Fraud Prevention:

The Prevention and Detection of Fraud Begins with You

Takeaways

- What is fraud?
  - Definition
  - Facts
  - Four Factors
- Fraud risk assessment
  - Four evaluation criteria
- Common fraud schemes
  - Case studies
- Prevention controls
  - What can you do?

What is fraud?

Definition

Fraud is any intentional act or omission designed to deceive others and resulting in the victim suffering a loss and/or the perpetrator achieving a gain.

The Association of Certified Fraud Examiners
The American Institute of Certified Public Accountants
The Institute of Internal Auditors

Fraud Facts

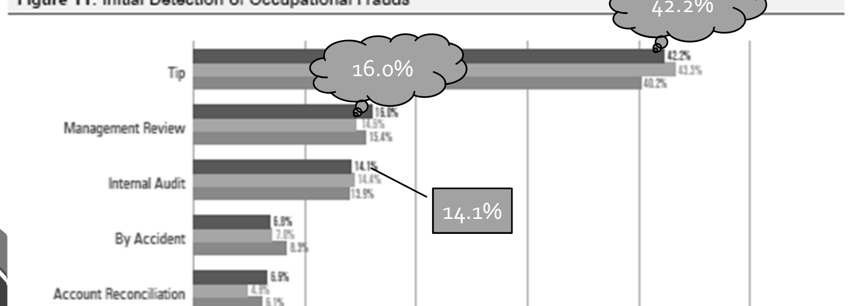
The 2014 Report to the Nations on Occupational Fraud & Abuse by the Association of Certified Fraud Examiners cited:

- The estimated typical organization loses 5% of revenues each year to fraud
- Operating revenues at Texas Tech University System for fiscal year 2014 were $1,085,666,337, meaning more than $54 million is at risk for fraud within the System!

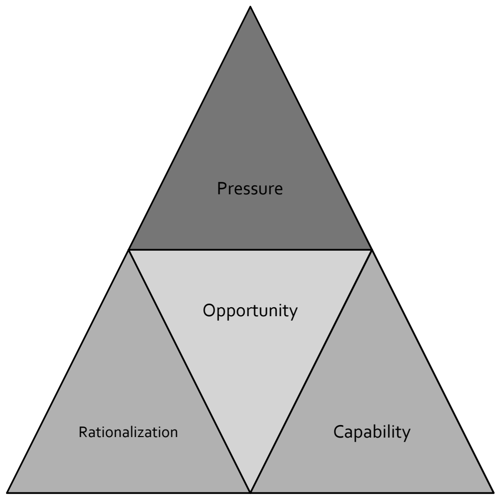
Fraud Facts

- In 2014, 58% of fraud cases were discovered by tips or during routine reviews by management.

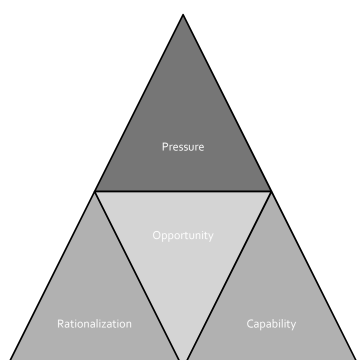
Figure 11: Initial Detection of Occupational Frauds



Four Fraud Factors

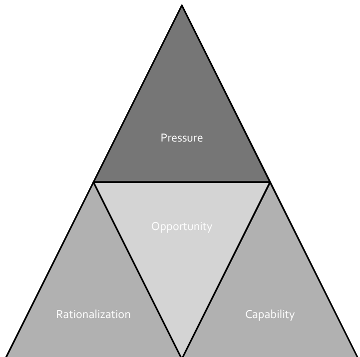


Four Fraud Factors: Pressure



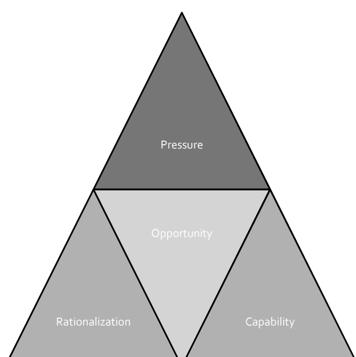
- Non-sharable financial pressure
- A situation that is so insurmountable the person cannot see any other way out
- Family pressures
- Insatiable desire for financial gain
- Pressure to meet institutional goals

Four Fraud Factors: Capability



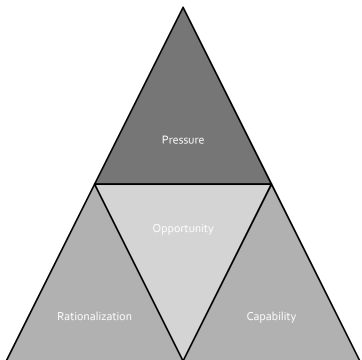
- Position or function within the organization
- Personal traits and abilities
- Confidence in one's ability to commit fraud undetected
- Ability to talk one's way out of trouble
- Deals well with stress

Four Fraud Factors: Rationalization



- A way to justify in the person's consciousness that the act of fraud is not so bad
- Common beliefs:
  - Person is owed this money
  - Just borrowing until they are able to pay it back
  - Everyone else is doing it

Four Fraud Factors: Opportunity



- The only aspect the organization really controls is opportunity.

Who Commits Fraud?

- Everyday people commit fraud given situational pressures.
- Most fraudsters exhibit certain behavioral traits that can be warning signs.

Characteristics of a Fraudster

- Unusually high personal debts
- Excessive gambling, alcohol, or drug problems
- Undue family, institutional, and peer pressure to succeed
- Dissatisfaction with job, feeling underpaid, or not recognized
- Overwhelming desire for personal gain

Characteristics of a Fraudster

- Belief that job is in jeopardy
- Close associations with suppliers or customers
- Lack of personal stability
- Intellectual challenge to beat the system
- Not taking vacations or sick time

Fraud Risk Assessment

Fraud Risk Assessment

- A fraud risk assessment identifies where fraud may occur within the organization.
- A fraud risk assessment should:
  - Consider relevant fraud schemes and scenarios
  - Map those schemes and scenarios to mitigating controls

Four Evaluation Criteria

1. Likelihood
   - What is the probability that this type of fraud will occur at our institution?
2. Pervasiveness
   - Assuming that this type of fraud could occur or is occurring, would it affect only a few division/departments or is it something that could be widespread?

Four Evaluation Criteria

3. Materiality
   - Assuming this fraud occurs at our institution, would the dollar amount and/or value lost be large or small?
4. Reputational Risk
   - Should the public discover that this type of fraud is occurring, how significantly would it impact the reputation or "brand" of our university (i.e., loss of public trust)?

Common Fraud Schemes

Common Fraud Schemes

- Asset Misappropriation
  - Cash Theft
  - Inventory and Other Assets
  - Fraudulent Disbursements
- Corruption
  - Conflicts of Interest
  - Bribery and Incentives

Asset Misappropriation: Cash

Cash Larceny

- A cash larceny may be defined as the intentional taking of an employer's cash (the term cash includes both currency and checks).
- A cash larceny scheme can take place in any circumstance in which an employee has access to cash.
- Most larceny schemes involve the theft of incoming cash, currency on hand (in a cash register, cash box), or theft of cash from the organization's bank deposits.

Asset Misappropriation: Cash

Types of Cash Larceny

- Theft of cash on hand
  - Reversing transactions
  - Altering cash counts
- Theft of cash from the deposit
  - Deposit lapping

Case Study: Medical Clinic Business Office

Schemes: Theft of Cash and Deposit Lapping

- Lack of segregation of duties in cash handling, payment posting, and deposit processes
- No supervisory review or approval of deposits
- Cashier stole over $530,000 in cash from deposits over an 8-year period.

Asset Misappropriation: Cash

Cash Skimming

- Skimming is the theft of cash from the entity before it is recorded in an accounting or cash system.
- Skimming is committed by employees.
- Skimming schemes are "off-the-books" frauds, meaning money is stolen before it is recorded in the organization's accounts.

Asset Misappropriation: Cash

Types of Cash Skimming

- Sales skimming
- Receivables skimming
  - Forcing account balances or destroying transaction records
  - Lapping
  - Writing off account balances

Asset Misappropriation: Inventory and Other Assets

- Employees target inventory, equipment, supplies, and other non-cash assets for theft in a number of ways. These schemes can range from stealing a box of pens to the theft of millions of dollars worth of equipment.
- The terms inventory and other assets are meant to encompass the misappropriation schemes involving any organizational assets other than cash.
- There are basically two ways a person can misappropriate a company asset: The asset can be misused or it can be stolen.

Asset Misappropriation: Inventory and Other Assets

Types of Inventory and Other Asset Misappropriation

- Misuse
  - Any use that is not associated with the University's intended or expressed used of the asset
- Larceny
  - Purchasing and receiving schemes
  - Asset requisitions and transfers

Asset Misappropriation: Fraudulent Disbursements

Types of Fraudulent Disbursements

- Billing schemes
- Payroll schemes
- Expense reimbursement schemes
- Check tampering
- Register disbursements

Asset Misappropriation: Fraudulent Disbursements

Billing schemes

- Billing schemes are a popular form of employee fraud mainly because they offer the prospect of large rewards.
- Since the majority of most businesses' disbursements are made in the purchasing cycle, larger thefts can be hidden through false-billing schemes.
- There are three principal types of billing schemes:
  - False invoicing via shell companies
  - False invoicing via non-accomplice vendors (Pay-and-return schemes)
  - Personal purchases with company funds

Case Study:
Center of Excellence in Cancer

Scheme: Billing Scheme – Personal Purchases

- Abuse of purchasing authority by fund manager
- Lack of segregation of duties in purchasing process
- 175 items (approximately $8,600) over an 8-month period that appeared to be personal or non-work related
- Pressure to spend down state funds

Asset Misappropriation: Fraudulent Disbursements

Payroll schemes

- In payroll schemes, the perpetrator typically falsifies a timecard or alters information in the payroll records.
- Payroll frauds involve disbursements to employees rather than to external parties.
- The most common payroll frauds are:
  - Ghost employees
  - Falsified hours and salary

Case Study: Timesheet Fraud

Scheme: Payroll – Falsified Wages

- Student Assistant reported 333 hours that she did not work over a 6-month time period, resulting in overpayments of $2,600
- Timesheet approver did not know actual hours worked
- Theft of time is still fraud

Asset Misappropriation: Fraudulent Disbursements

Expense reimbursement schemes

- Employees can manipulate an organization's expense reimbursement procedures to generate fraudulent disbursements.
- The most common disbursement frauds are:
  - Mischaracterized expense reimbursements
  - Fictitious expense reimbursements
  - Overstated expense reimbursements
    - Altered receipts
    - Overpurchasing
  - Multiple reimbursements

Asset Misappropriation: Fraudulent Disbursements

Check Tampering

- Check tampering is unique among the fraudulent disbursement schemes because it is the one group in which the perpetrator physically prepares the fraudulent check.
- In these schemes, the perpetrator takes physical control of a check and makes it payable to himself through one of several methods:
  - Forged maker
  - Forged endorsement
  - Altered payee

Case Study:
Nursing SIMLife Center

Scheme: Theft of Cash, Check Tampering, and Billing Scheme – Personal Purchases

- Two employees directed customers to pay with cash or leave checks blank
- No cash deposited
- Over $20,000 in cash and checks may have been stolen over a 1-year time period
- One employee gave her eRaider name and password to her son to set up carts in TechBuy

Corruption: Conflicts of Interest

Types of Conflicts of Interest

- Purchase schemes
- Entitlement schemes
- Conflicts of commitment

Case Study: College of Agriculture

Scheme: Conflict of Interest – Purchase

- Tenured professor awarded over $15,000 in scholarships to his children and $7,500 to his son's girlfriend
- Purchased livestock from his minor children
- Culture of department resulted in multiple issues over a 9-year period

Corruption: Bribery and Incentives

Types of Bribery and Incentives Schemes

- Bid-rigging schemes
  - "Need" recognition
  - Specifications
- Bribery schemes
  - Kickbacks

Case Study: Sports Nutrition

Scheme: Conflict of Interest – Purchase & Bid Rigging

- Director of Sports Nutrition Program owned company used to purchase supplements
- No segregation of duties in purchasing and inventory processes
- Athletics purchased over $430,000 of supplements over a 2-year time period

Prevention Controls

Fraud Prevention: Asset Misappropriation

What to Look For:

- Parties who submit invoices regularly slightly below bid limits
- Over-concerned or interested parties
- Parties who try to "rush" the procurement or payables process
- Parties who wish to remain the sole source of contact between the vendor and University
- Lack of vendor information on file, missing phone number or phone number not in service
- P.O. Box address, but no physical address

Fraud Prevention: Asset Misappropriation

What to Monitor:

- Monitoring vendor payments
  - Monitor for multiple payments across several invoices exceeding bid and purchasing limits within the fiscal year
  - Monitor for individual payments just below bid and purchasing limits
- Invoices
  - Consecutive invoice numbers
  - Generic invoices
- "Smell Test"
  - Does something just 'seem off'? Does it warrant more questions to ensure you have all the information you need?

Fraud Prevention: Personal Purchases

What to Look For:

- Over-purchasing—purchasing a larger number of items than what appears to be necessary.
- Unusually high number of P-Card transactions to stores that provide non P-Card refunds.
- Duplicate purchases on P-Cards on the same approximate date, time, and amount.
- Frequent purchasing of items from a vendor that can be purchased at a discount through procurement systems.

Fraud Prevention: Personal Purchases

What to Monitor:

- Pay attention to P-Cards
  - P-Card sharing
  - P-Card log
- Electronic approvals
  - DO NOT share your electronic credentials with ANYONE.
  - By sharing your credentials, you will be held personally liable for all activities performed under your credentials

Fraud Prevention: Expense Reimbursement

What to Look For:

- Fuzzy support / details
- Altered receipts
- Photocopies often submitted in place of originals
- Generic receipts providing very little information
- Missing receipts

Fraud Prevention: Expense Reimbursement

What to Monitor:

- Detailed expense reports should require the following information:
  - Original receipts or other supporting documentation
  - Explanation of the expense including specific business purpose
  - Date expense occurred
  - Place of expenditure
  - Amount

Fraud Prevention: Conflicts of Interest

What to Look For:

- Tips and complaints
- Favorable treatment of a certain vendor

Fraud Prevention: Conflicts of Interest

What to Monitor:

- Conflict of interest disclosures
- Procurement process violations
  - POs after the fact
  - No segregation—one person makes all the decisions
  - Other possible vendors not given appropriate consideration

Fraud Prevention: Bribery and Incentives

What to Look For:

- Gifts and favors
- A person who insists on being the point of contact
- Paying a higher price
- Using an unusual or non-contract vendor
- A constant vocal complainer

Fraud Prevention: Bribery and Incentives

What to Monitor:

- Favorable treatment of a certain vendor
- Market value of products purchased
- Higher than expected volume of purchases from particular vendors
- Unnecessary purchases

Fraud Prevention: What can employees do?

Ensure proper segregation of responsibilities
- No one person should have control of any process: purchasing, p-card, payroll, HR, cash handling
- No password sharing

Reconcile your FOPs monthly
- Conducted by a person not in the procurement process, if possible

Review procurement card statements, including receipts
- Do not simply sign them and pass them through

Review approval authorities
- Limit the number of individuals with approver or requestor authority on FOPs
- Ensure only current employees have access
- Conduct the review no less than annually

Review travel documents, including receipts

- Do not simply sign them electronically and pass them on

Count inventories regularly

- Conduct a count of inventory and compare to inventory amounts in tracking systems

Conduct surprise cash counts

- Stress that it isn't distrust of the employee, but is a routine responsibility in cash handling areas

ASK QUESTIONS

- No one has unquestioned authority to do as they wish

Presentation Resources and Works Cited

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Fraud Prevention

It Starts with You!