Fraud: What’s It All About?

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What is your highest aspiration?

1. Wealth
2. Fame
3. Integrity
4. Popularity
5. Knowledge

Adapted from a presentation prepared by L. Murphy Smith, Texas A&M University
If integrity is second to any of the alternatives, it is subject to sacrifice in situations where a choice must be made.

Such situations will inevitably occur in every person’s life.
The 2008 Report to the Nation on Occupational Fraud and Abuse estimated that U.S. organizations lose 7% of their annual revenues to fraud.

Source: Association of Certified Fraud Examiners
What is the theoretical UCB cost of fraud?

<table>
<thead>
<tr>
<th>Revenue Supporting Core Activities</th>
<th>FY2009</th>
<th>FY2008</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$ 1,808,629,000</td>
<td>$ 1,789,047,000</td>
</tr>
<tr>
<td>7%</td>
<td>$ 126,604,030</td>
<td>$ 125,233,290</td>
</tr>
<tr>
<td>6%</td>
<td>$ 108,517,740</td>
<td>$ 107,342,820</td>
</tr>
<tr>
<td>5%</td>
<td>$ 90,431,450</td>
<td>$ 89,452,350</td>
</tr>
</tbody>
</table>

| Salaries and Benefits             | $ 1,193,475,000 | $ 1,136,462,000 |
|                                   | 7% 10.61%        | 11.02%          |
|                                   | 6% 9.09%         | 9.45%           |
|                                   | 5% 7.58%         | 7.87%           |
Agenda

• What is Fraud
• How Fraud is Committed
• Why Fraud Occurs
• Principles of a Fraud Risk Management Program
• A&AS’ Assessment
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 to benefit the organization.
Theories of Fraud

Tip of the Iceberg
– When first discovered very few frauds yield their true extent, along with the actual amount of the loss.

Potato Chip
– Committing fraud and getting away with it can become addictive.

Rotten Apple
– Unchecked fraud in an organization or group can infect the group until it becomes the expected way of doing business
Fraud risk is the threat that an event or action will adversely affect the University’s ability to achieve its objectives and/or execute its strategies successfully due to acts of fraud committed against or by the University.
UCB Compliance Landscape

- Child Care
- Environmental Health and Safety
- Research Administration
- Harassment & Discrimination
- Student Health
- IRS and CA Tax
- Americans with Disabilities Act (ADA)
- Procurement
- Animal Research Subjects
- Technology Licensing/Intellectual Property
- Business Contract Management
- Credit Cards (PCI)/ACH
- Donor Gift Restrictions
- NCAA
- Digital Millennium Copyright Act, Software Licensing, SB 1386, Gramm-Leach-Blilley Act
- Scientific Misconduct
- Fire and Bldg Safety
- Workers Compensation
- Land and Facility Use
- Construction Contract Management
- Construction Contract Management
- Reporting of Campus Crime Statistics
- Student Financial Support
- Student Financial Aid
- Criminal Justice Act
- Academic Appointments
- Academic Appointments
- Human Research Subjects
- Security Exchange
- Research Policy
- EOC Affirmative Action
- Human Resources
- Immigration (DHS/DOS/SEVIS Reporting)
- Privacy: Student Records
- Conflicts of Interest
- Academic Appointments for Students
- NBCA
- America's with Disabilities Act (ADA)
- Securities Exchange
What Actions Constitute Fraud
# What Actions Constitute Fraud

## Type of Occupational Fraud & Abuse

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset Misappropriations</td>
<td>Any scheme that involves the theft or misuse of an organization’s assets.</td>
<td>• Fraudulent invoicing</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Payroll fraud</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Skimming revenues</td>
</tr>
<tr>
<td>Corruption</td>
<td>Any scheme in which a person uses his or her influence in a business</td>
<td>• Accepting or paying a bribe</td>
</tr>
<tr>
<td></td>
<td>transaction to obtain an unauthorized benefit contrary to that person’s</td>
<td>• Engaging in a business transaction where</td>
</tr>
<tr>
<td></td>
<td>duty to his or her employer.</td>
<td>there is an undisclosed conflict of interest</td>
</tr>
<tr>
<td>Fraudulent Statements</td>
<td>Falsification of an organization’s financial statements to make it</td>
<td>• Booking fictitious sales</td>
</tr>
<tr>
<td></td>
<td>appear more or less profitable.</td>
<td>• Recording expenses in the wrong period</td>
</tr>
</tbody>
</table>
2006 Report to the Nation on Occupational Fraud and Abuse. Copyright 2006 by the Association of Certified Fraud Examiners, Inc.
## How Occupational Fraud is Committed

### Schemes Involving Cash Receipts and Cash On Hand

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Skimming</strong></td>
<td>Any scheme in which cash is stolen from an organization before it is recorded on the organization’s books and records.</td>
<td>• Employee accepts payment from a customer but does not record the sale.</td>
</tr>
<tr>
<td><strong>Cash Larceny</strong></td>
<td>Any scheme in which cash is stolen from an organization after it has been recorded on the organization’s books and records.</td>
<td>• Employee steals cash and checks from daily receipts before they can be deposited in the bank.</td>
</tr>
</tbody>
</table>
## Non-Cash Misappropriations

<table>
<thead>
<tr>
<th>Category</th>
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<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inventory</td>
<td>Any scheme involving the theft or misappropriation of physical, non-cash assets such as inventory, equipment or supplies.</td>
<td>• Employee steals merchandise from warehouse or sales floor.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Employee diverts incoming shipments of inventory for personal use.</td>
</tr>
<tr>
<td>Information</td>
<td>Any scheme in which an employee steals or otherwise misappropriates proprietary confidential information or trade secrets.</td>
<td>• Employee accesses customer records for purposes of committing identity theft.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Employee provides company trade secrets to a competitor.</td>
</tr>
</tbody>
</table>
### Non-Cash Misappropriations

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</thead>
<tbody>
<tr>
<td>Securities</td>
<td>Any scheme involving the theft or misappropriation of stocks, bonds, or other securities.</td>
<td>• Employee fraudulently transfers stock held by company to personal account.</td>
</tr>
</tbody>
</table>
### How Occupational Fraud is Committed

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<tr>
<td>Billing</td>
<td>Any scheme in which a person causes his or her employer to issue a payment by submitting invoices for fictitious goods or services, inflated invoices or invoices for personal purchases.</td>
<td>• Employee creates a shell company and bills employer for nonexistent services.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Employee purchases items, submits invoices for payment.</td>
</tr>
<tr>
<td>Expense Reimbursement</td>
<td>Any scheme in which an employee makes a claim for reimbursement of fictitious or inflated business expenses.</td>
<td>• Employee files fraudulent expense report, claiming personal travel, nonexistent meals, etc.</td>
</tr>
</tbody>
</table>
How Occupational Fraud is Committed

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</table>
| **Check Tampering** | Any scheme in which a person steals his or her employer’s funds by forging or altering a check on one of the organization’s bank accounts or steals a check the organization has legitimately issued to another payee. | • Employee steals blank company checks, makes out to himself or an accomplice.  
• Employee steals outgoing check to a vendor, deposits it into her own bank account. |
| **Payroll**     | Any scheme in which an employee causes his or her employer to issue a payment by making false claims for compensation.                        | • Employee claims overtime for unworked hours  
• Employee adds ghost employees to the payroll.                                                 |
# How Occupational Fraud is Committed

## Schemes Involving Fraudulent Disbursements of Cash

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td><strong>Wire Transfers</strong></td>
<td>Any scheme in which a person steals his or her employer’s funds by fraudulently wire transferring them out of the employer’s bank accounts.</td>
<td>• Employee causes funds to be wired from company bank accounts to an account controlled by employee or accomplice.</td>
</tr>
<tr>
<td><strong>Register Disbursements</strong></td>
<td>Any scheme in which an employee makes false entries on a cash register to conceal the fraudulent removal of cash.</td>
<td>• Employee fraudulently voids a sale on his cash register and steals the cash.</td>
</tr>
</tbody>
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### How Occupational Fraud is Committed

#### Financial Statement Fraud Schemes

<table>
<thead>
<tr>
<th>Category</th>
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<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Concealed Liabilities</td>
<td>Scheme in which financial statements are misstated by improperly recording liabilities and/or expenses.</td>
<td>• Organization omits significant expenses or liabilities on its financial statements.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Organization records revenue-based expenses as capital expenditures, falsely increasing both net income and total assets in the current accounting period.</td>
</tr>
</tbody>
</table>
How Occupational Fraud is Committed

<table>
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</tr>
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</table>
| Fictitious Revenues | Schemes in which financial statements are inflated by recording sales of goods or services that never occurred or by inflating actual sales. | • 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 accounting period. |
<table>
<thead>
<tr>
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<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improper Asset Valuations</td>
<td>Schemes in which the value of an organization’s assets is fraudulently misstated in the organization’s financial statements.</td>
<td>• Organization fails to write off obsolete inventory.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Organization inflates its receivables by booking fictitious sales on account to nonexistent customers.</td>
</tr>
</tbody>
</table>
### Financial Statement Fraud Schemes

<table>
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<tr>
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<th>Examples</th>
</tr>
</thead>
</table>
| Improper Disclosures   | Schemes in which management fails to disclose material information in its financial statements in an attempt to mislead users of the financial statements. | • Organization’s financial statements fail to note potentially material contingent liability arising from 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. |
## How Occupational Fraud is Committed

### Financial Statement Fraud Schemes

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</thead>
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<tr>
<td><strong>Timing Differences</strong></td>
<td>Schemes in which financial statements are intentionally misstated by recording revenues in a different accounting period than their corresponding expenses.</td>
<td>• 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.</td>
</tr>
</tbody>
</table>
## How Occupational Fraud is Committed

<table>
<thead>
<tr>
<th>Corruption Schemes</th>
</tr>
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<tr>
<td><strong>Category</strong></td>
</tr>
<tr>
<td><strong>Conflicts of Interest</strong></td>
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How Occupational Fraud is Committed

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</tr>
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</table>
| Bribery   | Any scheme in which a person offers, gives, receives, or solicits something of value for the purpose of influencing an official act or a business decision without the knowledge or consent of the principal. | • An employee processes inflated invoices from a vendor and in return receives 10% of the invoice price as kickback.  
• An employee accepts payment from a vendor in return for providing confidential information about competitors’ bids on a project. |
### Corruption Schemes

<table>
<thead>
<tr>
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<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Illegal Gratuities</td>
<td>Any scheme in which a person offers, gives, receives, or solicits something of value for, or because of, an official act or business decision without the knowledge or consent of the principal.</td>
<td>• An official negotiates an agreement with a contractor, and in appreciation the contractor provides the official with a gift such as a free vacation.</td>
</tr>
</tbody>
</table>

*2006 Report to the Nation on Occupational Fraud and Abuse. Copyright 2006 by the Association of Certified Fraud Examiners, Inc.*
### Corruption Schemes

<table>
<thead>
<tr>
<th>Category</th>
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<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Extortion</td>
<td>The coercion of another to enter into a transaction or deliver property based on wrongful use of actual or threatened force, fear, or economic duress.</td>
<td>• An employee refuses to purchase goods or services from a vendor unless the vendor hires one of the employee’s relatives.</td>
</tr>
</tbody>
</table>
Sample Fraud Schemes and Indicators

Misappropriation of assets - Ghost employees and falsified timesheets

• Complaints (e.g., employees, students, vendors, customers, other departments)
• Intolerance of opposing views
• Single point of communication to senior management
• Autonomy over financial transactions
• Significant increase in funding
Sample Fraud Schemes and Indicators

Misappropriation of assets (use of equipment and time)

- Complaints (e.g., employees, customers)
- Significant personal business related items in workspace
- Poor justification of purchases
- Irregular work schedule with limited accountability for productivity
- Lack of work product
Sample Fraud Schemes and Indicators

Fraudulent Statements - Concealed liabilities and expenses

- Large unusual yearend adjustments
- Poor controls within the point of sale system
- Refusal to provide direct access to POS for senior manager
- Autonomy over business decisions
- Meeting sales goals regardless of changing business conditions
Sample Fraud Schemes and Indicators

Corruption - Conflict of Interest

• Employees serving in a key decision-making role for the University and third party doing business with the University

• Unusual sense of urgency; every invoice marked RUSH

• Invoices for the full amount of sub-awards

• Timing of invoices

• Budgets exactly the same each year
Detecting Occupational Fraud

Initial Detection of Occupational Frauds

- Tip: 34.2%
- By Accident: 25.4%
- Internal Audit: 20.2%
- Internal Controls: 19.2%
- External Audit: 12.0%
- Notified by Police: 3.8%

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.

2006 Report to the Nation on Occupational Fraud and Abuse. Copyright 2006 by the Association of Certified Fraud Examiners, Inc.
Detecting Occupational Fraud

**Percent of Tips by Source**

- **Vendor**: 10.7%
- **Customer**: 18.1%
- **Anonymous**: 64.1%
- **Employee**: 7.1%

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Why does fraud occur?
Pressure

• Habitual criminal who steals for the sake of stealing
• Personal prestige, goal achievement
• Morally superior, exempt from accountability
• Desperate need for money
• Vices gambling/drugs
• Undue family, community, University expectation
Opportunity

- Weak internal controls
- Circumvention of internal controls
- The greater the position, the greater the trust and exposure to unprotected assets
- “Most Trusted Employee”
Rationalization

- 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
- I deserve it
- It is for the greater good
- I’m not paid enough
- The University isn’t equitable in compensation
- It’s just part of the job
- I’m not gaining personally
- Resentment of superiors and frustration with job
- It’s legal
Conditions that 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
Organizational Red Flags

- No Communication of Expectations
- Too Much Trust in Key Employees
- Lack of Proper Authorization Procedures
- Lack of Attention to Detail

- Changes in Organizational Structure
- Tendency Toward Crisis Management

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

- 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
Ask Yourself:

- What are the weakest links in my department’s internal controls?
- What deviations from acceptable business practices are possible?
- How might a fraud perpetrator exploit weaknesses in the system of controls?
- How could a perpetrator override or circumvent controls?
- What could a perpetrator do to conceal the fraud?
Principles of a Fraud Risk Management Program

Principle 1: A **fraud governance structure** must be established to convey expectations and set standards.

Principle 2: **Fraud risk exposure** should be **assessed** periodically to identify specific potential schemes and events that need mitigation.

Principle 3: **Prevention techniques** to avoid potential key fraud risk events should be established to mitigate possible impacts.

Principle 4: **Detection techniques** should be established to uncover fraud events when preventive measures fail or unmitigated risks are realized.

Principle 5: A **reporting process** should be in place to solicit input on potential fraud, and a coordinated approach to **investigation and corrective action** should be used to help ensure potential fraud is addressed appropriately and timely.
Seven Essential Elements of a Compliance Program

- Standards & Procedures
- Oversight
- Training & Communication
- Care in Delegation
- Monitoring, Auditing, Reporting & Assessment
- Discipline & Incentives
- Response & Prevention

AND

- Risk Assessment
- Industry Practice

Source: Federal Sentencing Guidelines
COSO Internal Control
Integrated Framework

Diagram showing the COSO Internal Control Integrated Framework with layers including Internal Environment, Objective Setting, Event Identification, Risk Assessment, Risk Response, Control Activities, Information & Communication, and Monitoring.
### COSO Component: Control (Internal Environment (Objective Setting))

<table>
<thead>
<tr>
<th>Fraud Risk Management Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Establishing appropriate “tone at the top” and organizational culture.</td>
</tr>
<tr>
<td>• Documenting fraud control strategy, code of ethics, conduct, and hiring and promotion standards.</td>
</tr>
<tr>
<td>• Establishing, complementing, or evaluating internal audit functions.</td>
</tr>
<tr>
<td>• Developing curriculum; designing and providing training.</td>
</tr>
</tbody>
</table>

### Fraud Risk Management Activities

- Developing a policy and methodology to investigate potential occurrences of fraud.
- Investigating allegations or suspicions of fraud.
- Implementing and maintaining a fraud and ethics hotline and whistleblower program.

"Managing the Business Risk of Fraud: A Practical Guide"
COSO Internal Control Integrated Framework

<table>
<thead>
<tr>
<th>COSO Component</th>
<th>Fraud Risk Management Activities</th>
</tr>
</thead>
</table>
| Fraud Risk Assessment (Event Identification, Risk Assessment, Risk Response) | • Establishing a fraud risk assessment process that considers fraud risk factors and fraud schemes.  
• Involving appropriate personnel in the fraud risk assessment process.  
• Performing fraud risk assessments on a regular basis. |
| Anti-fraud Control Activities           | • Defining and documenting and documenting mitigating controls and linking them to identified fraud risks.  
• Modifying existing controls, designing and implementing new preventive and detective controls as necessary, and implementing supporting technologies. |

"Managing the Business Risk of Fraud: A Practical Guide"
<table>
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<th>COSO Component</th>
<th>Fraud Risk Management Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Information and Communication</td>
<td>• Promoting the importance of the fraud risk management program and the University’s position on fraud risk both internally and externally through campus communication programs.</td>
</tr>
<tr>
<td></td>
<td>• Designing and delivering fraud awareness training.</td>
</tr>
<tr>
<td>Monitoring</td>
<td>• Providing periodic evaluation of anti-fraud controls.</td>
</tr>
<tr>
<td></td>
<td>• Using independent evaluations of the fraud risk management program by internal auditing or other groups.</td>
</tr>
<tr>
<td></td>
<td>• Implementing technology to aid in continuous monitoring and detection activities.</td>
</tr>
</tbody>
</table>
Why Have a Fraud Risk Management Program?

Department of Justice Prosecution Policy (Original June 1999, revised January 2003)

The Department of Justice’s guidance (the Thompson Memo) instructs federal prosecutors that while having in place a compliance program does not absolve a corporation from criminal liability, it may provide factors that can be used in determining whether to charge an organization or only its employees and agents with a crime.

These factors include evaluating whether:

• The compliance program is merely a “paper program” or is designed and implemented effectively
• Corporate management is enforcing the program or tacitly encouraging or pressuring employees to engage in misconduct to achieve business objectives
• The corporation has sufficient staff to audit and evaluate results of its compliance efforts
• Employees are informed about the program and are convinced of the corporation’s commitment to it
Why Have a Fraud Risk Management Program?

2007 Federal Sentencing Guidelines: Chapter 8, Sentencing of Organizations

Part B – Effective Compliance and Ethics Program

• Organization shall exercise due diligence to prevent and detect criminal conduct

• Organization shall promote a culture that encourages ethical conduct and compliance

• Organization shall periodically assess the risk of criminal conduct and take appropriate steps to reduce the risks identified
Fraud Risk Governance

• Management Commitment (Policy)
  – Statement of Ethical Values
  – Standards of Ethical Conduct
  – Principles of Community

• Fraud Awareness
  – Communication (Chancellor’s Annual Notice – Whistleblower Policy)
  – Training (Ethics Briefing, Conflict of Interest)
Fraud Risk Governance

• Assignment of roles and responsibilities
  – Oversight
  – Program design and implementation
  – Execution of controls

• Process evaluation and improvement
Fraud Risk Governance

• Affirmation Process
  – Requirement for employees and contractors to acknowledge understanding of and compliance with the code of conduct

• Conflict Disclosure
  – Requirement for employees and contractors to internally self-disclose potential and actual conflicts of interest
  – Mechanism to address disclosures
Fraud Risk Assessment

University of Tasmania Risk Management Framework
Fraud Risk Assessment

- Identify where fraud may occur within the University
- Consider relevant fraud schemes and scenarios
- Map fraud schemes and scenarios to mitigating controls
- Assess periodically current and emerging risks
Fraud Mitigating Techniques

Key control objectives:

Prevent - Reduce the risk of fraud and misconduct from occurring.

Detect - Discover fraud and misconduct when it occurs.

Respond - Take corrective action and remedy the harm caused by fraud or misconduct.
Fraud Prevention Techniques

- Hire the right people (reference and background checks)
- Anti-fraud training
- Performance and compensation programs
- Align authority, responsibilities, and access to resources
- Continuous monitoring
Fraud Detection Techniques

- Reconciliation
- Independent review
- Physical inspection
- Data mining
- Management review
- Continuous monitoring
- Auditing
Fraud Reporting and Investigation

- Place to solicit input on potential fraud
- Protection of reporters from retaliation
- Investigation of allegations of fraud
- Protocols for investigation
  - Qualification of investigator
  - Preservation and handling of evidence
  - Reporting methodology
Fraud Related Corrective Actions

- Identification of contributing control weaknesses
- Corrective action for identified control weaknesses
- Disciplinary action for fraud perpetrators
- Communication of substantiated fraud, underlying control weaknesses, and corrective action taken to the campus community
Next Steps

A&AS Assessment of the campus risk management program

Risk Assessment Questionnaire – February 1 – 16, 2010

Risk Discussion – February 22, 2010

Fieldwork – February 1 – March 15, 2010

Report – March 31, 2010
QUESTIONS?
Fraud: What’s It All About?

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