University of California
2019 Ethics, Compliance and Audit Symposium
REACHING NEW HEIGHTS

First Class Travel, Fake Receipts and Pink Flamingos: Preventing and Detecting Fraud Through a Fraud Risk Management Program

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Course Outline

- Fraud Primer and Other Fun Fraud Facts

- First Class Travel, Fake Receipts and Pink Flamingos – Real Life Examples of Fraud

- What is a Fraud Risk Management?

- How UC Davis is Implementing A Fraud Risk Management Program

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What is Fraud?

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

Asset Misappropriation
- Cash theft
- Expense reimbursement schemes
- Fictitious vendors (accounts payable)
- Ghost employees (payroll)
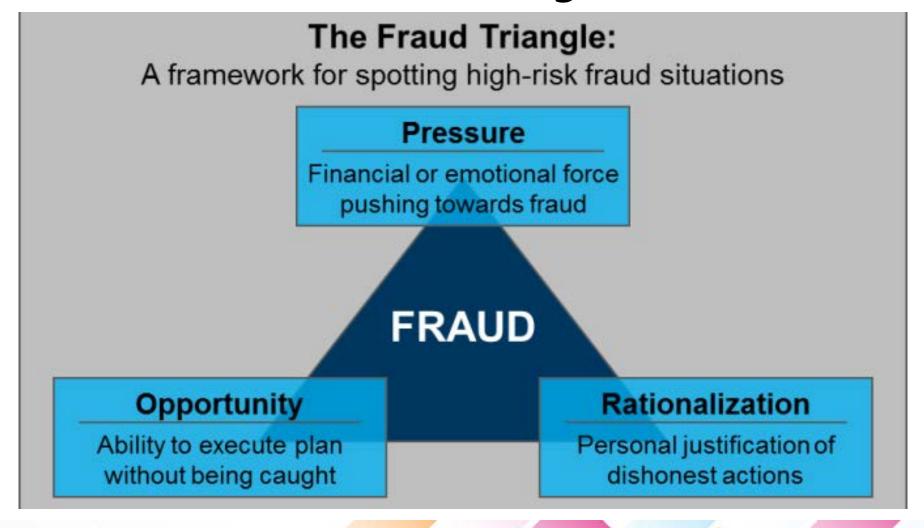- Misuse or theft of equipment

Corruption
- Conflict of interest
- Kickbacks
- Bid rigging
- Illegal gratuities

Financial Statement Fraud
- Misstatement of financial accounting data in order to:
  - Conceal operating losses/deficits
  - Report exaggerated revenues/results of operations

Fraud Triangle

The Fraud Triangle:
A framework for spotting high-risk fraud situations

Pressure

Financial or emotional force pushing towards fraud

FRAUD

Opportunity

Ability to execute plan without being caught

Rationalization

Personal justification of dishonest actions

Fraud Facts
ACFE 2018 Report to the Nations

Association of Certified Fraud Examiners (ACFE) publishes a biennial Report to the Nations, which is based upon a survey of fraud investigators from throughout the world. The majority of respondents are from the United States in a variety of industries. According to the 2018 Report to the Nations:

- When fraud investigators participating in the survey were asked to estimate the amount of revenues a typical organization loses to fraud each year, the median response was 5%. While the 5% figure is certainly imprecise due to variations in location, industry and experience of survey respondents, it provides one with a sense of the financial impact fraud can have on an organization.

- Asset misappropriation schemes are the most common and least costly, representing 89% of cases with a median loss of $114,000.

- Financial statement frauds are the least common and most costly, representing 10% of cases with a median loss of $800,000.

- The median duration of all fraud cases was 16 months.

- Internal control weaknesses were responsible for nearly half of the frauds.

- Fraud losses increase with duration of perpetrator's employment and level of authority.

- 40% of frauds were detected by tips. Of those tips, 53% came from employees.

- Data monitoring/analysis resulted in the greatest reduction in fraud losses and duration. Losses were 52% less and fraud schemes were detected 58% faster when data monitoring/analysis was in place.

Real Life Fraud Examples

- **Where's The Beef?** - A fake vendor was established in order to bill the University for nonexistent meat deliveries.

- **Not So Happily Ever After**– A purchasing card and stolen deposits were used to help pay for a wedding.

- **International Intrigue** – A former employee continued to purchase airline tickets for international trips after leaving the University.

- **Get More, Pay Less** – A corporate card was used to purchase grocery items and adult beverages for non-university related purposes.

- **Oh, The Places You'll Go –** An employee charged the University for travel to vacation destinations where there was no legitimate business reason for the travel.

- **Fixer Upper –** A subordinate's purchasing card was used to help remodel a supervisor's home.

- **Forgery for Dummies -** Receipts included with travel and entertainment claims were forged/altered, sometimes creating the appearance that the employee was in two locations at the same time. Further review resulted in the discovery of additional misconduct.

Consequences of Fraud

While we tried to inject some humor into real-life fraud examples, fraud actually isn't very funny. The consequences of fraud include:

- Financial loss;

- Erosion of stakeholder confidence;

- Damage to the organization's culture and employee morale; and,

- Increased scrutiny from outside agencies and regulatory bodies.

What Can Be Done About Fraud?

- It is almost impossible to completely eliminate fraud without the cost of the required internal controls being more than the amount at risk.

- Organizations must assess their fraud risk tolerance, and ensure that a system of internal controls are in place that enables fraud risk to be appropriately managed.

COSO Fraud Risk Management Principles

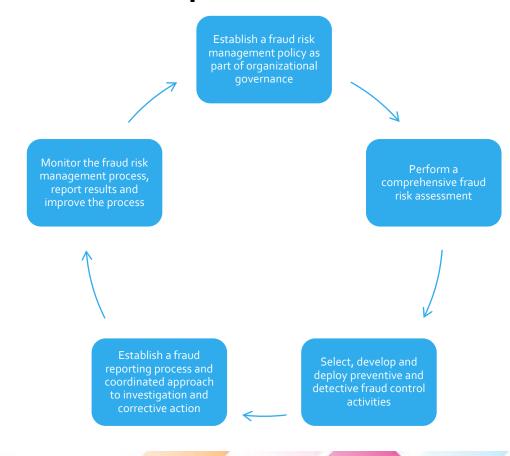|	
Fraud Risk Governance	• The organization establishes and communicates a Fraud Risk Management Program that demonstrates the expectations of the board of directors and senior management and their commitment to high integrity and ethical values regarding managing fraud risk."
Fraud Risk Assessment	• "The organization performs comprehensive fraud risk assessments to identify specific fraud schemes and risk, assess their likelihood and significance, evaluate existing fraud control activities, and implement actions to mitigate residual fraud risks."
Fraud Control Activities	• "The organization selects, develops, and deploys preventive and detective fraud control activities to mitigate the risk of fraud events occurring or not being detected in a timely manner."
Fraud Investigation and Corrective Action	• "The organization establishes a communication process to obtain information about potential fraud and deploys a coordinated approach to investigation and corrective action to address fraud appropriately and in a timely manner."
Fraud Risk Management Monitoring	• "The organization selects, develops, and performs ongoing evaluation to ascertain whether each of the five principles of fraud risk management is present and functioning and communicates Fraud Risk Management Program deficiencies in a timely manner to parties responsible for taking corrective action, including senior management and the board of directors."

Fraud Risk Management Principles in Action

Establish a fraud risk management policy as part of organizational governance

Perform a comprehensive fraud risk assessment

Select, develop and deploy preventive and detective fraud control activities

Establish a fraud reporting process and coordinated approach to investigation and corrective action

Monitor the fraud risk management process, report results and improve the process

UC Davis Fraud Risk Management Efforts – Gap Analysis

Principle Topic	What We Have	What is Needed
Governance	• Commitment to ethical behavior through Statement of Ethical Values and Standards of Ethical Conduct	• Assignment of responsibility for fraud risk management at executive level • Fraud risk management policy
Fraud Risk Assessment	• Risk assessment efforts, but not focused specifically on fraud	• Formalized fraud risk assessment

Control Activities	• Internal controls embedded in financial and administrative processes	• Data analytics
		  • To provide assurance about proper functioning of internal controls
		  • To identify fraud indicators

UC Davis Fraud Risk Management Efforts – Gap Analysis

Principle Topic	What We Have	What is Needed
Investigation and Corrective Action	• Whistleblower Policy • Locally Designated Official and team of investigators • Internal audit function • Investigations Coordination Workgroup	• De-identification and publication of summarized fraud investigation results where allegations are substantiated to serve as a deterrent
Monitoring	• Ethics Point system which facilitates tracking of key fraud investigation statistics	• Reporting on significant aspects of fraud risk management program to leadership • Periodic internal audits of fraud risk management program