Fraud Risk Management and Internal Auditing

Waheed Alkahtani
CFE and CCEP-I

Saudi Aramco Internal Auditing
Special Audits Division

February 2015

© Copyright 2015, Saudi Aramco. All rights reserved.

Questions:

• What do you know of Fraud Risks occurring in our business?
• Is it the tip of the ICEBERG?
• Has responsibility for managing fraud risk been clearly defined?
• What systems are in place to detect fraud and irregularity?
• Do you have reporting channels and are staff aware of them?
Getting the Big Picture

Today’s Agenda

What • is Fraud Risk Management?

Why • is it important?

Who • is Responsible?

How • to establish a forensic accounting unit.

Saudi Aramco: Public
Fraud Risk Management

Section One

**Fraud:** is any intentional act or omission designed to deceive others, resulting in the victim suffering a loss and/or the perpetrator achieving a gain.

**Fraud Risk Management:** a process, effected by an entity’s board/council, management and other personnel, applied in strategic setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its appetite, to provide reasonable assurance regarding the achievement of entity objectives.

Fraud and Risk Management
Fraud Risk Management

Why is it Risky?
The top 10 risks that Internal Audit departments will focus on across the next 6–12 months.

Corruption and Bribery

Risky Areas

2013 CEB Audit Leadership Council

Why do we want to Control FRAUD?

- All organizations are subject to fraud risks.
- Frauds have led to the downfall of entire organizations.
- Massive investment losses.
- Significant legal costs.
- Loss of key individuals and image.
- Many fraud cases involve safety.
• Lack of formal fraud risk management processes represents the highest risk, beyond those identified in ordinary business operations.

*Ethic Resource Center (ERC)*

**Fraud Risk Management**

<table>
<thead>
<tr>
<th>Company</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Boeing</td>
<td>$615 million</td>
</tr>
<tr>
<td>Artificial joint makers</td>
<td>$317 million</td>
</tr>
<tr>
<td>Tenet</td>
<td>$900 million</td>
</tr>
<tr>
<td>Columbia/HCA</td>
<td>$1.7 billion</td>
</tr>
<tr>
<td>AIG</td>
<td>$1.5 billion</td>
</tr>
<tr>
<td>Marsh &amp; McLennan</td>
<td>$850 million</td>
</tr>
<tr>
<td>Fannie Mae</td>
<td>$400 million</td>
</tr>
<tr>
<td>KPMG</td>
<td>$465 million</td>
</tr>
<tr>
<td>Tyco</td>
<td>$750 million</td>
</tr>
<tr>
<td>Cardinal Health</td>
<td>$600 million</td>
</tr>
<tr>
<td>Pharmas</td>
<td>$2.4 billion</td>
</tr>
<tr>
<td>Siemens</td>
<td>$463 million</td>
</tr>
<tr>
<td>Prudential</td>
<td>$2.8 billion, + fines</td>
</tr>
<tr>
<td>UnitedHealth Group</td>
<td>$915 million</td>
</tr>
</tbody>
</table>

*Bob Rudloff, Vice President, Internal Audit, MGM MIRAGE*

**The Cost of Fraud**
<table>
<thead>
<tr>
<th>Company</th>
<th>Amount (Year)</th>
<th>Reason</th>
</tr>
</thead>
<tbody>
<tr>
<td>Siemens</td>
<td>$1.6 billion (2009)</td>
<td>Bribery on an institutional scale across countries</td>
</tr>
<tr>
<td>Halliburton</td>
<td>$177 million (2009)</td>
<td>EPC contract scheme in Nigeria for disgorgement of profits</td>
</tr>
<tr>
<td>KBR</td>
<td>$402 million (2009)</td>
<td>Bribes related to payments to Nigerian officials</td>
</tr>
<tr>
<td>Baker Hughes</td>
<td>$11 million (2008)</td>
<td>Related to bribes to Kazakhstan officials for a Kazakhstan project.</td>
</tr>
<tr>
<td>Chevron</td>
<td>$4.7 million (2010)</td>
<td>FCPA violations</td>
</tr>
<tr>
<td>Marathon Oil</td>
<td>$4.7 million (2010)</td>
<td>FCPA violations</td>
</tr>
<tr>
<td>Shell</td>
<td>$236.5 million (2010)</td>
<td>FCPA customs bribery issues in Nigeria</td>
</tr>
<tr>
<td>Alcatel Lucent</td>
<td>$92 million (2010)</td>
<td>Failure of responsible executive to conduct appropriate due diligence on a third-party</td>
</tr>
<tr>
<td>IBM</td>
<td>$10 million (2011)</td>
<td>Penalties for bribes for Korean and Chinese officials</td>
</tr>
</tbody>
</table>

**Foreign Corrupt Practices Act (FCPA)**

**Organizational Risks**
• Local Employment and labor laws
• Global Anti-trust and Anti-corruption regulations, such as FCPA and UK bribery acts.

Laws/Rules/Regulations
Organizational Risks

Do we Know Now

Why it is important?
Who Owns Fraud Risks?
Section Three

The Gate Keeper
Who manages the RISK?

• “Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.”

• In relation to fraud, this means that internal auditing provides assurance to the board and to management that the controls they have in place are appropriate, given the organization’s risk appetite.

Internal Auditing
**Fraud Risk Assessment**
- Internal auditors should consider the organization’s assessment of fraud risk when developing their annual audit plan and periodically review management’s fraud management capabilities.

**Communicate and Report**
- They should interview and communicate regularly with those conducting the organization’s risk assessments, as well as others in key positions throughout the organization, to help them ensure that all fraud risks have been considered appropriately.

**Internal Controls**
- When performing engagements, internal auditors should spend adequate time and attention to evaluating the design and operation of internal controls related to fraud risk management.

---

**Role of the Internal Audit**

**Watch Red Flags**
- They should exercise professional skepticism when reviewing activities and be on guard for the signs of fraud.

**Respond**
- Potential frauds uncovered during an engagement should be treated in accordance with a well-defined response plan, consistent with professional and legal standards.

**Active Role**
- Internal auditing should also take an active role in support of the organization’s ethical culture.

---

**Role of the Internal Audit**

IIA Practice Advisory 2130-1
The 7 elements

Standards and Procedures
Oversight
Education and Training
Monitoring and Auditing
Report
Enforcement and Discipline
Response and Prevention

Basic compliance elements
Who Manages Fraud?

White-Collar Crime

- Occupational
- Money laundering
- Identity theft
- Copyright infringement

Black/White

Gray Area
Classes of Occupational Fraud

Financial Transaction

Occupational Fraud
Who Investigates Fraud?

National Anti Corruption Commission – Independent and report directly to the cabinet
Dubai Financial Audit Department – Directly to the ruler of Dubai

Fraud Investigation in Government Sectors
1. Total, Internal Auditing.
3. ExxMobile, Internal Audit has primary responsibility for investigating violations of the Corporation's internal controls.
4. Chevron, Investigative Audits, the Audit Committee.
5. Statoil, Chief Auditor.
6. Dow Chemical, Fraud Investigative Services, Corporate Auditor.

Fraud Investigation in Private Sectors

• “As director of Fraud Investigation Services, I report directly to Dow's Corporate Auditor.
• We have four full-time staff members, all directly involved in investigations.
• Their backgrounds vary and include accounting, business administration, criminal justice, law and certified fraud examination.
• Much of our time is spent analyzing data and documents, interviewing employees, documenting findings, and traveling approximately 30% to 40% of the time in North America and overseas.”

The Dow Chemical Company's Success Story
For every $1 we spend on investigating fraud, we recover nearly $4, which is very high by industry standards.

COST EFFECTIVENESS
Oh ... one more thing

The How to Question
Section Four
**Change Management Theory**

**Anti-Fraud Program**

- Fraud Risk Assessment
  - Consider potential fraud schemes
  - Evaluate likelihood and significance
  - Mitigation Plans

- Code of Conduct
- Business Ethics
- Whistleblower Policy
- Hotline

- Correction Policy
- Investigation
- Reporting
- Behavior Analysis
- Changing Minds
- Transparency

- Hotline
- Unscheduled Audits
- Red Flags/Fraud Indicators
- Monitoring and Data Mining

- Top Management
- New Hires
- Vendors and Contractors
- All means

- Assessment
- Prevention
- Detection
- Awareness

**Minimum Level of Protection**
What ...

Should  Can  Must

Be Done?

- You must be the change you wish to see in the world.

Set the Tone from the Top
Building Blocks

Gap Analysis Methodology

Gray Area
Not Enough Accountability

Overlapping
Inefficient Redundancy

Dark
No Accountability
How to respond to an incident

Small
- Establish ownership and accountability.
- Outsource.

Medium
- Establish ownership and accountability.
- Formation of forensic investigations.

Large
- Internal unit to address prevention, detection, investigation and remediation of fraud.

SCFE

Provide the minimum protection and prevention means

Five vs. Seven
The 7 elements

- Standards and Procedures
- Oversight
- Education and Training
- Monitoring and Auditing
- Report
- Enforcement and Discipline
- Response and Prevention

The 5 Principles

Principle 1 • Policy to convey the expectations of the board of directors regarding managing fraud risk.

Principle 2 • Periodically Risk Assessed.

Principle 3 • Prevention and awareness techniques to avoid potential key fraud risk events.

Principle 4 • Detection techniques should be established to uncover fraud events.

Principle 5 • A monitoring and reporting process should be in place to solicit input on potential fraud.
The following elements should be found within a fraud risk management and compliance program:
1. Fraud Prevention and Awareness Services
2. Fraud Forensic and Validation Services
3. Fraud Investigation and Correction Services
4. Business Compliance Services

Elements of an Anti-Fraud Program

The New Model
In Conclusion
Final section
It is a danger zone with a high risk area.

FCPA

“Company will be liable if it knows or has reason to know.”
It will not protect you.

Don't think there are no crocodiles because the water is calm.
If you ever think you’re too small to be effective, you have never been in bed with a mosquito.

Act now

THANKS

Q&A