Red Flags for Fraud

Red flags are indicators that fraudulent activity could exist; they are not absolute, but should be investigated to ensure fraudulent activity is not present. This exhibit is only a guide and not to be construed as an all-encompassing list.

Red Flags for Corruption

1. An organization paying more than the best price available.
2. Very specific requirements that tend to favor one bidder.
3. Projects that are broken into two contracts to circumvent review limits or approval authority.
4. Very narrow time frame for companies to submit bids.
5. A too-successful bidder who is consistently winning bids.
6. Social contact between the bid solicitors and bidders.
7. Lower quality goods from a new vendor.
8. A procurement officer living beyond their means.

Factors that detract from a Positive Work Environment and could provide motive to commit Fraud

1. Executive management does not appear to care about or reward good behavior.
2. Negative feedback and lack of recognition for job performance.
3. Perceived inequities in the organization.
4. Autocratic rather than participative management.
5. Low organizational loyalty or feelings of ownership.
6. Unreasonable budget expectations or other financial targets.
7. Fear of delivering “bad news” to supervisors and/or management.
8. Less than competitive compensation.
9. Poor training and promotional opportunities.
10. Lack of clear organizational responsibilities.
11. Poor communication practices or methods within the organization.

Employee Red Flags

1. Employee lifestyle changes: expensive cars, jewelry, homes, clothes, etc.
2. Significant personal debt and credit problems.
3. Behavioral changes indicating possible drug, alcohol, gambling addiction, or fear of losing job.
4. High employee turnover, especially in areas vulnerable to fraud.
5. Refusal to take vacation or leave.
6. Lack of segregation of duties.

Management Red Flags

1. Reluctance to provide information to auditors.
2. Frequent disputes with auditors.

3. Decisions are dominated by an individual or small group.
4. Lack of clear organizational responsibilities.
5. Disrespect for regulatory bodies.
6. A weak internal control environment.
7. Accounting personnel are lax or inexperienced in their duties.
8. Decentralization without adequate monitoring.
9. Excessive number of checking accounts.
10. Frequent changes in banking accounts.
11. Frequent changes in external auditors.
12. Continuous rollover of loans.
13. Excessive number of year end transactions.
14. High employee turnover.
15. Rumors of conflicts of interest, nepotism, breach of duty, and/or favoritism.
16. Unexpected overdrafts or declines in cash balances.
17. Refusal by organization or division to use serial numbered documents.
18. Compensation program that is out of proportion.
19. Financial transactions that do not make sense.
20. Service contracts resulting in no product.
21. Photocopied or missing documents.

Red Flags in Cash/Accounts Receivable

1. Excessive number of voids, discounts, and returns.
2. Unauthorized bank accounts.
3. Sudden activity in dormant bank accounts.
4. Customer complaints they are receiving non-payment notices.
5. Discrepancies between bank deposits and postings.
6. Abnormal number of expense items, supplies, or reimbursement to an employee.
7. Presence of employee checks in the petty cash for the employee in charge of petty cash.
8. Excessive or unjustified cash transactions.
9. Large number of write-offs of accounts.
10. Bank accounts that are not reconciled on a timely basis.

Red Flags in Payroll

1. Inconsistent overtime hours.
2. Overtime charged during a slack period.
3. Overtime charged for employees who normally would not have overtime wages.
4. Budget variations for payroll.
5. Employees with duplicate social security numbers, names, and/or addresses.
6. Employees with few or no payroll deductions.

Red Flags in Purchasing/Inventory

1. Increasing number of complaints for products and services.
2. Abnormal inventory shrinkage.
3. Lack of physical security over assets/inventory.
4. Charges without shipping documents.
5. Payments to vendors who are not on the approved vendor list.
6. Payments to vendors using duplicate invoices.
7. High volume of purchases from new vendors.
8. Purchases that by-pass the normal procurement procedures.
9. Frequent use of sole-source procurement contracts.
10. Vendors without physical address.
11. Vendor addresses matching employee addresses.
12. Purchasing agents that pick up vendor payments rather than have them mailed

Reference: ©2003 Association of Certified Fraud Examiners; Executive Roadmap to Fraud Prevention and
Internal Control, Martin T. Biegelman and Joel T. Bartow; Statement on Auditing Standards No. 99, Consideration of Fraud in a Financial Statement Audit, Exhibit; Red Flags for Fraud, Steven J. Hanc