

Identifying, Preventing, and Responding to FRAUD

August 7, 2019

Howard Lutwak | CIA, CFE,
Director of Internal Audit
California State University, Northridge



Agenda

- Definition of Fraud
- Types of Fraud
- Fraud Facts
- Fraud in Higher Education
- Preventing Fraud
- Red Flags
- What to do if you suspect fraud
- Quiz



What is Fraud?

Any intentional or deliberate act to deprive another of property or money by deception or other unfair means.

Lying for money



Fraud involves taking something from someone else through deception or concealment.

Types of Fraud

- Internal Fraud
 - Also referred to as *occupational fraud*
 - The use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the organization's resources or assets.
- External Fraud
 - Dishonest vendors and suppliers
 - Invoice fraud
 - Security breaches
 - Theft of proprietary information
 - Identity theft
 - Phishing

Types of Fraud

Three Major Types of Occupational Fraud:

Asset Misappropriation
Corruption
Fraudulent statements



Types of Fraud

Asset Misappropriation: An employee steals or misuses an organization's assets.

Cash thefts

- Skimming – cash is stolen before recording in the books
- Larceny – cash is stolen after recording in the books

Falsifying voids and refunds

Tampering with company checks

Filing fraudulent expense reports

Embezzlement

Claiming overtime for hours not worked

Stealing inventory and supplies

Adding ghost employees to the payroll



Types of Fraud

Corruption: schemes in which a fraudster wrongfully uses his influence in a business transaction for the purpose of obtaining a benefit for himself or another person.

Conflict of Interest

- Purchasing schemes
- Sales schemes

Illegal gratuities

Bribery

- Bribes to coaches
- Invoice kickbacks



Types of Fraud

Fraudulent Statements: schemes involving the intentional misreporting of an organization's financial information with the intent to mislead others.

Creating fictitious revenues or pledges

- Ponzi Scheme

Liabilities or expenses

- Concealing
- Overstating
- Understating



Could we get some more details?

Types of Fraud

Phishing: fake e-mails that impersonate a known business and urgently request you verify your credentials.

Spear Phishing – targeting specific individuals or employees at a company



Fraud Facts

Organizations lose approximately 5% of their annual revenues to fraud

Median loss: \$130,000 per case

Tips are the most common initial detection method

Median duration of a fraud scheme: 16 months

Fraudsters who had been with their company **LONGER** stole twice as much

- More than 5 years' tenure \$200,000 median loss
- Less than 5 years' tenure \$100,00 median loss

Fraud Facts

The more victims lose the less likely they are to make a full recovery

A majority of the victims **RECOVERED NOTHING**

53% recovered nothing
32% made a partial recovery
15% recovered all losses

Not all organizations seek to prosecute fraudsters

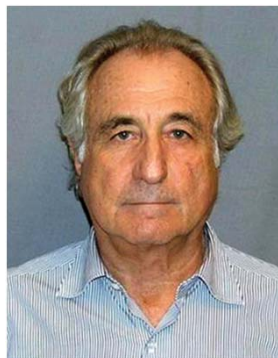
Top reason for not seeking prosecution is fear of bad publicity



Source: The ACFE's 2018 Report to the Nations

What a Fraudster Looks Like

Like you and me
Intelligent
Egotistical
Inquisitive/risk taker
Hard worker/Rule Breaker
Under stress
Disgruntled/Complainer

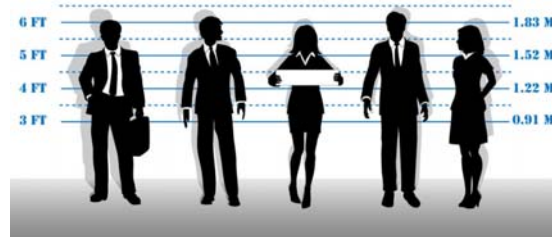


What a Fraudster Looks Like

Male: U.S. 58%; Global 67%

Losses caused by men are 75% larger than losses caused by women

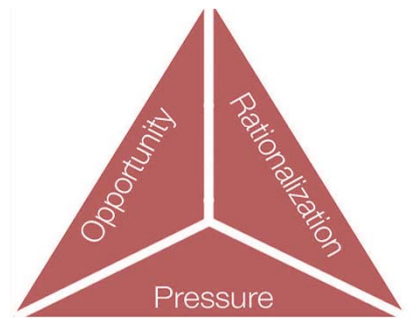
Occupational fraudsters are generally first-time offenders



What Causes People to Commit Fraud?

The Fraud Triangle

A model for explaining the factors that cause someone to commit occupational fraud



The Fraud Triangle

Pressure/Motive

- Financial need
- A gambling or drug habit
- Revenge
- Personal debt or poor credit
- A significant financial loss
- Peer or family pressure to succeed



The Fraud Triangle

Rationalization

- I'm underpaid
- They won't miss it
- I need it more than they do
- I'll pay it back
- Other people are doing it



The Fraud Triangle

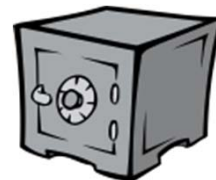
Opportunity

- Past failure of organization to discipline wrongdoers
- Inadequate supervision
- Lack of or circumvention of internal controls



Internal Controls

- Steps taken to obtain reasonable assurance that objectives are achieved.
- The policies and procedures that help ensure management directives are carried out.
 - Segregation of duties
 - Reconciliations
 - Authorizations and approvals
 - Supporting documentation
 - Physical safeguards – locks, safes
 - Passwords to protect computer files
 - Taking inventory
 - Audits



WACUBO BMI Fraud 19

Internal Control Weaknesses that Contribute to Fraud

- Lack of Internal Controls
- Override of Existing Controls
- Lack of Management Review
- Poor Tone at the Top
- Lack of Competent Personnel in Oversight Roles
- Lack of Independent Checks/Audits
- Lack of Employee Fraud Education
- Lack of Clear Lines of Authority
- Lack of Reporting Mechanism

Source: The ACFE's 2018 Report to the Nations



Fraud in Higher Education – Common Forms of Fraud in Higher Education

Entering into agreements with vendors without authorization
 Personal purchases on credit card, especially p-card
 Phishing – fraudulent emails from outside entities
 Fraudulent information on applicant's résumé
 Theft of inventory and supplies
 Theft of cash from deposits
 Invalid workers' comp claims
 Off-campus bank accounts
 Falsifying time reporting

Never waste a sick day on actually
being sick



Fraud in Higher Education – Common Forms of Fraud in Higher Education

Academic Fraud

Personal expenses charged to grant
 Data falsified on research
 Student stipends returned to Principal Investigator
 Class assignments for student athletes completed by
 staff members
 Grade tampering

Fraud in Higher Education – Some frauds make the news...

Admissions scandal

University Scammed of out more than \$1 million

Coach resigns after 5 days and a few lies

Engineering professor defrauds federal agencies of \$3 million in research grant money.

University employees fired following investigation into stolen financial aid

University employees face fraud charges after allegedly spending \$250,000 of university funds on personal items using a p-card



Case Study - Travel Claim – No free lunch

Joe attends a conference at a hotel located in another city

The conference program includes breakfast, lunch, and dinner for some of the days

After the conference, Joe submits an expense report that includes amounts for breakfast, lunch, and dinner for all of the days

Expense report was processed without incident

What is the problem?

Case Study - Travel Claim – No free lunch

Did Joe commit fraud?

What internal controls should be in place to prevent this type of fraud?

- Obtaining copy of conference agenda to determine what meals are included

- Obtain receipts for meals

Case Study - Food Court Cash Caper

Tony, a long-term employee, was lead cashier in the cash room

He often talked about his frequent trips to Las Vegas

Responsibilities included:

- Performing a second count of daily bank deposits

- Recording daily sales information into the general ledger

He disposed of the original deposit slip, and made new ones with lower amounts and then removed the corresponding amounts in cash from the deposits. An example of skimming.

He entered the lower amounts in the general ledger

Case Study - Food Court Cash Caper

Fraud Triangle in Action

Opportunity

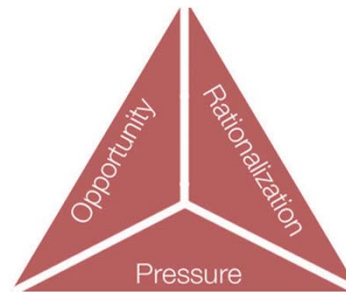
- Lack of segregation of duties
- Lack of reconciliations

Pressure

- Gambling debts

Rationalization

- They won't miss it



Case Study - Food Court Cash Caper

Consequences

- Employee arrested, convicted and made restitution of \$50,000

What internal controls should be in place?

- Reconciliation of sales to deposits
- Segregation of duties
 - Cash room no longer has access to GL
- Security cameras

Case Study - Phishing Fraud

Bob receives an email from his supervisor requesting that he purchase iTunes gift cards, “scratch it and take a picture of them and attach it to the email then send it to me here...”

What should Bob do?

Does this seem like a reasonable request from his supervisor?

Case Study - Phishing Fraud

- Here’s the email Bob received:

From: xxxxxxxx <xxxxxxx@my.com>

Sent: Monday, October 22, 2018 5:57 AM

To: XXXXXXXX

Subject: Re[2]: Follow up

Hi XXX. I'm in a meeting right now and that's why I'm contacting you through here. I should have call you, but phone is not allowed to be use during the meeting. I don't know when the meeting will be rounding up, And I want you to help me out on something very important right away.

I need you to help me get an iTunes gifts card from the store, I will pay back when i get to the office.

I need to send it to someone and it is very important cause i'm still in a meeting and I need to get it sent Asap. {

It's one of my best friend son birthday

The amount i want is \$100 each in three (3) piece so that will make it a total of \$300 I'll be paying back to you. I need physical cards which you are going to get from the store. When you get them,just scratch it and take a picture of them and attach it to the email then send it to me here ok.

I'll be waiting for a reply.

Thanks

--

Best Regards,

xxxxxxx

xxxxxxxxxx@my.com

Case Study - Phishing Fraud

- Let's take a closer look

From: xxxxxxxx <xxxxxxx@my.com>

Sent: Monday, October 22, 2018 5:57 AM

To: Bob

Subject: Re[2]: Follow up

Hi Bob. I'm in a meeting right now and that's why I'm contacting you through here. I should have call you, but phone is not allowed to be use during the meeting. I don't know when the meeting will be rounding up, And I want you to help me out on something very important right away.

- Red Flags

- Email address is not a valid campus address. Should be xxxx@xxxx.edu
- Poor grammar
- Time of day
- Sense of urgency

Case Study - Phishing Fraud

- Here's more:

I need you to help me get an iTunes gifts card from the store, I will pay back when i get to the office.

I need to send it to someone and it is very important cause i'm still in a meeting and I need to get it sent Asap. {

The amount i want is \$100 each in three (3) piece so that will make it a total of \$300 I'll be paying back to you. I need physical cards which you are going to get from the store.

When you get them,just scratch it and take a picture of them and attach it to the email then send it to me here ok. I'll be waiting for a reply.

Thanks

Case Study - Phishing Fraud

What to do if you suspect you received a phishing email:

Do not respond to the email!

Inform your Information Security Officer (ISO) or equivalent

Do not open any attachments

Do not click on any links

Case Study - Student Timesheet

A student worker on a research grant delivered her timesheet for processing after obtaining her supervisor's signature.

See a problem?

Case Study - Student Timesheet

The student falsified her hours after the professor approved the timesheet

She forged signatures and bypassed the approval process entirely.

An employee questioned the signatures

Consequence to student:

- Expulsion
- Criminal conviction
- Served jail time

Case Study - Student Timesheet

What Internal Controls should be in place?:

- Segregation of duties
- Students don't deliver timesheets
- Reconciliations
- Verification of authorized signatures

Case Study - Admissions

Bribery

Cheating on standardized tests



Student-athlete recruitment scam



Case Study - Admissions

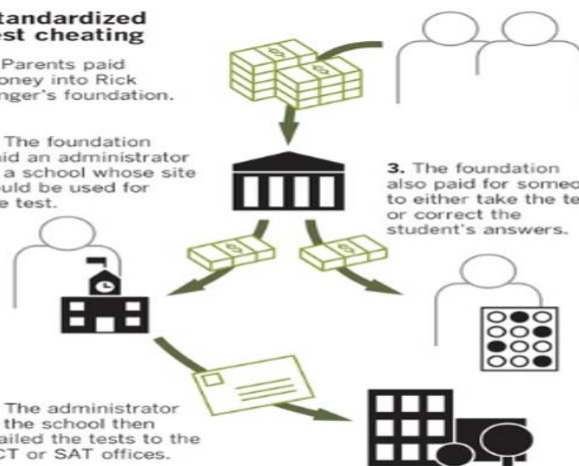
Standardized test cheating

1. Parents paid money into Rick Singer's foundation.

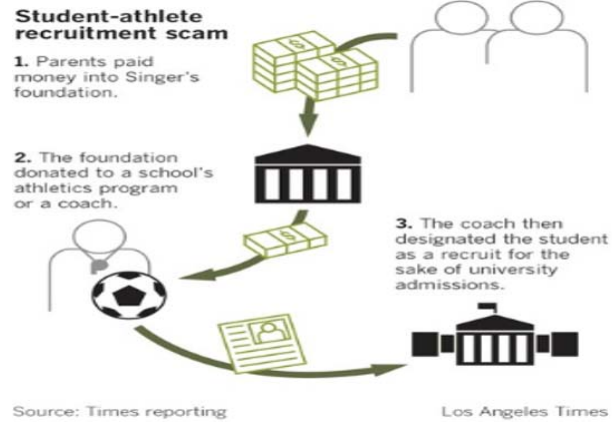
2. The foundation paid an administrator of a school whose site could be used for the test.

3. The foundation also paid for someone to either take the test or correct the student's answers.

4. The administrator of the school then mailed the tests to the ACT or SAT offices.



Case Study - Admissions



Case Study - Admissions

What Internal Controls should be in place?

The person who recommends the admission should verify the talent, and then a supervisor must approve it and send it on for a third-level review.

All recruited non-scholarship athletes be required to participate in the sport for at least a year and be monitored for compliance.

Document all contacts between athletics personnel and those at higher risk of inappropriate influence, such as donors or admissions consultants, and review any donation to see whether it was made in connection with any non-scholarship recruited athlete.

Regular review of the athletic department's slots to make sure they don't exceed the number of student-athletes needed to fill rosters.

Per UC audit of admissions. LA Times 6/20/19

Fraud Prevention: What Can I Do?

Fraud Prevention Starts with You!



"Are these just guidelines or are they actual new policies?"

Fraud Prevention: What Can I 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 regularly

Conducted by a person not in the procurement process, if possible

Fraud Prevention: What Can I Do?

Procurement cards

Pros and cons:

- Reduce amount of transactions for accounts payable
- Enable purchases to be made immediately
- Equivalent to giving an employee access to cash

Review statements and receipts thoroughly

- “Accidental” personal purchases
- Personal purchases on receipt that has numerous items
- Ensure purchases are business related

Review limits: single purchase, monthly

Restrict types of allowable purchases through merchant codes

Fraud Prevention: What Can I Do?

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 procedure in cash handling areas

Review approval authority

Limit the number of individuals with approver or requestor authority

Ensure only current employees have access

Fraud Red Flags

- Rationalization of contradictory or irrational behavior
- Absence of strong code of personal ethics
- Unstable life style; “Wheeler-Dealer” personality
- Braggs about past criminal background or friends
- Salary garnishment, calls from creditors or collection agencies
- Expensive lifestyle – cars, jewelry, Vegas weekends
- Living beyond one’s means
- Parking lot test
- Never takes vacation**



What to Do if You Suspect Fraud

- Inform your supervisor
- Inform Internal Audit
- Inform campus police
- If part of a state system, you may be able to file a whistleblower complaint with your state’s auditor or attorney general.



Conclusion

Everyone in the organization is responsible for fighting fraud.

Be alert to potential fraud.

Report any suspicions to your organization.



Any questions before we begin the quiz?