Updated 2013
COSO Framework –
fraud risk assessments

Fraud Investigation & Dispute Services
In May 2013, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) issued its updated framework for the design, implementation and conduct of systems of internal controls and the assessment of their effectiveness. The new framework takes much of the structure of the original framework issued in 1992 and highlights new areas of focus and concern. COSO has updated the framework to address the numerous changes in business and operating environments, including:

- Expectations for governance oversight
- Globalization of markets and operations
- Changes and greater complexities of business
- Demands and complexities in laws, rules, regulations and standards
- Expectations for competencies and accountabilities
- Use of, and reliance on, evolving technologies
- Expectations relating to preventing and detecting fraud

The 2013 Framework, effective December 15, 2014, places emphasis on fraud risks and compliance and will be the new standard for assessing the effectiveness of internal controls as part of FY14 audits.

### 1992 components vs. 2013 principles

<table>
<thead>
<tr>
<th>1992 components</th>
<th>2013 principles</th>
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<tbody>
<tr>
<td>Control environment</td>
<td>1. Demonstrates commitment to integrity and ethical values</td>
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<td>2. Exercises oversight responsibility</td>
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<td></td>
<td>3. Establishes structure, authority and responsibility</td>
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<td>4. Demonstrates commitment to competence</td>
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<td>5. Enforces accountability</td>
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<td>Risk assessment</td>
<td>6. Specifies suitable objectives</td>
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<td>7. Identifies and analyzes risk</td>
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<td>8. <strong>Assesses fraud risk</strong></td>
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<td>9. Identifies and analyzes significant change</td>
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<td>Control activities</td>
<td>10. Selects and develops control activities</td>
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<td>11. Selects and develops general controls over technology</td>
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<td>12. Deploys through policies and procedures</td>
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<td>Information and communication</td>
<td>13. Uses relevant information</td>
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<td>14. Communicates internally</td>
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<td>15. Communicates externally</td>
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<td>Monitoring activities</td>
<td>16. Conducts ongoing and/or separate evaluations</td>
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<td>17. Evaluates and communicates deficiencies</td>
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### Principle 8 – The organization considers the potential for fraud in assessing risks to the achievement of objectives.

- Fraud risks are considered in the context that individuals or entities may act outside of the organization's expected standards of ethical conduct.
- General risks under Principle 7 are considered in the context of management, employees and third parties adhering to the entity's expected standards of ethical conduct.

Fraud risk assessments are now considered distinct from general risk assessments. Because fraud risk is a separate principle, an otherwise robust and well-functioning enterprise risk assessment process that does not adequately consider fraud will likely not allow the organization to fully comply with the updated 2013 COSO Framework.
**Elements of an effective anti-fraud program**

- Code of conduct
- Fraud prevention policies
- Fraud awareness training
- Fraud risk assessment
- Fraud controls monitoring
- Fraud response plan

**Benefits of an anti-fraud program**

Management is ultimately responsible for detecting, preventing and responding to fraud. An anti-fraud program, aligned with a company's compliance framework, demonstrates that management is setting the proper “tone at the top” to address its fraud and compliance risks. An anti-fraud program will not provide assurance against fraud, but it can help mitigate the risk of fraud by allowing management to identify and prioritize fraud risks and allocate resources to address them.

**EY fraud risk assessment approach**

We leverage our fraud investigation and industry-specific experience to identify fraud risks and assess the likelihood of occurrence and potential impact on the company's strategic, operational and financial objectives. We assess management's understanding of its key fraud risks and its ability to proactively deal with them. We provide our observations and recommendations to improve fraud-risk management and to leverage the company's data to better detect and prevent fraud.

- Plan: Confirm goals and schedule
- Assess: Assess current state of fraud risks
- Respond: Identify strengths, gaps and recommendations
- Report: Present findings and finalize report recommendations

**Continuous coordination between management and assessment team**

- Assemble the proper team, considering:
  - Key stakeholders
  - Technical experience
  - Industry knowledge
  - Understand the fraud risk universe
  - Communicate the goals of the assessment to the organization
- Conduct interviews
- Lead facilitated sessions
- Distribute questionnaires and surveys
- Review documents and transactions
- Identify fraud risks present in the organization
- Assess the potential impact of the identified risks to the organization
- Map the identified risks to internal controls
- Assess the effectiveness of the controls
- Compare to leading practices
- Perform sample testing
- Determine the level of residual risk and assign priority ratings to each risk identified
- Determine and document management's response to residual risk
  - Avoid
  - Transfer
  - Mitigate
  - Assume
- Determine plan for continuous monitoring of identified risks

The assessment incorporates a multilevel approach to fully assess the company's risk of fraud.

- Entity-level review
  - Interactions with government/SOE s
  - Formal anti-bribery policies and procedures
  - Gift and entertainment policy
  - Employee training/awareness initiatives
  - Event reporting/whistle-blower hotlines
  - Compliance resources/staffing
  - Compliance monitoring plan
- Process-level review
  - Cash disbursements
  - Purchasing/vendor selection
  - Contracts
  - Sales and marketing activities
  - Accounts receivable
  - Licensor relationships
- Transaction level
  - Travel and entertainment expenses
  - Agent/broker commissions
  - Service vendor disbursements
  - Marketing and promotion expense
  - Petty cash
  - Rebates/discounts/aging
  - Charitable contributions

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