

FRAUD DETERRENCE AND DETECTION



Segregation of Duties (SOD) Definition

- Segregation of duties (SOD) provides the assurance that no individual has the physical and system access, to control all phases of a business process or transaction; from authorization of custody to record keeping. Thus in a way, it advocates Maker – Checker concept at various levels.

An individual should not have responsibility for more than one of these three transactions components: authorizing transactions (approval), recording transactions (accounting), and handling the related asset (custody).

For example, person who can authorize purchase orders (Purchasing) should not be capable of processing payments (Accounts Payable).




Corruption Scheme Red Flags

- Unchecked authority to approve
- No formal documented procedures
- Circumventing normal policies and procedures
- Employees receiving gifts or things of value from customers
- Falsified or altered documents
- Customers only asking for certain employees



Skimming Scheme Red Flags

- Inadequate separation of duties
- Employees who do not take vacations, work a lot of overtime, don't like for others to perform their duties or have access to their desk
- Missing register tapes or other records
- Consistent differences in register receipts to cash on hand (i.e. – longs and shorts)



Examples of Internal Controls to prevent Skimming Schemes:

- Separate duties over cash handling functions
- Surprise cash counts
- Motivate customers to ask for receipts
- Use pre-numbered receipts and account for all receipts daily
- Account for the numerical sequence of cash register transactions
- Reconcile cash drawers to cash register receipts
- Use surveillance equipment and periodically review the tapes
- Enforce mandatory vacations for all employees who handle cash
- Deposit cash receipts daily



Billing Scheme Red Flags

- Increase in services performed
- Falsified or altered documents
- Vendors with PO box addresses
- Delivery address other than departmental or company address
- Payments to unapproved vendors
- Excessive returns to vendors



Examples of Internal Controls to prevent Billing Schemes:

Separate duties over purchasing, receipt, and vendor payments

Require appropriate documentation on all transactions

Compare information on the purchase orders, receiving reports, and vendor invoices before making payments

Verify the legitimacy of vendors

Review cancelled checks, purchase orders, requisitions, receiving reports, etc. for alterations

Mark invoices and supporting documentation paid so they cannot be used again

Reconcile accounts payable ledger to recorded liabilities



Payroll Scheme Red Flags

- Lack of separation of duties
- Missing employee information
- No voluntary deductions
- No evidence of work performed
- No physical address or phone number for the employee
- Bypassing normal hiring procedures



Examples of Internal Controls over Payroll:

- Separate the duties of hiring, timekeeping functions, processing, authorizing, and distributing payroll, and reconciling payroll bank accounts
- Stringent access controls over the payroll database should be in place to restrict unauthorized changes
- Analyze employee deductions and withholdings
- Review payroll records (i.e. timesheets or timecards) for hours worked, management authorizations, overtime, etc.
- Compare the number of paychecks to the number of authorized workers



Non-Cash Scheme Red Flags

- Shrinkage in inventory
- Employees who frequently visit the office after normal business hours
- Missing tools, equipment, office supplies, etc.
- Missing, altered, or unmatched supporting documents to inventory records
- Employees borrowing office supplies, tools or equipment



Examples of Internal Controls over Non-Cash Items:

- Restrict physical access to inventory
- Monitor employees who have access to non-cash items
- Use surveillance devices, such as video cameras
- Separate the duties over the inventory process
- Take frequent inventory counts and hold employees responsible for any shortages
- Require proper documentation to support inventory items (i.e. – requisitions, receiving documents, inventory records, etc.)
- Implement and strictly follow a policy which prohibits the borrowing of non-cash assets



Check Tampering Scheme Red Flags

- One employee performs reconciliations without any independent checks
- Altered bank statements
- Voided checks do not match physical copies of the checks
- Altered check register, check disbursement journal, or cancelled checks
- Checks endorsed by an employee or dual endorsements



Examples of Internal Controls over Check Tampering:

- Separation of duties over disbursement process
- Bank reconciliations should be performed timely and reviewed by someone other than the preparer
- Supporting documentation required for all check disbursements
- Blank checks or check stock should be kept in a secure location where physical access is limited
- Checks should be mailed or delivered as soon as possible after being prepared
- Access to and changes made to the accounts payable database should be restricted



Behavioral Red Flags

- Living Beyond Means
- Financial difficulties
- Unusually close association w/ vendor
- Wheeler-dealer attitude
- Control issues, unwilling to share duties
- Divorce / family problems
- Irritability, suspiciousness, or defensiveness
- Addiction problems
- Complaining about inadequate pay
- No Behavioral Red Flags
- Refusal to take vacations
- Excessive pressure from within organization
- Past employment-related problems
- Past legal problems
- Excessive family / peer pressure for success
- Complaining about lack of authority
- Instability in life circumstances