

# **Fraud and Abuse: What is it to You?**

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MAMIAF**

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# **Fraud and Abuse: Focus on the Roles of Auditors**

- I. What is Fraud and Abuse?**
- II. Why and How do Auditors Detect and Deter Fraud and Abuse?**
- III. What do Auditors Expect Citizens, Management, Employees, and Attorneys, to do about Fraud and Abuse?**
- IV. Conclusion: How to Make the World A Better Place: Suggestions on How to Fight and Reduce Fraud and Abuse**

# I. What is fraud and abuse?

- **Fraud?**
- **Abuse?**
- **How are fraud and abuse different from each other?**

# What is fraud?

- **An illegal act characterized by deceit, concealment, or violation of trust.**
- **These acts are not dependent upon the threat of violence or physical force.**
- **Frauds are perpetrated by parties and organizations to obtain money, property, or services; to avoid payment or loss of services; or to secure personal or business advantage.**

# Some Indicators of Potential Fraud

- **Unsupported costs**
- **Inventory shortages**
- **Unexplained overruns**
- **Contracts not documented or monitored**
- **Defective materials**
- **Altered documents**
- **Unauthorized subcontracting**
- **Bid rigging**
- **Mischarged costs**
- **Unallowable costs**
- **Excessive overtime**
- **Conflicts of interest**
- **No duties separation**

# Occupational Fraud in the Public Sector

- **Corruption**
- **Asset Misappropriation**
  - Cash
  - Inventory and All Other Assets
- **Financial Statement Fraud**

# Match the Description with the Fraudster's Name

<u>Description</u>	<u>Name</u>
(1) No more "trade" winds at West Palm Beach	(1) Martha Stewart
(2) She cooks better than she steals	(2) Bernie Madoff
(3) Click here to sign up for "fake classes" where the "professor" gives high grades	(3) University of North Carolina Administrators and Athletes

# What is abuse?

- **Abuse involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances.**
- **Abuse also includes misuse of authority or position for personal financial interests or those of an immediate close family member or business associate.**
- **Abuse does not necessarily involve fraud or noncompliance with provisions of laws, regulations, contracts, or grant agreements.**

# Some Indicators of Potential Abuse

- **Examples of abuse include misuse of authority or official position, contradicting policies, overriding controls, mistreating others especially subordinates, and other unacceptable business behavior.**
- **After performing additional work managers, auditors, or investigators may discover that the abuse represents potential fraud or illegal acts.**

# Match the Description with the Abuser's Name

<b>Description</b>	<b>Name</b>
<b>(1) Poster boy for denying steroid abuse</b>	<b>(1) Jamie Dimon and Ina Drew of JP Morgan Chase Bank</b>
<b>(2) After losing \$2 plus billion on one deal, these two still don't understand "too big to fail"</b>	<b>(2) Roger Clemens</b>
<b>(3) Now agents need to "protect" themselves</b>	<b>(3) U.S. Secret Service Agents on vacation in Colombia</b>

## **POLL QUESTION ONE on**

### **“Fraud and Abuse: Focus on the Roles of Auditors”**

# **Fraud and abuse are not the same concepts.**

**What is the main difference between fraud and abuse?**

- a) Abuse may be an illegal act**
- b) Abuse is more damaging to organizations**
- c) Fraud is an illegal act**
- d) Fraud is usually not present in government organizations**
- e) Abuse and fraud are usually committed by corrupt executives**

# EXAMPLES FROM THE CITY OF AUSTIN

- **“Everything is a shade of grey” (fraudulently reporting efficiency and timeliness)**
- **“Providing oversight for federal funds doesn’t matter” (funding “fantasy” outputs and outcomes)**
- **What would you have done in my place? (abuse of “position” literally)**
- **“He won the Silver Star” (entity wide controls)**

**POLL QUESTION TWO on  
"Fraud and Abuse: Focus on the Roles of Auditors"**

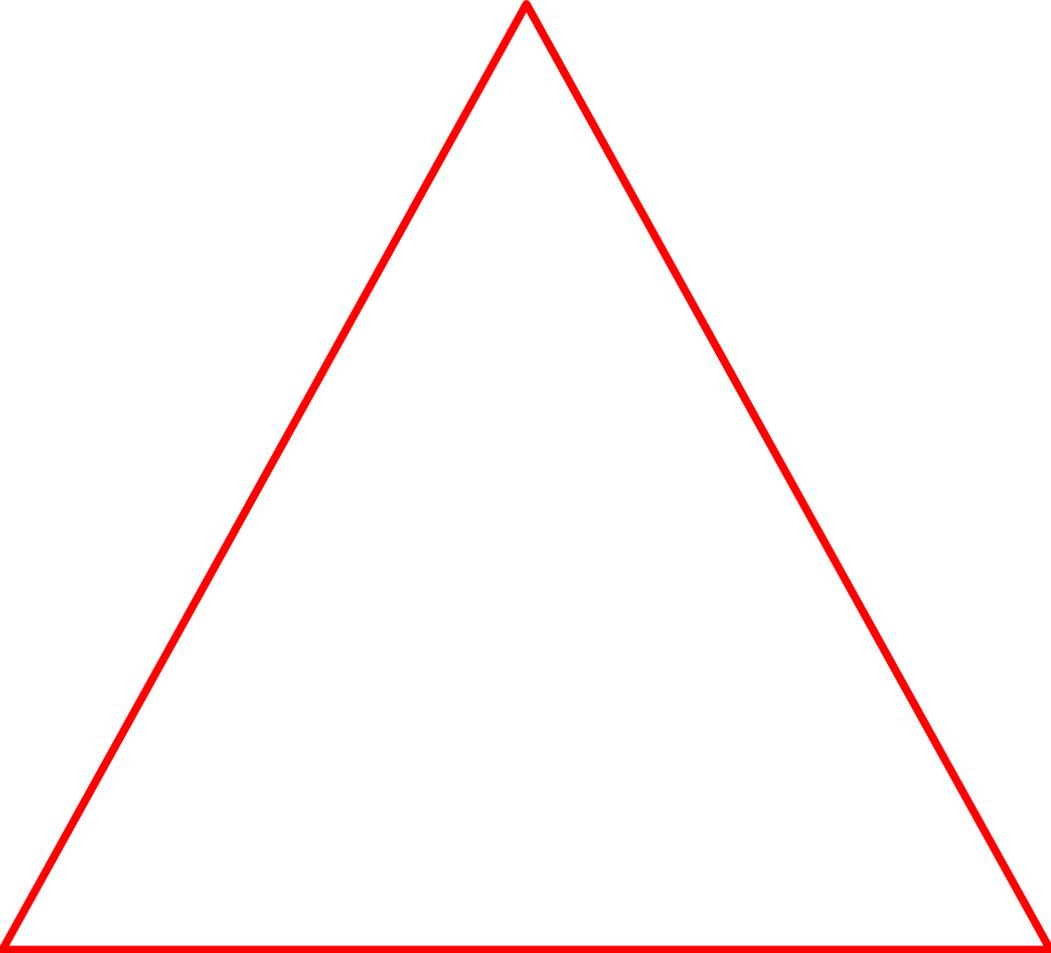
**Fraud and abuse can be detected through various means.**

**Which do you think is the most common way occupational fraud or abuse is initially detected?**

- a) Tip or "Whistle Blower"**
- b) Management Review**
- c) Internal Audit**
- d) By Accident**
- e) Account Reconciliation**
- f) External Audit**

# FRAUD TRIANGLE

Pressure/Incentive



Opportunity

Rationalization



# Draw Fraud Models

**(1) What additional aspect could be added to the fraud triangle to convert it into a fraud diamond?**

**(2) What additional aspect could be added to convert the diamond into a pentagon?**

## **II. Auditors Proactively Detect and Deter Through Audits and Assistance**

- **Audits are guided by standards pertaining to fraud and abuse.**
- **Auditors assess risk and vulnerability to fraud and abuse**
- **Auditors also provide assistance is to management and elected officials.**

# Why Auditors Detect and Deter: Standards and Guidance Provided by IIA and by GAO for the United States

- **IIA provides a Code of Ethics, Attribute and Performance Standards, and a Practice Guide “Internal Auditing and Fraud” (the “Red Book”).**
- **GAO provides Ethical Principles, General Standards, and Specific Audit Project Level Standards for Fieldwork and Reporting (the “Yellow Book”).**

# What do the IIA Standards Say About Fraud Audit Work at the Engagement Level?

- **1220.A1 – Exercise due professional care (“skepticism”) by considering the possibility of significant errors, intentional wrongdoing (abuse), fraud, or noncompliance.**
- **2120.A1 and 2130.A1 – Evaluate risk exposures (and controls) regarding safeguarding of assets and compliance with laws, regulations, policies, procedures, and contracts.**

## What else do the IIA Standards Say?

- **2120.A2 – Evaluate the potential for the occurrence of fraud and how the organization manages fraud risk.**
- **2210.A2 – When establishing audit objectives, consider the probability of significant errors, fraud, noncompliance, and other exposures.**

# What do the 2011 GAO Standards say?

- **3.61 – Professional Judgment – Exercise reasonable care and professional skepticism.**
- **6.28 – Noncompliance – Assess risk of violation of laws, regulations, contracts, grants within context of audit objectives.**
- **6.30 – Fraud - In planning the audit, assess risks of fraud occurring that are significant within the context of the audit objectives.**

## What do the 2011 GAO Standards Also Say?

- **6.32 – Throughout the audit, if information comes to auditors' attention that fraud may have occurred significant within the context of the audit objectives, auditors should extend the audit steps and procedures to determine whether fraud has likely occurred.**
- **6.34 – Abuse - During course of audit, if auditors become aware of significant abuse, ascertain the potential effects within the context of the audit objectives.**

## **POLL QUESTION THREE on**

### **“Fraud and Abuse: Focus on the Roles of Auditors”**

**The IIA issues the Red Book and the GAO issues the Yellow Book—both contain standards pertaining to auditor responsibilities to deter and detect fraud and abuse.**

**What frame of mind is emphasized in both the IIA and GAO Standards?**

- a) Listen to advice from management to detect fraud**
- b) Listen to advice from contractors to detect fraud**
- c) Follow the standards in the Orange book**
- d) Exercise skepticism and professional judgment regarding potential fraud**
- e) Use your “gut instinct” when in doubt**

**POLL QUESTION FOUR on  
“Fraud and Abuse: Focus on the Roles of Auditors”**

**The IIA issues the Red Book and the GAO issues the Yellow Book—both contain standards pertaining to auditor responsibilities to deter and detect fraud and abuse.**

**GAO requires auditors to be “proactive” in detecting fraud. This requirement applies to:**

- a) Financial Statement Auditors**
- b) Performance Auditors**
- c) IT Auditors**
- d) Investigators**
- e) Auditors using Yellow Book Standards**

# Planning Performance Audits— Responsibility for Abuse

**If the auditor becomes aware of indications of significant abuse, auditors perform audit procedures to determine**

- 1. whether abuse has occurred (Austin “bowling for beer” example), and**
- 2. the potential effect on the subject matter of the audit.**

However, because the determination of abuse is subjective, auditors are not required to provide reasonable assurance of detecting abuse.(6.34)

## **POLL QUESTION FIVE on**

### **“Fraud and Abuse: Focus on the Roles of Auditors”**

**The IIA issues the Red Book and the GAO issues the Yellow Book—both contain standards pertaining to auditor responsibilities to deter and detect fraud and abuse.**

**What approach does GAO and IIA recommend when government auditors are required to follow both sets of standards?**

- a) Follow the standards in the Red Book**
- b) Follow the standards in the Yellow Book**
- c) Follow the standards in the Orange book**
- d) Make up your own standards**
- e) Follow the most rigorous standard if in doubt**

## **EXAMPLES FROM THE CITY OF AUSTIN: How Auditors Detect and Deter**

- Auditors and investigators work with managers, employees, and citizens**
- Management Integrity Committee (auditors support top management to consistently “do the right thing”)**
- Citywide Administrative Bulletin on Fraud, and Other Integrity Violations**
- Auditors provide detection mechanisms including hotline, posters, and OCA website**
- Auditors analyze Citywide Annual Employee Confidential Survey**

# **Austin's Audit Approach Over the Years— Collaborate with Investigators and Customize to the Audit Objectives**

**Consult with investigators in determining:**

- **Fraud risks for City programs**
- **Common red flags of fraud for City functions/systems/sub-systems affected by the audit objectives**
- **Prior fraud-related findings related to audited area**

## Austin's Approach Over the Years (Cont.)

- **Types of fraud questions to ask**
- **Who and in what order to conduct interviews**
- **Techniques and procedures most effective in detecting fraud in the audited program area—functions/systems/sub-systems**

## **POLL QUESTION SIX on**

### **“Fraud and Abuse: Focus on the Roles of Auditors”**

# **What is the best example or approach from the City of Austin for detecting fraud?**

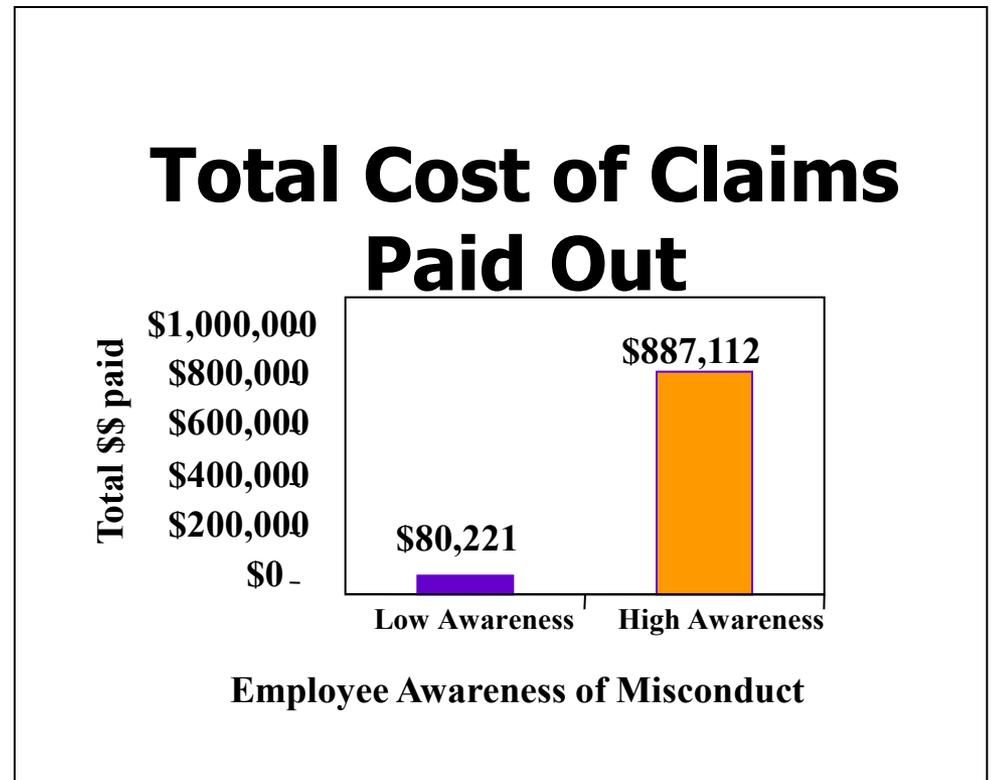
- a) Follow the standards in the Purple Book, “Detecting Fraud.”**
- b) Auditors and investigators work collaboratively with managers, employees, and citizens**
- c) Operate a Hotline six hours per day**
- d) Refer all fraud allegations to management with seven days of discovery**
- e) Contact the Police Department and the District Attorney’s Office**

# December 2009 IIA Practice Guide on Internal Auditing and Fraud

- **Auditing management controls over fraud – (auditing the entity-wide fraud risk management system)**
- **Auditing to detect fraud by testing high risk processes (fraud audit can be part of or separate from a performance or internal audit)**
- **Considering fraud as part of every audit (need to incorporate risks of fraud or abuse in planning and conducting all audits)**

# Auditing Entity-Wide Ethics and Safety in Austin—Impact on Paid Damages (Claims)

- **Costs of successful damage claims against the city were highest among departments where employees reported greater awareness of unethical conduct.**
- **Costs also higher where departments lacked a best practice safety program.**



# Four Key Steps Per IIA Practice Guide

- 1. Identify relevant fraud risks (including risk factors) or potential schemes.**
- 2. Map existing and potential controls to deter or detect potential fraud schemes and identify gaps.**
- 3. Test operating effectiveness of fraud prevention and detection controls.**
- 4. Document and report the fraud risk assessment.**

# Vulnerability Table—H/H Means Potential Fraud or Abuse

<b>Inherent Risk</b>	<b>High/Low</b>	<b>High/High</b> ★
	<b>Low/Low</b>	<b>Low/High</b>
	<b>Control Risk</b>	

## **POLL QUESTION SEVEN on**

### **“Fraud and Abuse: Focus on the Roles of Auditors”**

**If there is a high risk, but strong internal controls exist, what is the control risk or vulnerability?**

- a) It cannot be determined**
- b) High, because the risk is high**
- c) Low**
- d) Moderate to high**

# What Audit Success Looks Like

- **Select the most important programs to audit**
- **Select the most important risks and vulnerabilities within the programs including fraud and abuse risks**
- **Develop significant effects through measurement based performance auditing**
- **Base recommendations on underlying causes**

# What Audit Failure Looks Like

- **Unimportant issues selected for audit**
- **Deficient performance continues**
- **Fraud or abuse goes undeterred, undetected, and uncorrected—no recoveries are made**

# Auditors also Assist Management and the Elected Officials

- Prevent Occurrence (Advise on COSO/ERM especially ethics and other "soft controls")**
- Deter (Auditing Organization's Fraud Risk Management System)**
- Detect (HR and Technology Tools to Test Controls, Estimate Effect, and Establish Cause)**
- Resolve (Advice on I/C Improvements, Training, and Reporting)**
- Prevent Re-Occurrence (Analysis of Lessons Learned)**

**POLL QUESTION EIGHT on  
"Fraud and Abuse: Focus on the Roles of Auditors"**

**Audit offices plan efforts to deter or detect fraud and abuse in government programs.**

**A successful annual or strategic audit planning approach would incorporate focus on which of the following?**

- a) Any program that makes the news**
- b) Programs with the greatest risks and vulnerabilities**
- c) Any and all programs that are publicly funded**
- d) Programs that contribute to public charities**
- e) Experimental programs only**

# **Auditors Should Encourage Management and Other Stakeholders to Fight Fraud and Abuse**

- **Conduct ongoing self assessment and monitoring of risks to your systems and programs**
- **Develop and implement COSO/ERM or the model that works for your environment**
- **Support monitoring and audits to make sure controls actually work**
- **Support an ethical culture and environment—  
THE MOST IMPORTANT SOLUTION!**

### **III. What do we expect citizens, managers, employees, attorneys, and to do to detect and deter fraud?**

- **Detect through risk and vulnerability assessment, monitoring, and reporting.**
- **Deter through strengthening internal controls, fostering an ethical organizational culture/environment, and encouraging communication between management, auditors, employees, and citizens.**

## **POLL QUESTION NINE on**

### **“Fraud and Abuse: Focus on the Roles of Auditors”**

**A “tone at the top” that reflects integrity and supports an ethical organizational culture is essential to deter and detect fraud and abuse.**

**Which of these is not a characteristic of a highly ethical organizational culture with effective “tone at the top?”**

- a) Employees are encouraged to report bad behavior**
- b) Elected officials are indicted periodically**
- c) Internal audit is supported by the CEO and CFO**
- d) An ethical code of conduct is periodically reviewed for effectiveness**
- e) New employees receive an orientation that includes ethics awareness and mechanisms to report bad behavior**
- f) External audit is supported by the CEO and CFO**



# What does each stakeholder do to help auditors?

- **Citizens monitor and report concerns**
- **Management and employees self assess, implement the COSO/ERM Model or a model based on COSO/ERM, and foster an ethical culture/environment**
- **Attorneys provide advice to auditors and managers and potentially prosecute criminal integrity violations**

# Citizens Monitor, Report, and Demand Action

- **Citizens monitor government reports, websites, and services**
- **Citizens sometimes complain to management, employees, auditors, or elected officials**
- **Citizens sometimes demand action and may even vote**

## **POLL QUESTION TEN on**

**“Fraud and Abuse: Focus on the Roles of Auditors”**

**Fraud and abuse can be detected with the help of citizens.**

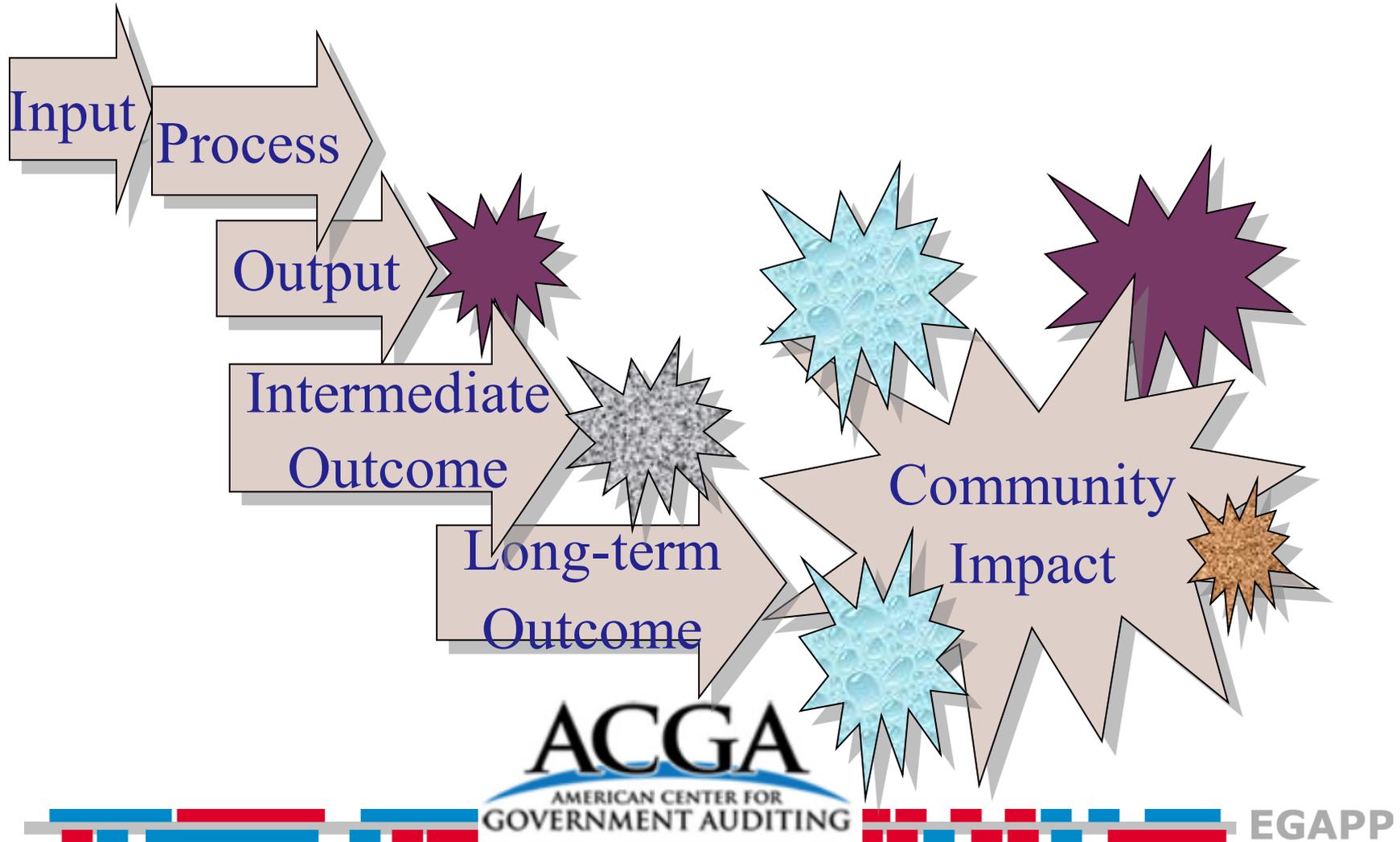
**What should citizens do if they think they see government officials or employees committing fraud or abuse?**

- a) Take a picture with your cell phone**
- b) Tell your neighbor to handle it**
- c) Call 911 to report an emergency**
- d) Call 311 and file a written complaint**
- e) Find out what the fraud hotline number is for the government entity and call that number**

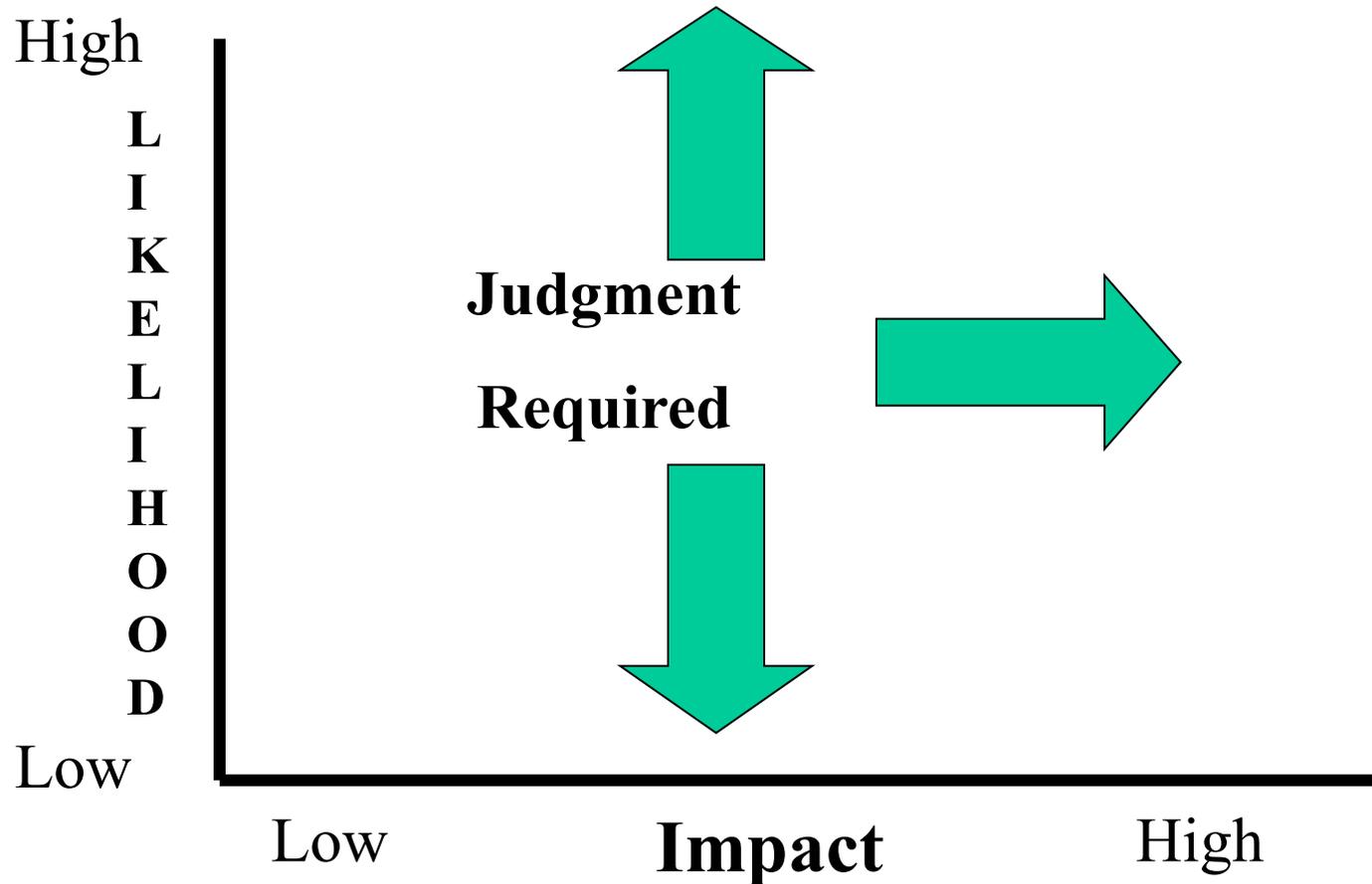
# **Management/Employees Implement COSO/ERM and Are Responsible for Detecting and Deterring**

- (1) Map/define your government programs**
- (2) Assess risk and vulnerability**
- (3) Implement controls including government wide and program level risk management systems (including a fraud risk management system)**

# (1) Define Government Program Before Assessing Fraud and Abuse Risk



## (2) Evaluate Risk and Select Programs to Monitor In Depth



# Critical Factors

- **Judgment & courage**

- Some managers consistently identify the right programs to closely monitor or suggest for in depth audit.
- Others focus on mediocre issues - avoid controversy, do not take on the tough issues, lack insight, and ultimately fail to detect or deter fraud and abuse.

# Three Key Questions to Ask About Vulnerability to Fraud

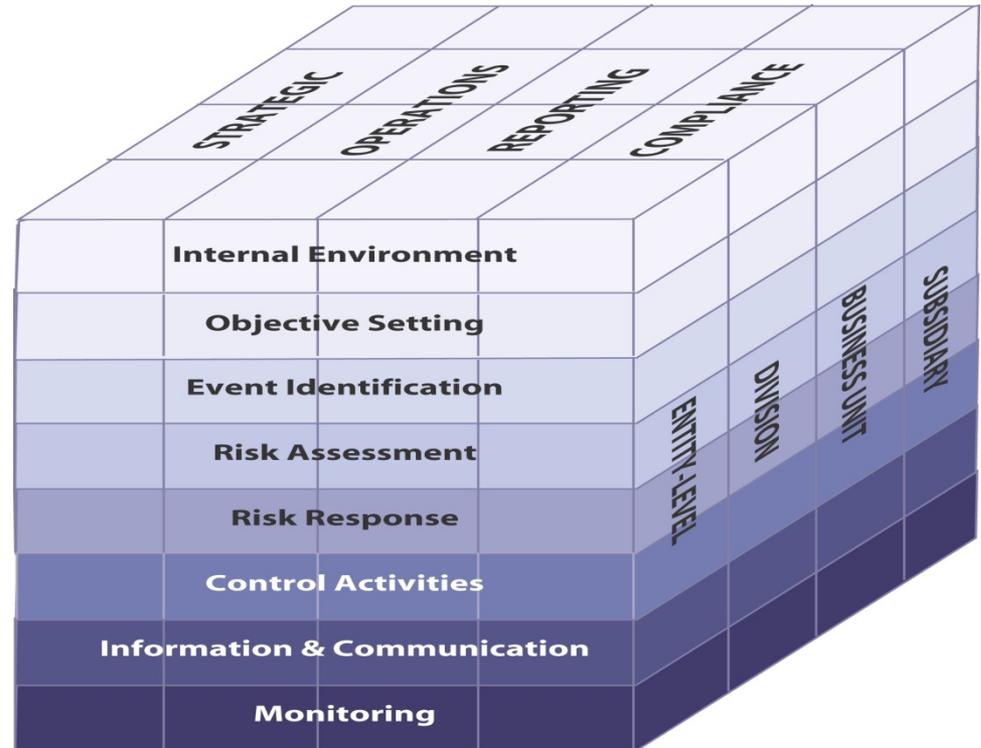
- **Where are the opportunities for fraud?**
- **What is the level of pressure management is under that would lead it to override internal controls?**
- **Are there any consequences if management fails to reach goals?**

**Source: IIA's 2009 Practice Guide on IA and Fraud**

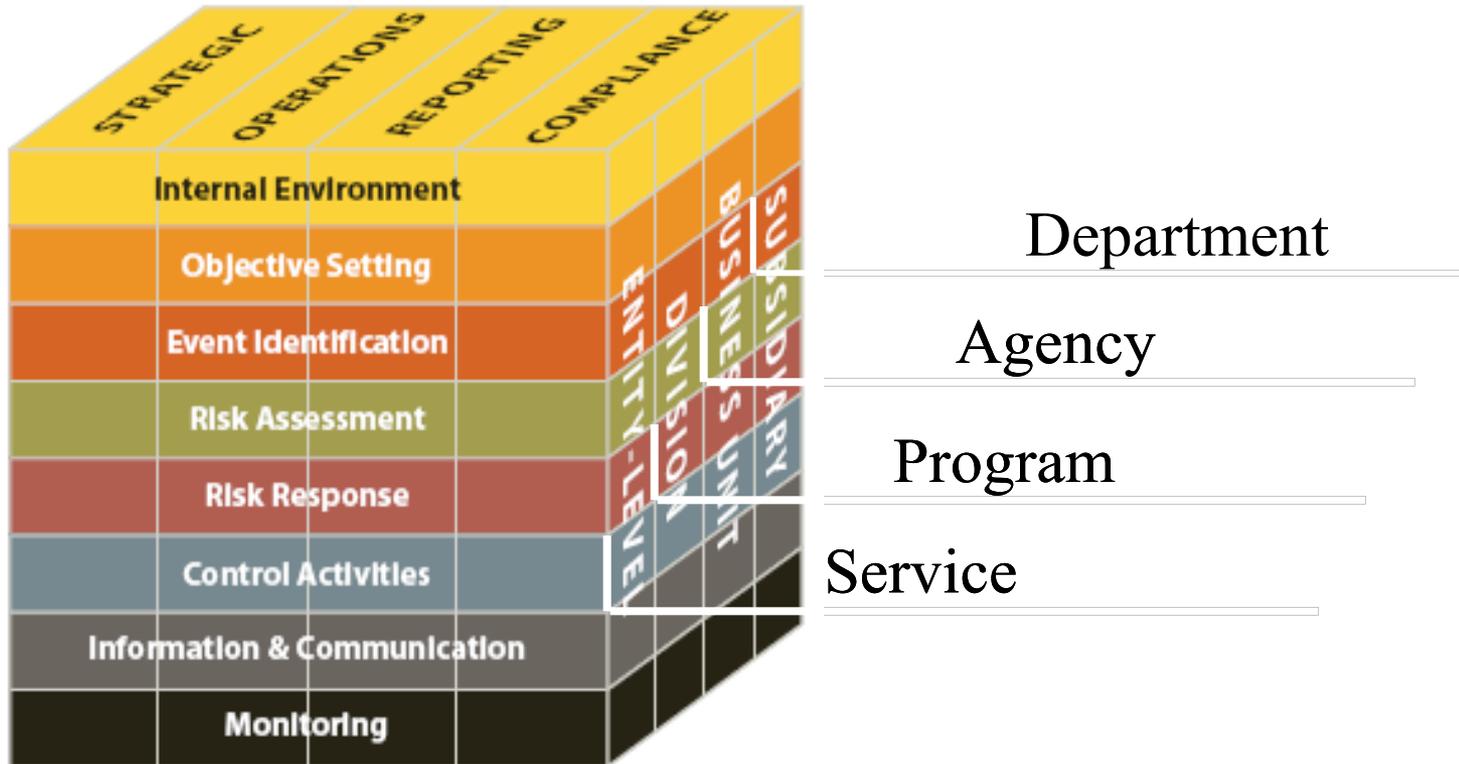


# (3) COSO/ERM is the "Best Practice" Control Model to Deter or Prevent Fraud and Abuse

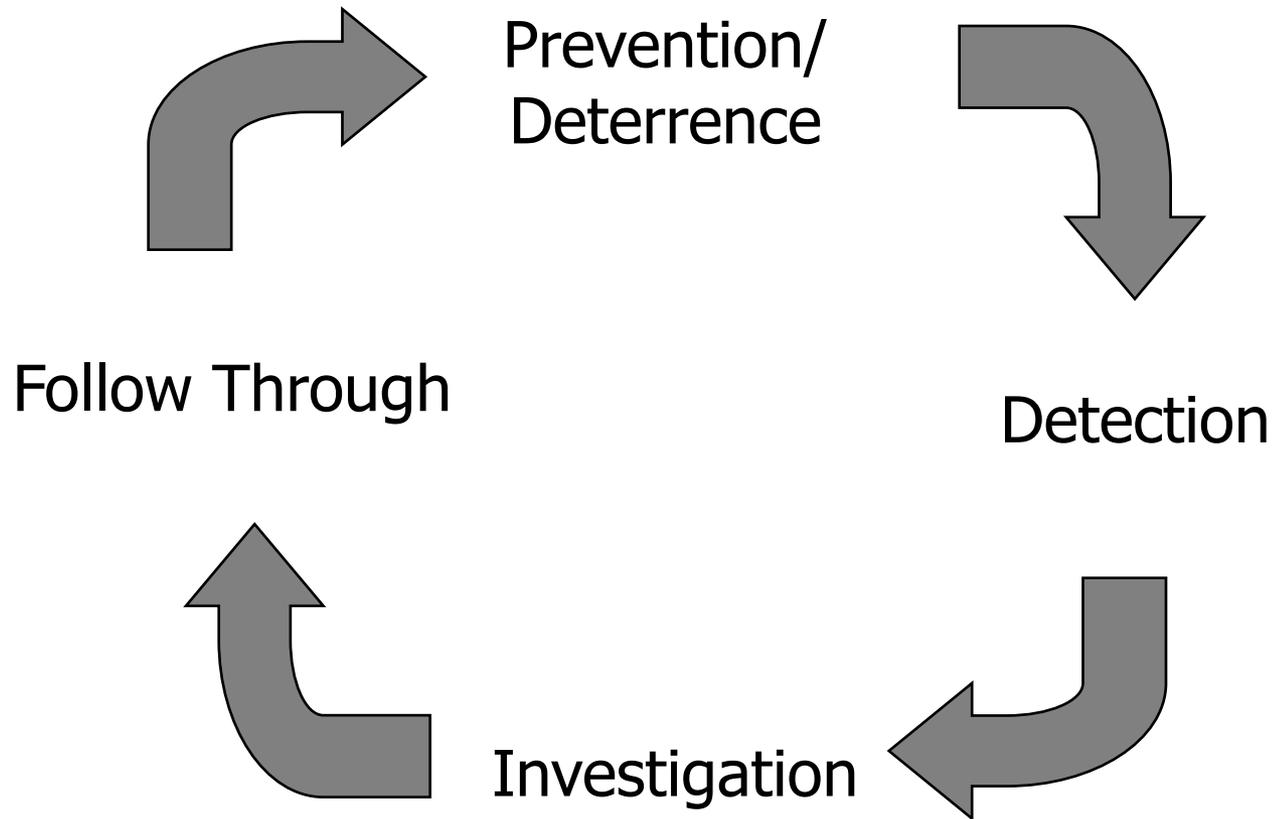
**The COSO/ERM Framework Has Eight Interrelated Components**



# COSO/ERM Model in Government



# Fraud Risk Management System is Within COSO/ERM



## **EXAMPLES FROM THE CITY OF AUSTIN: Management's Roles**

- Management requests audits and reports/  
supports investigations**
- Management Integrity Committee (auditors support  
top management to consistently "do the right thing;"  
management mostly does the right thing but "it isn't  
easy")**
- Review Austin's Citywide Administrative Bulletin  
on Fraud, and Other Integrity Violations**
- Training and new employee orientation from the  
City's Ethics Officer**
- Management supports detection mechanisms: Such  
as audit office hotline, posters, COA website, and  
Citywide Annual Employee Confidential Survey**

**POLL QUESTION ELEVEN on  
"Fraud and Abuse: Focus on the Roles of Auditors"**

**Managers should implement "best practices" to deter or detect fraud and abuse.**

**Which of the following is not a practice management should implement to deter or detect fraud and abuse?**

- a) Ensure internal controls are strong**
- b) Encourage scheduled and unscheduled audits**
- c) Support authorized, independent investigations**
- d) When considering whether an investigation is needed, obtain the involvement or assistance of qualified investigators who will determine "predication" for going forward**
- e) Focus on avoiding the potential for public embarrassment and getting restitution from the perpetrator**

# Attorneys Provide Advice and Support Civil and Criminal Processes Intended to Address Integrity Violations

- **Attorneys advise/assist other stakeholders especially managers, auditors, and investigators regarding how to address integrity investigations**
- **Attorneys may represent those charged with integrity violations (“Spygate” and “Deflategate”)**
- **District Attorneys and Assistant District Attorneys may prosecute potential fraudsters**

# **Attorneys Provide Advice and Support Civil and Criminal Processes Intended to Address Integrity Violations**

- **DA's and Assistant DA's may direct auditors or investigators on how to proceed with integrity investigations which may involve criminal violations**
- **Attorneys serving as judges, mediators, or administrative decision makers may decide what happens to those charged with or convicted of integrity violations**

**POLL QUESTION TWELVE on  
"Fraud and Abuse: Focus on the Roles of Auditors"**

**COSO/ERM provides a logical approach to establish systems and controls to deter and detect fraud and abuse.**

**In all organizations, which group is primarily responsible for deterring and detecting fraud and abuse?**

- a) Line employees**
- b) Managers**
- c) Internal and External Auditors**
- d) Attorneys**
- e) Citizens**
- f) Fraud Investigators and Examiners**

# IV. How can we reduce fraud and abuse to make the world a better place?

## Suggestions/Questions

# Questions to Ask About Your Organization

- 1. How much did your organization lose to fraudulent or abusive behavior last year?**
- 2. Do you have a written policy telling stakeholders (management, auditors, employees, and citizens) what to do in case of suspected wrongdoing?**
- 3. Do your stakeholders discuss fraud and abuse concerns openly and at high levels?**

# More Questions to Ask About Your Organization

**4. Do you have an established way for employees or citizens to report suspected fraud or abuse without fear of retribution?**

**5. Do you have the capability to investigate even the most damaging types of fraud?**

**6. Does your organization take remedial action (reprimand, termination, restitution, etc.) without regard for the perpetrator's position, performance, or length of service?**

# Top Ten Best Practices in Deterring and Detecting Fraud and Abuse

- **Establish a tone for fraud deterrence and detection from the “top down”**
- **Set organizational standards including a “compliance officer” who reports to the top**
- **Provide initial and ongoing training regarding code of conduct and duty to communicate potential fraud and abuse**
- **Ensure the “accountability” message is clear to managers, employees, contractors, and grantees**
- **Conduct internal fraud risk assessments**

## “Top Ten” Continued

- **Create a positive work environment**
- **Require mandatory vacations**
- **Maintain open lines of communication with all stakeholders**
- **Adopt preventative and detective control procedures and UPDATE them!**
- **Implement a social media policy**

# **Recommendation: Elected Officials, Management, Auditors, Employees, Attorneys, and Citizens Should Collaborate to Fight Fraud and Abuse**

- Fight for ethics and against corruption
- Establish and sustain governance structures including a formal agreement to prevent, deter, and report fraud
- Solve problems with intergovernmental and public/private partnerships
- Encourage “worldwide best practices”
- Nurture a positive organizational culture and ethical values

# So what organizational culture and values do we champion? We want our organization to be:

- Honest and Truthful
- Responsible and Accountable
- Fair and Equitable
- Respectful and Mindful
- Compassionate and Caring

# Thank You

- **More questions.**
- **More comments.**
- **Thank you, again.**