

Shaping Malta's Future 2021

Championing risk management through sustainability

Grant Thornton | Malta

2021



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Risk management and internal control

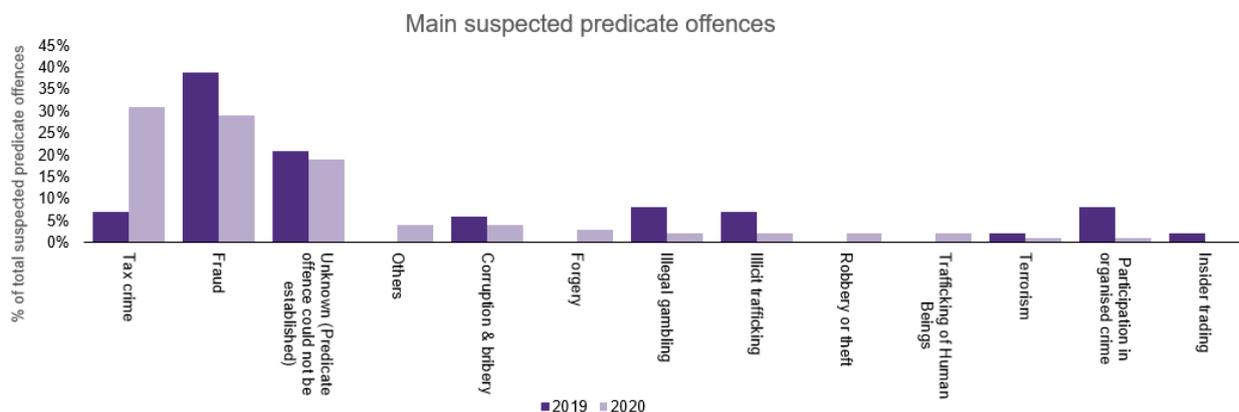
As defined by The Institute of Internal Auditors, internal auditing is “an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.” Conversely, risk management is a function that includes a set of procedures, actions and resources that enable managers to keep risks at an acceptable level for the organisation. Formidable internal controls and risk management ensure the effectiveness in curtailing fraud and mitigating risks faced by organisations.

The decade prior to the pandemic showed a consistent proportion of individuals working from home in the EU-27, with around 5.4% of total EU employees stating that they often worked remotely. Malta had been experiencing a gradual increase year-on-year. As expected, during the pandemic, this statistic increased, reaching 12% in terms of EU employees and 15% of Maltese employees, as of 2020.

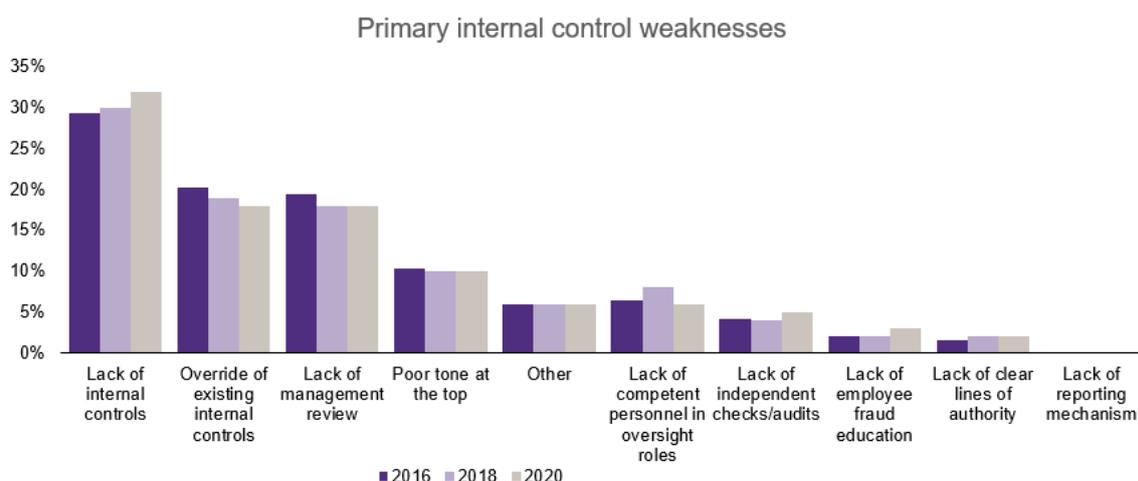
Fraud and internal control weaknesses

For consecutive years fraud was the most common suspected predicate offence in Malta till 2019, according to the 2019 FIAU report. As illustrated in the table below, in 2019, ‘fraud’ amounted to 39% of the total suspected predicate offences, whereas in 2020, fraud amounted to 29% of the total suspected predicate offences. In 2020, the most prevalent offence was tax crime which amounted to 31% of total suspected offences.

One might argue that the various threats, pressures and uncertainty caused during the Covid-19 pandemic have amplified the risk of fraud. The current post-pandemic environment has created new opportunities, such as; large amounts of funds made available to address the impacts of the pandemic, increased pressures on management to break-even, let alone make profits, the increased efforts in continuing to ensure effectiveness of internal controls and significant market opportunities that might provide an opportunity for fraud to be perpetrated. Even though the aforementioned pressures might incentivise management and employees to commit fraudulent activities, this was not representative on the local scene as Malta showed a fall in fraud related cases in 2020, in line with the aforementioned drop of 10 percentage points from the previous year (2019: 39% of the total suspected predicate offences related to fraud).



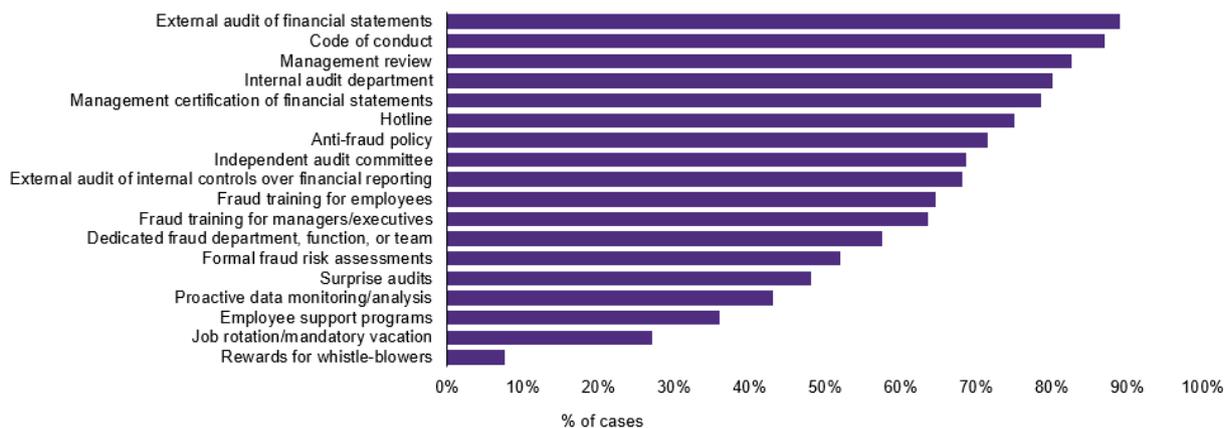
Internal control is an essential process that provides reasonable assurance of the reliability and accuracy of information, of compliance with applicable laws and procedures, and of the reliability of financial reporting. Internal controls are also established to enhance the efficient use of resources, the safeguarding of assets, and the accomplishment of organisations’ established goals and objectives. If an organisation’s internal control system is weak, that might justify the occurrence of occupational fraud. As evidenced in the ‘Report to the Nations’, a global study on occupational fraud and abuse, in 2016, 2018 and 2020, the most prevalent occupational fraud and abuse measures weakness was the lack of internal control, attributable to 29%, 30% and 32% of all the occupational fraud and abuses, respectively. As further depicted in the figure below, the override of existing internal controls and lack of management review also contributed to the overall picture on occupational fraud and abuse cases, with 18% in 2020 of all occupational fraud and abuse cases respectively.



Anti-fraud controls

For organisations to be able to curtail occupational fraud and mitigate their risks, it is of utmost importance to implement the required anti-fraud controls. According to the 'Report to the Nations', the most common anti-fraud control adopted by organisations in 2020 was the external audit of financial statements. In fact, 89% of all the respondents participating in the study.

European anti-fraud controls in 2020



Mitigations of internal control: ensuring effective preventive and detective controls

According to the 2020 'Report to the Nations', organisations lose 5% of their revenue due to fraud each year. Therefore, for an organisation to detect and identify possible errors, fraud or misstatements, effective preventive and detective internal controls are required.

The segregation of duties at a workplace is an effective preventive control against both fraud and abuse. The whole operation of a business must be split into smaller tasks and performed by different employees. By implementing this, organisations would ensure that those employees who have access to assets, do not have access to the records related to those assets as well.

Secondly, an organisation should ensure the upkeep of physical controls such as; keeping documents and files that include sensitive and confidential data locked in secure locations within the premises. Organisations might also invest in video surveillance and security guards to check and verify clients' credentials and restricting access, as required. An organisation should also ensure effective IT controls, such as ensuring that confidential files and data stored on computers, are restricted to specific users according to their role within the organisation. This control would minimise the chances for individuals to access confidential information not related to their respective area within the organisation and creating fictitious entries in a transaction. IT controls might also include the use of effective passwords, the use of anti-virus software to secure computers and data encryption.

Thirdly, organisations should also provide employees with necessary tailor-made training so that they would be able to detect possible fraud, abuse and errors that might hinder the reputation and profitability of the organisation. Furthermore, in order to ensure an effective internal audit function, the internal audit function should provide consultancy services and advice to the key stakeholders. The internal audit team should report to an independent director, who is external to the company and should have the required and appropriate resources ready and available. Whistleblowing is an essential feature for good governance since it reveals organisation's failures such as; fraud, corruption, bribery, negligence, health and safety shortfalls and the mis-selling of financial products. The independence and objectivity of internal auditors is important to create trust in the process and ensure effective whistleblowing.

Moreover, when an organisation adopts a rotational staff model as part of the internal audit function, it should be well planned and tailored according to the organisation objectives and goals. If there is excessive reliance on this rotational model, then the internal audit would be left vulnerable in the ability of the business to conduct effective audits, in terms of the organisation's resources and would hinder the organisations' competency in accounting.

The impact of Covid-19 on internal control and risk management

The Covid-19 pandemic has caused various disruptions in the functions of companies including the way how companies analyse and assess internal controls. Therefore, organisations had to change their processes to adapt to the changes caused by the pandemic. Organisations had to increase their risk assessments, whilst auditors might have had difficulties in testing and getting assessments due to various challenges that they faced during the pandemic, such as; difficulty in achieving effective communication between employees and clients, difficulty in achieving effective communication between employees themselves, difficulty to go on-site and increased fraud risk.

Furthermore, organisations had to change their internal control and risk management systems to adapt to the pandemic. Covid-19 has increased certain risks which relate to fraud and abuse. The fact that employees had to work remotely increased the risk of social engineering. These malicious activities mainly occur through the form of urgent emails sent to employees, pretending to be their manager or superior and ask them to send certain sensitive information or even wiring money.

Many factors have contributed to this increase in fraud risk. The fact that employees' and staff's compliance with rules, control requirements, and policies might have been weakened due to Covid-19. This might occur when employees work remotely and, their actions might be less monitored or else, be more distracted, thus, not complying with such policies. Moreover, the pressure caused by the pandemic lead management to reduce the level of oversight required from their end. Due to these and similar pressures that management might face, anti-fraud measures and rules might have been overridden or even downgraded.



Remote working also increases the risk of confidentiality leaks. During this crisis, many organisations had to purchase devices, tools, and software to equip their employees with the necessary products to work safely from home. However, given the situation, such purchases were often made under pressure and, thus organisations were more susceptible to fraudulent risks especially related to the purchase of software. Furthermore, given that many employees were working remotely during the pandemic, the controls which protect the assets of organisations, were more subject to vulnerability to both internal as well as external fraudsters.

Lastly, the internal audit team within the organisation needs to update the risk assessments on a regular basis. Therefore, organisations should reassess any process that might be vulnerable to fraud and how that process changed due to the pandemic. Based on the results of the risk assessment, the internal audit team within the organisation would have to adjust or introduce new controls, as deemed necessary, to mitigate the risks. They should also refer to anti-fraud frameworks to decide which controls are appropriate to mitigate the organisation's risks.

In conclusion, for an organisation to curtail fraud and strengthen its internal control system, it should ensure effective internal controls. This is crucial in every situation, however even more so during the much-awaited economic restart post-pandemic, since many organisations were more vulnerable to fraud due to the various disruptions caused in their functions. Therefore, ensuring effective preventive and detective internal controls and implementing the required anti-fraud controls are essential to prevent and detect fraudulent activities. By doing so, organisations would ensure that their reputation and profitability are not hindered, whilst being compliant with all necessary regulations.



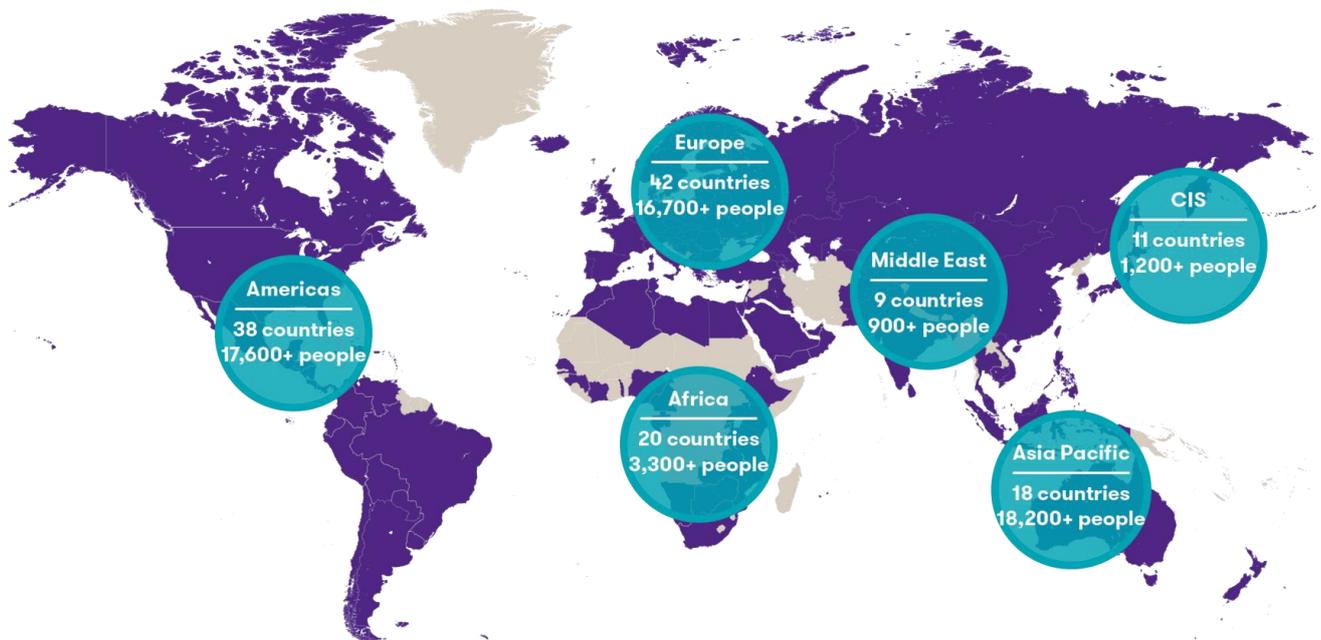
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USD5.76bn
(2020 revenue)



58,000+
people



750+
offices



138
countries

Grant Thornton Malta

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- risk modelling services
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- business process outsourcing and consulting

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- due diligence
- valuations
- foreign direct investment

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- recovery

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- blockchain technology
- fintech consultancy
- cyber security consultancy

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- global mobility services
- indirect tax advisory
- transfer pricing
- estate planning
- wealth advisory
- FATCA/CRS advisory and compliance
- IRS qualified intermediary advisory and compliance
- regulatory and legal
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- ship and aircraft registration
- company formation
- financial regulatory services
- trust and fiduciary services

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- human resources
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- consulting and processing engagements
- family business consulting

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- cost-benefit analyses
- cost effectiveness analyses
- value for money analyses
- public private partnership advisory
- public procurement advisory
- advocacy reporting
- evaluations of projects, policies and programmes
- strategy development
- product development costing and determination of pricing strategies
- market research
- survey design, collection and analyses
- ad-hoc engagements

Quantitative risk advisory

- ICAAP & ILAAP
- capital requirements
- ALM & Actuarial ALM
- stress testing (BASEL III / SOLVENCY II)
- independence reviews
- credit risk
- interest rate risk
- price risk (hedging)
- foreign exchange risk
- data mining
- data science
- Tableau dashboard
- data management
- statistics and data analytics
- remediation and anti-money laundering
- tool kit using research techniques

Other services

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- marketing and communications consultancy
- brand development
- human resource consultancy

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