FRAUD RISK & CONTROL

February 17, 2012

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Oregon University System Internal Audit Division
Educate on existing risks and control mechanisms to promote ethics, prevent future losses from fraud

How internal audit comes into play… Internal Auditing Standards ensure sound internal auditing practices:
- Promotes appropriate ethics and values within the university
- Evaluates design, implementation, and effectiveness of organization’s ethics-related objectives, programs, and activities
- Contributes to improving the ethical culture within the organization
Presentation Outline

- Overview of Occupational Fraud
- Financial Irregularity Statistics @ OUS
- OUS Fraud Deterrence Methods
Occupational Fraud

“The use of one’s occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization’s resources or assets.”

- Association of Certified Fraud Examiners (ACFE)
Impact of Fraud

- According to the Association of Certified Fraud Examiners (ACFE) 2010 Report to the Nation:
  - The typical organization loses an estimated 5% of its annual revenue to fraud.
  - The median loss for a fraud is $160,000.
  - The median duration of a fraud is 18 months before it is detected.
  - The estimated risk for higher education is likely much lower given the revenue stream controls over major sources, budget constraints, and lack of retail operation inventory shrinkage.
Fraud Types (ACFE)

- **Corruption**
  - Use of employee’s influence in a business which violates duty to employer for purpose of obtaining a benefit for employee or for someone else

- **Asset Misappropriation**
  - Theft or misuse of organization’s resources

- **Fraudulent Statements**
  - Intentional misstatement or omission of information that is material to organization
**Corruption** – use of employee’s influence in a business transaction which violates duty to employer, for purpose of obtaining a benefit for employee or for someone else

**Types of Corruption:**
1. Conflicts of Interest
2. Bribery
3. Illegal Gratuities
4. Economic Extortion
Fraud Types (ACFE)

Asset Misappropriation — theft or misuse of organization’s resources

Types of Asset Misappropriation:
1. Cash
2. Non-Cash
3. Fraudulent Disbursements
Fraud Types (ACFE)

Fraudulent Statements – intentional misstatement or omission of information that is material to organization

Types of Fraudulent Statements:

1. Financial
2. Non-Financial
Why Does Fraud Happen?

The Fraud Triangle

**Opportunity**

- Weak internal controls
- Trusted employees

**Pressure**

- Personal finances
- Vices

**Rationalization**

- “I’ll pay it back”
- “I deserve it”
Ous Risk Profile

- If OUS *did not* have any financial irregularities this would be an anomaly the board and executives should question, given the size and complexity of the organization.

- OUS is a complex organization with:
  - $2 billion annual revenue
  - $4 billion of assets
  - Over 12,000 employees
  - 100,000 students
  - Geographically-diverse locations throughout the state of Oregon
  - Varied operations: housing, dining, libraries, research labs, computer labs…to name a few
OUS Statistics

- Compiled for period Jan 2001 – June 2011

- Includes all projects where Internal Audit reached a conclusion regarding potential occupational fraud

- Does not include:
  - losses resulting from poor management practices
  - issues which were handled by the institutions
### OUS Irregularities (Jan 2001-Jun 2011)

<table>
<thead>
<tr>
<th>ACFE Type</th>
<th># of Instances</th>
<th>Quantifiable Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corruption</td>
<td>18</td>
<td>$113,132</td>
</tr>
<tr>
<td>Asset Misappropriation</td>
<td>69</td>
<td>$818,262</td>
</tr>
<tr>
<td>Fraudulent Statements</td>
<td>4</td>
<td>$0</td>
</tr>
<tr>
<td>No Abuse Found</td>
<td>45</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>136</strong></td>
<td><strong>$931,394</strong></td>
</tr>
</tbody>
</table>

- Extent of loss often difficult to determine due to insufficient documentation. Actual losses are likely much higher.
- Not all losses are quantifiable. Example: damage to OUS reputation resulting from a financial irregularity.
## OUS Irregularities (Jan 2001-Jun 2011)

### Corruption $113K
- Contracting with own or family business
- Prepayment for services with kickback to the employee
- Retaining revenues from a university course

### Asset Misappropriation $818K
- Theft of cash, equipment, and supplies
- Personal rental car and travel charges to the campus
- Personal charges to the procurement card or through accounts payable

### Fraudulent Statements $0
- Unintentional errors noted by Controllers Division and IAD
Loss Percentages by Type

Quantifiable OUS Loss by ACFE Type
(Jan 2001 - June 2011)

- Cash 15%
- Corruption 12%
- Fraudulent Disbursements 25%
- Non-cash 48%
- Asset Misappropriation 88%
Responsibility for Fraud

According to U.S. Federal Sentencing Guidelines

- Organizations shall exercise due diligence to prevent and detect criminal conduct
- Organizations shall promote a culture that encourages ethical conduct and compliance
- Organizations shall periodically assess the risk of criminal conduct and take appropriate steps to reduce the risks identified

- §8B2.1 Effective Compliance and Ethics Program
OUS Response to Financial Irregularities

- OUS has demonstrated commitment to taking financial irregularities seriously
- Actions taken as a result of identified financial irregularities include:
  - Police and DA involvement if crime suspected
  - Referral to state ethics commission
  - Termination of employment
  - Repayments to OUS
  - Organizational restructuring
  - Preventive and Detective Controls
The most cost-effective way to limit fraud losses is to prevent fraud from occurring:

- Set ethical tone at the top
- Raise awareness through training
- Surprise audits
- Perform employee background checks
- Understand the state of internal control structure (segregation of duties, monitoring, reconciliations)

What is not quantifiable is how much fraud is actually prevented by internal controls.
Controls in place at OUS to prevent fraud from occurring:

- Campus control self-assessments being conducted for fiscal operations
- Anonymous hotline in place to report fiscal concerns
- Tone-at-the-top letters to all employees reinforcing ethics, hotline, and key policy
- Formal protocol in place for incident response involving all key stakeholders
- Departmental training on internal controls and fraud awareness
- Control self-assessment guides available: [http://ous.edu/dept/intaudit/res]
Controls in place at OUS to prevent fraud from occurring (continued):

- Surprise audits conducted during the year
- Code of ethics being codified for all system employees to include state and industry best practices
- Employee background checks policy in place and currently being re-evaluated to incorporate industry best practice
Fraud Detection

According to 2010 ACFE Report to the Nation:

- 40% of fraud is detected by tips
- 30% of fraud is detected by internal controls
- 30% of fraud is detected by auditors, police, accidental discovery, and confessions that make up remaining percentage
Employee education is key to preventing and detecting fraud. Staff members are an organization’s top fraud detection method. Internal Audit 2012 plan includes fraud awareness training.

OUS financial concern hotline was implemented in 2009.

Expansion of hotline to non-fiscal areas planned for 2012 to supplement existing anonymous reporting methods.
Effective Detection: Reported Fraud
Concerns @ OUS  (Jan 2001 - June 2011)

<table>
<thead>
<tr>
<th>Notification Source</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>OUS Management</td>
<td>98</td>
</tr>
<tr>
<td>Hotline</td>
<td>13*</td>
</tr>
<tr>
<td>Outside OUS</td>
<td>16</td>
</tr>
<tr>
<td>Other</td>
<td>9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>136</strong></td>
</tr>
</tbody>
</table>

* Includes only hotline reports alleging potential occupational fraud
  (Hotline complaints reporting the same concerns have been grouped.)
## Effective Detection - OUS Hotline
(January 2009 to June 2011)

<table>
<thead>
<tr>
<th>OUS Hotline Reports</th>
<th>#</th>
</tr>
</thead>
<tbody>
<tr>
<td>Referred to campus/not investigated</td>
<td>16</td>
</tr>
<tr>
<td>IAD investigated (potential fraud)</td>
<td>13</td>
</tr>
<tr>
<td>Of those investigated, not substantiated - 9</td>
<td></td>
</tr>
<tr>
<td>Of those investigated, substantiated - 4</td>
<td></td>
</tr>
<tr>
<td>IAD currently evaluating</td>
<td>2</td>
</tr>
<tr>
<td>Total</td>
<td>31</td>
</tr>
</tbody>
</table>
Conclusion

- OUS needs to be aware of its risk profile.
  
  “Risk comes from not knowing what you’re doing.” Warren Buffet

- OUS experience notes fraud risk exists in several fraud categories.
  
  “The only source of knowledge is experience.” Albert Einstein

- Building upon controls known to be effective at preventing and detecting losses will assist OUS in reducing future reputational and financial risks.
  
  “An investment in knowledge pays the best interest.” Benjamin Franklin
Questions?