



Smart decisions. Lasting value.™

Anatomy of Fraud Risk Management Reporting and Response

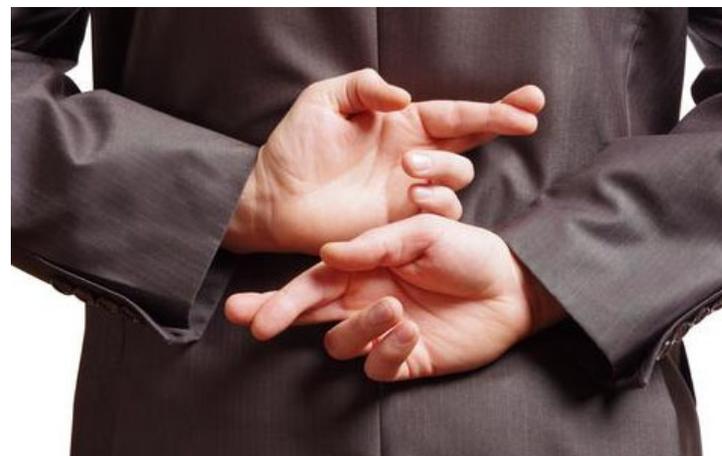
May 2021



Definition of Fraud



- An intentional perversion of truth
- for the purpose of inducing another in reliance upon it
- to part with some valuable thing or surrender a legal right



Motivation to Commit Fraud



Three factors are present when a person commits fraud

1. Perceived Pressure
2. Perceived Opportunity
3. Rationalization



Source: Donald Cressey – The Fraud Triangle. Other People’s Money: A Study in the Social Psychology of Embezzlement

Making The Connection



Ethics

- Standards of Behavior
- Ideals
- Moral action, conduct or character

Fraud

- Dishonesty
- Deception
- Bad Faith



The Underlying Issue of Fraud



The element of deception allows fraud to hide in plain sight among all the transactions posted

If you knew the transaction was fraudulent, you would not have processed it

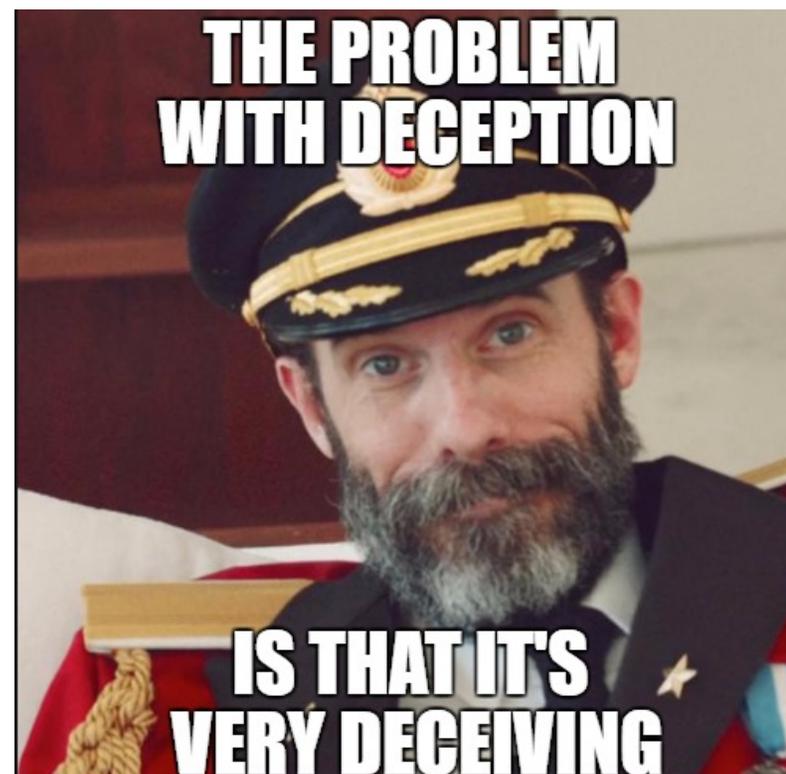
How do you identify anomalous transactions among all the transactions in the data set?



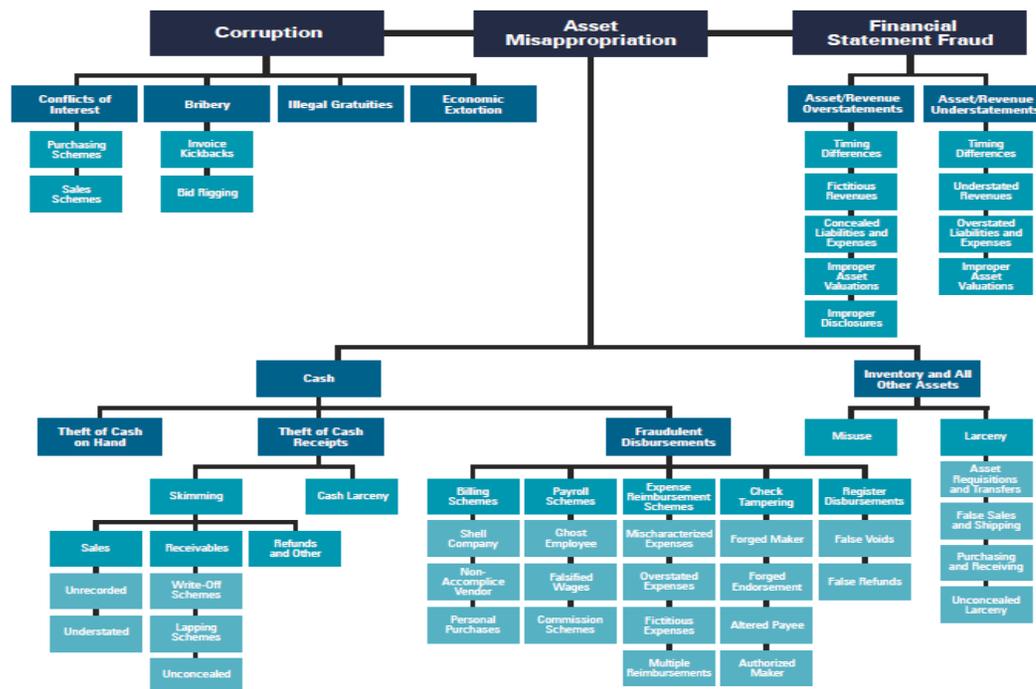
The Underlying Issue of Fraud



- Deception or falsehood is an act or statement which **misleads, hides the truth, or promotes a belief, concept, or idea that is not true.**
- Craft your questions carefully
- Listen to the response – Words have meaning
 - Misperception
 - Omission of critical details
- Professional skepticism



The Fraud Tree



Source: ACFE Occupational Fraud and Abuse Classification System (the Fraud Tree)

The Fraud Tree



Fraud, Waste & Abuse

Corruption

- Conflict of Interest
- Bribery / Kickbacks / Bid Rigging
- Illegal Gratuities
- Economic Extortion

Asset Misappropriation

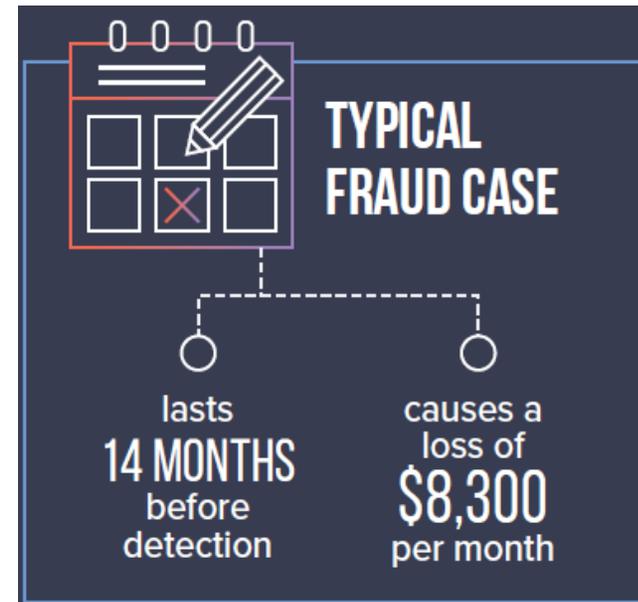
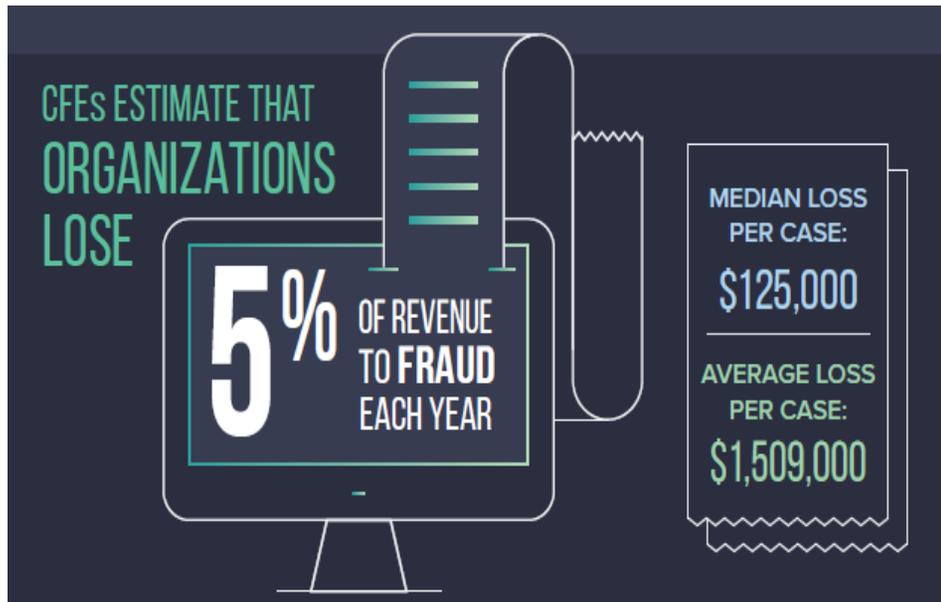
- Cash
- Fraudulent Disbursements
- Inventory and all other assets

Financial Statement Fraud

- Account revenue overstatement
- Asset revenue understatement



Define the Scope of the Issue



On average, businesses [lose about five per cent of their revenue to fraud](#) every year. Corruption, financial statement fraud, healthcare fraud, asset misappropriation and other forms of fraud are real risks for today's businesses.

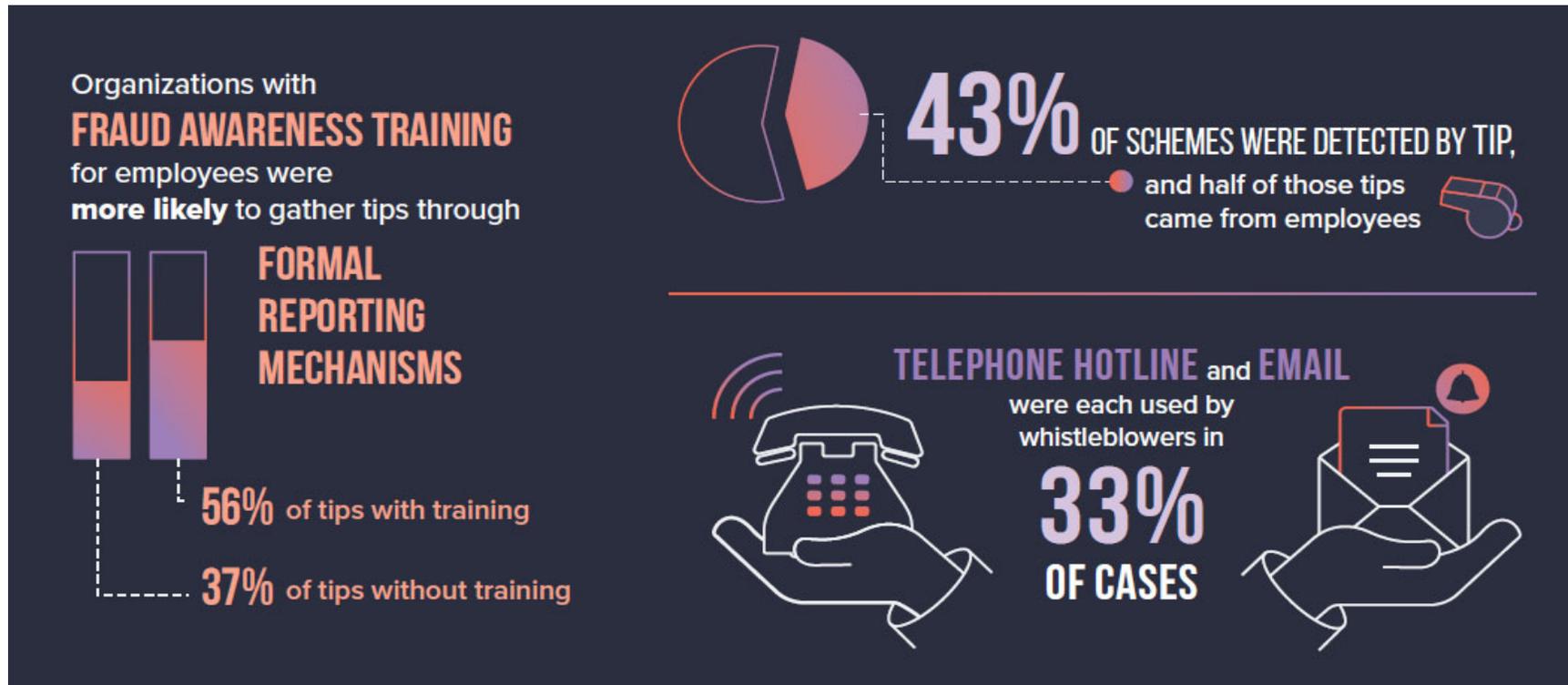
Source: ACFE Report to the Nation on the Risk of Occupational Fraud

Scope of the Issue Continued



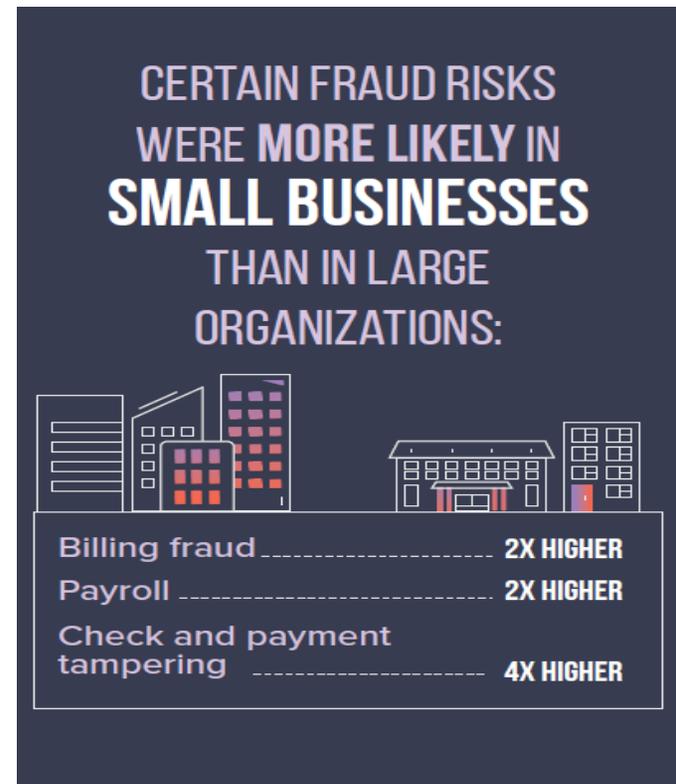
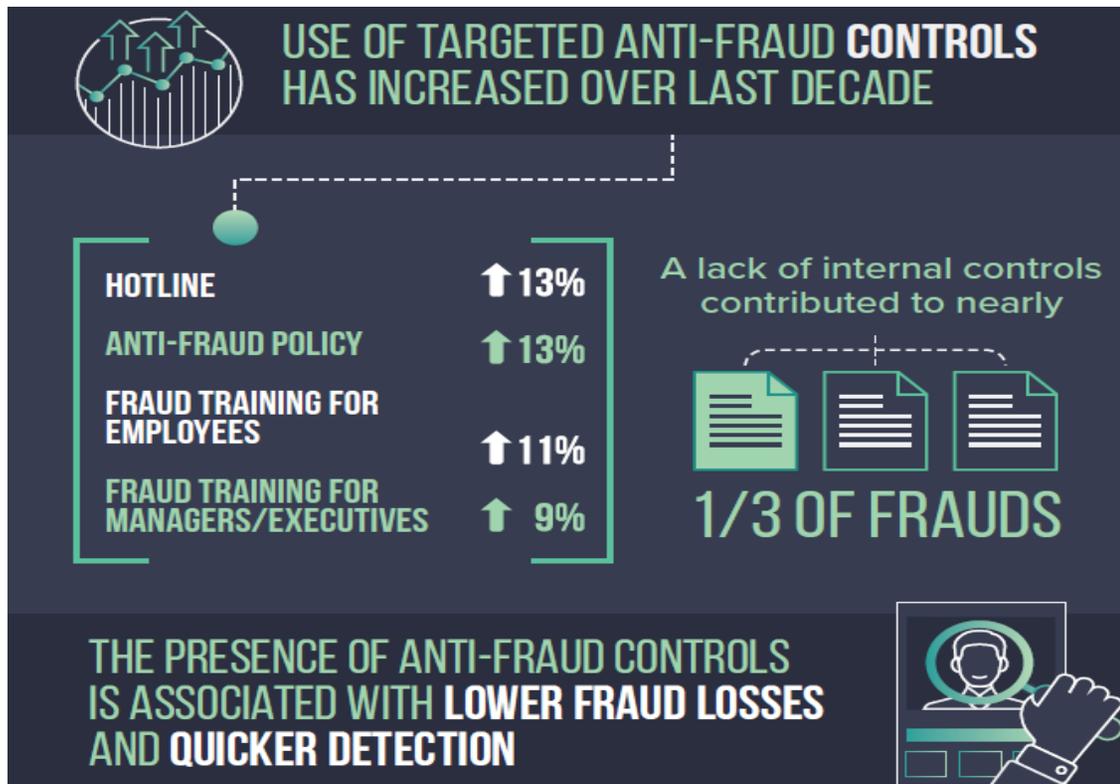
Source: ACFE Report to the Nation on the Risk of Occupational Fraud

How is Fraud Detected?



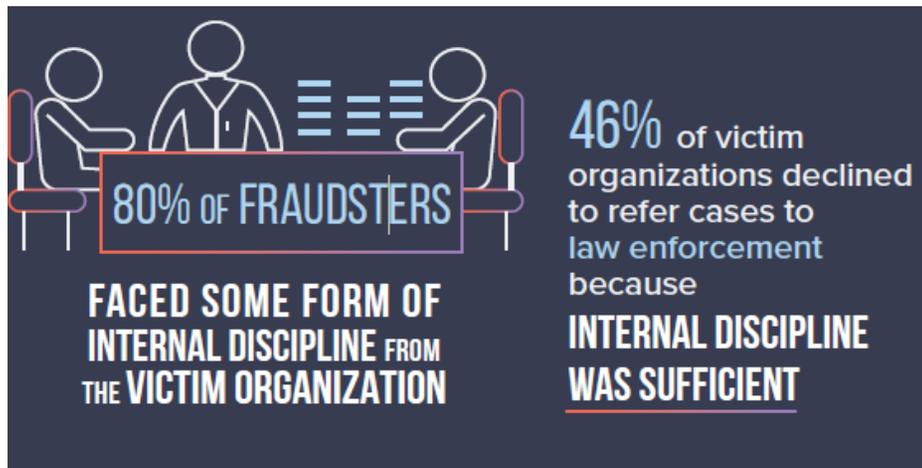
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How is Fraud Detected?



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How is Fraud Detected?



Source: ACFE Report to the Nation on the Risk of Occupational Fraud

Small Town Big Fraud – Trusted Employee



Rita Crundwell

- Former Comptroller, Dixon Illinois, \$83,000 annual salary
- Sentenced to 19.5 years in federal prison
- Stole \$54 million in city funds
- 169 unauthorized fund transfers over 12 years
- World class quarter horse breeder farm business RC Quarter Horses LLC, Dixon Illinois
- Winner of 52 world championships



Dixon, Illinois,

- Population 15,000 - 150 miles west of Chicago
- Largest municipal embezzlement in U.S. history
- Annual budget \$9 million
- City in financial crisis – hiring freeze – layoffs – multi year pay freeze - infrastructure improvements deferred – public safety improvements denied
- Crundwell opened a checking account that appeared to be a city account; RSCDA c/o Rite Crundwell
- Diversion of funds from City of Dixon State of Illinois municipal money market fund to RSCDA

Ponzi Schemer Bernie Madoff – Trusted Advisor



- Largest fraud in Wall Street history
- Largest Ponzi scheme in history
- New investor funding used to pay returns to older investors
- Provides the illusion of profitable investment



- Madoff was an investment advisor
- Helped launch NASDAQ and advised the SEC on the system
- Over several decades Madoff enjoyed the image of a self-made financial guru
- Statements claimed investor accounts totaled \$65 billion with double digit returns on investment
- **No securities were ever bought or sold**
- All the transactions on the statements were fake
- More than **15,400 claims against Madoff** were filed
- Estimates indicate the scheme ran **20 years**
- Victims ranged from Florida retirees to Hollywood elite
- Sentenced to 150 years in prison
- Madoff died April 14 in federal prison (82 years old)

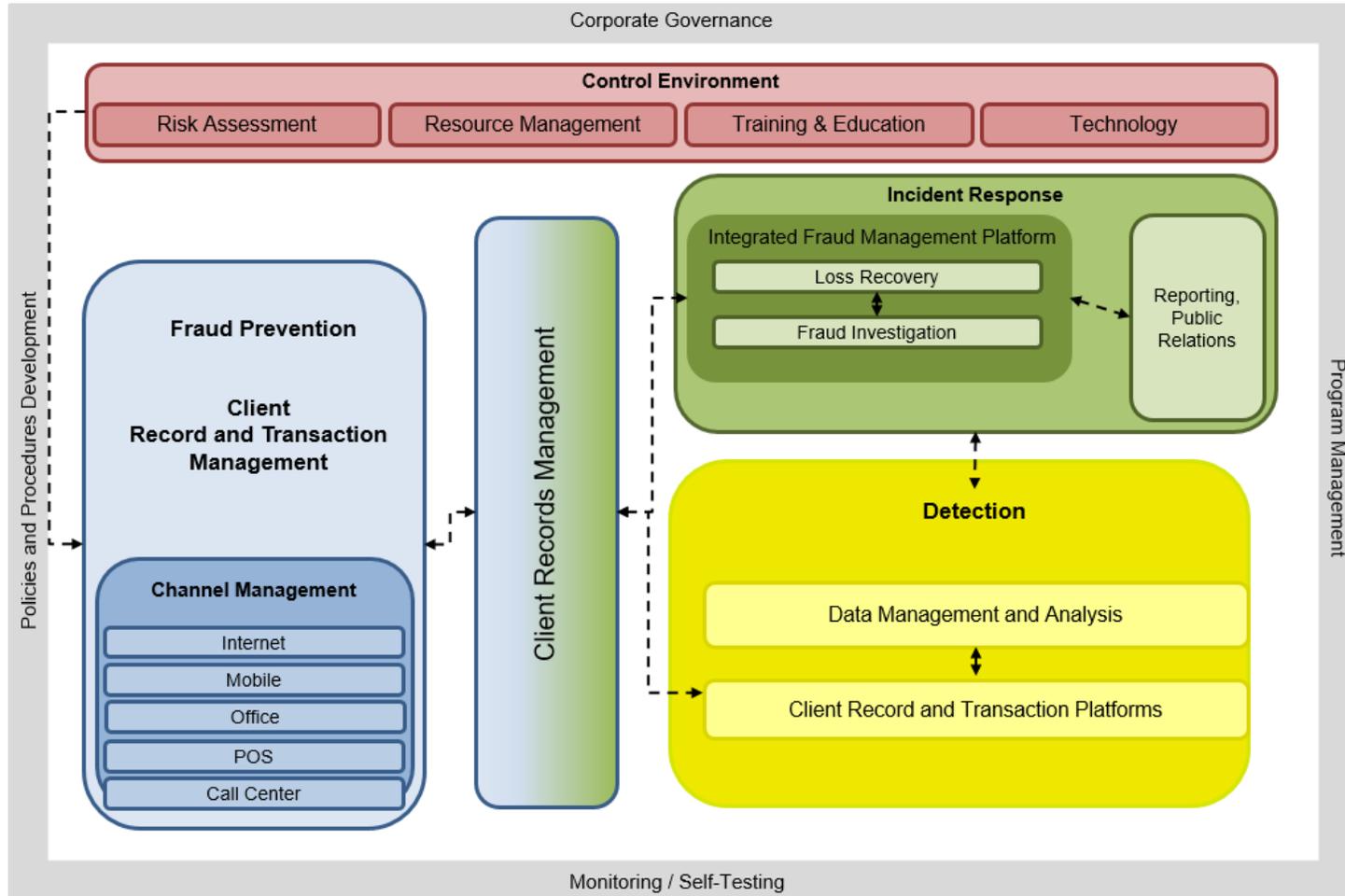
Fraud Risk Thrives in Uncertainty



- Historically, fraud fills the void when GDP declines
- Fraud thrives in times of uncertainty and anonymity
- Pandemic curtailed in person transactions in favor of e-commerce



Anti-Fraud Framework



Anti-Fraud Framework



Enterprise Foundation

- Formal fraud strategy
- Fraud Prevention Policy

Control Environment

- Risk Assessment
- Resource Management
- Training
- Socialize risk of fraud and red flags

Fraud Prevention

- Channel Management
- Account Management

Fraud Detection

- Ongoing monitoring
- Anomaly detection
- Data Management
- Data Quality
- Data Security
- Data Lineage
- Metadata Repository

Incident Response

- Enterprise-Wide Corporate Authority
- Investigation Management
- Loss Recovery
- Financial Management Reporting

Fraud Risk Mitigation – Culture – Code of Conduct and Code of Ethics



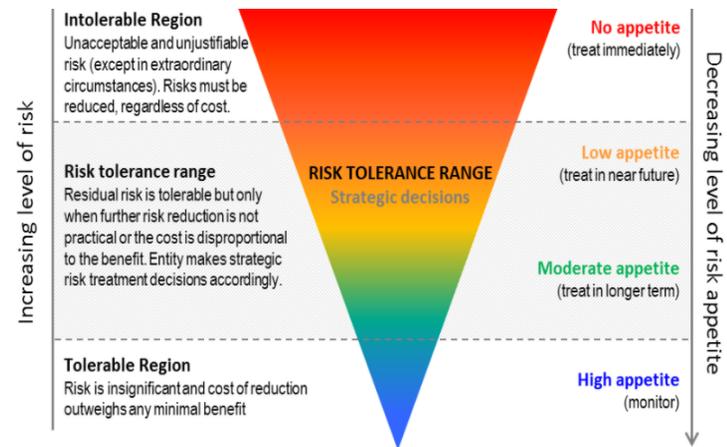
- Tone from the top
- Value Statement
- Good and lawful corporate citizen
- Do the right thing - Integrity
- Fair and respectful treatment
- Communicate expectations
- An affirmative duty to report
- Safe Harbor free from retaliation
- Employee Hotline



Enhancing the Anti-Fraud Risk Management Program



- Fraud strategy in alignment with enterprise risk
- Fraud policy align to strategy
- Procedures reflect strategy
- Fraud risk assessment
- Communication of the fraud risk management program
- Effective preventative and detective controls including transaction monitoring and testing
- Establish a communication plan to receive information
- Establish incident response plan
- Establish and Report on Fraud Typologies
- Monitor, evaluate and report on the enterprise fraud risk management program



Questions?



Closing thoughts

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