Fraud Risk Management

PREVENTING FRAUD

DETECTING WASTE

RESPONDING TO ABUSE

CREATING TRANSPARENCY

AND

ENSURING ACCOUNTABILITY
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
## Current Realities: Drivers in the Public and Political Environment

<table>
<thead>
<tr>
<th>Driver</th>
<th>Relevance</th>
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<tbody>
<tr>
<td>Executive Office</td>
<td>• Mandate for Transparency, Accountability and Efficiency.</td>
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<td></td>
<td>• Focus on issues surrounding the prevention and detection of fraud, waste and abuse.</td>
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<td>American Recovery and Reinvestment Act 2009</td>
<td>• Unprecedented level of government funding within short timeframe.</td>
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<td>• Strict requirements for regular and accurate reporting.</td>
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<td></td>
<td>• GAO and OMB released guidance on increased control over use of funds.</td>
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<td>• Recovery Accountability and Transparency Board mandates.</td>
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<td>Public Scrutiny</td>
<td>• Concentrated public and political scrutiny on government expenditure.</td>
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<td>• No tolerance for fraud waste and abuse.</td>
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## Current Realities:
Drivers in the Legal and Regulatory Environment

<table>
<thead>
<tr>
<th>Driver</th>
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<tbody>
<tr>
<td>Office of Chief Performance Officer</td>
<td>● New cabinet level post.</td>
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<td>● New administration’s focus on efficiency, transparency and accountability.</td>
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<td></td>
<td>● Anticipated targeted reviews of specific areas of government operation.</td>
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<tr>
<td>Government Auditing Standards (Yellow Book)</td>
<td>● Auditors have responsibilities for detecting fraud and illegal acts that have a material effect on the financial statements.</td>
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<td>● Auditors determine whether those charged with governance are adequately informed about fraud and illegal acts.</td>
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<td>Federal Funding Accountability and Transparency Act 2006</td>
<td>● Greater transparency in government contracting.</td>
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<td>● Greater public access to the details of each vendor and contract available online.</td>
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<tr>
<td>Improper Payments Information Act 2002</td>
<td>● Identify programs and activities that may be susceptible to significant improper payments</td>
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<td></td>
<td>● Annual estimation of improper payments</td>
</tr>
<tr>
<td>Federal Sentencing Guidelines</td>
<td>● Provides minimum criteria for programs to prevent and detect violations of law.</td>
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</tbody>
</table>
|                                                  | ● Requires periodic evaluation of the effectiveness of compliance programs.
|                                                  | ● Identified in DOJ policy on whether to prosecute agencies.              |
Why do People Commit Fraud or Misconduct?

- Incentive/Pressure
  - External pressures
  - Time constraints
  - Budgetary pressures
  - Financial need
  - Being a team player

- Opportunity
  - Lax controls
  - Poor oversight
  - Lack of guidance
  - Subjectivity

- Rationalization
  - Had to spend it or lose it or risked losing it
  - For the organization’s benefit / no personal gain
  - No one cares
  - I’m not a bad person
  - I didn’t know!
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
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

- Preventive controls
  - Lessons learned influence future use of preventive controls
- Detection and monitoring
- Investigations and prosecutions
- Potential fraud, waste, and abuse
- Potential fraud, waste, and abuse
- Potential fraud

Source: GAO.
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.
## Sample Compliance Risk Management Program Elements

<table>
<thead>
<tr>
<th>Prevention</th>
<th>Detection</th>
<th>Response</th>
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</thead>
<tbody>
<tr>
<td>Fraud and misconduct risk assessment</td>
<td>Hotlines and whistleblower mechanisms</td>
<td>Internal investigations and investigative protocols</td>
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<tr>
<td>Code of conduct and related standards</td>
<td>Auditing and monitoring</td>
<td>Enforcement and accountability protocols</td>
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<tr>
<td>Employee and third-party due diligence</td>
<td>Retrospective forensic data analysis</td>
<td>Disclosure protocols</td>
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<tr>
<td>Communication and training</td>
<td></td>
<td>Remedial action protocols</td>
</tr>
<tr>
<td>Process-specific fraud risk controls</td>
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<tr>
<td>Proactive forensic data analysis</td>
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Audit, Compliance and Monitoring Functions
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

<table>
<thead>
<tr>
<th>Typical Management Challenges</th>
<th>Sample Areas of Assistance</th>
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<tbody>
<tr>
<td>Are we focused on the right risk areas?</td>
<td>● Fraud and Misconduct Risk Assessment</td>
</tr>
<tr>
<td>Do we have the right controls in place?</td>
<td>● Gap Analysis</td>
</tr>
<tr>
<td>Is our program influencing behaviors and culture?</td>
<td>● Benchmarking Survey / Focus Groups</td>
</tr>
<tr>
<td>How can we leverage technology to identify red flags?</td>
<td>● Forensic Data Analysis</td>
</tr>
<tr>
<td>How do we monitor the integrity of funding initiatives?</td>
<td>● Compliance Monitoring</td>
</tr>
<tr>
<td>How can we get better at __________ (e.g., coordinating oversight functions, reporting, reducing conflicts of interest, performing due diligence on third parties, managing investigations?)</td>
<td>● Targeted and Tailored Assistance</td>
</tr>
</tbody>
</table>
Thank you.
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