

Pool Fraud Audits: Points to Ponder

The Need for an Independent Fraud Audit

Public entity pools benefit from a closed membership profile, making claims fraud possible but perhaps less likely than in many other insurance operations. Internal fraud is hopefully also unlikely in public entity pools, but it is possible and therefore a risk to be actively managed.

Fraud is a deliberate deed or omission calculated to mislead others, resulting in gain for the culprit and a loss for the organizational victim. Fraud can be perpetrated on many levels – from one person taking advantage of standard day-to-day operations to sophisticated systemic schemes involving structured work teams from across the organization.

Most pools conduct yearly independent financial audits which can be helpful indicators of fraud. However, even robust financial audits examine a relatively small number of transactions and may be limited to core financial transactions in your organization. Pools are beginning to conduct more thorough, specialized audits focused on fraud detection throughout the organization. While certainly helpful to detect any fraudulent activity underway, such an audit may be even more useful in terms of identifying risk areas, best practices, and other fraud prevention opportunities for a pool.

Scope

A fraud audit might be conducted as an entirely independent review, or could be completed in conjunction with another external audit process conducted by your pool – such as a financial audit, claims audit, technology systems audit, or other review.

The key to a fraud audit is to look at the total operational environment of the pool, focusing in key areas such as claims and finance but not limited to just those departments. A fraud audit might evaluate workflow, physical and technology access controls, payments and payee set-up processes, and other controls that could be manipulated by someone in order to commit fraud.

Fraud audits can vary in terms of the type and number of transactions examined. An audit could encompass either a percentage of transactions, a percentage of dollar amounts, or an analytical review of *all* transactions. If you choose to consider only dollar amounts, be sure to determine the amount reasonable, keeping in mind that fraud can occur in small increments over long periods of time.

The scope of a fraud audit will also vary depending on your pool's organizational structure, workflow, lines of coverage, internal controls, systems, and other factors. You may need to consider how contracted services will be reviewed. For instance, you may want to look at the controls between the claims and finance departments to evaluate risks in setting up a new claimant and making recurring payments. If you outsource claims administration and have an in-house finance department, your fraud

audit process may look different than if both departments are internal. And, if your finance and claims staff use an integrated system your fraud audit will look different than in a situation with multiple systems in place.

There's no right or wrong in terms of scope. You should be clear, though, on your pool's fraud audit goals and be sure to match the scope to your needs. In many cases, cost may be a driver in your decision – it may be that you can only go so deep on a fraud audit to remain within your planned budget.

Timing

Pools should engage an external fraud audit with some regularity – it's probably not something you need to perform every year, but conducting an audit once every five years or so would be a wise investment. Aside from the direct potential for loss, fraudulent activity at your pool could present very real reputational risk.

Cost

Cost will most certainly be a factor in the scope and nature of your pool's fraud audit. The more detailed and rigorous the audit, the more systems or relationships involved, the more a fraud audit will cost. You might consider setting a budget within which you are willing to work, asking service providers to scope the depth of proposed assessment to fit within your budget.

Fraud Audit Resources

You probably won't find a firm that specializes in fraud audits for public entity pooling operations (but if you do, be sure to let us know). Rather, you'll likely be expanding the scope of work requested from an independent financial auditor, claims auditor, technology auditor, or some other firm. Think broadly about your fraud audit needs and choose an appropriate resource. Talking with other pools about how they've conducted fraud audit activities may also be helpful as you consider your own approach.

Internal Resource Needs

There are few audits or assessments that can be completed without some engagement by a pool's in-house staff and related resources. Adequately plan for time to prepare, oversee, assist, and review the audit work. If you suspect there is an existing problem, consider the best person to oversee fraud audit work.

Three specific pool resources to consider and consult with prior to audit include your pool's general counsel, your finance director or CFO, and your Board of Directors. Whether in-house or contracted, both your general counsel and CFO can help scope the audit and review findings and best practice recommendations. In most cases, the fraud audit will not turn up actual fraudulent acts but will instead suggest changes or improvements to internal processes. Your general counsel can help determine which suggestions should be top priority, and your CFO can help implement them.

And, your pool Board of Directors has keen interest to oversee and receive a report of fraud audit findings. Be sure the Board is aware of the planned audit process, understands the scope (including what will not be reviewed as part of the audit process), and receives a report of findings. If the fraud audit does uncover a problem area, the Board of Directors should be made aware of it immediately, along with any corrective measures or process upgrades.

Questions to Ask

As you consider plans to conduct a fraud audit for your pool, consider the following questions:

- What is your planned scope for the fraud audit, including specific departments and work teams to be included?
- What sort of external resource will you use to conduct the fraud audit? Will it be part of another audit engagement or a standalone audit process?
- What will be the process for identifying fraud risks? What risk assessment techniques will be used?
- Will staff be allowed to communicate with the auditors directly and anonymously?
- How can your planned audit scope be relied upon to detect potential for material errors, fraud, illegal acts and other weaknesses in internal controls across multiple departments, work teams, and workflow processes?
- What will be the resulting deliverable – a report, a plan of action, specific action step recommendations?
- To whom will audit findings be reported (consider, especially, the pool's general counsel and Board of Directors)?
- How will you communicate with staff about plans to conduct a fraud audit? How will you communicate results to staff when the audit is complete?

Assuming your pool decides to contract for external assistance in conducting a fraud audit, you might also ask about the following:

- How is the fraud audit fee established – upon what scope of work, using what techniques?
- How will we know you've done the appropriate degree of inquiry?
- How will you prioritize your recommendations to us for implementation or correction?
- What is the total project timeline for fraud audit activities and when do you expect to complete your work?
- How will you communicate your overall findings to us?
- What will you do or how will the audit process change if you discover actual fraudulent behavior or a serious problem area?
- What responsibilities will our own staff (and/or third party administrators) have as part of the assessment project?
- What inputs or deliverables are we specifically responsible for, or will need to substantially contribute to?
- What are your firm's specific qualifications to perform this sort of audit or assessment? How many similar projects have you completed? What are the qualifications of the people who will be working on this project?
- How does your firm stay up-to-date in the area of operational fraud, public entity pooling, insurance, or other related areas? What qualifications, methods, or practices make your firm right for this work?

- Do you have specific experience with public entity pools? Small, boutique, or specialty insurers? Public sector entities?
- What referrals or testimonials from past clients can you share? What references may we contact?
- Do you have a client who was less-than-fully satisfied with your work who we can contact?
- On what recurring cycle should we complete this kind of assessment or fraud audit work – how frequently should we seek to repeat this engagement?

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Pool Fraud Audits: Known Firms

This is merely a list of firms that may be able to provide pools with fraud audit and assessment services. The list was created as of September 2015 and is listed in alphabetical order. AGRiP has not vetted these firms or their qualifications, and of course there may be other firms not on this list. Each firm listed provided the information for inclusion on this list. Pools are encouraged to conduct their own evaluation of the firm most qualified to meet their specific needs.

Firm	Notes Provided by Partner Noted by AGRiP
Cherry Bekaert Scott M. McKary, CPA, CFE, CIA, CCSA National Leader, Risk Advisory Services 919-985-6801 smckay@cbh.com http://www.cbh.com/services/advisory-services/risk-management/internatl-audit-financial-and-operational-audit-services/	
Clifton Larson Allen Yassir Karam Indianapolis, IN 317-569-6130 Yassir.karam@claconnect.com http://claconnect.com/	<i>Pool experience</i>
Deloitte Neil White Principal, Internal Audit Transformations 1633 Broadway New York, NY 212-436-5822 nwhite@deloitte.com http://www2.deloitte.com/us/en/pages/risk/solutions/internal-audit-transformation.html	
Ernst & Young Fraud Investigation and Dispute Services http://www.ey.com/US/en/Services/Assurance/Fraud-Investigation---Dispute-Services/EY-contact-our-team-5 http://www.ey.com/US/en/Services/Assurance/Fraud-Investigation---Dispute-Services/EY-about-fids-1	

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