GAO’s Fraud Risk Management Framework

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Plan for This Session …

- The Big Picture: Principles, Standards, and Best Practices
- Legislative Framework
- Fraud in Government and Government Programs: How it Differs from Fraud Elsewhere
- GAO’s Fraud Risk Management Framework: Not Just for Federal Agencies

The Big Picture: Principles, Standards, and Best Practices

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The Big Picture: Principles, Standards, and Best Practices

- Private Sector
  - Accounting Principles
  - Auditing Standards
  - Internal Control
  - Fraud Risk Management

- Government
  - Auditing Standards Board
  - Internal Control
  - Fraud Risk Management

Legislative Framework
Legislative framework

- IG Act
- Federal Managers’ Financial Integrity Act of 1982
  - GAO Standards for Internal Control in the Federal Government (Green Book): Adopt the COSO Framework
    - Principle 8: “Management should consider the potential for fraud when identifying, analyzing, and responding to risks.”
    - “A Framework for Managing Fraud Risks in Federal Programs”
  - OMB Circular A-123, Management’s Responsibility for Enterprise Risk Management and Internal Control
    - Adherence with leading practices in GAO’s Fraud Risk Framework
- CFO Act of 1990
- Improper Payments Elimination and Recovery Improvement Act of 2012
- Fraud Reduction and Data Analytics Act of 2015
- Other legislation, such as the False Claims Act

OMB Circular A-123: The link between fraud risk management and ERM

- An integral component of ERM
- Fraud Reduction and Data Analytics Act of 2015: OMB must establish guidelines to identify and assess fraud risks and identify and implement needed controls that incorporate GAO’s Fraud Risk Framework.
- OMB Circular A-123: Managers should “adhere” to the leading practices in GAO’s Fraud Risk Framework
  - Commit to combating fraud by creating an organization culture and structure conducive to fraud risk management
  - Plan regular fraud risk assessments and establish a fraud risk profile
  - Evaluate outcomes using a risk-base approach and adapt activities to improve fraud risk management
  - Design and implement a strategy with specific control activities to mitigate fraud risks and collaborate to help ensure effective implementation

With permission from and thanks to Jeff Steinhoff, Director, KPMG Government Institute

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Fraud in Government and Government Programs: How it Differs from Fraud Elsewhere

Characteristics of Fraud in Government and Government Programs

✓ Blurred lines between fraud, waste, abuse, and mismanagement
Case Study

Who Is This Man?

![Image of Jeff Neely]

Case Study

Waste, Abuse, or Fraud?

- Jeff Neely was GSA regional commissioner and oversaw a lavish $822,000 training conference in Las Vegas in 2010
- The waste and abuse included:
  - $136,000 on pre-conference scouting trips to the Las Vegas hotel
  - $146,000 for catered food
  - $6,300 on commemorative Recovery Act coins housed in velvet boxes
  - $75,000 on a bicycle-building training exercise.

Source: Federal News Radio

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Case Study

Waste, Abuse, or Fraud?

- Neely was indicted in September 2014 on five counts of falsely claiming reimbursement for pleasure trips or airplane tickets that he did not use.
- Neely pleaded guilty to one count of fraud against the government in April 2015.
- Neely was sentenced in June 2015 to 3 months in prison, 3 months under home confinement, and 3 years of probation.
- Neely was ordered to pay $8,000 in restitution, a $2,000 fine, and a $100 special assessment penalty.

Characteristics of Fraud in Government and Government Programs

- Blurred lines between fraud, waste, abuse, and mismanagement.
- “Materiality” has a different meaning to taxpayers and taxpayers don’t really differentiate between fraud, waste, abuse, and mismanagement.
Case Study

Waste, Abuse, or Fraud?

- The $822,000 spent on the training conference in Las Vegas was approximately ~ 0.000024% of the $3,456,000,000,000 federal budget for 2010

Case Study

The GSA “Training” Conference

Motive
Pressure

Rationalization

Opportunity

Fraud

Attitude

Rationalization
Case Study

The GSA “Training” Conference

FRAUD RISK FACTORS/INDICATORS

Characteristics of Fraud in Government and Government Programs

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- Virtually everything is in the public domain
Characteristics of Fraud in Government and Government Programs

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✓ VERY LARGE amounts of money are involved
Improper payments are not necessarily fraudulent... but, they could be

“Improper payments” occur when:
• federal funds go to the wrong recipient,
• the recipient receives the incorrect amount of funds (either an underpayment or overpayment),
• documentation is not available to support a payment, or,
• the recipient uses federal funds in an improper manner.
Characteristics of Fraud in Government and Government Programs

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✓ VERY LARGE amounts of money are involved
✓ Program objectives are often in conflict with strong/strict accountability

Program objectives not always consistent with strict accountability

Example
• The objective of disaster relieve programs is to alleviate the impact of disasters quickly
• Requiring checks, balances, thorough documentation (i.e., prevention controls) would interfere with achieving that objective
• Detective controls are more appropriate, but chasing fraudulent benefits paid is very difficult and expensive
Characteristics of Fraud in Government and Government Programs

- Governments do not always have the best accounting systems and capabilities

Case Study

The Errant EFT

- Black on Black Crime, Inc., was founded in 1972 to deal with crime and civil rights issues in Cleveland
- In 1997, BBCI found itself on the wrong side of the crime issue
Case Study

The Errant EFT

On March 31, 1997, a City of Cleveland clerk wired $617,596.99 to EFT account number 968-112-417-9436, the account (she thought) for Cinergy Services, Inc., one of the City’s utility providers.

Cinergy’s account number, however, is 968-112-147-9436.

Account number 968-112-417-9436 belongs to BBCI; the money appeared in the account on April 1, 1997 (April Fool’s Day).
Case Study

The Errant EFT

- Cleveland was “a bit” behind in doing account reconciliations, so the erroneous transfer was not discovered until almost 5 months later, in August 1997; and it took 5 more weeks to figure out where the money had ended up
- The errant money had only been missing for 6 months; surely, it shouldn’t be too difficult to get it back

In any event, by September 1997, the money was gone
- President McKoy, Chairman Hasan, members Eric Norvell and Derek Washington and BBCI were indicted on October 30, 1997 on one grand theft felony count each
- Norvell plead guilty to a misdemeanor charge of accepting stolen money
- McKoy, Hasan, and Washington went to trial
Case Study

The Errant EFT

- The 12-member jury found McKoy, Hasan, Washington, and BBCI guilty on April 23, 1998
- The jury concluded that “McKoy and [his] fellow Black on Black officials knew that a fortune they discovered in their bank account last year belonged to the City of Cleveland and used deception to keep control of it.”

Case Study

The Errant EFT

- Although evidence at trial showed that Art McKoy did not receive or benefit from any of the money personally, on May 21, 1998, he was sentenced to 2 years in prison
- Chairman Hasan was sentenced to 3 years in prison
- Washington’s sentencing was postponed pending a psychiatric evaluation; he was later sentenced to 3 years in prison
- BBCI was fined $10,000
Case Study

The Errant EFT

- Art McKoy was released from prison on May 18, 2000, and has resumed his leadership role with BBCI
- He now claims that he does not believe that the wire transfer was a mistake
- The City has recovered less than $400,000 of the $617,596.99

Case Study

The Errant EFT

**OPPORTUNITY**

**FRAUD**

**MOTIVE**

**PRESSURE**

**ATTITUDE**

**RATIONALIZATION**

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Case Study

The Errant EFT

FRAUD RISK FACTORS/INDICATORS

Characteristics of Fraud in Government and Government Programs

✓ Governments do not always have the best accounting systems and capabilities
✓ Government accounting principles, laws, rules, and regulations create opportunities for fraud
Case Study

Mr. Travel Voucher

Case Study

William John Burns

- Supervisor of USAID’s Fiscal Services Office
- FSO was part of USAID’s Office of Financial Management, Washington Accounting Operations Division
- FSO disbursed about $74 million per year of USAID’s $6.5 billion budget
- FSO disbursed about $4 million per year for travel expense reimbursements

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Case Study

William John Burns

- USAID bureau chiefs authorized obligations for travel expenses
- They tended to estimate high when deciding how much to obligate
  - This allowed them to avoid having to add to an obligation; and also tended to ‘support’ future year budget requests
- Bureau chiefs were usually careful to de-obligate and reprogram unspent funds in the current year

Case Study

William John Burns

- But, obligated amounts were often spent in subsequent years rather than in the current year
- De-obligated prior-year money reverts to the US Treasury and cannot be reprogrammed for agency use; hence, bureau chiefs did not track it or care about it
- FSO’s top priority was de-obligating current-year funds
Case Study

William John Burns

- Burns began his crime spree in 1982; it ended in 1988; he stole more than $1.2 million
- Burns took upon himself the accounting chore no one else wanted--reconciling prior year unliquidated obligations
- Burns established a false identity--Vincent Kauffman--and diverted unexpended travel money to ‘Kauffman’s’ bank account

Case Study

William John Burns

- Burns’ salary at the time of his arrest was $35,108 per year
- He lived in a 3-garage, $335,000 home and had 5 expensive cars
- He had attended 3 Super Bowls
- He told a neighbor that his hobby was “shopping for major appliances”
- He told co-workers that he inherited money when his mother died in 1982
Case Study

William John Burns

- Burns plead guilty to embezzlement, fraud, and evading taxes on August 11, 1988
- He forfeited nearly all of his assets and agreed to repay the balance of his estimated $1.2 million theft
- On October 11, 1988, Burns was sentenced to 6 years in prison

Case Study

Mr. Travel Voucher

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FRAUD RISK FACTORS/INDICATORS

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✓ Power corrupts
Case Study

Ripped from the Headlines

The Washington Post

Ethics law addresses ‘Dernoga money’ in Prince George’s

By Ovetta Wiggins, Thursday, April 21, 7:27 PM

Case Study

Dernoga Money

• Thomas E. Dernoga was a Prince George’s County Council member from 2001 to 2010
Case Study

**Dernoga Money**

- Dernoga chaired the county’s public works committee, responsible for reviewing/approving applications for development projects in the county.
- He routinely asked applicants (in private) to “donate” money for various needs in the county.

Case Study

**Dernoga Money**

- Dernoga “jokingly referred to himself as Robin Hood.”
- “contributions to various groups — which totaled about $1 million during his eight years in office — were Dernoga’s way of getting developers to help improve the communities where they did business, he said.”
- “He said the track at High Point High School was resurfaced with $125,000 he got from a couple of developers, and the bookshelves at the Deerfield Elementary School library were restocked with $20,000 he got from another.”
Dernoga Money

- Dernoga said he “never held up a project because a developer had declined his requests for a donation.”
- He said he “never crossed any ethical or legal boundaries and never used the money for himself.”
- “Dernoga regularly presented checks at back-to-school nights and other programs in his Laurel district. Community and school leaders have called the donations ‘Dernoga money.’”
Case Study

**Dernoga Money From the “Donors’” Perspectives**

- “… representatives for developers … said they think it is inappropriate to be asked for money while seeking approval on a project.”
- “The solicitations came in private, and if the developers raised questions, their projects were delayed, they said.”
- “‘It seemed like by not playing the game, we were suffering,’ said a representative for one developer.”

Case Study

**Classic Rationalizations**

- “If you don’t want to contribute, I’m not going to hold it against your project,” he said. “I’ll treat your project fairly. But don’t come look to me for favors.”
- “Most of the people want a favor. They want more density. They want more parking. They all want something. They seem to think they are entitled. You say you want the county to do you a favor that might be good for the county, but it is also going to make you a lot of money. But are you willing to support local needs?”
Case Study

**Public Corruption?**

- “Public corruption involves a breach of public trust and/or abuse of position by federal, state, or local officials and their private sector accomplices. By broad definition, a government official, whether elected, appointed or hired, may violate federal law when he/she asks, demands, solicits, accepts, or agrees to receive anything of value in return for being influenced in the performance of their official duties.”

-- [http://topics.law.cornell.edu/wex/public_corruption](http://topics.law.cornell.edu/wex/public_corruption)

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Case Study

**Dernoga Money**
Case Study

Dernoga Money

OPPORTUNITY

MOTIVE
PRESSURE

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Dernoga Money

FRAUD RISK FACTORS/INDICATORS
Characteristics of Fraud in Government and Government Programs

✓ Governments do not always have the best accounting systems and capabilities
✓ Government accounting principles, laws, rules, and regulations create opportunities for fraud
✓ Power corrupts

✓ WHAT ELSE ???

Government fraud risk environment

- Fraudsters go where there is money and opportunity
- Broad, diverse, and complex programs and operations
- Interdependencies and stovepipes
- Complex benefit eligibility, with voluminous implementing regulations
- Fraud risk secondary to public policy/program delivery considerations
- Underground economy impact on tax revenues
- Blurred lines between fraud, waste, abuse, and mismanagement
- Impact of technology and cyber risks
- Capacity to perform given fiscal and human capital challenges
- Detection versus prevention
- IG / Justice Department role versus management role
- Culture and accountability
- Low public confidence in performance

With permission from and thanks to Jeff Steinhoff, Director, KPMG Government Institute

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GAO’s Fraud Risk Management Framework: Not Just for Federal Agencies

“While the primary target audience of this study is managers in the U.S. federal government, the practices and concepts described in the Framework may also be applicable to state, local, and foreign government agencies, as well as nonprofit entities that are responsible for fraud risk management.”

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Methodology

- Starting point: Managing the Business Risk of Fraud: A Practical Guide
- Conferred with OIGs, CIGIE, national audit offices of other countries, and antifraud experts
- Conducted focus groups with antifraud experts
- Conducted extensive literature review
- Consulted with the COSO/ACFE Fraud Risk Management Task Force

Nutshell View—Alignment with COSO

Figure 2: The Fraud Risk Management Framework

- Control Environment
- Risk Assessment
- Monitor
- Control Activities
In government, usually the responsibility of another office—e.g., OIG
**Commit (Governance)**

Commit to Combating Fraud by Creating an Organizational Culture and Structure Conducive to Fraud Risk Management

<table>
<thead>
<tr>
<th>Table 1: Leading Practices for Creating a Culture and Structure to Manage Fraud Risks</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1.1 Create an Organizational Culture to Combat Fraud at All Levels of the Agency</strong></td>
</tr>
<tr>
<td>Demonstrate a senior-level commitment to integrity and combating fraud.</td>
</tr>
<tr>
<td>Involve all levels of the agency in setting an anti-fraud tone that permeates the organizational culture.</td>
</tr>
<tr>
<td><strong>1.2 Create a Structure with a Dedicated Entity to Lead Fraud Risk Management Activities</strong></td>
</tr>
<tr>
<td>Designate an entity to design and oversee fraud risk management activities that:</td>
</tr>
<tr>
<td>- understands the program and its operations, as well as the fraud risks and controls throughout the program;</td>
</tr>
<tr>
<td>- has distinct responsibilities and the necessary authority across the program;</td>
</tr>
<tr>
<td>- has a direct reporting line to senior-level managers within the agency, and</td>
</tr>
<tr>
<td>- is located within the agency and not the Office of Inspector General (OIG), so the latter can retain its independence to serve its oversight role.</td>
</tr>
<tr>
<td>In carrying out its role, the anti-fraud entity, among other things</td>
</tr>
<tr>
<td>- serves as the repository of knowledge on fraud risks and controls;</td>
</tr>
<tr>
<td>- manages the fraud risk-assessment process;</td>
</tr>
<tr>
<td>- leads or assists with trainings and other fraud-awareness activities; and</td>
</tr>
<tr>
<td>- coordinates anti-fraud initiatives across the program.</td>
</tr>
</tbody>
</table>

Source: GAO | GAO-15-522SP

For the sake of consistency, we generally refer to programs throughout this audit; however, the practices we discuss can apply to agencies as well. Managers decide whether to carry out each aspect of fraud risk management at the program level or agency level.
Assess (Fraud Risk Assessment)

2. Plan Regular Fraud Risk Assessments and Assess Risks to Determine a Fraud Risk Profile

Table 2: Leading Practices for Planning and Conducting Fraud Risk Assessments

2.1 Plan Regular Fraud Risk Assessments That Are Tailored to the Program

- Tailor the fraud risk assessment to the program.
- Plan to conduct fraud risk assessments at regular intervals and when there are changes to the program or operating environment, as assessing fraud risks in an iterative process.
- Identify specific tools, methods, and sources for gathering information about fraud risks, including data on fraud schemes and trends from reviewing and auditing activities.
- Involve relevant stakeholders in the assessment process, including individuals responsible for the design and implementation of fraud controls.

2.2 Identify and Assess Risks to Determine the Program’s Fraud Risk Profile

- Identify inherent fraud risks affecting the program.
- Assess the likelihood and impact of inherent fraud risks:
  - Involve qualified specialists, such as statisticians and subject-matter experts, to contribute expertise and guidance; and
  - Employing techniques like analyzing statistically valid samples to estimate fraud baselines and frequencies.
- Consider the financial impact of fraud risks, including impact on reputation and compliance with laws, regulations, and standards.
- Determine fraud risk tolerance.
- Examine the suitability of existing fraud controls and prioritize residual fraud risks.
- Document the program’s fraud risk profile.

Risk Matrices (Heat Map)

Figure 3: Example of Two-Dimensional Risk Matrices

- Very low risk tolerance
- Low risk tolerance

Risk Significance: VERY LOW, LOW, MEDIUM, HIGH, VERY HIGH

Risk Tolerance: Within Tolerance, Beyond Tolerance
Winter Seminar
19 January 2017

Assess (Fraud Risk Assessment)

Design & Implement (Control Activities)

1. Develop and Implement a Strategy with Specific Control Activities to Mitigate Assessed Fraud Risks and Collaborate to Help Ensure Effective Implementation

2. Use the fraud risk profile to help decide how to allocate resources to mitigate fraud risks.

3. Design and implement the following control activities to prevent and detect fraud:
   - Identify and assign responsibility for fraud prevention, screening, and responding to fraud, as well as monitoring and evaluation.
   - Establish roles and responsibilities of those involved in fraud risk management activities, such as the fraud entity and external parties responsible for fraud controls, and communicate the roles of the Office of Inspector General (OIG) in investigating potential fraud.
   - Consider the benefits and costs of control activities in addressing identified control risks.
   - Develop controls to enhance the efficiency of fraud risk management activities, as appropriate, including monitoring and evaluations.

4. Develop and implement a plan outlining how the program will respond to identified instances of fraud.

5. Establish mechanisms with stakeholders and create incentives to help ensure effective implementation of the antifraud strategy.

6. Communicate with stakeholders, including internal and external stakeholders, including other offices within the agency, federal, state, and local agencies, professional partners, and victims of fraud.

7. Provide guidance and other support and create incentive to help external parties, including contractors, effectively carry out fraud risk management activities.

### Design & Implement (Control Activities)

**Table 4: Key Elements of an Antifraud Strategy**

<table>
<thead>
<tr>
<th>Element</th>
<th>Description</th>
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<tbody>
<tr>
<td>Who is responsible for fraud risk management activities?</td>
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</tr>
<tr>
<td>What is the program doing to manage fraud risks?</td>
<td>Describe the program’s activities for preventing, detecting, and responding to fraud, as well as monitoring and evaluation.*</td>
</tr>
<tr>
<td>When is the program implementing fraud risk management activities?</td>
<td>Create timelines for implementing fraud risk management activities, as appropriate, including monitoring and evaluations.</td>
</tr>
<tr>
<td>Where is the program focusing its fraud risk management activities?</td>
<td>Demonstrate links to the highest internal and external residual fraud risks outlined in the fraud risk profile.</td>
</tr>
<tr>
<td>Why is fraud risk management important?</td>
<td>Communicate the antifraud strategy to employees and other stakeholders, and link antifraud efforts to other risk management activities, if any.</td>
</tr>
</tbody>
</table>

*Source: OIG. | OIG-15-0300P

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### Design & Implement (Control Activities)

**Table 5: Additional Leading Practices for Data-Analytics Activities, Fraud-Awareness Initiatives, Reporting Mechanisms, and Employee-Integrity Activities**

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**Fraud-Awareness Initiatives* | Description                                                                                                                                 |
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**Reporting Mechanisms** | Description                                                                                                                                 |
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**Employee-Integrity Activities** | Description                                                                                                                                 |
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**Company**

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Winter Seminar 19 January 2017

Design & Implement (Control Activities)

- Provide multiple options in addition to hotline for potential reporters of fraud to communicate, such as online systems, e-mail, fax, written format, or face-to-face.
- Ensure individuals outside the agency that may be aware of potential fraud, such as vendors, program beneficiaries, and the public, can report potential fraud.
- Take steps to ensure individuals feel comfortable reporting fraud by providing them with clear guidelines on how to report allegations and establishing procedures that prohibit retaliation for employees who make reports in good faith.
- Promote the existence of reporting mechanisms by reminding employees periodically about reporting mechanisms, and publicizing information on the reporting mechanism externally, such as including information about methods for reporting suspected fraud on the program’s website.
- Take steps such as conducting background checks, to screen employees for integrity issues, including prospective employees and employees in positions of trust or that pose a higher risk of fraud.
- Tolerate the extent of employee screening to the risk level of the position.
- Develop and communicate a standard of conduct that applies to all employees and includes information on:
  - the program’s general expectations of behavior, using specific examples, such as cases of prohibited behavior and situations employees may encounter, and
  - the program’s response to violations of the standard of conduct, such as disciplinary actions and sanctions.

Evaluate & Adapt (Monitor)

4. Evaluate Outcomes Using a Risk-Based Approach and Adapt Activities to Improve Fraud Risk Management

| 4.1 Conduct Risk-Based Monitoring and Evaluate All Components of the Fraud Risk Management Framework |
| Monitor and evaluate the effectiveness of preventive activities, including fraud risk assessments and the fraud risk strategy, as well as controls to detect and prevent fraud. |
| Collect and analyze data, including data from reporting mechanisms and instances of detected fraud, for real-time monitoring of fraud trends and identification of potential risks. |
| Engage a risk-based approach to monitoring by taking into account internal and external factors that can influence the fraud risk environment, such as organizational changes and emerging risks. |
| Engage stakeholders responsible for specific fraud risk management activities in the monitoring and evaluation process. |

| 4.2 Monitor and Evaluate Fraud Risk Management Activities with a Focus on Measuring Outcomes |
| Measure outcomes in addition to outputs of fraud risk management activities. |
| In the absence of sufficiently detailed data, assess how well managers follow recommended “leading practices” for designing fraud risk management activities. |

| 4.3 Adapt Fraud Risk Management Activities and Communicate the Results of Monitoring and Evaluations |
| Use the results of monitoring and evaluations to improve the design and implementation of fraud risk management activities. |
| Use analysis of identified instances of fraud and fraud trends to improve fraud risk management activities, including prioritizing and taking corrective actions, as well as enhancing fraud risk management training. |
| Use results of investigations and prosecutions to enhance fraud prevention and detection. |
| Communicate results of monitoring and evaluations, including corrective actions taken, if any, to relevant stakeholders. |

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Appendices

Appendix I: Objective, Scope, and Methodology
Appendix II: Challenges Related to Measuring Fraud
Appendix III: Examples of Control Activities and Additional Information on Leading Practices for Data Analytics and Fraud-Awareness Initiatives
Appendix IV: Risk Factors for Assessing Improper-Payment Risk
Appendix V: Example of a Fraud Risk Profile
Appendix VI: Endnotes
Appendix VII: GAO Contact and Staff Acknowledgments

GAO’s Fraud Risk Management Framework

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