

The Peculiar Nature of Fraud in the Pool Environment

Internal Fraud, Vulnerable Clients and Conspiracies

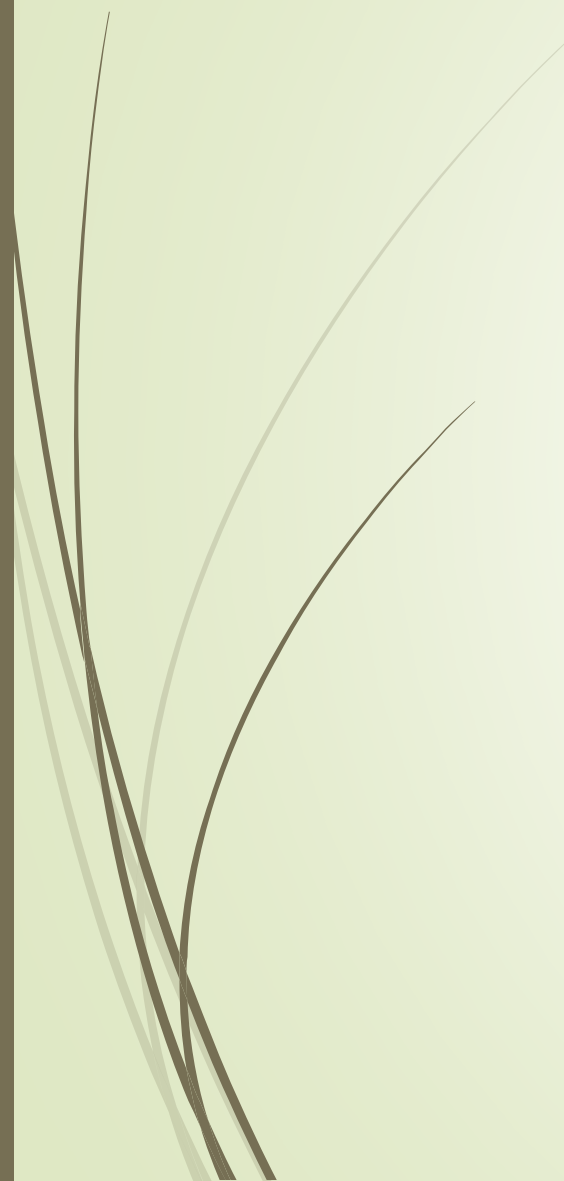
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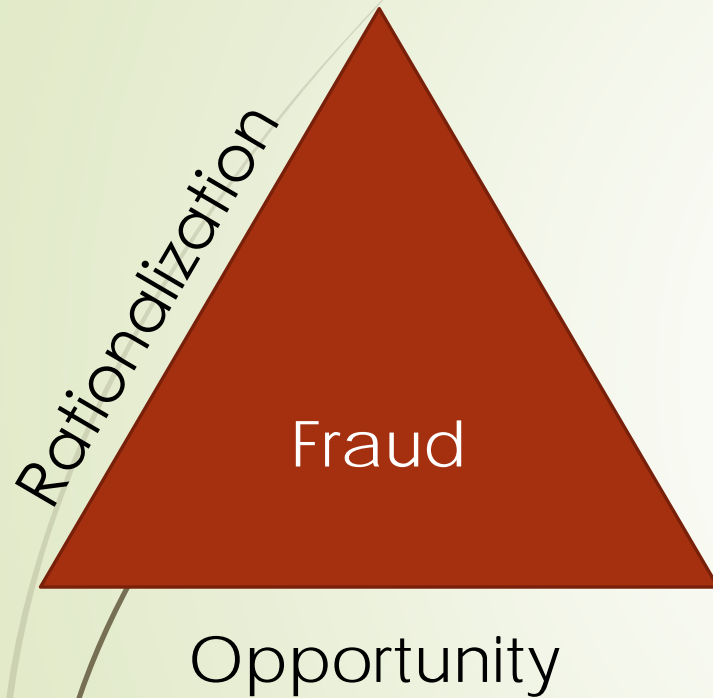
Why is this a big deal?

- ▶ The Association of Certified Fraud Examiners estimates that multiple forms of fraud, equivalent to around 5% of revenues, affect corporations each year.
- ▶ The Brummel Group reports that non-healthcare fraud alone cost the US an estimated \$40 billion a year.
- ▶ In our industry, we accumulate substantial financial resources and need to hold them for a long period of time... That makes us a big target for fraud.

How does fraud happen?



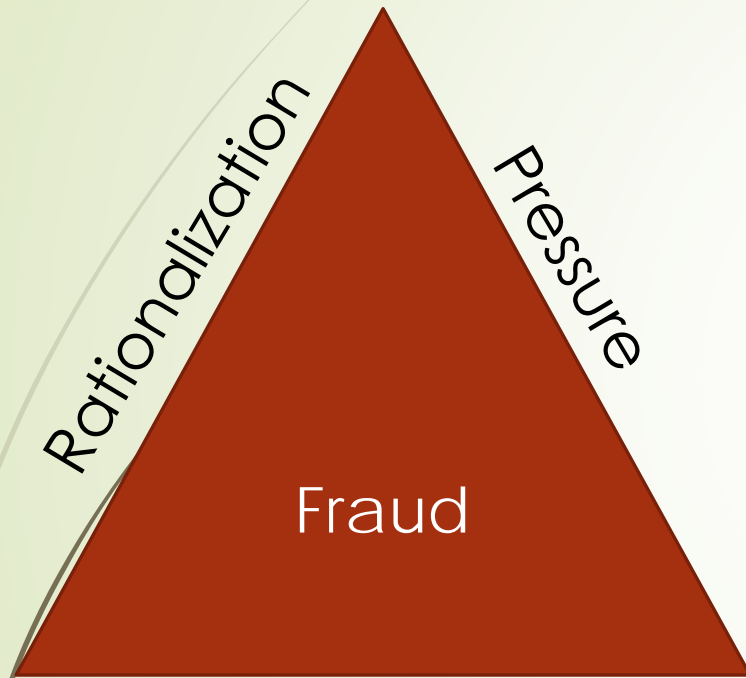




Pressure

- ▶ An insurmountable, un-shareable financial problem or psychological need. Most people need some sort of pressure to commit a criminal act.
 - ▶ Gambling debt
 - ▶ Addiction
 - ▶ Overwhelming medical bills
 - ▶ Hiding a costly error (think arbitrage losses), fear of job loss
 - ▶ Unrealistic sales targets (think Wells Fargo)
 - ▶ Greed, usually rationalized by perceived injustice

Opportunity



- A chance to commit the act without a high chance of being caught.
 - Access to financial resources
 - Control of financial processes
 - Weak or non-existent supervision

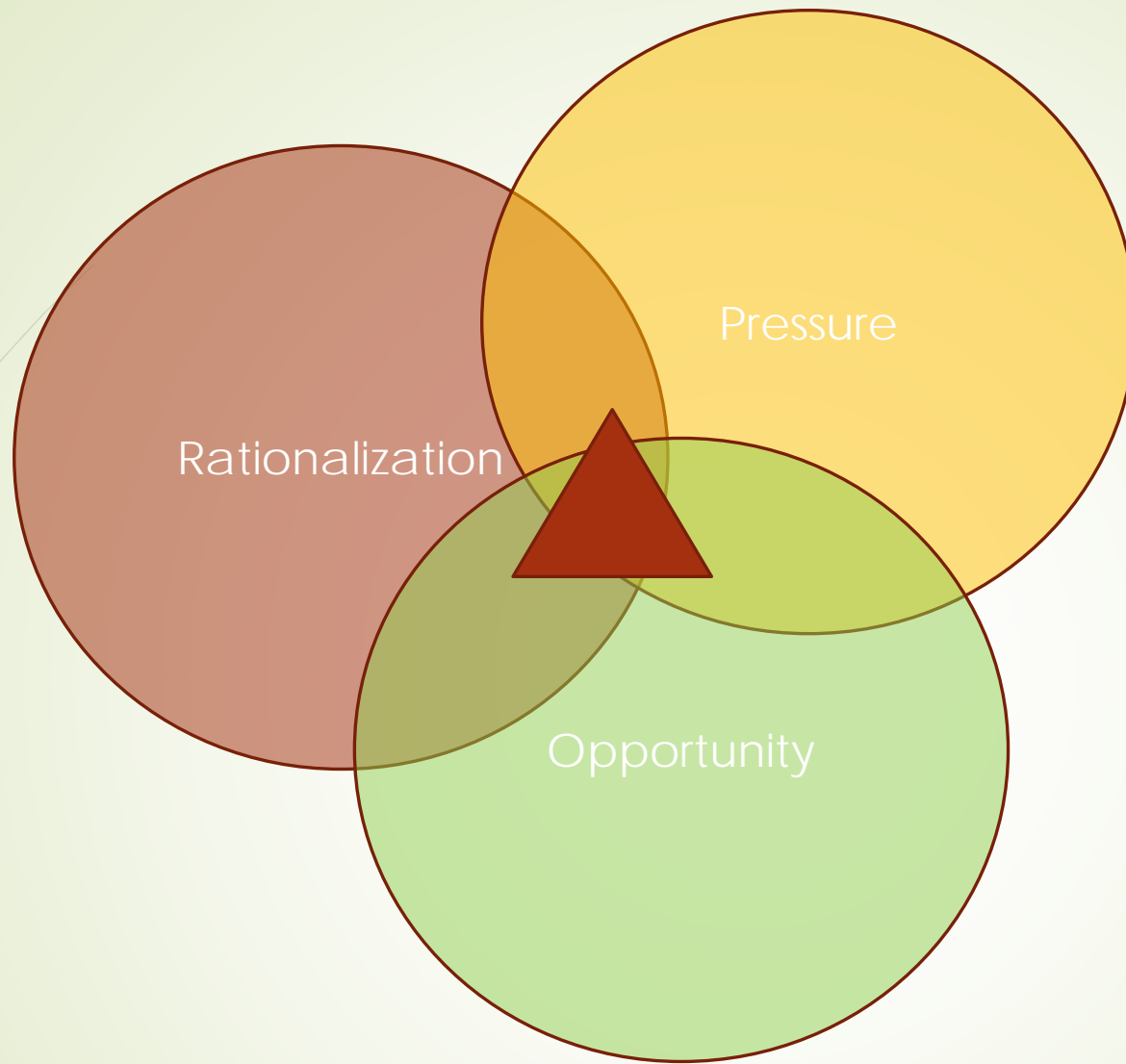
Rationalization

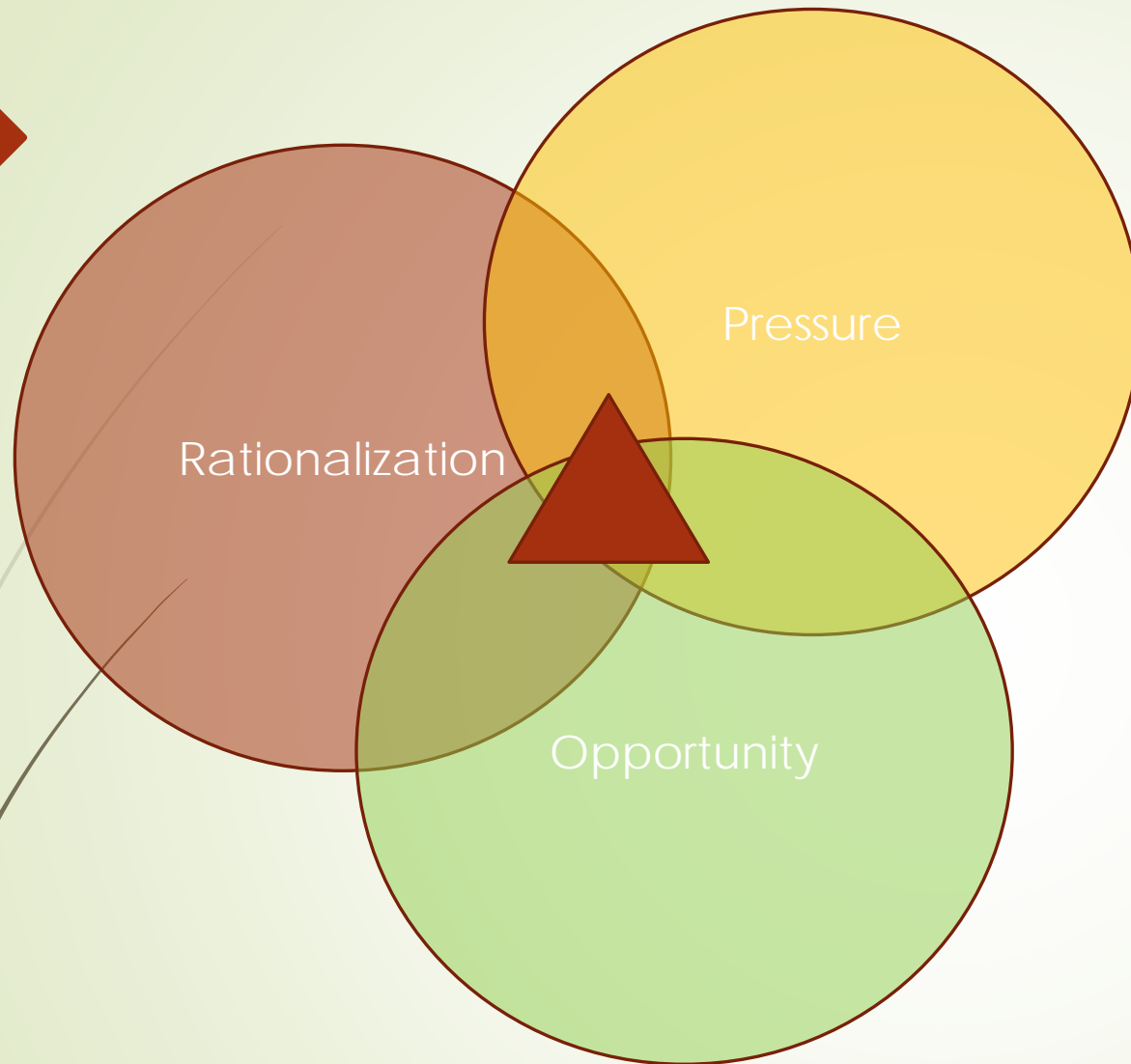


- The individual manages to justify what he or she is about to do. Many never feel they were actually committing a crime.
 - “Just borrowing it”
 - “I’ll put it back once my problem is solved”
 - “I need the money more than they do”
 - “They don’t pay me what I am worth. I am just balancing things”.
 - Revenge: perception of injustice. Overworked. Under appreciated.



- Frauds often start small then grow out of hand
- Among the 200 frauds interviewed by Cressey, none had joined the company planning to commit a crime.
 - "I'll put it back once my problem is solved"
 - "I need the money more than they do"





Problems with the fraud triangle model:

- Fraud, transactionally, is rare
- Prevention when focused upon the triangle edges is negative in a milieu of innocent experience.
- People just don't want to suspect people they trust, and most of the time, that trust is justified.

Come the 1980s

- ▶ Spectacular failures of Drysdale Government Securities, Washington Public Power Supply System, Baldwin-United and E.S.M. Government Securities.
- ▶ Congressional investigation as to why. Could better audit practice help?
- ▶ Treadway Commission was formed in October 1985 to address these questions.

The Treadway Commission

- The Commission was a private sector initiative sponsored and funded by five organizations:
 - American Institute of Certified Public Accountants (AICPA)
 - American Accounting Association (AAA)
 - Financial Executives International (FEI)
 - National Association of Accountants, now the Institute of Management Accountants (IMA)
 - Institute of Internal Auditors (IIA)
 - And supported by the SEC and other government organizations.
- Collectively, they form the Commission of Sponsoring Organizations, now better known as COSO.

The Tredway Report

- The Commission met for 2 years and in September 1987 issued their report.
- Many of their recommendations will be familiar to you today:

The Tredway Report- Recommendations

- The context of this first report was within public companies, though their findings have universal application.
- Recommend for public companies:
 - Tone must be set by top management
 - Internal accounting controls
 - Audit committee
 - Define the minimum requirements and responsibilities for management reports
 - Independent public accountants to review published reports
 - Timely quarterly reporting.

The Tredway Report- Recommendations

- Recommended for Public Accountants:
 - Crucial role in detecting and deterring fraud in financial reporting
 - Changes in auditing standards and the process for setting them
 - Clarity in auditor and client roles and responsibilities

The Tredway Report- Recommendations

- Recommended for the SEC and others:
 - New SEC sanctions: civil monetary penalties, cease and desist orders, power to bar or suspend corporate officers and directors.
 - Independent audit review of financials released to the public
 - Audit committee letter to accompany financials

The Tredway Report- Recommendations

- These recommendations brought new standards to bear and improved the transparency and professionalism of the accounting profession.
- But, a lot of the thinking was rules based... and the world changed faster than rules could be made.
- And the work of COSO continued with the release of the COSO Framework in 1992.

Evolution of Fraud Control

- ▶ The 1992 COSO framework – 5 principles
 - ▶ Control Environment
 - ▶ Risk Assessment
 - ▶ Control Activities
 - ▶ Information and Communication
 - ▶ Monitoring Activities



COSO principles vs triangle

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➤ Pressure/Motive

➤ Opportunity

➤ Rationale

Control Environment- Eye on motives and pressure

Risk assessment

- Appropriate workflow

Control Activities

- Systems enforced roles

Monitoring activities

- Meaningful review

Information and communication – Understand why.

The work of COSO continues

- ▶ In 2013 the COSO framework was expanded to cover a broader spectrum of financial information and changes in business and operating environments.
 - ▶ Principles based – so adaptive and flexible
 - ▶ Enhanced tools for assessing risk of fraud

The 2013 COSO framework- 17 Principles

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➤ Control Environment

➤ Risk Assessment

➤ Control Activities

➤ Information and Communication

➤ Monitoring Activities

1) Demonstrates commitment to integrity and ethical values

2) Exercises oversight responsibility

3) Establishes structure, authority and responsibility

4) Demonstrates commitment to competence

5) Enforces accountability

6) Specifies suitable objectives

7) Identifies and analyzes risk

8) Assesses fraud risk

9) Identifies and analyzes significant change

10) Selects and develops control activities

11) Selects and develops controls over technology

12) Deploys through policies and procedures

13) Uses relevant information

14) Communicates internally

15) Communicates externally

16) Conducts ongoing and/or separate evaluations

17) Evaluates and communicates deficiencies

COSO resources

- www.coso.org
- Publications on internal control framework and guidance on its implementation
- And the 2017 Enterprise Risk Management (ERM) update
- Webinars on current trends and emerging issues with fraud offered through FEI and others.

Why are JPAs different?

- ▶ We are at less risk of internal fraud than for-profit industry because:
 - ▶ Partnership with Members, non-competitive environment. Lower pressures, less room for rationalization
 - ▶ For claims: Regulated. Structured. Efficiencies gained with automated process flows.
- ▶ But this only works insofar as we have proper policies, procedures and training in place.

- ▶ But we have a concentration of resources so we are vulnerable to greed, particularly from the outside, and we have vulnerable clients.

Vulnerable clients

- ▶ In Workers' Comp, we serve clients who:
 - ▶ May be physically and emotionally compromised
 - ▶ Dealing with medical care environment that is totally unfamiliar
 - ▶ They are particularly vulnerable to fraud and identity theft

We do find malingering among clients

- It is a failing of human nature and most WC programs address this with monitoring and, as necessary, investigation.
- Motivation: Resent their loss and their pain. Possibly blame the employer. Reduced pay an additional hardship (2/3 base pay to a max of \$63k per year).
- Opportunity: They have a compensable claim! And some injuries are hard to measure.
- Rationale: comes from the motive. "They can afford it better than I can!"

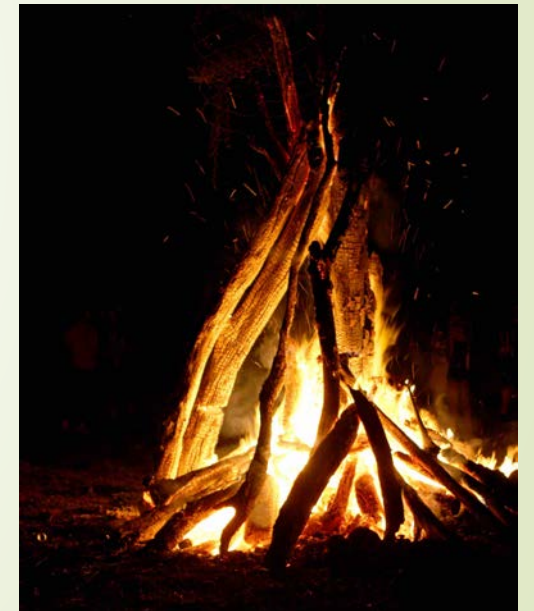
Our vulnerable client (names changed!)

- Oscar's Identity theft



What can we do to help?

- Educate our clients and their families on dangers of identity theft and how to respond.
- If a loss happens, have resources we can confidently recommend to our clients for help.
- Be compassionate and aware. Victims too often feel shame when tricked. We need to encourage them to get help.
- Use ACH or debit cards for payments and benefits where possible



And vendors are not immune

- The stolen picture



And vendors are not immune

- ▶ How can we help?
 - ▶ ACH again, where possible.
 - ▶ Positive pay and active communication with our service providers.



Conspiracy



Conspiracy – What drives them?

➤ Motive

- Doctors and may be feeling pressure in an environment where Medicare and Workers' Comp are paying far less than their normal bill rate for the same procedures. They may feel this is unjust. They have student loans to pay and society expects them to have a high income.

➤ Opportunity

- They have control over their billing process and can take advantage of naive or compromised clients.

➤ Rationale

- We have a concentration of financial resources so we "can afford the loss". A convenient rationalization.

Conspiracy - How does it happen?

- ▶ It starts small.
- ▶ Case background. The beginning

Conspiracy - How does it happen?

- ▶ The opportunity.
 - ▶ First deceptions

Conspiracy - How does it happen?

- ▶ The hubris.
 - ▶ Full maturity, and the discovery.

Conspiracy - Consequences

- ▶ Prosecution.
 - ▶ What it took to get them to court.

Conspiracy - Consequences

- ▶ Judgement and sanctions.
 - ▶ DIR regulatory action.
 - ▶ Criminal judgements.
 - ▶ Civil suits.

Conspiracy - Intervention

- ▶ What can we do to be more pro-active in discovering or preventing conspiracies?
 - ▶ Bill review, cost modeling to capture over-billing. Effective data mining.
 - ▶ Utilization reviews. Was the treatment reasonable and efficacious?
 - ▶ Stay close to your clients. Vigilant.
 - ▶ Be skeptical, in a healthy way.

To summarize:

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- Fraud is enabled by pressure, opportunity and rationalization
 - But it is rare, so we tend to ignore the possibility.
- The work of COSO and others has made fraud control efforts better by formulating principles that improve transparency, create rational control structures and build better corporate governance, audit practice and regulatory powers.
- JPAs are sheltered from internal fraud by their compassionate mission and partnerships... but that doesn't mean we ignore good practice.
- In Workers' Comp, our clients are vulnerable and we can help through education, vetted support options and technology.
- Because, particularly in Workers' Comp, we accumulate large pools of resources, we can be a target for conspiracy. But we can help through vigilance and good use of technology.

Questions or comments?