



Frank, Rimerman + Co. LLP certified public accountants

## International Fraud, Ethics and Culture Seen Through the Lens of a Fraud Examiner

**Steve C. Morang, CFE CCEP CIA CRMA**



© Copyright Steve C. Morang. All rights reserved.

Frank, Rimerman + Co. LLP certified public accountants

## Presentation Overview

- Introduction
- Understanding your fraud profile
- Establishing your Ethical Baseline
- Conducting a Fraud Risk Assessment
- Linking the FRA to your strategy
- Wrap-up / Q&A



## Introduction

Learning objectives for this session include:

- Identify the red flags of a ruinous corporate culture
- Establish your ethical baseline
- Assess weaknesses in an internal control framework
- Perform a fraud risk assessment using internal and external information
- Present your results during and after the fraud risk assessment



## Lesson 1: Honesty is the best policy!



## About Me



- 20+ years in fraud / internal audit
- Worked on dozens of various fraud investigations throughout Europe and the United States



## About Me



- My introduction to fraud began as a Marketing Manager for Central Eastern Europe for an American HVRAC manufacturer
- Bribes were the status quo (Romania, Uzbekistan, Ukraine, everywhere! )
- Managing Director of the Russian subsidiary set up own dealer network and defaulted on millions of dollars of payments
- After he was dismissed he was rehired as a consultant due to his excellent relationship with top decision makers
- Approximately five years after I left the company, the entire office was closed when reviewed by the new owners – Johnson Controls



## Fraud & Bribery Bootcamp 101



## PART I: How To Recognize Ruinous Culture



Morehead Compliance Consulting

Why are you here ?

Why should we care about  
understanding ethical  
behavior?



Morehead Compliance Consulting



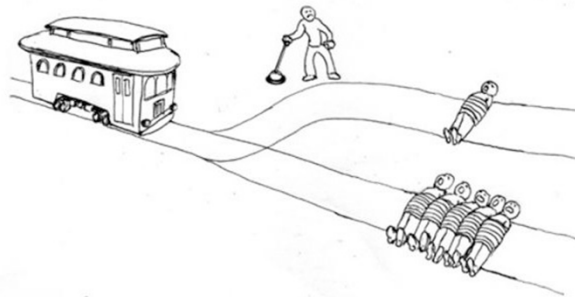
### Big Frauds:

- Wells Fargo
- Volkswagen
- Toshiba
- Theranos
- ABB Korea
- Pharma Bro
- Uber
- BT Italy
- Fyre Festival



Morehead Compliance Consulting

## The Trolley Car Dilemma



## The Trolley Car Dilemma



## The Top of the Slope



## Finding your Ethical Baseline

How can we measure your organizations ethical pulse?

How do you know if your sliding in the next reputational disaster ?

What tools and techniques can help us get a snapshot that others can understand?



## Finding your Ethical Baseline

What kind of question would you ask ?





### **PART I: Activity**

- Divide into your groups and spend 5 minutes putting together your team's list of 5-10 questions that you would like to ask your organization with regard to Ethical Baseline
- Additionally, spend an additional 5 minutes and list 4-5 examples that your group has identified as being examples of how a weak ethical culture has led to potentially unethical behaviors. These can be both real life and hypothetical examples.



### **Finding your Ethical Baseline**

What kind of question would you ask ?

- Use a tool like Survey Monkey
- Use a five point scale ((5)strongly agree to (1) strongly disagree)



## Finding your Ethical Baseline (Examples)

- Our organizational culture is trust based.
- Missing approvals are not a big deal here.
- Strong personalities dominate most departments
- Pressure to perform outweighs ethical behavior
- I share my passwords with my co-workers
- Retaliation will not be accepted here
- The saying - "Don't rock the boat!" fits to this organization



## Finding your Ethical Baseline

- I am encouraged to speak out whenever needed!
- It's the result that matters, not how I got there.
- As long as the customer is happy, I will be ok.
- I'm new here. I will just do as I am told.
- I don't feel comfortable questioning my boss's decisions.
- Popularity is the key to success at "my organization".
- Ethical behavior is a top priority of management
- I know where I can go if I need to report a potential issue.
- My job duties and responsibilities are clearly defined.



## Finding your Ethical Baseline

Interpreting the results –

What do we do with the results?

How does this influence the way we conduct the FRA?

With whom should we share the results of the Ethical Baseline?

How does my organization benchmark to others?

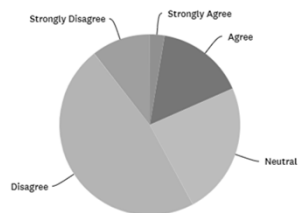
What about candy and batteries?



## Finding your Ethical Baseline

Bending the rules is acceptable behavior at

Answered: 38 Skipped: 0



| ANSWER CHOICES    | RESPONSES |
|-------------------|-----------|
| Strongly Agree    | 2.63% 1   |
| Agree             | 15.79% 6  |
| Neutral           | 23.68% 9  |
| Disagree          | 47.37% 18 |
| Strongly Disagree | 10.53% 4  |
| TOTAL             | 38        |



## Finding your Ethical Baseline

### **My big fat Greek Investigation -**

- A true story of how an organization was built upon an unethical business model, and how it infected all parts of the organization.



## Finding your Ethical Baseline



## Finding your Ethical Baseline



## Finding your Ethical Baseline



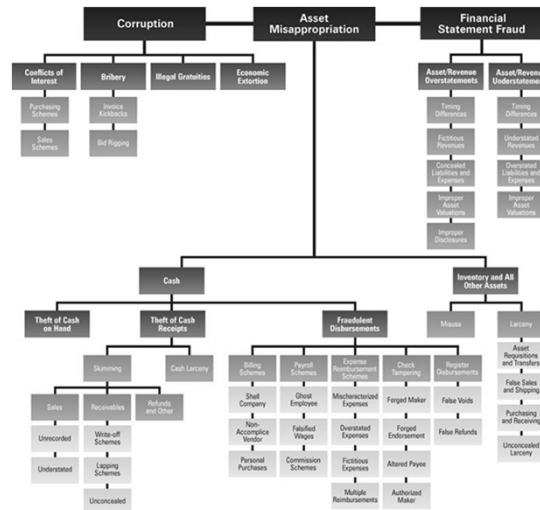
## Finding your Ethical Baseline



## Fraud Risk Assessment



## ACFE Fraud Tree



## Fraud Risk Assessment (FRA)

### Introduction to FRA

- Specifically focused on fraud risk
- Best conducted in small brain-storming sessions to facilitate the discovery of previously “unknown” fraud risks
- Facilitated by a fraud professional with the inclusion of operational management
- Develop potential fraud schemes
- Evaluate the effectiveness of internal controls

## Fraud Risk Assessment (FRA)

FRA analysis will look at:

- Internal controls
- Internal control environment
- Resources available to prevent, detect and deter fraud



## Fraud Risk Assessment (FRA)

Tools used during the FRA:

- **ACFE Fraud Risk Assessment Tool**
- Structured approach to evaluate key fraud schemes
- Tie back to risk appetite and risk tolerance specifically for:
  - ✓ Financial Statement Fraud
  - ✓ Asset Misappropriation
  - ✓ Corruption





## Fraud Risk Assessment (FRA)

### Drill down to detailed fraud schemes - Example

|                                       |   |
|---------------------------------------|---|
| <b>Purchasing and Billing Schemes</b> | Shell company schemes occur when an employee submits invoices for payment from a fictitious company controlled by the employee.   |
|                                       | Pay-and-return schemes occur when an employee arranges for overpayment of a vendor invoice and pockets the overpayment amount when it is returned to the company.                             |
|                                       | Personal purchase schemes occur when an employee submits an invoice for personal purchases to the company for payment, or when an employee uses a company credit card for personal purchases. |



## Fraud Risk Assessment (FRA)

### Important differences between FRA and ERM Risk Assessment

- FRA places emphasis on collusion and/or management overrides
- Consider the robustness of a control to adverse situations
- Consider the entity level controls , reporting structures, culture



## Fraud Risk Assessment (FRA)

### Best Practices in conducting an FRA

- Be creative
- Put on your “Fraud Goggles”!
- Have a good cross functional mix of persons included in the brainstorming
- Consider the advantages of using anonymous balloting technology



## Fraud Risk Assessment (FRA)

### Best Practices in conducting an FRA

- Fraud entails intentional misconduct designed to avoid detection
- Risk assessments identify where fraud might occur and who the potential perpetrators might be
- Consideration should be given to persons inside and outside of the organization who could be the perpetrators of such schemes



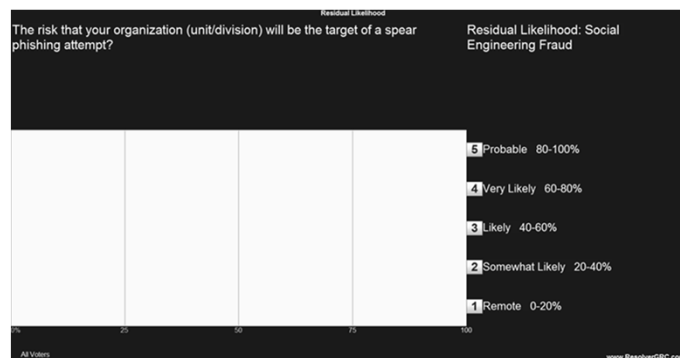
## Fraud Risk Assessment (FRA)

Ask the right questions

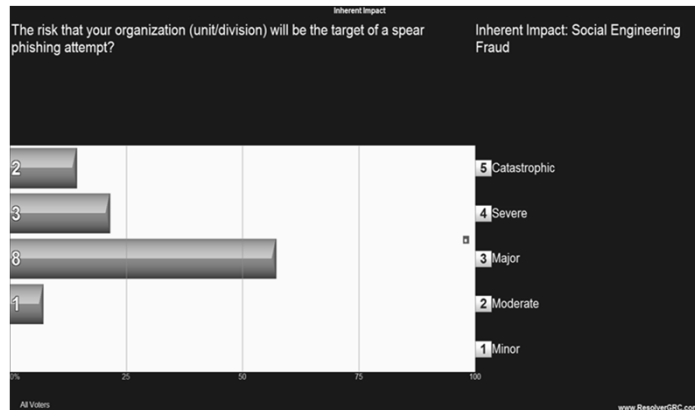
- How might a fraud perpetrator exploit weaknesses in the system of controls?
- How could a perpetrator override or circumvent controls?
- What are the possibilities that can be used to hide the fraud from detection?



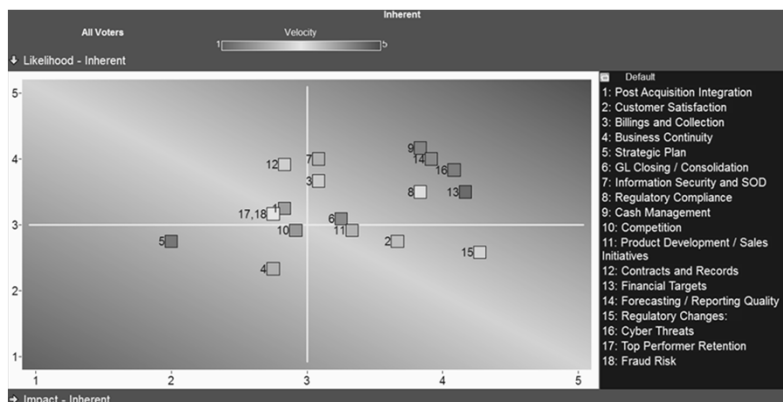
## Fraud Risk Assessment (FRA)



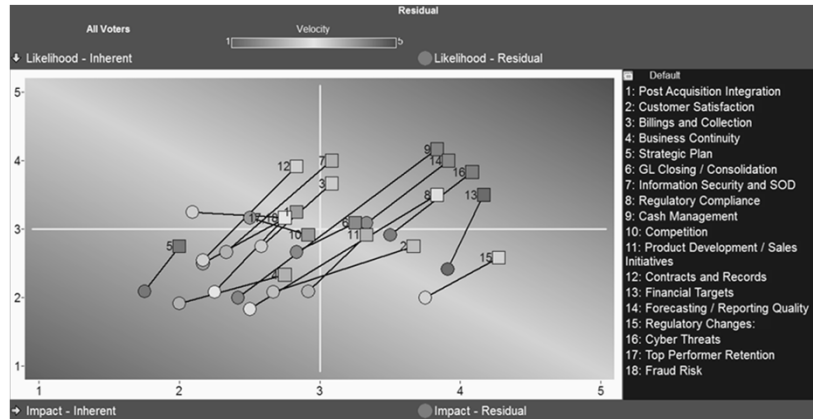
## Fraud Risk Assessment (FRA)



## Fraud Risk Assessment (FRA)



## Fraud Risk Assessment (FRA)



## Fraud Risk Assessment (FRA)

### The Story of Mr. Oh!



## Fraud Risk Assessment (FRA)

### The Story of Mr. Oh!

To keep his crimes hidden from both management and EY (the company's auditors) for almost two years, Oh had to be extensively doctoring the accounting books to conceal his fraud.

According to a March 31 article in The Asset, ABB claimed in a prepared statement that Oh, because of his position in the firm, might have had "Omnipotent Super User" rights within ABB's enterprise resource planning (ERP) system:



## Fraud Risk Assessment (FRA)

### The Story of Mr. Oh!

" 'Inappropriate access levels to the local ERP (enterprise resource planning) system' and a lack of 'adequate segregation of duties' allowed the treasurer to embezzle millions. ..." (See ABB fraud scandal highlights industry-wide vulnerabilities, by Sven Leichhardt, The Asset, March 31.)

This would allow Oh not only to have unlimited access to make journal entries but also the ability to completely erase or reverse transactions. He could've also granted and restricted his personal access rights during audits to avoid raising red flags.



## Linking the FRA and the ERM Program



## Linking FRA and ERM

Linking your FRA and ERM to one another has multiple advantages:

1. Raises the level of fraud risk awareness at the Board level and across the organization
2. Gives the Board and Management a better insight into how their strategic decisions can change the fraud risk profile of the organization
3. Ties strategic drivers directly to fraud risks, which allows a pro-active review of risk mitigating controls



## Linking FRA and ERM

### Step 1:

- Review and assess the strategic objectives of the organization
- Define the strategic drivers behind each objective
- Gain an understanding of the risks associated with each strategic objective and the associated drivers



## Linking FRA and ERM

### Step 2:

- Next we need to map each of the identified strategic drivers down to our FRA risk
- Use a **strategy fraud matrix (SFM)** to incorporate the various key elements
- Consider the Fraud Triangle, potential fraud schemes and any other contributing factors





## Linking FRA and ERM

Strategy Fraud Matrix (SFM)

| Strategy                      | Strategic Driver            | Fraud Triangle | Risk                        | Potential Scheme         | Contributing Factor                      |
|-------------------------------|-----------------------------|----------------|-----------------------------|--------------------------|--|
| <b>Growth</b>                 | International Expansion     | Pressure       | Corruption –FCPA Violations | Bribery / Kick-backs     | Bonus pay based on successful expansion  |
|                               |                             | Opportunity    | Asset Misappropriation      | Fraudulent disbursements | Lack of oversight leads to opportunities |
| <b>Increase profitability</b> | Reduction in overhead costs | Pressure       | Financial Statement Fraud   | Timing differences       | Systems not fully integrated             |
|                               |                             | Opportunity    | Asset Misappropriation      | Inventory fraud          | Segregation of duties issues             |



## Linking FRA and ERM

### Information Flows

- Ensure that protocols exist for information to flow in both directions
- Tailor outputs to meet stakeholder expectations and facilitate the cooperation
- Gain an understanding of the various touch-points between the ERM Risk Assessment and the FRA.
- Use the five phase ERM framework as a guide
- Rank the touch-points based on importance



## Linking FRA and ERM

### Touch-point Matrix – 1. Establish context

| ERM Step             | ERM Task               | FRA Touch-Point   |
|----------------------|------------------------|---|
| 1. Establish context | Set risk -appetite     | Consider the risk appetite and risk tolerance for the organization with regard to Fraud. Does this align to the overall “tone” and culture of the organization? |
|                      | Stakeholder interviews | When conducting the interviews with stakeholders, determine the importance of addressing fraud, waste and abuse at the ERM level.                               |



## Linking FRA and ERM

### Touch-point Matrix – 2. Communicate and consult

| ERM Step                   | ERM Task           | FRA Touch-Point  |
|----------------------------|--------------------|--|
| 2. Communicate and consult | Allocate resources | When considering the amount of resources needed to properly implement and manage the ERM program, understanding the complexity of the control environment from a fraud, waste and abuse perspective will be important. |
|                            | Risk owners        | When determining the risk owners for the ERM process, consider the Conflict of Interest inputs in the decision making process, to ensure that fraud incidents are not “kept quiet”.                                    |



## Linking FRA and ERM

### Touch-point Matrix – 3. Risk Assessment

| ERM Step           | ERM Task                                    | FRA Touch-Point  |
|--------------------|---|--|
| 3. Risk assessment | Determination of inherent vs. residual risk | The knowledge gained from the FRA will directly impact the evaluation of the residual risk associated with fraud, waste and abuse. |
|                    | Possible scenarios                          | When assessing the scenarios for fraud, waste or abuse, these can be pulled directly from the FRA.                                 |



## Wrap-up / Q & A

### Final Thoughts / Key take-aways

- Changes in strategic goals can lead to large increases in fraud risk to the organization. Being aware of these risks and assessing them timely is of great benefit to the organization.
- The ERM program covers risks to the organization that go well beyond the FRA, however leveraging the FRA can lead to multiple benefits to both programs.



## Wrap-up / Q & A

### Final Thoughts / Key take-aways

- Ethics needs to be Number 1 priority – period.
- Auditors should make organization aware of the tools and techniques that are available to establish the “Ethical Temperature” of the organization
- Link strategy to your fraud risks
- Be proactive before being hit by a life threatening crises



## Wrap-up / Q & A

### Questions ?



Thank you!

Contact Information:

Steve C. Morang, CFE CCEP CIA CRMA

[smorang@frankrimerman.com](mailto:smorang@frankrimerman.com)

(Cell) 415-781-9173

@sfacfe



Copyright Steve C. Morang. All rights reserved.