

Fraud Risk and Prevention: Campus Lesson Learned – Part II

During fiscal year 2010, an employee fraud was discovered in the Walton College of Business, resulting in losses to the University in excess of \$125,000. The first white paper, “Fraud Risk and Prevention: Campus Lesson Learned”, discussed the fraud triangle and related it to the WCOB incident. Continuing on, Part II discusses the response by Walton College to the incident and the steps taken to strengthen the college’s internal control system. Recognizing that our colleges and other administrative units have differing organizational structures, the solutions developed by Walton College may not be appropriate for all in terms of implementation, but can be a starting point for dialog within each unit to assess and improve their internal control systems.

Overview

Developing an effective internal control system limits opportunities to commit fraud. When the system is functioning properly, it provides reasonable, but not absolute assurance for the safeguarding of assets, the reliability of financial information, and compliance with laws and regulations. Risk is the probability that an event or action will adversely affect the university. The internal control system consists of five interrelated components. They are the control environment, risk assessment, control activities, information and communication and monitoring. It is important to strike a balance between identified risks and the level of control necessary to obtain reasonable assurance that the objectives of the unit will be met.

Control Environment

The control environment is an intangible factor, but is essential for all other components to function. It is the control consciousness of the university. Management is responsible for creating an environment where ethical and behavior standards are known, an operating style is developed that promotes internal control throughout the university and there is proper assignment of authority and responsibility to staff.

Management within WCOB reinforced the importance of establishing an effective control environment with their response to the fraud incident. Thoughtful consideration was given to identifying control weaknesses, developing lines of communication within the college across all positions and establishing new controls or strengthening existing controls.

Risk Assessment

Risk assessment is the identification and analysis of the risks associated with achieving unit goals and objectives for operations, financial reporting and compliance. Management is responsible for evaluating risk and managing those identified to an acceptable level. It is important to identify risk at not only the unit level, but also at the activity level. Both external and internal factors should be considered. As various risks are identified, management should prioritize them to determine which have the greatest potential for occurrence or, if occurred, have the greatest potential impact. When evaluating potential

impact of risk, both quantitative and qualitative costs should be considered. Quantitative costs include the cost of loss of assets, damage and repair expenses and legal fees. Examples of qualitative costs include loss of public trust, loss of future gifts or grants, injured reputation, decreased enrollment and increased legislation.

In response to the fraud incident, the WCOB Accounting Center and executive management completed an informal risk assessment to identify areas of potential control weakness and developed additional and/or new procedures. Two college-wide meetings were held to present management's ideas to the staff and gather feedback. Based on feedback received and best practices that were brought to the discussion by others, procedures were refined and finalized.

Control Activities

Control activities are actions supported by policies and procedures that, when carried out properly and in a timely manner, manage or reduce risk to an acceptable level. They should be designed so that risk is decreased to an acceptable exposure. Control activities include approvals, authorizations, verifications, reconciliations, performance reviews, asset security, segregation of duties and information system controls. As noted above, control activities were developed or revised by WCOB in response to the fraud incident. Through risk assessment, the accounting center identified several types of purchases that presented a higher risk as well as administrative procedures related to proxy signatures and blanket purchase orders. The following are the specific controls instituted by WCOB to address these identified risks:

- A standard P-Card Report form will be implemented in the College. This form will include the receipt, cost center number, category, reason for purchase, signature of the person who used the card and date, signature of the person who received the product and date (if applicable), and signature of the supervisor and date.
- The Accounting Center staff will run monthly reports of all P-Card transactions and reconcile them with supporting documentation received from the departments/units monthly. This report will be sent to each department chair/unit head for their review and stored digitally in the Accounting Center.
- When allowing another individual to use your P-Card, you must have them complete the P-Cardholder Delegation Form.
- The Accounting Center will maintain a list of P-Card holders and the last four digits of the P-Card number. This number will be checked against any Visa credit card purchases that are submitted for personal reimbursement. The Accounting Center will black-out remaining credit card numbers once the number has been checked in order to maintain PCI compliance.
- A standard Bookstore Report form will be implemented in the College. This form will include the receipt, cost center number, category, reason for purchase, signature of the person who purchased product and date, signature of the person who received the product and date (if applicable), and signature of the supervisor and date. The Accounting Center will pull Bookstore purchases from BASIS to create a monthly statement and reconcile with receipts received. These

statements will be sent to each department chair/unit head for review and stored digitally in the Accounting Center.

- A standard Print/Copy Report form will be implemented in the College. This form will include the receipt, cost center number, category, reason for purchase, signature of the person who purchased product and date, signature of the person who received the product and date (if applicable), and signature of the supervisor and date. The Accounting Center will pull Print/Copy purchases from BASIS to create a monthly statement and reconcile with receipts received. These statements will be sent to each department chair/unit head for review and stored digitally in the Accounting Center.
- A standard Sam's Club Report form will be implemented in the College. This form will include the receipt, cost center number, category, reason for purchase, signature of the person who purchased product and date, signature of the person who received the product and date (if applicable), and signature of the supervisor and date. The Accounting Center will pull Sam's Club purchases from BASIS to create a monthly statement and reconcile with receipts received. These statements will be sent to each department chair/unit head for review and stored digitally in the Accounting Center.
- A copy of all Office Max receipts will be sent to the Accounting Center electronically. The Accounting Center will pull Office Max purchases from BASIS to create a monthly statement and reconcile with receipts received. These statements will be sent to each department chair/unit head for review and stored digitally in the Accounting Center.
- When a key employee leaves the College, all blanket purchase orders to the University Bookstore/Razorback shop, computer store, and printing services from that employee's department will be cancelled and a new PO established.
- Under lock and key, the Accounting Center will keep a master list of college signatures on file to compare to signed documentation if it looks questionable.
- Employees, when signing as proxy for another individual, should indicate who is actually signing. This might be accomplished by making the signature and adding the signer's name or by adding the signer's initials. It is highly recommended that original signatures be obtained. This applies to digital signatures as well.
- All requisitions must include a brief description listing the reason for purchase in the PF9 "BU's comments to Purchasing."

Note that central themes among these controls are standard forms to be used throughout the college, reconciliation and operations management review. Proxy signature use and requiring more complete supporting documentation was also addressed.

Information and Communication

Communication systems, both formal and informal, are essential to maintaining an effective internal control system. Information about the control environment, identified risks, control activities and performance must be communicated up, down and across the organizational unit. Formal systems, varying from elaborate information technology to simple staff meetings are useful to provide data and

obtain feedback relative to operations, financial reporting and compliance. Informal conversations with faculty, staff, students, suppliers and others involved with the unit often provide critical information needed to identify risks or opportunities for improving the internal control system. These conversations may also offer clues to potential fraud activity, when partnered with other known facts.

WCOB plans to hold college-wide meetings at regular intervals to discuss the effectiveness of control procedures in place and gather feedback for needed revisions.

Monitoring

Monitoring is the assessment of the performance of the internal control system over time. It can be accomplished by ongoing monitoring activities and separate evaluations such as self-assessments, peer reviews and internal audits. Ongoing monitoring activities are often performed by management as they evaluate and improve the design, execution and effectiveness of a particular control activity. Spot checks of transactions and other sampling techniques can provide a reasonable level of assurance that controls are functioning. It is important to assess the effectiveness of the internal control system over several points in time.

Fraud Prevention

It is critical that employees fully understand their role in the internal control system and the importance of a functioning system in the detection and deterrence of fraud. It is equally important to provide training to staff to help them recognize red flags that may indicate fraudulent activity. Even so, The Association of Fraud Examiners *2010 Report to the Nations* indicated that occupational frauds are more likely to be detected by tips (40.2%) than by any other means - including management review, internal audits and external audits. For that reason a reporting mechanisms such as a confidential fraud hotline is vital in establishing an effective fraud prevention program. The University does have a confidential fraud hotline for the reporting of fraud or suspected fraudulent activity by internal or external sources. Staff should be encouraged to report suspicious activity either via the hotline or to management, without fear of reprisal.

If You Suspect Fraud Is Occurring

If you know of suspicious activity or suspect fraud is occurring you are encouraged to take the following steps:

- 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 hot line at 1-866-252-9838