

DEVELOPING INTERNAL CONTROLS TO PREVENT FRAUD

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Objectives

- What is fraud.
- Reasons to commit fraud.
- Elements necessary for fraud to occur.
- Behavior of fraudsters.
- Red flag fraud indicators.
- Internal control and its types.
- Walkthrough an example of internal control design. (Audience participation).
- Internal Control limitations.
- Interactive - ask questions

Our Office assists UI Management and the UIC Police in fraud investigations



- It is after the fact.
- It consumes a lot of resources.
- It never seems to end.

What is Fraud?

Honestly, there is no right definition for the many unique instances that are difficult to detect.

Fraud defined by Black's Law Dictionary is:

“...all multifarious means which human ingenuity can devise, and which are resorted to by one individual to get an advantage over another by false suggestions or suppression of the truth. It includes all surprise, trick, cunning, or dissembling, and any unfair way by which another is cheated.”

Why commit fraud?

- 2 common justifications fraudsters give as reasons for their actions
 - For the fraudster's personal enrichment (against the organization).
 - For the betterment of the company (for the organization).
- Either way its wrong.

Circumstances necessary for fraud and white-collar crime to be perpetrated and proved

- Intent
- Disguise of purpose
- Reliance
- Voluntary victim action
- Concealment



Intent is to knowingly to commit a wrongful act or to achieve a purpose inconsistent with law or public policy.

- Common ways to show intent are proof that the accused:
 - Make conflicting statements.
 - Had no legitimacy for the wrongful actions.
 - Repeatedly engaged in wrongful acts.
 - Act to impede the investigation.
 - Make blatantly false statements.
 - Make an admission.

Disguise of purpose is falsities or misrepresentations employed to accomplish the scheme.

- This is shown by the facts that the representation was made and it was false, either by omission or commission.
- This means the fraudster gets trapped in their lies or complexity of trying to hide their wrongdoing.
- A confession is when this element is discovered.

Reliance

- By the offender on the ignorance or carelessness of the victim. Unwittingly, the unit being victimized assists the fraudster. An example would be a P-Cardholder using their assigned card for personal use. The cardholder is their own reconciler and reconciles the unit's financial statements. The unit's Director does not review the statements or expenditure supporting documentation and relies on information provided by the cardholder.

Voluntary victim action

- The unit being ripped off provides assistance to the offender.
- This assistance is usually in the form of fiduciary capacity.
 - The unit gave the offender the authority to perform a business transaction did so trusting he/she would act in the best interests of the unit, however it does not review or verify transactions appropriate University business.

Concealment

- All frauds have concealment of the offense. This is what differentiates fraud from other crimes. Armed robbery is not concealed.
- The extent that fraudsters go to conceal their crime is quite extensive. They may create false invoices, vendors, or employees, to cover their tracks.

General Characteristics of Fraud Perpetrator

- Individual is trusted.
- Usually start small and then get greedy.
- Act is intentionally concealed.
- Employee doesn't take vacation.
- Never gives a definitive answer to direct questions.
- Never let others review their work.



General Characteristics of Fraud Perpetrator

- Works long hours; first in/last out.
- Always want to control their work with no supervision.
- Opposes cross training.
- Likeable and generous.
- Personality may change, moodiness may set in, when stress of the fraud catches up to them, or when they are about to be caught.
- Secretive, evasive and usually good at lying.

Fraud Red Flags

- Not separating functional responsibilities of authorization, custodianship, and record keeping. No one should be responsible for all aspects of a function from the beginning to the end of the process.
- Unrestricted access to assets or sensitive data (e.g., cash, personnel records, etc.).
- Not recording transactions resulting in lack of accountability.
- Not reconciling assets with the appropriate records.

More Red Flags

- Unauthorized transactions
- Controls not implemented due to lack of personnel or adequate training
- “Walk through” approvals
- Unimplemented Controls
- Living beyond one’s means

What can you do about fraud?



Fraud deterrence starts with Management

- Management sets the tone of the organization.
- Strong internal control environment-review and monitoring of transactions.
- Communicating expectations.
- Analyzing variances.
- Balancing resources.

Types of Internal Controls

- **Detective (rear view mirror)**
 - Designed to detect errors or irregularities that may have occurred.
- **Preventive (thru the windshield)**
 - Designed to keep errors or irregularities from occurring in the first place.
- **Corrective (ticket and fine)**
 - Designed to correct errors or irregularities that have been detected.

Detective Control Examples

- Account reviews and reconciliations.
- Periodic physical inventory counts.
- Transaction edits.
- Internal auditors.



Preventive Control Examples

- Restricted access.
- Credit checks.
- Job descriptions
- Required authorization signatures.
- Data entry checks.
- Physical control over assets to prevent their improper use.

Corrective Control Examples

- Budget variance reports.
- Formal Controlled Self-assessment programs.
- Quality circle teams.

Internal control design considerations



- Any control needs to fit your resources.
- Build in segregation of duties.
- Communicate to all employees how the particular business process is suppose to work.
- Management oversight.

Walkthrough the design of an internal control (Audience Participation)

- Need criteria for an example
 - Business process
 - Number of people involved
 - Type of control wanted

Internal Control Limitations

- They can only provide reasonable assurance that objectives have been achieved. Inherent limitations include:
 - Judgment
 - Breakdowns
 - Management override
 - Collusion

Our office will provide training
to Colleges and Schools that
request it.

Please contact me at 6-2748
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further information.

Reference Links

■ Fraud

- <http://www.acfe.com/>
- <http://www.fbi.gov/majcases/fraud/fraudschemes.htm>
- <http://www.pueblo.gsa.gov/scamsdesc.htm>
- <http://www.finaid.org/scholarships/fraudact.phtml>

■ Internal Control

- <http://www.obfs.uillinois.edu/manual/index.html>
- <http://www.audits.uillinois.edu/>
- <http://www.theiia.org/>
- <http://www.pcaobus.org/>
- <http://www.coso.org/>
- <http://www.sarbanes-oxley.com/>

Questions

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There is no wrong question.