



# Fraud: What's It All About?

Wanda Lynn Riley  
Chief Audit Executive  
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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.**

Adapted from a presentation prepared by L. Murphy Smith, Texas A&M University



The 2014 Report to the Nations on Occupational Fraud and Abuse estimated that organizations lose 5% of their annual revenues to fraud.

# What is the theoretical UC Berkeley cost of fraud?

In FY2013, five percent of UC Berkeley's total revenue was approximately

- A. \$500 million
- B. \$350 million
- C. \$240 million
- D. \$120 million
- E. \$60 million



# What is the theoretical UC Berkeley cost of fraud?



## Revenue Supporting Core Activities

Fraud	FY2013	FY2012
\$	2,392,114,000	\$ 2,191,760,000
5% \$	119,605,700	\$ 109,588,000
3% \$	71,763,420	\$ 65,752,800
1% \$	23,921,140	\$ 21,917,600

## Salaries and Benefits

\$	1,622,705,000	\$	1,433,259,000
5%		8%	8%
3%		5%	5%
1%		2%	2%



# Discussion Areas

- What is Fraud
- How Occupational Fraud is Committed
- Why Fraud Occurs
- Organizational Red Flags
- Sample Indicators of Fraud



# ***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.**





# ***What is Fraud?***

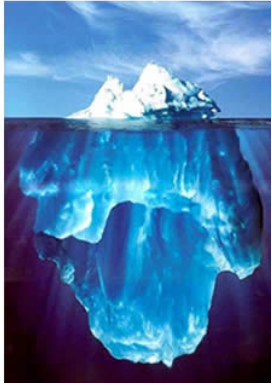
A knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment.

*Bryan Garner, ed., Black's Law Dictionary. 8th Ed. (2004), s.v., "fraud."*

Consequently, fraud includes any intentional or deliberate act to deprive another of property or money by guile, deception, or other unfair means.

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# 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

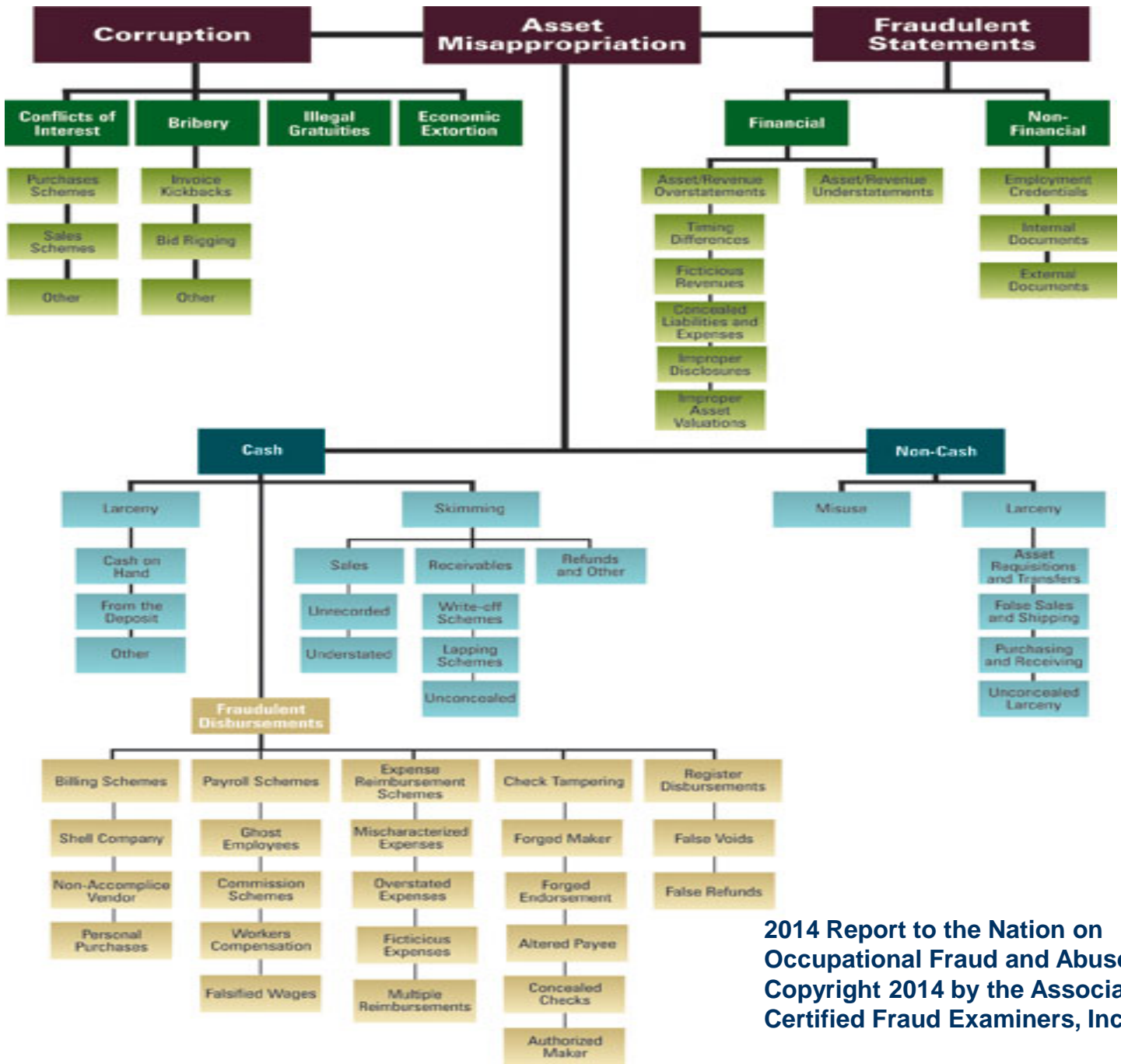
- Unchecked fraud in an organization or group can infect the group until it becomes the expected way of doing business

# What Actions Constitute Fraud

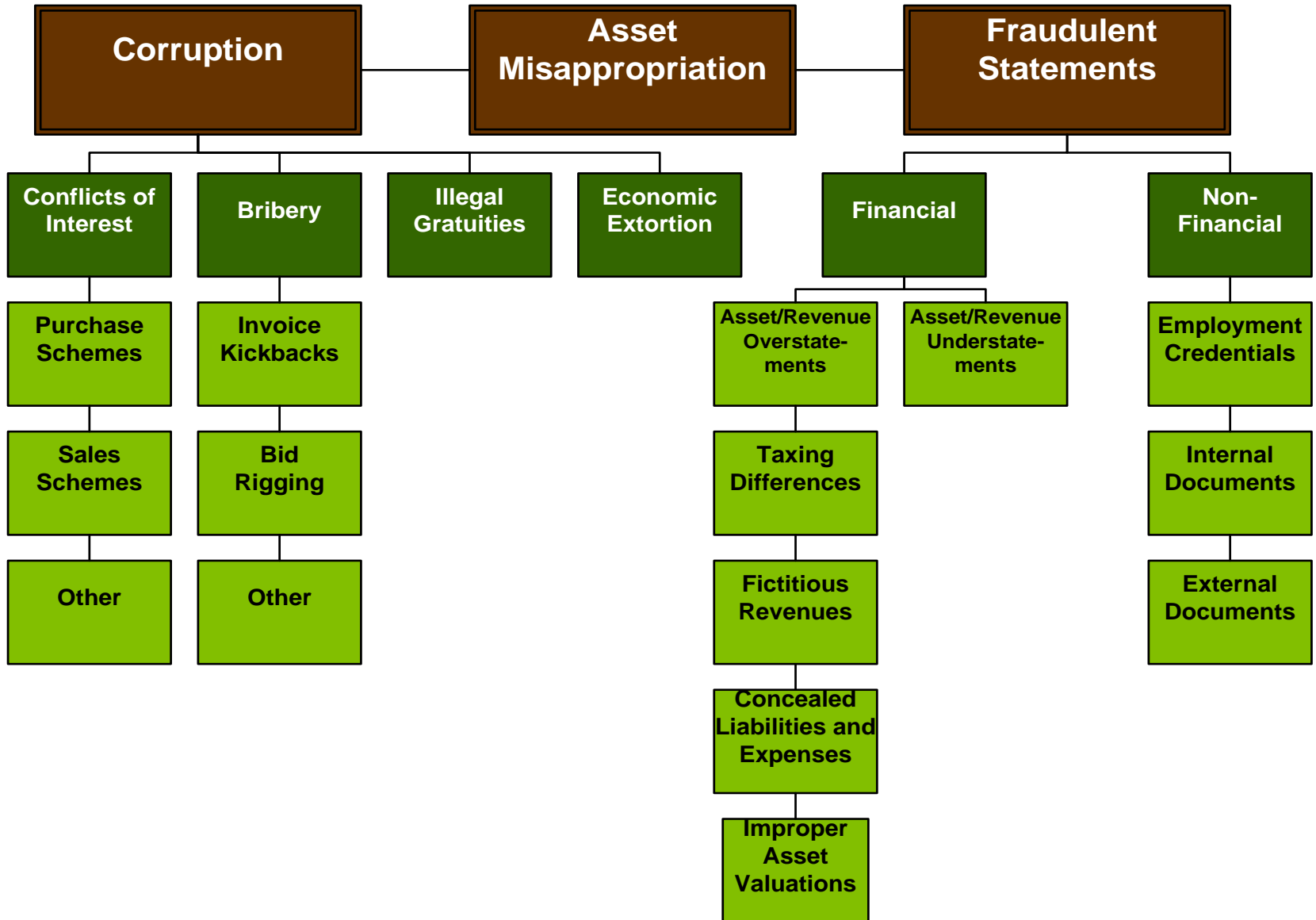


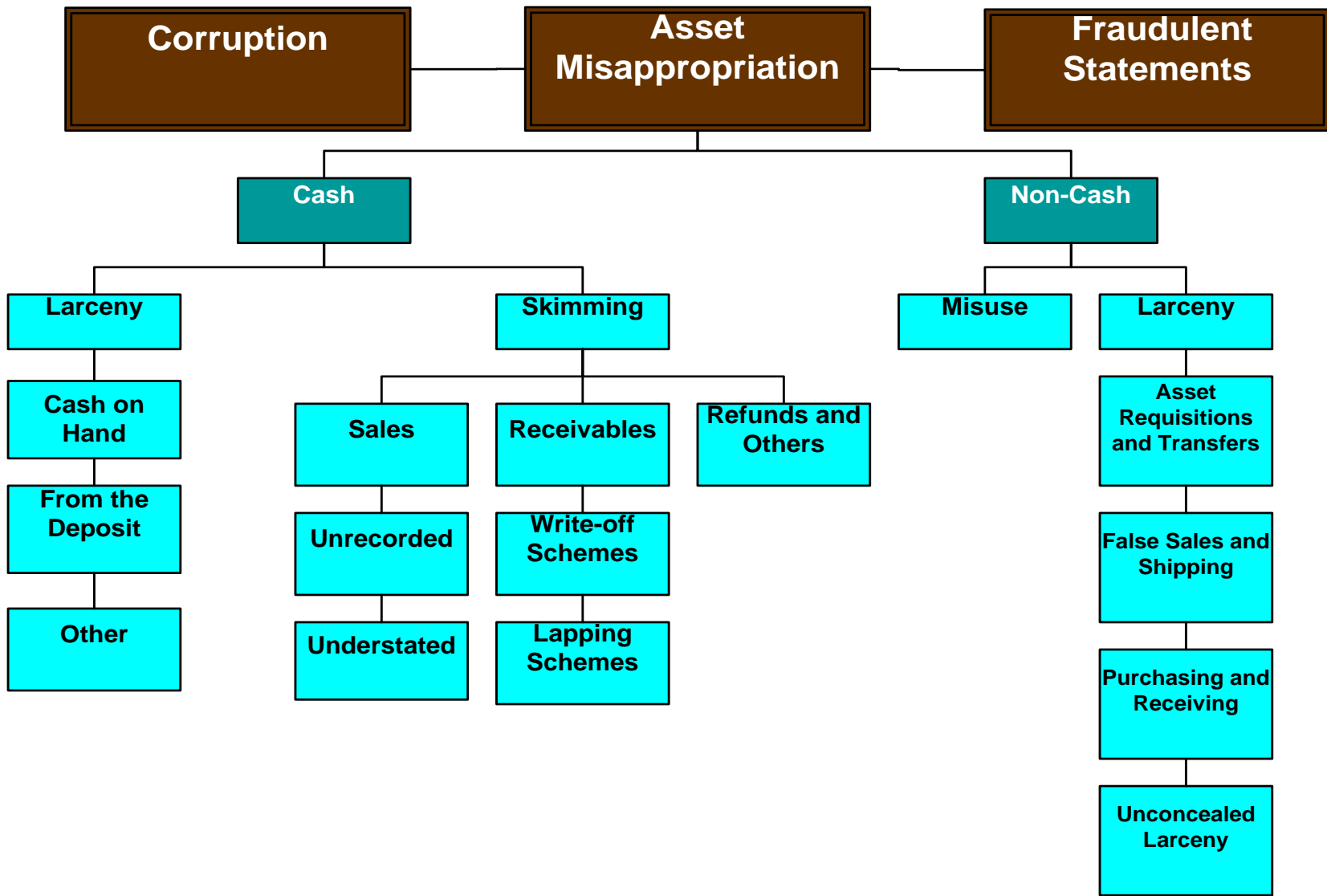
## Type of Occupational Fraud & Abuse

Category	Description	Examples
<b>Asset Misappropriations</b>	Any scheme that involves the theft or misuse of an organization's assets.	<ul style="list-style-type: none"><li>•Fraudulent invoicing</li><li>•Payroll fraud</li><li>•Skimming revenues</li></ul>
<b>Corruption</b>	Any scheme in which a person uses his or her influence in a business transaction to obtain an unauthorized benefit contrary to that person's duty to his or her employer.	<ul style="list-style-type: none"><li>•Accepting or paying a bribe</li><li>•Engaging in a business transaction where there is an undisclosed conflict of interest</li></ul>
<b>Fraudulent Statements</b>	Falsification of an organization's financial statements to make it appear more or less profitable.	<ul style="list-style-type: none"><li>•Booking fictitious sales</li><li>•Recording expenses in the wrong period</li></ul>



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**Corruption**

**Asset Misappropriation**

**Fraudulent Statements**

**Cash**

**Non-Cash**

**Larceny**

**Skimming**

**Misuse**

**Larceny**

**Cash on Hand**

**Sales**

**Receivables**

**Refunds and Others**

**Asset Requisitions and Transfers**

**From the Deposit**

**Unrecorded**

**Write-off Schemes**

**False Sales and Shipping**

**Other**

**Understated**

**Lapping Schemes**

**Purchasing and Receiving**

**Unconcealed Larceny**

**Corruption**

**Asset  
Misappropriation**

**Fraudulent  
Statements**

**Cash**

**Fraudulent  
Disbursements**

**Billing  
Schemes**

**Shell Company**

**Non-  
Accomplice  
Vendor**

**Payroll  
Schemes**

**Ghost  
Employees**

**Commission  
Schemes**

**Workers Comp**

**Falsified Wages**

**Expense  
Reimbursement  
Schemes**

**Mischaracter-  
ized Expenses**

**Overstated  
Expenses**

**Fictitious  
Expenses**

**Multiple  
Reimbursements**

**Check  
Tampering**

**Forged Maker**

**Forged  
Endorsement**

**Altered Payee**

**Concealed  
Checks**

**Authorized  
Maker**

**Register  
Disbursements**

**False Voids**

**False Refunds**



# How Occupational Fraud is Committed



## Schemes Involving Cash Receipts and Cash On Hand

Category	Description	Examples
<b>Skimming</b>	Any scheme in which cash is stolen from an organization before it is recorded on the organization's books and records.	Employee accepts payment from a customer but does not record the sale.
<b>Cash Larceny</b>	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.

# How Occupational Fraud is Committed

## Non-Cash Misappropriations

Category	Description	Examples
<b>Inventory</b>	Any scheme involving the theft or misappropriation of physical, non-cash assets such as inventory, equipment or supplies.	<ul style="list-style-type: none"><li>• Employee steals merchandise from warehouse or sales floor.</li><li>• Employee diverts incoming shipments of inventory for personal use.</li></ul>
<b>Information</b>	Any scheme in which an employee steals or otherwise misappropriates proprietary confidential information or trade secrets.	<ul style="list-style-type: none"><li>• Employee accesses customer records for purposes of committing identity theft.</li><li>• Employee provides company trade secrets to a competitor.</li></ul>

# How Occupational Fraud is Committed



## Non-Cash Misappropriations

Category	Description	Examples
Securities	Any scheme involving the theft or misappropriation of stocks, bonds, or other securities.	Employee fraudulently transfers stock held by company to personal account.

# How Occupational Fraud is Committed



## Schemes Involving Fraudulent Disbursements of Cash

Category	Description	Examples
<b>Billing</b>	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.	<ul style="list-style-type: none"><li>• Employee creates a shell company and bills employer for nonexistent services.</li><li>• Employee purchases items, submits invoices for payment.</li></ul>
<b>Expense Reimbursement</b>	Any scheme in which an employee makes a claim for reimbursement of fictitious or inflated business expenses.	<ul style="list-style-type: none"><li>• Employee files fraudulent expense report, claiming personal travel, nonexistent meals, etc.</li></ul>

# How Occupational Fraud is Committed

## Schemes Involving Fraudulent Disbursements of Cash

Category	Description	Examples
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.	<ul style="list-style-type: none"><li>• Employee steals blank company checks, makes out to himself or an accomplice.</li><li>• Employee steals outgoing check to a vendor, deposits it into her own bank account.</li></ul>
Payroll	Any scheme in which an employee causes his or her employer to issue a payment by making false claims for compensation.	<ul style="list-style-type: none"><li>• Employee claims over-time for unworked hours</li><li>• Employee adds ghost employees to the payroll.</li></ul>

# How Occupational Fraud is Committed

## Schemes Involving Fraudulent Disbursements of Cash

Category	Description	Examples
<b>Wire Transfers</b>	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.	Employee causes funds to be wired from company bank accounts to an account controlled by employee or accomplice.
<b>Register Disbursements</b>	Any scheme in which an employee makes false entries on a cash register to conceal the fraudulent removal of cash.	Employee fraudulently voids a sale on his cash register and steals the cash.

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# How Occupational Fraud is Committed



## Financial Statement Fraud Schemes

Category	Description	Examples
<b>Concealed Liabilities</b>	Scheme in which financial statements are misstated by improperly recording liabilities and/or expenses.	<ul style="list-style-type: none"><li>• Organization omits significant expenses or liabilities on its financial statements.</li><li>• Organization records revenue-based expenses as capital expenditures, falsely increasing both net income and total assets in the current accounting period.</li></ul>



# How Occupational Fraud is Committed



## Financial Statement Fraud Schemes

Category	Description	Examples
<b>Fictitious Revenues</b>	Schemes in which financial statements are inflated by recording sales of goods or services that never occurred or by inflating actual sales.	<ul style="list-style-type: none"><li>• Organization records the sale of inventory to a phantom customer.</li><li>• Organization creates invoices showing sale of goods to existing customer but goods are never delivered. Sales are reversed at beginning of next accounting period.</li></ul>

# How Occupational Fraud is Committed



## Financial Statement Fraud Schemes

Category	Description	Examples
<b>Improper Asset Valuations</b>	Schemes in which the value of an organization's assets is fraudulently misstated in the organization's financial statements.	<ul style="list-style-type: none"><li>• Organization fails to write off obsolete inventory.</li><li>• Organization inflates its receivables by booking fictitious sales on account to nonexistent customers.</li></ul>

# How Occupational Fraud is Committed



## Financial Statement Fraud Schemes

Category	Description	Examples
<b>Improper Disclosures</b>	Schemes in which management fails to disclose material information in its financial statements in an attempt to mislead users of the financial statements.	<ul style="list-style-type: none"><li>• Organization's financial statements fail to note potentially material contingent liability arising from corporate guarantee of personal loans taken out by an officer.</li><li>• Organization's financial statements fail to note that one of its largest suppliers is owned by the corporation's president.</li></ul>

# How Occupational Fraud is Committed



## Financial Statement Fraud Schemes

Category	Description	Examples
Timing Differences	Schemes in which financial statements are intentionally misstated by recording revenues in a different accounting period than their corresponding expenses.	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.

# How Occupational Fraud is Committed



## Corruption Schemes

Category	Description	Examples
<b>Conflicts of Interest</b>	Any scheme in which an employee, manager or executive has an undisclosed economic or personal interest in a transaction that adversely affects the company as a result.	An employee owns an undisclosed interest in a supplier. The employee negotiates a contract between the employer and the supplier, purchasing materials at an inflated price.

# How Occupational Fraud is Committed



## Corruption Schemes

Category	Description	Examples
<b>Bribery</b>	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.	<ul style="list-style-type: none"><li>• An employee processes inflated invoices from a vendor and in return receives 10% of the invoice price as kickback.</li><li>• An employee accepts payment from a vendor in return for providing confidential information about competitors' bids on a project.</li></ul>

# How Occupational Fraud is Committed



## Corruption Schemes

Category	Description	Examples
<b>Illegal Gratuities</b>	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.	An official negotiates an agreement with a contractor, and in appreciation the contractor provides the official with a gift such as a free vacation.



# How Occupational Fraud is Committed



## Corruption Schemes

Category	Description	Examples
<b>Extortion</b>	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.	An employee refuses to purchase goods or services from a vendor unless the vendor hires one of the employee's relatives.

# 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

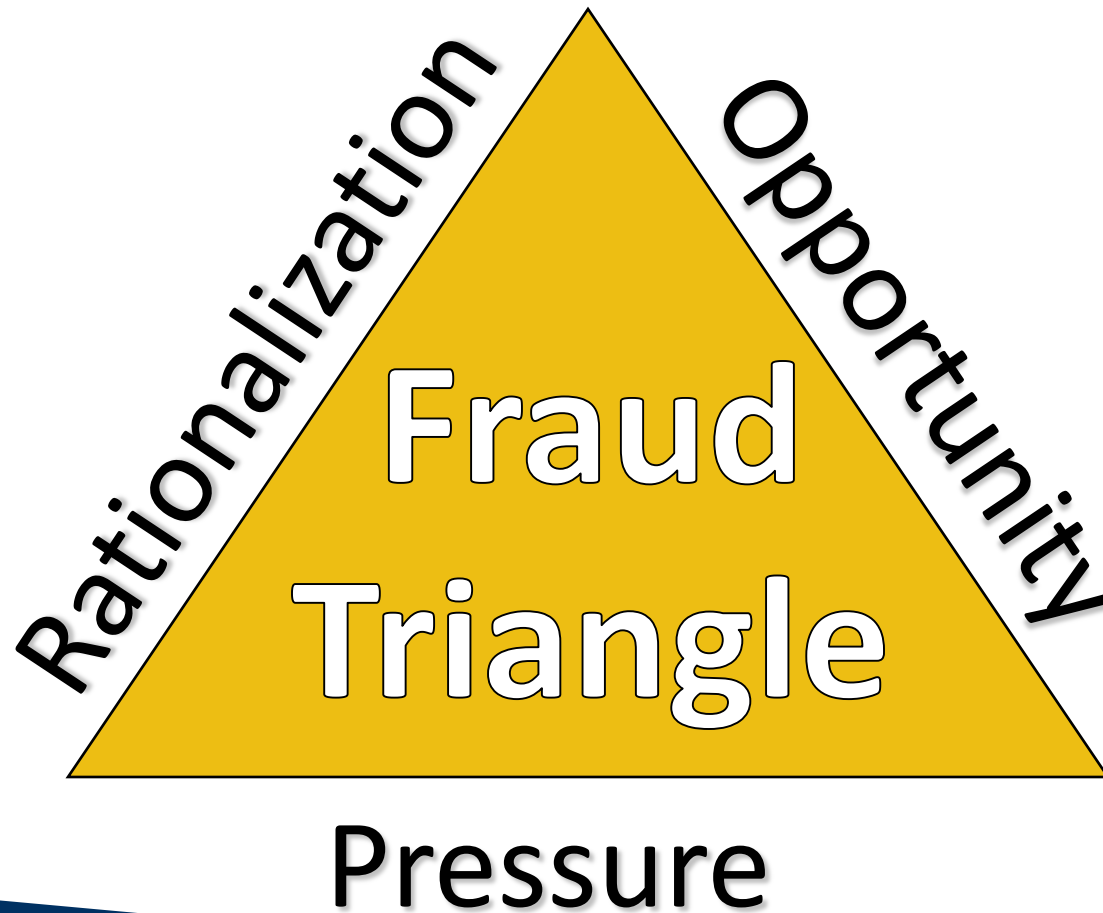
# Typical Fraudster Profile



Key characteristics of fraudsters include:

- Between 36 and 55 years of age
- Employees of the victim organization
- Employee of the victim organization for more than six years,
- Colluded with two to five others (Collude – turn a blind eye, provide passwords, falsify documents)
- The related fraud a misappropriation of assets,
- Fraud lasted one to five years,
- Fraud committed in multiple transactions
- Subordinates performing tasks as instructed without asking questions.
- An environment of unlimited authority; a sense of superiority

# Fraud Triangle



# 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



# 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



# 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 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?

