Audit & Fraud Awareness

Virginia Tech
Invent the Future

Sharon Kurek, CPA, CFE – Director of Internal Audit
What You Will Take Aware With You

- Definition of Internal Auditing
- Scope of Audit Activities
- Risk and Control Process
- Common Audit Topics
- Fraud Awareness
- Invitation to Participate
Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.
Internal Audit assesses and makes appropriate recommendations for improving the governance process in its accomplishment of the following objectives:

- Promoting appropriate ethics and values within the university.
- Ensuring effective organizational performance management and accountability.
- Effectively communicating risk and control information.
- Effectively coordinating the activities of and communicating information among the board, external and internal auditors, and management.
Scope of Audit Activities – Risk Management

- Internal Audit assists the university by identifying and evaluating significant exposures to risk, assessing the effectiveness of the university's risk management system, and contributing to continuous improvement.

- Particularly, evaluate risk exposures relating to the university's governance, operations, and information systems regarding the
  - Reliability and integrity of financial and operational information.
  - Effectiveness and efficiency of operations.
  - Safeguarding of assets.
  - Compliance with laws, regulations, and contracts.
Scope of Audit Activities – Internal Controls

- Assist the university in maintaining effective controls (encompassing governance, operations, and information systems) by evaluating their effectiveness and efficiency and by promoting continuous improvement.

- Ascertain the extent to which operating and program goals and objectives have been established and conform to those of the University, results are consistent with established goals and objectives, and management has established adequate criteria to determine whether objectives and goals have been accomplished.
Risk and Control Process

- Perform Risk Assessment
- Implement Control Activities
- Monitor Performance
- Information
- Training
- Communication

Promote Culture of Accountability, Responsibility and Ethics
Risk and Control Process

**Control Activities:**
- Purchasing limits
- Approvals
- Security
- Reconciliation
- Specific policies

**Risk Assessment:**
- Internal and external events
- Internal audit risk assessment
- A strategy to manage risks

**Control Environment:**
- Tone from the top
- Corporate Policies
- Organizational authority

**Monitoring:**
- Monthly reviews of performance reports
- Internal audit function

**Information & Communication:**
- Reporting
- University communications
Your Role in Risk and Control

• Our EMPLOYEES perform many controls that will reduce many of the university’s risks.
  • Purchasing
  • Reconciliation

• Implementing a system of internal controls that identifies and manages risks.

• Ensuring evidence of review is documented at the department level

• Taking corrective action when control deficiency or weakness is identified and documenting such action.
Common Audit Topics

• **Fiscal Responsibility**
  - Do monthly reconciliations have supporting documentation?
  - Are they reviewed timely and properly approved?

• **Records Retention**
  - Do you maintain the following:
    • Reconciliations (3 fiscal years plus the current year)
    • Purchase Card Statements (5 fiscal years plus the current year)
    • Educational Abroad documents (3 years after student graduates or withdraws)
    • Scholarship documents including student applications, committee review results, or student essays, to support scholarship awards (2 years)
Common Audit Topics

• **Wage Payroll**
  – Are hours worked appropriately documented, approved, and entered correctly?
  – Are reconciliation reports reviewed timely by someone other than the enterer and appropriately maintained?

• **P14s**
  – Is there a formal offer letter on file?
  – Is there a P-14A form filled out with signature approval on file?
Common Audit Topics

• **Leave Reporting**
  – Do the hours on the Leave and Hour Work Reports match the hours on the Leave Report submitted electronically?
  – Are the Leave Reports submitted by the 16th?

• **Overtime Compensation**
  – Is overtime recorded and approved?
  – Is overtime calculated accurately and recorded only after employee has worked 40 hours?
Common Audit Topics

• **Procurement Card**
  - Are original receipts retained by department?
  - Are the purchases allowed per the Purchasing Department’s procedure?

• **Funds Handling**
  - Do you have a funds handling plan approved by the Bursar?
  - Is there segregation of duties between the cashier, depositor, and reconciler?
  - Are funds adequately safeguarded?
  - Are funds deposited timely?
Common Audit Topics

• **Fixed Assets**
  - Is there a custodian assigned for each movable asset?
  - Is the custodian current?
  - Are home use forms filled out?
  - Has your fixed assets coordinator received training by the Controller’s Office?

• **Emergency Management**
  - Do you have a complete up-to-date Emergency Action Plan on file?
Common Audit Topics

• **Personnel Activity Reports (PARs)**
  - Are PARs certified by the employee or the principal investigator who has firsthand knowledge of the employee’s effort? If not, did the certifier utilize suitable means of verification?
  - Were PARs submitted timely to OSP per University Policy 3105?

• **Cost Transfers**
  - Are journal entries adequately documented, recorded timely, and properly approved?
  - Is the allocation methodology documented a portion of the original expense is transferred from or to a project?
Common Audit Topics

• **Information Technology and Personally Identifying Information**
  - Are security patches and anti-virus software automatically updated?
  - Are strong password enforced?
  - Is PII encrypted when stored or transmitted over the network?
  - Is PII encrypted on your flash drives?
  - Do you regularly scan for PII using IdentityFinder on your computers?
Common Audit Topics

- **Family Educational Rights and Privacy Act (FERPA)**
  - Are academic records adequately protected other than from Educational Officials whose position requires access to the records to fulfill their stated job responsibilities?
  - Are you aware of directory information components that do not require prior written permission to release?
Common Audit Topics

• Use of University Resources
  – Are any university resources (personnel time, vehicles, supplies, computers, cell phones, procurement cards, and other equipment) utilized for non-business purposes?

• Outside Employment/Conflict of Interest
  – Do employees seek permission for outside employment or consulting per University Policy 4070 and 13010?
“The university will not tolerate theft, waste, or abuse of state, university, or university-related funds, property, or other resources through fraudulent means.” – Policy 1040, Reporting Suspected Fraudulent Activities
Definitions

**FRAUD**

Any *intentional* act or omission designed to deceive others, resulting in the victim suffering a loss and/or the perpetrator achieving a gain.
Definitions

WASTE

Any thoughtless or careless expenditure, consumption, mismanagement, use, or squandering of resources. Waste also includes incurring unnecessary costs as a result of inefficient or ineffective practices, systems, or controls.
Definitions

**ABUSE**

The excessive or improper use of a thing, or to employ something in a manner contrary to the natural or legal rules for its use.

Abuse also includes intentional destruction, diversion, manipulation, misapplication, maltreatment, misuse of resources, or excessive use as to abuse one’s position or authority.
Distribution of Fraud Schemes

In 2010, 15% of all reported fraud cases occurred in the government and higher education sectors with a median loss per case of $76,000.

<table>
<thead>
<tr>
<th>Industry of Victim Organizations (sorted by frequency)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industry</td>
</tr>
<tr>
<td>Banking/Financial Services</td>
</tr>
<tr>
<td>Manufacturing</td>
</tr>
<tr>
<td>Government and Public Administration</td>
</tr>
<tr>
<td>Retail</td>
</tr>
<tr>
<td>Healthcare</td>
</tr>
<tr>
<td>Insurance</td>
</tr>
<tr>
<td>Education</td>
</tr>
<tr>
<td>Services (other)</td>
</tr>
<tr>
<td>Construction</td>
</tr>
<tr>
<td>Technology</td>
</tr>
<tr>
<td>Transportation and Warehousing</td>
</tr>
<tr>
<td>Oil and Gas</td>
</tr>
<tr>
<td>Real Estate</td>
</tr>
<tr>
<td>Services (professional)</td>
</tr>
<tr>
<td>Arts, Entertainment and Recreation</td>
</tr>
<tr>
<td>Utilities</td>
</tr>
<tr>
<td>Wholesale Trade</td>
</tr>
<tr>
<td>Religious, Charitable or Social Services</td>
</tr>
<tr>
<td>Telecommunications</td>
</tr>
<tr>
<td>Agriculture, Forestry, Fishing and Hunting</td>
</tr>
<tr>
<td>Communications/Publishing</td>
</tr>
<tr>
<td>Mining</td>
</tr>
</tbody>
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<table>
<thead>
<tr>
<th>Education -- 90 Cases</th>
<th># of Cases</th>
<th>% of Cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>Billing</td>
<td>38</td>
<td>42.2%</td>
</tr>
<tr>
<td>Corruption</td>
<td>22</td>
<td>24.4%</td>
</tr>
<tr>
<td>Skimming</td>
<td>19</td>
<td>21.1%</td>
</tr>
<tr>
<td>Expense Reimbursements</td>
<td>15</td>
<td>16.7%</td>
</tr>
<tr>
<td>Non-Cash</td>
<td>11</td>
<td>12.2%</td>
</tr>
<tr>
<td>Larceny</td>
<td>11</td>
<td>12.2%</td>
</tr>
<tr>
<td>Payroll</td>
<td>9</td>
<td>10.0%</td>
</tr>
<tr>
<td>Check Tampering</td>
<td>7</td>
<td>7.8%</td>
</tr>
<tr>
<td>Cash on Hand</td>
<td>7</td>
<td>7.8%</td>
</tr>
<tr>
<td>Financial Statement Fraud</td>
<td>1</td>
<td>1.1%</td>
</tr>
<tr>
<td>Register Disbursements</td>
<td>0</td>
<td>0.0%</td>
</tr>
</tbody>
</table>
In 2010, over 60% of fraud cases were discovered by tips, management reviews, or employees accidentally stumbling upon them during the course of their job duties.

**Detection of Fraud Schemes**

<table>
<thead>
<tr>
<th>Method</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tip</td>
<td>40.2%</td>
</tr>
<tr>
<td>Management Review</td>
<td>15.4%</td>
</tr>
<tr>
<td>Internal Audit</td>
<td>13.9%</td>
</tr>
<tr>
<td>By Accident</td>
<td>8.3%</td>
</tr>
<tr>
<td>Account Reconciliation</td>
<td>6.1%</td>
</tr>
<tr>
<td>Document Examination</td>
<td>5.2%</td>
</tr>
<tr>
<td>External Audit</td>
<td>4.6%</td>
</tr>
<tr>
<td>Surveillance/Monitoring</td>
<td>2.6%</td>
</tr>
<tr>
<td>Notified by Police</td>
<td>1.8%</td>
</tr>
<tr>
<td>Confession</td>
<td>1%</td>
</tr>
<tr>
<td>IT Controls</td>
<td>0.8%</td>
</tr>
</tbody>
</table>

Source: Association of Certified Fraud Examiners 2010 Report to the Nations on Occupational Fraud and Abuse
Fraud Facts

It is estimated that the cost of fraud in the typical organization translates to 5% of revenues. This translates to $2.9 trillion in annual fraud losses when applied to the 2009 Gross World Product.

<table>
<thead>
<tr>
<th>Occupational Frauds by Category</th>
<th>Frequency</th>
<th>Median Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset misappropriation</td>
<td>86.30%</td>
<td>$135,000</td>
</tr>
<tr>
<td>Corruption</td>
<td>32.80%</td>
<td>$250,000</td>
</tr>
<tr>
<td>Fraudulent Statements</td>
<td>4.80%</td>
<td>$4,100,000</td>
</tr>
</tbody>
</table>

Source: Association of Certified Fraud Examiners 2010 Report to the Nations on Occupational Fraud and Abuse
Fraud Schemes

- Vendor Fraud
- Abuse of Authority
- Conflict of Interest
- Falsification of Univ. Records
- Misuse of Property
- Improper Use of Univ. Resources
- Theft/Embezzlement
- Personal Business on State Time
- State Vehicle Abuse
- Missing Asset
- Misfeasance and Waste
- Leave or Time Abuse
VT Fraud, Waste, and Abuse Data

Average 45% substantiation since 2000

8 cases are still open from FY 2011
Since FY 1999-00, over 70% of allegations fall within five general categories:

- Leave or time abuse
- Improper use of university resources
- Theft or embezzlement
- Abuse of authority
- Conflict of Interest

Gradual increase in allegations regarding leave or time abuse and improper use of university resources
Organizational Flags

- Placing too much trust in key employees
- No communication of expectations
- Lack of proper authorization of transactions
- Inadequate attention to details
- No separation of duties between accounting functions
- Lack of clear lines of authority and responsibility
- Tendency toward crisis management
- Relaxed management style
- Poor system design
- Inadequate training
## Personal Red Flags

<table>
<thead>
<tr>
<th>Behavioral Flag</th>
<th>% of Cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>Living beyond means</td>
<td>43%</td>
</tr>
<tr>
<td>Financial difficulties</td>
<td>36%</td>
</tr>
<tr>
<td>Control issues; unwillingness to share duties</td>
<td>23%</td>
</tr>
<tr>
<td>Unusually close association with vendor or customer</td>
<td>22%</td>
</tr>
<tr>
<td>Wheeler-dealer attitude</td>
<td>19%</td>
</tr>
<tr>
<td>Divorce/family problems</td>
<td>18%</td>
</tr>
<tr>
<td>Irritability, suspiciousness or defensiveness</td>
<td>14%</td>
</tr>
<tr>
<td>Addiction problems</td>
<td>12%</td>
</tr>
<tr>
<td>Refusal to take vacations</td>
<td>10%</td>
</tr>
</tbody>
</table>

The sum of percentages in this chart exceeds 100% because in many cases perpetrators displayed more than one behavioral red flag.
Actions to Minimize Fraud

• Tone at the Top
• Education & Training
• Integrity Risk & Controls
• Reporting & Monitoring
• Proactive Detection
• Investigation & Follow-up
Preventive and Detective Controls

5 Controls to Consider:

1. Establish a Control Conscious Environment
2. Ensure Separation of Duties
3. Watch Authorizations, Approvals, and Verifications
4. Maintain Control over Assets
5. Take Time for Monitoring
Reporting Suspected Fraudulent Activities

Upon discovery of circumstances suggesting a fraudulent transaction or irregularity has occurred, immediately notify one of the following:

VT Internal Audit Department
- 540-231-4744
- 540-231-9478
- 540-231-7496

VT Police Department: 540-231-6411

State Employee Hotline: 800-723-1615
Fraud Prevention – Risk Analysis

All organizations have an obligation to identify risk as it pertains to every facet of its business.

We are conducting a fraud risk assessment of the activity at Virginia Tech and

NEED YOUR HELP!
Questions?

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