



Fraud Risk Awareness for First Nations

   September 2018





Agenda

1. Objective for this Session – Why Fraud Awareness
2. Introduction to Fraud
3. Fraud in Government Organizations
4. Common Fraud Schemes
5. Fraud Risk Management
6. Examples of Cases
7. Questions



Objective for this session

To increase:

Awareness of the risk for fraud

Understanding fraud, its prevention and detection

- Being proactive, watching for red flags
- Putting in place strong internal controls
- Understanding how the Department can help
- Knowing who and when to seek support from and/or report concerns to



Fraud Awareness: Why?

- Every organization is susceptible to fraud
- Personnel at all levels of an organization (leadership, administration and programs) have responsibility for dealing with fraud risk
 - Fraud should be detected by personnel in the normal course of performing their duties, if strong controls exist
- We can't stop fraud but we can mitigate the risk of fraud
 - Can't manage or mitigate something you don't understand
 - Awareness and understanding is the first step



What is Fraud?

- Many definitions, most common elements:
 - Intentional act or omission
 - Designed to deceive (a deception or misrepresentation)
 - Results in loss to the victim and/or a gain to the perpetrator
- Treasury Board Secretariat Directive on Loss of Money or Property:
 - “A criminal deception involving the use of false representation with the specific intent of gaining an unfair or dishonest advantage. Fraud ordinarily involves either wilful misrepresentation or deliberate concealment of material facts for the purpose of inducing another person to either part with cash or something else of value or to surrender a legal right.”



Fraud vs Misconduct or Misuse of Funds

Misconduct: Conduct causing a loss

- The act or omission causing a loss to his or her employer
- Designed to deceive (a deception or misrepresentation)
- Results in loss to the victim and/or a gain to the perpetrator

Intent

- The conduct must have been wilful or at least of a careless or negligent nature that one could say the employee wilfully disregarded the effects of his or her actions would have on job performance

Misuse of funds

- Using funds for purposes outside of those approved by the grantor. This can happen both intentionally, such as in the case of grant fraud, or unintentionally, through misuse of grant funds.



The Fraud Triangle

Lack of effective oversight
Weak controls

Poor corporate governance
Lack of segregation of duties

“Others do it and no one seems to care”

“I’ll never get caught”

“They can afford it”

“I am just borrowing the money, I will pay it back later”



Family pressures

Revenge

Debts/financial pressure

“Results at any cost”



SUMMARY

Although there is little you can do about someone's motivation or rationalization, you can reduce opportunities.



Different Categories of Fraud

- Many reasons why
- Many potential perpetrators (employees, management, partners, service providers, consultants, contractors, sub-contractors, other govt officials)

Fraud schemes generally fall into three categories:

1. Asset misappropriation

- expense report/credit card fraud
- fictitious vendors
- fictitious payroll
- other

2. Corruption

- bribes
- kickbacks
- conflict of interest
- collusion

3. Financial statement manipulation

- overstated revenues/assets, understated expenses/liabilities
- improper internal reporting of results



Impact of Fraud

- Impacts of fraud can be significant and severe
 - Puts ability of organization (or recipient) at risk of being unable to continue to provide service/carry on operations
 - Damages reputation and credibility of the First Nation, management, partners, the Department, the Minister and employee morale
 - Higher than required costs for the project(s) in question, wasted resources, ineffective use of funds, project delays
 - Puts health and safety and/or quality of life of stakeholders at risk
 - Additional resource drain and financial loss from investigation, litigation

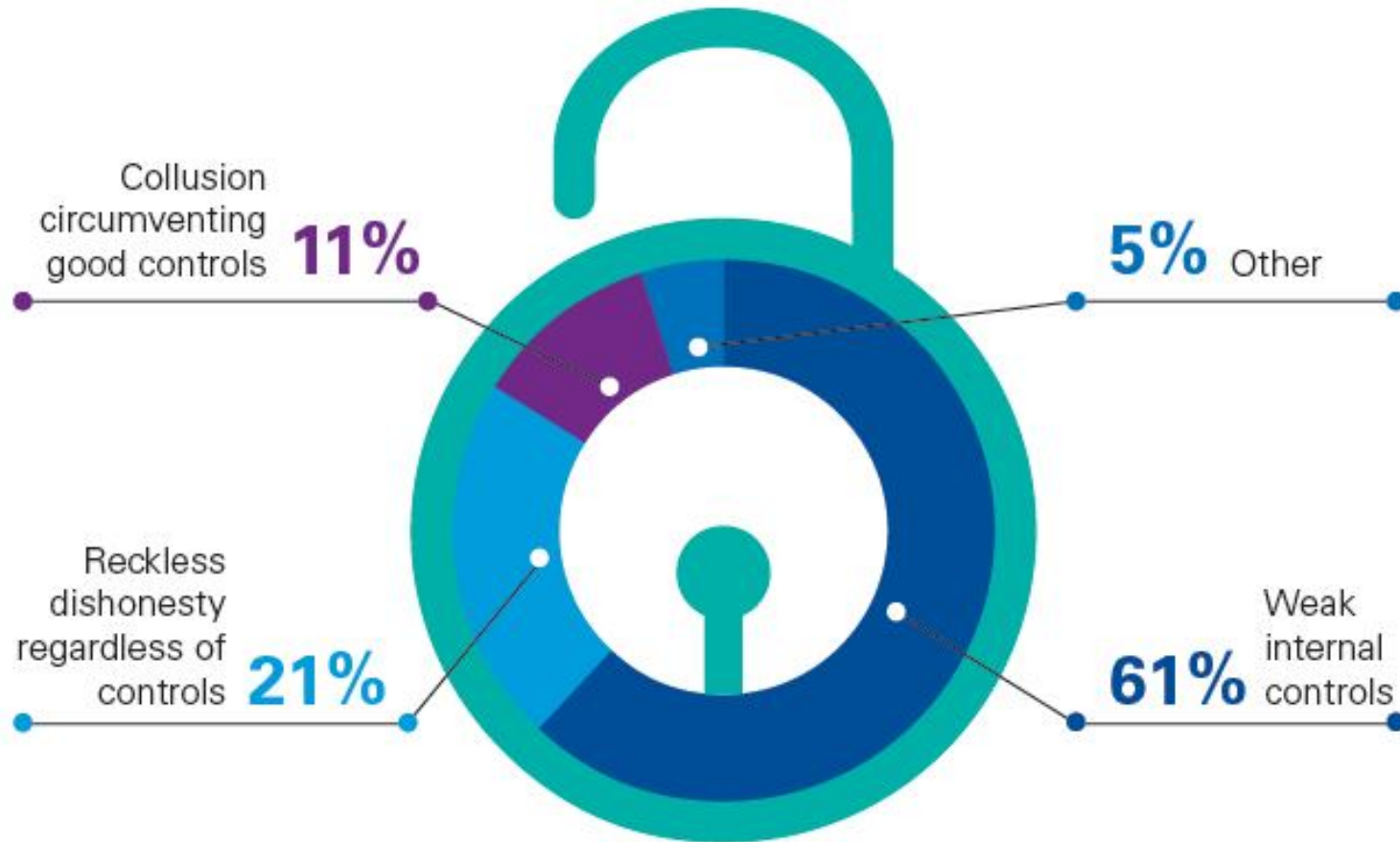


Reputational Issues

- Reputational issues can arise during and following a fraud incident.
- The financial impact of reputation can surpass the impacts of the fraud incident itself.
- Reacting to these issues appropriately is critical to minimize potential damage.
- Impacts on reputation can affect the organization, management, employees and the community you serve.



Factors contributing to the facilitation of fraud



Source: "Global Profiles of the Fraudster", KPMG International, 2016



Fraud Risk Management – What is it?

Includes setting policies, implementing process and controls, and monitoring to ensure programs and controls are effective.

Managing fraud risk is like managing any other risk. You need to:

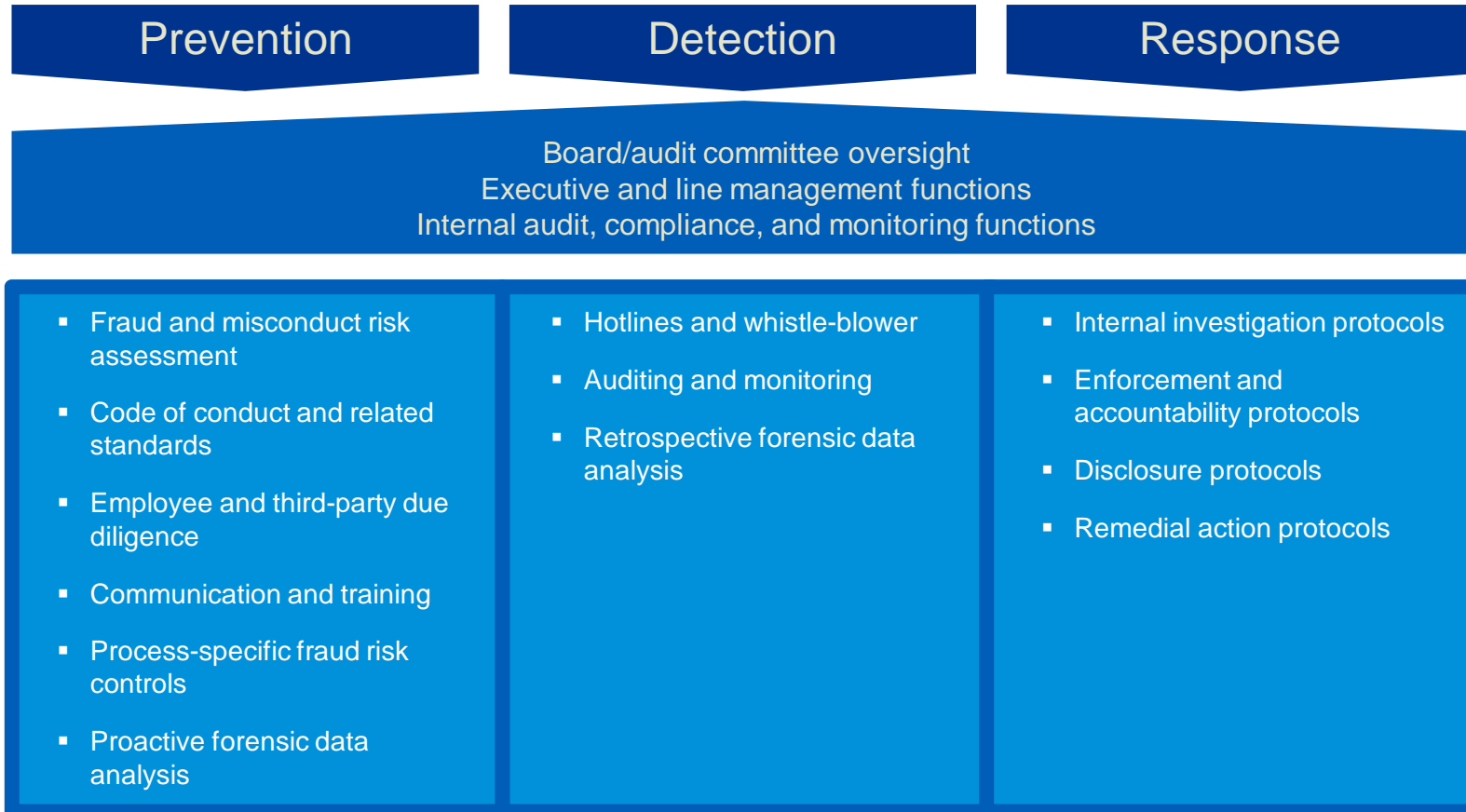
- Understand the risk you are trying to manage
- Understand why the risk occurs
- Understand your environment
- Understand your specific business

A Fraud Risk Management program is a key component of:

- A well designed and comprehensive compliance program
- Overall governance and risk management frameworks



Elements of Fraud Risk Management





Anti-fraud Controls Have an Impact

Control	Percent of Cases	Control in Place	Control Not in Place	Percent Reduction
Proactive Data Monitoring/Analysis	36.7%	\$92,000	\$200,000	54.0%
Management Review	64.7%	\$100,000	\$200,000	50.0%
Hotline	60.1%	\$100,000	\$200,000	50.0%
Management Certification of Financial Statements	71.9%	\$104,000	\$205,000	49.3%
Surprise Audits	37.8%	\$100,000	\$195,000	48.7%
Dedicated Fraud Department, Function, or Team	41.2%	\$100,000	\$192,000	47.9%
Job Rotation/Mandatory Vacation	19.4%	\$89,000	\$170,000	47.6%
External Audit of Internal Controls over Financial Reporting	67.6%	\$105,000	\$200,000	47.5%
Fraud Training for Managers/Executives	51.3%	\$100,000	\$190,000	47.4%
Fraud Training for Employees	51.6%	\$100,000	\$188,000	46.8%
Formal Fraud Risk Assessments	39.3%	\$100,000	\$187,000	46.5%
Employee Support Programs	56.1%	\$100,000	\$183,000	45.4%
Anti-Fraud Policy	49.6%	\$100,000	\$175,000	42.9%
Internal Audit Department	73.7%	\$123,000	\$215,000	42.8%
Code of Conduct	81.1%	\$120,000	\$200,000	40.0%
Rewards for Whistleblowers	12.1%	\$100,000	\$163,000	38.7%
Independent Audit Committee	62.5%	\$114,000	\$180,000	36.7%
External Audit of Financial Statements	81.7%	\$150,000	\$175,000	14.3%

Source: Association of Certified Fraud Examiners – 2016 Report to the Nations on Occupational Fraud and Abuse.



The People Factor

Hiring good people does not eliminate risk.

Why?

- Because people and circumstances change

Examples:

- Financial changes – spouse laid off
- Gambling or drug addictions
- Family and other pressures
- Results-based compensation



Some “Red-flags”

Living Beyond Means	45.8%
Financial Difficulties	30.0%
Unusually Close Association with Vendor/Customer	20.1%
Control Issues, Unwillingness to Share Duties	15.3%
“Wheeler-Dealer” Attitude	15.3%
Divorce/Family Problems	13.4%
Irritability, Suspiciousness or Defensiveness	12.3%
Addiction Problems	10.0%
Complained About Inadequate Pay	9.0%

Source: Association of Certified Fraud Examiners – 2016 Report to the Nations on Occupational Fraud and Abuse.



Common Fraud Schemes

	Internal	External
Traditional	<ul style="list-style-type: none">Expense report fraudMisappropriation of physical assetsMisappropriation of cashFictitious vendor/COI	<ul style="list-style-type: none">Over billing by supplierSubstandard productUnder reported royalties
Collusion		
Technology Assisted	<ul style="list-style-type: none">Theft of proprietary informationBreach of privacy / confidentiality“Ghosts” on the payroll	<ul style="list-style-type: none">Executive impersonationPhishing schemesCredit card data theftIdentity theftMalware / Ransomware



Fraud in the Public Sector

- The Public Sector is currently the third most represented sector among the fraud cases analyzed by the Association of Certified Fraud Examiners in their *2018 Global Fraud Survey*.
- The Sector was in second position in the 2016 survey.

Source: Association of Certified Fraud Examiners – 2018 Report to the Nations on Occupational Fraud and Abuse.

FIG. 15 How does occupational fraud affect organizations in different industries?



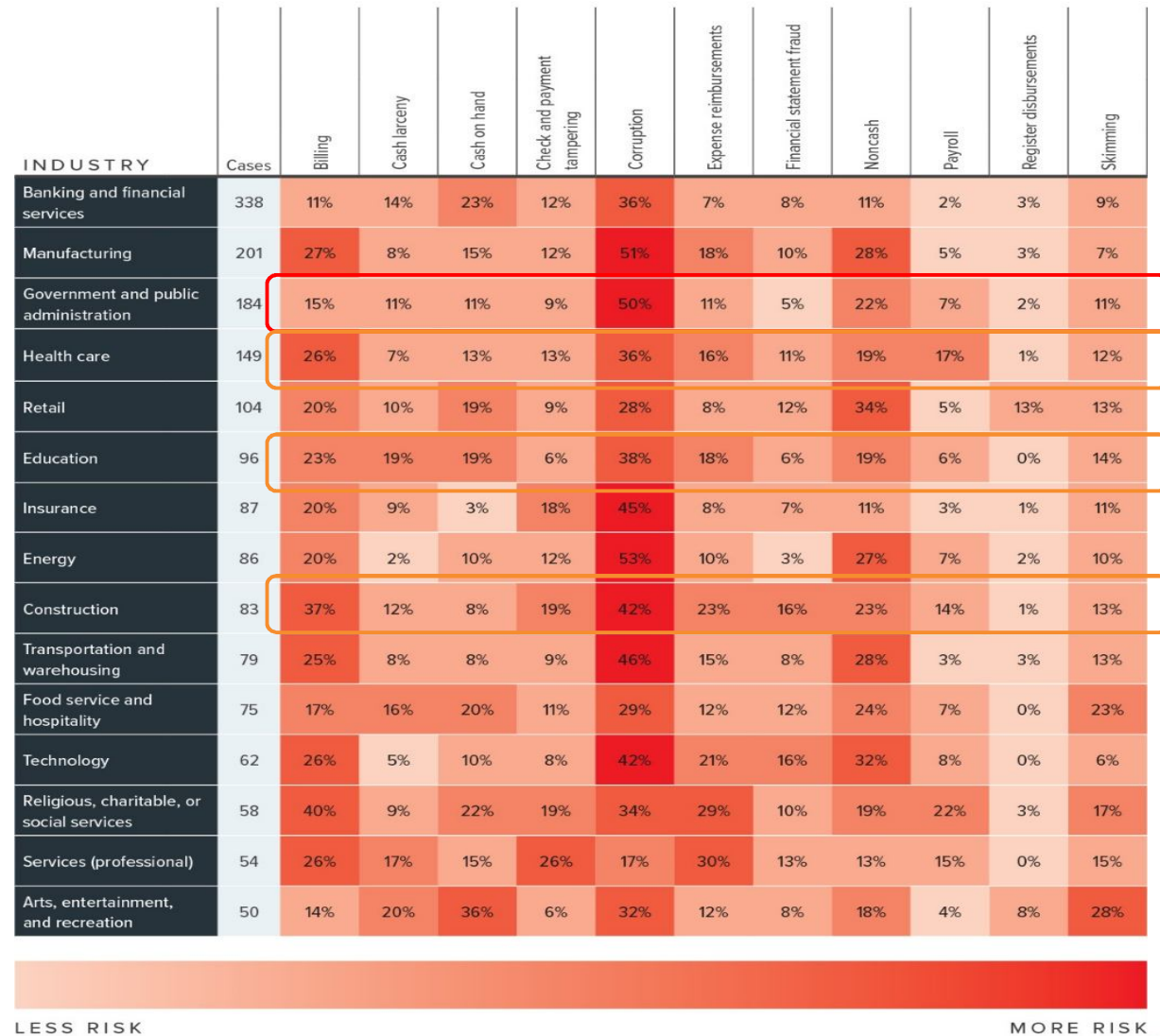


Fraud in the Public Sector

FIG. 16 What are the most common occupational fraud schemes in various industries?

Most Common:

- Corruption
- Non cash
- Billing



Source: Association of Certified Fraud Examiners – 2018 Report to the Nations on Occupational Fraud and Abuse.



Fraud in the Public Sector

Most Common Fraud Scheme Methods

	%
Corruption	50
Non-Cash	22
Billing	15
Skimming	11
Expense Reimbursement	11
Cash on Hand	11
Payroll	7

Source: Association of Certified Fraud Examiners – *2018 Report to the Nations on Occupational Fraud and Abuse.*



Red Flags

- A symptom of fraud, a warning that something *might be* or is wrong
 - Something odd or just not right
 - Might be fraud, might be an error (due to workload, carelessness, lack of training, etc)
 - Indicates the need for further consideration, further questions and perhaps further action
- Red flags are an important aspect of detection (or prevention if recognized early enough)
 - Employees and management need to be aware of red flags in order to monitor the situation and then take corrective action as needed



Expense Reimbursement Fraud

Examples

- Claiming personal expenses (e.g. purchase of supplies for personal use or mileage)
- Overstating legitimate expenses (e.g. duplicate claims for expenses)
- Claiming fictitious expenses (e.g. fictitious receipt for taxi)
- Cash advances for travel not reconciled with expense receipts



Expense Reimbursement Fraud

Red Flags

- Unexplained increase in number and/or frequency of claims when compared to history
- Budget / Peers
- Trend of missing or incomplete support for expenditures
- Lack of / or incomplete originals of supporting documentation
- Receipts with sequential receipt numbers
- Claims out of sequence / time lag
- Unusual invoices or receipts
- Frequent use of personal credit card rather than employer issued card



Expense Reimbursement Fraud

Key Controls

- Clearly defined, consistently applied and well communicated policies
- Thorough review of expenses by knowledgeable individuals
- Periodic review or monitoring of expense claims by third party (e.g. internal audit or other)
- Periodic trend analysis where practical



Corruption

Examples

- Kickbacks paid to employee for directing business to a supplier
- Conflict of interest



Corruption

Red Flags

- Close or familial relationships with vendors
- Use of sole-source vendor without valid explanation
- Vendors and employees with matching addresses and/or bank account information
- Unmatched / missing documents (e.g. receiving reports, purchase orders, vendors invoices)
- Complaints from other suppliers
- Odd looking documentation (e.g. taxes not charged)
- Significant cost overruns in particular areas



Corruption

Key Controls

- Clearly defined, consistently applied and well communicated policies around tendering of contracts and vendor selection
- Thorough review of supporting documentation before approving payment / signing cheque
- Vendor complaint mechanism
- Periodic review of vendor master data or trend / data analysis
- Thorough management review of costs relative to budget and/or expectation



Construction Fraud Schemes

Examples

- Billing, false invoices, overbilling expenses
- Non-cash, presents, travel and entertainment
- Cheque tampering, falsification of numbers, forgery
- Cash transactions
- Retaining payment from sub-contractors and material suppliers
- Billing for unperformed work
- Diverting purchases and stealing equipment/tools
- Diverting lump-sum cost to time and material (change orders)
- Substituting inferior material or removing material
- Subcontractor collusion
- False representation of quality or completion for billing



Fraud Example, Red Flags and Prevention

- **Fraud Example:** An individual is in collusion with a supplier (voluntary or coerced) to approve invoices for phony services or goods, inflated prices, substitution of inferior materials
- **Example Red Flags:**
 - Approval of vaguely defined contracts
 - Insistence on involvement in decision making even if not their specific area
 - Secretive, withholding of information, lack of documentation
 - Frequent change orders
 - Avoidance of site visits
 - Personal connections, complaints and rumours from other stakeholders
- **Example Internal controls that could prevent (and or detect)**
 - Clearly articulated scope, materials, contract, etc.
 - Segregation of duties
 - Vendor approval process
 - On site inspections, monitoring
 - Completion certifications, third party certifications
 - Project steering committee
 - Fraud hot line (allegations and complaints national line), well known complaints/tips mechanism



Fraud Example, Red Flags and Prevention

- **Fraud Example:** An individual is receiving bribes for ensuring approval of a contract, an application or certification
- **Example Red Flags:**
 - Unjustified/unnecessary quick timeline for approval
 - Insisting on involvement, control
 - Surrounds self with inexperienced/under qualified colleagues
 - Personal relationship with company
 - Approved even though the study/report is vague or incomplete
 - “Accidentally” missed approvals
 - Unexplained exclusion of key knowledgeable players
 - Living beyond means
- **Example Internal controls that could prevent (and or detect)**
 - Segregation of duties, clearly defined authority, roles and responsibilities
 - Standard requirements for studies, formal approval process
 - Sufficient time and resources to review, challenge and approve
 - Formal process for exceptions/exemptions



Fraud Examples, Red Flags and Prevention

- **Fraud Example:** An individual is receiving a “commission” or bribe to approve inflated scope/padded projects
- **Example Red Flags:**
 - Expensive lifestyle of an individual, living beyond their means
 - Lack of involvement of qualified technical persons/firms in key steps
 - Exclusion of readily available in-house technical experts
 - A “fast-track” or emergency need
 - Huge variation in quotes received for project
- **Example Internal controls that could prevent (and or detect)**
 - Project steering committee involvement
 - Insistence on involvement of technical experts in review and challenge
 - Additional oversight where “fast track” approval is required
 - On-site inspections
 - Approval gates from feasibility through to end
 - Segregation of duties



Fraud Examples, Red Flags and Prevention

- **Fraud Example:** An individual offers bribes to third party experts to issue false reports or certifications
- **Example Red Flags:**
 - Reports or certifications are vague, not in usual format, unsigned or undated, “heavy” on scope restrictions
 - Third party officer/entity is unknown, or has history of “issues”
 - Requests for second opinion refused
 - Attempts to limit circulation and sharing of the report
- **Example Internal controls that could prevent (and or detect)**
 - Segregation of duties, clearly defined authority and roles and responsibilities
 - Standard requirement for studies, formal approval process
 - Well trained officers
 - Sufficient time and resources to review, challenge and approve



Fraud Response

- Actions that respond to suspicions of or actual fraud (ie. reporting, assessing, investigating and, as applicable, applying sanctions and penalties and/referring to policing agencies)
 - A consistent approach to responding to fraud is a key component of an organization’s entity level controls or “tone at the top”
- Assessment and Investigation Services Branch (AISB) in the Audit and Evaluation Sector (AES) is
 - Responsible for assessing and investigating allegations and complaints on behalf of the Department
 - May refer to and work with policing authorities on files that involve criminal activities



Reporting Fraud (or Suspected Fraud)

Allegations and Complaints

- Related to concerns about the use of funding provided by ISC/ CIRNAC regarding First Nation, Inuit and Metis bodies and organizations
- Allegations and complaints should be referred to the National or Regional Allegation and Complaints Coordinator to determine the most appropriate next steps, including referral and discussion with INAC's AISB
- In compliance with the *Access to Information Act* and the *Privacy Act*



Your Role in Mitigating Fraud Risk

- Acknowledge and understand the risk for fraud
- Put in place strong internal controls
- Be aware, maintain a healthy skepticism as you carry out your duties
- Be proactive, watch for red flags
- Exercise your responsibilities and authority consistently and effectively
- Know who and when to seek support and/or report concerns
 - Allegations and Complaints Line (1-855-504-6760); CNAP-NACC@aadnc-aandc.gc.ca
 - Local Policing Authority