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# Anti Fraud training course

## Risks of fraud: measurement models for and analysis supporting tools

Padova, May 6-26th 2015

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# Risks of fraud: measurement models for and analysis supporting tools

Padova, May 6th 2015

**Mr. Andrea Chiusani**  
**Mr. Luca Marzegalli**  
**Mr. Piero Di Michele**  
**Mr. Marco Ferrara**

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## Risks of fraud: measurement models for and analysis supporting tools

- Introduction to the EU Legislation
- Anti Fraud Model
- The elements of an anti fraud risk management program
- Managing fraud risk through awareness
- Fraud risk assessment
- Anti Fraud control activities and monitoring



# Introduction to the EU Legislation

## Guideline for the certification audit of EAGF/EAFRD accounts

- Only accredited Paying Agencies (PAs) are entitled to receive Union funding in respect of the European Agricultural Guarantee Fund (EAGF) and the European Agricultural Fund for Rural Development (EAFRD).
- Member States are responsible for accrediting PAs.
- PAs shall only be accredited by Member States if they comply with certain minimum criteria established at Union Level:
  - internal environment,
  - control activities,
  - information and communication and
  - monitoring.

This should include Risk Assessment, as this is considered to be an important element of control activities.





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# Introduction to the EU Legislation

## Guideline for the certification audit of EAGF/EAFRD accounts

- The EU budget shall be implemented in accordance with an effective and efficient internal control, providing assurance of achieving prevention and detection of fraud and irregularities.
- Member States are responsible to prevent and deal with irregularities and fraud.
- DG AGRI shall ensure the Member States have implemented and operated an effective management and control systems making sure funds are efficiently and correctly used so as to guarantee the legality and regularity of expenditure.
- PAs must take measures to prevent and detect fraud and irregularity in the context of their activities in the CAP 2014/2020.





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# Introduction to the EU Legislation

## Anti Fraud Regulations in the Common Agricultural Policy

### **Regulation (EU) No 1306/2013**

Concerning financing, management and monitoring of the common agricultural policy

### **Commission Delegated Regulation No 907/2014**

Concerning paying agencies and other bodies

### **Commission Implementing Regulation No 908/2014**

Concerning paying agencies and other bodies.





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# Introduction to the EU Legislation

## Art. 58 Regulation (EU) No. 1306/2013

Member States shall adopt all legislative, regulatory and administrative provisions and take any other measures necessary to ensure effective protection of the financial interests of the Union, in particular to:

- (a) check the legality and regularity of operations financed by the Funds;
- (b) ensure effective prevention against fraud, especially in areas with a higher level of risk, and which will act as a deterrent, having regard to the costs and benefits as well as the proportionality of the measures;
- (c) prevent, detect and correct irregularities and fraud;
- (d) impose penalties which are effective, dissuasive and proportionate in accordance with Union law, or failing this, national law, and bring legal proceedings to that effect, as necessary;
- (e) recover undue payments plus interest, and bring legal proceedings to that effect as necessary.





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# Introduction to the EU Legislation

## Commission Delegated Regulation No. 907/2014

A new approach to fraud prevention and detection:

- Before authorizing a claim for payment, PAs shall inter alia carry out checks as required by Article 58 of Regulation (EU) No 1306/2013 to prevent and detect fraud and irregularity with particular regard to the risks incurred (Section 2 (A) (iii) of Annex I);
- PAs' internal control activities shall cover, inter alia, monitoring procedures to prevent and detect fraud and irregularity with particular regard to areas of CAP expenditure under its competence which are exposed to a significant risk of fraud or other serious irregularities (Section 4 (A) (iv) of Annex I);
- PAs shall ensure that staff training is appropriate at all operational levels, including fraud awareness (Section 1 (B) (iv) of Annex I).







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# Introduction to the EU Legislation

## Commission Delegated Regulation No. 908/2014

- The accreditation (pre-accreditation review) shall cover, inter alia (Art. 1 (3) (c))
  - “procedures and systems put in place for payment authorization and execution”;
  - “the extent to which the procedures and systems put in place are apt to safeguard the Union budget including risk-based anti-fraud measures.”
- The management declaration of the Director of the PA shall include (Annex 1):
  - “Furthermore, I confirm that effective and proportionate anti-fraud measures under article 58 of Regulation (EU) No 1306/2013 are in place and take account of the risks identified”





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# Introduction to the EU Legislation

## Recommendations of the Commission: the 5 steps to follow

1. Fraud Risk assessment with ranking;
2. Analysis of the existing administrative and control structures to possibly increase fraud prevention and detection;
3. Register of fraud indicators;
4. Internal rules on dealing with suspicion of fraud;
5. Staff training for fraud awareness.





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# Introduction to the EU Legislation

## Irregularities and Fraud Character

A Fraud risk assessment deals only with specific fraud risks, not irregularities. However, indirectly, effective implementation of the exercise may also have an impact on prevention and detection of irregularities at large, being understood as a larger category than fraud.

Article 1(2) of Regulation (EC) No 2988/955 defines "**irregularity**" as:

*"any infringement of a provision of Community law resulting from an act or omission by an economic operator, which has, or would have, the effect of prejudicing the general budget of the Communities or budgets managed by them, either by reducing or losing revenue accruing from own resources collected directly on behalf of the Communities, or by an unjustified item of expenditure".*





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# Introduction to the EU Legislation Irregularities and Fraud Character

The Convention on the protection of the European Communities' financial interests drawn up on the basis of Article K.3 of the Treaty on European Union, defines "fraud", in respect of expenditure, as any intentional act or omission relating to:

- "- the use or presentation of false, incorrect or incomplete statements or documents, which has as its effect the misappropriation or wrongful retention of funds from the general budget of the European Communities or budgets managed by, or on behalf of the European Communities;*
- non-disclosure of information in violation of a specific obligation, with the same effect;*
- the misapplication of such funds for purposes other than those for which they were originally granted."*





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# Introduction to the EU Legislation Irregularities and Fraud Character

Irregularities

Fraud

- ▶ **Fraud** is always an irregularities
- ▶ **Irregularity** is a **Fraud** only when intentional



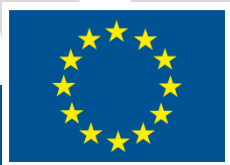


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# Anti fraud Model



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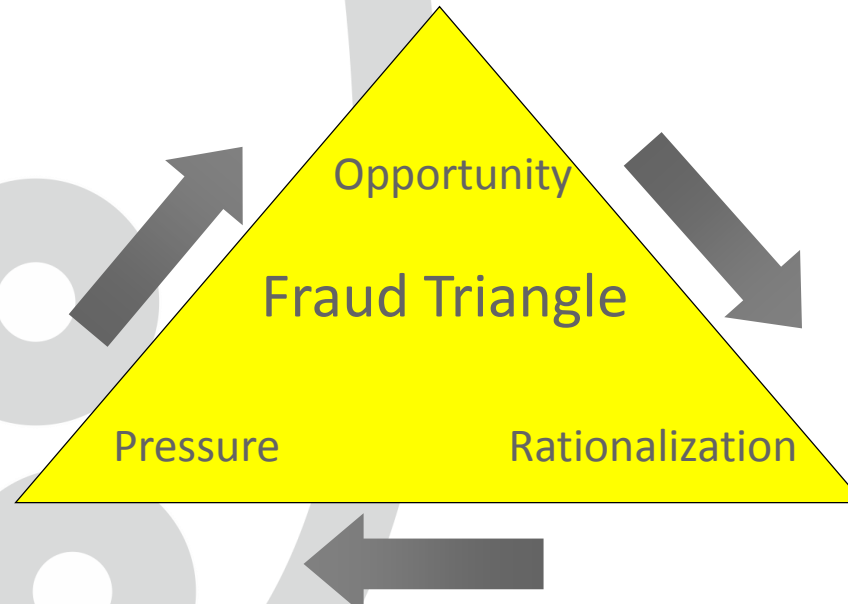
# What is Fraud and Why is it Committed

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Fraud is any intentional act or omission designed to deceive others and resulting in the victim suffering a loss and/or the perpetrator achieving a gain

Many studies suggest that employees who commit fraud do so because there is opportunity, pressure, and rationalization: the Fraud Triangle.



This framework is a useful tool for those seeking to understand fraud risks.





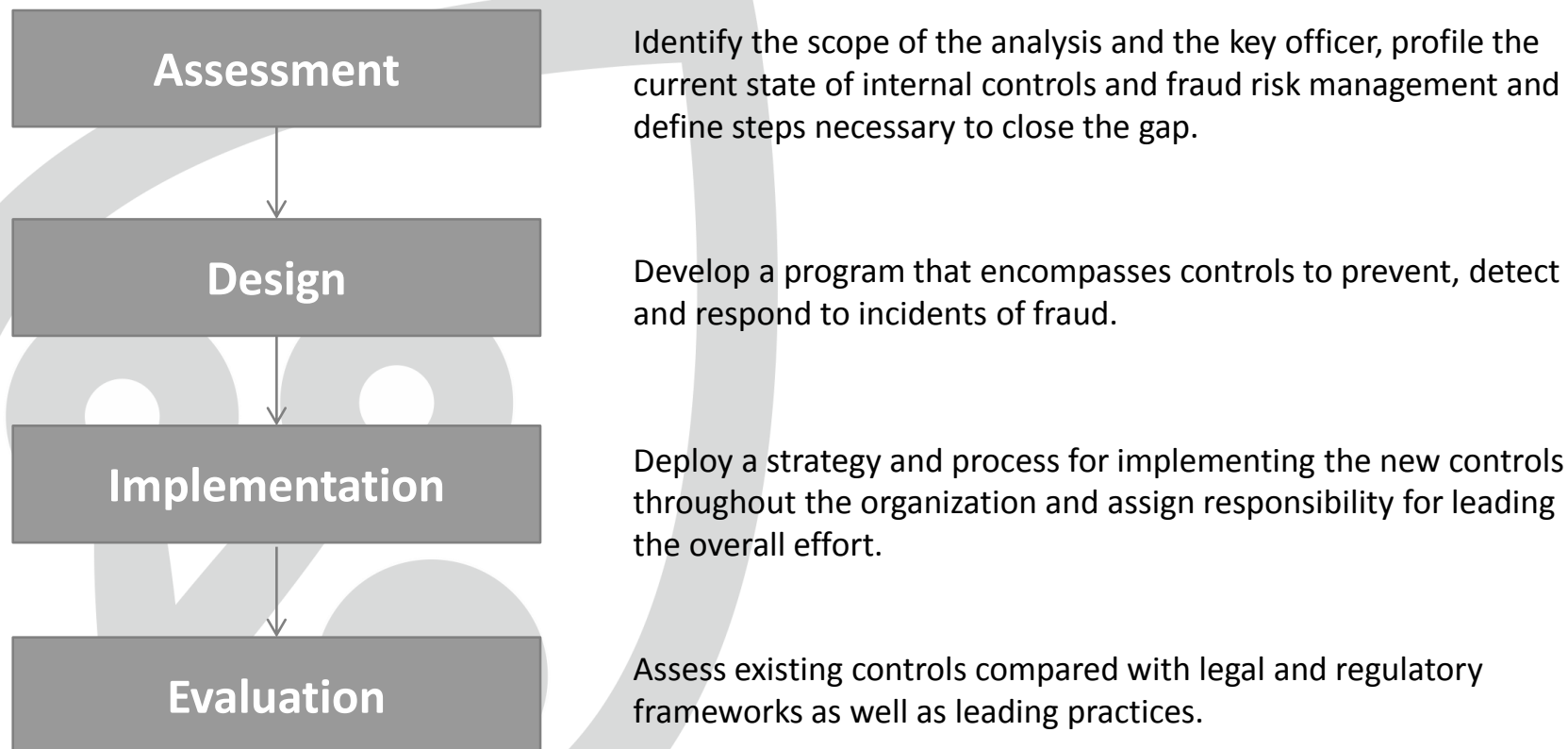
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# Anti-Fraud Model

## The elements of anti fraud risk management program

Effective fraud risk management provides an organization with tools to manage fraud risk. Such approach has four phases:







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# The elements of an anti fraud risk based program

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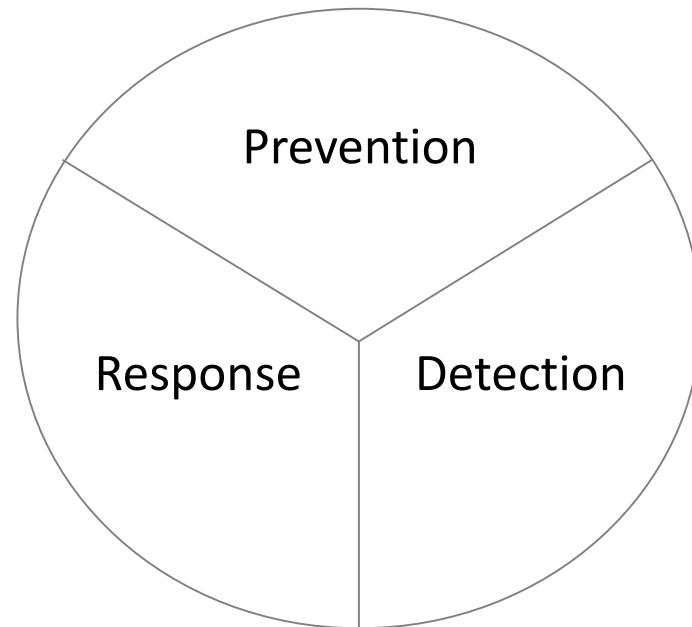
# The Key Mechanisms: Prevention, Detection, Response

Based on DG Justice Anti Fraud strategy,

*«an effective anti fraud strategy should encompass three mechanisms:*

- *a preventive,*
- *a detective,*
- *and a dissuasive one.*

*They are complementary and need to be used in synergy to maximize effectiveness.»*





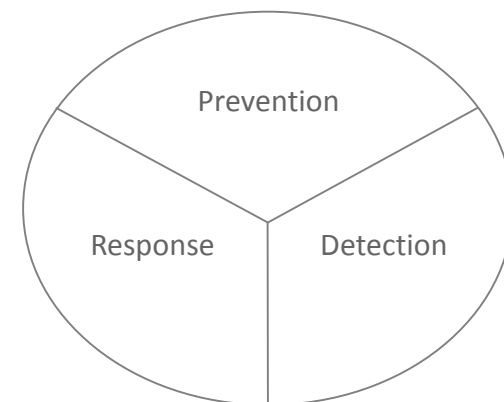
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# The Key Mechanisms: Prevention, Detection, Response

An effective, business-driven fraud and misconduct risk management approach is one that is focused on three objectives:

- ▶ **Prevention:** includes those controls designed to reduce/prevent the risk of fraud and misconduct from occurring in the first instance;
- ▶ **Detection:** includes those strategies/controls designed to discover as soon as possible fraud and misconduct when it occurs;
- ▶ **Response:** respond appropriately to a fraud when it is detected and take corrective action and remedy the harm caused by fraud or misconduct
- ▶ **Monitoring:** provide information that demonstrate compliance with fraud control strategy or raise alerts





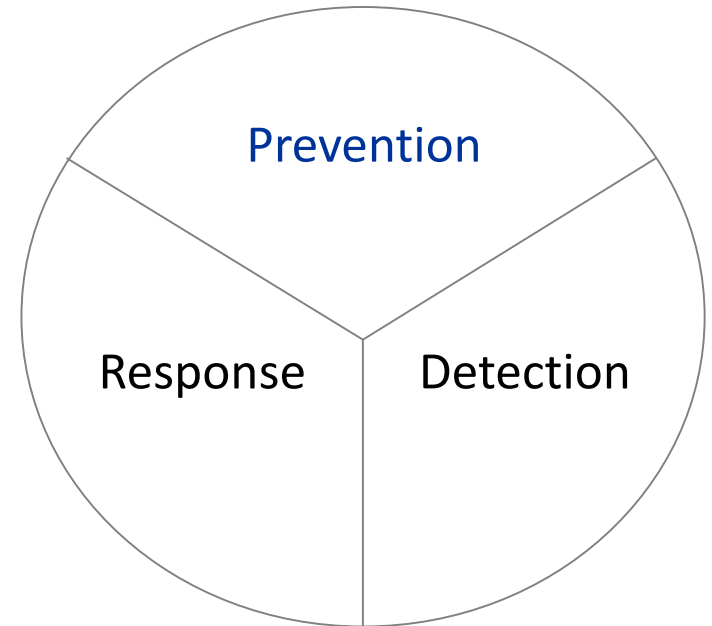
# The Key Mechanisms: Prevention

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## ▶ Prevention

- ▶ Code of conduct and related standards;
- ▶ Policies, Procedures and Process-specific fraud risk controls;
- ▶ Communication and training;
- ▶ Fraud risk assessment;
- ▶ Third-party due diligence.





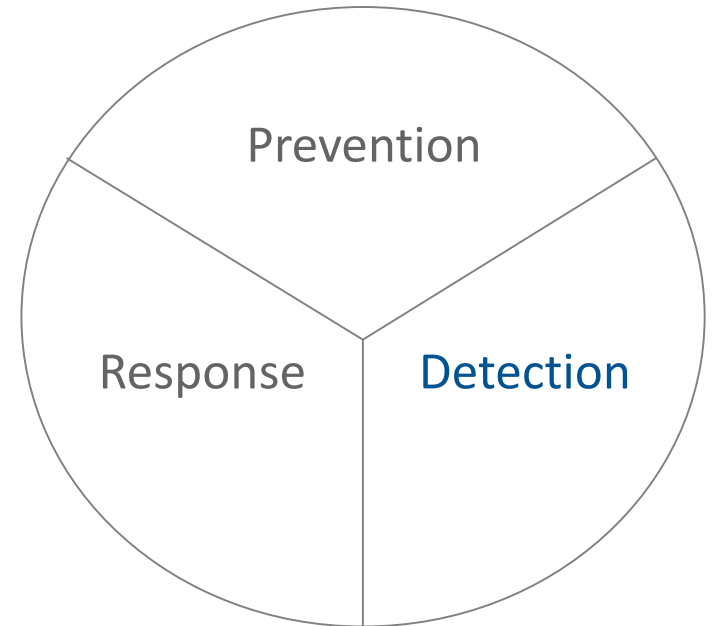
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# The Key Mechanisms: Detection

## ▶ Detection

- ▶ Fraud risk assessment;
- ▶ Hotlines and whistle-blower mechanism;
- ▶ Auditing and monitoring;
- ▶ E discovery;
- ▶ Forensic data analysis.





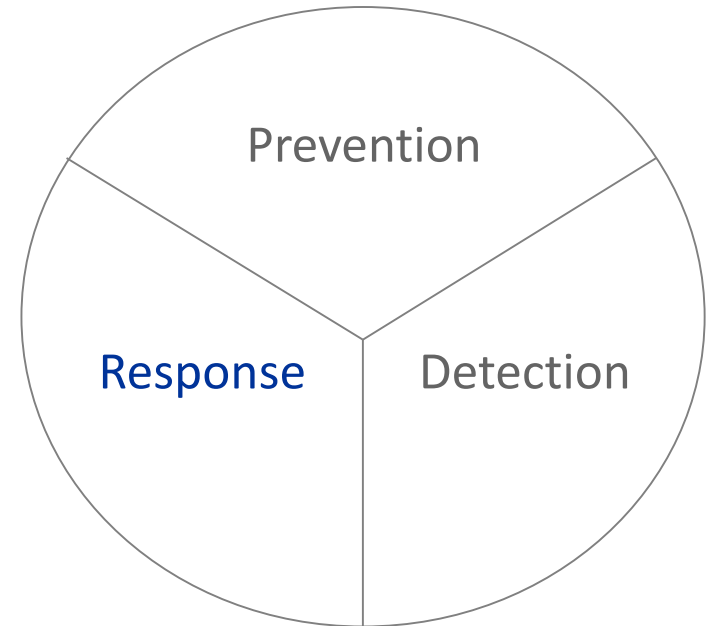
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# The Key Mechanisms: Response

## ▶ Response

- ▶ Internal investigation protocols;
- ▶ Enforcement and accountability protocols;
- ▶ Disclosure protocols;
- ▶ Remedial action protocols.





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# Managing fraud risk through awareness



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# Creating a culture of compliance

## Why it is so important in managing fraud

- ▶ People make decisions daily that impact the company's ethics and compliance posture
- ▶ Compliance and integrity management are used to augment a sustainable ethical culture in the organization
- ▶ Critical success factors are:
  - ▶ Business integrity
  - ▶ Leadership
  - ▶ Culture
- ▶ An ethical decision making model as well as the policies and procedures adopted can guide employees when the «right» code of conduct or action may not be clear





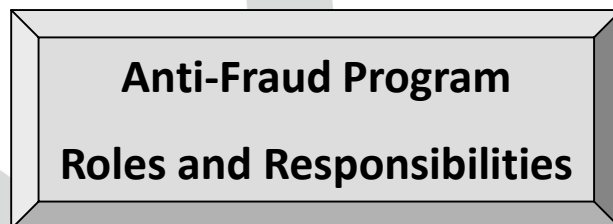


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# Managing fraud involves several key groups within PA

## Director:

- ▶ Setting the proper tone
- ▶ Ensure management designs effective fraud risk management policies
- ▶ Establish mechanisms to ensure it receives accurate and timely information
- ▶ Monitor the effectiveness of the Anti-Fraud program

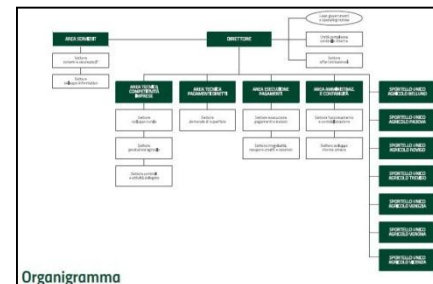


## Internal Audit:

- ▶ Ensures fraud prevention and detection controls are sufficient for identified risks
- ▶ Responsible for investigating suspected instances of fraud
- ▶ Active role in the risk assessment process
- ▶ Monitors fraud risks via internal auditing
- ▶ Direct reporting channel for external audit

## Area Manager:

- ▶ Responsible for design, implementation and day-to-day execution of the Anti-Fraud program
  - ▶ Setting the proper tone
  - ▶ Reactive
  - ▶ Proactive
- ▶ Reinforces setting the proper tone at the top
- ▶ Helps to create a culture of zero fraud tolerance



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# Code of conduct regarding fraud

A Code of conduct is one of the most important communication vehicle that PAs could use to communicate employees on key standard that define ethical conduct. A code of conduct regarding fraud should be:

- ▶ recognized as mutual commitment among the stakeholders
- ▶ periodically refreshed to reflect PA's risks
- ▶ specifically addressed to fraud

In addition,

- ▶ it's simple, concise and can be easily understood by all the employees
- ▶ its effectiveness is measured and reported
- ▶ it actively encourages employees to «speak up»





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# Policies, procedures, processes and controls for fraud prevention and detection

- ▶ An internal control system comprises all those policies and procedures that, taken together, support an organization's effective and efficient fraud prevention and detection activity.
- ▶ Policies and procedures in order to minimise fraud should be a guidance for identified fraud areas/risks and the controls stated should address fraud red flags, as:
  - Unexplained favourable treatment of an applicant by a programme (project) employee over a period of time.
  - Same evaluators for same applicants over a period of time;
  - Repeated contracts with the same applicants;
  - Requests for amendments soon after grant agreement signed;
  - Apparent connections between bidders (e.g. common addresses, phone numbers, ...)
  - Bids for particular items appear to be unreasonably low.





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# Fraud awareness training and communication

- ▶ In conclusion, a sound ethical culture and an effective system of internal control are essential elements of an anti-fraud strategy.
- ▶ Effective internal controls reduce exposure to financial risks and ‘contribute to the safeguarding of assets, including the prevention and detection of fraud’.
- ▶ However, a sound system of internal control cannot provide complete protection against all fraudulent behavior, highlighting the importance of other fraud prevention and fraud detection measures.





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# Fraud awareness training and communication

- ▶ It is important to raise awareness through a formal education and training program as part of the overall risk management strategy.
- ▶ It is essential that all employees are made aware of what constitutes fraud, how to identify fraudulent behaviour, and how to respond if they suspect or detect instances of fraud.
- ▶ Employees may be periodically educated through a number of mediums, such as formal training sessions, group meetings, posters, employee newsletters, payroll bulletins or awareness pages on internal websites on ethics including information on roles and responsibilities regarding ethical conduct such as whistleblowing.
- ▶ Communication should be ongoing and a combination of methods is usually most successful.





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# Fraud Risk Assessment



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# Why conduct a Fraud Risk Assessment

## The EU guidance

- ▶ *“DG Justice recognizes importance of risk assessment in effective fraud prevention and detection. The DG Justice internal guide on risk assessment puts emphasis on areas that could be affected by financial or non financial fraud or irregularities as areas of potential risks”*
- ▶ Based on the EU Guidance the methodology for fraud risk assessment has five main steps:
  1. Quantify the likelihood and impact of the specific fraud risk (gross risk)
  2. Assess the effectiveness of the current controls in place to mitigate the fraud risk
  3. Assess the net risk after taking into account the effect of the current controls and their effectiveness (residual risk)
  4. Assess the effect of planned additional controls on the net (residual) risk
  5. Define the target risk, i.e. the risk level which the managing authorities consider tolerable.





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# Why conduct a Fraud Risk Assessment

- ▶ Management is ultimately responsible for detecting and preventing fraud within the organization. Conducting a fraud risk assessment is an indicator of management taking proactive steps to manage fraud risk.
- ▶ An independent assessment of the company's anti-fraud program provides valuable information to enhance the management of fraud risk.





# Conduct the fraud risk assessment: confirm goals and schedule

Plan

Assess

Respond

Report

- ▶ Collect and review information pertaining to the Company that may be of assistance as we prepare to conduct the fraud risk assessment.
- ▶ Assemble the proper team and conduct a scoping meeting.
- ▶ Understand the fraud risk universe.





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# Conduct the fraud risk assessment: Understand organization risks

Plan

Assess

Respond

Report

Understand the types of risks present:

**Inherent risk** – Present regardless of management's actions, based on the nature of the business.

**Residual risk** – Remaining risk after management's actions, contingent upon what controls are in place

The ultimate goal of the Fraud Risk Assessment is to determine the residual risk present in the organization.

**However, during the planning stage, all risks should be considered**





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# Conduct the fraud risk assessment: Assess current state of fraud risks

Plan

Assess

Respond

Report

- ▶ Conduct interviews of key officer from the relevant areas within the Company to gain the necessary background information to assist in documenting the Company's fraud risk areas and the existing anti-fraud program(s).
- ▶ Review and compile results from the interviews.
- ▶ Identify and prioritize of the relevant fraud risks and develop a fraud risk "map".
- ▶ Perform "gap analysis": identify controls that are currently in place to mitigate fraud risk that have been identified.





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# Conduct the fraud risk assessment: Understand risk impact

Plan

Assess

Respond

Report

- During the assessment phase, the team should make an effort to understand the potential impact to the organization posed by each risk

Dollar impact of risk = \$10,000,000

Likelihood of occurrence = 20%

Potential impact = \$10,000,000 x 20% = \$2,000,000

- Also consider the non-financial impacts of fraud risks as:
  - Reputational
  - Legal
  - Regulatory





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# Conduct the fraud risk assessment: Assess effectiveness of controls

Plan

Assess

Respond

Report

- Each risk should be mapped to its corresponding controls
- For key risks, the controls can be tested, through sample testing
- The team will assess whether the controls seem to be functioning as intended

**Control** – All employee expense reports must be approved by manager

**Test** – Select a sample of expense reports and look for evidence of approval

**Result** – If a significant percentage of the sample lacked approval, the control may not be functioning properly





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# Conduct the fraud risk assessment: Determine management response

Plan

Assess

Respond

Report

Management will decide on the organizational response to the residual risks identified:

- **Avoid** – Management can avoid a risk by stopping the underlying activity all together.
- **Transfer** – Management can transfer a risk by moving the potential impact elsewhere.
- **Mitigate** – Management can mitigate a risk by adding additional controls which will reduce the residual risk to an acceptable level.
- **Assume** – Management can assume a risk by determining that the currently present residual risk is already at an acceptable level when considered against the cost of additional controls.





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# Conduct the fraud risk assessment: Determine management response

Plan

Assess

Respond

Report

- The fraud response plan will deliver a coordinated fraud response
- Conduct transaction testing and targeted data analytics on identified fraud risks and corresponding controls to assess the effectiveness and sensitivity of these controls to mitigate the risks
- Re determinate the level of fraud risk and assign priority rating to each risk identified.



# Conduct the fraud risk assessment: Report results

Plan

Assess

Respond

Report

- The Report should summarize findings identified during the fraud risk assessment including a list of observations and potential recommendations for next steps that could be used to assist management in addressing fraud risks identified.
- The results of the fraud risk assessment should be present during a meeting.
- Periodically, key risks from the assessment should be revisited, with key controls continuously monitored







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# Anti-fraud control activities and monitoring

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# The use of fraud risk based approach verifying the projects

All of the tools covered so far have their uses in identifying the irregularities and frauds, but, to be effective, they must be combined with a methodical approach to the analysis of the irregularities and fraud identified in order to:

- Build an overall better defense against error and fraud
- Maximizing limited resources and multiplicity of operations and systems,
- Promote the use of a risk based approach in the verifications of the projects (focus on most risky projects)
- Complement the risk assessment with regard to fraud alerts and irregularities
- Identify continuously possible irregular circumstances on the basis of predefined risk criteria
- Identify predefined specific fraud indicators





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# The continuous monitoring on the basis of predefined fraud indicators

- Monitoring utilize forensic data analytics and fraud dashboard;
- Monitoring reports should be used to improve the anti fraud management strategy;
- Businesses are dynamic and the controls that are in place will need to be monitored to assess whether or not they are succeeding in their objectives. The risk management group should be empowered to monitor the effectiveness of the actions being taken in each specific area, as these can be affected by internal and external factors;
  - In each instance where fraud is detected, PAs should reassess the adequacy of the internal control environment and consider whether improvements are required;
  - The chosen strategy may require the implementation of new controls or the modification of existing controls.

