BOARD AND INTERNAL AUDIT OVERSIGHT ON FRAUD AND CULTURE

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Wednesday, 14th August 2019

Occupational Fraud

❖ Largest and most prevalent threat among the various kinds of fraud that face organizations

❖ Fraud committed against the organization by its own employees, officers, directors,

❖ Constitutes of attack against the organization from within, by the very individuals entrusted to protect its assets and resources.

Occupational Fraud

- ❖ Organizations invest significantly in technology when fraud arises
- ❖ However, combating fraud using investments in technology particularly occupational fraud can produce diminishing returns
- ❖ Investing in people would be more productive in combating fraud than technology alone

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2,690 real cases of occupational fraud

from **125** countries

in **23** industry categories

$7 BILLION+ IN TOTAL LOSSES

$130,000 MEDIAN LOSS PER CASE

22% OF CASES CAUSED LOSSES OF **$1 MILLION+**

Median duration of a fraud scheme

16 MONTHS

CORRUPTION was the most common scheme in every global region

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❖ Fraudsters who had been with their companies longer stole twice as much
❖ The median loss for more than 5 years tenure was $200, 000 while less than 5 years was $100,000
❖ Only 4% of perpetrators had a prior fraud conviction
❖ A majority of the victims recovered nothing

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❖ Data monitoring analysis and surprise audits were correlated with the largest reductions in fraud loss and duration yet only 37% of victim organisations implemented these controls

❖ Over the past 10 years occupation fraud referrals to prosecution declined 16%

❖ The top reason for non- referrals was fear of bad publicity

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❖ Owners/executives were more likely to collude with others

❖ Among owners/executives, 66% of cases involved collusion

❖ Among non-owners/executives 45% of cases involved collusion

❖ Owners/executives engaged in non-fraud related misconduct more often accounting for 62% of the cases while non-owners/executives accounted for 41% of the cases
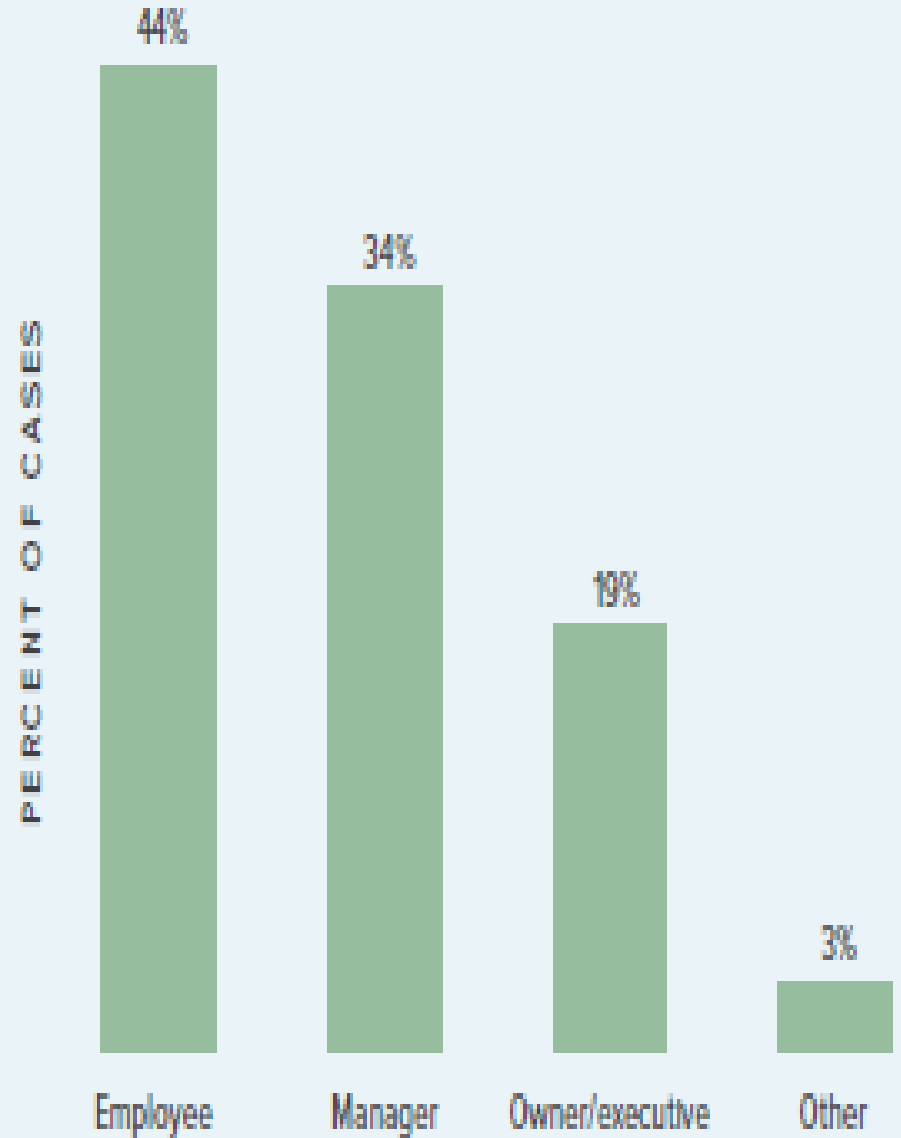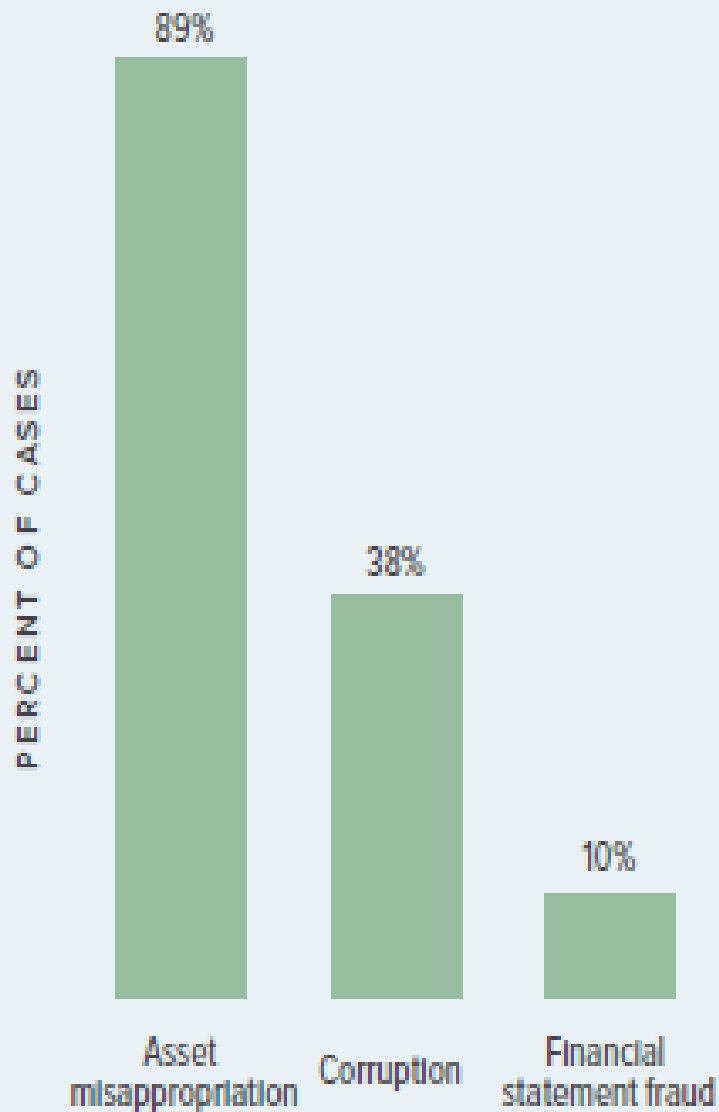
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❖ Bullying or intimidation was the most common form of misconduct and it was observed in 41% of owner/executive cases

❖ 1 in 8 owner/executive cases of fraud were detected by a third party, auditor or law enforcement while 1 in 25 were recorded for non-owners/executives

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Hotlines and Reporting Mechanisms

- ❖ The presence of a hotline or other reporting mechanisms affect how organisations detect fraud and the outcome of the case
- ❖ 63% of victim organizations had hotlines
- ❖ Fraud losses were 50% smaller in organizations with hotlines than those without
- ❖ Organizations without hotlines were more than twice as likely to detect fraud by accident or external audit

Hotlines and Reporting Mechanisms

❖ Telephone hotlines were the most popular but whistle-blowers use various reporting mechanisms with 42% compared to email 26%, web/online forms 23%, mailed letters 16%, fax 1% and others at 9%.

❖ Corruption is particularly likely to be detected by tip compared to asset misappropriation, and financial fraud at 50%, 38%, and 38% respectively

❖ When a reporting mechanism is not used, whistle-blowers are most likely to report to: direct supervisors (32%), executives (15%), fraud investigation team (13%), co-worker (12%), and internal audit (10%)

Hotlines and Reporting Mechanisms

- ❖ Tips are by far the most common initial detection method at 40% compared to internal audit at 15% and management review at 13%
- ❖ Organizations with hotlines detect fraud by tips more often (46%) compared to those without hotlines (30%)
- ❖ Employees provide more than half of tips and almost 1/3 come from outside parties
- ❖ Small businesses lost almost twice as much per scheme to fraud

Hotlines and Reporting Mechanisms

- ❖ Asset misappropriation schemes are the most common and least costly with a median loss of $114,000 and accounting for 89% of the cases
- ❖ Financial Statement fraud schemes are the least common and most costly with a median loss of $800,000 and accounting for 10% of the cases
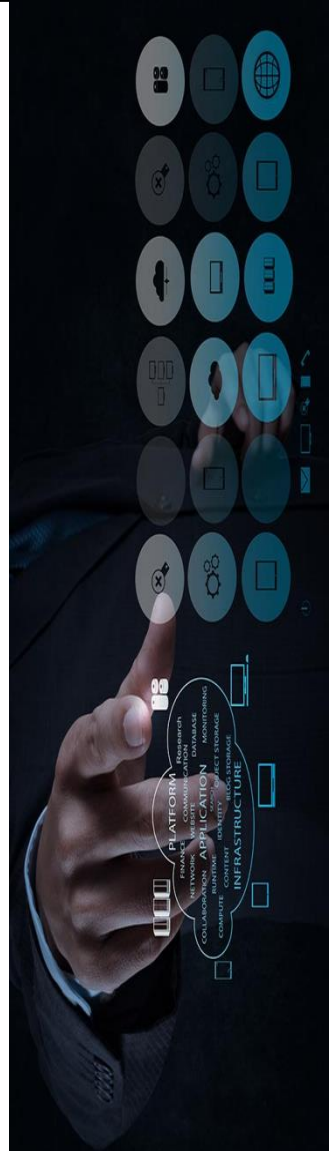
Red flags of Fraud

❖ In 85% of cases fraudsters displayed at least one behavioural red flag

❖ In 50% they portrayed multiple red flags

❖ 6 behavioural red flags were the most common in the cases. These are: living beyond means, financial difficulties, unusually close association with vendor/owner, control issues, family problems, and wheeler dealer attitude
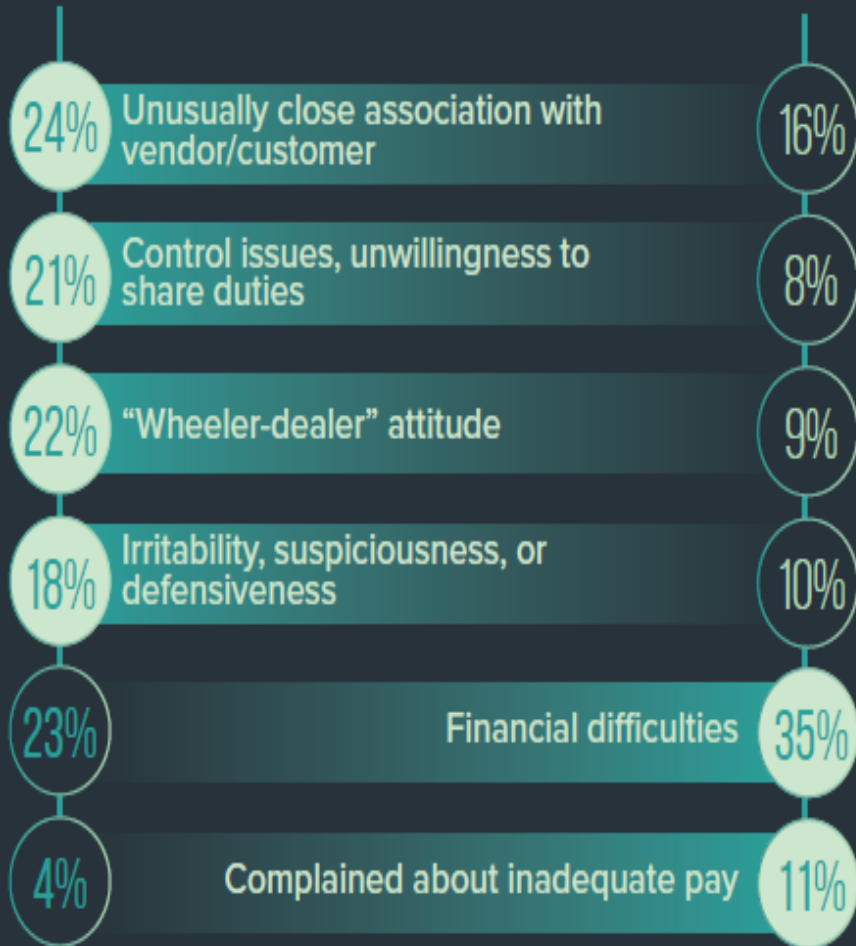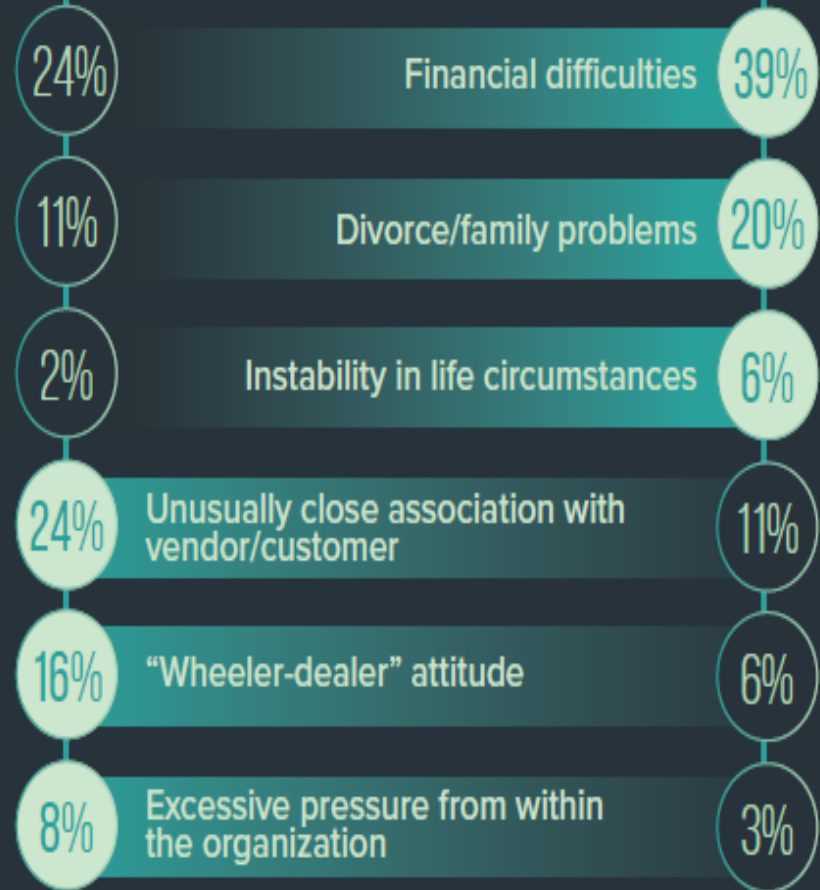
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Occurrence of Fraud (Fraud Triangle)

How fraud occurs

#	Causes	Consideration
Motivation	• Pressure to meet targets • Poor financial performance • Personal financial problems	• Do you employ the right competent staff? • Are the set targets realistic? • How is financial performance rewarded? • Is there satisfaction among employees?
Opportunity	• The structure of the organization (complex or unstable) • The nature of operations (complex or unstable) • Effectiveness of internal controls	• What is the opportunity for management override? • Are conflicts of interest managed? • Are fraud risks profiled? • Do basic controls work?
Rationalization	• It won't hurt anyone • It is for a "good reason" • It will be rectified later • It will not be detected	• What example is set by the leadership? • Are the organization's values and ethics understood? • Has compliance been assessed?

Understanding Culture

Standards & Policies

People

Compensation

Leadership

Environment & Atmosphere

Culture

Organization

What is Organisational Culture?

- ❖ The culmination of the shared values, beliefs and assumptions that shape the behavior of the organization
- ❖ A clear culture of compliance, ethics, and integrity should be set and demonstrated by boards and audit committees
- ❖ The board should confirm that ethics compliance policies and procedures are followed to preserve the culture and deliver effective compliance.
- ❖ Feedback on compliance levels is essential

Fundamental elements of a company's culture

❖ In 2017, The National Association of Corporate Directors in their NACD Blue Ribbon Commission report on Culture as a corporate asset, recommended that boards should establish absolute clarity on the foundational elements of the organizational culture in two areas:

✓ *Behaviours attracting zero tolerance*
✓ *Values and behaviours facilitating the company's excellence and are to be encouraged*

➢ Send a clear message to management on compliance.

➢ Evaluate soundness of policies, training and enforcement

➢ Evaluate the effectiveness of employee hotline mechanisms.

➢ Establish types of complains that must be brought to the attention of the board

➢ Determine whether compensation incentives including clawbacks exist to motivate compliance and the right behaviours

➢ Monitor red flags

➢ Clarify duty of officers and directors to share workforce misconduct information with the full board

➢ Recognize the importance of the board independence, diversity and refreshment as essential to good governance

Key behaviors in the execution of strategy

To help the company excel, what is the culture we want?

← Disruptor	Heavily regulated company →
— Taking risks and experimenting	— Risk averse
— Innovation	— Compliance oriented
— Tolerance for failure	— No errors
— Nonstandard marketing	— Standard marketing
— Fast paced	— Slow paced; avoid "stagnation"

Critical alignments

Culture (behaviors) Purpose	Values Strategy	Incentives Controls

Methods used to gain a better understanding of the corporate culture

Digital compliance tools
- ✓ Employee surveys programs
- ✓ Whistleblower hotline reports
- ✓ Customer complaints
- ✓ Reviewing dashboards of leading and lagging indicators of culture and conduct

Other methods

- ✓ Monitoring social media
- ✓ Visiting company facilities and talking to employees below senior management
- ✓ Walking the halls of corporate headquarters

"use multiple ways to gauge corporate culture, not just one"

Board's role in third-party risk management

❖ Exercising vigilance in confirming the organizations' monitoring of heightened risk presented by third-party service providers.

❖ Challenging the company to construct a clear profile of all third-party partners and the potential risks they pose.

❖ Emphasizing on proper due diligence, strong contracts that protect the company, and methods to consistently evaluate and monitor each service provider.

Board oversight of culture -critical success factors

- ❑ Understand "culture" and its importance today
- ❑ Establish clarity on fundamental elements of the company's culture
- ❑ Clarify the board's culture oversight role
- ❑ Assess where culture belongs on the board and committee agendas
- ❑ Embed culture in critical aspects of the organization's process
- ❑ Tone at the top remains a critical antidote to deter fraud

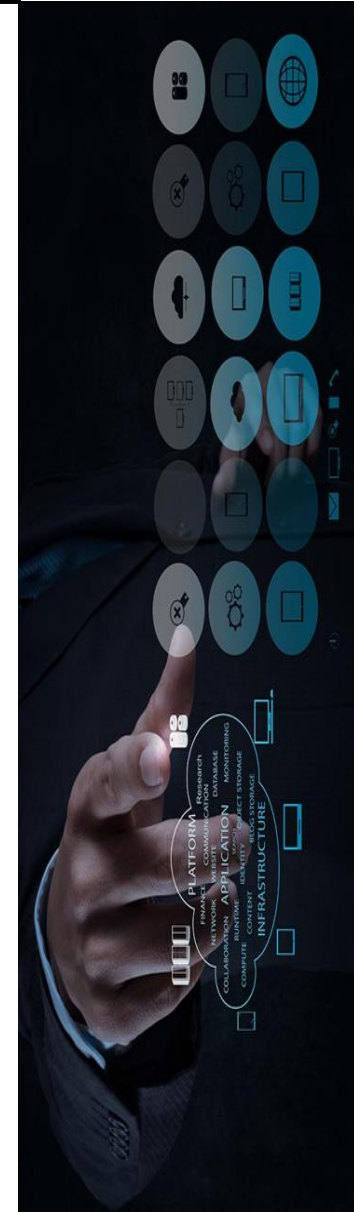**Governance –***keeping culture front and centre in the boardroom*

➢ Where is culture on the boardroom committee agendas?

➢ Is it a priority, with clear roles for the board and key committees?

➢ Does the CEO set the tone needed to achieve the desired results?

➢ Does culture encourage the behaviours essential to the execution of the company's strategy?

- ✓ Do you know the norms for ethics and compliance in your industry?
- ✓ Does your ethics and compliance programme explicitly target fraud?
- ✓ Do your incentive programmes consider pressures that it can create on your employees and can you monitor it?
- ✓ Do you have an open-door policy or hotline that could serve as an early warning sign of internal fraud?
- ✓ Have you probed your internal culture for potential trouble spots?

Thank You