Fraud Prevention in 2012

College and University Auditors of Virginia

Spring 2012 Conference

May 22, 2012
Discussion Points

• Relating the Audit to Fraud
• Quantify the Fraud Problem
• Prevention, Deterrence, Detection
• Fraud in Higher Education
It’s About the People!
Fraud’s Expectations Gap

- “Where were the auditors??”
  - Able to but not looking for fraud
  - Not their engagement
  - Not a realistic shareholder expectation

- Regulators are adding fuel to the fire:
  - “We have a clear view that it is their job”

- Professional standards say “NO”
Financial Auditors and Fraud Detection

Financial Audit
- Routine and ongoing
- Examine financial statements and support for assertions
- Express opinion on f/s and GAAP compliance
- Not adversarial

Fraud Detection
- Non-recurring
- Limited to specific allegations
- Determine existence of fraud and who is responsible
- Adversarial in nature
SAS 99 Expectations

• Management:
  – Create and foster an ethical, honest culture
  – Establish and monitor appropriate controls

• Auditors:
  – Document fraud risk discussions and brainstorming sessions take place
SAS 99: Why Brainstorm?

• Enhance Professional Skepticism
  – Increased sensitivity to vulnerabilities
  – Increased documentation (PCAOB)

• More auditors = more experience = more … ?
  – Risk factors identified
  – Potential fraud schemes identified
  – Fees?
SAS 99 Expectations

Auditor has a responsibility to plan and perform the audit to obtain **reasonable assurance** about whether the financial statements are free of material misstatement, whether caused by error or fraud.
External Audit Report, 1

We have audited (someone). These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with … standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.
External Audit Report, 2

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of (someone) in conformity with accounting principles generally accepted in (the country where the report is issued).
What is Fraud?

• AICPA’s definition: An intentional act or omission designed to deceive others.

• IRS’ definition: Obtaining something of value from someone else through deceit.

• Generally, using deception gain an advantage and / or profit from another’s resulting loss.
Why: A Geometric View

"We committed crime simply because we could. … We had no rationalization. The incentive and opportunity was there, but the morality and excuses were lacking. We never had 1 conversation about morality during the 18 years that the fraud was going on."

http://www.whitecollarfraud.com/947660.html
Why: A Geometric View

![Diagram of a diamond and a pentagon with various labels: Incentive, Opportunity, Rationalization, Capability, Arrogance, Competence, Opportunity, Pressure, Rationalization.]

Crowe's Fraud Pentagon™
## Fraud By The Numbers: ACFE’s Reports to the Nation

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<td></td>
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<td>Est. Rev Lost</td>
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<td>7%</td>
<td>5%</td>
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<td>6%</td>
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<tr>
<td>Est. Fraud Cost</td>
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<td>$996B</td>
<td>$652B</td>
<td>$660B</td>
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Sources: ACFE Reports to the Nations, years indicated
The sum of percentages in this chart exceeds 100 percent because in some cases respondents identified more than one detection method.

2010 ACFE Report to the Nations on Occupational Fraud & Abuse
The Tone at the Top

The size of a loss is consistent with one’s access to and control over company asset.

AVERAGE LOSSES:

- $573k ($723k), Executives
- $180k ($160) if you look at all categories.
- $60k ($80k), Rank n File

Sources: 2012 (2010) ACFE Reports to the Nations
Deter, Prevent or Detect?

• Deterrence: Tasks or barriers to discourage one from trying to commit fraud

• Prevention: Strategies to stop those who are not discouraged

• Detection: Investigate allegations or suspicions that fraud may have occurred
Deterrence

• Governance
  – Internal Audit
  – Budgets
• Ethical Culture
  – TAT & History
  – Peer Pressure
• Perception
Detection / Investigation

- Analytic Review
- Non-Financial Measures
- Interviews
- Inspect / Examine
- 3rd Party Verification
- Be Aware!

LET'S NOT JUMP TO CONCLUSIONS!
“Badges of Fraud”: Affirmative Acts of Taxpayers

- “Unusual, inconsistent or incongruous acts”
- Concealment
- Two Sets of Books
- False Statements
- “The Flood”
- Property Transfers
Prevention

- Monitoring IC
- Internal Audit
- Water Cooler
- Surprise Audit/Exam
- Management Review
- Segregate / Rotation
- Risk Assessment & Monitoring
ACFE’s 2012 Recommendations

• Proactive anti-fraud measures
• Don’t rely on the external audits
• Enable suspicious activity reporting
• Targeted fraud awareness training

Source: 2012 ACFE Report to the Nations on Occupational Fraud & Abuse
Proactive Measures Are ..

• Recommending controls that will
  – Deter / discourage commission of fraud
  – Prevent / block a fraud from occurring
  – Detect / identify a fraud early-in

• Education and Training
  – Policies and procedures
  – Sensitivity to “fraud”
  – Sensitivity to non-financial cost/burden
Environmental Awareness

• Industry
• Economy
• Organization structure:
  – Strategic Plan
  – Attitude on Internal Control
  – Leadership Stability
  – Key Employees + Qualifications
Technology Risk Awareness

- Social Networking
- Mobile Computing
- Cloud Computing
- Mis-aligned IT & Business Strategy
- IT Infrastructure Security
Organization: Managing Fraud Risk
Risks Within ANY Organization

- Management: Phantom employees, insider trading, corruption, FS fraud
- “Corporate Insiders”: T&E, asset theft, fictitious billing/invoicing, trade secrets
- Customers/Vendors: Short ships, duplicate bill and refund, fictitious invoicing, bribery
Higher Ed – Is it So Different?

- Procurement Cards
  - Travel/Meal/Other
  - Expense Reports
- Purchasing Schemes
- Conflicts of Interest
  - Bid Rigging
  - Kickbacks
- Asset Liquidation
- Payroll Abuse
Make Money Without Trying
Prevent Expense Report Fraud

• Itinerary = unacceptable documentation
• Require full invoice not just summary or credit card receipt
• Identify employees on same trip
• Daily expenses, not total per trip
• Timely submission of expense report
• Timely review / approval of report
Other Preventive Measures

• Review current policies and procedures
  – Identify and close any gaps
  – Strengthen existing policies

• Diligent review of documentation
  – Obtain direct from 3rd party if possible
  – Not a popularity contest but a profitability contest
Q. What documentation should we have for shared rooms?
   A. Each of the travelers should have an original bill from the hotel. … pay individually and retain your original *itemized* receipt *showing proof of payment* and a *zero balance due on the bill* for reimbursement.

Q. Do I need to reference the other person’s Travel Order Number (T #) on my reimbursement?
   A. Yes! University requires you to note on your hotel bill that you shared a room. You should note on the bill *the traveler’s name and their T number*.

Q. Can one person pay for the entire cost of the room and have the others reimburse them?
   A. No. Having one person pay and the reimbursing with cash does not create a clean audit trail. Each individual must pay the vendor directly.
Rentals, Fuel, and Mileage Reimbursement Schemes

• The Long Way Home
• Come On and Take a Free Ride!
• I Can Drive Two Cars at Once
• Mileage Investment Account
• Free Gas with Rental
• One Fill-up for the Price of Two
Purchase Card Follies: Redundance in Abundance

• Excessive documentation to support a “real” purchase is submitted multiple times for reimbursement

• Who else can help you?
  – Unwitting co-conspirator, your credit card
  – Unwitting co-conspirator, your vendor
  – Knowing (?) co-conspirator, the payroll clerk who processes reimbursements!
Georgia Tech: 2008

- Implement P-Card Program
- Internal audit: little if any oversight – investigation starts
  - 20,000 cards, $350M annual spend
  - 18 instances of abuse (12 employees)
  - $350,000 over a six-years in 1 case
Key Points

• Fraud remains a people problem
  – Own your piece of Fraud Prevention
  – Hold Management accountable

• Proactive management has a stronger ROI than reactive response

• Original and complete receipts or other documentation, submitted timely

• IF IT DOESN’T MAKE SENSE ..
Questions?

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