What You Will Take Away With You

• Glossary of Fraud Terms
  – Definitions and Fraud Facts

• Understanding Fraud
  – What situations are typically present when fraud exists
  – What are types of frauds
What You Will Take Away With You

• Red Flags and Controls
  – How to spot behavioral patterns and lifestyle changes that might indicate social pressure to commit fraud
  – What organizational conditions exist when fraud is present
What You Will Take Away With You

• Preventing Fraud and Minimizing the University’s Exposure
  – How to prevent fraud or determine if fraud may be occurring

• Policy on Reporting Suspected Fraudulent Activities
  – How to respond to concerns of wrong doing
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.
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.
Fraud Facts

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</th>
<th># of Cases</th>
<th>% of Cases</th>
<th>Median Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking/Financial Services</td>
<td>298</td>
<td>16.6%</td>
<td>$175,000</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>193</td>
<td>10.7%</td>
<td>$300,000</td>
</tr>
<tr>
<td>Government and Public Administration</td>
<td>176</td>
<td>9.8%</td>
<td>$81,000</td>
</tr>
<tr>
<td>Retail</td>
<td>119</td>
<td>6.6%</td>
<td>$85,000</td>
</tr>
<tr>
<td>Healthcare</td>
<td>107</td>
<td>5.9%</td>
<td>$150,000</td>
</tr>
<tr>
<td>Insurance</td>
<td>91</td>
<td>5.1%</td>
<td>$197,000</td>
</tr>
<tr>
<td>Education</td>
<td>90</td>
<td>5.0%</td>
<td>$71,000</td>
</tr>
<tr>
<td>Services (other)</td>
<td>88</td>
<td>4.9%</td>
<td>$109,000</td>
</tr>
<tr>
<td>Construction</td>
<td>77</td>
<td>4.3%</td>
<td>$200,000</td>
</tr>
<tr>
<td>Technology</td>
<td>65</td>
<td>3.6%</td>
<td>$250,000</td>
</tr>
<tr>
<td>Transportation and Warehousing</td>
<td>62</td>
<td>3.4%</td>
<td>$300,000</td>
</tr>
<tr>
<td>Oil and Gas</td>
<td>57</td>
<td>3.2%</td>
<td>$478,000</td>
</tr>
<tr>
<td>Real Estate</td>
<td>57</td>
<td>3.2%</td>
<td>$475,000</td>
</tr>
<tr>
<td>Services (professional)</td>
<td>51</td>
<td>2.8%</td>
<td>$110,000</td>
</tr>
<tr>
<td>Arts, Entertainment and Recreation</td>
<td>49</td>
<td>2.7%</td>
<td>$190,000</td>
</tr>
<tr>
<td>Utilities</td>
<td>45</td>
<td>2.5%</td>
<td>$120,000</td>
</tr>
<tr>
<td>Wholesale Trade</td>
<td>42</td>
<td>2.3%</td>
<td>$513,000</td>
</tr>
<tr>
<td>Religious, Charitable or Social Services</td>
<td>41</td>
<td>2.3%</td>
<td>$75,000</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>37</td>
<td>2.1%</td>
<td>$131,000</td>
</tr>
<tr>
<td>Agriculture, Forestry, Fishing and Hunting</td>
<td>27</td>
<td>1.5%</td>
<td>$320,000</td>
</tr>
<tr>
<td>Communications/Publishing</td>
<td>16</td>
<td>0.9%</td>
<td>$110,000</td>
</tr>
<tr>
<td>Mining</td>
<td>12</td>
<td>0.7%</td>
<td>$1,000,000</td>
</tr>
</tbody>
</table>

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

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

- Tip: 40.2%
- Management Review: 15.4%
- Internal Audit: 13.9%
- By Accident: 8.3%
- Account Reconciliation: 6.1%
- Document Examination: 5.2%
- External Audit: 4.6%
- Surveillance/Monitoring: 2.6%
- Notified by Police: 1.8%
- Confession: 1%
- IT Controls: 0.8%

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.

### Occupational Frauds by Category

<table>
<thead>
<tr>
<th>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>

The sum of percentages exceeds 100% because several of the cases involved schemes.

Source: Association of Certified Fraud Examiners 2010 Report to the Nations on Occupational Fraud and Abuse
Donald R. Cressey (1919-1987) a noted scholar of fraud hypothesized that a classic model existed for the fraud offender. This became known as the “Fraud Triangle.”
Fraud Factors

OPPORTUNITY

The situation that allows fraud to occur or that decreases the probability that fraud will be disclosed or punished.

- Weak internal controls or circumvention of internal controls
- Familiarity with operations, including cover-up capabilities
- The greater the position, the greater the trust and exposure to unprotected assets
- “Most Trusted Employee”
Fraud Factors

The need for committing fraud (e.g., need for money)

- Non-sharable financial pressure
- Family pressures - Unexpected expenses-illness
- Resentment – Against company, boss
- Getting even or “just taking what they owe me”
- Living beyond ones means
- Vices – Gambling, extramarital activity, alcohol/drugs
- Insatiable desire for financial gain
- Strong challenge to “beat the system”
- Pressure to meet institutional goals
- Close association with suppliers/vendors & other key people
Fraud Factors

**RATIONALIZATION**

*The mindset of the fraudster that justifies them to commit fraud*

Common beliefs:
- Person is owed this money
- Just borrowing until they are able to pay it back
- Everyone else is doing it
- The university is big enough that it won’t miss it
- Nobody will get hurt
- It is for the greater good
Types of Fraud

- **Misappropriation of assets** – theft or misuse of university assets.
- **Corruption** – Abusing influence or power within the university to obtain some benefit at the university’s expense.
- **Fraudulent Financial Reporting** – material misstatements or omissions of amounts or disclosure in financial statements.
VT Fraud, Waste, and Abuse Data

Average 44% substantiation since 2000

Note: Three cases from 2010 are still active.
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
Primary Internal Control Weakness Observed by CFEs

- Lack of Internal Controls: 37.8%
- Override of Existing Internal Controls: 19.2%
- Lack of Management Review: 17.9%
- Poor Tone at the Top: 8.4%
- Lack of Competent Personnel in Oversight Roles: 6.9%
- Lack of Independent Checks/Audits: 5.6%
- Lack of Employee Fraud Education: 1.9%
- Lack of Clear Lines of Authority: 1.8%
- Lack of Reporting Mechanism: 0.6%

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

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

**Gender of Fraudster**
- 66.7% Male
- 33.3% Female

**Position of Fraudster**
- Owner/Exec: 16.9%
- Manager: 41.0%
- Employee: 42.1%

**Age of Fraudster**
- <26: 5.2%
- 31-35: 9.6%
- 41-45: 19.3%
- 51-55: 13.7%
- >60: 2.2%
Profile of a Fraudster

How would you describe the personal profile of a fraudster?

Bottom Line: There is no “generic fraud profile”
Characteristics of a Fraudster

- Usually work their crimes alone.
- Tend to be compulsive (gambling, abusing alcohol/drugs).
- Spend money freely (their own and/or the university’s).
- Work themselves into favor by using their compulsiveness on-the-job.
- Rationalize their thefts by thinking they are merely “borrowing.”
- Tend to repeat their crime.
- Exploit weaknesses in internal controls to cover up their crimes.
- Have ready access on-the-job to cash or its equivalent.
### 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
- Pressure to Perform
- Inadequate staff/resources
- Poor 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.

Source: Association of Certified Fraud Examiners *2010 Report to the Nations on Occupational Fraud and Abuse*
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
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
Fraud Prevention: Minimize Exposure

1. Develop internal controls to protect the organization and the employee
2. Don’t let an individual have complete control of a financial process
3. Restrict access to computer facilities and data
4. Rotate job duties and cross-train
5. Review monthly statements; know where the money is going
6. Notice and pay attention to the red flags
7. Communicate with your staff about fraud awareness; advertise that fraud detection is a priority; Distribute whistleblower policies
8. Know your employees
9. Include background and reference checking in the hiring process
10. Increase the perception of detection (Active monitoring)
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!
Fraud Prevention: Internal Control Framework

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

**Control Activities:**
- Purchasing limits
- Approvals
- Security
- Reconciliations
- 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

**Information & Communication:**
- Reporting
- University communications
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 can I get a check issued or get my hands on cash, property, or information?
• What accounting documents are easiest to access and forge?
QUIZ
The term “occupational crime” covers at least four types of white-collar offenses. Which of the following is one of those types?

A. Crimes by individuals
B. Crimes by professionals
C. Crimes by organizations
D. All of the above.
Individuals who witness fraud in the workplace (such as taking university assets) should do which of the following:

A. Contact either the State Hotline, Internal Audit, or Campus Police.
B. Confront the suspected fraudster.
C. Participate in the fraudulent act.
D. Do nothing.

✅ A. Contact either the State Hotline, Internal Audit, or Campus Police.
Which of the following are types of fraud?

A. Misappropriation of assets (e.g., cash inventory)
B. Corruption (e.g., Conflicts of interest, bribery)
C. Theft of intellectual property (e.g., trade secrets, copyrights)
D. All of the above.
Why does fraud occur?

A. Pressure
B. Opportunity
C. Rationalization
D. All of the above.
How is fraud most often discovered?

A. Vision in a crystal ball
B. Message in a fortune cookie
C. Tips from employees
D. None of the above.

Correct answer: C. Tips from employees
Quiz

Who commits fraud?

A. Executives
B. Managers
C. Employees
D. All of the above.

✓ D. All of the above.
Describe the profile of a fraudster.

A. A 6’3” 250 lb. rough and tough guy
B. A left handed person
C. The person sitting next to you
D. There is no “generic profile”

✓ D. There is no “generic profile”
What are some red flags of fraud that people may exhibit?

A. Living beyond means
B. Addiction (drugs, alcohol, gambling)
C. Unusual secrecy
D. All of the above
What are some ways to help prevent or deter fraud?

A. Ensure segregation of duties
B. Proper authorizations, approvals and verifications
C. Maintain control over assets
D. All of the above

✓ D. All of the above
What is the most common type of occupational fraud?

A. Misappropriation of assets
B. Corruption
C. Fraudulent financial statements
D. None of the above.

The correct answer is: A. Misappropriation of assets
Quiz

Where on campus can fraud occur?

A. Bursar
B. Facilities Services
C. Controller’s Office
D. Anywhere on campus

✓ D. Anywhere on campus
Who can help fight fraud?

A. Dr. Steger
B. Business Managers
C. Fiscal Technicians
D. Everyone has a part

D. Everyone has a part

✓
“The university will not tolerate theft, waste, or abuse of state, university, or university-related funds, property, or other resources through fraudulent means.”

- University Policy 1040: Reporting Suspected Fraudulent Activities
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  231-4744
                          231-9478
                          231-7496

VT Police Department: 231-6411

State Employee Hotline  800-723-1615
Reporting Suspected Fraudulent Activities

- Act Promptly
- Maintain Confidentiality
- Consult *University Policy 1040, Reporting Suspected Fraudulent Activities*
Whistleblower

What NOT to do when confronted with a whistleblower allegation:

• Dismiss the matter out of hand
• Launch your own investigation
• Confront the accused or otherwise tip them off
• Disclose the matter to any unnecessary parties
• Try to settle or resolve the matter yourself
1. Employees should understand fraud, its impact on an organization, where to seek advice, and that Virginia Tech has a zero-tolerance policy.

2. Concerns of wrongdoing should be reported to Internal Audit or the hotline. Reports can be handled anonymously or confidentially without fear of reprisal.
3. Increase employee perception of detection by communicating that auditors ask questions about fraud, conducted unscheduled reviews of transactions, and uses automation to identify potential fraudulent transactions.

4. Management climate sets the tone of the organizational culture – honesty, integrity, realistic goals, awareness of fraud risks.
Fraud Prevention Checklist

5. Conduct fraud risk assessments to proactively identify and mitigate the university’s vulnerabilities to internal and external fraud.

6. Incorporate strong anti-fraud controls in processes, including
   a. Proper Separation of Duties
   b. Adequate Documentation
   c. Use of authorizations
   d. Physical Safeguards
   e. Monitor, Reconcile and Review Activity
Fraud Prevention Checklist

7. Hiring employees should include the following (where permitted by law):
   a. Past employment verification
   b. Criminal and civil background checks
   c. Credit checks
   d. Drug screening
   e. Education verification
   f. References check

8. Refer employees to support programs as needed for addictions, mental/emotional health, family or financial problems.
9. Allow employees to speak freely about pressures, providing management the opportunity to alleviate such pressures before they become acute.

10. Encourage all employees to participate in the anonymous employee climate surveys to be conducted later this year to assess employee morale.
Final Thoughts

- Be Aware of Your Environment
- Take Steps to Minimize Fraud
- Be Aware of Red Flags to Detect Fraud
- Balance Risk and Controls
Questions?

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