

DAVID L. COTTON, CPA, CFE, CGFM
COTTON & COMPANY LLP CHAIRMAN

Dave Cotton is chairman of Cotton & Company LLP, Certified Public Accountants, headquartered in Alexandria, Virginia. The firm was founded in 1981 and has a practice concentration in assisting Federal and State government agencies, inspectors general, and government grantees and contractors with a variety of government program-related assurance and advisory services. Cotton & Company has performed grant and contract, indirect cost rate, financial statement, financial related, and performance audits for more than two dozen Federal inspectors general as well as numerous other Federal and State agencies and programs.

Cotton & Company's Federal agency audit clients have included the U.S. Government Accountability Office, U.S. Navy, U.S. Marine Corps, U.S. House of Representatives, U.S. Capitol Police, U.S. Small Business Administration, U.S. Bureau of Prisons, Millennium Challenge Corporation, U.S. Marshals Service, and Bureau of Alcohol, Tobacco, Firearms and Explosives. Cotton & Company also assists numerous Federal agencies in preparing financial statements and improving financial management, accounting, and internal control systems.

Dave received a BS in mechanical engineering (1971) and an MBA in management science and labor relations (1972) from Lehigh University in Bethlehem, PA. He also pursued graduate studies in accounting and auditing at the University of Chicago Graduate School of Business (1977 to 1978). He is a Certified Public Accountant (CPA), Certified Fraud Examiner (CFE), and Certified Government Financial Manager (CGFM).

Dave served on the Advisory Council on Government Auditing Standards (the Council advises the United States Comptroller General on promulgation of **Government Auditing Standards**—GAO's yellow book) from 2006 to 2009. He served on the Institute of Internal Auditors (IIA) Anti-Fraud Programs and Controls Task Force and co-authored **Managing the Business Risk of Fraud: A Practical Guide**. He served on the American Institute of CPAs Anti-Fraud Task Force and co-authored **Management Override: The Achilles Heel of Fraud Prevention**. Dave is the past-chair of the AICPA Federal Accounting and Auditing Subcommittee and has served on the AICPA Governmental Accounting and Auditing Committee and the Government Technical Standards Subcommittee of the AICPA Professional Ethics Executive Committee. Dave chaired the Fraud Risk Management Task Force, sponsored by COSO and ACFE and is a principal author of the **COSO-ACFE Fraud Risk Management Guide**. He is presently serving on the AICPA's Performance Audit Standards Task Force.

Dave served on the board of the Virginia Society of Certified Public Accountants (VSCPA) and on the VSCPA Litigation Services Committee, Professional Ethics Committee, Quality Review Committee, and Governmental Accounting and Auditing Committee. He is a member of the Association of Government Accountants (AGA) and past-advisory board chairman and past-president of the AGA Northern Virginia Chapter. He is also a member of the Institute of Internal Auditors and the Association of Certified Fraud Examiners.

Dave has testified as an expert in governmental accounting, auditing, and fraud issues before the United States Court of Federal Claims and other administrative and judicial bodies.

Dave has spoken frequently on cost accounting, professional ethics, and auditors' fraud detection responsibilities under SAS 99, *Consideration of Fraud in a Financial Statement Audit*. He has been an instructor for the George Washington University masters of accountancy program (**Fraud Examination and Forensic Accounting**), and has instructed for the George Mason University Small Business Development Center (**Fundamentals of Accounting for Government Contracts**).

Dave was the recipient of the AGA's 2006 Barr Award ("to recognize the cumulative achievements of private sector individuals who throughout their careers have served as a role model for others and who have consistently exhibited the highest personal and professional standards") as well as AGA's 2012 Educator Award ("to recognize individuals who have made significant contributions to the education and training of government financial managers").



Professional Development Training
Prevent and Protect: The First Line of Defense
April 27, 2017

Managing Fraud Risk: ACFE/COSO Fraud Risk Management Guide

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Plan for This Session ...

- Fraud Happens
- Anti-Fraud Guidance
- Managing the Business Risk of Fraud
- COSO Internal Control Update and Assessing Fraud Risk
- COSO-ACFE Task Force and the Fraud Risk Management Guide
- The Future: What to Expect

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Fraud Happens ...

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Billy-Bob ...

- **Is fantastic ...**
- **Has been with us for years ...**
- **Does *ALL* of the accounting stuff so that we can focus on more important things ...**
- **Works long hours and many weekends ...**
- **Never takes a vacation ...**
- **Works for very modest pay and never asks for a raise (we think he inherited some money/retired after a successful career in some other field) ...**
- **Has turned down offers to work elsewhere for more money because he believes in our mission ...**

Mary-Lou ...

- **Is fantastic and totally dedicated to our mission ...**
- **Has been our executive director since our founding ...**
- **We wouldn't be where we are today without her ...**
- **Is a "hands-on" and "no nonsense" executive and makes all of the important decisions ...**
- **Works long hours and most weekends ...**
- **Never takes a vacation ...**
- **Knows everyone on the board and personally recommended each one ...**
- **Makes board service easy, because she really runs the organization with an iron hand ...**



Fraud Happens ...

Four words precede EVERY fraud:

Eight words follow EVERY fraud:

The Case of the Trusted Treasurer



Rita Crundwell

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Rita Crundwell

- Born Jan 10, 1953
- Grew up on a family farm near Dixon, Illinois (population ~15,000; boyhood home of Ronald Reagan)
- Appointed treasurer/comptroller of Dixon in 1983
- Embezzled ~\$53 million from the city from 1990 to 2012
 - 1991--\$181,000;
 - 2008--\$5.8 million
- Arrested April 17, 2012
- Pled guilty on November 14, 2012
- Sentenced to 19 years and 7 months in prison on February 14, 2013

**Dixon's 2012
budget was
~\$17 million**

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How Did She Do It?

- Opened a bank account called Reserve Sewer Capital Development Account (RSCDA) with herself as the only signatory
- Moved City funds into a legitimate City account—Capital Development Account (CDA)
- Created phony invoices that she paid with CDA checks payable to “Treasurer”
- Deposited checks into the RSCDA
- Used funds to run her thoroughbred horse farm and business and on “prize-winning horses, expensive jewelry, luxury cars and even birthday bashes in Venice Beach, Fla.”*

*Source: http://www.huffingtonpost.com/2013/02/06/rita-crundwell-sentencing_n_2633791.html

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Rita's \$2.1 Million Motor Coach



How Did She Get Caught?

- While Rita was away at a horse show, another city employee stumbled upon the secret account.

Psychopath or Sociopath?





Psychopath or Sociopath?

... prosecutors noted that while Crundwell was stealing from the city, she repeatedly argued for painful spending cuts at budget meetings. She claimed the shortfalls were the result of an economic downturn and late payments from Illinois' state government, according to prosecutors.

"Day after day, for more than 20 years, (the) defendant would work with employees of the city of Dixon and interact with citizens in her capacity as comptroller while lying about the reason the city of Dixon lacked funds," U.S. Attorney Gary Shapiro wrote.

... the impact of the theft: Police could not afford to upgrade squad car radios or make new hires, streets could not be resurfaced, a waste water treatment facility had to be delayed and the city had to issue \$3 million in bonds to cover financial obligations.

"... prosecutors included a news article about Crundwell's 2010 birthday party in Venice Beach. Paid for with the help of stolen money, the party had live music, prime rib and jumbo shrimp cocktails.

"Rita was gorgeous as always in one of her trademark 'must have' coats," said the article in GoHorseShow.com.

Source: http://www.huffingtonpost.com/2013/02/06/rita-crundwell-sentencing_n_2633791.html

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[http://www.nbcnews.com/video/rock-center/
49113424#49113424](http://www.nbcnews.com/video/rock-center/49113424#49113424)

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Dixon, IL – Outcomes

- Attorneys fees for investigating the fraud and negotiating settlements with accounting firms and the bank totaled \$10 million
- Settlement with the CPA firm that assisted Dixon with accounting and financial management: \$35.15 million
- Settlement with the CPA firm that performed Dixon's annual audit since 2006: \$1 million
- Settlement with the bank where Dixon's accounts were maintained and where Crundwell set up the bogus account: \$3.85 million

Dixon, IL – Outcomes

Bottom Line:

Amount misappropriated by Crundwell:	~\$54 million
Attorneys fees:	<u>~\$10 million</u>
Loss to Dixon:	~\$64 million
Recovery from sale of Crundwell assets:	~\$10 million
Settlement with accounting firm:	~\$35 million
Settlement with audit firm:	~\$1 million
Settlement with bank:	<u>~\$4 million</u>
Dixon's net monetary loss:	<u>~\$14 million</u>

***What control procedure(s)
would have thwarted Rita's
fraud?***



The Case of the the Talented AGA Member from Tennessee

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Case Study

The Talented AGA Member from Tennessee



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Jeffrey Wayne Hughes, CGFM, CFE, MBA



Case Study

The Talented AGA Member from Tennessee

Jeffrey Wayne Hughes has an impressive resume

- BBA, Human Resources Management & Accounting, 2005, Univ. of Northern Alabama
- MBA, Management, 2008, Univ. of North Alabama
- Auditor II, Tennessee Comptroller of the Treasury, Mar 2006 - Feb 2010
- Regional Accountant, TN Dept. of Health, Feb 2010 – Sep 2010
- Chairman of the Board, A Kid’s Place Child Advocacy Center, Jul 2014 – Mar 2016
- Lawrence County (TN) Commissioner, Sep 2014 – Mar 2016
- Fiscal Director, Tennessee Dept. of Corrections, Sep 2012 – Apr 2016
- Customer Service Representative, Amazon, Jun 2016 – Jul 2016



Case Study

The Talented AGA Member from Tennessee

Jeff Hughes was a rising star at AGA

Finance and Budget Committee Member

Association of Government Accountants (AGA)
July 2015 – March 2016 (9 months) | Alexandria, Virginia



 Honors & Awards

2008-2009 Nashville AGA Member of the Year

Nashville Chapter of AGA
May 2009

Innovative Idea Award

Nashville Chapter of AGA
May 2010

President's Award

Nashville Chapter of AGA
May 2014

Emerging Leader Award of Excellence

Association of Government Accountants
June 2014

Each year, AGA presents one or more crystal awards to nationally recognize younger government financial managers for notable contributions toward excellence in financial management. It is hoped that this recognition will encourage others to achieve early in their professional lives.





**Professional Development Training
Prevent and Protect: The First Line of Defense
April 27, 2017**



NASHVILLE NOTES

April 2009
Volume 31, Number 9

Do Volunteer Organizations Have Good Controls?

By Jeff Hughes

Many of us belong to various clubs and organizations in both our professional and personal life. Most, if not all, of these organizations collect money and write checks. Are there controls in place to help prevent theft though? I have noticed in some of the organizations in which I am a member, people volunteer their time dearly; however, most of these have no financial background and do not think of the checks and balances that should be in place.

Just this January I was asked to take over the Treasury position for an organization in Lawrence County. All of the members of this organization are volunteers and no one receives any compensation for their time. The reason I was asked if I would take over is because of my background. This organization is the Board to the 13 volunteer fire departments within the County.

Another thing to consider is where the mail is going. The organization I belong to does not have a "physical" location, so there was not a set mailing address. When I became Treasurer I learned that mail was being sent to about 3 or 4 different addresses. That type of situation can cause a lot of confusion and could allow unusual transactions to go unnoticed. That stopped the day I was given the checkbook. All mail is now routed to a post office box in which only three people have a key.

All organizations, no matter how small, must have monitoring procedures in place. Everyone hates having to balance a checkbook but it is an essential part of life. The previous Treasurer was the only person involved in reconciling the bank account. Now before the bank statement reaches me the

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"Was it Voter Fraud" by Jeff Hughes

September / October 2010
Volume 34, Number 1

In the recent county general elections that were held across the state, the county I live in had an interesting turn of events take place. We had a person who lives in Giles County decide that he wanted to run in the Lawrence County Sheriff's race. In order to do so he only had to be a resident of Tennessee and registered to vote in that county. Well luckily this guy owned a shack in Lawrence County so the same day that he qualified to be on the ballot was the same day he became a registered voter in

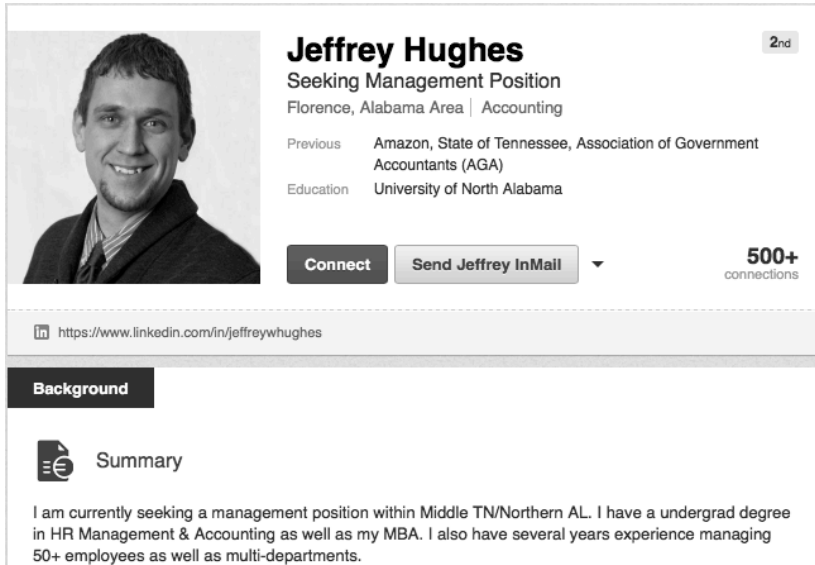
This case went to trial last week, and the judge did declare that the Giles County candidate was not a qualified candidate for the race in Lawrence County; however, he did not believe "fraud" took place.

After the case last week, I was curious how one could live in one county but vote in another so I looked at the voter application and did some reading. I do agree that a local election commission cannot go looking at properties to see if someone really lives there or not, that just isn't possible. So what does

Case Study

The Talented AGA Member from Tennessee

Jeff Hughes was, until recently, seeking new employment




Jeffrey Hughes 2nd
Seeking Management Position
Florence, Alabama Area | Accounting

Previous Amazon, State of Tennessee, Association of Government Accountants (AGA)
Education University of North Alabama

[Connect](#) [Send Jeffrey InMail](#) 500+ connections

<https://www.linkedin.com/in/jeffrewhughes>

Background

 Summary

I am currently seeking a management position within Middle TN/Northern AL. I have a undergrad degree in HR Management & Accounting as well as my MBA. I also have several years experience managing 50+ employees as well as multi-departments.

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Case Study

The Talented AGA Member from Tennessee

What is the anomaly in Jeff's impressive resume?

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- MBA, Management, 2008, Univ. of North Alabama
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- Regional Accountant, TN Dept. of Health, Feb 2010 – Sep 2010
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- Customer Service Representative, Amazon, Jun 2016 – Jul 2016

Case Study

The Talented AGA Member from Tennessee

Jeffrey's life changed abruptly in April 2016



Former Lawrence Co. commissioner indicted on theft, forgery charges

Posted: Apr 15, 2016 5:18 PM EDT

Updated: Apr 29, 2016 5:18 PM EDT

Posted by Stuart Ervin **CONNECT**

LAWRENCEBURG, TN (WSMV) - A former Lawrence County commissioner has been indicted for allegedly stealing more than a quarter-million dollars.

Officials said Jeffrey Hughes is charged with theft of over \$250,000 from Lawrence County Fire and Rescue, and theft of over \$10,000 from Crossroads Volunteer Fire Department. He is also facing 136 counts of forgery.

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Source: <http://www.wsmv.com/story/31738666/former-lawrence-co-commissioner-indicted-on-theft-forgery-charges>

Case Study

The Talented AGA Member from Tennessee

Jeffrey's life changed abruptly in April 2016



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Source: <http://www.wsmv.com/story/31738666/former-lawrence-co-commissioner-indicted-on-theft-forgery-charges>



Case Study

The Talented AGA Member from Tennessee



Monday, December 5, 2016

Former county commissioner garners twenty-seven year sentence

Lawrenceburg Now

A former Lawrence County Commissioner, indicted earlier this year on more than two hundred criminal charges for the theft of more than a quarter of a million dollars from local fire departments, appeared in court for a sentencing hearing Monday morning.

After hearing evidence in the case, Lawrence County Circuit Court Judge Russ Parkes sentenced Jeffrey Hughes to a total of twenty-seven years, to be served with the Tennessee Department of Corrections.



Source: <http://www.lawrenceburgnow.com/120516former.html>

Case Study



LAWRENCE COUNTY FIRE AND RESCUE, INC. AND CROSSROADS VOLUNTEER FIRE DEPARTMENT

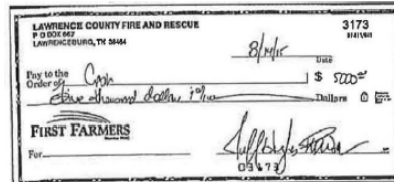
Special Investigation
April 18, 2016



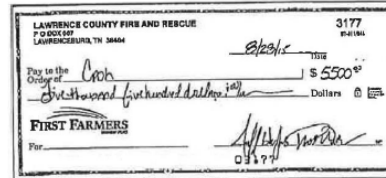
Case Study

According to the Comptroller's Investigation

- Lawrence County Fire and Rescue operates as an umbrella organization to facilitate the operations of the 13 volunteer fire departments in Lawrence County, including Crossroads VFD.
- Hughes served as treasurer for both Lawrence County Fire and Rescue and for the Crossroads VFD
- Hughes misappropriated at least \$254,266 by issuing unauthorized fire and rescue checks for his personal benefit



Exhibits 1 & 2



Case Study

According to the Comptroller's Investigation

- Hughes:
 - Wrote more than 80 checks payable to cash totaling over \$188,679
 - Wrote more than 80 checks totaling \$42,491 to Walmart ... to purchase gift cards
 - Made other improper withdrawals totaling \$12,651
 - Funneled \$10,445 from the LCF&R account to the Crossroads VFD account, then diverted those funds for his personal use
 - Misappropriated at least \$10,800 from Crossroads VFD



Case Study

According to the Comptroller's Investigation

Summary of Misappropriated Funds by Jeffrey Hughes	Amount	Totals
Lawrence County Fire and Rescue		
Method of Misappropriation		
Checks payable to cash	\$188,679	
Purchase of Walmart gift cards	42,491	
Other improper withdrawals	12,651	
Money funneled to Crossroads	<u>10,445</u>	
Total Lawrence County Fire and Rescue		\$254,266
Crossroads Volunteer Fire Department		
Method of Misappropriation		
Checks payable to cash or Walmart	<u>\$ 10,800</u>	
Total Crossroads Volunteer Fire Department		<u>\$ 10,800</u>
Total Misappropriation		<u>\$265,066</u>

This matter was turned over to the local district attorney general. On April 15, 2016, the Lawrence County Grand Jury indicted Jeffrey Hughes on one count of Theft over \$250,000, one count of Theft over \$10,000, and 136 counts of Forgery.

Case Study

According to the Comptroller's Investigation

- LCF&R officers indicated that their signatures on the unauthorized checks were not authentic
- The LCF&R board did not approve and was not aware of the fraudulent activity



Case Study

The Talented AGA Member from Tennessee



Case Study

The Talented AGA Member from Tennessee

FRAUD RISK FACTORS/INDICATORS

- ~~Poor~~ NO segregation of duties
- Lax governance and board oversight
- Reliance on trust rather than sound controls and oversight
- An “*it can't happen here*” attitude

Case Study

According to the Comptroller's Investigation

Our investigation revealed a significant deficiency in the financial processes that contributed to the former officer's ability to perpetrate the misappropriation without prompt detection. The financial process deficiency was:

- Lawrence County Fire and Rescue and Crossroads Volunteer Fire Department failed to separate incompatible financial duties. The former treasurer determined which expenses were to be paid, prepared and signed checks, and reviewed bank statements, with virtually no oversight by the board.

Board members indicated that they have already corrected this deficiency.

Case Study

Former The Talented and Tragic AGA Member from Tennessee



Anti-Fraud Guidance

Historical Perspective on Anti-Fraud Guidance

- **2000-2002 were traumatic years for the accountability profession**
 - Enron, WorldCom, Tyco, Global Crossing, Waste Management, Baptist Foundation of America, Peregrine, AOL/Time Warner, HealthSouth, Adelphia, IMClone
 - Demise of Arthur Andersen
- **In 2002, the AICPA formed a task force: *The Antifraud Programs and Controls Task Force***



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April 27, 2017**

Antifraud Programs and Controls Task Force

Ronald L. Durkin, *Chair*
KPMG LLP

Dan L. Goldwasser
Vedder, Price, Kaufman, & Kammholz, PC
Audit Committee member

Mark Beasley
North Carolina State University

Ronald B. Norris
The Estée Lauder Companies Inc.

Toby J.F. Bishop
Association of Certified
Fraud Examiners

Zoe-Vonna Palmrose
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David Cotton
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Thomas M. Stemlar
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George P. Fritz
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Accounting & Auditing Consultants LLC

AICPA Staff

Charles E. Landes
Director
Audit and Attest Standards

Michael P. Glynn
Technical Manager
Audit and Attest Standards



Historical Perspective on Anti-Fraud Guidance

- **The Task Force’s Mandate: develop “attestable criteria” for an organization to follow in implementing anti-fraud programs and controls**
- **The Task Force rebelled against that mandate**
 - More immediately important guidance was needed
 - Recent catastrophic frauds (Enron, WorldCom, Tyco, Global Crossing, Waste Management, Baptist Foundation of America, Peregrine, AOL/Time Warner, HealthSouth, Adelphia, IMClone) **ALL** caused by management override of internal control



New Guidance for Audit Committees

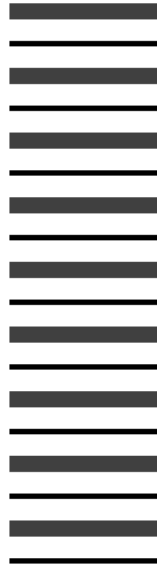
AICPA

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

MANAGEMENT OVERRIDE OF INTERNAL CONTROLS:

The Achilles' Heel
of Fraud Prevention

The Audit Committee
and Oversight of
Financial Reporting



FREE at:
[http://www.cottoncpa.com/
outreach/thought-leadership/](http://www.cottoncpa.com/outreach/thought-leadership/)

Published in 2005
Soon to be updated ...

Management Override: The Achilles' Heel of Internal Control

- **The Audit Committee's Responsibilities**
- **Actions to Address the Risk of Management Override of Internal Controls**
 - Maintaining Skepticism
 - Strengthening Committee Understanding of the Business Brainstorming to Identify Fraud Risks
 - Using the Code of Conduct to Assess Financial Reporting Culture
 - Cultivating a Vigorous Whistleblower Program
 - Developing a Broad Information and Feedback Network
- **Appendix: Suggested Audit Committee Procedures: Strengthening Knowledge of the Business and Related Financial Statement Risks**
 - Incentives or Pressures on Management
 - Opportunities Management Can Exploit



A Restructured Task Force then Went Back to the Future

- Under IIA leadership (President Dave Richards), a reconstituted task force returned to the original (attestable criteria) mandate



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 The Institute of Internal Auditors

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 PricewaterhouseCoopers LLP

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 Associate Professor and Selvo J. Boyer Fellow
 Brigham Young University

Larry Harrington
 Vice President, Internal Audit
 Raytheon Company





Professional Development Training
Prevent and Protect: The First Line of Defense
April 27, 2017

***Is your organization fully
committed to protecting
stakeholder assets?***

The cover of the book "Managing the Business Risk of Fraud: A Practical Guide" features a grayscale background of a person's face in profile, looking down. The title is prominently displayed in the center. Sponsor information is listed on the left, and logos for AICPA, ACFE, and IIA are at the bottom right.

SPONSORED BY:
The Institute of Internal Auditors
The American Institute of
Certified Public Accountants
The Association of
Certified Fraud Examiners

**Managing
the Business
Risk of Fraud:
A Practical Guide**

AICPA®
ACFE
The Institute of
Internal Auditors

Company

FREE at:
[http://www.cottoncpa.com/
wp-content/uploads/
2014/08/
ManagingTheBusinessRiskofFr
aud.pdf](http://www.cottoncpa.com/wp-content/uploads/2014/08/ManagingTheBusinessRiskofFraud.pdf)

Published in 2007



Managing the Business Risk of Fraud: A Practical Guide

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Managing the Business Risk of Fraud: A Practical Guide

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Anti-Fraud Principles

Principle 1: As part of an organization's governance structure, a fraud risk management program should be in place, including a written policy (or policies) to convey the expectations of the board of directors and senior management regarding managing fraud risk.

Principle 2: Fraud risk exposure should be assessed periodically by the organization to identify specific potential schemes and events that the organization needs to mitigate.

Anti-Fraud Principles

Principle 3: Prevention techniques to avoid potential key fraud risk events should be established, where feasible, to mitigate possible impacts on the organization.

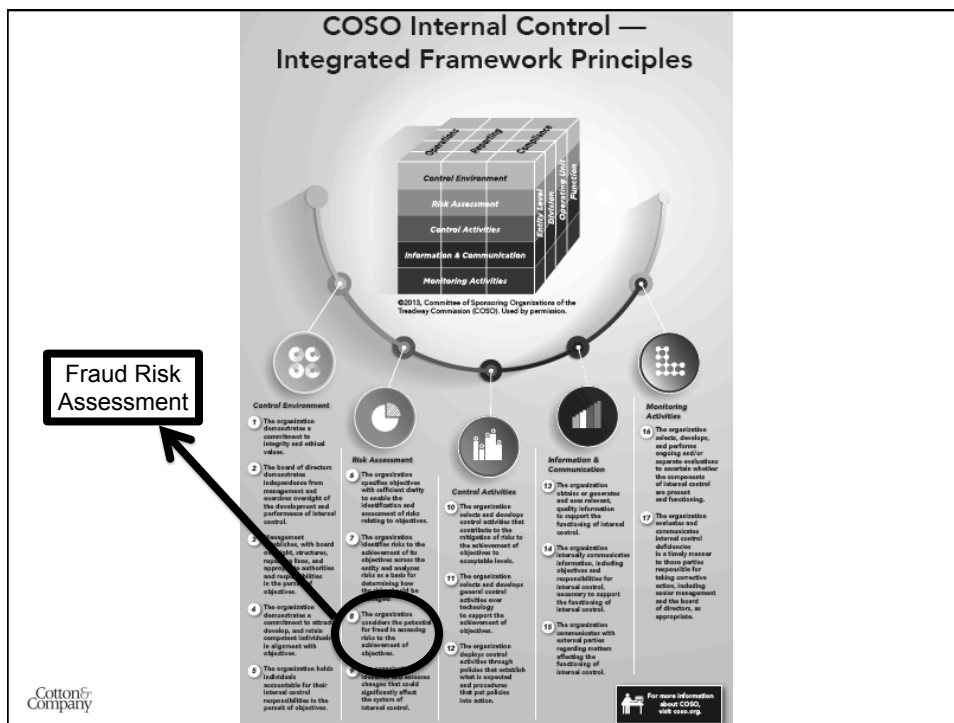
Principle 4: Detection techniques should be established to uncover fraud events when preventive measures fail or unmitigated risks are realized.

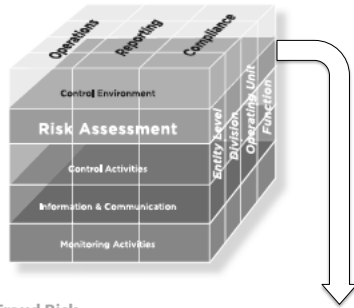
Principle 5: A reporting process should be in place to solicit input on potential fraud, and a coordinated approach to investigation and corrective action should be used to help ensure potential fraud is addressed appropriately and timely.

FLASH UPDATE

- **The 2013 Updated COSO Internal Control Framework added 17 Principles**
- **Principle #8: *“The organization considers the potential for fraud in assessing risks to the achievement of objectives.”***







Assesses Fraud Risk

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

Points of Focus

The following points of focus highlight important characteristics relating to this principle:

- **Considers Various Types of Fraud**—The assessment of fraud considers fraudulent reporting, possible loss of assets, and corruption resulting from the various ways that fraud and misconduct can occur.
- **Assesses Incentive and Pressures**—The assessment of fraud risk considers incentives and pressures.
- **Assesses Opportunities**—The assessment of fraud risk considers opportunities for unauthorized acquisition, use, or disposal of assets, altering of the entity's reporting records, or committing other inappropriate acts.
- **Assesses Attitudes and Rationalizations**—The assessment of fraud risk considers how management and other personnel might engage in or justify inappropriate actions.

Joint ACFE-COSO Task Force

- **COSO Principle #8 (Assess Fraud Risk) resulted in a need for more specific guidance on assessing fraud risk**
- **Task Force updated Managing the Business Risk of Fraud: A Practical Guide (originally published in 2007)**
- **Update was completed by the end of 2015**
- **Issued by COSO and ACFE in September 2016**



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April 27, 2017**

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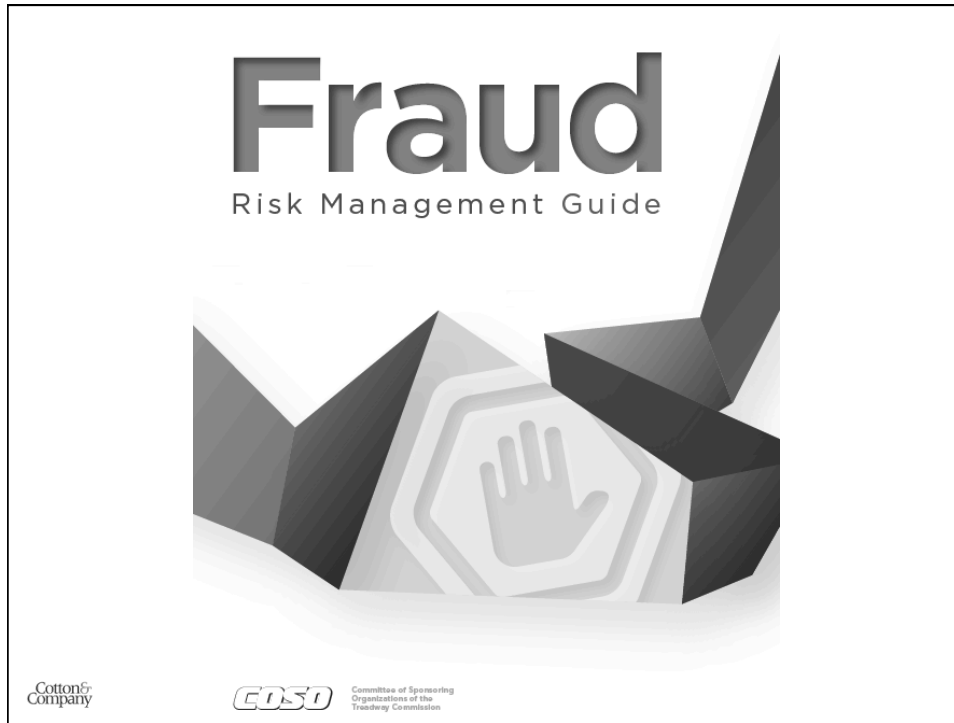
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Updated Guide

- **Similar to MBRF; more up-to-date**
- **More emphasis on data analytics**
- **5 Principles (slightly different than MBRF) and many Points of Focus**
- **5 Fraud Risk Management Principles correlate with the COSO Components and Principles**
- **More robust appendices**
- **MBRF: ~80 pages**
- **Updated version: ~285 pages**

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	COSO Framework Components and Principles	Fraud Risk Management Principles
Control Environment	1. The organization demonstrates a commitment to integrity and ethical values.	1. The organization establishes and communicates a Fraud Risk Management Program that demonstrates the expectations of the board of directors and senior management and their commitment to high integrity and ethical values regarding managing fraud risk.
	2. The board of directors demonstrates independence from management and exercises oversight of the development and performance of internal control.	
	3. Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.	
	4. The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.	
	5. The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives.	
Risk Assessment	6. The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.	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 controls to mitigate residual fraud risks.
	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.	
Control Activities	9. The organization identifies and assesses changes that could significantly impact the system of internal control.	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.
	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.	
Information & Communication	12. The organization deploys control activities through policies that establish what is expected and procedures that put policies into action.	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.
	13. The organization obtains or generates and uses relevant, quality information to support the functioning of other components of internal control.	
Monitoring Activities	14. The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control.	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.
	15. The organization communicates with external parties regarding matters affecting the functioning of other components of internal control.	
	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.	

Mapping of COSO Components and Principles to the Fraud Risk Management Guide

Figure 1. Ongoing, Comprehensive Fraud Risk Management Process



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Updated Guide Can Be Used:

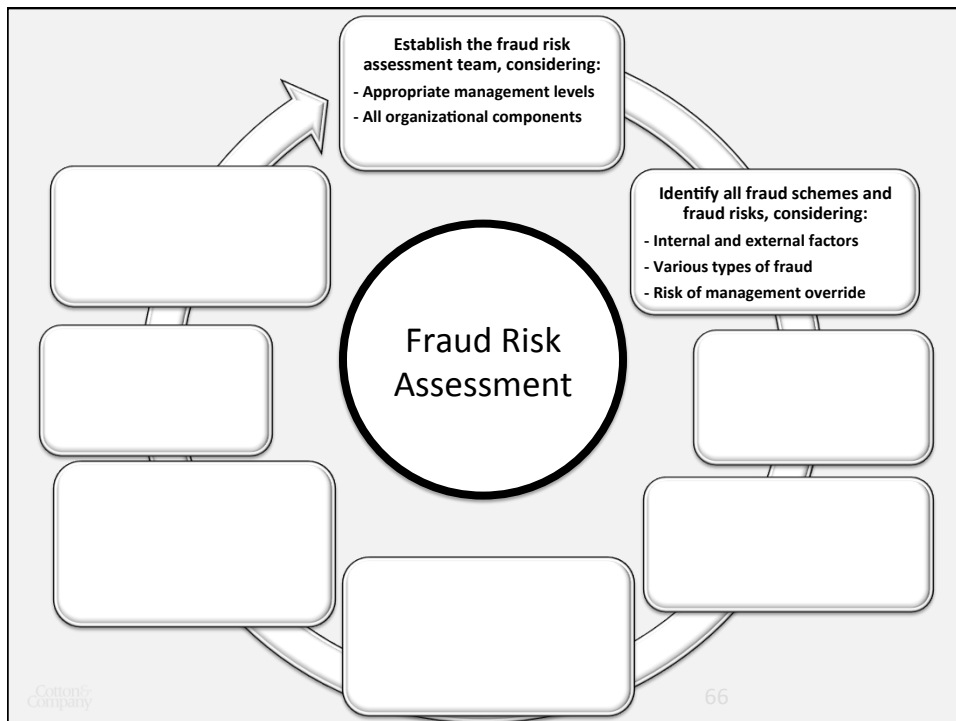
- Just for complying with Principle #8—performing a fraud risk assessment, or
- For developing and implementing a comprehensive fraud risk management program

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So,

You get to work one Monday morning and your boss says,

“Hey, we need to do a fraud risk assessment in order to comply with the new COSO Principle about fraud risk, and we want you to head up the effort to do that for us. Get started right away and report back when you are done.”





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APPENDIX G: FRAUD RISK EXPOSURES

The following table illustrates the types of fraud schemes and fraud exposures an organization might encounter.³ This listing is not meant to be all-inclusive, but rather, to support an initial assessment for an organization to identify areas vulnerable to fraud. This list can serve as a starting point for the risk assessment process. By reviewing this list and asking, "could this happen in our organization?" the assessment team will gain an overview understanding of potential fraud risks. More focus will be needed to identify the organization's specific industry, location, and cultural factors that can influence other fraudulent behavior.

Intentional manipulation of financial statements through:
• Inappropriately reported revenues
• Fictitious revenues
• Fraudulent audit confirmations
• Re-dating or refreshing receivables to conceal uncollectables
• Manipulation of promotional allowances
• Improper adjustments to estimates
• Premature revenue recognition
• Side agreements
• Bill and hold
• Channel stuffing
• Round-trip transactions
• Altered or false shipping documents
• Sell-through agreements
• Up-front fees
• Holding accounting periods open
• Failure to record sales provisions or allowances
• Manipulating percentage of completion
• Manipulating estimated costs to complete
• Improper contract or grant revenue and expense recognition
• Product substitution
• False or inflated claims
• Inflated or unjustified change orders
• Falsified or unsupported research
• Falsified effort (time) reporting
• Cost mischarging
• Inappropriately reported expenses

• Improper period recognition of expenses
• Improper use of special purpose variable interest entities
• Inappropriately reflected balance sheet amounts, including reserves
• Improper asset valuation
• Misstated inventory quantities
• Misstated inventory values
• Misstated accounts receivable
• Misstated merger and acquisition values
• Improper capitalization of intangible items
• Changing or manipulating depreciation methods
• Changing or manipulating useful lives, or salvage values
• Failure to recognize impaired assets
• Unrealistic or unsupported estimates
• Misclassification of assets
• Manipulating the value of investments
• Inappropriate depreciation methods
• Recording fictitious assets
• Concealed liabilities and expenses
• Omission
• Sales returns and allowances and warranties
• Capitalization of operating expenses
• Unrealistic or unsupported estimates
• Tax liability
• Improper or unjustified consolidation entries
• Inter-company transaction manipulations
• Sham related-party transactions
• Improper use of special purpose variable interest entities
• Inappropriately improved and/or masked disclosures
• Liabilities omissions
• Subsequent events
• Related-party transactions
• Accounting changes
• Management frauds uncovered
• Backdating transactions
• Unrealistic or unsupported estimates
• Concealing misappropriation of assets
• Concealing unauthorized receipts and expenditures
• Concealing unauthorized acquisition, disposition, and use of assets
Misappropriation of tangible assets by:
• Cash theft



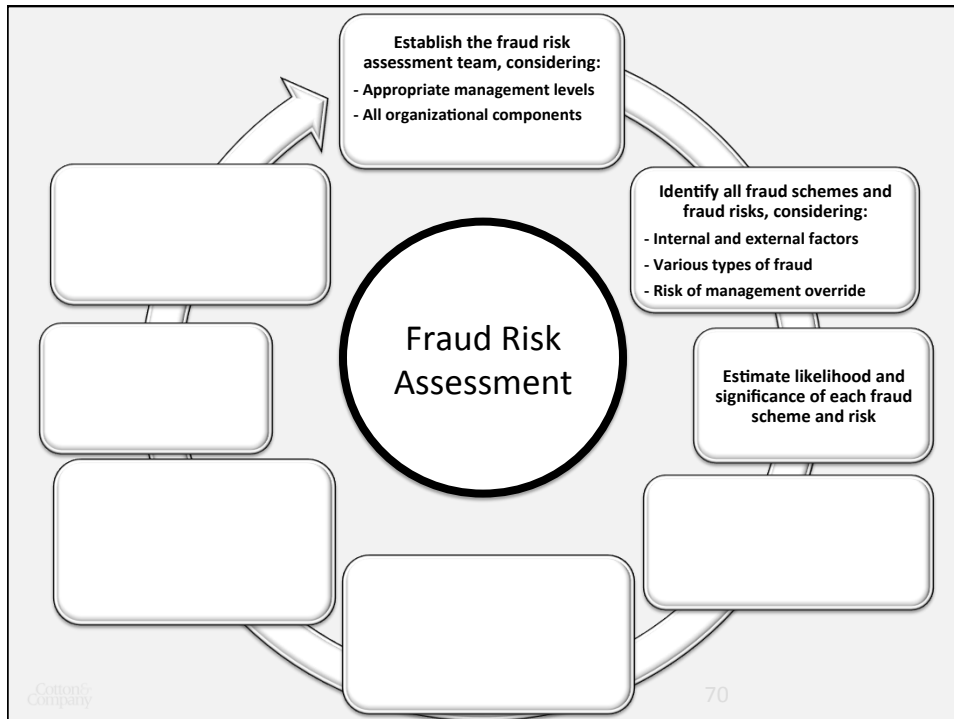
• Sales register manipulation
• Skimming
• Lapping
• Collection procedures
• Understated sales
• Theft of checks received
• Check for currency substitution
• Lapping accounts
• False entries to sales account
• Inventory padding
• Theft of cash from register
• Deposit lapping
• Deposits in transit
• Fraudulent disbursements
• False refunds
• False voids
• Small disbursements
• Check tampering
• Billing schemes
• Personal purchases with company funds
• Returning merchandise for cash
• Creation of false or fictitious vendors, suppliers, or subcontractors
• Delivery of purchased assets or inventory to unauthorized locations
• Payments for services not received
• Recording income on consignment sales
• Recording income on products shipped for trial or evaluation purposes
• Payroll fraud
• Ghost employees
• Falsified hours and salary
• Failure to remove terminated employees from payroll
• Failure to report leave taken
• Commission sales
• Expense reimbursement
• Mischaracterized expenses
• Overstated expenses
• Fictitious expenses
• Multiple reimbursements
• Loans
• Loans to nonexistent borrowers
• Double pledged collateral
• False application information

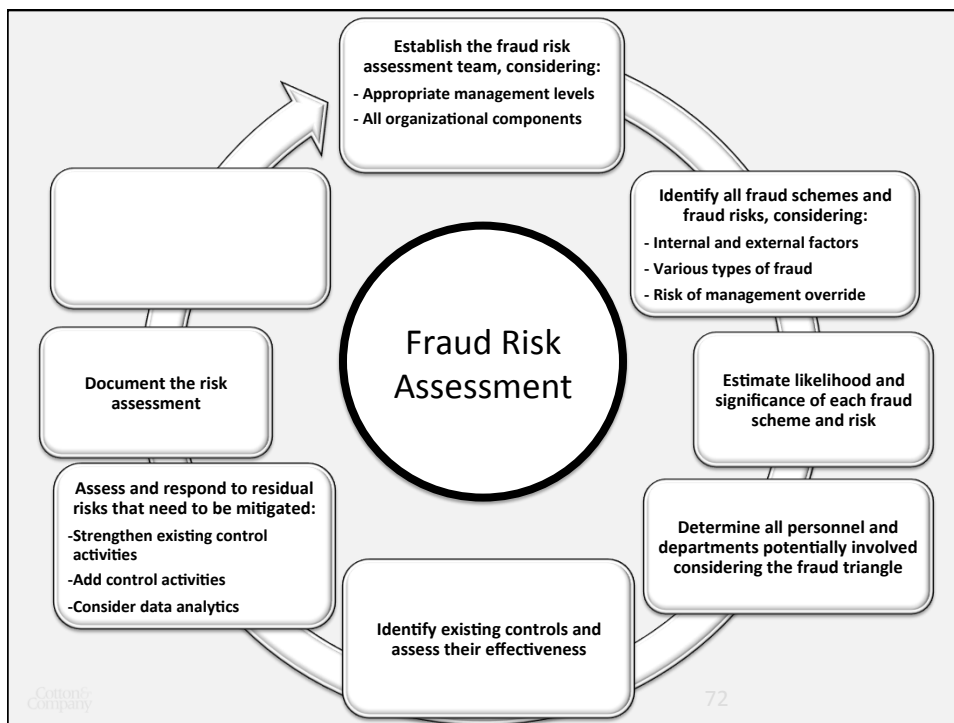
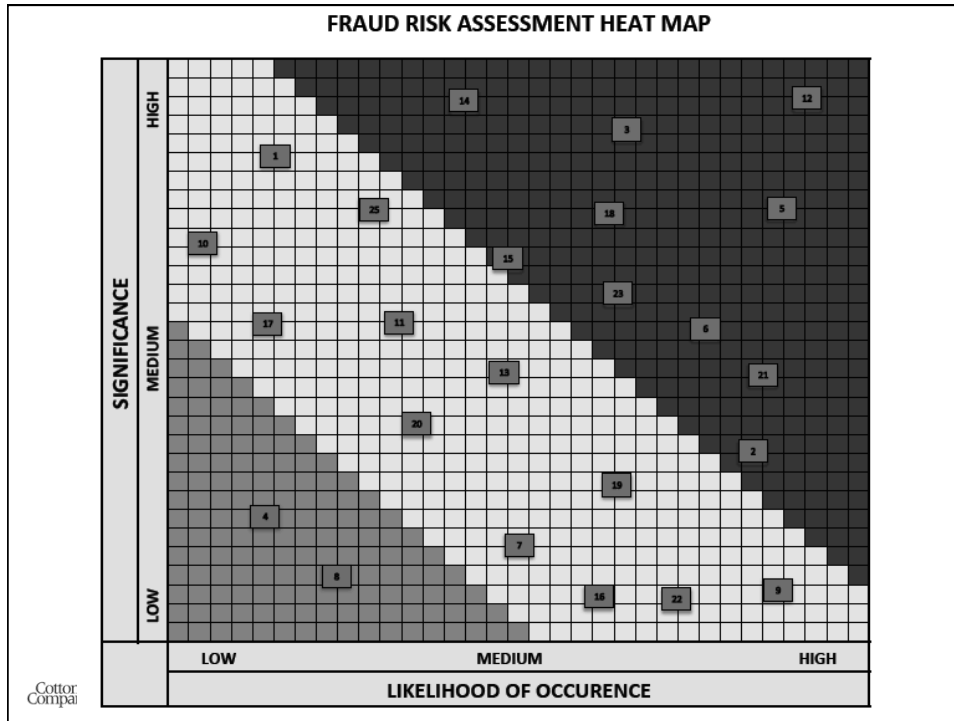
• Construction loans
• Real estate
• Appraisal value
• Fraudulent appraisal
• Wire transfer
• System password compromise
• Forged authorizations
• Unauthorized transfer account
• ATM
• Check and credit card fraud
• Counterfeiting checks
• Check theft
• Stop payment orders
• Unauthorized or lost credit cards
• Counterfeit credit cards
• Mail theft
• Insurance fraud
• Dividend checks
• Settlement checks
• Premium
• Fictitious payee
• Fictitious death claim
• Underwriting misrepresentation
• Vehicle insurance — staged accidents
• Inflated damages
• Rental car fraud
• Pension fraud
• Inflated final income used in benefit calculation
• Under-reported income in years not used for benefit calculation
• False service reported for service purchase
• Enrolling ineligible persons
• Not enrolling all eligible persons
• Inventory
• Misuse of inventory
• Theft of inventory
• Off-site or fictitious inventory
• Purchasing and receiving falsification
• False shipments
• Concealing inventory shrinkage
Misappropriation of intangible assets by:



• Theft of intellectual property
• Espionage
• Loss of information
• Spying
• Infiltration
• Informants
• Trash and waste disposal
• Surveillance
• Destruction of customer goodwill
• Compromising vendor relationships
• Proprietary business opportunities
Corruption
• Bribery and gratuities to
• Companies
• Private individuals
• Public officials
• Embezzlement
• False accounting entries
• Unauthorized withdrawals
• Unauthorized disbursements
• Paying personal expenses from bank funds
• Unrecorded cash payments
• Theft of physical property
• Moving money from dormant accounts
• Receipt of bribes, kickbacks, and gratuities
• Bid rigging
• Kickbacks
• Diverted business to vendors
• Over billing
• Illegal payments
• Gifts
• Travel
• Entertainment
• Loans
• Credit card payments for personal items
• Transfers for other than fair value
• Favorable treatment
• Conflicts of interest
• Purchases
• Sales

• Business diversion
• Resourcing
• Financial disclosure of interest in vendors
• Ownership interest in suppliers
• Foreign Corrupt Practices Act (FCPA) violations
• Anti-bribery provisions
• Books and records violations
• Internal control weaknesses
• Money laundering
• False statements
• Aiding and abetting fraud by other parties (customers, vendors)



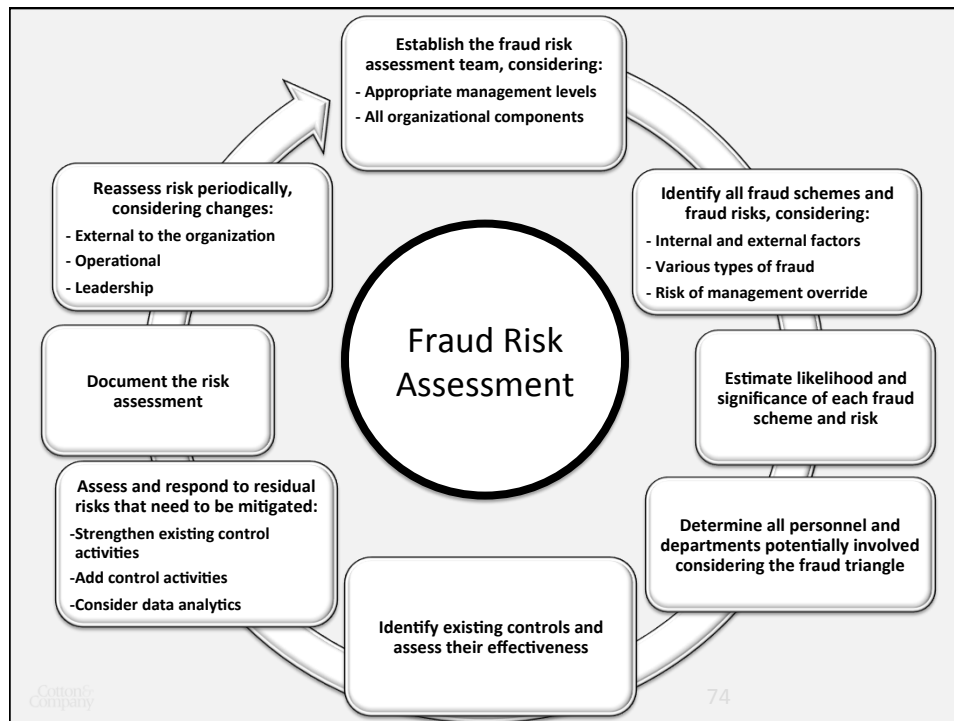


Documenting the Fraud Risk Assessment

Figure 8. Fraud Risk Management Assessment Matrix Example

1. Identified Fraud Risks and Schemes	2. Likelihood	3. Significance	4. Personnel/ Departments Involved	5. Existing Fraud Control Activities	6. Effectiveness of Existing Control Activities	7. Residual Fraud Risks	8. Fraud Risk Responses
Financial Reporting • •							
Non-Financial Reporting • •							
Asset Misappropriation • •							
Illegal Acts and Corruption • •							

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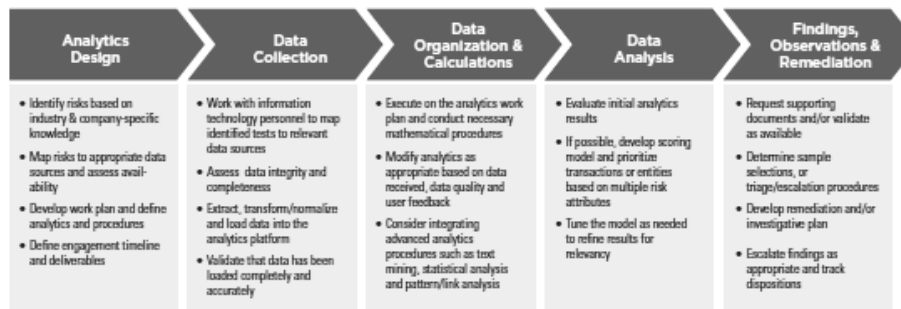
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Appendices

- A: GLOSSARY**
- B: ROLES AND RESPONSIBILITIES**
- C: CONSIDERATIONS FOR SMALLER ENTITIES**
- D: REFERENCE MATERIAL**
- E: DATA ANALYTICS**

Data Analytics

Figure 12. Example of a Data Analytics Framework



Appendices

F: SAMPLE GOVERNANCE MATERIALS

F1: FRAUD CONTROL POLICY FRAMEWORK

F2: FRAUD RISK HIGH-LEVEL ASSESSMENT

F3: FRAUD POLICY RESPONSIBILITY MATRIX

F4: FRAUD RISK MANAGEMENT POLICY

F5: FRAUD RISK MANAGEMENT SURVEY

G: LIST OF FRAUD RISK EXPOSURES

H: SAMPLE FRAUD RISK ASSESSMENT

Fraud Risk Assessment Example

This hypothetical example is for illustrative purposes and focuses on just some potential schemes that might be documented during an organization's fraud risk assessment process. An actual fraud risk assessment would often be more extensive and have more detailed and organization-specific documentation, especially for large or complex organizations. This fraud risk assessment consists of four sections: (A) Financial Reporting, (B) Non-financial Reporting, (C) Asset Misappropriation and (D) Illegal Acts/Corruption. To facilitate review, risks in each section are listed in descending order of Residual Risk and then by Likelihood and Significance.

1. Identified Fraud Risks and Schemes	2. Likelihood	3. Significance	4. Personnel/Departments Involved	5. Existing Fraud Control Activities	6. Effectiveness of Existing Control Activities	7. Residual Fraud Risks	8. Fraud Risk Responses
Section A. Financial Reporting							
FR1. Inappropriate journal entries	Medium	High	General manager and accounting & finance staff at the operating unit level and/or CFO, accounting & finance staff and senior executives (e.g., CEO and COO) at the head office level	Established process for consolidation Established, systematic access controls to the general ledger Standard monthly and quarterly journal entry log maintained. Review process in place for standard entries and non-standard entries subject to two levels of review with particular emphasis on quarter-end and year-end transactions and those transactions that reversed in the following month.	Tested by IA-some findings Tested by IA-no findings Tested by management	High - Risk of management override of internal controls to misstate financial results by making journal entries	Data analysis of journal entry population by IA for: • Unusual DR/CR combinations • Late entries to accounts subject to significant judgments & estimates • Indications of journal entries being approved or entered by persons not usually involved, e.g., by more senior management or others using special or unauthorized system access
FR2. Revenue Recognition - Side letters/agreements with concessioners, e.g., extended payment terms, price reductions, rebates, unusual sales/marketing support funding for dealers, distributors or retailers	Medium	High	Salespersons, sales management Potentially senior executives (e.g., CEO and COO), legal and accounting & finance	Annual training of sales and finance personnel on revenue recognition practices Quarterly signed attestation of sales personnel concerning sales contractual agreements Internal audit confirming with customers that there are no other agreements, written or oral, that would modify the terms of the written agreement.	Training deemed adequate Tested by IA-no findings Strong and effective	High - Risk of management override of internal controls leading to significant/material misstatement of revenue and net income Medium - Lack of enforcement of training requirement may lead to isolated examples of improper revenue recognition by lower-level personnel	Disaggregated analysis of sales, sales returns, and adjustments by salesperson Add to all purchase orders, invoices and contracts a statement about the organization's ethics and how to report misconduct Have sales personnel affirm annually that they have not modified terms of sales contracts by allowing



Appendices

I: FRAUD RISK MANAGEMENT ASSESSMENT SCORECARDS

I1: FRAUD RISK GOVERNANCE

I2: FRAUD RISK ASSESSMENT

I3: FRAUD CONTROL ACTIVITIES

I4: FRAUD INVESTIGATION AND FOLLOWUP

I5: FRAUD RISK MANAGEMENT MONITORING



Appendix I-1.

Fraud Risk Governance Scorecard

To assess the strength of the organization's fraud governance, carefully assess each area below and score the area, factor, or consideration as:

- **Red:** indicating that the area, factor, or consideration needs substantial strengthening and improvement to bring fraud risk down to an acceptable level
- **Yellow:** indicating that the area, factor, or consideration needs some strengthening and improvement to bring fraud risk down to an acceptable level
- **Green:** indicating that the area, factor, or consideration is strong and that fraud risk has been reduced — at least — to a minimally acceptable level

Each area, factor, or consideration scored either red or yellow warrants having a note associated with it that describes the action plan for bringing it to green on the next scorecard.

Fraud Risk Governance Area, Factor or Consideration	Score	Notes
Making an Organizational Commitment to a Fraud Risk Management Program		
Our organization has a strong correlation between our organizational culture and fraud risk management.		
Our organization's leadership demonstrates "tone at the top" by promoting ethical behavior and emphasizing a focus on deterring, preventing and detecting fraud.		
Our organization's leadership leads by example to ensure that all personnel, vendors, and contractors understand that the organization is serious about promoting ethical behavior and is committed to deterring, preventing and detecting fraud.		
The way that our management reacts to instances of fraud sends a powerful message inside and outside the organization and acts as a strong deterrent to fraudulent behavior.		
Our organization has a policy regarding our standards of business conduct that reflects the commitment of our organization and our board of directors, officers, executives, and other personnel to conduct business according to the highest standards of integrity and ethics.		
Our organization creates a positive work environment for employees, hires and promotes appropriate employees, and conducts effective training programs.		
Our organization requires employees to periodically confirm their understanding of our code of conduct.		
Our organization disciplines employees appropriately and consistently regardless of their positions.		
Supporting Fraud Risk Governance		





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Appendix I-2.

Fraud Risk Assessment Scorecard

To assess the strength of the organization's fraud risk assessment process, carefully assess each area below and score the area, factor, or consideration as:

- **Red:** indicating that the area, factor, or consideration needs substantial strengthening and improvement to bring fraud risk down to an acceptable level
- **Yellow:** indicating that the area, factor, or consideration needs some strengthening and improvement to bring fraud risk down to an acceptable level
- **Green:** indicating that the area, factor, or consideration is strong and that fraud risk has been reduced—at least—to a minimally acceptable level

Each area, factor, or consideration scored either red or yellow warrants having a note associated with it that describes the action plan for bringing it to green on the next scorecard.

Fraud Risk Assessment Area, Factor or Consideration	Score	Notes
Involving Appropriate Levels of Management		
Our fraud risk assessment team includes all appropriate levels of management and internal and external sources to assess fraud throughout the organization.		
Our risk assessment team includes resources such as: <ul style="list-style-type: none"> • Accounting/finance personnel • Non-financial business unit and operations personnel • Information technology personnel • Risk management personnel • Legal and compliance personnel • Internal audit personnel • External consultants, if expertise is not available internally 		
Management, senior management, business unit leaders, and significant process owners participate in the risk assessment because they are ultimately accountable for the effectiveness of our organization's fraud risk management efforts.		
Our fraud risk assessment team reviews our organization's strategic plan, process maps, and control matrices to identify the population of activities that are potentially exposed to fraud.		
Our fraud risk assessment team engages in brainstorming sessions to identify incentives, pressures, and opportunities to commit fraud; the risk of management override of controls; and the fraud risks that are most relevant to our organization.		
Our fraud risk assessment team shares its fraud risk identification information with the board and solicits feedback from them.		



Appendix I-3.

Fraud Control Activities Scorecard

To assess the strength of the organization's fraud control activities, carefully assess each area below and score the area, factor, or consideration as:

- **Red:** indicating that the area, factor, or consideration needs substantial strengthening and improvement to bring fraud risk down to an acceptable level
- **Yellow:** indicating that the area, factor, or consideration needs some strengthening and improvement to bring fraud risk down to an acceptable level
- **Green:** indicating that the area, factor, or consideration is strong and that fraud risk has been reduced—at least—to a minimally acceptable level

Each area, factor, or consideration scored either red or yellow warrants having a note associated with it that describes the action plan for bringing it to green on the next scorecard.

Fraud Control Activities Area, Factor or Consideration	Score	Notes
Promoting Fraud Deterrence Through Preventive and Detective Control Activities		
Our organization attempts to deter fraud by: <ul style="list-style-type: none"> • Establishing a visible and rigorous fraud governance process • Creating a transparent and sound anti-fraud culture • Conducting a robust and thorough fraud risk assessment periodically • Designing, implementing, and maintaining preventive and detective fraud control processes and procedures • Taking swift action in response to allegations of fraud and against those involved in wrongdoing 		
Our organizational culture clearly communicates through its words and actions that perpetrators of fraud face a high likelihood of getting caught and being held responsible and punished.		
We implement detective controls in those situations in which the implementation of preventive controls would be too costly or too intrusive to business operations.		
Our organization has overt control activities in place, such as basic procurement procedures and supervisory and managerial approval requirements that are generally known to employees and those with whom we interact.		
Our organization has covert control activities in place that remain unknown to employees and those with whom we interact, such as data analytics procedures designed to identify unusual transactions.		
Integrating With The Fraud Risk Assessment		
If the fraud risk assessment revealed that there are no control activities in place to mitigate an identified fraud risk, management has effectively addressed this issue by selecting, developing, and implementing the necessary controls to reduce this risk to an acceptable level.		





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Appendix I-4.

Fraud Investigation and Corrective Action Scorecard

To assess the strength of the organization's fraud investigation and corrective action processes, carefully assess each area below and score the area, factor, or consideration as:

- **Red:** indicating that the area, factor, or consideration needs substantial strengthening and improvement to bring fraud risk down to an acceptable level
 - **Yellow:** indicating that the area, factor, or consideration needs some strengthening and improvement to bring fraud risk down to an acceptable level
 - **Green:** indicating that the area, factor, or consideration is strong and that fraud risk has been reduced — at least — to a minimally acceptable level
- Each area, factor, or consideration scored either red or yellow warrants having a note associated with it that describes the action plan for bringing it to green on the next scorecard.

Fraud Investigation and Corrective Action Area, Factor or Consideration	Score	Notes
Establishing Fraud Investigation and Response Protocols		
Our organizational culture promotes and supports open communication.		
Our organization ensures that any reasonably suspected or known violation, deviation, or other breach of code of conduct, fraud, or corruption is dealt with in a timely and effective manner.		
Our board and senior management positively encourage the identification of fraud by committing to an internal communication process.		
Our organization stresses the importance of having a documented process in place by which allegations of fraud are to be consistently captured, assessed, and responded to in a timely manner.		
Our fraud investigation and response system includes protocols for: <ul style="list-style-type: none"> • Updating a central repository for allegations and complaints • Maintaining anonymity or confidentiality of involved individuals, except as is necessary to investigate • Initially evaluating the allegations to determine if an investigation is warranted and the appropriate degrees of urgency • Notifying employees regarding document preservation and securing data systems • If necessary, engaging independent counsel and forensic accounting support • Conducting the investigation while controlling and safeguarding evidence • Reporting the results in the appropriate format (oral summary of key points or comprehensive written report with exhibits) • Following policies regarding retention of reports, documents, work papers, and other information • Assessing root causes and initiating mitigating processes and controls 		
We have multiple communication paths by which allegations and complaints can be brought to the attention of our organization without naming the alleged perpetrator of fraud.		



Appendix I-5.

Fraud Risk Management Monitoring Scorecard

To assess the strength of the organization's fraud risk management monitoring, carefully assess each area below and score the area, factor, or consideration as:

- **Red:** indicating that the area, factor, or consideration needs substantial strengthening and improvement to bring fraud risk down to an acceptable level
 - **Yellow:** indicating that the area, factor, or consideration needs some strengthening and improvement to bring fraud risk down to an acceptable level
 - **Green:** indicating that the area, factor, or consideration is strong and that fraud risk has been reduced — at least — to a minimally acceptable level
- Each area, factor, or consideration scored either red or yellow warrants having a note associated with it that describes the action plan for bringing it to green on the next scorecard.

Fraud Risk Management Monitoring Area, Factor or Consideration	Score	Notes
Considering a Mix of Ongoing and Separate Evaluations		
Our organization performs ongoing evaluations that monitor control activities on a real-time basis as a routine process.		
Our organization's fraud risk management monitoring plan targets our areas of highest fraud risk.		
Our monitoring activities focus on these aspects of the analysis performed: "Why," "Who," "What," "Where," and "What's next?"		
Our ongoing monitoring activities include data analytics procedures used to form conclusions about information collected.		
Our organization performs separate evaluations to help assure management that our Fraud Risk Management Program is functioning as designed.		
Our separate evaluations of controls occur periodically and are not part of our organization's routine operations.		
Our separate evaluations are performed by internal audit, others within the organization, or third parties (outsourcers).		





Appendices

I: FRAUD RISK MANAGEMENT ASSESSMENT SCORECARDS

I1: FRAUD RISK GOVERNANCE

I2: FRAUD RISK ASSESSMENT

I3: FRAUD CONTROL ACTIVITIES

I4: FRAUD INVESTIGATION AND FOLLOWUP

I5: FRAUD RISK MANAGEMENT MONITORING

J: HYPERLINKS TO ADDITIONAL TOOLS

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HYPERLINKS TO ADDITIONAL TOOLS

- Points of Focus Documentation Templates

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Points of Focus Documentation Templates

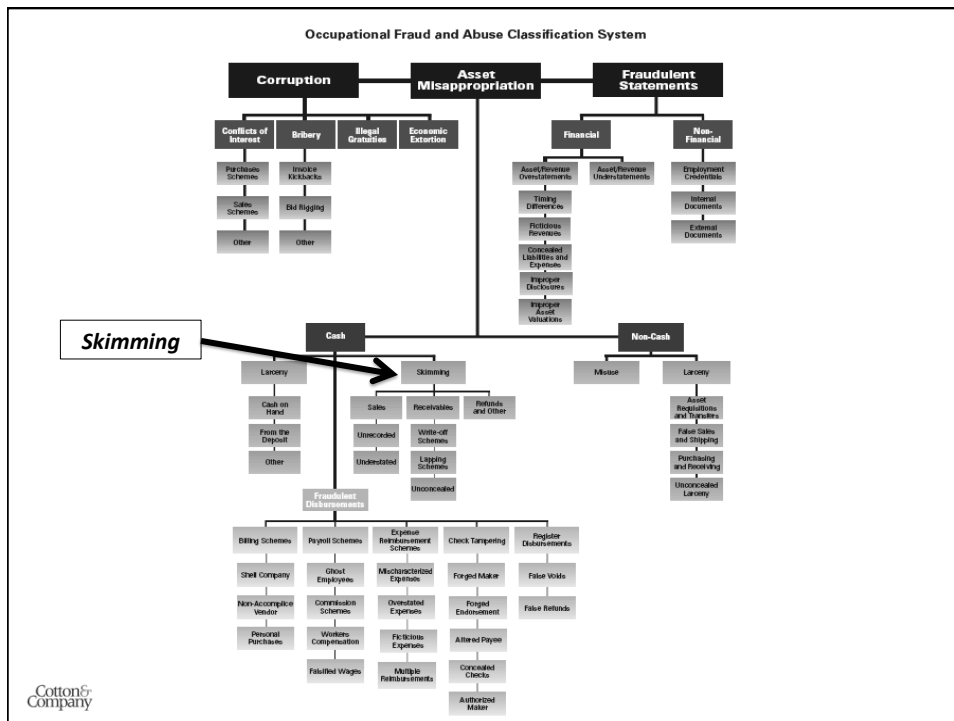
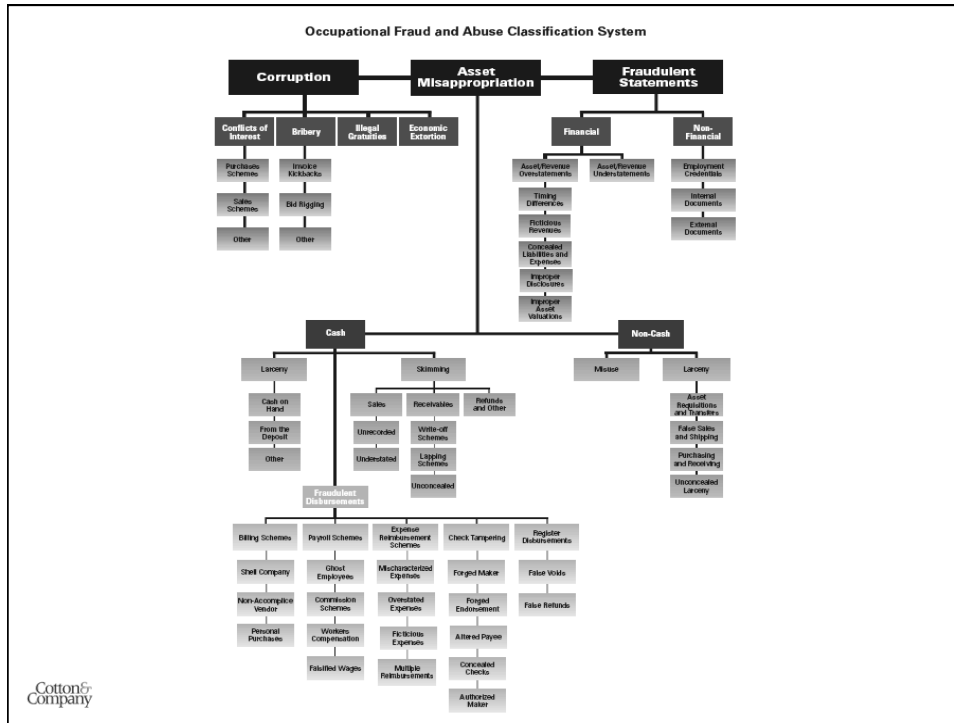
Fraud Risk Governance Points of Focus and Our Organization's Response	
Points of Focus	Our Organization's Response Including Cross-References to Other Material and Documentation
Makes an Organizational Commitment to Fraud Risk Management — The board of directors and senior management initiate the fraud risk management process by establishing an organizational commitment to deter, prevent, and detect fraud.	
Supports Fraud Risk Governance — The board of directors and senior management make an organizational commitment to fraud risk management as a key element of corporate governance.	
Establishes a Comprehensive Fraud Risk Management Policy — The board of directors and senior management provide a solid foundation of fraud risk management by establishing a comprehensive fraud risk management policy.	
Establishes Fraud Risk Governance Roles and Responsibilities throughout the Organization — The board of directors and senior management identify the roles and responsibilities of all personnel as they relate to fraud risk governance.	
Documents the Fraud Risk Management Program — The board of directors and senior management ensure that the fraud risk management program is thoroughly documented and updated on a regular basis.	
Communicates Fraud Risk Management at all Organizational Levels — The board of directors and senior management support the ongoing effectiveness of the fraud risk management program by maintaining and communicating a continuous focus on fraud deterrence, prevention, and detection throughout the organization.	



HYPERLINKS TO ADDITIONAL TOOLS

- **Points of Focus Documentation Templates**
- **Risk Assessment and Follow-up Actions Template**

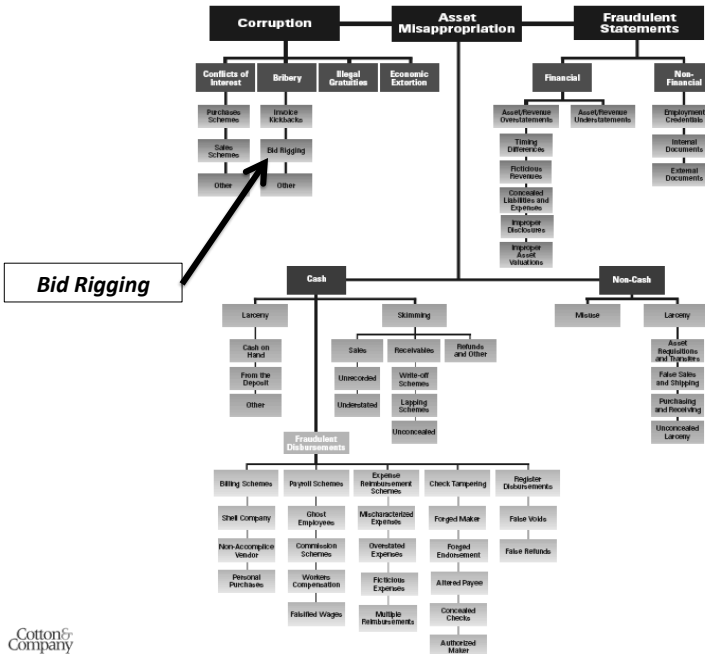




Library of Data Analytics Tests

CASH - SKIMMING	
Cash Receipts Analysis	Review sequential numbering of cash receipts journal to ensure no out-of-sequence numbers
Vertical Analysis	Vertical analysis of sales accounts, (i.e., cash as a percentage of total assets over time, etc. can be used to detect skimming at a high level)
Horizontal Analysis	Horizontal analysis of sales accounts, (i.e., cash percent change over time, can be used to detect skimming at a high level)
Current Ratio Analysis	Track current assets to current liabilities over time
Quick Ratio Analysis	(Cash+Securities+Receivables) over Current Liabilities percent change over time
Inventory Analysis	Track inventory shrinkage due to unrecorded sales. Inventory detection may include statistical sampling, trend analysis, reviews of receiving reports and inventory records and verification for material requisition and shipping documentation as well as actual physical inventory counts
Red Flags	Bank employee questions the validity of a check
Red Flags	Inspect for a forged endorsement on a check
Red Flags	Inspect for an employee bank account with a name similar to the company name
Red Flags	Inspect for alteration of the check payee or endorsement
Journal Entry Review	Analysis of journal entries made to the cash and inventory accounts to identify: (1) False credits to inventory to conceal unrecorded or understated sales, (2) Write-offs related to lost, stolen or obsolete product, (3) Write-offs to accounts receivable, (4) Irregular entries to cash accounts
Journal Entry Review	Analysis of journal entries to review suspicious or inaccurate journal entries.
Journal Entry Review	Identify larger entries split into smaller entries to avoid exceeding their approval limit. To ensure authorization and validity of the Journal Entry based on the approval limits

Occupational Fraud and Abuse Classification System

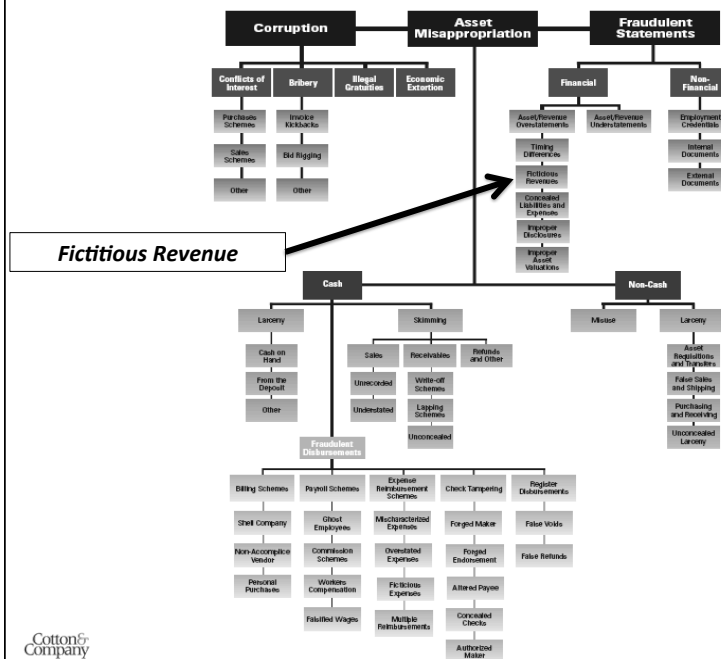


Library of Data Analytics Tests

BID RIGGING

Corruption: Bid Rigging	Compare inventory levels and turnover rates on a by project or by product basis, by region
Corruption: Bid Rigging	Inventory written-off and then new purchase made (total write-offs and quantities purchased by product)
Corruption: Bid Rigging	Compare contract awards by vendor (number of contracts won compared to bids submitted)
Corruption: Bid Rigging	Sole sourced contracts - number of bids per contract
Corruption: Bid Rigging	Check for vague contract specifications: (i) amendments, extension, increases in contract values, (ii) total number of amendments, (iii) original delivery date and final delivery date, (iv) original contract value and final contract value
Corruption: Bid Rigging	Check for split contract (same vendor, same day)
Corruption: Bid Rigging	Bids submitted after bid closing date
Corruption: Bid Rigging	Last bid wins
Corruption: Bid Rigging	Low bidder drops out, and subcontracts to higher bidder (compare contractor with invoice payee)
Corruption: Bid Rigging	Fictitious bids - verify bidders and prices

Occupational Fraud and Abuse Classification System





Library of Data Analytics Tests


REVENUE RECOGNITION	
Bill & Hold	Analysis of inventory that has been "segregated" or shipped to a third party intermediary where the customer has not taken title and assumed the risks, yet the company has booked this isolated inventory as revenue
Bill & Hold	Identify revenue and receivables recorded prior to shipment
Channel Stuffing	Compare discounts or incentives on a monthly basis to identify unusual spikes at the end of the quarter or year.
Channel Stuffing	Compare sales and corresponding returns on a per customer basis
Debt Swap	Identification of Journal Entries with Net Debit to Liability and Credit to Revenue
Debt Swap	Identification of Journal Entries with Net Debit to Liability and Credit to Expenses
Fake Invoices	Analysis of sequentially numbered invoices
Fake Invoices	Benford's analysis of the first two digits to identify anomalies such as a disproportionate number of invoices starting with 7, 8 or 9
Fake Invoices	Analysis of company names that "sound like" known vendors
Fake Invoices	Examine inventory records to identify locations or items that require specific attention during or after the physical inventory count
Revenue Recognition	Analysis and anomaly detection of the sequence of transactions to identify missing checks, invoices
Revenue Recognition	Compare A/R credit memos to A/P invoices
Revenue Recognition	Compare revenue reported by month and by product line during the current period with comparable prior periods
Revenue Recognition	Confirm with selected, high risk customers relevant contract terms or question company staff regarding shipments near the end of the period.
Revenue Recognition	Identification of revenue recognized at period end and subsequently reversed or partially reversed
Fraud Triangle Analytics	E-mail analysis of selected employees (accounting or sales) for "Rev Rec" related key words around incentive/pressure, opportunity and rationalization

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Appendices


- G: LIST OF FRAUD RISK EXPOSURES**
- H: SAMPLE FRAUD RISK ASSESSMENT**
- I: FRAUD RISK MANAGEMENT ASSESSMENT SCORECARDS**
 - I1: FRAUD RISK GOVERNANCE**
 - I2: FRAUD RISK ASSESSMENT**
 - I3: FRAUD CONTROL ACTIVITIES**
 - I4: FRAUD INVESTIGATION AND FOLLOWUP**
 - I5: FRAUD RISK MANAGEMENT MONITORING**
- J: HYPERLINKS TO ADDITIONAL TOOLS**
- K: MANAGING THE RISK OF FRAUD IN GOVERNMENT**

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Future

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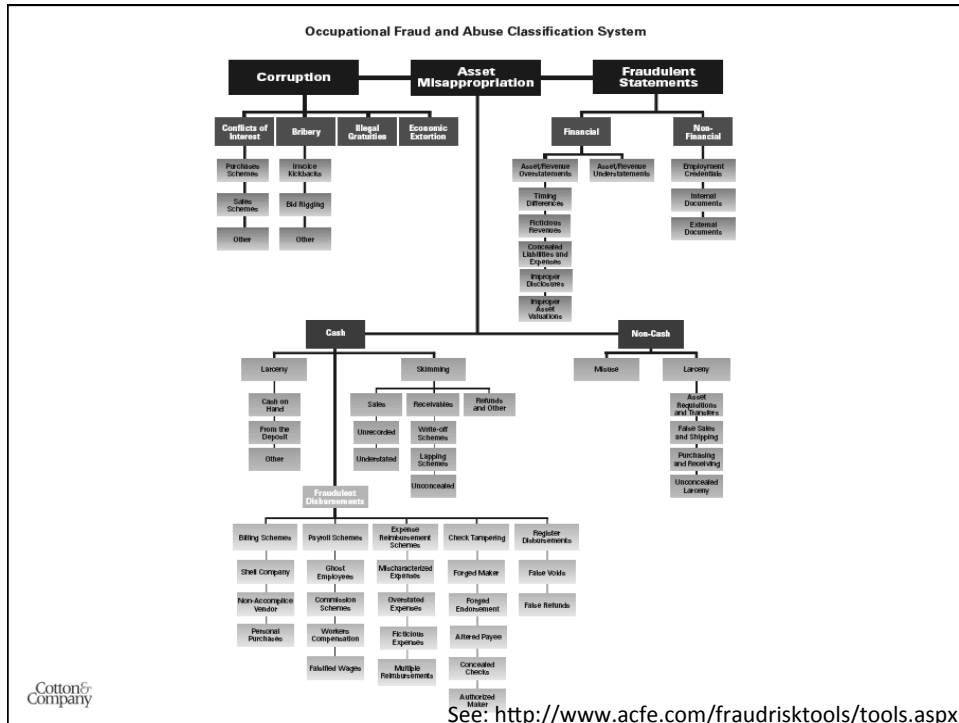
What Can We Expect to See in the Future?



- Data analytics will be where most of the focus will be

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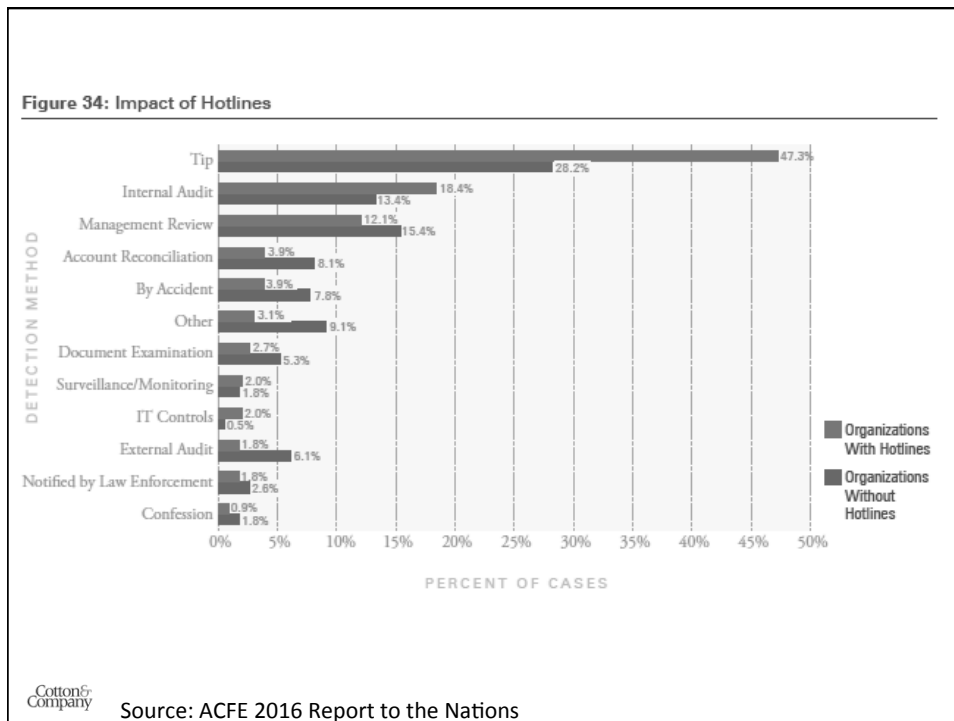
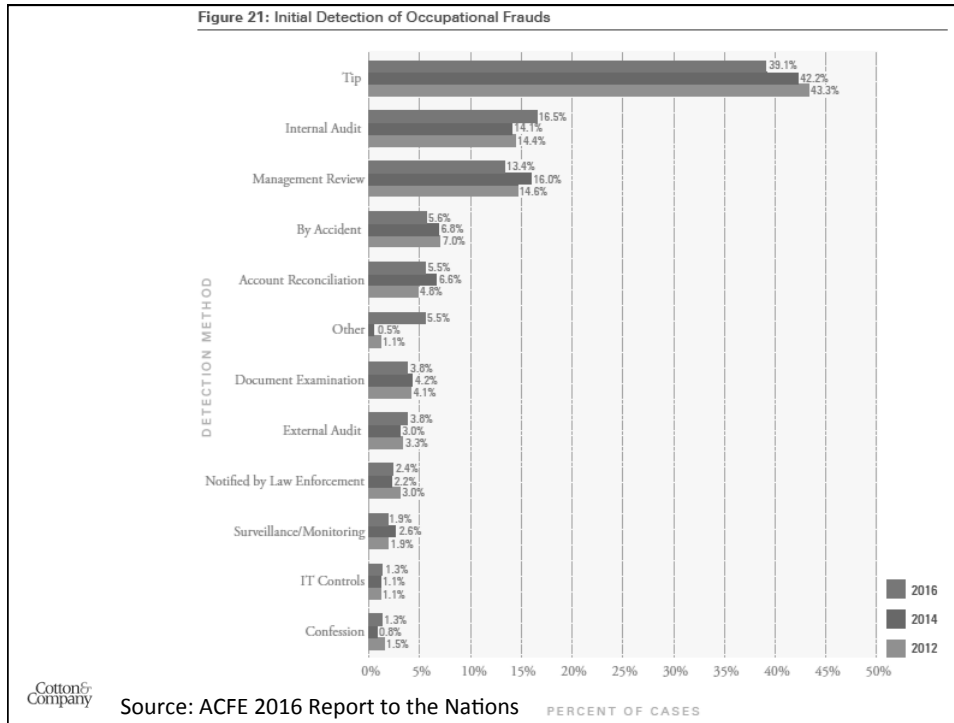




What Can We Expect to See in the Future?



- Data analytics will be where most of the focus will be
- More emphasis on “hotline” employee reporting



What Can We Expect to See in the Future?



- Data analytics will be where most of the focus will be
- More emphasis on “hotline” employee reporting
- More auditor focus on fraud risk management (FRM)

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What Does FRM Mean for External Auditors?



- External auditors are required to assess fraud risk
- Audits are risk-based: higher risk = more audit work needed = higher audit fees
- If you tell your auditors that you have implemented rigorous fraud risk management processes, their assessment of fraud risk should go down ...

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Prediction:



- Auditing standards will be revised to *REQUIRE* auditors to evaluate and test management's fraud risk management system and processes
- Similar to the existing requirement that auditors must evaluate and test management's system of internal control

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For consideration and pilot testing:



- Auditing standards already require auditors to conduct expanded inquiries about fraud (i.e. talk to employees throughout the organization about fraud possibilities)
- Let's have auditors set up an "audit hotline" website at the beginning of the audit and make it known to and accessible by every auditee employee

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What Can We Expect to See in the Future?



- Data analytics will be where most of the focus will be
- More emphasis on “hotline” employee reporting
- More auditor focus on fraud risk management (FRM)
- Perhaps, a 3rd COSO Framework

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COSO Frameworks

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COSO

Committee of Sponsoring Organizations of the Treadway Commission

Internal Control – Integrated Framework

Executive Summary



[4]

COSO

Committee of Sponsoring Organizations of the Treadway Commission

Enterprise Risk Management

Aligning Risk with Strategy and Performance



[2,862]

Fraud
Risk Management
Guide

Coming soon ...



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Professional Development Training
Prevent and Protect: The First Line of Defense
April 27, 2017



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April 27, 2017

Managing Fraud Risk: ACFE/COSO Fraud Risk Management Guide

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