

Fraud Prevention and Deterrence

Fraud Prevention Programs

Fraud Prevention Policy

- The best way to sell the establishment of a fraud policy is by stressing the **impact** on the bottom line.
- Companies are sensitive to adverse **publicity**.



Procedures to Prevent Fraud

- Increasing the perception of detection
 - Easier to prevent fraud than detect it
 - Perception of detection may be most effective fraud prevention method
 - Employee education
 - Job rotation
 - Effective reporting programs

Procedures to Prevent Fraud

- Proactive Audit Procedures
 - Use of analytical review procedures
 - Fraud assessment questioning
 - Surprise audits where possible
- Employee Anti-Fraud Education
 - EVERY employee; Ongoing from date of hire
 - Topics should include specific risks and:
 - What is fraud
 - How it hurts the organization
 - How to identify fraud
 - How to report fraud
 - Punishment for dishonest acts

Procedures to Prevent Fraud

- Enforcement of mandatory vacations
- Job rotation
- Management oversight (be observant)
- Reporting programs
 - Hotlines
 - Rewards
- Tone at the top
 - Create an environment in which employees feel safe to challenge management's decisions or speak up if they think something is wrong
 - Management must "exude" ethics (walk the talk)

Procedures to Prevent Fraud

- Well-designed organizational structure
- Background checks (on existing employees, too)
- Performance management and measurement
 - Well-defined job descriptions and goals
 - Training on a consistent basis
 - Don't push them toward fraud
 - Ethics-based metrics

Procedures to Prevent Fraud

- Handling of known fraud incidents
 - Be consistent
 - Public record of incidents
- Minimize employee pressures
 - Open-door policies
 - Fair personnel policies and procedures
 - Employee support programs

Fraud Prevention Policy

- Actions constituting fraud
 - Detail what actions constitute fraudulent conduct.
- Legal considerations
 - Best to spell out specific unacceptable conduct. If the type of conduct that is considered unacceptable is not accurately detailed, there might be legal problems in discharging a dishonest employee.

Ethics Programs

- Communicate to new and old employees
- Give to vendors
- Post on website
- Give message to parties outside the organization that unethical conduct is not tolerated
- 12 suggested components

Corporate Sentencing Guidelines

- Guidelines state that they are designed to provide incentives for organizations to maintain internal mechanisms for preventing, detecting, and reporting criminal conduct.
- Guidelines require that a compliance and ethics program be reasonably designed, implemented, and enforced so that it is generally effective in preventing and detecting criminal conduct.

Corporate Sentencing Guidelines

- Considerations:
 - Applicable industry size and practice
 - Size of the organization
 - Recurrence of similar misconduct
- Seven factors that are required:
 - Don't include fraudsters
 - Monitor, audit, evaluate
 - Appropriate incentives for compliance and appropriate disciplinary measures

Corporate Sentencing Guidelines

- Require that the company's governing authority be knowledgeable about the content and operation of the program and exercise reasonable oversight regarding its implementation and effectiveness
- "Governing authority" is defined as the board of directors or, if the organization does not have a board of directors, the organization's highest-level governing body

Corporate Sentencing Guidelines

- Must communicate the policy to everyone who can bind the corporation
 - Board of directors
 - Executives
 - Managers and supervisors
 - Low-level employees
 - Contractors
- Must conduct “effective training”
- Must enforce the program by disciplining rulebreakers

Sample Prep Question

1. Unless specific unacceptable conduct is detailed in a fraud prevention policy, there can be legal problems in discharging a dishonest employee.
 - A. True
 - B. False

Correct Answer: A

- Many companies have learned that it is best to spell out specific unacceptable conduct. If the type of conduct that is considered unacceptable is not accurately detailed, there might be legal problems in discharging a dishonest employee. Check with your counsel regarding any legal considerations with respect to a fraud policy. One of the most important legal considerations is to ensure everyone and every allegation is handled in a uniform manner.

Sample Prep Question

2. Which of the following should be covered in employee anti-fraud training?
 - A. The exact procedures management uses to detect fraud
 - B. A detailed explanation of the company's anti-fraud controls
 - C. Examples of past transgressions and how they were handled
 - D. All of the above

Correct Answer: C

- The content covered by the organization's anti-fraud programs should focus on the specific risks faced by the organization to provide employees with practical, implementable knowledge. However, it should not give employees the information they need to "beat the system" by explaining the details of controls and procedures used to detect fraud. In that regard, the following topics form the basis of an effective program:

Correct Answer: C

- What fraud is, including examples of what behavior is acceptable and what is not
- How fraud hurts the organization
- How fraud hurts employees
- Common characteristics that lead individuals to commit fraud (i.e., pressure, opportunity, and ability to rationalize the act)
- How to identify fraud (i.e., specific examples of financial, transactional, behavioral, and other red flags to watch for)
- How to report fraud
- The punishment for dishonest acts, including examples of past transgressions and how they were handled

Sample Prep Question

3. To reinforce an anti-fraud culture, management should:
 - A. Show employees that unethical behavior will not be tolerated
 - B. Create an environment in which employees feel safe challenging management's decisions
 - C. Visibly adhere to the same set of ethics policies that are required of all employees
 - D. All of the above

Correct Answer: D

- To achieve an organizational culture with a strong value system founded on integrity, management must show employees through its words and actions that dishonest or unethical behavior will not be tolerated. Management must also create an environment in which employees feel safe to challenge management's decisions or speak up if they think something is wrong.
- Additionally, management must exude ethics in order to model the behavior that is expected of the staff. When management acts ethically and follows organizational policies, the staff tends to respect and appreciate the behavior and copy it.

Fraud Prevention and Deterrence

Ethics for Fraud Examiners

Why Is a Code Needed?

- Makes explicit some of the criteria for conduct
- Provides direct solutions that may not be available from ethical theories
- Furthermore, an individual is better able to know what the profession expects his conduct to be
- Facilitates enforcement

Ethical Decisions

- Most start analysis with “Is it legal?”
 - Law deals with permitted and prohibited actions
 - Though it is the lowest reference level for moral decisions



ACFE Code of Professional Ethics

- Commitment to professionalism and diligence in the performance of duties
- Shall not engage in any illegal or unethical conduct or conflict of interest
- Exhibit highest level of integrity in performance of professional assignments

ACFE Code of Professional Ethics

- Accept only assignments for which there is a reasonable expectation that they will be completed with professional competence
- Comply with lawful orders of the courts
- Testify to matters truthfully and without bias
- Obtain evidence to establish basis for any opinion rendered

ACFE Code of Professional Ethics

- No opinion shall be expressed about the guilt or innocence of any person or party
- Shall not reveal confidential information obtained during an engagement without proper authorization

ACFE Code of Professional Ethics

- Shall reveal all material matters discovered during the course of an examination, which, if omitted, could cause a distortion of facts
- Strive to increase the competence and effectiveness of professional services performed

Professional and Diligence

- The “diligence in performing his or her duties” phrase in the rule refers to several activities that collectively define high-quality fraud examination work. They include planning assignments and supervising assistants and colleagues, avoiding conflicts of interest, performing with competence, obtaining sufficient evidence to establish a basis for opinions, maintaining confidential relations, and avoiding distortion of facts.

Legal and Ethical Conduct

- Illegal Conduct
- Libel and Slander
- False Imprisonment
- Ignorance of the Law
 - Some rules for professionals insert the word “knowingly” in relation to illegal activities.
 - The ACFE Code of Professional Ethics does not include this way out.
- Unethical Conduct

Legal and Ethical Conduct

- Conflicts of Interest
 - Not engage in other jobs that create a hardship or loss to the employer
 - Should not be a “double agent” employed by one company, but retained by another company or person to infiltrate the employer and transmit inside information
 - Should not accept engagements from both sides to a controversy
 - Financial and managerial interests
 - Appearance of a conflict or lack of independence

Integrity and Competence

- Integrity
 - Honesty, truthfulness, trustworthiness, and confidentiality
- Professional Competence
 - Context of the “prudent practitioner”
- Professional Skepticism
 - Begin with belief that something is wrong or that someone is committing fraud
 - Professional skepticism can be dispelled only by evidence
 - As a result, opinions or attestations about a fraud-free environment are absolutely prohibited

Court Orders and Testimony

- Must comply with all lawful court orders
- Testify truthfully and without bias or prejudice



Reasonable Evidential Basis for Opinion

- Fraud examiners must collect evidence, whether exculpatory or incriminating, that supports fraud examination results and will be admissible in subsequent proceedings
- Proper chain of custody
- A fraud examiner cannot express an opinion about whether an individual is legally guilty or innocent of a crime
- Opinions on technical matters allowed

Confidential Information

- *Confidential information* is information the fraud examiner obtains during the course of work.
- *Privileged information* is information that cannot be demanded, even by a court.
- Fraud examiners do not have any legal privilege in common law or by statute.
- If the client or employer consents to disclosure of information otherwise considered confidential, then the fraud examiner can transmit it to others.

Confidential Information

- Proper authorization
- Can't promise confidentiality or leniency
- Blowing the whistle
 - Evidence of managerial-level complicity can be reported to the board of directors and its audit committee without trampling on the confidentiality rule.
 - In general, fraud examiners are not legally obligated to blow the whistle on clients or employers.
 - However, circumstances might exist in which they are morally and legally justified in making disclosures to appropriate outside parties.

Complete Reporting and Professional Improvement

- Fraud examiners shall reveal all material matters.
- Evidence and conclusions are material if they would affect the client's decision.
- CFEs are required to earn 20 hours of CPE annually.

Sample Prep Question

1. The lowest level of reference for moral decisions is:
 - A. Religious beliefs
 - B. The law
 - C. The instrumental perspective
 - D. Professional codes

Correct Answer: B

- When faced with an ethics-related problem, it is tempting and appropriate to begin the analysis of a possible action by asking: “Is it legal?” The law deals with actions that are permitted and prohibited. With all due respect to the law, it is nevertheless the lowest level of reference for moral decisions. It happens, for example (though not frequently), that a law may permit an action that is prohibited by a profession's code of ethics.

Sample Prep Question

2. Robert, a Certified Fraud Examiner, is hired by a client to conduct a fraud examination. At the conclusion of the engagement, he issued a written report to the client and closed his file. A year later, Robert receives a subpoena from the local district attorney's office to provide the report. Under the ACFE Code of Professional Ethics, he will not be able to respond.

A. True

B. False

Correct Answer: B

- Two articles cover the action by Robert. Article IV of the ACFE Code of Professional Ethics states: “An ACFE member will comply with lawful orders of the courts, and will testify to matters truthfully and without bias or prejudice.” Article VI says: “An ACFE member shall not reveal any confidential information obtained during an engagement without proper authorization.” In this particular situation, the fraud examiner must comply under Article IV, even though Article VI seems to be at odds. The latter states “... without proper authorization.” It does not state that the authorization has to come from the client. A subpoena is proper authorization under the ACFE Code of Professional Ethics.

Sample Prep Question

3. Lee, a Certified Fraud Examiner, was hired to investigate a company. After he carefully examined the company, he issued a report that stated, in part, "... in my opinion, this operation is free of material fraud." Such an opinion is permitted under the ACFE Code of Professional Ethics.

- A. True
- B. False

Correct Answer: B

- Fraud examiners must always perform their work with skepticism, beginning with the belief that something is wrong or someone is committing a fraud. At no time is a fraud examiner entitled to assume a fraud problem does not exist. Thus, professional skepticism can be dispelled only by evidence. As a result, opinions or attestations about a fraud-free environment are absolutely prohibited for ACFE members.

Sample Prep Question

4. Information obtained by a CFE during an engagement is legally privileged from disclosure to anyone.
- A. True
 - B. False

Correct Answer: B

- *Privileged information* is information that cannot be demanded, even by a court. Common-law privileges exist for husband-wife and attorney-client relationships, and physician-patient and priest-penitent relationships have obtained the privilege through state statutes. Fraud examiners do not have protected privileges in common law or statute, and the ACFE Code of Professional Ethics does not assume a privileged status for the fraud examiner-client/employer relationship.

Sample Prep Question

5. In the context of a fraud examination, a mindset of professional skepticism means:
- A. Fraud examiners should always begin their assignments with the belief that something is amiss
 - B. Fraud examiners should relax their attitude of skepticism only when the evidence shows no signs of fraud
 - C. A fraud examiner may not provide opinions or attestations about a fraud-free environment
 - D. All of the above

Correct Answer: D

- As part of exercising professional integrity and competence, fraud examiners must always perform their work with a mindset of professional skepticism and begin assignments with the belief that something is wrong or someone is committing a fraud (depending on the nature of the assignment and the preliminary information available). Furthermore, fraud examiners should relax their attitude of skepticism only when the evidence shows no signs of fraudulent activity. At no time is a fraud examiner entitled to assume a fraud problem does not exist. Thus, professional skepticism can be dispelled only by evidence. As a result, opinions or attestations about a fraud-free environment are absolutely prohibited for ACFE members.

Exam Schedule

- Fraud Prevention Exam
 - Turn in by 5:30
- Second Exam (if needed)
 - Pickup by 5:30
 - **Turn in by 7:00**