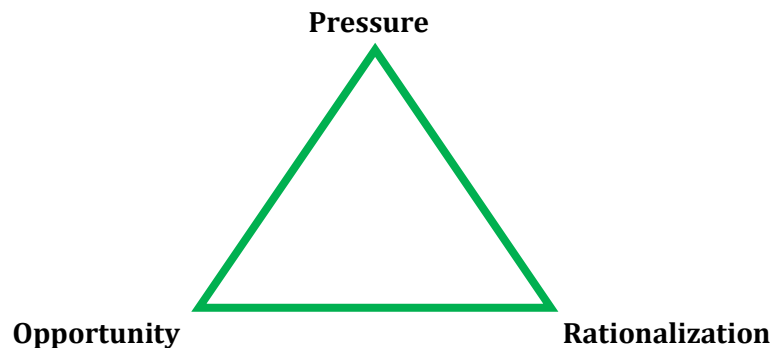


## Fraud Risk and Prevention: Campus Lesson Learned

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. Blanket internal purchase orders, procurement card transactions and forgery were all used as a means to make unauthorized, non-University related purchases. This fraud occurred over several years and continued even after the employee had transferred to a department outside of WCOB. This purpose of this memo is to discuss the elements that must be present for any fraud to occur and relate each to the incident at WCOB. In doing so, it will serve as a refresher for those charged with fiscal oversight of the steps that can be taken by the University and individual departments to influence fraud elements and ultimately reduce fraud risk.

### Overview

The following diagram depicts what is commonly referred to as the fraud triangle. In order for fraud to occur, all three elements must be present. Management and staff should be aware of how these elements interrelate and contribute to the University's overall fraud risk. Managers should take time to consider potential pressures and assess how they may increase fraud risk to the University. Rationalizations can be reduced by promoting a strong sense of ethical behavior among employees and creating a positive work environment. Implementing strong internal controls can remove much of the opportunity for fraud to occur and can increase the chances of detection.



### Pressure

Pressure is what causes a person to commit fraud. Pressure can come from a significant financial need or a problem. It can be almost anything such as medical bills, expensive tastes, addiction problems, divorce or on and on. Often the person believes their problem must be solved in secret and will not seek assistance or advice from their closest family, friends or associates. However, some frauds are committed simply out of greed alone. In the WCOB fraud, no single significant pressure was revealed, but the employee was a single parent of two children. Her home and workspace were decorated with numerous spirit items, and she and her children dressed well. In retrospect, these elements may have been a signal that she was supporting a lifestyle beyond her means at her current salary level.

## Opportunity

Opportunity is the ability to commit fraud. Opportunity is created by weak internal controls, poor management oversight and/or the use of one's position and authority. Of the three elements, opportunity is the leg that the University has the most control over. It is essential that processes, procedures and controls be periodically reviewed to determine that they are adequate to not only deter fraud from occurring, but also detect fraudulent activity when it occurs. Several factors made WCOB vulnerable for employee fraud. The following describes the major factors, along with a discussion of controls that were in place to prevent or detect fraud and why the control was not effective in this instance:

- As an administrative assistant, the employee's position provided her with the ability and responsibility to purchase items. She also willingly served as the unofficial "social director" and organized both official and unofficial events for the college and staff.
- The nature of the operating activities of the Undergraduate Program Office provided a good cover for the fraudulent purchases. This department was responsible for recruiting, orientation, advising and tutoring programs for the College. Purchases for textbooks, food items, spirit items, or prizes would all be reasonable operating expenses for a department with these responsibilities. They were also the types of items purchased that were not authorized or University related.
- Blanket internal purchase orders did not expire. The fraud began with purchases of textbooks at the University bookstore using a blanket internal purchase order. The textbooks would later be re-sold at local bookstores for cash. The department was required to annually review and certify all blanket POs in use, but since they did not expire the employee was able to continue to use the PO number when she left WCOB.
- Department managers responsible for operating activities did not actively review expenditures. Transaction review provides assurance that not only the purchase is compliant with State purchasing regulations and is accurately recorded, but also that the purchase is reasonable for the particular account. This level of review cannot be accomplished without partnership between operations management and the financial officers of the unit. Finance officers normally do not have the perspective to recognize a particular purchase that is not program-related. In the WCOB case, the types of goods purchased did not appear unreasonable from a finance officer (or central administration for PCards) perspective for the Undergraduate Program Office. It is likely that Operations staff within the department could have recognized that certain purchases were not legitimate or University related if the "reasonableness check" from an operations perspective had been performed.
- Primary funding for department programs was from soft funds rather than state funds. Only a small, formal operating "hard" budget existed for this department, and a budget for foundation discretionary funds was not required or prepared. Operating budgets provide a yardstick to compare actual revenue and expenses to expected results. Because of the lack of budget data, management could not readily recognize that actual activity was not in alignment with what was expected. WCOB management did recognize that expenditures for the program continued

to escalate, and attempted through trend analysis of historical data to pinpoint causes. This was not effective because the data being analyzed included the fraudulent activity, and it was spread throughout numerous cost centers so that no one area stood out as unusual or problematic.

- The employee signed for her boss on documents using only his signature with no indication of proxy. This practice allowed the employee to forge his signature on PCard supporting documentation indicating approval for the unauthorized purchases. Because she signed most documents, others did not recognize that the forged signature was not authentic. The use of proxy signatures and signature stamps should be discouraged. If a proxy signature is necessary, it should be clearly indicated with the use of “by J. Smith” or other distinguishing language.
- Receiving is not required for Bookstore internal purchases. Sales receipts are signed by the purchaser, but are not routed back to the department. Charges appear on DART reports for departmental reporting. These charges were not monitored by WCOB operations management. Accounting reports should be regularly pulled from the BASIS DART module and reviewed by management to identify any unusual or unexpected activity.
- There were too many open blanket Purchase Orders at the Bookstore. As a matter of convenience, WCOB financial officers had allowed most of the programs within the college to establish blanket POs at the Bookstore. The employee committing fraud had access to many cost centers with numerous open blanket POs. As a result, unauthorized purchases could be spread among several cost centers thus not creating any single spike in expenses.
- Blanket internal purchase orders can be used by any staff member who knows the PO number. This internal control weakness, combined with no expiration date for the PO, allowed the employee to continue to use a WCOB PO for unauthorized purchases after leaving the college. Of course, consistent, periodic, review of internal Bookstore charges by WCOB operations management may have resulted in detection of the fraudulent charges.
- The PCard purchases do not go through the normal procurement process. The PCard owner is able to receive on their own purchases. To strengthen controls, supporting documentation submitted to Business Affairs must contain a supervisor’s signature indicating review and approval, when the card owner receives on their own purchase. In the WCOB instance, this signature was forged, thus providing a means to procure items via the PCard with no review from WCOB operations management. Business Affairs reviews PCard charges on a post-audit basis, but did not detect anything unusual based on the types of goods purchased. It should be noted that supporting documentation submitted was exceptionally complete and accurate to deter any questions from post-audit review or finance officers within the college.

### **Rationalization**

Rationalization is a crucial element for fraud. It involves a person reconciling his behavior (stealing) with the commonly accepted ideals of decency and trust. Of course, there is a small population of fraudsters who have no ability to understand their actions or the consequences, or they simply don’t care. Some common rationalizations for committing fraud are as follows:

- The person believes stealing is justified to save a loved one
- The person believes they will lose everything if they don't steal
- The person believes there is no outside help available to them
- The person labels the theft as "borrowing" and fully intends to pay it back at some future date
- The person, because of job dissatisfaction (low pay, environment, treatment by supervisor, etc) believes that something is owed to them

In the WCOB fraud, the employee did confess to officials when confronted with evidence of the fraud. No explanation (rationalization) was offered.

### **Summary**

People at every level affect internal control. Recognizing red flags and acting on them is vital to prevent or detect fraudulent activity. Managers must create an effective control environment that promotes ethical behavior by employees. A positive control environment helps to alleviate the rationalization element of the fraud triangle. Employee behavior is greatly influenced by the extent to which individuals recognize they will be held accountable for their actions. It is also important to consider pressures that might motivate a person to commit fraud. This process, often a part of the risk assessment process, is vital to a healthy internal control structure. By identifying potential pressures, and who may be most affected, potential behaviors that raise a red flag may be more easily recognized. Where it is often difficult to change an employees' mindset or response to pressure and/or rationalization, opportunity is most easily manipulated by the University. Internal control activities, supported by policies and procedures, are the most effective tools to eliminate opportunity to commit fraud. Implementing budgets, reviewing supporting documentation, approving transactions and reviewing accounting reports are all important activities to support a healthy internal control structure. In the incident discussed above, an underlying theme was the lack of review from an operations perspective of the purchases completed by this employee. It is imperative that operations staff and finance staff work together to build an effective control structure. Controls must be communicated to everyone in the unit so that all understand their roles and responsibilities. And finally a healthy internal control system, one that can reduce the risk of loss from fraud, is continually monitored to determine if it is working effectively. Each unit should take an objective look at their business practices and processes and evaluate each to determine if the controls in place are adequate to reduce the risk of fraud. Risk assessment tools are available to assist with this process.