

5/8 1:00 Session

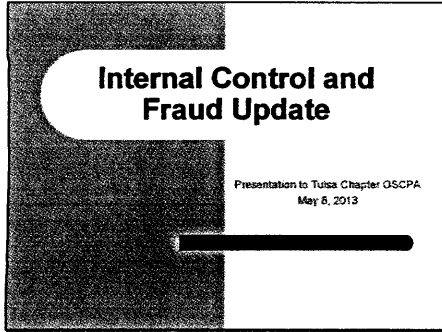
## **CATHY CRISWELL's**

### **16 Common Anti-Fraud Controls**

1. External audit of financial statements
2. Code of Conduct
3. Management certification of financial statements
4. Internal audits
5. External audit of internal control over financial reporting
6. Management reviews
7. Independent audit committee
8. Employee support programs
9. Hotline
10. Fraud training for management/executives
11. Fraud training for employees
12. Anti-fraud policy
13. Formal fraud risk assessment
14. Surprise audits
15. Job rotation/mandatory vacations
16. Rewards for whistleblowers



Slide 1



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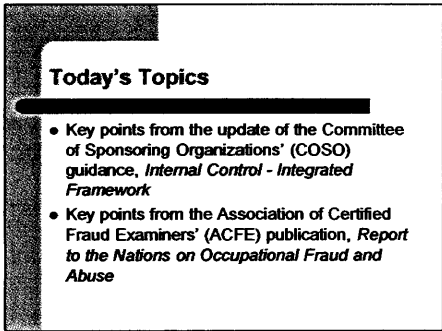
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Slide 2



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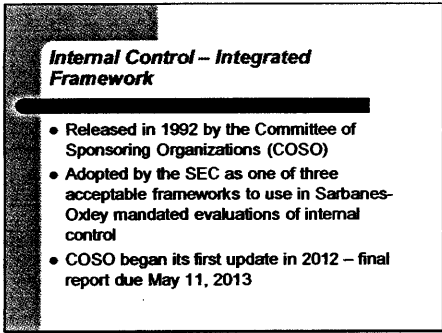
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Slide 3



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Slide 4

**What did NOT change in the update**

- Definition of internal control
- 5 components of internal control
- The broad criteria to be used in an assessment of internal control

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Slide 5

**What DID change in the update**

- Internal control concepts codified into principles and attributes
- Updates and enhancements to the report that help address changes in business and operating environments

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Slide 6

**Definition of internal control**

Internal control is a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations
- Reliability of reporting
- Compliance with applicable laws and regulations

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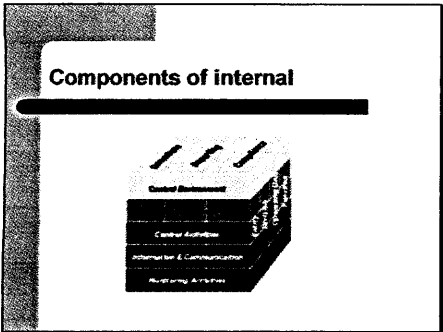
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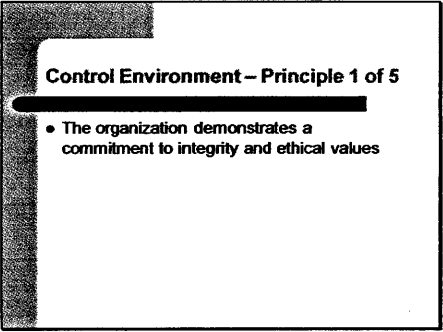
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Slide 8



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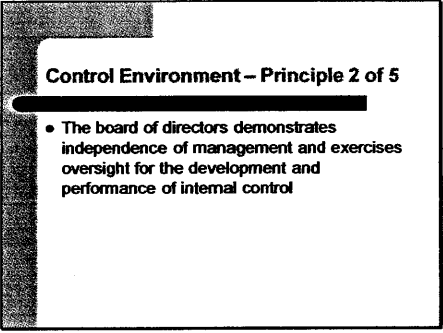
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Slide 9



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**Control Environment – Principle 3 of 5**

- Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives

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**Control Environment – Principle 4 of 5**

- The organization demonstrates a commitment to attract, develop and retain competent individuals in alignment with objectives

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**Control Environment – Principle 5 of 5**

- The organization holds individuals accountable for their internal control responsibilities in pursuit of objectives

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**Risk Assessment – Principle 1 of 4**

- The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives

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**Risk Assessment – Principle 2 of 4**

- The organization identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed

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**Risk Assessment – Principle 3 of 4**

- The organization considers the potential for fraud in assessing risks to the achievement of its objectives

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**Risk Assessment – Principle 4 of 4**

- The organizations identifies and assesses changes that could significantly impact the system of internal control

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**Control Activities – Principle 1 of 3**

- The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels

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**Control Activities – Principle 2 of 3**

- The organization selects and develops general control activities over technology to support the achievement of objectives

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**Control Activities – Principle 3 of 3**

- The organization deploys control activities as manifested in policies that establish what is expected and in relevant procedures to effect the policies

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**Information and Communication – Principle 1 of 3**

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

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**Information and Communication – Principle 2 of 3**

- The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of other components of internal control

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**Information and Communication – Principle 3 of 3**

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

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**Monitoring Activities – Principle 1 of 2**

- The organization selects, develops, and performs on-going and/or separate evaluations to ascertain whether the components of internal control are present and functioning

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**Monitoring Activities – Principle 2 of 2**

- 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

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**Report to the Nations on Occupational Fraud and Abuse**

- The ACFE does this research to study the costs, methodologies and perpetrators of fraud within organizations
- The 2012 report was the 7th research project of this nature completed by ACFE
- The data in the 2012 report is based on 1,388 cases of occupational fraud that were reported by the Certified Fraud Examiners (CFEs) who investigated them

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**The Cost of Occupational Fraud**

- The typical organization loses an estimated 5% of its annual revenues to occupational fraud
- This statistic is based on estimates provided by CFEs who participated in the research project

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**The Cost of Occupational Fraud**

- The median loss caused by the occupational fraud cases in the study was \$140,000
- More than one-fifth of these cases involved losses exceeding \$1 million per case

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**Types of fraud cases reported in the study**

- Asset misappropriation schemes were the most common type of fraud, comprising 87% of the reported cases
- Asset misappropriation schemes were the least costly type of fraud with a median loss of \$120,000 per case

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**Types of fraud cases reported in the study**

- Financial statement fraud schemes were the least common type of fraud, comprising 8% of the cases in the study
- Financial statement fraud caused the greatest median loss at \$1 million per case

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**Types of fraud cases reported in the study**

- Corruption schemes fell in the middle, occurring in just over 33% of reported cases
- Corruption schemes caused a median loss of \$250,000 per case

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**Fraud facts from the study**

- Occupational fraud is more likely to be detected by a tip than by any other method

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**Fraud facts from the study**

- Corruption and billing schemes pose the greatest risks to organizations throughout the world

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**Fraud facts from the study**

- Occupational fraud is a significant threat to small businesses

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**Fraud facts from the study**

- The industries most commonly victimized in the study were the banking and financial services, government and public administration, and manufacturing sectors

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**Fraud facts from the study**

- Anti-fraud controls significantly decrease the cost and duration of occupational fraud schemes
- Victim organizations that had implemented any of 16 common anti-fraud controls experienced considerably lower losses and time-to-detection than organizations lacking these controls

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**Fraud facts from the study**

- Perpetrators with higher levels of authority tend to cause much larger losses
- The longer a perpetrator has worked for an organization, the higher fraud losses tend to be
- Most frauds (77%) were committed by individuals working in one of six departments: accounting, operations, sales, executive/upper management, customer service and purchasing

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**Fraud facts from the study**

- In 81% of cases, the perpetrator displayed one or more behavioral red flags
- The red flags included: Living beyond means (36% of cases), financial difficulties (27%), unusually close association with vendors or customers (19%) and excessive control issues (18%)

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**Conclusions**

- Providing individuals a means to report suspicious activity is a critical part of an anti-fraud program
- Fraud reporting mechanisms, such as hotlines, should be set up to receive tips from both internal and external sources and should allow anonymity and confidentiality
- Management should actively encourage employees to report suspicious activity, as well as enact and emphasize an anti-retaliation policy

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**Conclusions**

- External audits should not be relied upon as an organization's primary fraud detection method
- External audits detected only 3% of the frauds reported
- While external audits serve an important purpose and can have a strong preventive effect on potential fraud, their usefulness as a means of uncovering fraud is limited

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**Conclusions**

- Targeted fraud awareness training for employees and managers is a critical component of a well-rounded program for preventing and detecting fraud
- At a minimum, staff members should be educated regarding what actions constitute fraud, how fraud harms everyone in the organization and how to report questionable activity

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**Conclusions**

- Research continues to show that small businesses are particularly vulnerable to fraud, primarily because they have fewer resources for implementing anti-fraud controls
- Small businesses should conduct fraud risk assessments
- The most cost-effective control mechanisms for small businesses include hotlines, employee education and setting a proper ethical tone within the organization

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**Conclusions**

- In all organizations, managers, employees, and auditors should be trained to recognize behavioral red flags
- In all organizations, management should continually assess the organization's specific fraud risks and evaluate its fraud prevention programs

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