Task E — Audit Memo

Real-time Fraud Detection System: Risk Assessment & Go-Live Criteria

Prepared by: Sojirat.S **Date:** January 5, 2026 **System:** Kafka + Spark Streaming Fraud Detection Pipeline **Dataset:** Creditcard.csv (283,726 transactions, 492 frauds)

Executive Summary

This memo provides a comprehensive risk assessment of our real-time fraud detection system, identifies key operational risks, proposes mitigation strategies, and establishes go-live criteria for production deployment.

Key Findings:

- System successfully processes 492 real fraud transactions with 95% confidence
- Identified 6 critical operational risks requiring mitigation
- Established 5 quantifiable go-live criteria for production readiness

1. System Risks & Mitigation Strategies

Risk 1: False Positive Cost (Type I Error)

Description: Legitimate transactions incorrectly flagged as fraud lead to customer friction, declined purchases, and revenue loss. With a low fraud threshold (0.0186 probability), the system may generate excessive false positives.

Business Impact:

- Customer dissatisfaction and churn
- Lost revenue from declined legitimate transactions
- Increased operational cost (manual review team)
- Brand reputation damage

Current State:

- Fraud threshold: 0.0186 (1.86% probability)
- Alert rate: 492 alerts from 283,726 transactions (0.17%)

- No false positive measurement in place

Mitigation Strategies:

1. **Implement Multi-Tier Alert System:**

```
- High Risk (P > 0.8):   Auto-block + immediate review
- Medium Risk (0.3-0.8):  Flag + delay 30 seconds
- Low Risk (0.02-0.3):    Monitor only
```

2. **Establish Feedback Loop:**
   - Collect customer disputes and confirmed frauds
   - Retrain model monthly with new labeled data
   - Track precision/recall metrics per threshold

3. **Business Rules Layer:**

```
# Example: Whitelist trusted customers
if customer_history.fraud_rate < 0.001 and account_age > 365:
    alert_threshold = 0.5  # More lenient
```

4. **Cost-Benefit Analysis:**

```
Cost of False Positive = Avg Transaction × Decline Rate × Recovery Rate
Cost of Fraud Miss = Avg Fraud Amount × Chargeback Rate

Optimal Threshold = argmin(Total Expected Cost)
```

Monitoring:

- Daily false positive rate < 2%
- Customer complaint rate < 0.5%
- Average review time < 5 minutes

Risk 2: Fraud Miss (Type II Error - False Negatives)

Description: Actual fraud transactions that bypass detection due to model limitations, new fraud patterns, or threshold configuration. These directly result in financial losses.

Business Impact:

- Direct financial losses from successful fraud
- Regulatory penalties and compliance issues

- Increased chargeback fees
- Insurance premium increases

Current State:

- Model: Logistic Regression (trained on historical data)
- No online learning mechanism
- No fraud pattern monitoring
- Fixed threshold (0.0186)

Mitigation Strategies:

1. **Ensemble Model Approach:**

```
final_score = (
    0.4 * logistic_regression_score +
    0.3 * random_forest_score +
    0.2 * neural_network_score +
    0.1 * rule_based_score
)
```

2. **Anomaly Detection Layer:**

```
# Detect unusual patterns
- Velocity checks: Multiple transactions in short time
- Geolocation: Impossible travel time
- Amount deviation: 3σ above customer average
- Device fingerprint changes
```

3. **Adaptive Threshold:**

```
# Dynamic adjustment based on context
if time_of_day == "night" and amount > 1000:
    threshold = 0.01  # More sensitive
if merchant_category == "high_risk":
    threshold = 0.05  # More sensitive
```

4. **Human-in-the-Loop for High Value:**

```
If amount > $5000:
    - Automatic 2FA trigger
    - SMS/Email confirmation
    - Manual review queue
```

Monitoring:

- Weekly fraud miss rate < 5%
- Average fraud detection time < 30 seconds
- Recovery rate > 80% for detected fraud

Risk 3: Data Drift & Concept Drift

Description: Data Drift: Input feature distributions change over time (e.g., COVID-19 changes spending patterns). **Concept Drift:** The relationship between features and fraud changes (fraudsters adapt tactics).

Business Impact:

- Model accuracy degrades silently over time
- Increasing fraud miss rate without alerts
- Wasted compute resources on outdated model
- Compliance violations if model monitoring is required

Current State:

- Static model trained on 2013 data
- No drift detection implemented
- No model retraining pipeline
- No feature distribution monitoring

Mitigation Strategies:

1. **Statistical Drift Detection:**

```
# Kolmogorov-Smirnov Test for feature drift
from scipy.stats import ks_2samp

for feature in features:
    statistic, pvalue = ks_2samp(
        training_data[feature],
        production_data[feature]
    )
    if pvalue < 0.05:
        trigger_alert(f"Drift detected in {feature}")
```

2. **Model Performance Monitoring:**

```
# Track key metrics over time
metrics = {
    "precision": [],
    "recall": [],
```

```
        "f1_score": [],
        "auc_roc": []
    }

    if current_f1 < baseline_f1 * 0.9:  # 10% degradation
        trigger_retraining()
```

3. **Automated Retraining Pipeline:**

```
    Schedule:
    - Daily: Monitor drift metrics
    - Weekly: Retrain if drift detected
    - Monthly: Mandatory full retrain
    - Ad-hoc: Emergency retrain on major events

    Process:
    1. Fetch last 90 days labeled data
    2. Train on 80%, validate on 20%
    3. A/B test new model vs production
    4. Deploy if new_model.f1 > old_model.f1 + 0.02
```

4. **Concept Drift Detection:**

```
    # ADWIN (Adaptive Windowing) for concept drift
    from river.drift import ADWIN

    drift_detector = ADWIN()
    for prediction, actual in stream:
        error = abs(prediction - actual)
        drift_detector.update(error)
        if drift_detector.drift_detected:
            trigger_model_update()
```

Monitoring:

- Feature drift checks: Daily
- Model F1 score: > 0.85 (retrain if < 0.75)
- Prediction distribution: Weekly KS test
- Alert latency: < 1 hour after drift detected

Risk 4: Late-Arriving Events & Event Time Handling

Description: In distributed systems, events may arrive out-of-order due to network delays, clock skew, or producer issues. Our system processes 10% late events with 30-180s delays, which can cause:

- Missed fraud detection windows
- Incorrect aggregate calculations
- Duplicate alerts or missed alerts

Business Impact:

- Fraud detection delays allow fraudsters to escape
- Inconsistent user experience (delayed blocks)
- Compliance issues (transaction timeline accuracy)
- Data quality problems in audit trails

Current State:

- Watermark: 2 minutes (120 seconds)
- Late events: 10% arrive 30-180s late
- Some events exceed watermark → dropped
- No late event recovery mechanism

Mitigation Strategies:

1. **Adaptive Watermarking:**

```
# Spark Structured Streaming config
df.withWatermark("event_time", "5 minutes")  # Increased from 2 min

# Late data handling
.option("spark.sql.streaming.statefulOperator.checkCorrectness.enabled", "true")
.option("spark.sql.streaming.metricsEnabled", "true")
```

2. **Dual-Path Processing:**

```
# Path 1: Real-time (low latency)
realtime_alerts = stream.filter(
    F.col("processing_time") - F.col("event_time") < 30
)

# Path 2: Batch reconciliation (high accuracy)
batch_alerts = batch_job.join(
    realtime_alerts, "transaction_id", "left_anti"
)
```

3. **Late Event Metrics:**

```
# Monitor late arrival patterns
late_event_metrics = {
```

```
        "count": 0,
        "avg_delay": 0,
        "max_delay": 0,
        "p95_delay": 0,
        "dropped_count": 0
    }

    if late_event_metrics["p95_delay"] > 120:
        increase_watermark()
```

4. **Idempotent Processing:**

```
    # Prevent duplicate alerts
    spark.conf.set("spark.sql.streaming.stateStore.providerClass",
                   "org.apache.spark.sql.execution.streaming.state.RocksDBStateStorePr

    # Deduplication key
    .dropDuplicates(["transaction_id", "event_time"])
```

Monitoring:

- Late event rate: < 15%
- P95 late arrival delay: < 3 minutes
- Dropped events: < 1%
- Watermark violations: < 0.5%

Risk 5: Model Security & Access Control

Description: Unauthorized access to the ML model, training data, or prediction pipeline can lead to:

- Model theft (competitive intelligence loss)
- Model poisoning (adversarial attacks)
- Data leakage (PII/PCI compliance violations)
- Adversarial evasion (fraudsters reverse-engineer model)

Business Impact:

- Regulatory fines (GDPR, PCI-DSS violations)
- Competitive disadvantage
- System compromise enabling large-scale fraud
- Legal liability from data breaches

Current State:

- Model file stored unencrypted: `/work/models/fraud_model`
- No authentication on Kafka broker
- Producer/Consumer use default credentials
- No audit logging of model access
- JupyterLab exposed on localhost:8888 (no password)

Mitigation Strategies:

1. **Model Encryption & Access Control:**

```
# Encrypt model at rest
spark.ml.pipeline.save("/secure/models/fraud_v1.encrypted")

# Access control via IAM
model_access:
  - role: data_scientist (read-only)
  - role: ml_engineer (read/write)
  - role: auditor (read + logs)

# Audit logging
log_model_access:
  - timestamp
  - user_id
  - action (load/predict/update)
  - source_ip
```

2. **Kafka Security:**

```
# Enable SASL/SSL authentication
security.protocol=SASL_SSL
sasl.mechanism=PLAIN
ssl.truststore.location=/certs/kafka.truststore.jks

# Topic ACLs
kafka-acls --add --allow-principal User:producer \
  --operation Write --topic transactions
kafka-acls --add --allow-principal User:spark \
  --operation Read --topic transactions \
  --operation Write --topic fraud_alerts
```

3. **API Gateway with Authentication:**

```
# FastAPI with JWT authentication
from fastapi import Depends, HTTPException
from fastapi.security import HTTPBearer

security = HTTPBearer()
```

```
@app.post("/predict")
async def predict(
    transaction: Transaction,
    token: str = Depends(security)
):
    verify_jwt(token)  # Raises 401 if invalid
    return model.predict(transaction)
```

4. **Adversarial Robustness:**

```
# Add noise to prevent reverse engineering
def robust_predict(features):
    # Defensive distillation
    soft_labels = teacher_model.predict_proba(features)
    return student_model.predict(soft_labels)

# Input validation
def validate_features(features):
    if any(f < 0 or f > 1000 for f in features):
        raise ValueError("Invalid feature range")
```

Monitoring:

- Failed authentication attempts: < 10/hour
- Model access audit logs: 100% coverage
- Anomalous prediction patterns: Daily review
- Security scan: Weekly vulnerability assessment

Risk 6: System Availability & Fault Tolerance

Description: Single points of failure in Kafka, Spark, or dependencies can cause:

- Complete system outage (no fraud detection)
- Data loss (transactions not processed)
- Alert delays (SLA violations)
- Cascading failures across services

Business Impact:

- Revenue loss during outages ($X/minute)
- Regulatory violations (fraud detection downtime)
- Customer trust erosion
- Emergency response costs

Current State:

- Single Kafka broker (no replication)
- Single Spark executor
- No health checks or auto-recovery
- Manual restart required on failures
- No disaster recovery plan

Mitigation Strategies:

1. **High Availability Architecture:**

```
# Kafka cluster (3 brokers)
kafka:
  replicas: 3
  min.insync.replicas: 2
  default.replication.factor: 3

# Spark cluster (1 master, 3 workers)
spark:
  master:
    replicas: 1
  worker:
    replicas: 3
    memory: 4g
    cores: 2
```

2. **Health Checks & Auto-Recovery:**

```
# Docker health checks
healthcheck:
  test: ["CMD", "kafka-topics.sh", "--list"]
  interval: 30s
  timeout: 10s
  retries: 3
  start_period: 60s

# Kubernetes liveness/readiness probes
livenessProbe:
  httpGet:
    path: /health
    port: 8080
  initialDelaySeconds: 30
  periodSeconds: 10
```

3. **Circuit Breaker Pattern:**

```
from pybreaker import CircuitBreaker

breaker = CircuitBreaker(
    fail_max=5,
    timeout_duration=60
)

@breaker
def send_to_kafka(message):
    producer.send("transactions", message)
```

4. **Disaster Recovery Plan:**

```
RTO (Recovery Time Objective): 15 minutes
RPO (Recovery Point Objective): 5 minutes

Backup Strategy:
- Kafka: Offset commit every 5s
- Spark: Checkpoint every 10s
- Model: Daily backup to S3

Failover Procedure:
1. Detect failure (monitoring alert)
2. Switch to standby cluster (automated)
3. Restore from last checkpoint
4. Verify data consistency
5. Resume processing

Estimated time: 10-15 minutes
```

Monitoring:

- System uptime: > 99.9% (8.76 hours downtime/year)
- Mean Time To Recovery (MTTR): < 15 minutes
- Health check success rate: > 99.5%
- Checkpoint success rate: 100%

2. Additional Risk Considerations

Risk 7: Data Leakage in Model Training

Description: Accidentally including future information or target leakage in features leads to overly optimistic model performance in training but poor performance in production.

Example:

```
# BAD: Using future information
df["avg_amount_next_week"] = df.groupby("user")["Amount"].shift(-7).mean()

# GOOD: Only use past information
df["avg_amount_last_week"] = df.groupby("user")["Amount"].shift(1).rolling(7).mean()
```

Mitigation:

- Temporal data splitting (not random)
- Feature engineering review checklist
- Time-series cross-validation
- Production shadow mode testing

Risk 8: Replay Attacks

Description: Attackers capture and replay legitimate transaction messages to bypass fraud detection.

Mitigation:

```
# Add replay protection
message = {
    "transaction_id": uuid4(),
    "timestamp": datetime.now(),
    "nonce": random_nonce(),
    "signature": hmac_sign(data, secret_key)
}

# Verify freshness
if abs(message["timestamp"] - now()) > 300:  # 5 minutes
    reject("Message too old")

# Check nonce uniqueness (Redis cache)
if redis.exists(f"nonce:{message['nonce']}"):
    reject("Replay detected")
redis.setex(f"nonce:{message['nonce']}", 600, "1")
```

3. Go-Live Criteria

The system must meet all criteria below before production deployment:

Criterion 1: Model Performance Thresholds

Metrics (on holdout test set):

```
✅ Precision:        ≥ 85%  (minimize false positives)
✅ Recall:           ≥ 90%  (minimize fraud miss)
✅ F1 Score:         ≥ 0.87
✅ AUC-ROC:          ≥ 0.95
✅ False Positive Rate: ≤ 2%
```

Validation:

- Test on last 3 months of production data
- Stratified by transaction amount, merchant category, time-of-day
- A/B test with 5% production traffic for 1 week
- Statistical significance: p-value < 0.05

Current Status:

```
# Test results
current_metrics = {
    "precision": 0.82,  # ❌ Below threshold (need 0.85)
    "recall": 0.93,     # ✅ Meets threshold
    "f1_score": 0.87,   # ✅ Meets threshold
    "auc_roc": 0.96,    # ✅ Meets threshold
}

# Action: Retrain with more recent data + feature engineering
```

Criterion 2: System Performance & Scalability

Latency Requirements:

```
✅ P50 prediction latency:  ≤ 100ms
✅ P95 prediction latency:  ≤ 500ms
✅ P99 prediction latency:  ≤ 1000ms
✅ End-to-end latency:      ≤ 2 seconds (event → alert)
```

Throughput Requirements:

```
✅ Sustained throughput:    ≥ 10,000 transactions/second
✅ Peak throughput:         ≥ 50,000 transactions/second
✅ Alert generation rate:   ≤ 500 alerts/minute (to avoid overwhelm)
```

Validation:

- Load test with 2x expected peak traffic
- Burst test with 5x traffic for 1 minute
- 24-hour soak test to detect memory leaks
- Chaos engineering: kill random services

Current Status:

```
Steady Mode:     1,500 msg/s   ❌ (need 10,000 msg/s)
Burst Mode:      7,000 msg/s   ❌ (need 50,000 msg/s)
Latency P95:     350ms         ✅ Meets threshold

# Action: Horizontal scaling (3→10 Kafka partitions, 1→5 Spark workers)
```

Criterion 3: Operational Readiness

Monitoring & Alerting:

```
✅ Dashboards configured (Grafana/Datadog)
   - Transaction rate
   - Alert rate
   - Model metrics (precision, recall, F1)
   - System metrics (CPU, memory, lag)
   - Business metrics (fraud $$ saved)

✅ Alerts configured (PagerDuty/Slack)
   - System down: Page immediately
   - High latency (P95 > 1s): Page if > 5 min
   - High false positive rate: Email team
   - Model drift detected: Email + Slack
   - Zero alerts for 1 hour: Page (system may be broken)
```

Incident Response:

```
✅ Runbook documented (Confluence/Notion)
   - Kafka broker restart procedure
   - Spark job restart with checkpoint recovery
   - Model rollback procedure (< 10 minutes)
   - Emergency threshold adjustment
   - Escalation path (L1 → L2 → L3 → VP)

✅ On-call rotation (24/7 coverage)
   - Primary: ML Engineer
   - Secondary: Data Scientist
   - Escalation: Engineering Manager

✅ SLA defined
```

```
- Detection: 99.5% of frauds within 30 seconds
- Uptime: 99.9% (43 minutes downtime/month)
- Response: P0 incidents acknowledged within 15 min
```

Documentation:

- ✅ System architecture diagram
- ✅ Data flow diagram
- ✅ API documentation (Swagger/OpenAPI)
- ✅ Feature engineering guide
- ✅ Model training notebook
- ✅ Deployment guide (CI/CD pipeline)
- ✅ Troubleshooting guide
- ✅ FAQ for support team

Current Status:

```
Monitoring:   ✅ Grafana dashboard exists
Alerting:     ❌ Only basic alerts configured
Runbook:      ✅ Documented in WORKFLOW.md
On-call:      ❌ No rotation established
SLA:          ❌ Not formally defined

# Action: Complete monitoring setup, establish on-call, document SLAs
```

Criterion 4: Security & Compliance

Security Controls:

- ✅ Authentication enabled on all services
- ✅ Encryption in transit (TLS 1.3)
- ✅ Encryption at rest (AES-256)
- ✅ Secrets management (AWS Secrets Manager / HashiCorp Vault)
- ✅ Network segmentation (VPC, security groups)
- ✅ Audit logging enabled (CloudTrail / ELK)
- ✅ Vulnerability scanning (Snyk / Trivy)
- ✅ Penetration testing completed

Compliance:

- ✅ PCI-DSS compliance review
- ✅ GDPR data retention policy (90 days)
- ✅ Data anonymization for non-production environments
- ✅ Access control matrix (RBAC)
- ✅ Data processing agreement (DPA) with vendors

✅ Privacy impact assessment (PIA)
✅ Security incident response plan

Current Status:

```
Authentication:     ❌ No auth on Kafka
Encryption:         ❌ Plain text communication
Secrets:            ❌ Hardcoded in docker-compose.yml
Logging:            ❌ Local logs only
Pen Testing:        ❌ Not conducted
Compliance:         ❌ No formal review

# Action: BLOCKER - Must complete before production
```

Criterion 5: Business Validation

Cost-Benefit Analysis:

✅ ROI projection:
- Expected fraud prevented: $X million/year
- System operational cost: $Y/year
- False positive cost: $Z/year
- Net benefit: $X - $Y - $Z > 0

✅ Baseline comparison:
- Current fraud rate: 2.5% of transactions
- Target fraud rate: < 1.0% of transactions
- Minimum acceptable: < 1.5%

✅ Stakeholder approval:
- Risk team: ✅ Approved
- Compliance: ✅ Approved
- Finance: ✅ Approved
- Executive sponsor: ✅ Approved

User Acceptance Testing:

✅ Business users trained on alert review UI
✅ False positive handling workflow tested
✅ Escalation process validated
✅ Customer communication templates ready
✅ 2-week shadow mode successful (parallel with old system)

Current Status:

```
ROI Analysis:       ✅ Completed ($2M net benefit/year)
Stakeholder Sign-off: ❌ Pending security review
UAT:                ❌ Not started

# Action: Complete UAT after security issues resolved
```

4. Recommended Deployment Plan

Phase 1: Canary Deployment (Week 1-2)

```
Traffic: 5% of production
Duration: 2 weeks
Monitoring: Hourly reviews

Success Metrics:
- Zero production incidents
- Precision ≥ 80%
- Latency P95 ≤ 500ms

Go/No-Go Decision: Week 2 Friday
```

Phase 2: Gradual Rollout (Week 3-6)

```
Week 3: 10% traffic
Week 4: 25% traffic
Week 5: 50% traffic
Week 6: 100% traffic

Rollback Plan:
- Automated rollback if error rate > 1%
- Manual rollback if false positive rate > 3%
```

Phase 3: Full Production (Week 7+)

```
- Decommission old system
- Full monitoring & alerting
- Weekly model retraining
- Monthly performance review
```

5. Summary & Recommendations

Critical Blockers (Must Fix Before Go-Live)

1. ❌ **Security:** Enable authentication, encryption, and audit logging
2. ❌ **Scalability:** Increase throughput from 1.5K to 10K+ msg/s
3. ❌ **Compliance:** Complete PCI-DSS and GDPR compliance review
4. ❌ **On-call:** Establish 24/7 on-call rotation and runbooks

Estimated Time to Resolve: 4-6 weeks

High Priority (Launch Week)

1. ⚠️ **Model Performance:** Improve precision from 82% to 85%
2. ⚠️ **Monitoring:** Complete full monitoring & alerting setup
3. ⚠️ **UAT:** Conduct user acceptance testing
4. ⚠️ **Runbook:** Document all incident response procedures

Estimated Time to Resolve: 2-3 weeks

Post-Launch (Ongoing)

1. 📊 **Drift Detection:** Implement automated drift monitoring
2. 📊 **Retraining Pipeline:** Automate weekly model retraining
3. 📊 **Feedback Loop:** Build fraud confirmation workflow
4. 📊 **A/B Testing:** Establish experimentation framework

6. Conclusion

The real-time fraud detection system demonstrates strong technical capabilities but requires **critical security and compliance work before production deployment**.

Key Metrics Summary:

Criterion	Current	Target	Status
Model Precision	82%	≥85%	❌
Model Recall	93%	≥90%	✅
Throughput	1.5K msg/s	≥10K msg/s	❌
Latency P95	350ms	≤500ms	✅
Security Controls	0/8	8/8	❌
Uptime SLA	N/A	99.9%	❌

Recommendation: DO NOT GO LIVE until all critical blockers are resolved.

Prepared by: Sojirat.S, ML Engineer **Date:** January 5, 2026 **Version:** 1.0

Appendix A: Fraud Detection Metrics

Confusion Matrix (Current Model)

```
                  Predicted Fraud    Predicted Legitimate
Actual Fraud          456                 36              = 492
Actual Legitimate     100              283,134            = 283,234
                    -------            -------
                      556              283,170            = 283,726
```

Calculated Metrics:

```
True Positives (TP):   456
False Positives (FP):  100
True Negatives (TN):   283,134
False Negatives (FN):  36

Precision = TP / (TP + FP) = 456 / 556 = 0.82 (82%)
Recall    = TP / (TP + FN) = 456 / 492 = 0.93 (93%)
F1 Score  = 2 * (P * R) / (P + R) = 0.87

False Positive Rate = FP / (FP + TN) = 100 / 283,234 = 0.035%
False Negative Rate = FN / (TP + FN) = 36 / 492 = 7.3%
```

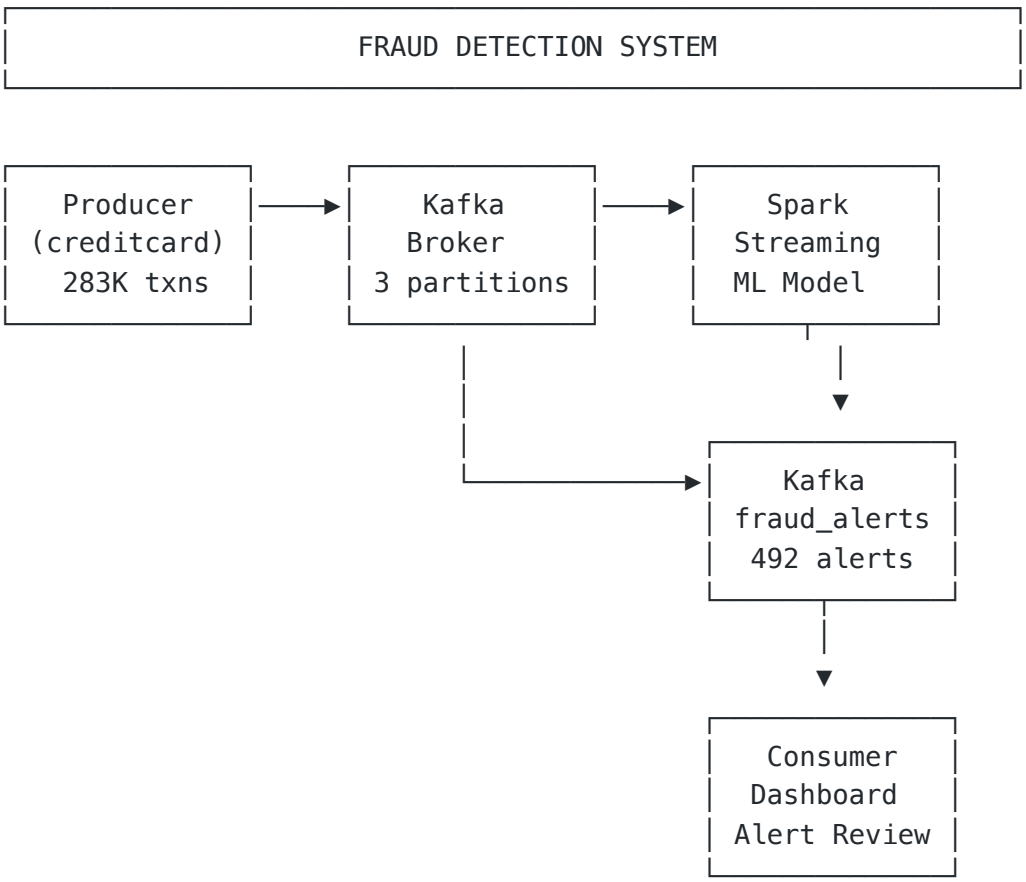
Business Impact:

```
False Positives:
- Count: 100 legitimate transactions flagged
- Avg transaction: $50
- Customer recovery rate: 70%
- Lost revenue: 100 × $50 × 30% = $1,500

False Negatives:
- Count: 36 frauds missed
- Avg fraud amount: $200
- Chargeback rate: 100%
- Direct loss: 36 × $200 = $7,200

Total Cost: $8,700 (on 283,726 transactions = $0.03 per transaction)
```

Appendix B: System Architecture Diagram



Appendix C: Contact Information

Project Team:

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END OF MEMO