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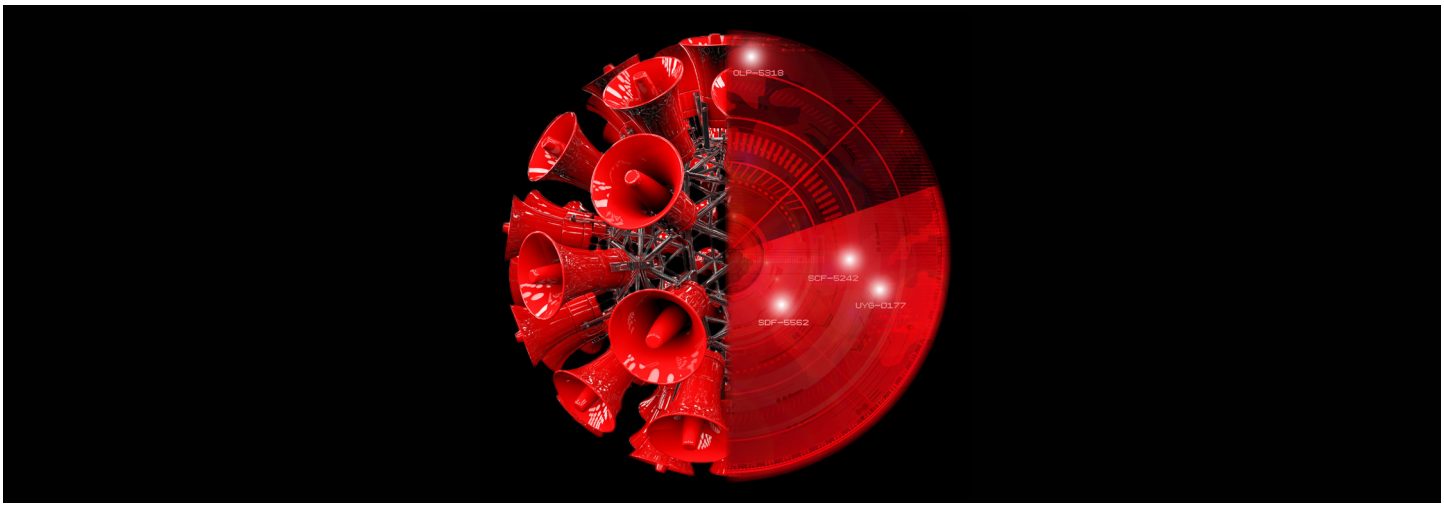

COVID-19: Fraud risk considerations in changing control environments

Organizations should not overlook their ability to identify, mitigate, and respond to a change in fraud risks as a result of this disruption.

Overview

COVID-19 has caused unprecedented change for financial institutions across many aspects of their organizations, including the control environment. Organizations should not overlook their ability to identify, mitigate, and respond to a change in fraud risks as a result of this disruption. Changes to an entity's risk, control, and defense models should also incorporate an assessment of fraud risks, fraud risk factors, and fraud schemes as part of changes to the design or effectiveness of an internal control over a variety of functional areas.

Fraud risk assessment

What effect may COVID-19 have on an organization's current fraud risk assessment approach and fraud risk landscape?

When preparing fraud risk assessments, financial institutions should:

- Revisit fraud risk assessments and fraud risks and adjust for potential COVID-19 impact, for example:
  - Conduct interviews remotely
  - Consider technology and infrastructure disruptions

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  - Consider workforce disruption, including processes that are reliant on select few resources (for example, highly technical areas) or those that may require updates to delegation of authority
  - Consider highly manual processes
  - Review areas that are susceptible to fraud (such as money movement and insider trading)
  - Understand third-party service providers, how they are responding to the impact of COVID-19, and their ability to meet service-level agreements
- Monitor for emerging risks resulting from changes in control environment and incorporate them into the fraud risk assessment process

Effective allocation of resources

Does the organization have sufficient resources to identify, assess, and test fraud risks, fraud risk factors, and fraud schemes resulting from shifts in the control environment relating to personnel changes?

During its analysis of the amount and placement of resources, financial institutions should:

- Identify and prepare backup personnel (potentially secondary) for specific fraud-related responsibilities, including executing fraud control activities
- Review segregation of duties to ensure continued enforcement and consider the implications of performing virtual segregation of duties
- Allocate sufficient resources to liaise with third-party service providers and perform comprehensive reviews of inputs provided to and outputs received from third parties
- Confirm that essential fraud detection, deterrence, and monitoring positions have current fraud procedural documentation suitable as a backup resource
- Analyze labor arbitrage across geographies to build resilience
- Establish a COVID-19 "task force" to represent affected areas of the organization and consider retaining outside specialists to provide an outside perspective

Third-party reliance

What is the extent of business disruption for third parties involved in operations and financial reporting? Does the organization require additional fraud monitoring and oversight procedures during the disruption period?

Financial institutions can help prepare for the impact of the business disruption on third parties by:

- Identifying all third parties involved in operations and financial reporting and evaluating their significance
- Assessing fraud risks and fraud risk factors resulting from temporary changes outsourced services providers have made to their processes and controls
- Evaluating the extent to which additional fraud oversight is required and how it can be remotely conducted
- Determining what in-house versus outsourced fraud detection, deterrence, and monitoring changes are needed based upon changes to existing risk assessment process
- Contacting outsourced service providers to evaluate their ability to operate in accordance with established fraud guidelines and key performance indicators (KPIs), including monitoring those providers for fraud-related risks

Remote access

Has the organization considered the impact of remote access on fraud?

Financial institutions are now relying on a more mobile workforce and can prepare for the new associated risks by:

- Determining if people, processes, and controls have changed due to increased remote access
- Ensuring fraud considerations are part of the risk assessment made in light of changes due to remote access
- Enhancing the monitoring of the corporate network for unauthorized activity due to remote users' insecure home networks
- Evaluating the organization's virtual private network's (VPN) ability to continue to encrypt data as the VPN supports increased users
- Evaluating customer authentication controls to mitigate the risk of fraud being perpetrated on the financial institution by fraudsters

Impact of fraud on controls and monitoring

Has the organization considered the risk of fraud for required control modifications or the need for enhanced fraud monitoring processes transaction controls?

When determining the need for the modification of controls or new controls, financial institutions should:

- Assess the risk of fraud related to modifications from evidencing review and approval through electronic means (such as emails and e-signatures)
- Identify fraud risks associated with automated controls that are most susceptible to fraud, either due to COVID-19 or based on historical trends
- Consider alternatives for fraud controls that require physical observation
- Leverage fraud analytics and fraud-related KPIs to identify potential early warning signs of fraudulent activity
- Evaluate whether monitoring controls exist and are operating effectively to mitigate any fraud risks due to failure to operate automated business controls
- Identify fraud risks related to remote monitoring controls

Culture and communication

Has the organization assessed the need for enhanced communications regarding the increased risk of fraud to both internal and external parties? Has the organization considered the importance of culture and its continued importance in the fight against fraud?

Regulators have institutions' culture top of mind—even if not explicitly. For example, on March 23, 2020, Stephanie Avakian and Steven Peikin, codirectors of the US Securities and Exchange Commission's (SEC) Division of Enforcement, released a statement emphasizing the importance of maintaining market integrity and following corporate controls and procedures.[1] Institutions can promote their internal culture through actions that include:

- Reinforcing the importance of fraud awareness and monitoring using remote technology (such as newsletters and video conference)
- Promoting a culture of compliance and the importance of speaking up in a time of crisis
- Encouraging control owners to be aware of the increased risk of fraud if they encounter challenges in performing their fraud controls remotely
- Communicating with control owners to emphasize the importance of documenting any fraud risk assessment changes and resultant fraud-related controls
- Establishing accountability for control owners by establishing communication lines for key control and fraud issues being dealt with on an ongoing basis
- Evaluating the latest SEC disclosure guidance[2] on reporting the fraud risks of COVID-19 on your business, financial condition, and results of operations

Preparation for future fraud risk considerations

Has the organization considered updating fraud risk assessments, fraud control descriptions, or creating alternative fraud controls?

Financial institutions will need to prepare for the fraud risk typologies that arise from the COVID-19 pandemic. Forward-looking institutions conduct activities, including:

- Updating entity-wide fraud risk assessment to reflect the new or enhanced fraud risks resulting from the COVID-19 pandemic
- Creating or enhancing existing fraud policies and procedures to adapt to COVID-19 impact, inclusive of roles and responsibilities in a remote environment
- Evaluating fraud risks for affected areas due to changes to people, process, and technology and updating fraud risk assessments and fraud controls accordingly
- Raising significant fraud risks arising from changes to risks and control environment to senior management and the board
- Preparing for the likelihood of remote fraud testing and the need for greater cooperation with both internal and external parties involved in fraud testing, as such testing programs may change
- Considering the use of technologies to support the fraud testing, including communication tools, file-sharing platforms, and video conferencing, to allow fraud specialists and related personnel to assess required information
- Engaging with all fraud testing parties (testers and those being tested)—including internal audit, compliance, and external service providers—to understand and communicate the organization's increased fraud risk and management's expectations

Conclusion

In response to COVID-19, financial institutions can take a number of proactive steps to respond to the fraud risks that may occur due to the business disruption, recover from the weaknesses fraud uncovers, and prepare the institution to thrive going forward. Organizations taking these proactive steps should involve all related stakeholders across the three lines of defense.

Contacts

Don Fancher
US and Global Leader, Deloitte Forensic
Principal | Deloitte Risk & Financial Advisory
Deloitte Financial Advisory Services LLP

Kamran Masood
Principal | Deloitte Risk & Financial Advisory
Deloitte Financial Advisory Services LLP

Michael Brodsky
Managing Director | Deloitte Risk & Financial Advisory
Deloitte Financial Advisory Services LLP

Deloitte Center for Regulatory Strategy

Irena Gecas-McCarthy
FSI Director, Deloitte Center for Regulatory Strategy, Americas
Principal | Deloitte Risk & Financial Advisory
Deloitte & Touche LLP

Austin Tuell
Manager| Deloitte Risk & Financial Advisory
Deloitte Center for Regulatory Strategy
Deloitte & Touche LLP

Kyle Cooke
Senior Consultant | Deloitte Risk & Financial Advisory
Deloitte Center for Regulatory Strategy
Deloitte & Touche LLP

Endnotes

1. US Securities and Exchange Commission (SEC), "Statement from Stephanie Avakian and Steven Peikin, Co-Directors of the SEC's Division of Enforcement, Regarding Market Integrity," March 23, 2020, accessed April 9, 2020.
2. SEC, "The Importance of Disclosure – For Investors, Markets and Our Fight Against COVID-19," April 8, 2020, accessed April 9, 2020.