

# Fraud Risk Management

**PREVENTING FRAUD  
DETECTING WASTE  
RESPONDING TO ABUSE  
CREATING TRANSPARENCY  
AND  
ENSURING ACCOUNTABILITY**



# FRAUD, WASTE AND ABUSE

## KPMG Forensic Integrity Survey Data (2009)

- 80% of employees in the government and public sector have observed misconduct over the last year (compared to 74% across all sectors nationally).
- 56% stated they had seen instances of wasting, mis-managing or abusing organizational resources (compared to 46% across all sectors nationally).
- 33% reported they had seen mishandling of confidential or proprietary information (compared to 23% across all sectors nationally).
- 26% stated they were aware of employees or managers making false or misleading claims to the media (compared to 15% across all sectors nationally).
- 56% of those employees said that what they observed could cause a “significant loss of public trust” if discovered (compared to 46% across all sectors nationally).
- 41% lacked confidence that appropriate action would be taken if they reported a violation (compared to 34% across all sectors nationally).

Source: KPMG 2008-2009 Integrity Survey



©2009 KPMG LLP, a U.S. limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International. KPMG Forensic is a service mark of KPMG International. Service offerings are subject to legal and regulatory restrictions. Some service offerings may not be available to KPMG's audit or other attest service clients.

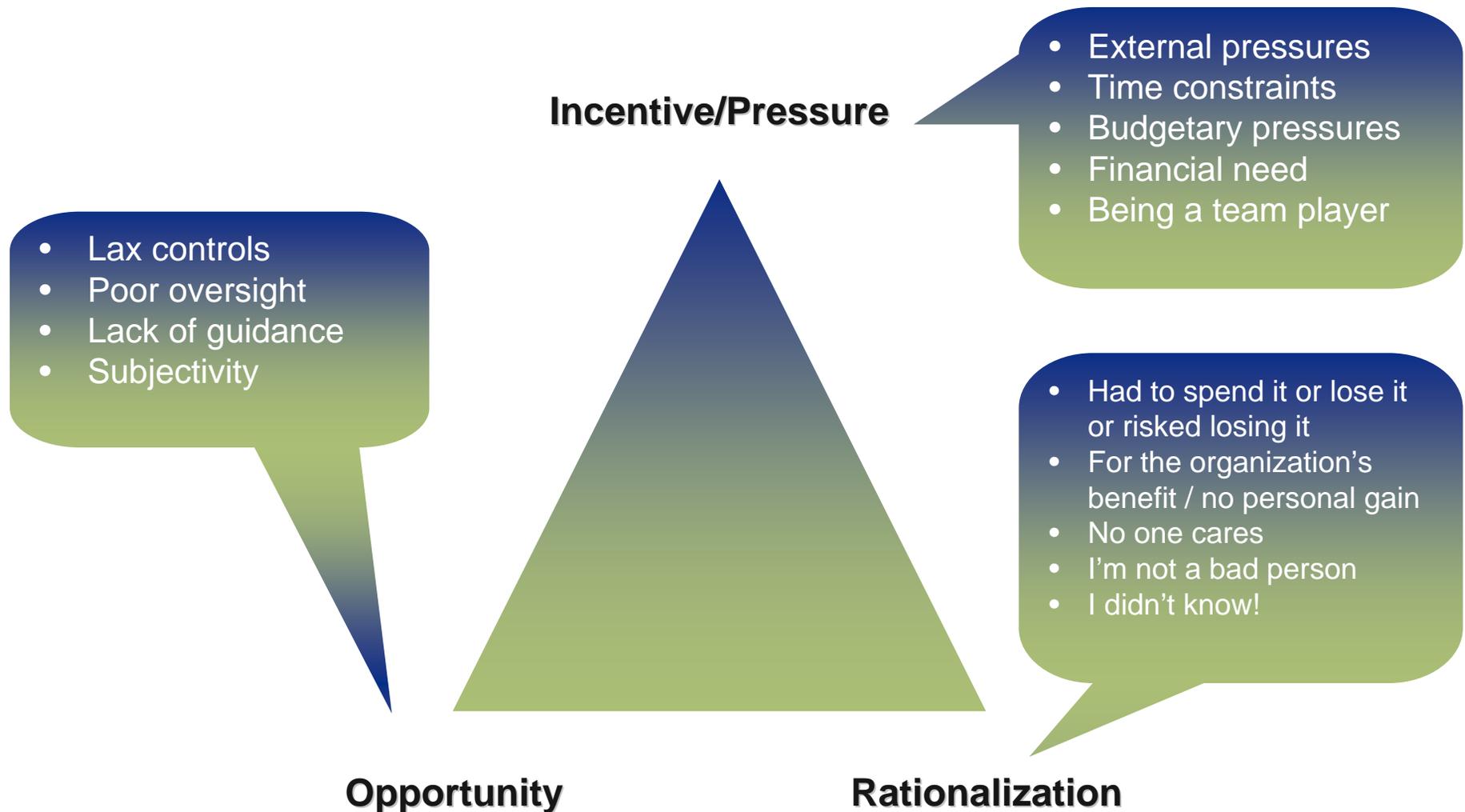
# Current Realities: Drivers in the Public and Political Environment

Driver	Relevance
Executive Office	<ul style="list-style-type: none"> <li>● Mandate for Transparency, Accountability and Efficiency.</li> <li>● Focus on issues surrounding the prevention and detection of fraud, waste and abuse.</li> </ul>
American Recovery and Reinvestment Act 2009	<ul style="list-style-type: none"> <li>● Unprecedented level of government funding within short timeframe.</li> <li>● Strict requirements for regular and accurate reporting.</li> <li>● GAO and OMB released guidance on increased control over use of funds.</li> <li>● Recovery Accountability and Transparency Board mandates.</li> </ul>
Public Scrutiny	<ul style="list-style-type: none"> <li>● Concentrated public and political scrutiny on government expenditure.</li> <li>● No tolerance for fraud waste and abuse.</li> </ul>

# Current Realities: Drivers in the Legal and Regulatory Environment

Driver	Relevance
Office of Chief Performance Officer	<ul style="list-style-type: none"> <li>● New cabinet level post.</li> <li>● New administration's focus on efficiency, transparency and accountability.</li> <li>● Anticipated targeted reviews of specific areas of government operation.</li> </ul>
Government Auditing Standards (Yellow Book)	<ul style="list-style-type: none"> <li>● Auditors have responsibilities for detecting fraud and illegal acts that have a material effect on the financial statements.</li> <li>● Auditors determine whether those charged with governance are adequately informed about fraud and illegal acts.</li> </ul>
Federal Funding Accountability and Transparency Act 2006	<ul style="list-style-type: none"> <li>● Greater transparency in government contracting.</li> <li>● Greater public access to the details of each vendor and contract available online.</li> </ul>
Improper Payments Information Act 2002	<ul style="list-style-type: none"> <li>● Identify programs and activities that may be susceptible to significant improper payments</li> <li>● Annual estimation of improper payments</li> </ul>
Federal Sentencing Guidelines	<ul style="list-style-type: none"> <li>● Provides minimum criteria for programs to prevent and detect violations of law.</li> <li>● Requires periodic evaluation of the effectiveness of compliance programs.</li> <li>● Identified in DOJ policy on whether to prosecute agencies.</li> </ul>

# Why do People Commit Fraud or Misconduct?



# How to Prevent, Detect and Respond to Fraud

## What is it?

Fraud Risk Management is aimed at helping companies achieving three core objectives:

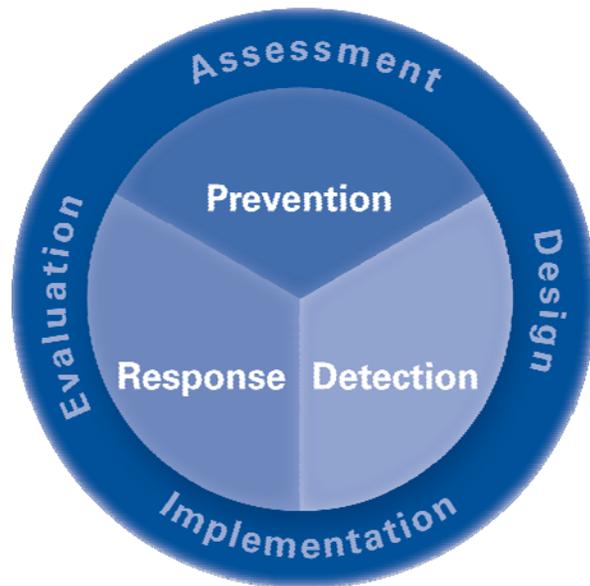
- **Prevent** instances of fraud, waste, abuse, misconduct and non-compliance from occurring in the first place
- **Detect** instances when they do occur
- **Respond** appropriately and take corrective action when instances arise

Companies should focus their efforts to achieve these objectives through the:

- **Assessment** of needs based on the nature of fraud and misconduct risks and existing controls
- **Design** of programs and controls in a manner consistent with legal and regulatory criteria as well as industry practices that organizations have generally found to be effective
- **Implementation** of programs and controls through assigning roles, building competencies and deploying resources
- **Evaluation** of program and control design and operational effectiveness in achieving their objectives



# Fraud and Misconduct Risk Assessment Leading Practices



## Understanding fraud red flags

- Incentives/Pressures
- Opportunities

## Evaluating entity-level/operating unit/process/functions

## Determining inherent/residual risk

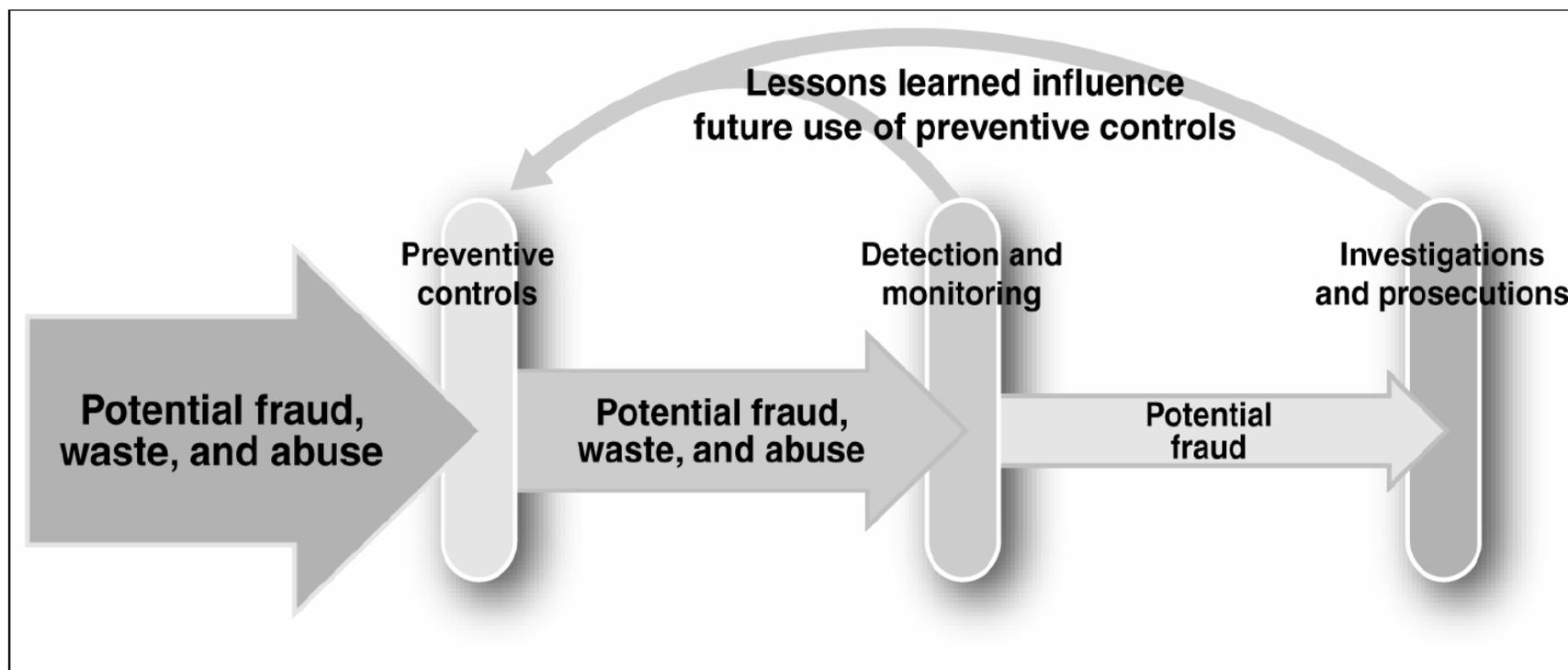
## Balancing risk and control

## Assessing management override & collusion

## Facilitating Fraud Workshop/Brainstorming sessions

# Process Flow of an Effective Fraud Risk Management Program

**Figure 1: Program Designed to Minimize Fraud, Waste, and Abuse**



Source: GAO.

# Key Elements of Fraud Risk Management and Compliance Risk Management

## Sample Compliance Program Processes

The graphic to the right depicts the key elements typically associated with fraud and compliance risk management models:

- Assessing the nature, likelihood and impact of fraud, waste and misconduct risk.
- Establishing policies and standards that meet expectations on acceptable practices.
- Exercising due diligence to screen employees and government representatives that may have a propensity to violate the agency's standards.
- Providing communication and training to raise employee awareness and understanding of the compliance risks associated with their responsibilities.
- Auditing and monitoring to evaluate the degree to which the program is operating as intended and compliance with the agency's standards is being achieved.
- Investigating allegations of wrongdoing.
- Taking corrective action in response to substantiated instances of non-compliance.
- Measuring and reporting on the overall effectiveness of program activity.

COMPLIANCE PROCESS OVERVIEW



# Sample Compliance Risk Management Program Elements

Prevention	Detection	Response
<b>Audit, Compliance and Monitoring Functions</b>		
<ul style="list-style-type: none"> <li>● Fraud and misconduct risk assessment</li> <li>● Code of conduct and related standards</li> <li>● Employee and third-party due diligence</li> <li>● Communication and training</li> <li>● Process-specific fraud risk controls</li> <li>● Proactive forensic data analysis</li> </ul>	<ul style="list-style-type: none"> <li>● Hotlines and whistleblower mechanisms</li> <li>● Auditing and monitoring</li> <li>● Retrospective forensic data analysis</li> </ul>	<ul style="list-style-type: none"> <li>● Internal investigations and investigative protocols</li> <li>● Enforcement and accountability protocols</li> <li>● Disclosure protocols</li> <li>● Remedial action protocols</li> </ul>

# Critical Success Factors – Fraud Risk Management

## *What Works and What Does Not*

Based on our previous work and experience, the following are high level guidelines for Fraud Risk Management.

- ✓ **Enterprise-wide risk-based approach**
- ✓ **Strong governance model with active involvement of senior executives and regular robust reporting to the Board of Directors**
- ✓ **End-to-end process to identify, measure, monitor, and manage vendor risks**
- ✓ **Centralized data repository for all third-party provider information**
- ✗ **Fragmented and disparate policies, procedures, and approach.**
- ✗ **Focus solely on spend and cost, not risk.**
- ✗ **De-centralized data repository of vendor information.**
- ✗ **Lack of risk management and due diligence**

# Identifying and Filling the Gaps

Typical Management Challenges	Sample Areas of Assistance
Are we focused on the right risk areas?	<ul style="list-style-type: none"> <li>● Fraud and Misconduct Risk Assessment</li> </ul>
Do we have the right controls in place?	<ul style="list-style-type: none"> <li>● Gap Analysis</li> </ul>
Is our program influencing behaviors and culture?	<ul style="list-style-type: none"> <li>● Benchmarking Survey / Focus Groups</li> </ul>
How can we leverage technology to identify red flags?	<ul style="list-style-type: none"> <li>● Forensic Data Analysis</li> </ul>
How do we monitor the integrity of funding initiatives?	<ul style="list-style-type: none"> <li>● Compliance Monitoring</li> </ul>
How can we get better at _____ (e.g., coordinating oversight functions, reporting, reducing conflicts of interest, performing due diligence on third parties, managing investigations?)	<ul style="list-style-type: none"> <li>● Targeted and Tailored Assistance</li> </ul>

Questions?

**Thank you.**

**Darren Donovan**

**KPMG Forensic**

**[djdonovan@kpmg.com](mailto:djdonovan@kpmg.com)**

**617-988-1833**

