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Managing fraud risk: prevent, detect, and respond

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Managing fraud risk: prevent, detect, and respond

Managing fraud risk differs from other risks as these intentional misconduct are specifically designed to evade detection. Organisations need to realise the importance of addressing fraud risks strategically and move away from being reactive, to adopting a proactive approach.

Understanding fraud

Fraud, an intentional act of deception for financial or personal gain to the disadvantage of others, is an issue faced by all organisations regardless of size, industry, or location. Fraud manifests itself in many different forms and originates from sources both internal and external to an organisation.

Examples of fraud include lost and stolen credit cards, intercepted enterprise payments, falsified financial statements, identity theft, account takeover, and fraudulent insurance claims.

The actual cost of fraud incurred by organisations extend beyond the direct loss, to costs for fraud investigation and recovery, regulatory penalties and reputational damage that impacts customer and partner relationships.

The presence of anti-fraud controls is notably correlated to decreases in the cost and duration of fraud schemes. The need for organisations to establish a fraud risk management framework and ensure a robust system of internal controls arise to minimise the risk of loss through fraud.

The Fraud Triangle

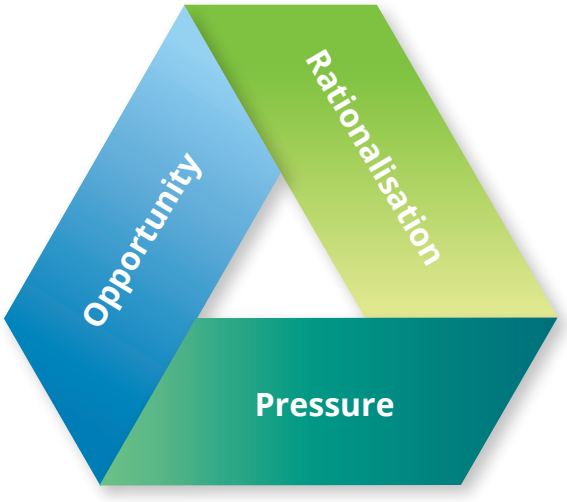
To better manage fraud, organisations must not only acknowledge that it occurs, but also understand how and why it occurs. The Fraud Triangle explains that for fraud to occur, the following three (3) elements must be present:

(A) **Opportunity – circumstances that allow the fraudulent act to take place.** E.g. weak controls, lack of segregation of duties, too much trust.

(B) **Pressure – motivation or incentive to commit the fraudulent act.** E.g. pressure to perform, dissatisfaction with pay, overlooked for promotion, high bills, debt.

(C) **Rationalisation – mind-set that justifies the wrongdoing.** E.g. "other people are doing it", "it does not hurt the organisation", "it is what I deserve".

The Fraud Triangle



Components of an effective fraud control strategy

Organisations need to do more than just detect and remedy fraud instances in isolation. An effectively designed, implemented, and managed fraud control strategy needs to be tailored to the organisation's specific risk profile.

Fraud risk governance

While there is no one-size-fits-all approach to fraud risk governance, there is a need for organisations to adopt more formalised governance mechanisms. This includes setting the tone for fraud risk management from the top by those charged with governance and clearly delineating roles and responsibilities with regards to fraud risk management. Policies that encourage ethical behaviour should be established, communicated throughout the organisation, and have their effectiveness assessed periodically.

Fraud risk assessment

Fraud risk assessment is a structured approach to fraud risk identification, assessment of significance and likelihood and determination of risk mitigation plans. It uncovers which areas and what activities are more susceptible to fraud, assesses internal controls, and helps organisations make informed decisions about where best to deploy scarce anti-fraud resources.

To reap the full benefits of fraud risk assessment, it should be executed independently and periodically through the right sponsor (e.g. board committee) with cross-departmental ownership of the assessment outcome.

Fraud prevention

Fraud prevention is the first line of defence in reducing fraud risk. Fraud prevention is implemented through a sound system of preventive controls which decreases motive, restricts opportunity, and limits rationalisation of fraudulent acts. Fraud prevention techniques include codes of conduct, employee and third-party screening, communication and training, segregation of duties, and continued transaction monitoring.

The effectiveness of the various fraud prevention schemes is highly dependent on continuous communication and reinforcement across the organisation.

Fraud detection

Fraud prevention is not absolute and may not stop all potential fraudulent acts, fast detection of fraud comes into play to reduce the damage and acts as a deterrent to would-be fraudsters.

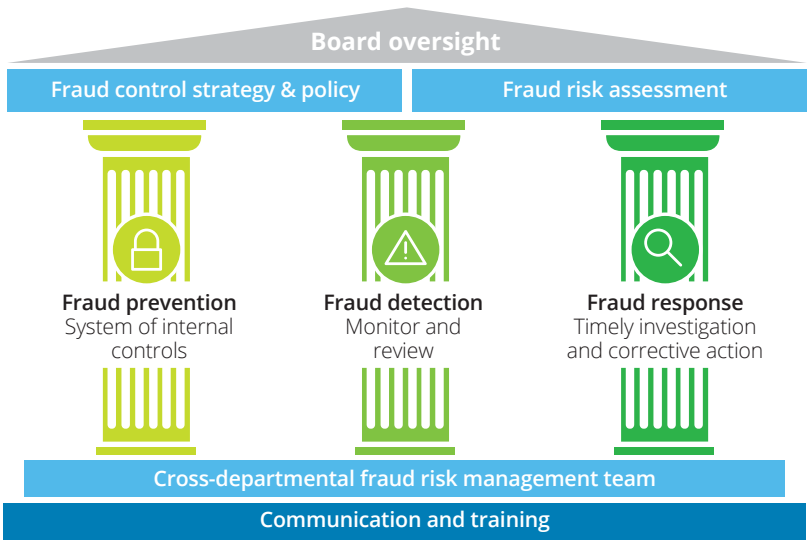
Fraud detection involves the use of monitoring and review tools to detect fraud when it occurs, e.g. process-level detection controls, substantive testing, and whistleblowing channels. This is followed with a reporting mechanism for getting the information to the right person. With the growing volume of data available today, investing in technologies and employing analytics to identify and mitigate fraud is increasingly viable.

Fraud response

Fraud response strategies are designed to provide guidance on dealing with detected or suspected cases of fraud in a measured and consistent manner. These are critical to restrict the damage and minimise the losses caused by fraud.

Organisations benefit from incorporating thorough investigation protocols, remedial action protocols, and reporting and disclosure protocols into their fraud response plans. Modification to the fraud control strategy where weaknesses were identified may be warranted to prevent similar behaviour.

Fraud Risk Management Framework



Deloitte's continuous improvement approach to fraud risk management

Fraud risk management is not a one-off exercise but a dynamic process. As organisations grow and evolve, so does their fraud risks. Deloitte's continuous improvement approach to fraud risk management requires regular measurements of where the organisations are and where they want to/can be in terms of detecting and preventing fraud.

Why should organisations be especially concerned now?

Pressure points in the 'new normal'

COVID-19 provides fertile ground for fraudsters with the rapid shift to online transactions. Business models are challenged and organisations are more focused on operational measures than fighting fraud. Job cuts may create an incentive for employees to commit fraud.

Evolving fraud patterns

As procedures and controls are being placed, the conduct of fraud will evolve to evade them. Traditional rules-based monitoring limited by human bias deciding on the rules often fail to detect new suspicious activities.

Use of analytics

Organisations are moving away from time-consuming manual transaction analysis and incorporating analytics as part of their fraud risk management program. They benefit from an expanded coverage of monitoring and reduction in errors.

Globalisation

It is common today to see businesses source for supplies from other countries or expand sales to emerging markets, the cross-border transactions coupled with increased reliance on information technology has added complexity and exposure to fraud risk.

How can Deloitte help?

Fraud risk management capabilities gap analysis
Identifying missing elements against industry practices to uncover improvement opportunities for fraud risk management practices already in place. Determining priorities for addressing the gaps and building implementation roadmap to arrive at target state.

Fraud risk assessment
Performing organisation-wide fraud risk assessment to identify high risk functions and processes, evaluating adequacy of internal controls in risk mitigations, and documenting findings via an overall fraud risk profile.

Fraud risk management policy and fraud response plan
Developing fraud risk management policy and fraud response plan to (i) delineate roles and responsibilities and establish the baselines to managing fraud risk; and (ii) effectively guide the response and reporting procedures in the event of detected or suspected fraud activities.

Data assessment and continued transaction monitoring
Gathering data across systems and mining for anomalies, discrepancies, and unusual patterns. Supports case management and investigation, and improves false positive rate.

Fraud risk awareness training
Conducting fraud awareness trainings or ethical dilemma workshops to employees, aimed at training employees to recognise red flags that may appear, guiding them where to seek assistance, and advice and demonstrating management's commitment to curbing fraud.

Whistleblowing mechanism
Establishing whistleblowing policy which encourages employees and third parties to speak up without fear of retaliation. Setting up secure and confidential reporting channel e.g. in the form of an unmanned complaint box, dedicated email ID, toll free number, anonymous e-forms etc.

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