



Fraud Risk Assessment – Identifying Vulnerabilities to Fraud and Misconduct

POWERFUL INSIGHTS

Managing the risk of fraud and misconduct is a growing concern for management and stakeholders in today's business environment. According to a recent study by the Association of Certified Fraud Examiners, a typical organization loses approximately 7 percent of its annual revenues to fraud.¹ High-profile fraud schemes, public expectations for companies to manage their fraud risks and increased enforcement of regulatory requirements worldwide have heightened management's need to identify and address these risks.

An organization must recognize the specific fraud risks that could threaten its financial, operational and brand stability. A structured fraud risk assessment aids management in understanding its particular fraud risks and enables it to manage them effectively.

Issue

Regulators and law enforcement have long emphasized risk assessment as a crucial component of mitigating fraud risk and other illegal acts, as have professional standard-setters and membership organizations. In *Managing the Business Risk of Fraud: A Practical Guide*,² the internal and external audit community, as well as forensic professionals, highlight the benefits of robust evaluation of an organization's fraud risk and anti-fraud controls. Furthermore, The Institute of Internal Auditors' Standard 2120. A2 requires internal auditors to evaluate the potential for the occurrence of fraud and how the organization manages fraud risk.

Challenges and Opportunities

On a periodic basis, management should assess the organization's exposure to fraud risk to identify potential fraud schemes and corruption risk events that need to be mitigated and monitored. An effective fraud risk assessment is tailored to an organization's industry and unique operations. It should be performed on an annual basis and

refreshed when a change in the internal or external environment occurs.

An effective fraud risk assessment methodology includes risk identification, assessment of inherent fraud risk (measured in terms of likelihood and significance) and risk response. Fraud risk identification is best performed by gathering relative information on fraud risk from a variety of sources within the organization and industry. This enables management to consider the totality of fraud risk threatening the organization, as well as the impact of incentives, pressures, opportunities and rationalization that lead to fraud.

Response to residual fraud risk should be balanced. Management's objective should be to implement effective anti-fraud controls, the benefits of which exceed their cost. Often, this involves a combination of manual and automated fraud prevention and detection techniques that enable the organization to monitor for indicators of fraud within the scope of its risk tolerance.

Accepting that fraud risk exists within an organization can sometimes be an impediment to robust discussion of this threat. However, authoritative guidance includes the premise that the risk of fraud occurs naturally within all organizations. Open and honest discussion about fraud risk through brainstorming, surveys and workshop activities should not be an organizational "taboo." In particular, it is important to note that because management has primary responsibility for the design, implementation and monitoring of internal controls, organizations are exposed to the danger of management override of controls. This is a key risk to consider during the fraud risk assessment process.

Our Point of View

Fraud risk assessment is an essential component in helping organizations to protect their people, assets, reputations and bottom lines. In addition to meeting prescriptive guidance, regulatory requirements and shareholder expectations, fraud risk assessment provides a beneficial and budget friendly means by which to better understand and address financial and operational vulnerabilities before they materialize into costly fraudulent or illegal acts.

¹ Association of Certified Fraud Examiners, *2008 Report to the Nation on Occupational Fraud and Abuse*.

² Publication sponsored and co-developed by the American Certified Fraud Examiners (www.acfe.org), the American Institute of Certified Public Accountants (www.aicpa.org) and The Institute of Internal Auditors (www.theiia.org).

PROVEN DELIVERY

How We Help Companies Succeed

Protiviti helps clients address fraud risk proactively by understanding where it can occur and implementing strategies to combat it. As a result, organizations protect their reputations, improve their bottom lines and achieve their fiduciary and regulatory responsibilities.

We assist management in the identification and prioritization of the organization's fraud risk in highly collaborative projects that promote knowledge and skill transfer to the organization's personnel. Each fraud risk assessment is tailored to meet the specific needs, and culture, of an organization. Utilizing Protiviti's Common Fraud Scenarios, we work with management to develop and document a sustainable process, enabling an organization to refresh the identification and rating of key fraud and misconduct risks on a periodic and ongoing basis. Techniques include:

- Development of common fraud scenarios
- Document review and analysis
- Interviews with designated members of management, process and/or control owners
- Electronic data analysis
- Surveys
- Facilitated fraud risk brainstorming sessions and workshops

Protiviti brings objectivity, independence and insight that aid management in addressing areas of exposure in an organization where the internal controls environment may

have limitations, such as collusion and/or vulnerability to management overrides.

Examples

We have assisted organizations in a variety of industries by developing a fraud risk assessment methodology for individual implementation, as well as conducting fraud risk assessment. Following are a few examples:

- Protiviti worked with our client in the banking and financial services industry to provide tailored common fraud scenarios that reflect the unique risks of the organization. We facilitated and documented management's identification of residual fraud risks. We also recommended enhancement of anti-fraud controls to prevent and detect embezzlement from dormant accounts and mortgage fraud schemes.
- Protiviti facilitated fraud risk assessments for two pharmaceutical companies, identifying potential improvement opportunities to help our clients mitigate and monitor both fraud and corruption risk, especially risk related to payments in overseas countries.
- Protiviti assisted a global hospitality industry company with offices worldwide address its fraud risk by facilitating several fraud risk workshops with designated employees and members of management. Protiviti also trained management to execute similar sessions in remote areas. Once all sessions were completed, we assisted our client in collating information from each country to construct an enterprisewide fraud risk profile.

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About Protiviti

Protiviti (www.protiviti.com) is a global consulting firm that helps companies solve problems in finance, technology, operations, governance, risk and internal audit. Through our network of more than 70 offices in over 20 countries, we have served more than 35 percent of FORTUNE 1000® and FORTUNE Global 500® companies. We also work with smaller, growing companies, including those looking to go public, as well as with government agencies.

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