



FEBRUARY 26 – 27, 2015
Oklahoma Conference on
NONPROFIT LAW & FINANCE
For Funders, Nonprofits and Professional Advisors

Fraud Deterrence, Prevention and Detection

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DAVID L. COTTON, CPA, CFE, CGFM
COTTON & COMPANY LLP CHAIRMAN

Dave Cotton is chairman of Cotton & Company LLP, Certified Public Accountants. Cotton & Company is headquartered in Alexandria, Virginia. The firm was founded in 1981 and has a practice concentration in assisting Federal and State government agencies, inspectors general, and government grantees and contractors with a variety of government program-related assurance and advisory services. Cotton & Company has performed grant and contract, indirect cost rate, financial statement, financial related, and performance audits for more than two dozen Federal inspectors general as well as numerous other Federal and State agencies and programs.

Cotton & Company's Federal agency audit clients have included the U.S. Government Accountability Office, the U.S. Navy, the U.S. House of Representatives, the U.S. Capitol Police, the U.S. Small Business Administration, the U.S. Bureau of Prisons, the Millennium Challenge Corporation, the U.S. Marshals Service, and the Bureau of Alcohol, Tobacco, Firearms and Explosives. Cotton & Company also assists numerous Federal agencies in preparing financial statements and improving financial management, accounting, and internal control systems.

Dave received a BS in mechanical engineering (1971) and an MBA in management science and labor relations (1972) from Lehigh University in Bethlehem, PA. He also pursued graduate studies in accounting and auditing at the University of Chicago, Graduate School of Business (1977 to 1978). He is a Certified Public Accountant (CPA), Certified Fraud Examiner (CFE), and Certified Government Financial Manager (CGFM).

Dave served on the Advisory Council on Government Auditing Standards (the Council advises the United States Comptroller General on promulgation of **Government Auditing Standards**—GAO's yellow book) from 2006 to 2009. He served on the Institute of Internal Auditors (IIA) Anti-Fraud Programs and Controls Task Force and co-authored **Managing the Business Risk of Fraud: A Practical Guide**. He served on the American Institute of CPAs Anti-Fraud Task Force and co-authored **Management Override: The Achilles Heel of Fraud Prevention**. He is the past-chairman of the AICPA Federal Accounting and Auditing Subcommittee and has served on the AICPA Governmental Accounting and Auditing Committee and the Government Technical Standards Subcommittee of the AICPA Professional Ethics Executive Committee. He authored the AICPA's 8-hour continuing professional education course, **Joint and Indirect Cost Allocations—How to Prepare and Audit Them**. He is presently serving on the AICPA's Performance Audit Standards Task Force and the Fraud Risk Guide Task Force, sponsored by COSO and the ACFE.

Dave served on the board of the Virginia Society of Certified Public Accountants (VSCPA) and on the VSCPA Litigation Services Committee, Professional Ethics Committee, Quality Review Committee, and Governmental Accounting and Auditing Committee. He is member of the Greater Washington Society of CPAs (GWSCPA). He is a member of the Association of Government Accountants (AGA) and past-advisory board chairman and past-president of the AGA Northern Virginia Chapter. He is also a member of the Institute of Internal Auditors and the Association of Certified Fraud Examiners.

Dave has testified as an expert in governmental accounting, auditing, and fraud issues before the United States Court of Federal Claims and other administrative and judicial bodies.

Dave has spoken frequently on cost accounting, professional ethics, and auditors' fraud detection responsibilities under SAS 99, *Consideration of Fraud in a Financial Statement Audit*. He has been an instructor for the George Washington University masters of accountancy program (**Fraud Examination and Forensic Accounting**), and instructs for the George Mason University Small Business Development Center (**Fundamentals of Accounting for Government Contracts**).

Dave was the recipient of the AGA's 2006 Barr Award ("to recognize the cumulative achievements of private sector individuals who throughout their careers have served as a role model for others and who have consistently exhibited the highest personal and professional standards") as well as AGA's 2012 Educator Award ("to recognize individuals who have made significant contributions to the education and training of government financial managers").

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 (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 ...

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Answers Questioned

Not-for-Profit Organizations and Fraud, Waste, and Abuse

 Cotton & Company

Are not-for-profits vulnerable to fraud?

The screenshot displays two Google search results. The top search is for "charity & embezzlement", showing approximately 472,000 results in 0.34 seconds. The bottom search is for "not-for-profit & embezzlement", showing approximately 509,000 results in 0.38 seconds. Both searches have the "Web" tab selected. The Cotton & Company logo is visible in the bottom right corner of the slide.

Are not-for-profits vulnerable to fraud?

The screenshot displays two Google search results. The top search is for "not-for-profit & fraud", showing approximately 39,700,000 results in 0.42 seconds. The bottom search is for "charity & fraud", showing approximately 48,000,000 results in 0.37 seconds. Both searches have the "Web" tab selected. The Cotton & Company logo is visible in the bottom right corner of the slide.

Why are not-for-profits vulnerable to fraud?

- A. Weak internal control?
- B. Use of volunteers?
- C. Hiring employees on the basis of trust?
- D. No direct connection between inputs (\$\$) and outputs?
- E. Weak governance?
- F. An “it can’t happen here” attitude?

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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.”

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Case Study

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William Aramony and the United Way



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Case Study

8

William Aramony and the United Way

- Aramony was CEO of the United Way of America from 1970 to 1992
- 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

[http://en.wikipedia.org/wiki/William_Aramony]

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Case Study

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



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Case Study

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

Let's look at the facts.

FACTS:

- UNITED WAY of the NATIONAL CAPITAL AREA is your local United Way whose sole purpose is to serve this community. It is one of over 2,000 local and autonomous United Ways across the nation.
- Your local United Way sees that more than 90 cents out of every dollar collected goes directly to services.

Our suspended dues will go to local services.

We take our stewardship seriously. Our immediate response to this troubling controversy at the United Way of America was to suspend our payment of dues and call for a full and open investigation of the United Way of America and its spin-off operations.

In keeping with our dedication to serve this community, the suspended dues payments will now be made available for increased programs and services needed in our community.

Geoffrey Edwards Volunteer President United Way of the National Capital Area	Ronald Townsend Chairman of Trustees Assembly	Burt K. Fischer 1992 General Campaign Chairman	Sheldon W. Fantele Vice Chairman of Trustees Assembly and Campaign Advisory Chairman	Delano E. Lewis 1991 Campaign Chairman
Jean Ross Senior Vice President and Chairman of Membership and Allocations Committee	Rosa E. Byrd Alexandria Chairman	Mary Kay Parker Arlington Chairman	Gwendolyn E. Boyd District of Columbia Chairman	
Thomas D. Rust Fairfax-Falls Church Chairman	Paul C. Drainey Loudoun Chairman	Jacqueline D. Simon Montgomery Chairman	Jane Gibson Prince George's Chairman	Kenneth Swenson Prince William Chairman

United Way of the National Capital Area

Cotton & Company

Case Study

11

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

Let's look at the facts.

FACTS:

- UNITED WAY of the NATIONAL CAPITAL AREA is your local United Way whose sole purpose is to serve *this* community. It is one of over 2,000 *local* and *autonomous* United Ways across the nation.
- Your local United Way sees that more than 90 cents out of every dollar collected goes directly to services.

FACTS:

- UNITED WAY OF AMERICA is the national trade association for local United Ways. It is not a headquarters and neither raises nor allocates any funds.
- United Way of America sets no policy for local United Ways and is supported by dues of one percent from local United Ways.

Our suspended dues will go to local services.

We take our stewardship seriously. Our immediate response to this troubling controversy at the United Way of America was to suspend our payment of dues and call for a full and open investigation of the United W.

In keeping with our dedication to serve **"We take our stewardship seriously."** now be made available for increased programs and services needed in our community.

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United Way of the National Capital Area

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Case Study

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In other words ...

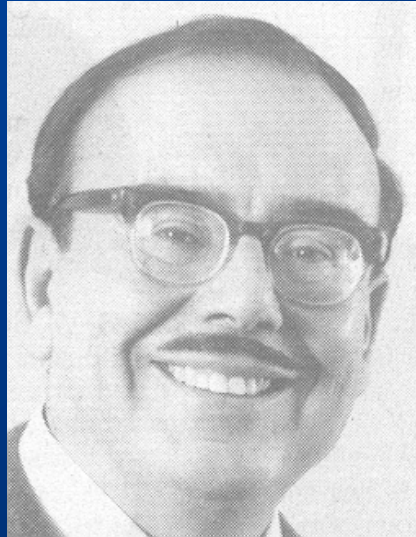
"It can't happen to us."

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The Washington Post

May 1, 2004

Ex-Chief Of Local United Way Sentenced



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The Washington Post

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
- UWNCA 2002 revenue: \$19,000,000

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Case Study

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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 ...



Case Study

16

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

Let's look at the facts

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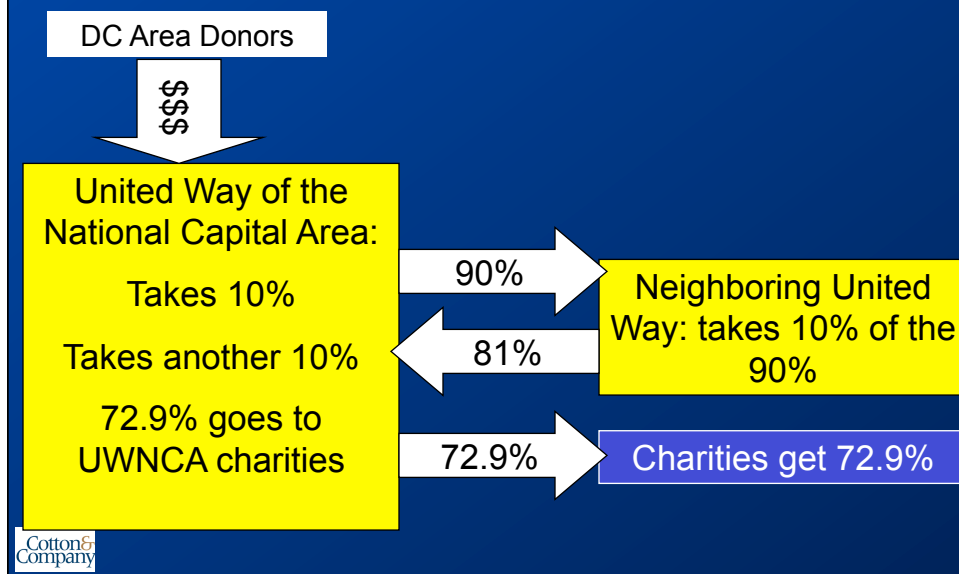
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United Way of the National Capital Area

“Your local United Way sees that more than 90 cents out of every dollar collected goes directly to services.”



The Suer investigation revealed another scheme: Round-Tripping Receipts



***Strong Governance Can
Make a Big Difference***

Fraud Deterrence, Prevention and Detection

- The Magnitude of Fraud
- Historical Perspective on Anti-Fraud Guidance
- Managing the Business Risk of Fraud: A Practical Guide
 - Anti-Fraud Principles
 - Fraud Risk Governance
 - Roles and Responsibilities
 - Fraud Risk Assessment
 - Fraud Prevention and Detection
 - Investigation and Corrective Action
 - Appendices



The Magnitude of Fraud

REPORT TO THE NATIONS
ON OCCUPATIONAL **FRAUD** AND **ABUSE**
2014 Global Fraud Study

Costs	Schemes	Detection	Victims	Perpetrators
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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


Answers Questioned

The Magnitude of Fraud

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This is where most of the fraud action is.

But, these frauds can be and often are catastrophic.


Answers Questioned

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

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Answers Questioned

The Magnitude of Fraud

- 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

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Answers Questioned

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

The Magnitude of Fraud

- 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

ACFE Conclusions

- 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

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Answers Questioned

The Magnitude of Fraud

REPORT TO THE NATIONS

ON OCCUPATIONAL FRAUD AND ABUSE

2014 Global Fraud Study

Costs

Schemes

Detection

Victims

Perpetrators

<http://www.acfe.com/rttn.aspx>

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Answers Questioned

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



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

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KPMG LLP

Mark Beasley
North Carolina State University

Toby J.F. Bishop
Association of Certified
Fraud Examiners

David Cotton
Cotton & Company LLP

George P. Fritz
PricewaterhouseCoopers LLP (retired)
Accounting & Auditing Consultants LLC

Dan L. Goldwasser
Vedder, Price, Kaufman, & Kammholz, PC
Audit Committee member

Ronald B. Norris
The Estée Lauder Companies Inc.

Zoe-Vonna Palmrose
University of Southern California

Thomas M. Stemlar
Arthur Andersen LLP (retired)
Audit Committee member

AICPA Staff

Charles E. Landes
Director
Audit and Attest Standards

Michael P. Glynn
Technical Manager
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

AICPA

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

MANAGEMENT OVERRIDE OF INTERNAL CONTROLS:

The Achilles' Heel
of Fraud Prevention

The Audit Committee
and Oversight of
Financial Reporting

FREE at: [http://www.aicpa.org/
ForThePublic/
AuditCommitteeEffectiveness/
DownloadableDocuments/
achilles_heel.pdf](http://www.aicpa.org/ForThePublic/AuditCommitteeEffectiveness/DownloadableDocuments/achilles_heel.pdf)

Published in 2005

Management Override: The Achilles' Heel of Internal Control

AICPA

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MANAGEMENT OVERRIDE OF INTERNAL CONTROLS:

The Achilles' Heel
of Fraud Prevention

The Audit Committee
and Oversight of
Financial Reporting

TARGET AUDIENCE:

Those Charged with
Governance

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Answers Questioned

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

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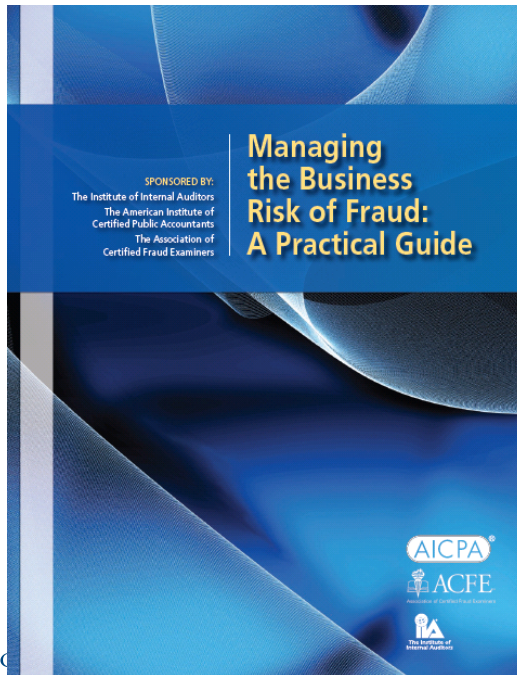
Larry Harrington
Vice President, Internal Audit
Raytheon Company



***Is your organization fully
committed to protecting
stakeholder assets?***



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FREE at <http://www.theiia.org/media/files/fraud-white-paper/fraud%20paper.pdf>

Published in 2007

Managing the Business Risk of Fraud: A Practical Guide

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Answers Questioned

Managing the Business Risk of Fraud: A Practical Guide

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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.

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Answers Questioned

Wait, what happened to deterrence?

Fraud deterrence is a direct result and product of the organization making it known that it has:

- Written fraud risk management policies
- Performed a fraud risk assessment
- Strong prevention controls in place
- Strong detection controls and mechanisms in place
- Zero tolerance for fraud

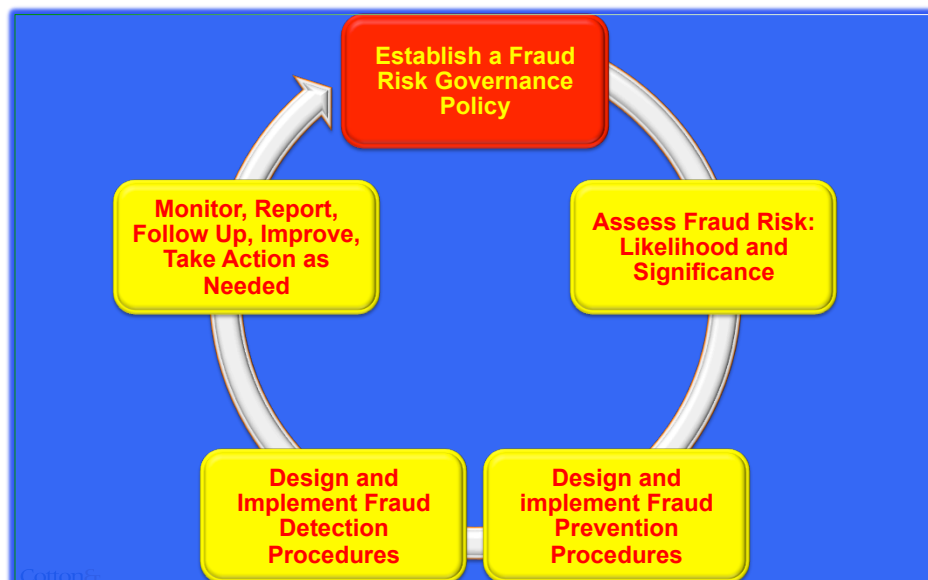
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Answers Questioned

Managing Fraud Risk



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Answers Questioned

Managing Fraud Risk



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Answers Questioned

Fraud Risk Governance

- The governance body should
 - Set the tone at the top
 - Ensure that management is fully committed to the antifraud program
 - Monitor the effectiveness of the antifraud program
- A single, executive-level individual should be held responsible and accountable for the antifraud program
- The antifraud program should be documented

Fraud Risk Governance

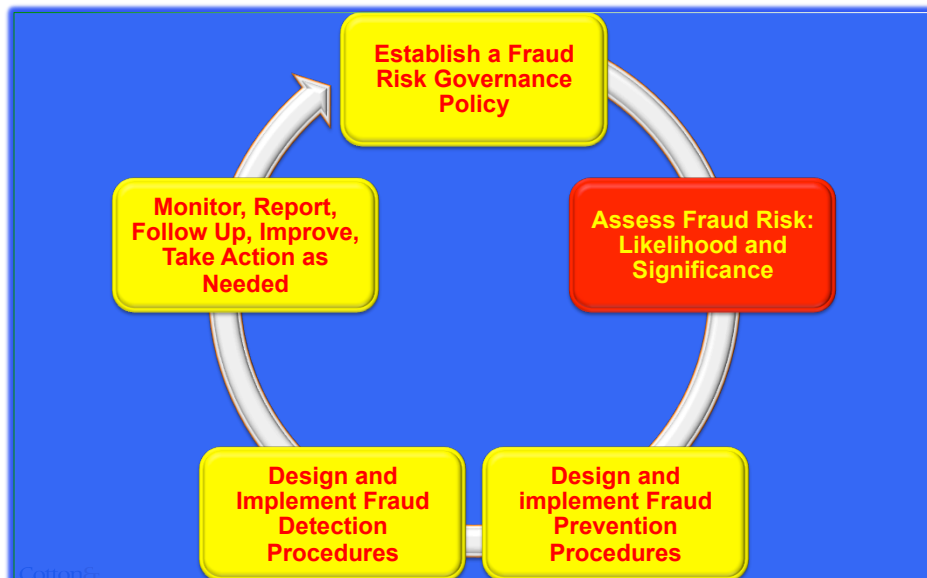
- Who should be involved?
 - Board of directors
 - Audit committee
 - Management
 - Staff
 - Internal audit

Antifraud Program Documentation

- Roles and responsibilities
- Commitment
- Fraud awareness
- Affirmation process
- Conflict disclosure
- Fraud risk assessment
- Reporting procedures and whistleblower protection
- Investigation process
- Corrective action
- Quality assurance
- Continuous monitoring

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Answers Questioned

Managing Fraud Risk



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Answers Questioned

Fraud Risk Assessment

Different organizations face different fraud risks:

- Retail
- Manufacturing
- Service
- Governmental
- Academic
- Not-for-profit
- Centralized, decentralized
- Large, small
- New, mature
- Public, private



Fraud Risk Assessment

Should include (at a minimum):

- Risk identification
 - Employee and management incentives, pressures, opportunities
 - Potential override of controls
 - Internal and external threats
- Identification of all *inherent risks*
- Assessment of *risk likelihood*
- Assessment of *risk significance*
 - Monetary
 - Legal and regulatory
 - Reputation
- Risk response

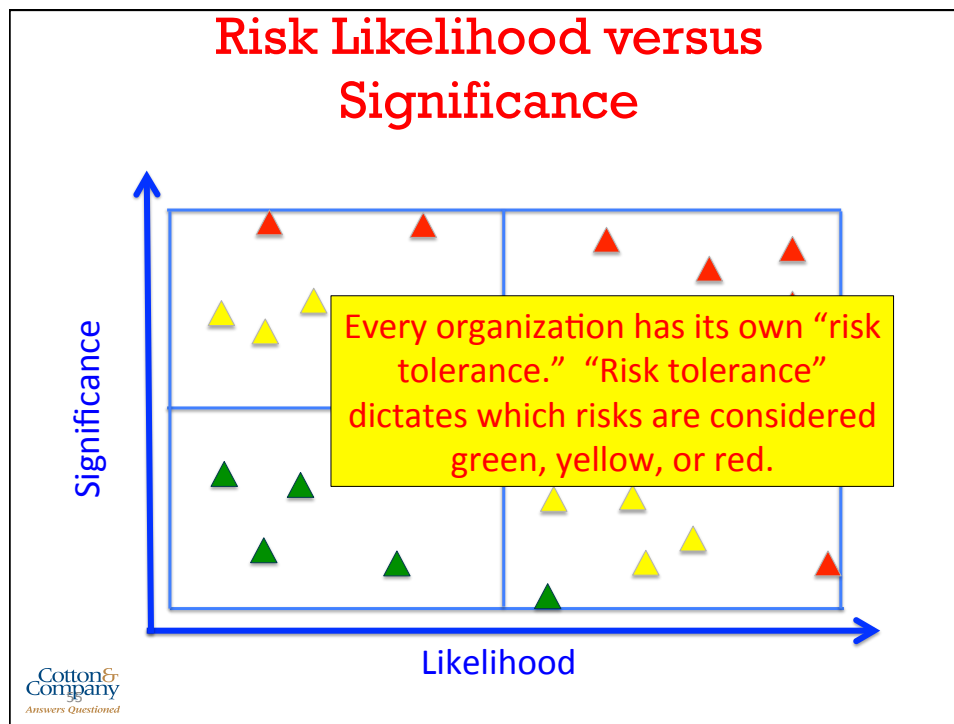


Risk Assessment

- Risk assessment team
 - Accounting/finance
 - Nonfinancial business unit and operations
 - Risk management
 - Legal and compliance
 - Internal audit
 - External consultants
- Brainstorm to identify risks
 - Fraud triangle (motive—opportunity—attitudes)
 - Override of controls
 - Misappropriation of assets
 - Fraudulent financial reporting
 - Corruption
 - Regulatory and legal
 - Reputation

Fraud Risk Assessment Documentation Framework

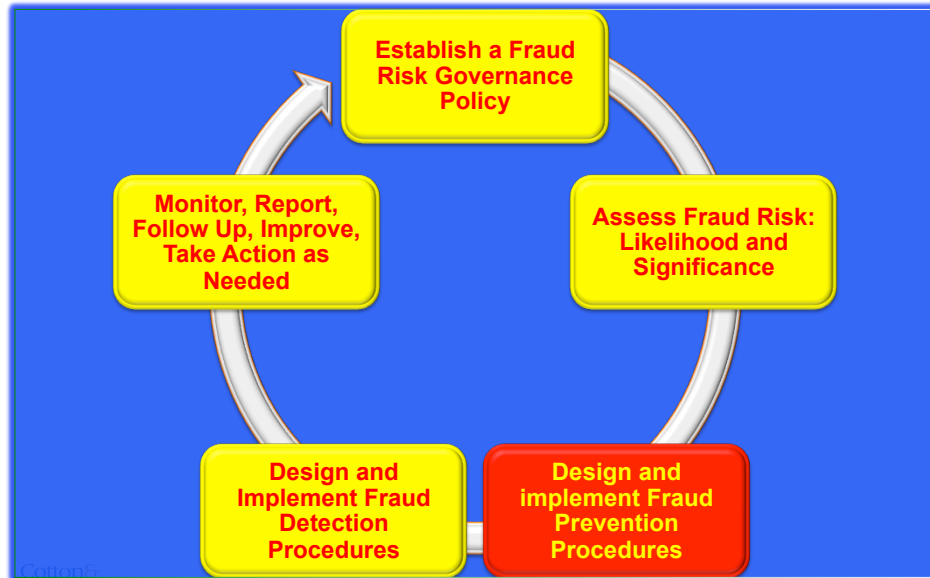
Identified Fraud Risks and Schemes	Likelihood	Significance	People and/or Department	Existing Anti-fraud Controls	Controls Effectiveness Assessment	Residual Risks	Fraud Risk Response
<i>Financial reporting</i> Revenue recognition - Backdating agreements - Channel stuffing - Inducing distributors to accept more product than necessary - Holding books open - Via recording detail transactions in a sub-ledger - Via recording top-side journal entries - Additional revenue risks							



Organizational Risk Tolerance

- Mitigate the risk to varying degrees;
- Accept the risk—but monitor exposure;
- Design specific procedures to deal with each specifically-identified risk
- Follow a structured rather than haphazard approach
- Benefits should exceed costs
- “Zero tolerance for fraud” vs “zero tolerance” when fraud happens

Managing Fraud Risk



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Answers Questioned

Prevention versus Detection

- If we have sufficient prevention controls in place, do we even need any detection controls?
- Theoretically, we should be able to design procedures to address *every* risk and thereby prevent *every* fraud.

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Answers Questioned

Prevention versus Detection

- Is it actually possible to identify *every* fraud risk?
- Prevention controls come with a cost
 - Monetary
 - Interference with business processes and objectives
 - Example: to prevent shoplifting, let's not allow customers to take any shopping or handbags into our store; let's install CCTV in dressing rooms; etc.

Fraud Risk Assessment Documentation Framework

Identified Fraud Risks and Schemes	Likelihood	Significance	People and/or Department	Existing Anti-fraud Controls	Controls Effectiveness Assessment	Residual Risks	Fraud Risk Response
<i>Financial reporting</i> Revenue recognition - Backdating agreements - Channel stuffing - Inducing distributors to accept more product than necessary - Holding books open - Via recording detail transactions in a sub-ledger - Via recording top-side journal entries - Additional revenue risks				<div style="text-align: center; color: red; font-weight: bold;"> Some are prevention controls; some are detection controls </div>			

Fraud Prevention Technique Documentation

Identified Fraud Risks and Schemes	Prevention Control/ Technique	Responsible Person(s)
		

Preventing Fraud, Waste, and Abuse

APPENDIX D: FRAUD PREVENTION SCORECARD

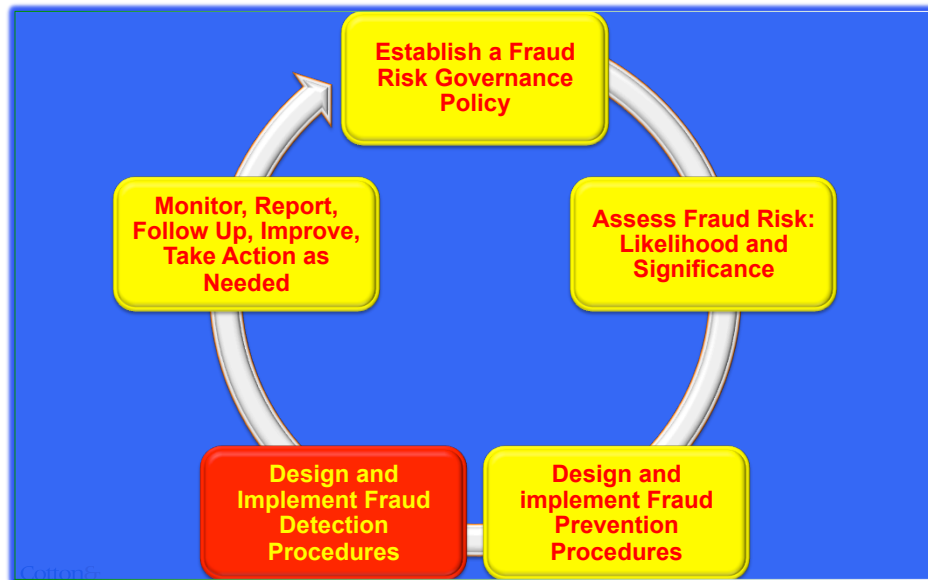
To assess the strength of the organization's fraud prevention system, carefully assess each area below and score the area, factor, or consideration as either:

- Red: indicating that the area, factor, or consideration needs substantial strengthening and improvement to bring fraud risk down to an acceptable level.
- Yellow: indicating that the area, factor, or consideration needs some strengthening and improvement to bring fraud risk down to an acceptable level.
- Green: indicating that the area, factor, or consideration is strong and fraud risk has been reduced — at least — to a minimally acceptable level.

Each area, factor, or consideration scored either red or yellow should have a note associated with it that describes the action plan for bringing it to green on the next scorecard.

Fraud Prevention Area, Factor, or Consideration	Score	Notes
Our organizational culture — tone at the top — is as strong as it can possibly be and establishes a zero-tolerance environment with respect to fraud.		
Our organization's top management consistently displays the appropriate attitude regarding fraud prevention and encourages free and open communication regarding ethical behavior.		
Our Code of Organizational Conduct has specific provisions that address and prohibit inappropriate relationships whereby members of our board or members of management could use their positions for personal gain or other inappropriate purposes.		

Managing Fraud Risk



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Answers Questioned

Fraud Detection

- Conceptually, we allow for the fact that some frauds may get through the prevention controls
- Strong detection controls assure that frauds get discovered quickly, and before they become large
- **Visible and known** detection controls also support deterrence
- Having **“clandestine”** detection controls provides further deterrence
 - Occur in the ordinary course of business.
 - Draw on external information to corroborate internally generated information.
 - Formally and automatically communicate identified deficiencies and exceptions to appropriate leadership.
 - Use results to enhance and modify other controls.


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Company
Answers Questioned

Fraud Detection

- Whistleblower hotlines—essential to organizations with a strong commitment to fraud detection
 - Expensive
 - Must provide for anonymity
 - All calls must be taken seriously
 - Periodic reports summarizing calls and results should be distributed to senior management and the governing board

Fraud Detection Technique Documentation

Identified Fraud Risks and Schemes	Detection Control/Technique	Responsible Person(s)



Detecting Fraud, Waste, and Abuse

APPENDIX G: FRAUD DETECTION SCORECARD

To assess the strength of the organization's fraud detection system, carefully assess each area below and score the area, factor, or consideration as:

- Red: indicating that the area, factor, or consideration needs substantial strengthening and improvement to bring fraud risk down to an acceptable level.
- Yellow: indicating that the area, factor, or consideration needs some strengthening and improvement to bring fraud risk down to an acceptable level.
- Green: indicating that the area, factor, or consideration is strong and fraud risk has been reduced — at least — to a minimally acceptable level.

Each area, factor, or consideration that scores either red or yellow should have a note associated with it that describes the action plan for bringing it to green on the next scorecard.

Fraud Prevention Area, Factor, or Consideration	Score	Notes
We have integrated our fraud detection system with our fraud prevention system in a cost-effective manner.		
Our fraud detection processes and techniques pervade all levels of responsibility within our organization, from the board of directors and audit committee, to managers at all levels, to employees in all areas of operation.		
Our fraud detection policies include communicating to employees, vendors, and stakeholders that a strong fraud detection system is in place, but certain critical aspects of these systems are not disclosed to maintain the effectiveness of hidden controls.		


Answers Questioned

Some Policies/Procedures Can Promote Deterrence, Prevention, and Detection

ABC Corporation (ABC) statement on every contract and purchase order

ABC is committed to honesty and transparency in business relationships. If any employee or agent of ABC asks you—either explicitly or implicitly—for anything of value in return for this contract or purchase order, please contact Mr. John Honest, Senior Vice President for Business Integrity, at 444-555-2323, or jhonest@abc.com immediately.


Answers Questioned

Managing Fraud Risk



Cotton
Company
Answers Questioned

Fraud Investigation and Corrective Action

- Do not wait until your organization has been victimized to decide what to do; have protocols in place well in advance.
- Action taken must be swift.
- Punitive actions must be appropriate.
- Punitive actions should, whenever possible, be made known to everyone.
- The same rules should be applied to everyone, ***including senior management.***

Cotton
Company
Answers Questioned

Fraud Investigation and Corrective Action

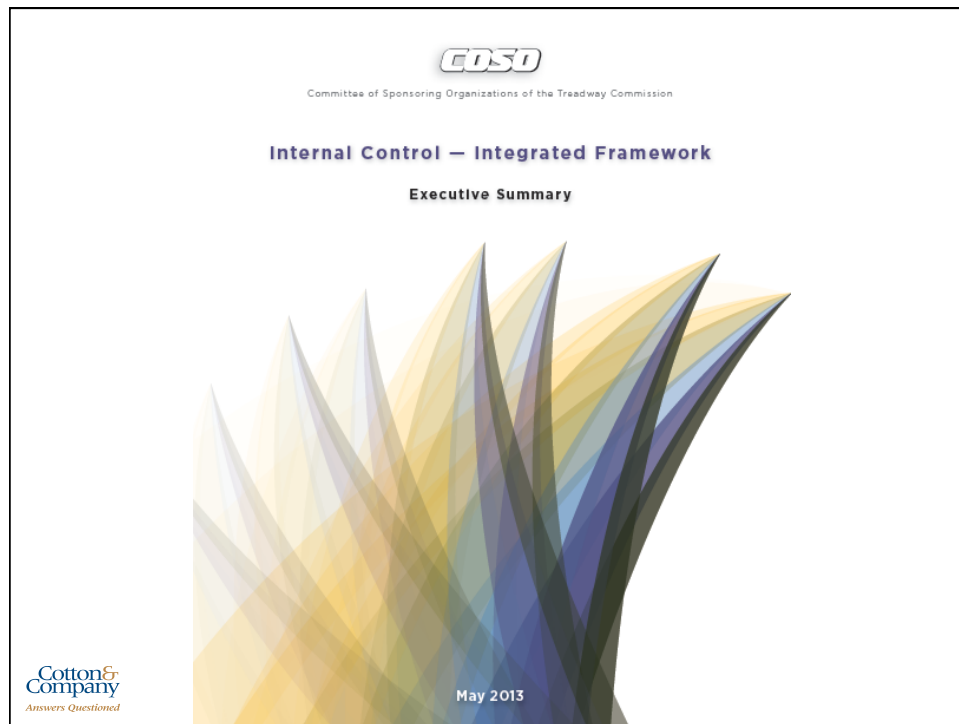
Possible corrective actions:

- Criminal referral.
- Civil action.
- Disciplinary action.
- Insurance claim.
- Extended investigation.
- Business process remediation.
- Internal control remediation.

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.”*

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Assesses Fraud Risk

Principle 8: The organization considers the potential for fraud in assessing risks to the achievement of objectives.

Points of Focus
The following points of focus highlight important characteristics relating to this principle:

- **Considers Various Types of Fraud**—The assessment of fraud considers fraudulent reporting, possible loss of assets, and corruption resulting from the various ways that fraud and misconduct can occur.
- **Assesses Incentive and Pressures**—The assessment of fraud risk considers incentives and pressures.
- **Assesses Opportunities**—The assessment of fraud risk considers opportunities for unauthorized acquisition, use, or disposal of assets, altering of the entity's reporting records, or committing other inappropriate acts.
- **Assesses Attitudes and Rationalizations**—The assessment of fraud risk considers how management and other personnel might engage in or justify inappropriate actions.

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.”
- COSO and ACFE are sponsoring a new Task Force to update “Managing the Risk of Fraud”
- The updated Guide could become a third COSO Framework alongside the IC and ERM Frameworks.



FLASH UPDATE

- In addition to the COSO-ACFE Task Force, we have a larger Advisory Panel that will review draft chapters and provide input from a variety of perspectives
- Send me an email or give me your card if you'd like to serve on this Advisory Panel



Not Quite Sure You Need This?

- ✓ Download the Guide
- ✓ Go to the Scorecards [Appendices F (Prevention) and G (Detection)]
- ✓ Self-assess at your next senior staff or governing board meeting (30-45 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.

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Fraud Deterrence, Prevention and Detection



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