

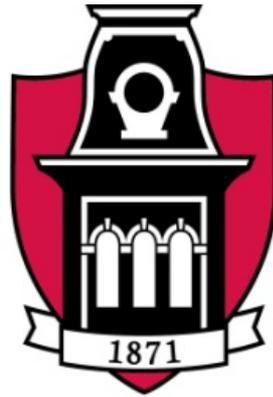


# Red Flags of Fraud

## OVERVIEW

Red Flags of Fraud are warning signs that may indicate a higher fraud risk. They are NOT evidence that fraud is actually occurring. Many employees demonstrate one or more of the flags on the list, and the existence of one or two flags is not likely to cause concern. However, if multiple flags are identified that span the three categories AND accounting irregularities and/or weak internal controls are identified, the risk that fraud is occurring or could occur is significantly higher.

<p><b>Common Personality Traits of Fraudsters</b></p>	<ul style="list-style-type: none"> <li>• Wheeler-dealer attitude</li> <li>• Controlling and unwilling to share duties</li> <li>• Don't like people reviewing their work</li> <li>• Strong desire for personal gain</li> <li>• Live beyond their means</li> <li>• Often have "too good to be true" work performance</li> <li>• Outwardly, appear to be very trustworthy</li> <li>• Unable to relax</li> <li>• Don't take vacation or sick time or only take leave in small amounts</li> <li>• Often work excessive overtime</li> <li>• Have a "Beat the System" attitude</li> </ul>
<p><b>Common Sources of Pressure</b></p>	<ul style="list-style-type: none"> <li>• Financial problems</li> <li>• Medical problems</li> <li>• Divorce</li> <li>• Legal problems – criminal or civil</li> <li>• Need to maintain a certain lifestyle – pressure to "keep up with" or "out-do" others in regards to material possessions</li> <li>• Purchase a new home, second home or major home renovation</li> <li>• Unreasonable performance goals</li> <li>• Gambling</li> <li>• Drug/Alcohol addiction</li> </ul>
<p><b>Changes in Behavior</b></p>	<ul style="list-style-type: none"> <li>• Buys more material items – houses, cars, boats, clothes, jewelry</li> <li>• Brags about purchases</li> <li>• Starts to carry unusual amounts of cash</li> <li>• Creditors/Collectors show up at work or call frequently</li> <li>• Borrows money from co-workers</li> <li>• Becomes irritable or moody</li> <li>• Becomes unreasonably upset when questioned</li> <li>• Becomes territorial over area of responsibility</li> <li>• Refuses to take vacation or sick leave</li> <li>• Starts coming in early or staying late</li> <li>• Redo or Rewrite work to "make it neat"</li> <li>• Mentions family or financial problems</li> <li>• Exhibits signs of addiction – absenteeism, become manipulative, looks ill, inconsistent or illogical behavior, loss of sleep, loss of appetite</li> <li>• Exhibits signs of dissatisfaction – decreased productivity, change in attire, irregular schedules, frequent complaining about work issues</li> </ul>



UNIVERSITY OF  
ARKANSAS.  
— THE YOU OF A —

**“YOU” Can Prevent Fraud!**

**SDP Session 7A**

**May 10, 2011**



UNIVERSITY OF  
ARKANSAS  
— THE YOU OF A —

# What can “YOU” do?

- ❖ **Define - What is Fraud?**
- ❖ **Analyze – Dissect Fraud Elements**
- ❖ **Manage Risk – Internal Control System**
- ❖ **Prevent – Fraud Awareness**



UNIVERSITY OF  
ARKANSAS  
— THE YOU OF A —

# What is Fraud?

## Webster's Dictionary defines as:

1

$a$  : deceit, trickery; *specifically* : intentional perversion of truth in order to induce another to part with something of value or to surrender a legal right  $b$  : an act of deceiving or misrepresenting : trick

2

$a$  : a person who is not what he or she pretends to be : impostor; *also* : one who defrauds : cheat  $b$  : one that is not what it seems or is represented to be



UNIVERSITY OF  
ARKANSAS  
— THE YOU OF A —

# What is Fraud?

**Board of Trustees Policy 350.1 defines as:**

..... the intentional, false representation or concealment of a material fact for the purpose of inducing another to act upon it to his or her injury.



UNIVERSITY OF  
ARKANSAS  
— THE YOU OF A —

# What is Fraud?

Ultimately all frauds are

.....a violation of trust

For organizations, no trust violation has the potential to be as harmful as those committed by the very group that is relied upon for success

.....its employees



UNIVERSITY OF  
ARKANSAS  
— THE YOU OF A —

# What is Fraud?

**The Association of Certified Fraud Examiners defines *Occupational Fraud* as**

The use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets



UNIVERSITY OF  
ARKANSAS  
— THE YOU OF A —

# Occupational Fraud

## ➤ Asset Misappropriation

➤ The employee steals or misuses the organization's resources

## ➤ Corruption

➤ The employee uses his influence in business transactions in a way that violates his duty to the organization in order to obtain personal gain

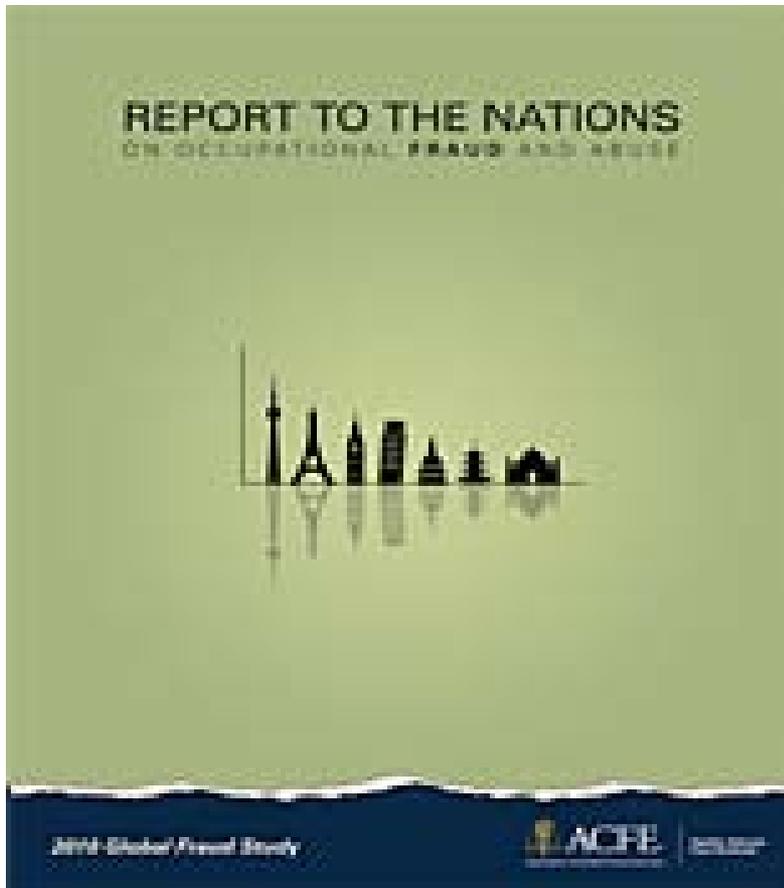
## ➤ Financial Statement Fraud

➤ Intentional misstatement or omission of material information in the organization's financial report



UNIVERSITY OF  
ARKANSAS  
— THE YOU OF A —

# Occupational Fraud



Study covered 1843 cases of occupational fraud that occurred in more than 100 countries on 6 continents.

Participants in study were anti-fraud specialists with a median of 12 years of experience in the fraud examination field.



UNIVERSITY OF  
ARKANSAS  
— THE YOU OF A —

# Occupational Fraud

## Summary of Key Findings

- Median loss caused was \$160,000
- Median duration before detection was 18 months
- Initial detection came from tips in 40.2% of the cases, followed by management review at 16.4%
- Small organizations are disproportionately victimized by occupational fraud



UNIVERSITY OF  
ARKANSAS  
— THE YOU OF A —

# Occupational Fraud

## Summary of Key Findings

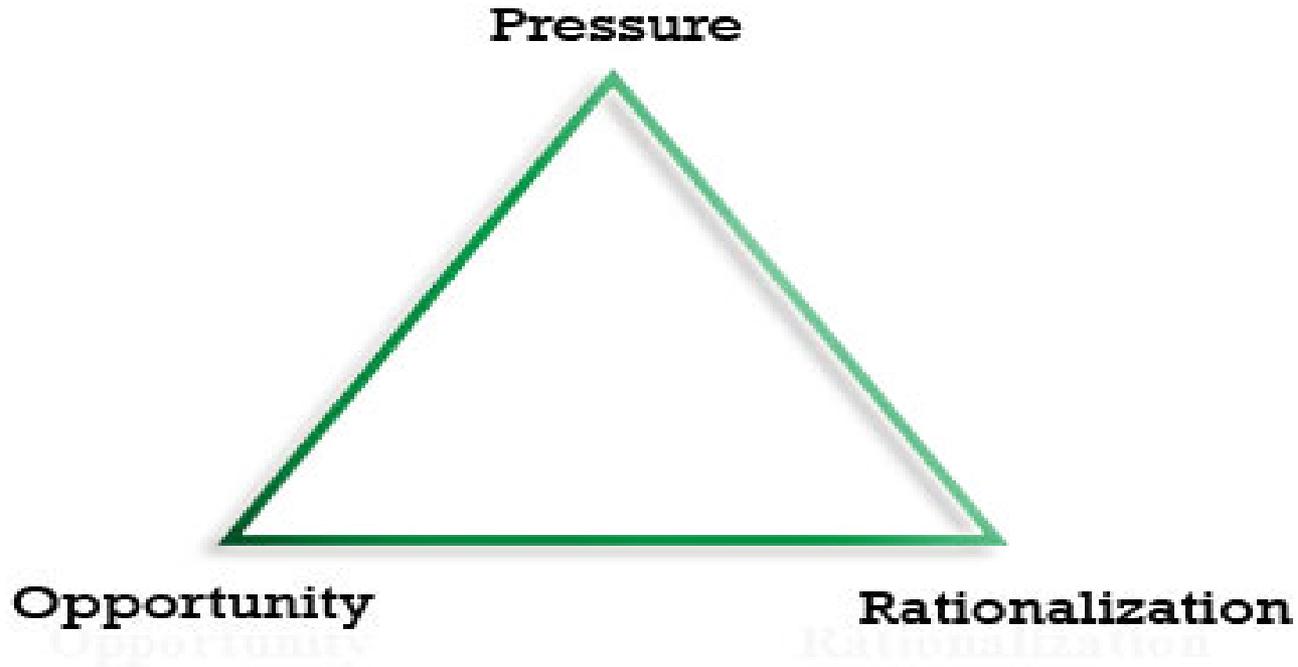
- 85% of fraudsters in the study had never been previously charged or convicted of a fraud-related offense
- Fraudsters often display warning signs or behavioral red flags that indicate they may be engaged in illicit activity
- Anti-fraud controls appear to help reduce the cost and duration of occupational fraud schemes



UNIVERSITY OF  
ARKANSAS  
— THE YOU OF A —

# Fraud Dissected

## Fraud Triangle





UNIVERSITY OF  
ARKANSAS  
— THE YOU OF A —

# Fraud Dissected

## Pressure

What causes a person to commit fraud

- ✓ Living beyond means to create a certain lifestyle
- ✓ Medical crisis
- ✓ Addiction
- ✓ Divorce
- ✓ Family crisis



UNIVERSITY OF  
ARKANSAS  
— THE YOU OF A —

# Fraud Dissected

## Opportunity

The ability to commit fraud. Opportunity is created by:

- ✓ Weak or non-functioning internal controls
- ✓ Poor management oversight/supervision
- ✓ Misuse/abuse of one's position and authority
- ✓ Belief they won't get caught



UNIVERSITY OF  
ARKANSAS  
— THE YOU OF A —

# Fraud Dissected

## Rationalization

The reconciliation of the fraudulent behavior with the commonly accepted ideals of decency and trust

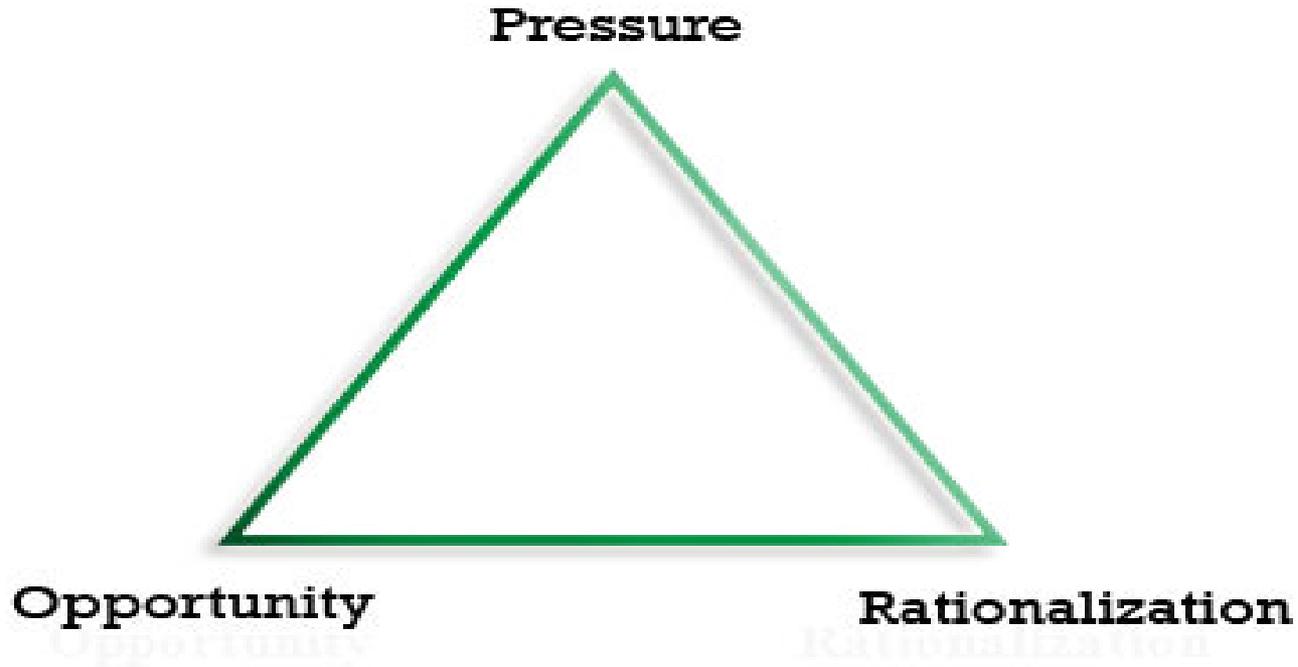
- ✓ Stealing justified to save a loved one
- ✓ They will lose everything if they don't steal
- ✓ Belief that no outside help is available to them
- ✓ Labels stealing as “borrowing” and fully intend to pay back
- ✓ Job dissatisfaction creates belief that the organization “owes” them



UNIVERSITY OF  
ARKANSAS  
— THE YOU OF A —

# Fraud Dissected

## Fraud Triangle





UNIVERSITY OF  
ARKANSAS  
— THE YOU OF A —

# Internal Control System

Internal control is broadly defined as a process, effected by the organization's board of trustees, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations
- Safeguarding of assets



UNIVERSITY OF  
ARKANSAS  
— THE YOU OF A —

# Internal Control System





UNIVERSITY OF  
ARKANSAS  
— THE YOU OF A —

# Internal Control System

## Control Environment

- ✓ Control consciousness of the organization
- ✓ Atmosphere in which activities are conducted and staff carries out their control responsibilities
- ✓ Intangible
- ✓ Employees understand their responsibilities and limits to their authority

## Control Environment Tips:

- ✓ Develop a leadership philosophy and operating style that promotes internal control
- ✓ Properly assign authority and responsibility to staff



UNIVERSITY OF  
ARKANSAS  
— THE YOU OF A —

# Internal Control System

## Risk Assessment

- ✓ Relative to achieving goals and objectives
- ✓ Identifying risks associated with achievement
- ✓ Identify at both unit and activity level
- ✓ Consider external and internal factors

## Management is responsible for:

- ✓ Determining the level of acceptable risk the organization can assume
- ✓ Prioritizing identified risks
- ✓ Considering qualitative and quantitative costs when developing a management plan



UNIVERSITY OF  
ARKANSAS  
— THE YOU OF A —

# Internal Control System

## Control Activities

Actions, supported by policies and procedures, to manage risk

### **PREVENTIVE**

Proactive controls to  
prevent loss

- ✓ Segregation of Duties
- ✓ Transaction Approvals
- ✓ Documentation
- ✓ Security of Assets

### **DETECTIVE**

Provide evidence a loss  
has occurred

- ✓ Audits
- ✓ Reconciliations
- ✓ Physical Inventories
- ✓ Security of Assets



UNIVERSITY OF  
ARKANSAS  
— THE YOU OF A —

# Internal Control System

## Information and Communication

- ✓ Sharing information up, down and across organizational units
- ✓ From both internal and external sources
- ✓ Presented in a form and time frame that is useful

### Formal Systems

- Information technology
- Staff meetings
- Reports
- Hotline

### Informal Systems

- Casual Conversations with faculty, staff or students
- Vendors and regulators
- May offer clues when combined with other known facts



UNIVERSITY OF  
ARKANSAS  
— THE YOU OF A —

# Internal Control System

## Monitoring

Purpose is to determine whether the internal control system is adequately designed , properly executed and effective

- ✓ Can determine if all 5 components are present and functioning
- ✓ Important to assess effectiveness over several points in time

## Ongoing

- Supervisor activities the evaluate
- Focus on high risk areas
- Spot checks and sampling

## Separate Evaluations

- Self-assessments
- Internal Audits
- Peer Reviews



UNIVERSITY OF  
ARKANSAS  
— THE YOU OF A —

# Fraud Prevention

To detect and deter fraud, it is critical that employees:

- ✓ Understand the importance of a functioning internal control system
- ✓ Fully understand their role in the internal control system
- ✓ Are provided training to recognize red flags
- ✓ Be able to report suspicious activity without fear of reprisal.



UNIVERSITY OF  
ARKANSAS  
— THE YOU OF A —

# Fraud Prevention

## Red Flags of Fraud

Warning Signs that may signal fraud risk is higher. They are NOT evidence that fraud is actually occurring.

- Common Personality Traits
- Common Sources of Pressure
- Changes in Behavior



UNIVERSITY OF  
ARKANSAS  
— THE YOU OF A —

# Fraud Prevention

## What to do if you suspect fraud

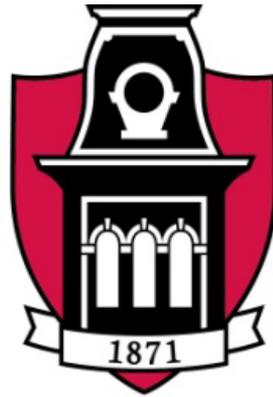
1. Talk to your **immediate supervisor** and discuss your concerns.
2. Report the activity to the **Office of Financial & Management Analysis**, ADMN 130, 575-5553  
or
3. Call the **confidential fraud hotline** at  
1-866-252-9838



UNIVERSITY OF  
ARKANSAS  
— THE YOU OF A —

# Review

- ✓ Fraud is a violation of trust
- ✓ Pressure, Opportunity, Rationalization must all be present for fraud to occur
- ✓ Organizations have most control over opportunity
- ✓ An effective Internal Control System limits opportunity
- ✓ Managers should be aware of Red Flags of Fraud
- ✓ Report known fraud or suspicious activity



UNIVERSITY OF  
ARKANSAS.  
— THE YOU OF A —

Jean Schook, Associate Vice Chancellor  
ADMN 316, 575-4547  
jschook@uark.edu