ETHICS AND FRAUD IN THE WORKPLACE

AUDIT AND ADVISORY SERVICES
WHISTLEBLOWER PROGRAM
ETHICS AND FRAUD

This Training Presentation Will Cover:

• Ethics
  ○ Definition
  ○ Ethics at UC
  ○ Ethical Challenges

• Fraud
  ○ Why Do We Care?
  ○ What is Fraud?
  ○ Who Commits Fraud?
  ○ Risk Management Program
  ○ Your Role
  ○ Internal Audit’s Role

• Resources
ETHICS
What is Integrity?

• The quality of possessing and steadfastly adhering to high ethical principles or professional standards.
ETHICS

Definition

- A System of Guiding Principles
- The Principles or Expectations of Conduct Governing the Behavior of an Individual or a Group
ETHICS

- UC Statement of Ethical Values
- UC Standards of Ethical Conduct
- UC Faculty Code of Conduct
Statement of Ethical Values

Members of the University of California community are committed to the highest ethical standards in furtherance of our mission of teaching, research and public service. We recognize that we hold the University in trust for the people of the State of California. Our policies, procedures, and standards provide guidance for application of the ethical values stated below in our daily life and work as members of this community.

We are committed to:

Integrity
We will conduct ourselves with integrity in our dealings with and on behalf of the University.

Excellence
We will conscientiously strive for excellence in our work.

Accountability
We will be accountable as individuals and as members of this community for our ethical conduct and for compliance with applicable laws and University policies and directives.

Respect
We will respect the rights and dignity of others.
ETHICS

UC Standards of Ethical Conduct

- Fair Dealing
- Individual Responsibility and Accountability
- Respect for Others
- Compliance with Applicable Laws and Regulations
- Compliance with Applicable University Policies, Procedures, and Other Forms of Guidance
- Conflicts of Interest or Commitment
- Ethical Conduct in Research
- Records: Confidentiality/Privacy and Access
- Internal Controls
- Use of University Resources
- Financial Reporting
- Reporting Violations and Protection from Retaliation
ETHICS

UC Faculty Code of Conduct

• Part 1: Professional Rights of Faculty

• Part 2: Professional Responsibilities, Ethical Principles, and Unacceptable Faculty Conduct
  o Teaching and Students
  o Scholarship
  o The University
  o Colleagues
  o The Community

• Part 3: Enforcement and Sanctions
ETHICS

Examples of Ethical Violations

• Harassment
• Discrimination
• Theft
• Deception/Lying
• Fraud
ETHICAL CHALLENGES IN THE UNIVERSITY ENVIRONMENT

Scenario: In addition to working for UCSB, John owns and operates a small business.

Is it ethical for John to:

• Print or copy promotional flyers using UCSB equipment?
• Pass those flyers out to co-workers? Pass them out to students he interacts with while at work?
• Store files for his small business on his work computer?
• Include a link to his business’s website in his UCSB email signature?
Scenario: Sam is a UCSB PI who also owns and operates a private business. The work conducted for UCSB and for the private business is very similar. The distinction between the two can be unclear, especially to outside observers.

Is it ethical for Sam to:
• Use UCSB equipment while conducting work for his business?
• Employ other UCSB employees to work for his business?

What actions can Sam take to ensure ethical conduct?
ETHICAL CHALLENGES IN THE UNIVERSITY ENVIRONMENT

Scenario: Marie is a staff member with a campus program that provides services to children from low-income families.

Is it ethical for her to:
• Provide service to a child even if the child does not meet the program requirements?
• Process invoices or review contracts for program activities without proper training?
• Administer program funds without proper training or knowledge of UC and program policies?
• Bring family members along on day-trips?
ETHICAL CHALLENGES IN THE UNIVERSITY ENVIRONMENT

Scenario: As a PI, Robert must submit a grant proposal, budget, and narrative to his administering department.

Is it ethical for him to:
• Incur costs in advance of approval of the grant?
• Charge costs that are needed for his project but are not provided for in the grant?
• Write the award budget to include purposefully ambiguous categories?
FRAUD

Definition

“...any intentional act or omission designed to deceive others and resulting in the victim suffering a loss and/or the perpetrator achieving a gain.”

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

“...any attempt to deceive another party to gain a benefit.”

Source: Association of Certified Fraud Examiners (ACFE)
FRAUD: WHY DO WE CARE?

The Association of Certified Fraud Examiners (ACFE) 2012 Global Fraud Study

- ACFE conducted a study of 1,388 cases of occupational fraud that occurred worldwide between January 2010 and December 2011.

Source: Association of Certified Fraud Examiners (ACFE)
Survey participants estimated that the typical organization loses 5% of its annual revenue to fraud. Applied to the 2011 Gross World Product, this figure translates to a potential projected annual fraud loss of more than $3.5 trillion.

The median loss caused by the occupational fraud cases in the study was $140,000. More than one-fifth of these cases caused losses of at least $1 million.

The frauds lasted a median of 18 months before being detected.

Source: Association of Certified Fraud Examiners (ACFE)
FRAUD: WHY DO WE CARE?

• If the ACFE survey participant estimate is extrapolated for UCSB, that would mean a loss of $41,769,150* for fiscal year 2011-2012.

• If the estimate is extrapolated for the UC system, that would mean a loss of 1,183,597,050** in 2011.
  
  o There is no reason to believe that the amount would hold true for UC, but it does give us reason to redouble our efforts to prevent fraud.

*Based on total income figures from the 2011-2012 UCSB Campus Profile
**Based on total revenue figures from the UC Revenue and Expense Trends Report
FRAUD: WHY DO WE CARE?

Other Costs of Fraud

• Reputation of the Institution
• Employee Morale
• Costs of Human Resources and Investigations
• Fraud Undermines Every Aspect of the University’s Mission:
  o Teaching
  o Research
  o Public Service
FRAUD: WHY DO WE CARE?

• All types of organizations have fraud; we are not excluded because we have an important or worthy mission.

• The University has a responsibility to manage the funds of the people of California, students, and governmental funding and contracting agencies, consistent with policies and agreements made to stakeholders.

• Auditing Standards and Requirements – Internal and Industry
FRAUD: WHY DO WE CARE?

- Subject to audit and investigation by outside organizations
  1. Inspector General
  2. Bureau of State Auditors (BSA)
  3. Federal, state, local, and private funding agencies
  4. Various other parties with interest

- Possible penalties and loss of funds
WHAT IS FRAUD?
FRAUD: WHAT IS FRAUD?

Types of Fraud

- Bribery
  - California Penal Code 641.3
    (a) Any employee who solicits, accepts, or agrees to accept money or any thing of value from a person other than his or her employer, other than in trust for the employer, corruptly and without the knowledge or consent of the employer, in return for using or agreeing to use his or her position for the benefit of that other person, and any person who offers or gives an employee money or any thing of value under those circumstances, is guilty of commercial bribery.
    (b) This section does not apply where the amount of money or monetary worth of the thing of value is two hundred fifty dollars ($250) or less.
FRAUD: WHAT IS FRAUD?

Types of Fraud

• **Illegal Gratuities**
  - Definition: Illegal gratuities is similar to bribery but the payment is after the act and acts as a reward for the act. It creates an expectation of a reward for similar acts that benefit the payer.

• **Economic Extortion**
  - Definition: This contrasts with illegal gratuities and bribery in that the extorter demands payment for official actions. Extortion is the obtaining of property from another, with his consent, or the obtaining of an official act of a public officer, induced by a wrongful use of force or fear, or under color of official right.
FRAUD: WHAT IS FRAUD?

Types of Fraud

• **Cash Receipts and Disbursements**

• **Payroll**
  - Time and Leave Reports
  - Expense Reimbursement Schemes
  - Check Tampering

• **Non-Cash**
  - Misuse
  - Larceny (The wrongful taking and carrying away of the personal goods of another from his or her possession with intent to convert them to the taker’s own use)

• ** Billing**
  - Improper Charging of Contracts and Grants
FRAUD: WHAT IS FRAUD?

Types of Fraud

• Conflict of Interest

  o UCSB Accountability and Internal Control Policy 5101 section II D: A financial conflict of interest exists when an employee initiates, influences, authorizes, or approves a business decision that results in a financial benefit to the employee, a relative of the employee, a business associate or personal friend of the employee, or a business or investment in which the employee is associated.

  o Institute of Internal Auditors: Conflict of interest is any relationship that is, or appears to be, not in the best interest of the organization.
Conflict of Interest

• Remember the examples of John and Sam from earlier in this presentation?
  - John uses University resources to promote his small business.
  - Sam has a private business that conducts work that is very similar to the work he does for the University.
FRAUD: WHAT IS FRAUD?

Types of Fraud

• Financial (asset and revenue overstatement and understatement)
• Non-Financial
  o Time Theft (excessive internet use, etc.)
  o Employment Credentials (employment application, social security number, references, job references, etc.)
  o Documentation (references over or understating performance, forging contract signatures, signing something you are not authorized to sign, status and performance reports, altering documents inappropriately, etc.)
FRAUD

WHO COMMITS FRAUD?
FRAUD: WHO COMMITS FRAUD?

The Fraud Triangle

- Incentive/Potential
- Attitude/Ethics
- Perceived Opportunity
FRAUD: WHO COMMITS FRAUD?

Honesty Scale

Let's explore the factors that contribute to fraud:

- **Pressure**
- **Attitude**
- **Opportunity**

These factors can push someone towards dishonesty on the Honesty Scale.
FRAUD: WHO COMMIT FRAUD?

- Incentive/Pressure
  - Habitual criminal who steals for the sake of stealing
  - Personal prestige, goal achievement
  - Morally superior, justified in making others victims
  - Desperate need for money
  - Vices such as gambling/drugs
FRAUD: WHO COMMITS FRAUD?

- Perceived Opportunity
  - Weak internal controls
  - Circumvention of internal controls
  - The greater the position, the greater the trust and exposure to unprotected assets
  - “Most Trusted Employee”
FRAUD: WHO COMMITS FRAUD?

• Attitude/Rationalization

Top Ten Rationalizations for Committing Fraud

1. I need it more than the other person.
2. I’m borrowing and will pay it back later.
3. Everybody does it.
4. The University is so big that it won’t even be missed.
5. Nobody will get hurt
6. I deserve it.
7. It’s for the greater good.
8. I’m not paid enough.
9. It’s just part of the job.
10. I’m not gaining personally.

And a bonus #11... It’s legal!
FRAUD: WHO COMMITS FRAUD?

- Why are people honest?
  - Beliefs
  - Perceptions & Attitudes
  - Organizational Culture
  - No Reason to be Dishonest
  - Lack of or Inadequate Opportunity
  - Fear
FRAUD: WHO COMMITS FRAUD?

Conditions that Contribute to Fraud

- Poor Internal Controls
- Inadequate Staff/Resources
- Inadequate Pay
- Low Loyalty
- Rigid Rules
- Poor Promotion Opportunities

- Pressure to Perform
- Lack of Recognition
- Budget Pressure
- Failure to Address Known Issues
- Poor Work Environment
- Inadequate Training
FRAUD: WHO COMMITS FRAUD?

Organizational Red Flags

• Bad “Tone at the Top”
• No Communication of Expectations
• Too Much Trust in Key Employees
• Lack of Proper Authorization Procedures
• Lack of Attention to Detail
• Poor Segregation of Duties
• Tendency Toward Crisis Management
FRAUD: WHO COMMITS FRAUD?

- Employee Level and Risk

ACFE 2012 Global Fraud Study:

- Not surprisingly, there was a strong correlation between the perpetrator’s position of authority and the losses caused by fraud.

- The median loss in owner/executive frauds was more than three times the loss caused by managers, and more than nine times higher than losses in employee fraud cases.

Source: Association of Certified Fraud Examiners (ACFE)
FRAUD: WHO COMMITS FRAUD?

Source: Association of Certified Fraud Examiners (ACFE)
FRAUD: WHO COMMITS FRAUD?

Source: Association of Certified Fraud Examiners (ACFE)
Behavioral Red Flags of Perpetrators

- Instability in Life Circumstances: 4.1%
- Excessive Family/Peer Pressure for Success: 4.7%
- Complained About Lack of Authority: 4.8%
- Past Legal Problems: 5.3%
- Excessive Pressure from Within Organization: 6.5%
- Refusal to Take Vacations: 6.5%
- Complained About Inadequate Pay: 7.9%
- Past Employment-Related Problems: 8.1%
- Addiction Problems: 8.4%
- Irritability, Suspiciousness, or Defensiveness: 12.6%
- Wheeler-Dealer Attitude: 14.8%
- Divorce/Family Problems: 14.8%
- Control Issues, Unwillingness to Share Duties: 18.2%
- Unusually Close Association with Vendor/Customer: 19.2%
- Financial Difficulties: 27.1%
- Living Beyond Means: 35.6%

Percent of Cases

Source: Association of Certified Fraud Examiners (ACFE)
FRAUD

RISK MANAGEMENT PROGRAM
Organizational Culture

• Define Acceptable Behavior
  
  o Employees, vendors, contractors and others need to know what is allowed and not allowed.
  o Make sure employees and managers know the rules.
  o Make sure vendors, contractors and other third parties know restrictions on gifts and entertainment.
  o Consider discussing our codes of conduct when entering into agreements with third parties.
FRAUD: RISK MANAGEMENT PROGRAM

Organizational Culture

• Clarify Expectations
  o Laws and Regulations
  o Statement of Ethical Values
  o UC Code of Conduct
  o Faculty Code of Conduct
  o Policies and Procedures
  o Job Descriptions
  o Whistleblower Policy
  o Training on All of the Above
Controls

• Preventive Controls
  o Good Management
  o Policies and Procedures
  o Clear Roles and Responsibilities
  o Segregation of Duties
  o Proper Management Review and Approval
  o Systems
  o Risk Assessments
  o Audits
  o Training
FRAUD: RISK MANAGEMENT PROGRAM

What Prevents Controls From Working?

- Resources don’t understand policies, procedures, and reports
- Resources don’t have the information needed to ensure transactions are proper
- Not enough time to do the control procedures
- Blind trust
- The process mentality
- Not enforcing documentation requirements
- Inadequate fraud prevention and detection skills
- Those responsible for control procedures override controls
FRAUD: RISK MANAGEMENT PROGRAM

• Resources Committed to Fraud Prevention, Detection, and Response
  o UCSB Police Department
  o UC Whistleblower Program
  o Audit and Advisory Services
  o Human Resources
  o Academic Personnel
  o Accounting Services and Controls
  o Office of Research
  o Environmental Health and Safety/Risk Management
  o Office of Equal Opportunity and Sexual Harassment/Title IX Compliance
  o Campus General Counsel
FRAUD: RISK MANAGEMENT PROGRAM

- Resources Committed to Fraud Prevention, Detection, and Response
  
  All UC Employees!

  - To begin, act ethically and encourage ethical behavior in your colleagues, vendors, and contractors.
  
  - Fraud Training
  
  - Reporting Channels
FRAUD: YOUR ROLE

• Ability to Report Without Fear of Reprisal

  o Whistleblower Protection Policy/Procedure:

  “The University of California is committed to protecting employees and applicants for employment from interference with making a protected disclosure or retaliation for having made a protected disclosure or for having refused an illegal order as defined in this policy. This policy is derived from the California Whistleblower Protection Act (Government Code Sections 8547-8547.12). Pursuant to this code section, a University employee may not: (1) retaliate against an employee or applicant for employment who has made a protected disclosure or who has refused to obey an illegal order, nor (2) directly or indirectly use or attempt to use the official authority or influence of his or her position or office for the purpose of interfering with the right of an applicant or an employee to make a protected disclosure to the University Auditor, the employee’s immediate supervisor or other appropriate administrator or supervisor within the operating unit, the locally designated University official as defined in the University’s Whistleblower Policy, or the State of California Bureau of State Audits about matters within the scope of this policy. It is the intention of the University to take whatever action may be needed to prevent and correct activities that violate this policy.”

  o Supervisor/Manager’s Duty
Deciding When to Escalate an Issue

- You should use the Whistleblower Policy or contact the LDO if:
  - Your actions in dealing with a matter are outside of your normal supervisorial scope.
  - Your management actions begin to resemble an investigation.

- If you are unsure, you should err on the side of reporting to the Whistleblower hotline, the Whistleblower Complaint Investigator, or the LDO.
FRAUD

INTERNAL AUDIT’S ROLE
FRAUD: INTERNAL AUDIT’S ROLE

- UC’s Auditors must act in accordance with standards set down by the Institute of Internal Auditors (IIA)
  
  - **Standard 1200: Proficiency**
    Auditors “must have sufficient knowledge to evaluate the risk of fraud.”

  - **Standard 1220: Due Professional Care**
    Auditors must “exercise due professional care by considering the ... probability of significant errors, fraud, or non-compliance.”
FRAUD: INTERNAL AUDIT'S ROLE

- **Standard 2120: Risk Management**
  Auditors must evaluate both "the potential for the occurrence of fraud" and "how the organization manages fraud risk."

- **Standard 2210: Engagement Objectives**
  When establishing the objectives of an audit, auditors must consider fraud risk when developing objectives.

- **Standard 2060: Reporting to the Board**
  Directors report to a Committee on a regular basis. The IIA standards detail what must be reported by the Audit Director to the Audit Committee. Reporting must include any fraud risk.
RESOURCES
Contacts

- Pam Lombardo, Acting Associate Vice Chancellor of Administrative Services, Locally Designated Official - Ext. 8291
- Robert Tarsia, Director, Audit and Advisory Services - Ext. 4080
- John Kushwara, Senior Investigator - Ext. 4335
- Jim Corkill, Controller and Director, Business and Financial Services - Ext. 5882
- Tricia Hiemstra, HR Director - Ext. 2489
- Cindy Dougherty, Academic Personnel Director - Ext. 8332
- Michael Witherell, Vice Chancellor for Research - Ext. 8270
- Ali Aghayan, Acting Director, Environmental Health and Safety - Ext. 2040
- Ricardo Alcaíno, Director, Office of Equal Opportunity and Sexual Harassment
- Dustin Olson, Chief of Police, UCSB Police Department - Ext. 4151
- Nancy Hamill, Chief Campus Counsel - Ext. 3459
Policies

- Statement of Ethical Values
- UC Standards of Ethical Conduct
- Faculty Code of Conduct
- UC Whistleblower Policy
- UC Whistleblower Retaliation Policy
- Conflict of Interest
  - Standards of Ethical Conduct - 6. Conflicts of Interest or Commitment
  - UC Personnel Policies for Staff Members 32 – Conflict of Interest
  - UC Business and Finance Bulletin G-39 - Conflict of Interest Policy
  - UC Business and Finance Bulletin 43 – Materiel Management
- Use of University Resources
  - Standards of Ethical Conduct - 10. Use of University Resources
  - Personnel Policies for Staff Members 31, 32, 33
  - Electronic Communications Policy and Local Implementing Procedures
  - Policies Applying to Campus Activities, Organizations and Students 40.00 – Policy on Use of University Properties
  - Business and Finance Bulletin 29 - Management and Control of University Equipment, Section XIII – Personal Use of Property
  - Business and Finance Bulletin 65 – Guidelines for University Mail Services
- Exercising Official Duties
  - Business and Finance Bulletin 43 – Materiel Management
SOURCES

- Report to the Nations on Occupational Fraud and Abuse: 2012 Global Fraud Study
  - The Association of Certified Fraud Examiners (ACFE)
  - Full report available at ACFE.com

- International Standards for the Professional Practice of Internal Auditing & Glossary
  - The Institute of Internal Auditors