Fraud By Any Other Name…Is Still Fraud

A Fraud Awareness Briefing Presented By

Ethics, Risk and Compliance Services
Chancellor’s Office
FRAUD AWARENESS
Fraud by any other name…is still fraud

Agenda
This briefing is designed to filter through the smoke and mirrors of occupational deception. By the end of this training, you will have learned:

- What Fraud is
- How to identify Fraud
- How to minimize Fraud
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What is Fraud?

An array of irregularities and illegal acts characterized by intentional deception, perpetrated by individuals inside or outside of the organization for their personal benefit or benefit to the organization.

The Association of Certified Fraud Examiners (ACFE) defines fraud as:
“The use of one’s occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization’s resources or assets.”
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Actions Constituting Fraud

The terms defalcation, misappropriation, and other fiscal wrongdoings refer to, but are not limited to:

- Any dishonest or fraudulent act
- Forgery or alteration of any document or account belonging to the Company
- Forgery or alteration of a check, bank draft, or any other financial document
- Misappropriation of funds, securities, supplies, or other assets
- Impropriety in the handling or reporting of money or financial transactions
- Profiteering as a result of insider knowledge of company activities
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Opportunity
Generally provided through weaknesses in internal controls. Examples include:
- Weak internal controls
- Circumvention of internal controls
- The greater the position, the greater the trust and exposure to unprotected assets
- “Most Trusted Employee”
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Rationalization
The individual develops a reason for their fraudulent activities. Examples include:
- Sense of entitlement from feeling wronged
- I need it more than the other person
- I’m borrowing and will pay it back later
- Everybody does it
- The University is big enough that it won’t miss it
- Nobody will get hurt
- It is for the greater good
- I’m not paid enough
- I’m not gaining personally
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Pressure
May be imposed due to:
- Personal financial problems
- Vices such as gambling, drugs, extensive debt, etc.
- Unrealistic deadlines and performance goals
- Personal prestige, goal achievement
- Morally superior, justified in making others victims
- Economic pressure resulting from price volatility, low profit margin, etc.
- Greed

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Conditions that can Contribute to Fraud

- Managers not caring about honesty
- Inadequate Pay
- Low Loyalty
- Crisis Management
- Rigid Rules
- Repression of Differences
- Poor Promotion Opportunities
- Lack of Recognition
- Unreasonable Budget Expectations
- Short-Term Focus
- Reactive vs. Proactive
- Hostile Work Environment
- Poor Training
- Pressure to Perform
- Inadequate staff/resources
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Red Flags (Organizational)

- No communication of expectations
- Too much trust in key employees
- Lack of Proper Authorization Procedures
- Lack of Attention to Detail
- Changes in Organizational Structure

*From Harvard Internal Audit Home Page
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Red Flags (Accountability and Control)

- Lack of Separation of Duties
- Lack of Physical Security and/or Key Control
- Weak Links in Chain of Controls and Accountability
- Missing Independent Checks on Performance
- Relaxed Management Style
- Poor System Design
- Inadequate Training

From Harvard Internal Audit Home Page
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HOW OCCUPATIONAL FRAUD IS COMMITTED
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How Occupational Fraud is commonly Committed

- **Asset Misappropriation** – (*91.5% of all cases)
  - Fraudulent invoicing
  - Payroll fraud
  - Skimming revenues

- **Corruption**
  - Accepting or paying a bribe
  - Engaging in a business transaction where there is an undisclosed conflict of interest

- **Fraudulent Statements**
  - Booking fictitious sales
  - Recording expenses in the wrong period

*The sum of percentages in this table exceeds 100% because several cases involved schemes that fell into more than one category.

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Schemes Involving Cash Receipts and Cash On Hand

- **Skimming** –
  Any scheme in which cash is stolen from an organization **before** it is recorded in the books or records
  - Employee accepts payment from a customer but does not record the sale.

- **Cash Larceny** –
  Any scheme in which cash is stolen from an organization **after** it has been recorded on the organization’s books and records.
  - Employee steals cash and checks from daily receipts before they can be deposited in the bank.

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Non-Cash Misappropriations

- **Inventory**
  - Employee steals merchandise from warehouse or sales floor
  - Employee diverts incoming shipments of inventory for personal use.

- **Information**
  - Employee accesses customer records for purposes of committing identity theft
  - Employee provides company trade secrets to a competitor

- **Securities**
  - Employee fraudulently transfers stocks or bonds held by company or personal account.

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Schemes involving Fraudulent Disbursements or Cash

- **Billing**
  - Employee creates a shell company and bills employer for nonexistent services
  - Employee purchases personal items and submits invoice for payment

- **Expense Reimbursements**
  - Employee files fraudulent expense report claiming personal travel, nonexistent meals, etc.

- **Check Tampering**
  - Employee steals blank company checks, makes them out to himself or an accomplice
  - Employee steals outgoing check to a vendor, deposits it into their own bank account.

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Schemes involving Fraudulent Disbursements or Cash - continued

- **Payroll**
  - Employee claims overtime for unworked hours
  - Employee adds ghost employee to the payroll

- **Wire Transfers**
  - Employee causes funds to be wired from company bank accounts to account controlled by employee or accomplice

- **Register Disbursements**
  - Employee fraudulently voids a sale on his cash register and steals the cash.

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Financial Statement Fraudulent Schemes

- **Concealed Liabilities**
  - Organization omits significant expenses or liabilities on its financial statements
  - Organization records revenue-based expenses as capital expenditures, falsely increasing both net and total assets in the current accounting period.

- **Fictitious Revenues**
  - Organization records the sale of inventory to a phantom customer
  - Organization creates invoices showing sale of goods to existing customer, but goods are never delivered. Sales are reversed at beginning of next account period
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Financial Statement Fraudulent Schemes continued

- **Improper Asset Valuations**
  - Organization fails to write off obsolete inventory
  - Organization inflates its receivables by booking fictitious sales on account to nonexistent customers

- **Improper Disclosures**
  - Organization’s financial statements fail to note potentially material liability arising from a corporate guarantee of personal loans taken out by an officer
  - Organization’s financial statements fail to note that one of its largest suppliers is owned by the corporation’s president.

- **Timing differences**
  - Organization manipulates net income by recording sales that occur in December of Year 1, but not recording the corresponding expenses until January of Year 2.

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Corruption Schemes

- **Conflicts of Interest**
  - An employee owns an undisclosed interest in a supplier and negotiates a contract between his employer and the supplier, purchasing materials at an inflated price

- **Bribery**
  - An employee processes inflated invoices from a vendor in return for a 10% kickback on the invoice price
  - An employee accepts payment from a vendor in return for providing confidential information about competitors bids on a project.
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Corruption Schemes

- **Illegal Gratuities**
  - An official negotiates an agreement with a contractor and in appreciation the contractor provides the official with a gift such as a free vacation.

- **Extortion**
  - An employee refuses to purchase goods or services from a vendor unless the vendor hires one of the employee’s relatives.
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FRAUD INDICATORS
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- Acting beyond the normal scope of duties
- Award to other than the lowest qualified bidder
- Bad reputation
- Close socialization
- Complaints about the job
- Discrepancies of errors Employee SSN
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- Duplicate documentation
- Failure to accept promotions
- Failure to take vacations or time off
- Favoritism with a particular supplier
- Financial problems
- High employee turnover
- Unusual approval patterns
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Association of Fraud Examiners Conclusion on Detecting Fraud:

“Relatively few occupational fraud and abuse offenses are discovered through routine audits. Most Fraud is uncovered as a result of tips and complaints from other employees.”
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Detecting Occupational Fraud

- Based on percentage of tips regarding fraudulent activities – by source

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Detecting Occupational Fraud

![Graph showing initial detection of occupational frauds](chart.png)

Initial Detection of Occupational Frauds

<table>
<thead>
<tr>
<th>Detection Method</th>
<th>Percent of Cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tip</td>
<td>34.2%</td>
</tr>
<tr>
<td>By Accident</td>
<td>25.4%</td>
</tr>
<tr>
<td>Internal Audit</td>
<td>20.2%</td>
</tr>
<tr>
<td>Internal Controls</td>
<td>19.2%</td>
</tr>
<tr>
<td>External Audit</td>
<td>12.0%</td>
</tr>
<tr>
<td>Notified by Police</td>
<td>3.8%</td>
</tr>
</tbody>
</table>

The sum of percentages in this chart exceeds 100% because in some cases respondents identified more than one detection method. The same is true for all charts in this Report showing how occupational frauds were detected.

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How to deal with Fraud upon Detection
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What to do when confronted with a whistleblower allegation:

✓ Recognize and be alert to informal communications of allegations (protected disclosures)

✓ Notify one of the following, orally or in writing
  ✓ Locally Designated Official
  ✓ Appropriate campus administrator(s)
  ✓ Campus Investigative Unit(s)
  ✓ UC Whistleblower Hotline

✓ Act promptly

✓ Maintain confidentiality

✓ Consult Whistleblower policies/information
  http://ucwhistleblower.ucop.edu
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Fraud Opportunity Checklist

Ask Yourself:

✓ What are the weakest links in my department’s internal controls?
✓ What deviations from acceptable business practices are possible?
✓ How can I get a check issued or get my hands on cash, property, or information?
✓ What accounting documents are easiest to access and forge?
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How Can You Minimize Exposure to Fraud?

- Know your employees
- Include reference checking in the hiring process
- Look for duplicate payments
- Look for rounded amount invoices
- Look for invoices just below approval amounts
- Look for uncommon repeat vendors
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How Can You Minimize Exposure to Fraud?

- Develop internal controls to protect the organization and the employee
- Don’t let an individual have complete control of a financial process
- Restrict access to computer, facilities and data
- Rotate job duties and cross-train
- Review monthly statements; know where the money is going
- Notice and pay attention to the red flags
- Communicate with your staff about fraud awareness; advertise that fraud detection is a priority. Distribute Whistleblower Policies
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Reporting and Investigating Improper Activities - Responsibilities

Campus Investigative Units:

- **Audit and Advisory Services**
  - Investigates alleged financial misconduct and other misuse of University resources

- **Human Resources**
  - Investigates alleged labor relations issues

- **Sexual Harassment Complaint Resolution Office**
  - Investigates alleged sexual harassment/misconduct cases

- **Academic Affairs/Office of Research**
  - Investigates alleged academic/scientific misconduct

- **Campus Police**
  - Investigates alleged crimes against persons or property
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UC Whistleblower Policy

- Locally Designated Official
  *Vice Chancellor Administrative Services (??)*

- Investigations Workgroup
  *performs preliminary investigative procedures & assigns case to one of the campus investigative units*

- UC Whistleblower Hotline
  *(1-800-403-4744)*

- Whistleblower policies/information
  *http://ucwhistleblower.ucop.edu*

- Protection from Retaliation
What not to do when confronted with a whistleblower allegation:

- Dismiss the matter out of hand
- Launch your own investigation
- Confront the accused or otherwise tip them off
- Disclose the matter to any unnecessary parties
- Try to settle or resolve the matter yourself
Conclusion

- Be Aware of Your Environment
- Take Steps to Minimize Fraud
- Be Aware of Red Flags to Detect Fraud
- Balance Risk and Controls