



Macro Socioeconomic Fraud Factors

Governing fraud risk - a competitive advantage?

BDO South Africa Advisory Services (Pty) Limited

JAMES ROBERTS

1 June 2010



Governance of Fraud

Purpose of presentation


The purpose of the presentation is to:

- Understand how *economic downturn* affects organisations
- Review stakeholder *downturn behaviours*
- Explore the most common *fraud risk management failings*
- Review *the four point checklist* against your organisation

Note: Changes have been made to the content of the presentation versus the brochure to accommodate the cross section of private and public sector attendees.

WHY IS FRAUD MORE RELEVANT TODAY?

Understanding how economic downturn affects organisations



How has the economic
downturn affected your
organisation?



Governance of Fraud

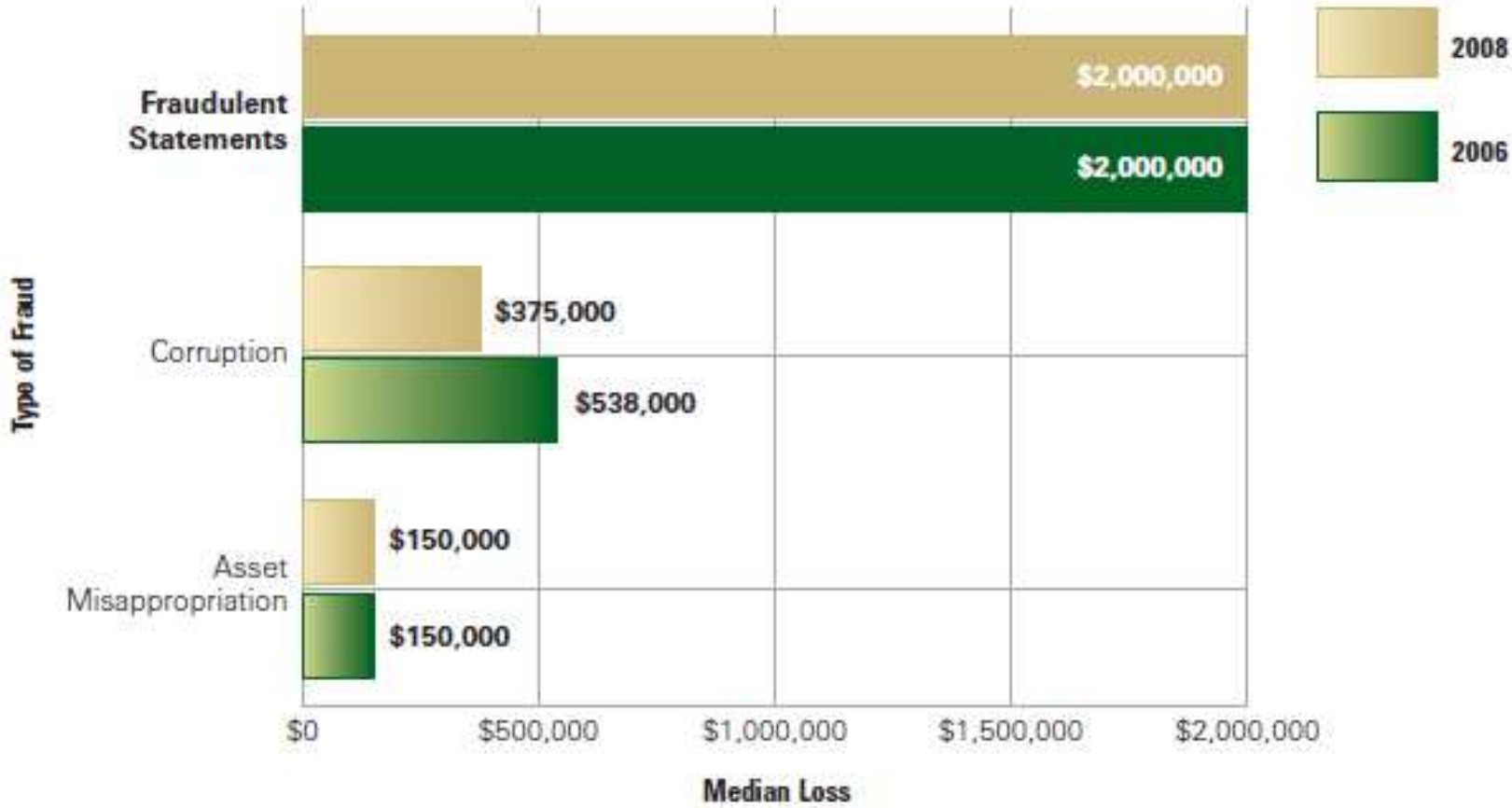
Value at risk

Occupational fraud schemes tend to be extremely costly. The median loss caused by the occupational frauds in this study was \$175,000. More than **one-quarter of the frauds** involved losses of at least **\$1 million**.

Participants in our survey estimated that U.S. organizations lose **7% of their annual revenues** to fraud.

*Source: Association of Certified Fraud Examiners
Title: Report to the Nation on Occupational Fraud and Abuse
Date: 2008*

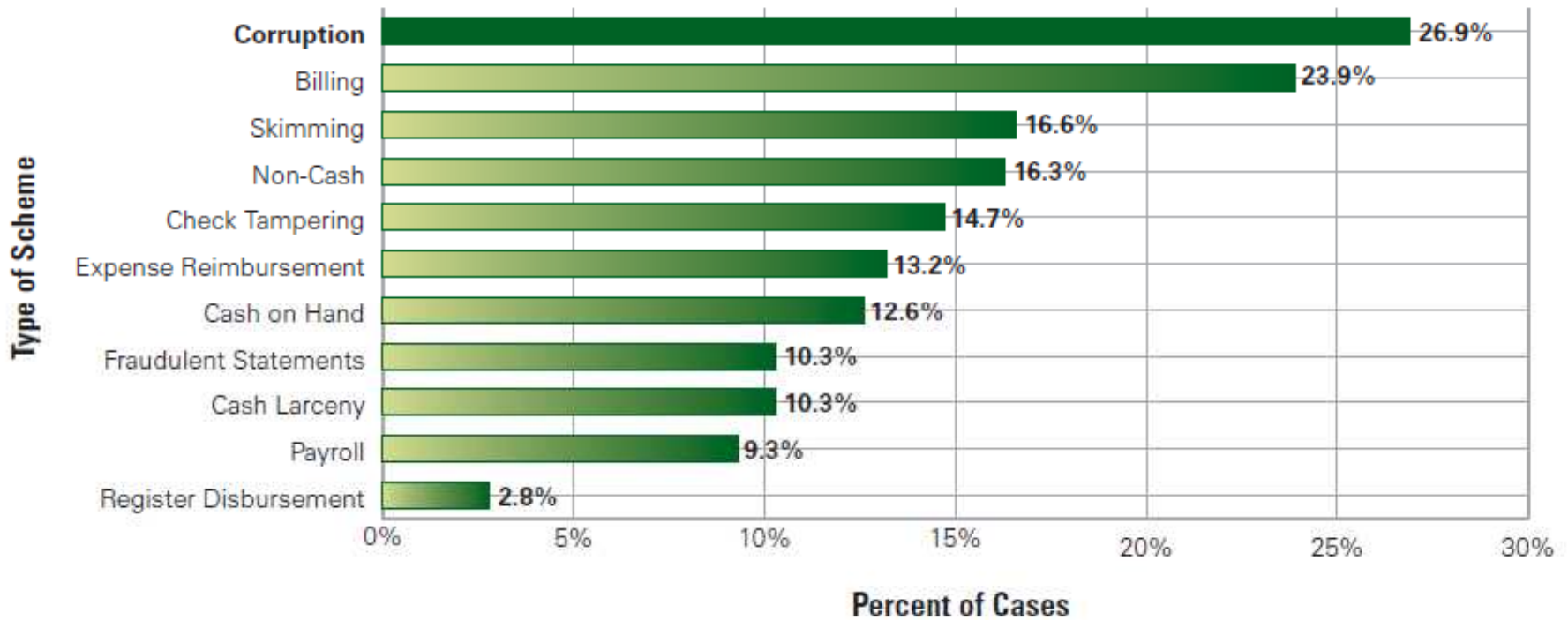
Occupational Frauds by Category — Median Loss



*Source: Association of Certified Fraud Examiners
 Title: Report to the Nation on Occupational Fraud and Abuse
 Date: 2008*



Breakdown of All Occupational Fraud Schemes — Frequency³



³The sum of percentages in this chart exceeds 100 percent because several cases involved multiple schemes from more than one category.



Governance of Fraud

Stakeholder wide impact of fraud

Fraud and corruption has a significant *stakeholder wide impact*:

- **Employees** - Loss of jobs, lower increases, lower bonuses
- **Customers/Public** - Increased product cost, lost investments, inefficient use of tax spend (fruitless and wasteful expenditure)
- **Suppliers** - Loss of revenue, margin squeeze, inequitable supplier selection methods
- **Shareholders (private sector)** - Loss of investments, reduced profitability

ALTERNATIVE DOWNTURN STRATEGIES

A high level exploration of often used strategies during episodes of downturn



Governance of Fraud

Alternative strategies to mitigate downturn

The following strategies are often used to mitigate risks produced by downturn:

- Full time employee numbers rationalisation
- Reduction of operational costs
- Automation of processes



Has your organisation considered fraud risk management as a vehicle for returning a portion of the value lost to economic downturn?



STAKEHOLDER DOWNTURN BEHAVIOURS

Understanding the reactions of stakeholders to economic downturn



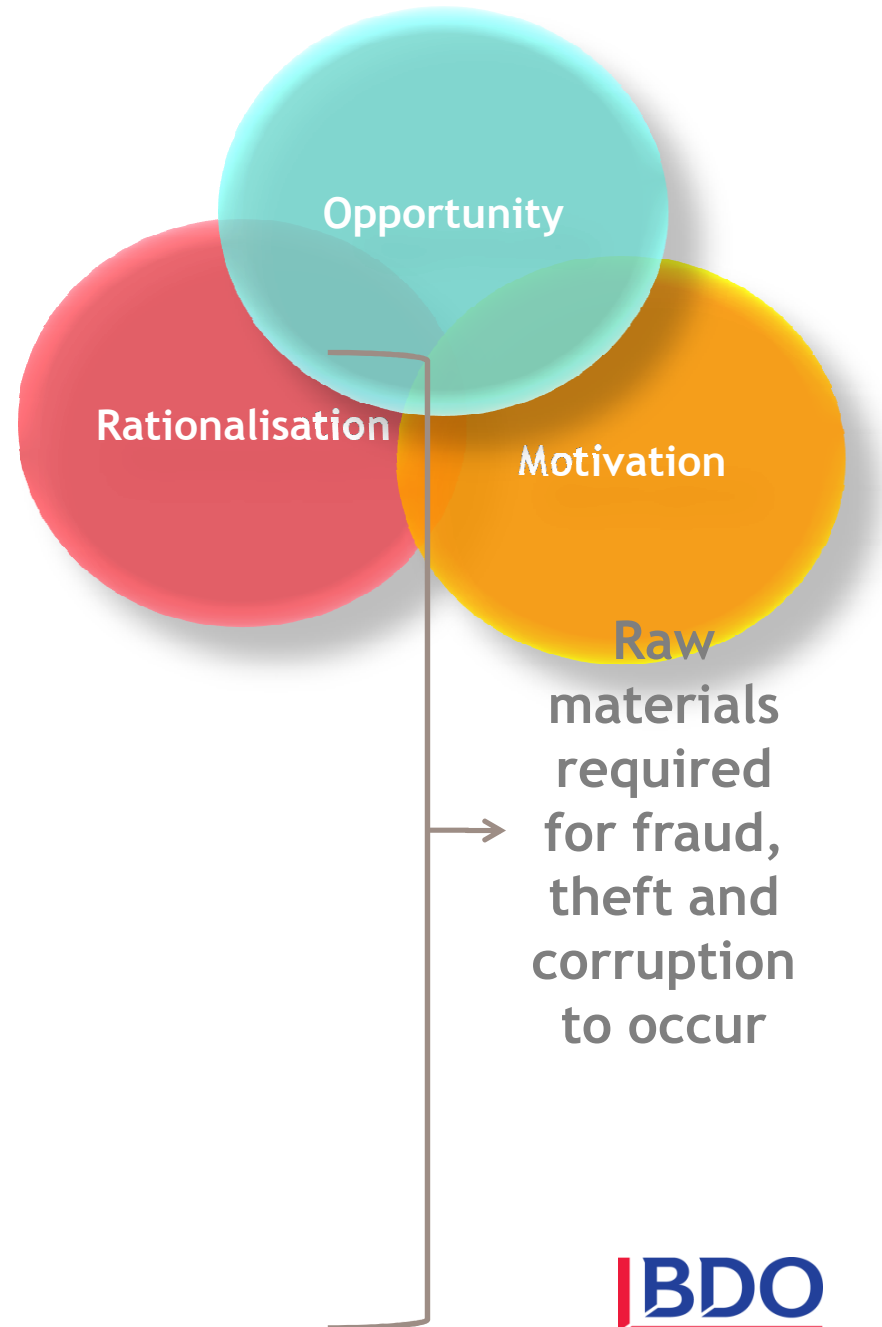
How has the economic downturn affected *you*?



Governance of Fraud

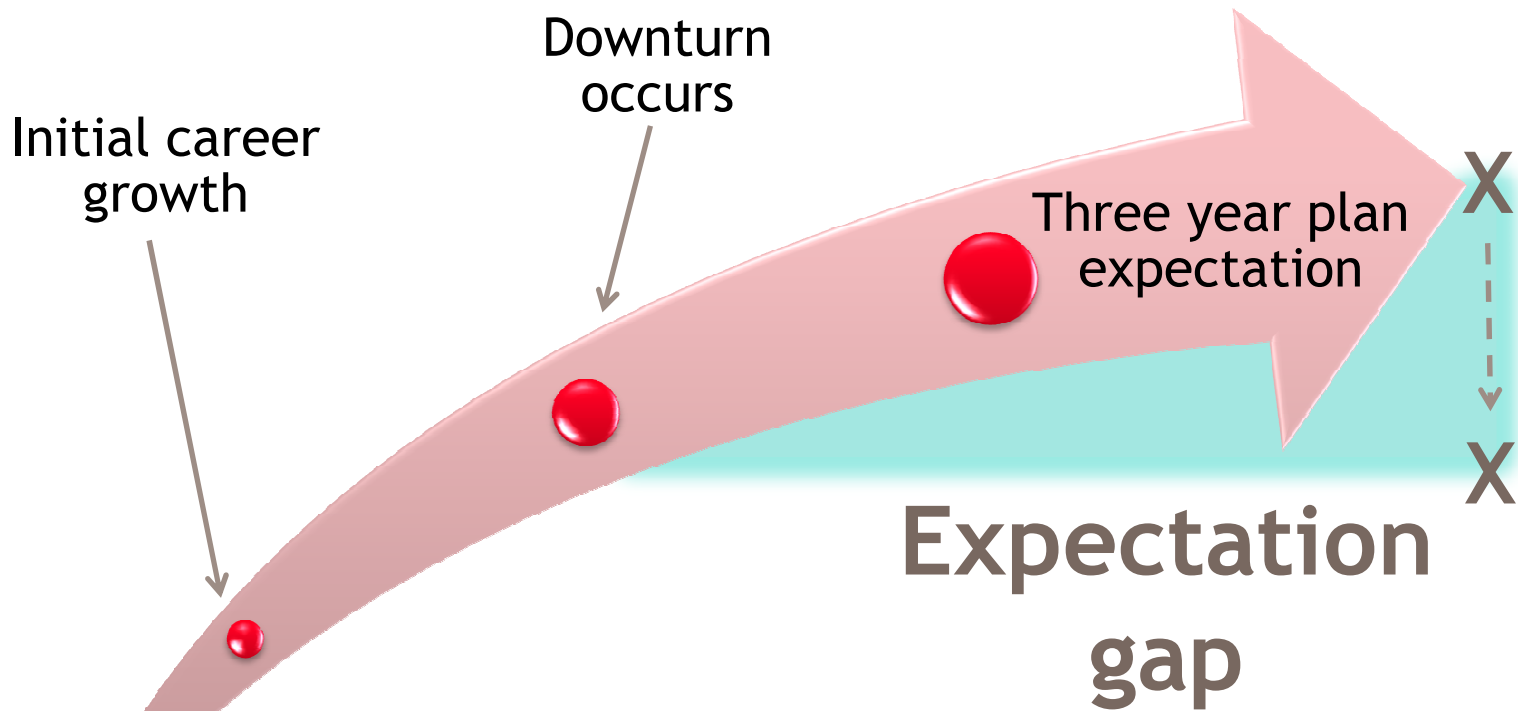
Socioeconomic conditions

- “I worked the hardest this year but received my lowest increase/bonus to date”
 - “The increases don’t match actual inflation, I have less money”
 - “I should have been promoted”
-
- Personal growth not matching expectations
 - Poor debt management (NCA)
 - Instant gratification culture
 - Market uncertainty (nest egging)
-
- Downsizing/retrenchments
 - System automation
 - Rapid roll outs of products/services
 - Acquisitions/JV without due diligence
 - Expansion into developing world countries
-



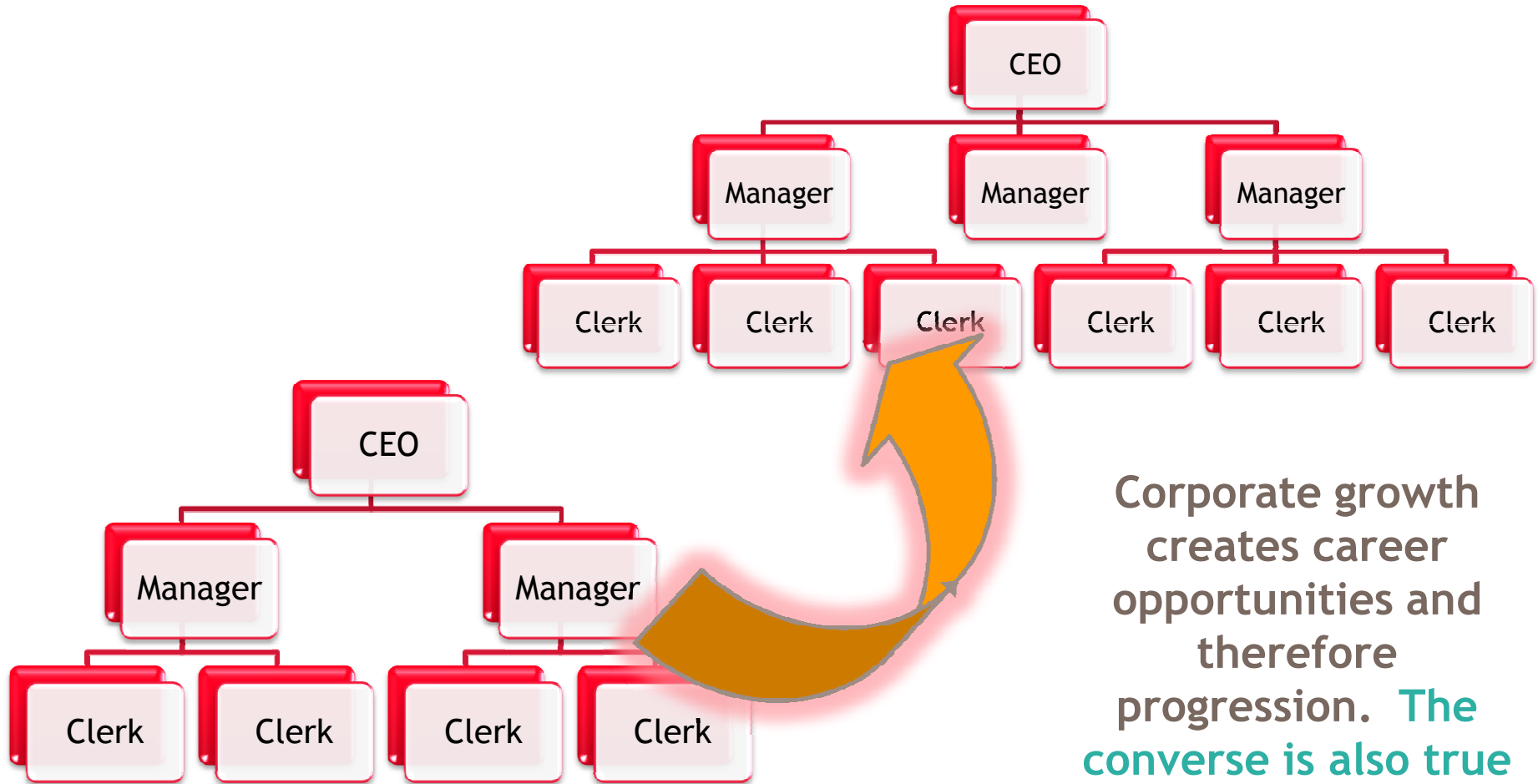
Governance of Fraud

The expectation gap



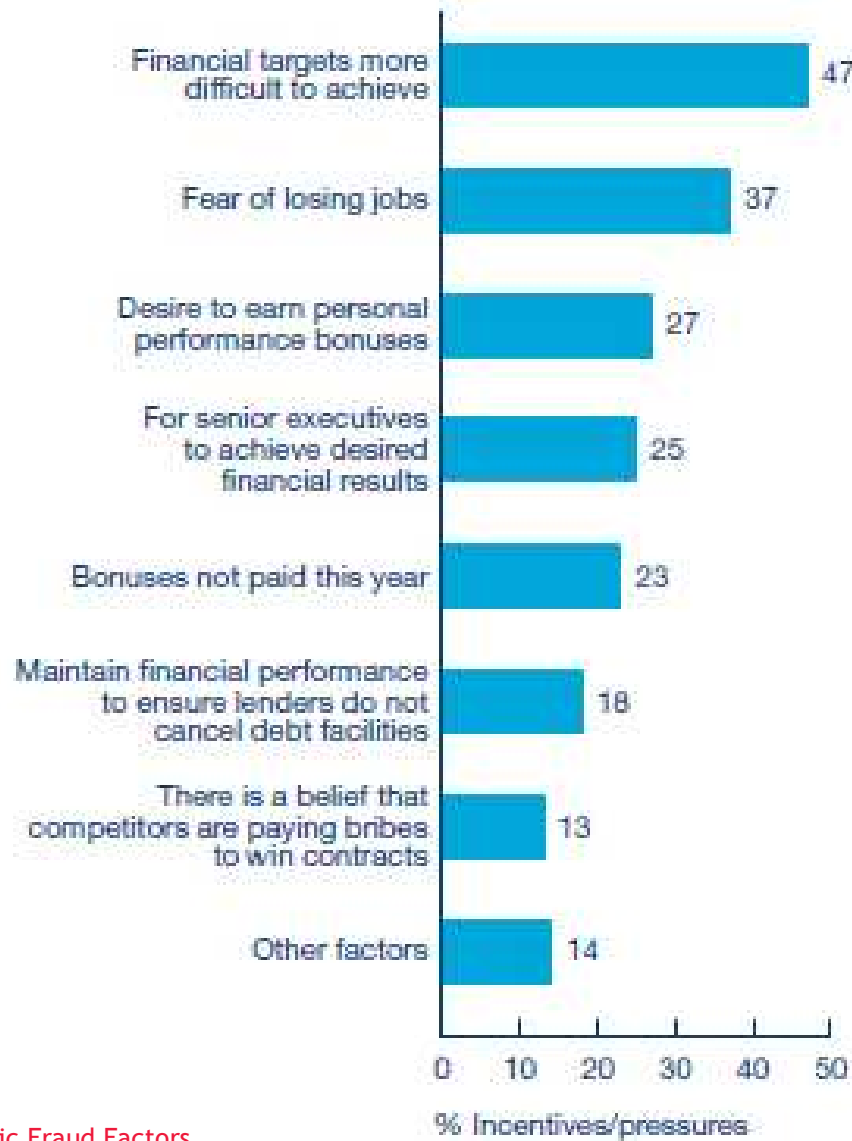
Governance of Fraud

Frozen career prospects



Corporate growth creates career opportunities and therefore progression. **The converse is also true**

Figure 2: Factors contributing towards increased incentives/pressures to commit fraud



Source: PricewaterhouseCoopers
Title: Global Economic Crime Survey
Date: November 2009

Governance of Fraud

Example Investigations

Investigations:

- **Equities Manager**
 - Stagnant career
 - Gambling habit
 - R1.3 million identified
- **Airport Bookkeeper**
 - Stagnant career
 - Garnishee orders
 - Lifestyle change
- **Custody Clerk**
 - Syndicate pressure
 - Sole breadwinner
 - Default on municipality bills
 - R6 million identified






Has the ethical fabric of society weakened?



Do you believe that
your country is
ethical?



Do you believe that
you are ethical?




Have you ever told a
lie to stay out of
trouble?



Have you ever.....?

- a) Driven while under the influence
- b) Exceeded the speed limit
- c) Purchased DVD material from road side vendors
- d) Have an iPod where you did not purchase all the songs recorded on it
- e) Exaggerated your mileage on your tax return
- f) etc



Are some unethical
behaviours now socially
acceptable?



Governance of Fraud

Socially acceptable behaviours?

Have the following unethical behaviours become socially acceptable:

- Over stating business related mileage in tax return
- Purchasing goods at far below market value
- Overstating the value of insured assets during a claim
- Copying and distributing copyrighted material

Is it easier to commit unethical acts when society, through technology, reduces interpersonal contact with the prejudiced party? Victimless crimes...



Governance of Fraud

The Pareto Principle - Conditional Ethics

Ethics or rationalisation is deemed as being a factor conditional on the individual's environment and personal experience.

The Pareto principle states:

10% of people are inherently **dishonest**

10% of people are inherently **honest**

80% are fence sitters

Would you steal to feed your family if they were starving?

Would you steal to pay medical aid bills if your child was ill and you could not afford cover?



COMMON FRAUD RISK MANAGEMENT FAILINGS

A high level overview of a sample of the top two fraud risk management failings



“We have a code of ethics and I think that we do some form of ethics training upon induction”

Governance of Fraud Ethical Corporate Culture

A code of ethics alone, in the best case scenario, is lip service to corporate governance principles and worst case scenario either a paper tiger or deliberately misleading.



Governance of Fraud

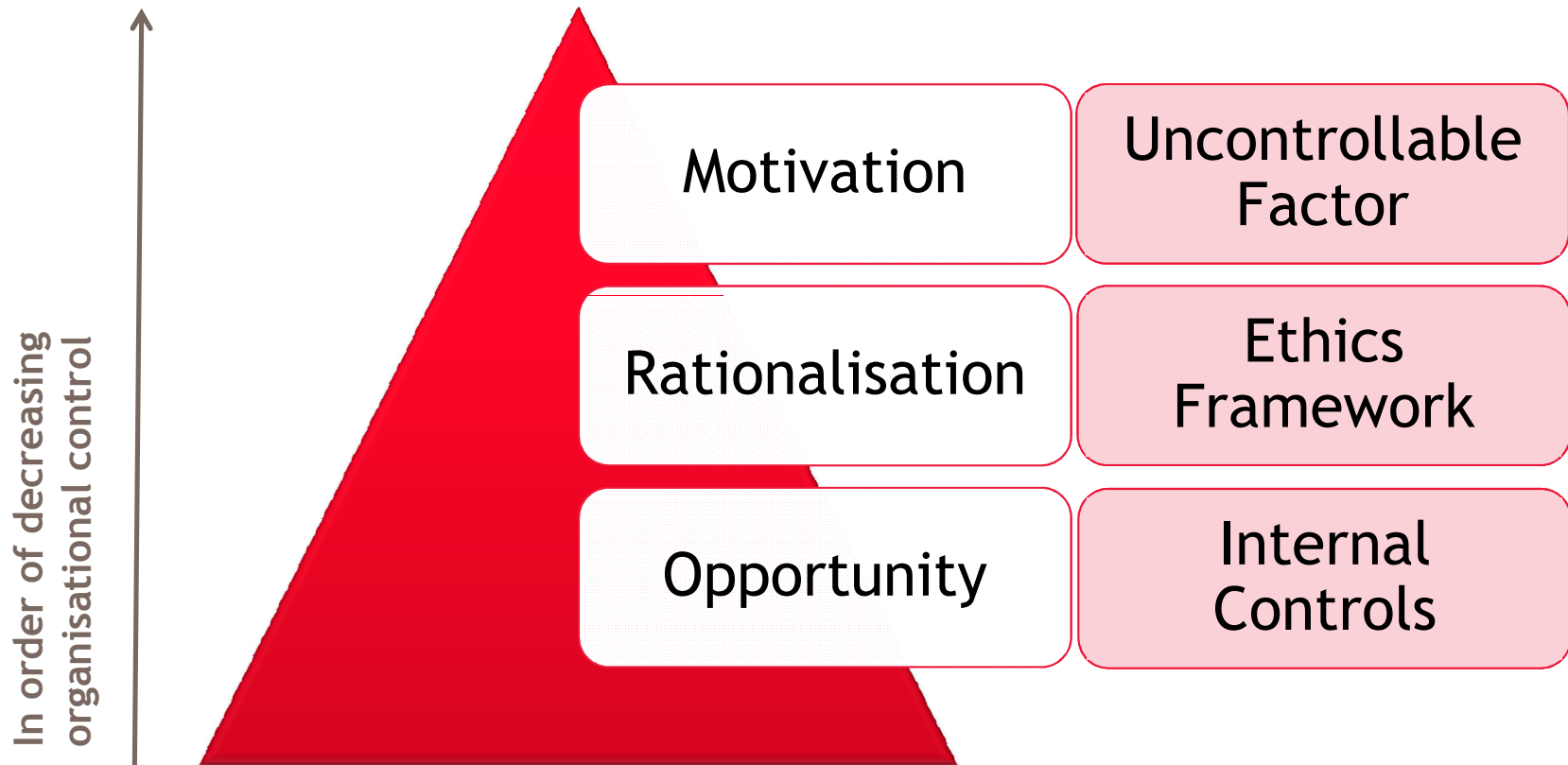
Ethical Corporate Culture




Source: Dr Muel Kaptein
Title: The Living Code: Embedding Ethics into the Corporate DNA
Date: 2008

Governance of Fraud

Fraud Triangle - Cressey, 1953





How are you embedding an ethical corporate culture in your organisation?

How are you measuring the ethical corporate culture within your organisation?




Governance of Fraud


Ethical risk mitigation

While not an exhaustive list, do your internal governance functions perform the following ethical assurance functions to mitigate potential corporate failure:

- Ethical risk assessments:
 - 360 degree survey
 - Independent and anonymous
 - Stratified hierarchical report
 - Perception based responses
 - Perception - Kernel of truth
 - Risk based action plan
- Ethics training for all employees
- Ethics training for Directors, Principals and Executives



“Yes, we use manual internal audit samples to detect fraud and corruption in our organisation”



The nature of fraud in comparison to errors is that it is deliberately concealed.



Governance of Fraud

Forensic data analytical risk mitigation

What is the ratio of errors to fraud?


100 to 1

1 000 to 1

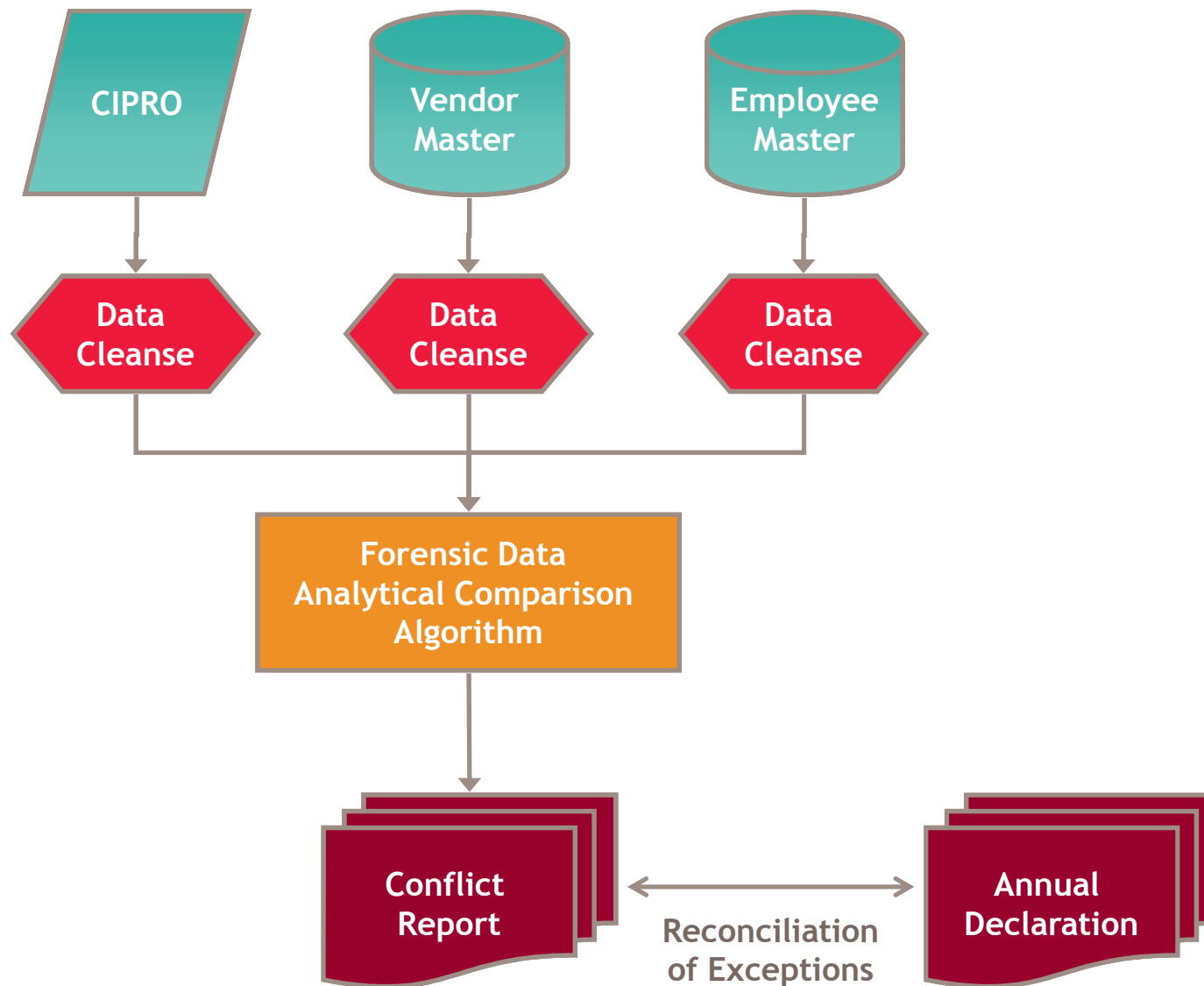
10 000 to 1

100 000 to 1..and so on

If fraud occurs significantly less than errors would a manual internal audit sampling technique be appropriate or effective in detecting fraudulent transactions?



Do your internal auditors have sufficient levels of professional skepticism and forensic investigatory experience to design effective forensic data analytical routines?





Governance of Fraud

Forensic data analytical risk mitigation

While not an exhaustive list, do your internal governance functions perform the following forensic data analytical assurance activities:

- Perform strategic risk assessment
- Identify areas appropriate for data analysis
- Select a forensic specialist to assist in the design of the algorithms
- Review industry and organisation fraud history
- Design algorithms
- Test algorithms against historical fraud data
- Implement, monitor and act decisively on exceptions
- Design, implement and evaluate cycle
- Continuously changing fraud and corruption modus operandi



FOUR POINT CHECKLIST

Your four point checklist to verify whether your organisation is on track to manage fraud and corruption

Governance of Fraud


Four common failings - Checklist

1 - Ethics - Do you measure and react to ethical risk?

2 - Risk Assessments - Do you perform fraud risk assessments?

3 - Detection - Do you run data analytical routines to detect fraud?

4 - Investigation - Do you consistently investigate and prosecute?



Managing fraud is not about having thousands of anti-fraud strategies but rather about doing the basics well.



Questions?