

Red Flags and their role in Fraud and Corruption Detection

In many cases fraud and corruption arise out of relationships between people. It is normally detected by reacting to tips or other vague clues that may point to the presence of fraud and corruption. It is very seldom clear from the start what has actually happened however, and the warning signals are often not connected to the specific impropriety. The signs associated with it can be small, such as an employee being uncharacteristically nervous or agitated, or one who has started working unusual working hours or has changed their work habit etc. the key to this is understanding Red Flags

What is a Red Flag?

A **Red Flag is an event or set of circumstances that ought to alert an organisation to the presence of risk.** Managers need to be alert to red flags; what to look out for, how to respond, and how to follow up. By responding appropriately, fraud and corruption can be detected sooner and, in some cases prevented altogether.

Ignore them at your own Risk

The Association of Certified Fraud Examiners (ACFE) has found that in 85% of cases, a fraudster has displayed at least one behavioural Red Flag, while in 50% of cases they have displayed two or more. Despite this, a KPMG study has found that 94% of the time organisation's ignore or fail to react to them.

Red Flags to watch for

Following are **general** red flags that can be used to help identify which parts of an organisation may be most at risk:

Does this describe an area of your business? (Yes/No)

- There are difficult relationships and a possible lack of trust between the business and the internal/external auditor.
- Excessive secrecy about a function, its operations, and its financial results. When questions are asked, answers and supporting information are often stalled or withheld.

- Some practices within a function do not appear straightforward, and may even be illegal or unethical.
- There is excessive pressure on employees to tamper with results to meet analysts' high expectations for the business.
- Elsewhere in the industry, companies are struggling and sales and/or profits are declining. Your business appears to buck the trend.
- Increases in profitability fail to lead to increased cash flows.
- Senior managers receive large bonuses linked to meeting targets.
- There are multiple banking arrangements rather than one clear provider—a possible attempt to reduce transparency over the business' finances.
- A division or department of the business is perceived as complex or unusually profitable, thereby diverts the attention of management and the audit functions.
- Where matters of financial judgment/accounting treatment are involved, the business consistently pushes the limits/boundaries.
- High staff turnover within a function. Employees may be more likely to commit fraud in a business with low morale and inconsistent oversight.
- Complex/unusual payment methods, agreements between the business and certain suppliers/customers, may be set up in a deliberately opaque manner to hide their true nature.
- A remote operation not effectively monitored by the head office.

Behavioural Red Flags

Certain characteristics can typify a fraudster. An awareness of certain types of behaviour can help organisations identify frauds earlier. Employers should be alert to the following employee related **behavioural red flags**:

Do you work with someone who displays these types of behaviours? Yes/No

- Refuses or does not seek promotion and gives no reasonable explanation.
- Rarely takes holidays.
- Does not or will not produce records/information voluntarily or on request.
- Unreliable and prone to mistakes and poor performance.
- Tends to shift blame and responsibility for errors. Seems unhappy at work and is poorly motivated.
- Surrounded by “favourites” or people who do not challenge them.
- Persistent rumours/indications of personal bad habits/addictions/vices.
- Bullies or intimidates colleagues.
- Vendors/suppliers will only deal with this individual.
- Lifestyle seems excessive for income.
- Volatile and melodramatic, arrogant, confrontational, threatening, or aggressive when challenged.
- Is suspected to have over-extended personal finances.
- The level of performance or skill demonstrated by new employees does not reflect past experience detailed on CVs.
- Cuts corners and/or bends rules.
- Accepts hospitality that is excessive or contrary to corporate rules.
- Seems stressed and under pressure.
- Have opportunities to manipulate personal pay and reward.
- Self-interested and concerned with own agenda.
- Micromanages some employees; keeps others at arm’s length.

Third Party Red Flags

Fraud and corruption within an organisation’s third-party / delivery partners should also be monitored. In addition to the standard due diligence process to follow, the following Red Flags should also be monitored on an ongoing basis:

- Inadequate governance mechanism. No clear accountability structure.
- All power rests with one or a small number of people.
- Lack of transparency. No clear answers to questions. Unwillingness to inform about the organisation, or parts of it, and how it is structured and organised.
- All tasks related to money are centralised to one or a small number of staff members.
- The head of finance has inadequate formal qualifications and lacks experience.
- Reports are late and unclear.
- The organisation does not produce consolidated annual accounts.
- The project budget is unclear and is difficult to relate to planned activities.
- The organisation is not audited by a qualified auditor.
- Frequent anonymous tips or rumours of improprieties.
- Charismatic leader who talks a lot about what they are doing but little else.

Notes:

For more resources or support go to: www.integritas360.org. Integritas360 is a boutique consultancy who specialise in supporting NGOs / NFPs and charities to fraud and corruption proof themselves.