Fraud Risk Assessment

VirginiaTech
Invent the Future

Brian J. Daniels, CISA, GCFA – Associate Director
Sharon M. Kurek CPA, CFE – Director of Internal Audit

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!

Analysis of your feedback will be used to:

- Review the key controls mitigating the more substantial fraud risks that you've identified.
- Document fraud analysis during the planning of each audit engagement.
- Develop an audit testing program for testing the key controls identified through this process.

Fraud Risk Assessment

Key Pad Practice

What is the most common type of fraud?

1. ✓ Asset Misappropriation
   0%
2. Corruption
   0%
3. Fraudulent Statements
   0%

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

Category	Frequency	Median Loss
Asset misappropriation	86.30%	$135,000
Corruption	32.80%	$250,000
Fraudulent Statements	4.80%	$4,100,000

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*

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.

What percentage of perpetrators have criminal histories?

1. More than 80%
   0%
2. 50-80%
   0%
3. 20-50%
   0%
4. ✓ Less than 20%
   0%

Criminal History

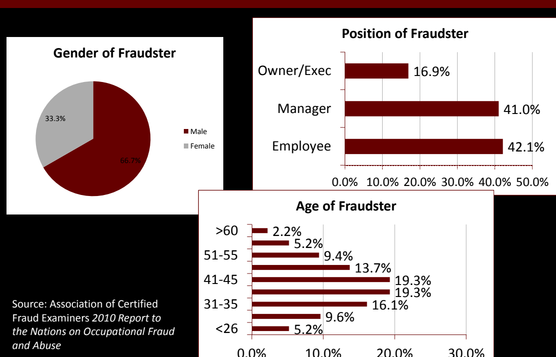
- 87.9% have never been charged or convicted
- 7.7% have prior convictions
- 4.4% have been charged but not convicted

What do these percentages tell us?

What age group of perpetrators had the highest median loss?

1. ✓ Greater than 60 years old
   0%
2. 51-60
   0%
3. 41-50
   0%
4. 36-40
   0%
5. 31-35
   0%
6. 26-30
   0%
7. Less than 26 years old
   0%

Who Commits Fraud?



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

Profile of a Fraudster

How would you describe the personal profile of a fraudster?

Bottom Line:
There is no "generic fraud profile"

Evaluation Criteria

LIKELIHOOD

What is the probability that this type of fraud would occur at Virginia Tech?

PERVASIVENESS

Assuming this type of fraud could occur, would it affect only a few departments or would it be widespread?

Evaluation Criteria

MATERIALITY

Assuming this fraud occurs at Virginia Tech, would the dollar amount and/or value lost be large or small?

REPUTATIONAL RISK

Should the public discover this type of fraud is occurring, how significantly would it impact the reputation or “brand” of Virginia Tech?

Fraud Risk Assessment

Corruption

Conflicts of Interest & Bribery

Types of Corruption

- Conflicts of Interest
  - Purchasing schemes
  - Sales schemes
- Bribery and Incentives
  - Bid-Rigging schemes
    - Need Recognition and Specifications Schemes
  - Kickback schemes
  - Bid pooling

Conflicts of Interest: Purchasing Schemes

Turnaround Sales

- A special kind of purchasing scheme sometimes used by fraudsters is called the turnaround sale or the flip.
- In this type of scheme an employee knows his employer is seeking to purchase a certain asset and takes advantage of the situation by purchasing the asset himself (usually in the name of an accomplice or shell company).
- The fraudster then turns around and resells the item to his employer at an inflated price.

Conflict of Interest: Sales Scheme

Writing Off Sales

- A type of sales scheme involving tampering with the books of the victim company to decrease or write off the amount owed by the company in which the employee has a hidden interest.

Bribery and Incentives: Bid Rigging

Bid Rigging Schemes

- A vendor offers something of value to the employee to influence the awarding of a contract.
- The way competitive bidding is rigged depends largely upon the level of influence of the corrupt employee. The more power a person has over the bidding process, the more likely the person can influence the selection of a supplier.

Bribery and Incentives: Bid Rigging

Special Bid Rigging Schemes

- **Need Recognition**
  - A conspiracy between the buyer and contractor where an employee of the buyer receives something of value and in return recognizes a "need" for a particular product or service.
  - The result of such a scheme is that the victim organization purchases unnecessary goods or services from a supplier at the direction of the corrupt employee.
- **Specifications Schemes**
  - Corruption scheme that occurs in this process is the fraudulent tailoring of specifications to a particular vendor.

Bribery and Incentives: Kickbacks

Kickback Schemes

- Kickbacks, in the commercial sense, are the giving or receiving anything of value to influence a business decision without the employer's knowledge and consent.
- They involve the submission of invoices for goods and services that are either overpriced or completely fictitious.
- Kickbacks are classified as corruption schemes rather than asset misappropriations because they involve collusion between employees and vendors.

Bribery and Incentives: Bid Pooling

Bid Pooling

- Bid pooling is a process by which several bidders conspire to split contracts up and assure that each gets a certain amount of work.
- Instead of submitting confidential bids, the vendors discuss what their bids will be so they can guarantee that each vendor will win a share of the purchasing company's business.

Fraud Risk Assessment

Cash:
Larceny &
Skimming

Cash Larceny

- The intentional taking of an employer's cash (the term cash includes both currency and checks).
- Can take place in any circumstance in which an employee has access to cash.
- Involves the theft of incoming cash, currency on hand (e.g., in a cash register, cash box), or theft of cash from the victim organization's bank deposits.

Cash Larceny

Types of Cash Larceny we will be discussing:

- Theft of cash on hand
  - Reversing transactions
  - Register manipulation
  - Altering cash counts
- Theft of cash from the deposit
  - Deposit lapping
  - Deposits in transit

Cash Larceny: Theft of Cash on Hand

Theft of Cash on Hand

- A large percentage of cash larceny schemes occur at the cash register, and for good reason— the register is usually where the cash is.
- The most straightforward cash larceny scheme is to simply open the register and remove currency or checks.

Cash Larceny: Theft of Cash from the Deposit

- At some point in every revenue-generating business, someone must physically take the company's currency and checks to the bank.
- This person or persons, left alone literally holding the bag, will have an opportunity to take a portion of the money prior to depositing it into the company's accounts.

Theft of Cash from the Deposit

Types of theft from the deposit:

- Deposit Lapping
- Deposits in Transit

Theft of Cash from Deposit: Deposit Lapping

Deposit Lapping

- Lapping occurs when an employee steals the deposit from day one, then replaces it with day two's deposit. Day two is replaced with day three, and so on. The perpetrator is always one day behind.

Theft of Cash from Deposit: Deposits in Transit

Deposits in Transit

- A strategy used to conceal stolen deposits is to carry the missing money as deposits in transit, which are a way of accounting for discrepancies between the company's records and the bank statement.

Cash Skimming

- The removal of cash from a victim entity prior to its entry in an accounting system.
- Employees steal sales or receivables before they are recorded in the company books.
- Skimming schemes are known as “off-book” frauds, meaning money is stolen before it is recorded in the victim organization’s accounts.

Types of Cash Skimming

- Sales Skimming
- Receivables Skimming
  - Forcing account balances or destroying transaction records
  - Lapping
  - Writing off account balances

Cash Skimming: Sales Skimming

Sales Skimming

- The most basic skimming scheme occurs when an employee sells goods or services to a customer, collects the customer’s payment, but makes no record of the sale.
- The employee simply pockets the money received from the customer instead of turning it over to his employer.

Cash Skimming: Receivables Skimming

- **Forcing Account Balances or Destroying Transaction Records:** Among the most dangerous receivables skimming schemes are those in which the perpetrator is in charge of collecting and posting payments. If a fraudster has a hand in both ends of the receipting process, he or she can falsify records to conceal the theft of receivables payments.
- **Lapping:** Lapping customer payments is one of the most common methods of concealing receivables skimming. Lapping is the crediting of one account through the abstraction of money from another account. It is the fraudster’s version of “robbing Peter to pay Paul.”
- **Writing Off Account Balances:** Some employees cover their skimming by posting entries to contra revenue accounts such as “discounts and allowances.” If, for instance, an employee intercepts a $1,000 payment, he would create a $1,000 “discount” on the account to compensate for the missing money. Another account that might be used in this type of concealment is the bad debts expense account.

Fraud Risk Assessment

Misuse and Larceny

of Inventory and Other Assets

Inventory and Assets

- Employees target inventory, equipment, supplies, and other non-cash assets for theft in a number of ways. These schemes can range from stealing a box of pens to the theft of millions of dollars worth of company equipment.
- The terms inventory and other assets are meant to encompass the misappropriation schemes involving any assets held by a company other than cash.
- There are basically two ways a person can misappropriate a company asset. The asset can be misused or it can be stolen.

Misuse of Inventory and Assets

- Assets that are misused but not stolen typically include company vehicles, supplies, computers, cell phones, procurement cards, and other office equipment.
- Misuse would include any use that is not associated with the company's intended or expressed use of the asset.

Larceny of Assets and Inventory

Larceny, or the theft, of inventory and assets typically includes two methods of fraud:

- Purchasing and receiving schemes
- Asset requisitions and transfers

Larceny: Purchasing and Receiving Schemes

- Dishonest employees can manipulate the purchasing and receiving functions of a company to facilitate the theft of inventory and other assets.
- Assets are intentionally purchased by the company and later misappropriated by the perpetrator.
- The company loses both the value and use of the merchandise.

Asset Requisitions and Transfers

- Asset requisitions and other documents that allow non-cash assets to be moved from one location in a company to another can be used to facilitate the theft of those assets.
- Employees use internal transfer paperwork to gain access to merchandise which they otherwise might not be able to handle without raising suspicion.
- These documents do not account for missing merchandise, but they allow a person to move the assets from one location to another. In the process of this movement, the thief steals the merchandise.

Fraud Risk Assessment

Fraudulent Disbursements

Types of Fraudulent Disbursements

- Billing schemes
- Payroll schemes
- Expense reimbursement schemes
- Check tampering
- Register disbursements

Fraudulent Disbursements: Billing Schemes

Billing Schemes

- Popular form of employee fraud mainly because they offer the prospect of large rewards.
- Since the majority of most disbursements are made in the purchasing cycle, larger thefts can be hidden through false-billing schemes than through other kinds of fraudulent disbursements.

Fraudulent Disbursements: Billing Schemes

Three principal types of billing schemes:

- Personal purchases made with university funds
- False invoicing via shell companies
- False invoicing via non-accomplice vendors

Billing Schemes: Personal Purchases with University Funds

1. Instead of undertaking billing schemes to generate cash, many fraudsters simply purchase personal items with their university's money.
2. The university ends up unknowingly buying goods or services for a dishonest employee.

Billing Schemes: Invoicing via Shell Companies

Shell companies are fictitious entities created for the purpose of committing fraud. They may be nothing more than a fabricated name and a post office box that an employee uses to collect disbursements from a false billings.

Billing Schemes: Invoicing via non-accomplice vendors (pay and return schemes)

1. Instead of using shell companies in their billing schemes, some employees generate fraudulent disbursements by using invoices of legitimate, third-party vendors who are not a part of the fraud scheme.
2. In pay and return schemes, employees intentionally mishandle payments owed to legitimate vendors.
3. Examples include purposely double-paying an invoice and pocketing the second payment or intentionally purchasing excess merchandise, returning the excess and pocketing the refund.

Fraudulent Disbursements: Payroll Schemes

- Perpetrator typically falsifies a timecard or alters information in the payroll records.
- Payroll frauds involve disbursements to employees rather than to external parties.
- Most common:
  - Ghost employees
  - Falsified hours and salary schemes

Payroll Schemes: Ghost Employees

- The term ghost employee refers to someone on the payroll who does not actually work for the victim employer.
- Through the falsification of personnel or payroll records a fraudster causes paychecks to be generated to a ghost.

Payroll Schemes: Falsified Hours and Salary

The most common method of misappropriation of funds is by falsifying the number of hours worked or changing the wage rate.

Expense Reimbursement Schemes

Employees can manipulate an organization's expense reimbursement procedures to generate fraudulent disbursements.

Mischaracterized Expense Reimbursements

- Most companies only reimburse certain expenses of their employees.
  - Which expenses a company will pay for depends to an extent upon policy, but in general, business-related travel, lodging, and meals are reimbursed
- One of the most basic expense reimbursement schemes is perpetrated by simply requesting reimbursement for a personal expense by claiming that the expense is business related.

Fictitious Expenses

- Employees sometimes seek reimbursement for wholly fictitious expenses.
- Instead of overstating a real business expense or seeking reimbursement for a personal expense, an employee just invents an expense and requests that it be reimbursed.

Overstated Expense Reimbursements

Instead of seeking reimbursement for personal expenses, some employees overstate the cost of actual business expenses. This can be accomplished in a number of ways.

- **Altered Receipts:** The most fundamental example of an overstated expense reimbursement scheme occurs when an employee doctors a receipt or other supporting documentation to reflect a higher cost than what he actually paid.
- **Over Purchasing:** Another way to overstate a reimbursement form is the "over-purchasing" of business expenses. This method is typically used by employees seeking reimbursement for travel expenses.
- **Multiple Reimbursements:** The least common of the expense reimbursement schemes is the multiple reimbursements. This type of fraud involves the submission of a single expense several times.

Check Tampering

Check tampering is unique among the fraudulent disbursement schemes because it is the one group in which the perpetrator physically prepares the fraudulent check.

In these schemes the perpetrator takes physical control of a check and makes it payable to himself through one of several methods.

Types of these schemes include:
- Forged Maker
- Forged Endorsement
- Altered Payee

Check Tampering: Forged Maker and Endorsement

The person who signs a check is known as the "maker" of the check. A forged maker scheme is when an employee misappropriates a check and forges the signature.

Forged endorsements are those where an employee intercepts a company check intended to pay a third-party and converts the check by endorsing it in the third-party's name.

Check Tampering: Altered Payee Schemes

This scheme is where an employee intercepts a company check and alters the payee designation by inserting their name or another so that the check can be converted by the employee or an accomplice.

Register Disbursement

Fraudulent disbursements at the cash register are different from the other schemes that often occur at the register, such as skimming and cash larceny.

When cash is stolen as part of a register disbursement scheme, the removal of the cash is recorded on the register tape. A false transaction is entered so it appears that the disbursement of money was legitimate.

Examples of these schemes are:
- False Refunds
- False Voids

Reporting Suspected Fraudulent Activities

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

VT Department of Internal Audit	231-4744
	231-9478
	231-7496
VT Police Department:	231-6411
State Employee Hotline	800-723-1615

Thank you.

Brian Daniels • 9478
bdaniels@vt.edu

Sharon Kurek • 1-7496
kurek@vt.edu

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