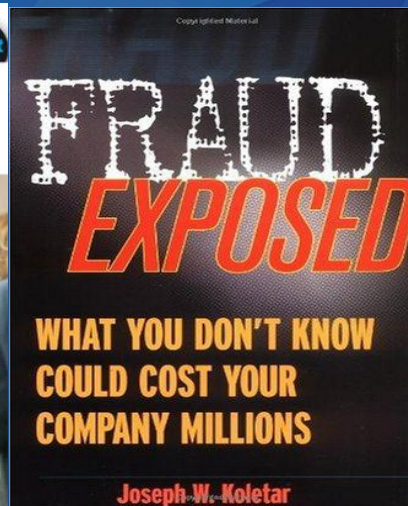
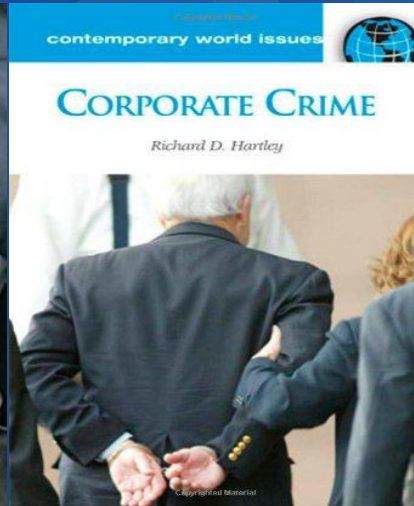
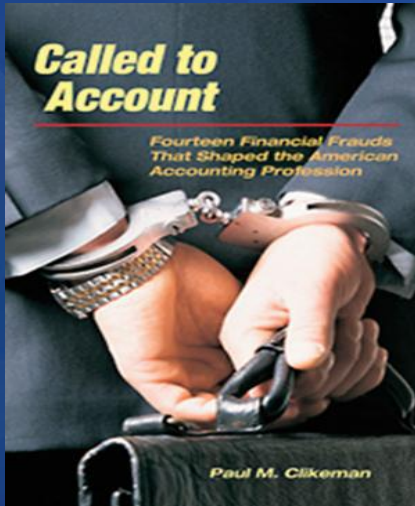


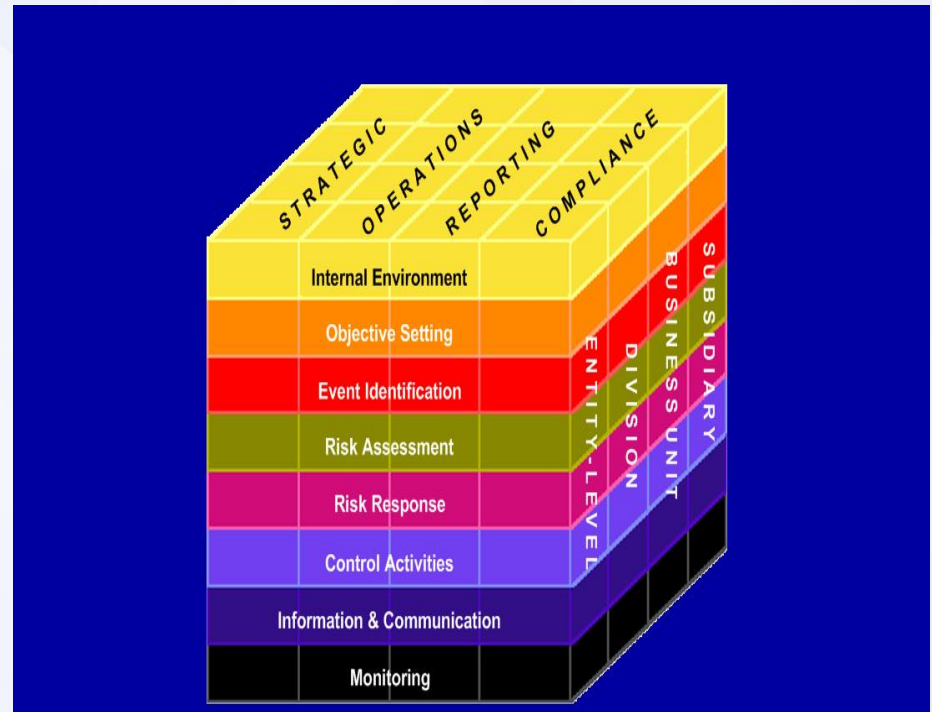
A Climate of Change

Are you seeing the internal audit opportunities?

FRAUD DETECTION THROUGH THE EYES OF COSO



COSO & ERM



Effective Governance – Aligning Culture and Strategy to Create Value

- Governance
 - Strategy
 - Ethics
- Ethics
 - Governance
 - Strategy

How much has 70 years of legislation impacted fraud?

—“Greed is smarter and faster than regulation.”

- The Board is generally surprised
- The Audit Committee is shocked
- Yet People know about the fraud



17 Principles of the Updated ICIF

Control Environment

1. Demonstrates commitment to integrity and ethical values
2. Exercises oversight responsibility
3. Establishes structure, authority and responsibility
4. Demonstrates commitment to competence
5. Enforces accountability

Risk Assessment

6. Specifies suitable objectives
7. Identifies and analyzes risk
8. Assesses fraud risk
9. Identifies and analyzes significant change

Control Activities

10. Selects and develops control activities
11. Selects and develops general controls over technology
12. Deploys through policies and procedures

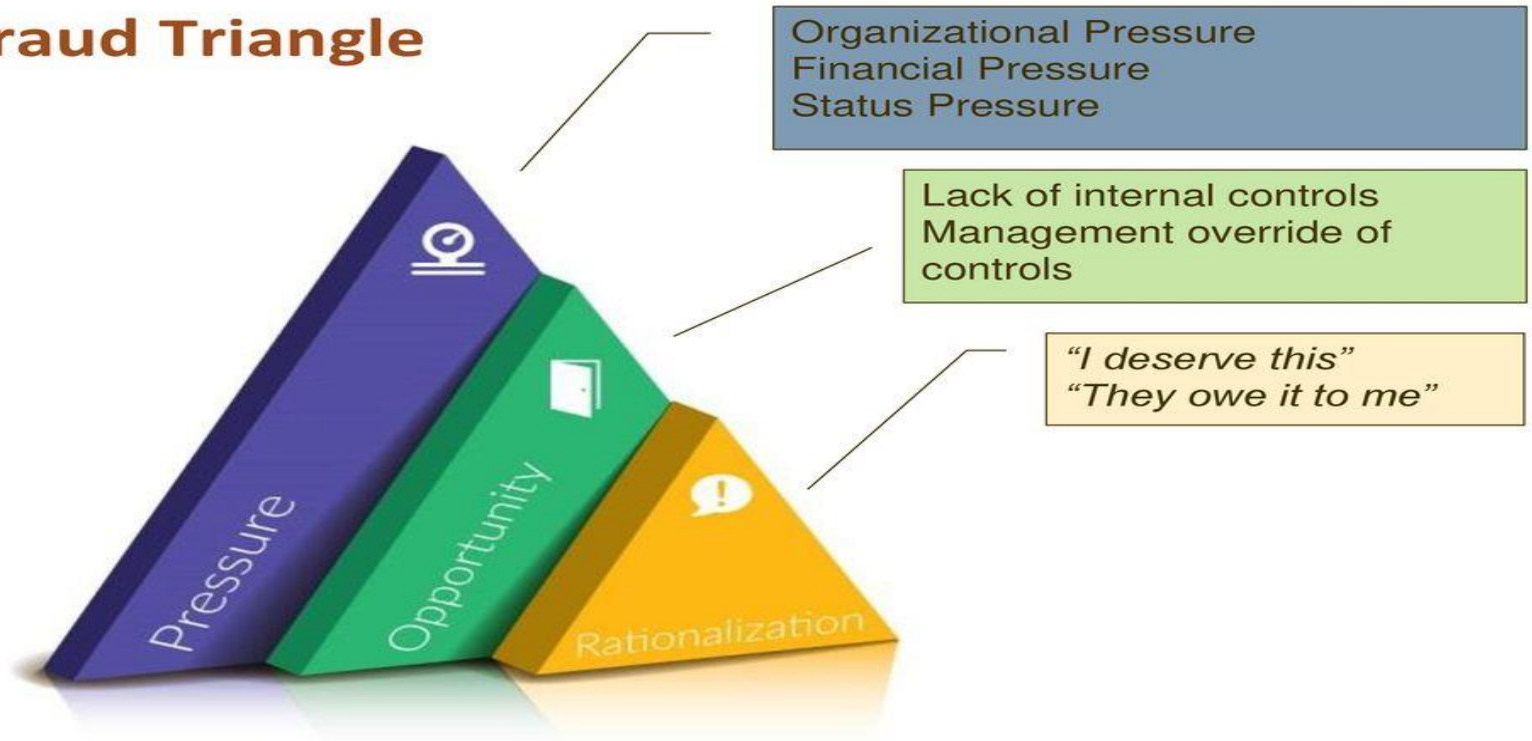
Information & Communication

13. Uses relevant information
14. Communicates internally
15. Communicates externally

Monitoring Activities

16. Conducts ongoing and/or separate evaluations
17. Evaluates and communicates deficiencies

Fraud Triangle



Why Update COSO?

- 20 Years
- How Could You Not?
- Management Override of Controls
- Conflict of Interest
- Lack of Segregation of Duties
- Poor transparency
- Siloed Risk Management
- Ineffective Board Oversight
- Dysfunctional/Irresponsible Behavior

COSO 2013 Internal Controls Framework

Principles 1 through 5

Control Environment



COSO Framework

Principles 6 through 9

Risk Assessment

COSO Framework Principles

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

7. 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.

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

9. The organization identifies and assesses changes that could significantly impact the system of internal control.

Fraud Risk Management Principles

2. The organization performs comprehensive fraud risk assessments to identify specific fraud schemes and risks, assess their likelihood and significance, evaluate existing fraud control activities, and implement actions to mitigate residual fraud risks.

Analytic Considerations

- Surveys & heat maps
- Media scans and external sources such as industry news
- Complaints database



COSO Framework Principles 10 through 12

Control Activities

COSO Framework Principles

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

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

12. The organization deploys control activities through policies that establish what is expected and procedures that put policies into action.



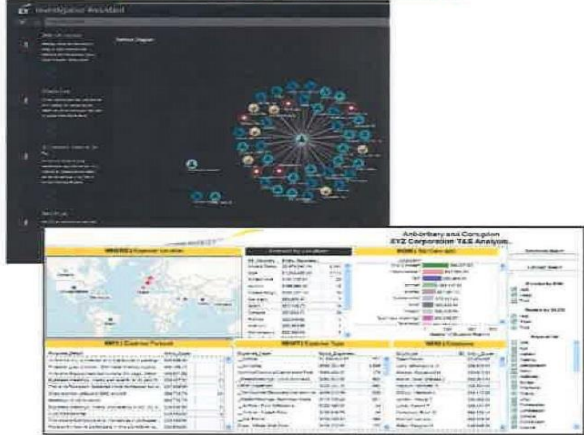
Fraud Risk Management Principles

3. The organization selects, develops, and deploys preventive and detective fraud control activities to mitigate the risk of fraud events occurring or not being detected in a timely manner.



Analytic Considerations

- ABaC analytics
- P2P, O2C, T&E, CRM analysis
- General ledger transaction analysis



COSO Framework Principles 13 through 15

Information & Communication

COSO Framework Principles

- 13. The organization obtains or generates and uses relevant, quality information to support the functioning of other components of internal control.
- 14. The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control.
- 15. The organization communicates with external parties regarding matters affecting the functioning of other components of internal control.



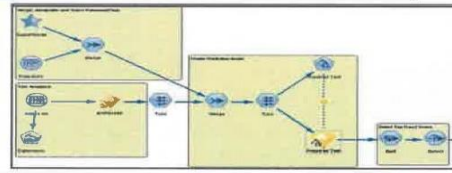
Fraud Risk Management Principles

4. The organization establishes a communication process to obtain information about potential fraud and deploys a coordinated approach to investigation and corrective action to address fraud appropriately and in a timely manner.



Analytic Considerations

- Case management
- Escalation and triage
- Review workflow management



COSO Framework

Principles 16 & 17

Monitoring Activities

COSO Framework Principles

16. The organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning.

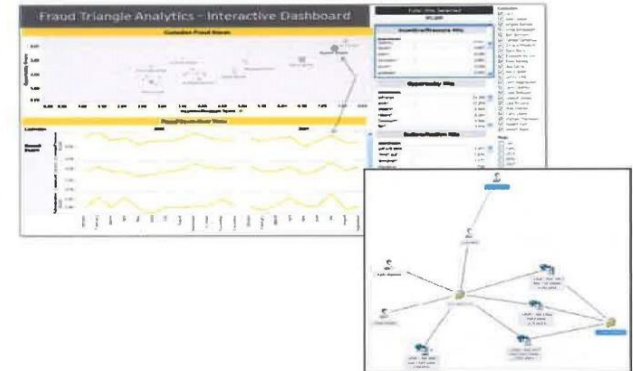
17. The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate.

Fraud Risk Management Principles

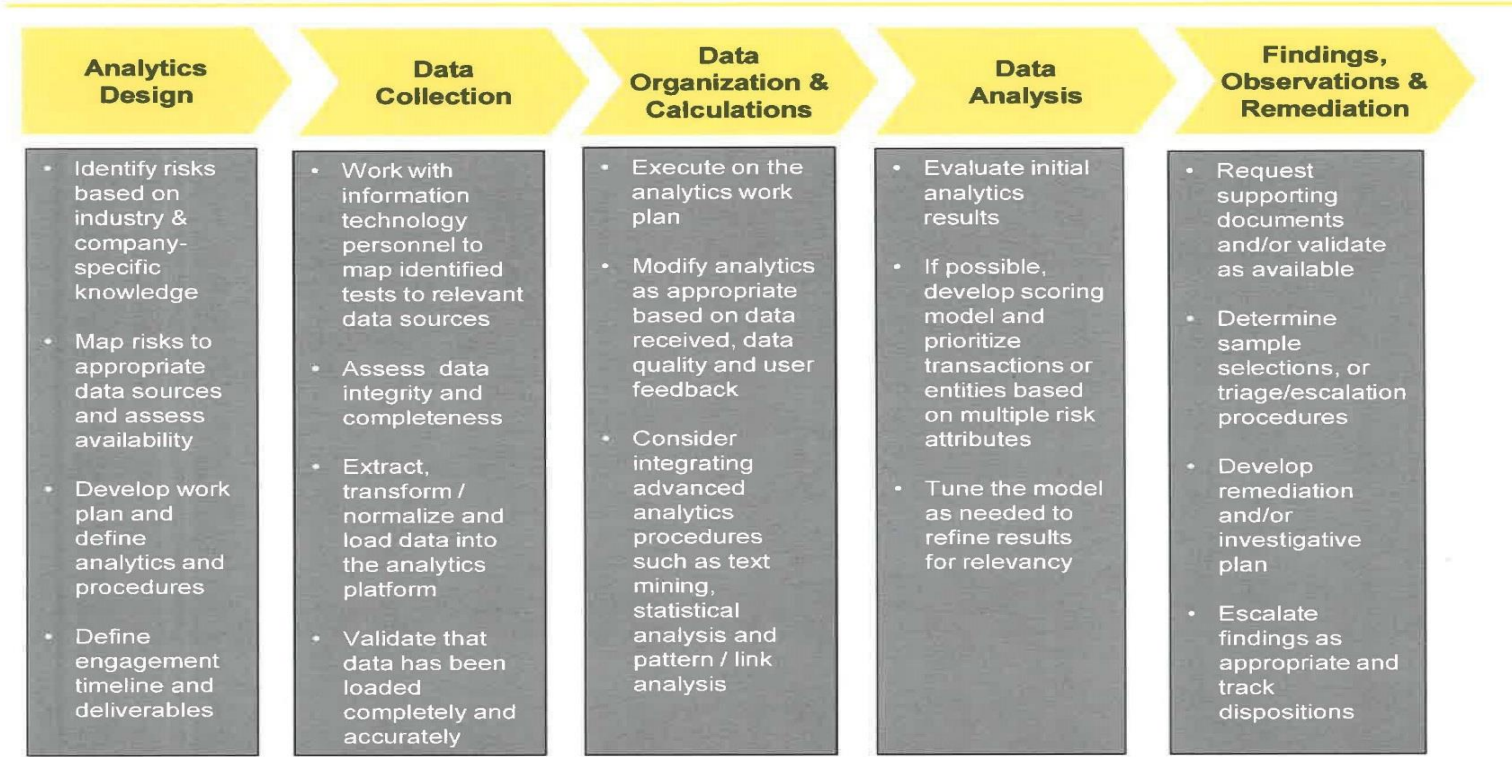
5. The organization selects, develops, and performs ongoing evaluations to ascertain whether each of the five principles of fraud risk management is present and functioning and communicates fraud risk management program deficiencies in a timely manner to parties responsible for taking corrective action, including senior management and the board of directors.

Analytic Considerations

- Investigative procedures
- Deep dive analysis
- Email and communications review



Graphic 1: Forensic Data Analytics Process used in COSO guidance



Qualities of a Healthy Organizational Ethics

- Strong governance with clear policy and procedures.
- Communication of policy and procedures throughout the organization.
- Clear and consistent “tone at the top” communication from senior management regarding their expectations around control and appropriate behavior.
- Consistent application of policy and procedures to all levels of management without exception.
- Alignment of rewards to the right behaviors.

Good News - Integrity delivers business benefits

Real business benefits can be achieved by companies that act with integrity:

Two-thirds of our respondents agree that there are commercial advantages for companies with strong reputations for ethical behavior.

45% would be unwilling to work for a company involved in a major bribery or corruption scandal.

53% of respondents state that they would be unwilling to hire suppliers or agents involved in a major bribery or corruption case

These are the Big Three

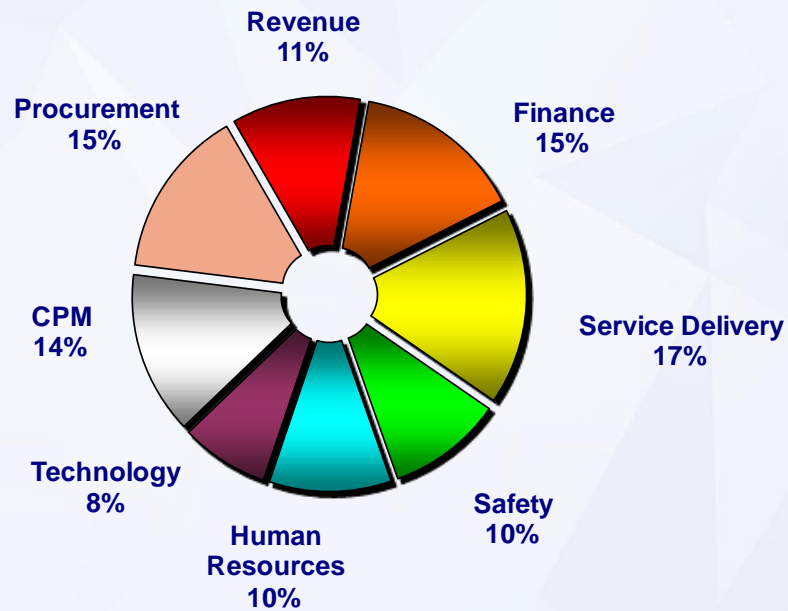
Figure 59: Median Loss Based on Presence of Anti-Fraud Controls

Control	Percent of Cases	Control in Place	Control Not in Place	Percent Reduction
Proactive Data Monitoring/Analysis	36.7%	\$92,000	\$200,000	54.0%
Management Review	64.7%	\$100,000	\$200,000	50.0%
Hotline	60.1%	\$100,000	\$200,000	50.0%
Management Certification of Financial Statements	71.9%	\$104,000	\$205,000	49.3%
Surprise Audits	37.8%	\$100,000	\$195,000	48.7%
Dedicated Fraud Department, Function, or Team	41.2%	\$100,000	\$192,000	47.9%
Job Rotation/Mandatory Vacation	19.4%	\$89,000	\$170,000	47.6%
External Audit of Internal Controls over Financial Reporting	67.6%	\$105,000	\$200,000	47.5%
Fraud Training for Managers/Executives	51.3%	\$100,000	\$190,000	47.4%
Fraud Training for Employees	51.6%	\$100,000	\$188,000	46.8%
Formal Fraud Risk Assessments	39.3%	\$100,000	\$187,000	46.5%
Employee Support Programs	56.1%	\$100,000	\$183,000	45.4%
Anti-Fraud Policy	49.6%	\$100,000	\$175,000	42.9%
Internal Audit Department	73.7%	\$123,000	\$215,000	42.8%
Code of Conduct	81.1%	\$120,000	\$200,000	40.0%
Rewards for Whistleblowers	12.1%	\$100,000	\$163,000	38.7%

More than just a fraud risk assessment

- Guidance on establishing an overall fraud risk management program includes:
 - ► Establishing fraud risk governance policies
 - ► Performing a fraud risk assessment
 - ► Designing and deploying fraud prevention and detect control activities
 - ► Conducting investigations
 - ► Monitoring activities

Where is Ethics and Fraud?



Remember:

Fraud is Perpetrated for Two Reasons

- **Profit or Performance**
- **We focus on Employee fraud**
- **Focus on Corporate Fraud**

What We Are Up Against

- 47% of CFO's say they could justify unethical behavior to help their organization survive the economic downturn
- Nearly half of those survey stated they would be willing to cut ethical corners to meet performance targets, particularly in the last 4 years
- 40% surveys stated that their companies do business in countries in which bribery and fraud occur frequently

Unethical behavior still tolerated

Companies must be prepared for the challenges posed by greater regulatory scrutiny. A large proportion remains tolerant of unethical conduct across all levels of organizations

Almost 1 in 5 company employees, regardless of grade, consider it acceptable to pay bribes to win or retain business.

This is not new. Companies are not making progress in strengthening their ethical culture.

-
- Many ways Ethics and Culture is not an easy area to audit because assessment techniques are less defined than in more traditional audit areas.
 - CAEs often find it is an area for which they do not have prior experience, cannot use traditional audit approaches,
 - **“Not the Auditor’s Job to Detect Fraud” The reality is:** Internal audit is a natural resource for Fraud Risk Assessment
 - What does Fraud Look like on your desk

Developing a Best in Class Fraud Risk Assessment

Category	High Fraud Potential	Lower Fraud Potential
Management Style	Autocratic	Participative
Management Orientation	Power-Driven	Achievement-Driven
Distribution of Authority	Centralized (Reserved by top)	Decentralized (Dispersed to all levels, delegated)
Planning	Centralized (short range)	Decentralized (long range)
Performance Measures	Quantitatively and on a short term basis	Measured both quantitatively and subjectively
Business Focus	Profit-Focused	Customer-Focused
Management Strategy	Management by Crisis	Management by Objectives
Reporting	Reporting by Exception	Reporting by Routine
Policies and Rules	Rigid and Inflexible (Strongly Policed)	Reasonable (Fairly Enforced)
Customer Satisfaction	Many Complaints	Few Complaints

- Is fraud increasing, decreasing, or staying the same?
- How would you classify the global mood? Optimistic or pessimistic?
- What is fraud?
- Do we audit?
- Values
- Is it really a mistake?
- If legal says that it is okay, is it okay?

- Find a way to take part in executive- and board-level discussions of strategic risks and strategic risk management.
- As risk management experts, auditors can help not only identify areas of strategic risks, but also recommend how to keep these risks at bay, mitigate them, and take advantage of the opportunities they present.

Characteristics of a High Performing Department

Forward Thinking View of Risk

- > **Comprehensive approach to assess and evaluate risk**
- > **Enhance ability to monitor emerging risk**
- > **Think and act strategically**
- > **Audit plan , strategy and resources are aligned with risk**
- > **Plan is flexible to changing business requirements**

Deep Knowledge and Insight

- > **Develop knowledge of the business**
- > **Promote risk and control awareness**
- > **Self assess Internal Audit skills and competencies**
- > **Leverage resources and tools**
- > **Incorporate monitoring into audit activities**
- > **Use of experts**
- > **Deliver advise and best practices**
- > **IA has a continuous improvement strategy for audit teams and function**

Clarity of Communication

- > **Understanding of Vision and Mission**
- > **Develop trust though ongoing dialogue**
- > **Understand context of findings, including implications and mitigating factors**
- > **Make recommendations that are compelling, relevant, in sufficient depth and practical to implement (cost vs. benefit)**
- > **Connect the dots**

Developing a Best in Class Fraud Risk Assessment

- > Step 1 - Evaluate Fraud Risk Factors
- > Step 2 - Identify Possible Fraud Schemes and Scenarios
- > Step 3 – Analyze / Prioritize Identified Fraud Risks
- > Step 4 – Evaluate Mitigating Controls

Auditors have to align risk management practices with anti-fraud measures to maximize protection to the company.

Fraud Worksheet

- Area / Types of Fraud
- Fraud / Risk Likelihood
- Risk Impact
- Perpetrators
- Method used to perpetrate
- Control Prevent
- Control / Detect
- Override / Control
- Audit Program Step

Risk Assessment Questions

- Is nepotism a fraud?
- Is favoritism a fraud?
- Is “Tone at the Top” changing?
- Do You Have Fraud Risk Assessment
- If management authorizes corruption, is it still corruption?
- If management rewrites policy to be in compliance is it non-compliance?
- If a deviant condition is approved does that make it okay?

Why the emphasis on Culture ...
From a company perspective...

When Bad Things Happen You have to get around
Internal Controls...if they are there

Be Better, Be Smarter, then Cheat

All the **Red Flags** came up and nobody did anything

Must Dos

- Know Your Company Strategy
- Lead a debrief at meetings on poor governance issues around the world
- Gauge employees perceptions of Organizational culture
- Review the misconduct reporting process
- Look outside the box for risk information
- Reevaluate incentive structure
- Update Ethics training