



# **Committee for Senior Business Administrators**

## ***Fraud Prevention and Detection***

**Presented by: Charley B. Clark  
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# Fraud

- Any intentional act or omission designed to deceive others resulting in the victim suffering a loss or the perpetrator achieving a gain.
- A willful or deliberate act or failure to act with the intention of obtaining an unauthorized benefit such as money or property, by deception or other unethical means.

# Occupational Fraud

- The use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets.

# Occupational Fraud



- Committed by people who work for the organization.
- Includes
  - Internal frauds
  - Abuse (petty crimes or bad behavior)
    - Personal use of company equipment
    - Arriving late and/or leaving early
    - Using employee discounts to purchase goods for friends, family, etc.
    - Other counterproductive acts

# Question #1

J. Fox is a cashier. On Tuesday, he stole \$100 from his cash drawer. Which of the following best describes what Fox has done?

- a. Fraud
- b. Abuse
- c. Waste
- d. No violation has occurred

# Question #1a

J. Fox is a cashier. He earns \$500 per week. On Tuesday, he falsely called in sick. Which of the following best describes what Fox has done?

- a. Fraud
- b. Abuse
- c. Waste
- d. No violation has occurred

# Fraudulent Activity

- Clandestine (secret, hidden)
- Violates employee's fiduciary duties to the organization
- Committed for the purpose of direct or indirect financial benefit to the employee
- Costs the employing organization assets, revenues, or reserves
- Fraud always includes some form of deception

# Elements of Fraud

- *A material* false statement
- *Knowledge* that the statement was false when it was uttered
- *Reliance* on the false statement by the victim
- *Damages* resulted from the victim's reliance on the false statement.

# Elements of Larceny (Stealing)



- There was a taking or carrying away of money or property of another without the consent of the owner and with the intent to deprive the owner of its use or possession.
- Proof requires
  - There was taking or carrying away
  - Of the money or property of another
  - Without the consent of the owner
  - With intent to deprive owner of its use or possession

# Conversion

- The unauthorized assumption and exercise of the right of ownership over goods or chattels (property other than real estate) belonging to another, to the alteration of their condition or the exclusion of the owner's rights.

# Embezzlement

- Willfully taking or converting to one's own use, another's money or property of which the wrongdoer acquired possession lawfully, by reason of some office or employment or position of trust.

# Breach of Fiduciary Duty



- Existence of a fiduciary relationship between the plaintiff and the defendant.
  - Fiduciary is someone of trust who acts for the benefit of another
- The defendant (fiduciary) breached their duty to the plaintiff.
  - Occurs when fiduciary violates that duty
- The breach resulted in either harm to the plaintiff or benefit to the fiduciary.

# Example

An employee took departmental supplies and sold them on Ebay.

- Did the employee commit larceny? (YES)
- Did the employee commit conversion? (YES)
- Is the employee an embezzler? (YES)
- Did the employee breach their fiduciary duty? (YES)
- Did the employee commit fraud? (YES)

# Common Fraud Schemes



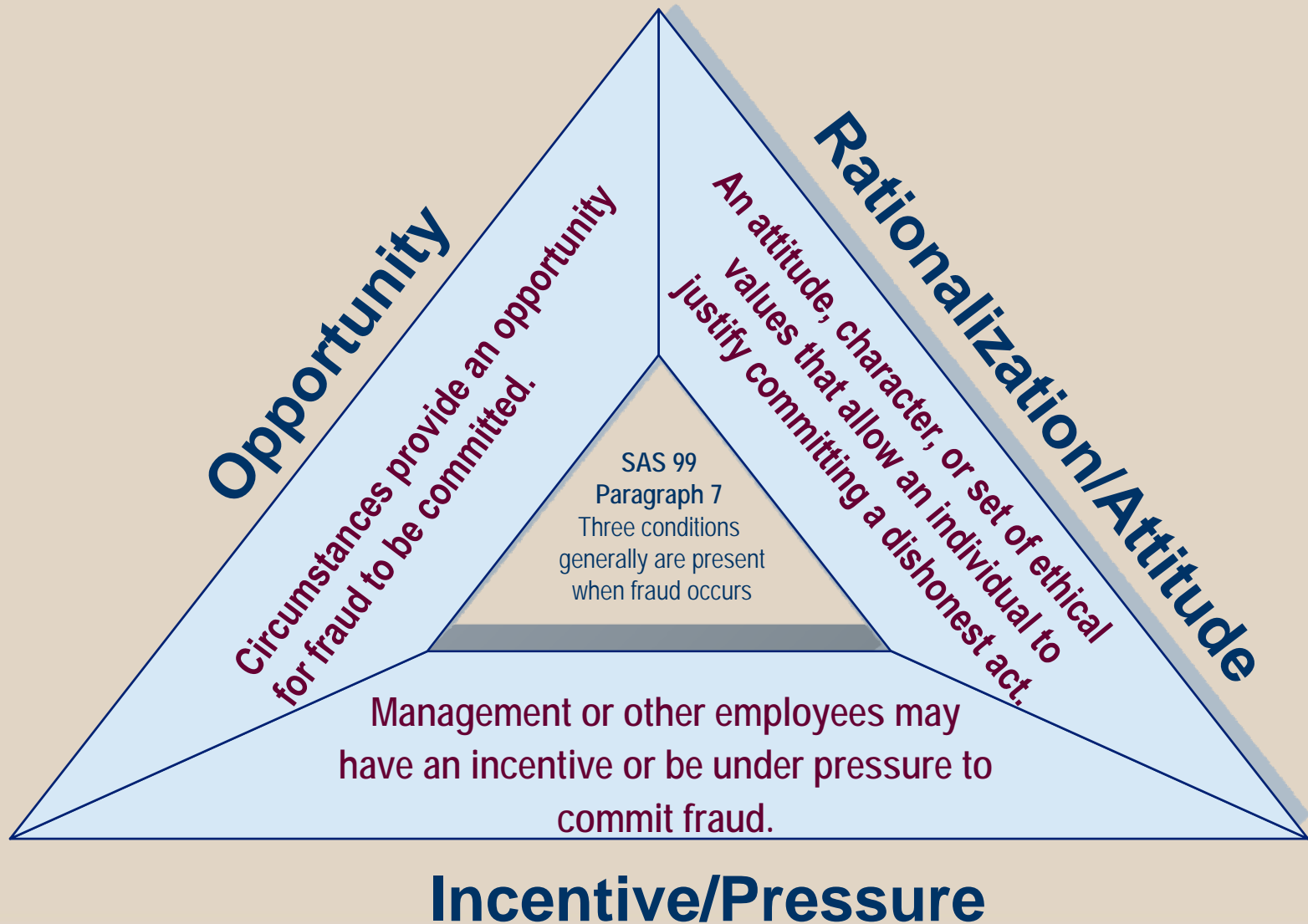
- Billing
- Payroll
- Expense reimbursement
- Check conversion
- Journal entry manipulation
- Lapping of sales or receivables
- Skimming
- Stealing money/merchandise
- Kickbacks/bribery
- Falsifying internal reports
- Price-fixing/discounts
- Fraudulent financial reporting
- Software piracy/unauthorized use of computers
- Fraudulent disbursements
- False refunds
- Fraudulent check coding
- Inventory shrinkage or inflation
- Computer crime
- Incoming cash and deposit theft
- Falsification of government documents
- Travel reimbursement schemes
- Conflicts of interest
- Bid rigging

# Fraud Triangle

- Donald Cressey
  - Defined embezzlers/fraudsters as trust violators
  - Developed the Fraud Triangle

# The Fraud Triangle

(Source: State Auditor's Office)



# The Fraud Triangle (Pressure)



- Perceived non-shareable financial needs
  - Personal obligations
  - Business reversals
  - Employer – employee relations
  - Other commitments

# The Fraud Triangle (Opportunity)



- There are two components for a trust violation
  - General information (employee has the knowledge that their position of trust can be violated)
  - Technical skill (employee has the abilities necessary to commit the violation)

# The Fraud Triangle (Rationalization)



- Embezzlers/fraudsters generally rationalize their crimes by viewing them as
  - Non-criminal
  - Justified
  - Part of a general irresponsibility for which they were not completely accountable

# Question #2

M. Doe is a clerk in the accounts payable department. She recently discovered that G. Smith, another clerk in the department, received a bigger raise than she did, even though Doe has been with the department longer and frequently has to correct Smith's errors. Which leg of the Fraud Triangle best applies to Doe's situation?

- a. Motive
- b. Perceived opportunity
- c. Rationalization**
- d. Non-sharable financial need

# Common Excuses for Committing Fraud



- I was only borrowing the money
- It's not much, the organization won't miss it
- Everyone does it
- They owe me
- I'll stop once I get over this financial hump
- The organization mistreats me
- I haven't gotten a raise in years

# Profile of a Fraudster

- Excellent attendance record
  - Comes to work even when very sick
  - Few days off/doesn't take long vacations
  - Willing to stay late and work weekends
- Performs job extremely well
- Always willing to take on additional responsibilities
- Is the “ideal”, “indispensable”, “trusted” employee

# Question #3



In a study by Albrecht, Romney, and Howe, participants were asked to rank characteristics of the organizational environment that contributed to fraud. The highest ranked factor was:

- a. Lack of clear lines of authority
- b. Inadequate attention to detail
- c. Lack of an internal audit department
- d. Placing too much trust in key employees

# Preventing Fraud

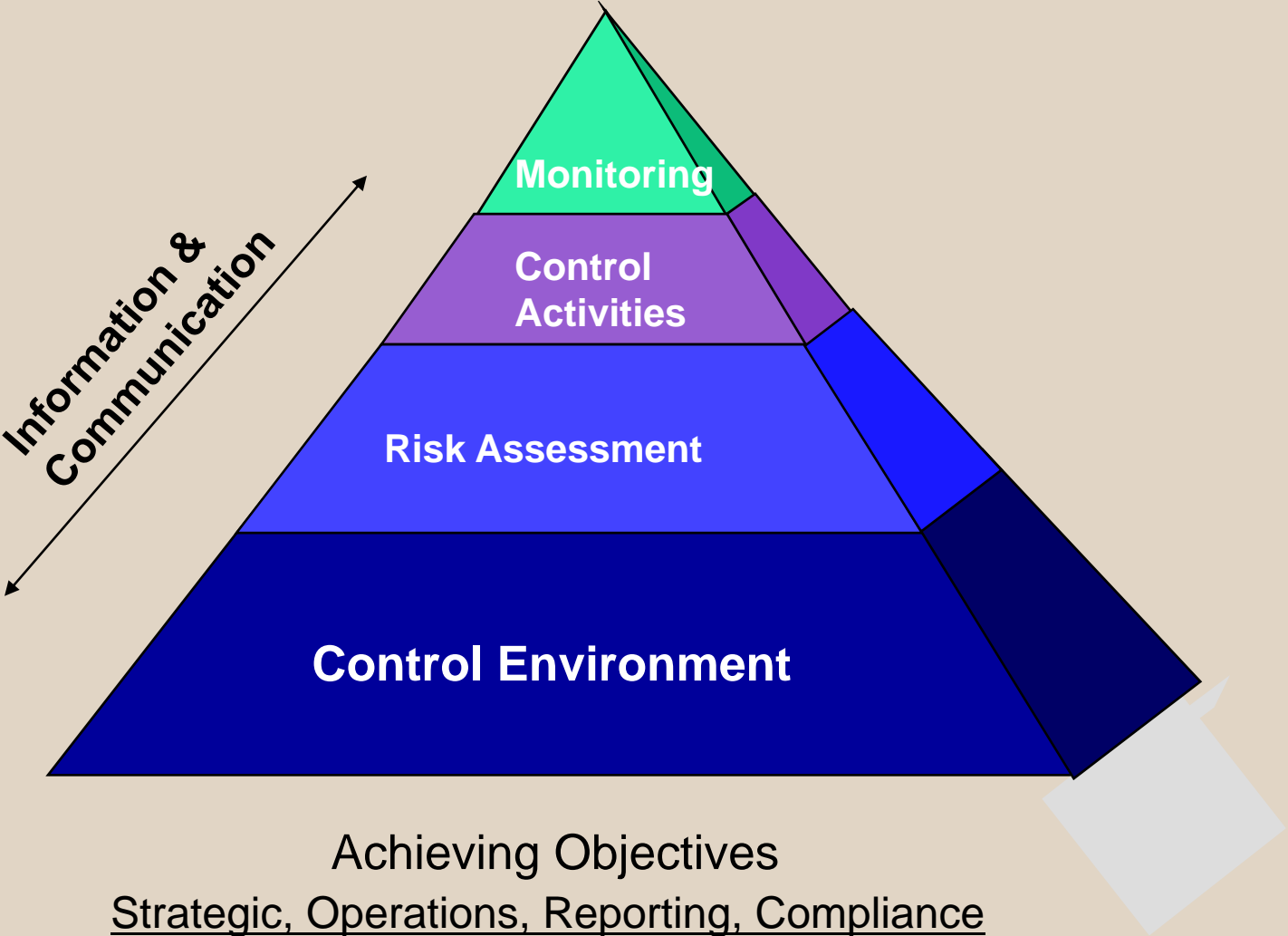
- Most cost-effective way to deal with fraud is to prevent it through good internal controls.

- Definition:** A process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:
- Effectiveness and efficiency of operations
  - Reliability of financial reporting
  - Compliance with applicable laws and regulations

## Key Concepts:

- Internal control is a *process*. It's a means to an end, not an end in itself.
- Internal control is effected by *people*. It's not merely policy manuals and forms, but people at every level of an organization.
- Internal control can be expected to provide only *reasonable assurance*, not absolute assurance, to an entity's management and board.
- Internal control is geared to the achievement of *objectives* in one or more separate but overlapping categories.

# Committee of Sponsoring Organizations of the Treadway Commission (COSO) Framework



# Control Environment

- Serves as a foundation for the other components and sets the tone for the organization's
  - Integrity
  - Ethical values
  - Competence
- Starts with the attitudes and habits of those in charge
- Establishes a culture of integrity or encourages laxness and dishonesty

# Risk Assessment

- Every organization faces a variety of risks from external and internal sources that must be assessed.
- Risk assessments include identifying, analyzing, and managing risks relevant to the achievement of the organization's objectives.

# Control Activities

- Policies and procedures that help ensure management directives are carried out.
- Control activities occur throughout the organization, at all levels and in all functions.
- Include a wide range of activities such as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets and segregation of duties.

# Monitoring

- Ensures that the internal control system continues to operate efficiently and high risk areas are effectively managed
- Can be assessed through:
  - Ongoing monitoring activities such as regular management and supervisory activities; and/or
  - Separate evaluations such as self-assessments.
- Internal control deficiencies are reported to the appropriate management level

# Information and Communication



Ties other components together

- Information is:
  - Delivered to people timely and in an useful format
  - Exchanged up, down, and across the organization and with external parties
  - Provided to help personnel understand their role in the internal control system and how their activities relate to the work of others

# Roles and Responsibilities



Everyone in an organization has responsibility for internal control.

- **Management** is directly responsible for internal controls.
- **Board of Regents** provides guidance and oversight.
- **Internal Auditors** evaluate the effectiveness of control systems, and contribute to ongoing effectiveness.
- **Everyone** is responsible for exercising due care in performing their duties and reporting any noncompliance with the code of conduct, or other violations of policy or illegal actions, to a higher organizational level.

# Limitations of Internal Control



- **Judgment** – managers can make bad decisions
- **Breakdowns** – people with control responsibilities may not carry them out effectively
- **Management Override** – a manager may intentionally go outside established practices for illegitimate purposes
- **Collusion** – two or more people can collaborate to subvert controls
- **Costs versus Benefits** – resources are limited. Managers properly accept a degree of risk when the cost of controlling that risk exceeds the benefit

# Detection of Frauds in Government Agencies



- Tip 50%
- Internal Audit 27%
- Internal Controls 20%
- By Accident 17%
- External Audit 10%
- Police Notification 5%

Note: The sum of percentages in this chart exceeds 100% because in some cases respondents identified more than one detection method.

Source: [2008 Report to the Nation on Occupational Fraud and Abuse](#), Assoc. of Certified Fraud Examiners

# Detecting Fraud

- Become knowledgeable about fraud schemes
- Monitor
- Follow up on suspicions
- Take action when fraud is detected
- Know the warning signs (red flags or fraud indicators)

# Red Flags: Employees

- Financial pressure on employees
  - High personal debts
  - Great financial losses
  - Extensive gambling
- Key employees with too much control
- An employee living beyond his or her means
- Associations with vendors outside of normal working relationships
- Developing outside businesses closely associated with main employment
- Marked personality changes



# Red Flags: Transactions



- Unauthorized transactions
- Unexplained pricing exceptions
- Excessive or unexplained voids
- Excessive payments to vendors
- Changes in purchasing norms
- Large and/or past due working funds
- Missing invoices
- Rising or unexplained department expenses
- Increases in accounts receivable



# Texas Penal Code



Section 31.03: Increases penalties for thefts committed by public servants.

- If the person committing the theft is:
  - defined as a public servant at the time of the offense, and
  - the stolen property came into the person's possession by virtue of his or her position,
  - then, the punishment increases to the next highest category.

# Reporting Fraud, Waste, and Abuse



- Every person, regardless of position, shares in the responsibility for reporting fraud, waste, and abuse.
- Anonymously report suspected incidents to the Risk and Misconduct Hotline.
  - Website:  
[https://secure.ethicspoint.com/domain/en/report\\_custom.asp?clientid=20488](https://secure.ethicspoint.com/domain/en/report_custom.asp?clientid=20488)
  - Dial Toll-Free: 888-501-3850

# Fraud Program

- As required by the Texas Governor's Executive Order RP-36, Texas A&M University has appointed the following fraud contact person:
  - Charley B. Clark  
Associate Vice President, University Risk and Compliance

# University Risk and Compliance



## Contact Information:

- Charley B. Clark, Associate Vice President for University Risk and Compliance
  - [cbc@tamu.edu](mailto:cbc@tamu.edu)
  - 845-1323
- Website
  - <http://urc.tamu.edu>