



RISK & ADVISORY SERVICES
FRAUD RISK GOVERNANCE

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“BDO’s FRAUD RISK ASSESSMENT PROGRAMME ENABLES ORGANISATIONS TO EFFECTIVELY BENCHMARK THEIR CONTROL PROCESSES IN MEETING THE FRAUD CHALLENGES”

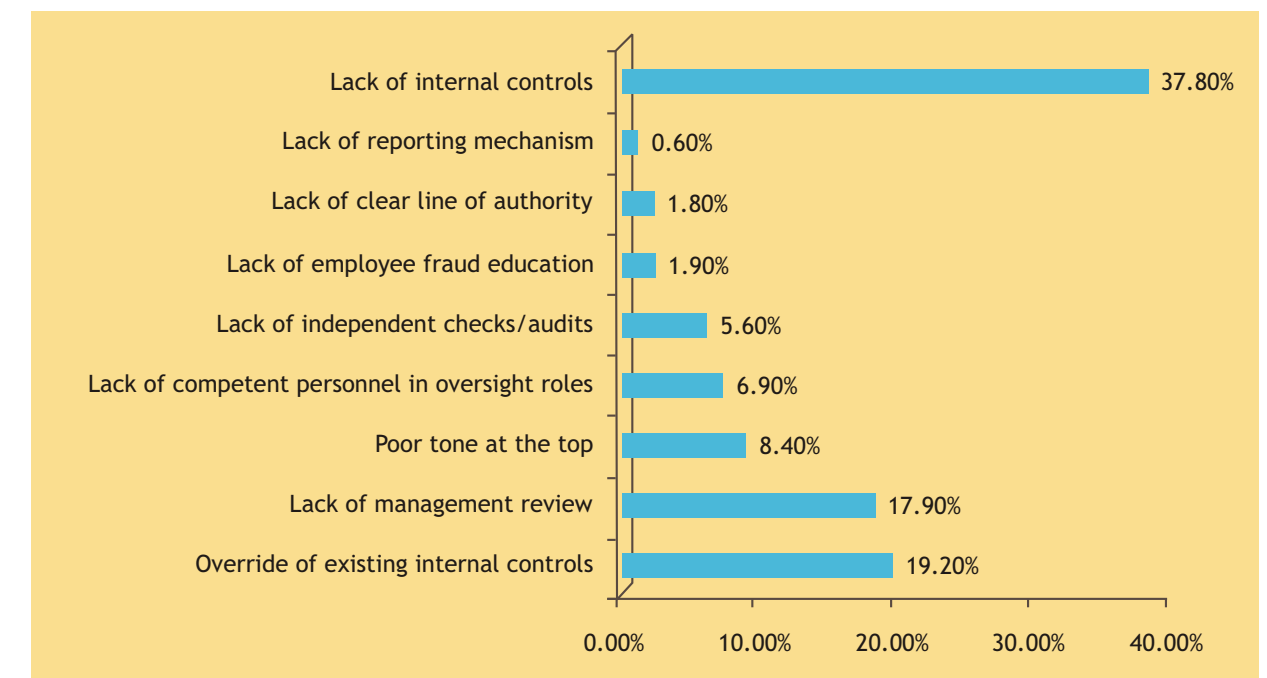
- ▶ Organisations have formalised various components of fraud risk management programmes, but have neglected to conduct a thorough effectiveness assessment of these programmes to identify the weak links.
- ▶ Initiating a Fraud Risk Governance Programme enables businesses to promote Anti-Fraud Culture and provide a composite framework on Anti-Fraud measures. This paper provides a comprehensive approach and solution for implementing an anti-fraud environment and measures.
- ▶ BDO’s fraud risk governance programme builds an anti-fraud environment with the goal of helping organisations align with recognised Best Practices and Regulatory Requirements which preserve and enhance value.
- ▶ It provides an overview of BDO’s fraud risk governance solutions which identifies new regulatory mandates from around the world and spotlights key practices that organisations have generally found to be effective in the dynamic and complex fraud environment.
- ▶ We hope this perspective provides Fresh Insights as you consider the risks of fraud at home and abroad, and the Effectiveness of Controls you rely on to mitigate those risks.

MAJOR ROOT CAUSES FOR FRAUD AND TYPES OF FRAUD RISK

BACKGROUND

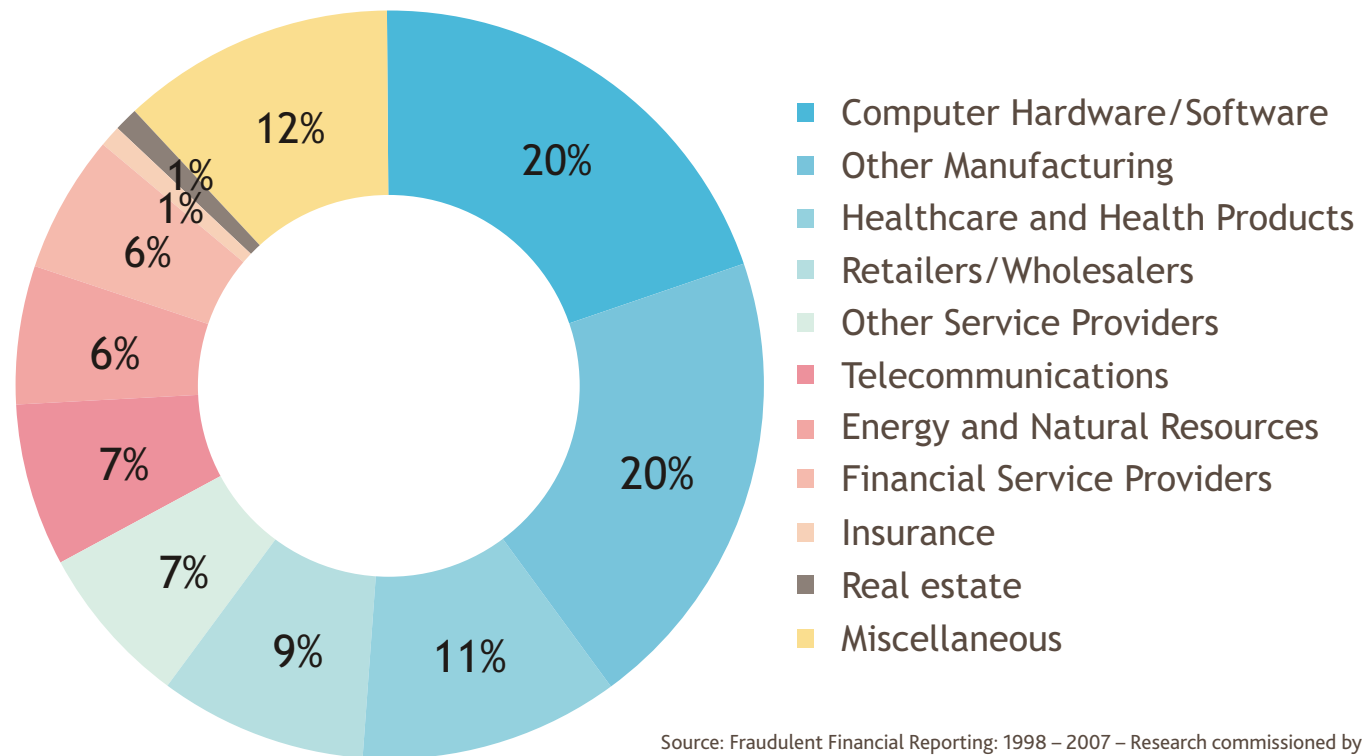
- ▶ Economic crime remains one of the most problematic issues for businesses – both in India and worldwide. Further, fraud continues to be a prominent issue and has become increasingly important in the eyes of regulators – both in India and around the world.
- ▶ A study initiated by the Association of Certified Fraud Examiners (ACFE) estimates that typically organisations lose some 7% of revenue to fraud.
- ▶ This translates to big numbers on the bottom line with billions of dollars lost each year. Monetary loss is only one consideration. Fraud can also mean significant damage to reputation, disruption to business, regulatory sanctions and sharp decline in market valuations.
- ▶ Lack of internal controls, such as segregation of duties, was cited as the biggest deficiency in 38% of the cases. In more than 19% of the cases, internal controls were in place but were overridden by the perpetrator or perpetrators in order to commit and conceal the fraud.

MAJOR ROOT CAUSES FOR FRAUD



Source: 2010 report to the nations on occupational fraud and abuse

PRIMARY INDUSTRIES OF SAMPLE FRAUD COMPANIES

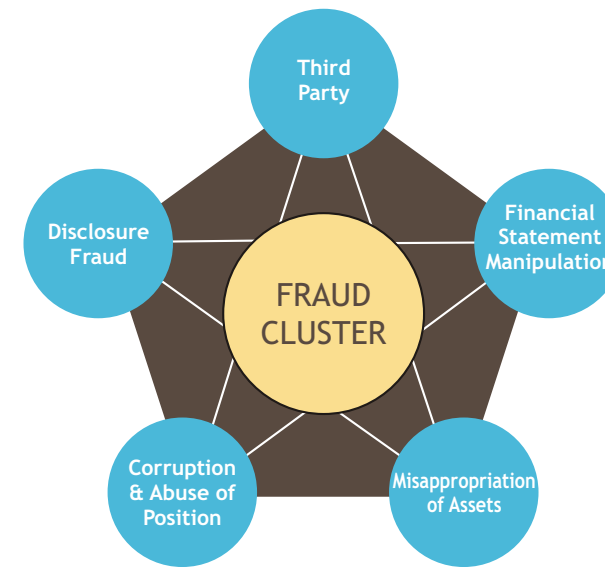


Source: Fraudulent Financial Reporting: 1998 – 2007 – Research commissioned by COSO

- ▶ The COSO Study on Fraudulent Financial Reporting issued in May 2010 revealed that Computer Hardware/Software and manufacturing industry are facing the highest cases of fraud amongst other industries.
- ▶ The average cumulative misstatement amount was \$ 397.68 Million, while the median cumulative misstatement was \$ 12.05 Million.
- ▶ More than of the frauds in the study were committed by individuals in six departments: Accounting, Operations, Sales, Executives/Upper Management, Customer Service and Purchasing.
- ▶ The higher frequency of related party transactions for fraud firms suggests that the presence of related party transactions may reflect heightened fraud risk.

FRAUD RISK GOVERNANCE PROGRAMME

FRAUD CLUSTER



ELEMENTS OF THE FRAUD CLUSTER

Third Party:

- ❑ Fraud related to third party of the organisation i.e. suppliers, customers, and agents
- ❑ Fraudulent round-trip transaction
- ❑ Cartel Activities
- ❑ Commission Payback
- ❑ Piracy

Financial Statement Reporting:

- ❑ Improper revenue recognition
- ❑ Manipulated asset valuations
- ❑ Inappropriate judgments regarding the capitalisation of development costs
- ❑ Concealment of liabilities
- ❑ Related party transactions
- ❑ Misstatement of acquisition accounting

Misappropriation of Assets:

- ❑ False expense claims
- ❑ Cash/materials theft
- ❑ Theft of trade secrets/I.P.
- ❑ Procurement fraud
- ❑ Theft of customer data

Corruption and Abuse of Position:

- ❑ Management override of controls
- ❑ Conflicts of interest
- ❑ Inappropriate use of company assets
- ❑ Contrivance against fair competition

Disclosure Fraud:

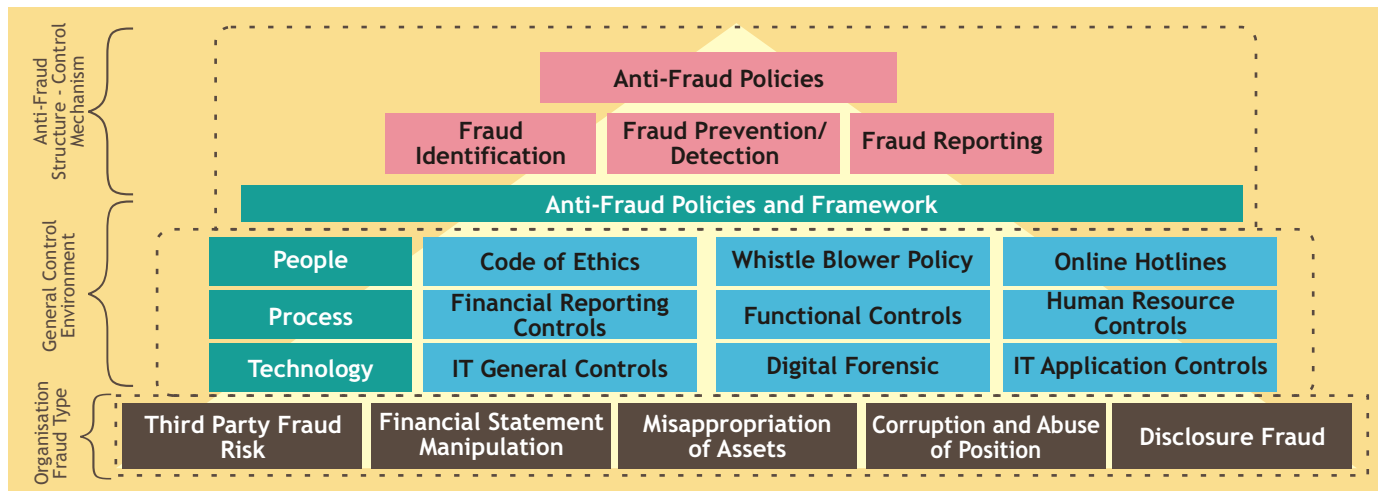
- ❑ Omission or misstatement financial/non-financial information
- ❑ Misrepresentation regarding undertakings to regulators/and third parties such as banks

PROMOTING REGULATORY COMPLIANCE & BEST PRACTICES

- ▶ Laws and assurance standards aimed at preventing fraud have produced a more complex landscape for organisations to navigate. Forward-thinking organisations seek to maximise stakeholder value through regulatory compliance and the implementation of best practices.
- ▶ The legal requirements and authoritative guidance for anti-fraud programmes and prevention of money laundering are provided under:

International Laws, Regulations & Sections	Indian Laws, Regulations & Sections
The Sarbanes-Oxley Act (Section 103 & 404)	RBI Guidelines for Banking, NBFC and Other Financial Services
Statement of Auditing Standards (SAS 99) - "Consideration of Fraud in Financial Audit"	Prevention of Money Laundering Act 2002
SEC Regulation and Enforcement Policy	SEBI Guidelines including Clause 49
PCAOB Standard # 2	Prevention of Corruption Act, 1988
COSO's Internal Control and Enterprise Risk Management Integrated Framework	The Companies Act, 1956 and proposed bill 2009
Foreign Corrupt Practice Act	Foreign Exchange Management Act, 1999
UK Bribery Act and Companies Act of 2004	Banking Regulation Act, 1949
The Corporate Law Economic Reform Programme (Audit Reform and Corporate Disclosure) Act 2004 of Australia	Securities Contract (Regulation) Act, 1956
The Canadian Criminal Code	Income Tax Act, 1961
Financial Services Action Plan (FSAP) of European Union	IRDA Guidelines
FATF Guidelines	

FRAUD RISK GOVERNANCE PROGRAMME ELEMENTS



THE BENEFITS OF FRAUD RISK GOVERNANCE PROGRAMME

- ▶ In addition to compliance, an organisation with an effective anti-fraud programme can reap tangible, long-term benefits, including the following:
 - Preserve and enhance reputation
 - Increased transparency and accuracy of financial reporting
 - Reduced misappropriation of assets
 - Fewer adverse findings by auditors and regulators
 - Reduced exposure to stock price volatility
 - Reduced litigation burden
 - Easier access to capital
 - Enhanced investor confidence
- ▶ Left unchecked, fraud can spell disaster for an organisation. Fraud can have a negative effect on a public company's market value by a significant multiple amount of the fraud. Conversely, implementation of a fraud risk governance programme can help an organisation reap operational and strategic benefits and maximise stakeholder value.

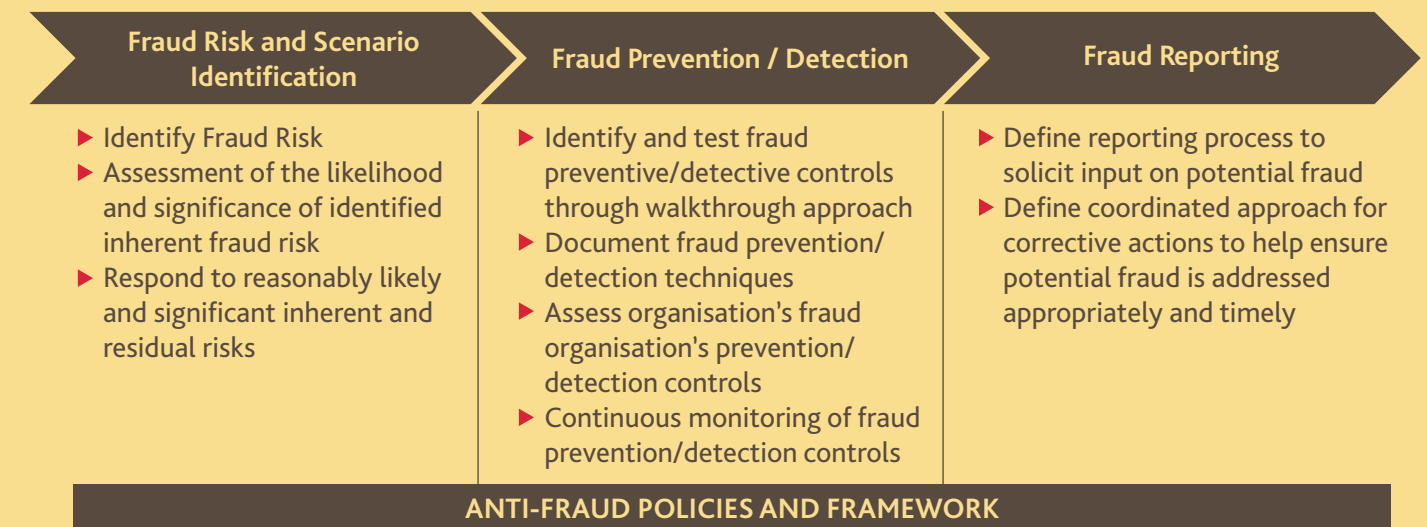
FRAUD RISK GOVERNANCE PROGRAMME – BDO'S APPROACH

BDO'S APPROACH

Our approach focusses on the kinds of fraud risks to which an organisation is vulnerable, their significance and likelihood, and how effectively those risks are currently managed. Based on our extensive experience in fraud investigation and developing remediation action plans our international capability to develop fraud risks/scenarios, we assist in identifying fraud risks and to implement appropriate anti-fraud detection and control measures.

Integrating these controls into the infrastructure and operations of an organisation fosters an environment resulting in significant deterrence of fraud and early detection of attempted fraud. Early detection enables an organisation to address potential fraud risks internally before they have affected employee morale or external perceptions.

Implementation of Fraud Risk Governance Programme and the resultant anti-fraud environment shows a proactive focus on achieving organisational objectives by Directors, Senior Management, financial reporting personnel and employees at all levels. As a result, organisations demonstrate their commitment to align with regulatory requirements and best practices thereby maximising stakeholder value.



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