time, a best-in-class fraud risk assessment must take a deep dive into how to improve current processes. Some questions to consider in your deep dive include:

What are my company's top risks?

What controls are already in place, and how effective are they?

What are the key gaps and vulnerabilities in my organization?

Who are the key stakeholders that should be involved in my fraud risk assessment?

How can my company strategically integrate its fraud risk strategy across departments?

Sources:

- *Report to the Nations—2020 Global Study on Occupational Fraud and Abuse*
 - Association of Certified Fraud Examiners
- *What Is a Fraud Risk Assessment? And Why Do I Need One?*
 - Auditboard.com
 - <https://www.auditboard.com/blog/what-is-fraud-risk-assessment/>



Questions? Comments?

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