



Trends in Fraud: Dude, We've Got a Problem

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Trends in Fraud: Dude, We've Got a Problem

(How to Build Better Mouse Traps)

Presented by:

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Definition of Internal Control

Internal control is a process – effected by those charged with governance, management, and other personnel – designed to provide reasonable assurance about the achievement of entity's objectives with regard to:

- **Reliability of financial reporting**
- **Effectiveness and efficiency of operations, and**
- **Compliance with applicable laws and regulations**

Source: AICPA SAS 115 2

Internal Control Is Affected by
those charged with Governance –
an Entity's Board of Directors,
Management, & Other Personnel.
The Establishment of Internal
Control Is
MANAGEMENT'S
Responsibility.

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Those Charged With Governance:

is defined as: "the person(s) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting and disclosure process."

In most entities, governance is a collective responsibility....

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Internal Control, No Matter How
Well Designed and Operated,
Can Only Provide
REASONABLE Assurance
to Management and the
Board of Directors Regarding
Achievement of an Entity's
Control Objectives.

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COSO 2013 Internal Control Framework Consists of 5 Interrelated Components (and, 17 Principles):

- *Control environment*
- *Risk assessment*
- *Control activities*
- *Information and communication*
- *Monitoring*

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Summary of Updates

Codification of 17 principles embedded in the original Framework

Control Environment	<ol style="list-style-type: none"> 1. Demonstrates commitment to integrity and ethical values 2. Exercises oversight responsibility 3. Establishes structure, authority and responsibility 4. Demonstrates commitment to competence 5. Enforces accountability
Risk Assessment	<ol style="list-style-type: none"> 6. Specifies relevant objectives 7. Identifies and analyzes risk 8. Assesses fraud risk 9. Identifies and analyzes significant change
Control Activities	<ol style="list-style-type: none"> 10. Selects and develops control activities 11. Selects and develops general controls over technology 12. Deploys through policies and procedures
Information & Communication	<ol style="list-style-type: none"> 13. Uses relevant information 14. Communicates internally 15. Communicates externally
Monitoring Activities	<ol style="list-style-type: none"> 16. Conducts ongoing and/or separate evaluations 17. Evaluates and communicates deficiencies

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Control Environment

The control environment sets the tone of an organization influencing the control consciousness of its people.

It is the foundation for effective internal control, providing discipline and structure.

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Management's Philosophy and Operating Style

Management philosophy is the set of shared beliefs and attitudes characterizing how the agency handles everything it does, from developing and implementing strategy to day-to-day activities. This philosophy reflects the agency's values, influencing its culture and operating style, and affects how well fiscal programs can implement, maintain, and enforce control.

MAAPP Manual Section 30 9

Management's Philosophy and Operating Style

Management philosophy appears in policy statements, oral and written communications, and decision-making. Management reinforces the philosophy more with everyday actions than with its words.

MAAPP Manual Section 30 10

Evaluating Controls – Not a One Time Thing...

Processes change, positions are not replaced, budget reductions, new threats emerge.....

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When you think you have the perfect mouse trap....



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Epic Failure in Controls

Remember: internal controls will only work if you actually use them and use them correctly.



Avoid the Myths...

- “We will send it through and if it is processed, if it is, then it’s okay.”
Fiduciary responsibility rests with you if you send something through you are saying it’s okay.
- “It is our money anyway, we can spend it however we want.” State and federal law dictate what is allowable – you are a steward of funds.
- “If the law doesn’t address it, then we can do it.” Just because the law doesn’t address it doesn’t mean it’s okay...

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And you must remember why this matters...

- For every dollar you lose to a compliance failure and its remediation, it’s a dollar lost to your primary mission.
- For every dollar you lose to fraud and its remediation, it’s a dollar lost to your primary mission.
- This doesn’t even factor in morale effects of a substantial event.



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Focus on Fraud

Controls matter in preventing and detecting fraud. Because of this strong correlation, we will now talk about specific fraud risks.



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Fraud Defined

In *criminal law*, **fraud** is the crime or offense of deliberately deceiving another in order to damage them – usually, to obtain property or services unjustly.



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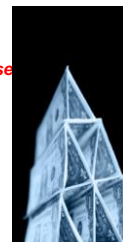
ACFE 2016 Report to the Nation

The term “occupational fraud” may be defined as:

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

Measuring the Cost of Occupational Fraud:

At the outset, it should be clear to anyone who has spent time dealing with the subject of occupational fraud that attempts to accurately measure the frequency or cost associated with occupational fraud in the United States will be, at best, incomplete.



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The Fraud Triangle

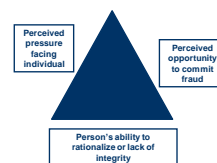
Perceived pressure facing individual

Perceived opportunity to commit fraud

Person's ability to rationalize or lack of integrity

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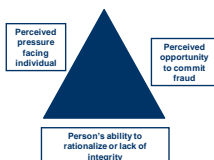
Pressure



- Key is that the pressure is non-sharable.
- Typical pressures include
 1. Debt
 2. Addictions: alcohol, gambling, drugs
 3. Family problems: health, marital

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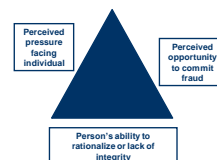
Rationalization



- They don't pay me enough.
- I'm only borrowing.
- Everyone else is doing this.
- This is a corrupt organization.

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Opportunity



- Access to funds
- Access to inventory
- Ability to process transactions

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Fraud Quick Facts:

- Most fraud is found by employees & managers simply paying attention to what is going on.
- Perception of detection is the best deterrent to fraud.
- All employees have a role in ensuring ethical business dealings of the institution.
- When fraud occurs it has implications: donors, legislators, research, etc...

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"Never trust the people you cheat with.
They will throw you under the bus."
Marianne M. Jennings

"Three people can keep a secret if two are dead." Ben Franklin

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Fraud Trivia

Results of ACFE 2016 *Report to the Nations on Occupational Fraud and Abuse*:

- 2,410 actual cases of occupational fraud investigated between Jan. 2014 & Oct. 2015
- Cases from 114 Nations; ~51% non-US
- Median loss - \$150,000
- Median duration – 18 months (yet more than 32% exceeds two years)
- ~23.2% of cases - \$1M or more
- 18.7% of cases were in government organizations (median loss ~ \$109,000)

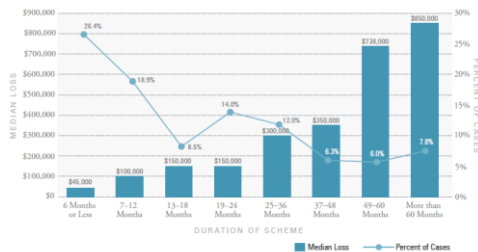
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Source: Association of Certified Fraud Examiners, Inc.

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Frequency & Median Loss Based on Duration of Fraud

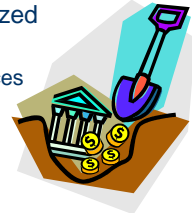


Source: Association of Certified Fraud Examiners, Inc.

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Cost of Fraud and Abuse

- \$3.7 trillion potential annual world wide
- 5% of GWP revenues (\$74.16T)
- Most commonly victimized sectors:
 - Banking/financial services
 - Government/public administration
 - Manufacturing



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Damages to Victims go Beyond Dollars & Cents

- Reputation
- Loss of Public Confidence
- Detrimental to attracting new potential customers, legislators, employees, donors & volunteers
- Damage to relationships
- Sagging staff morale
- Distraction from the mission

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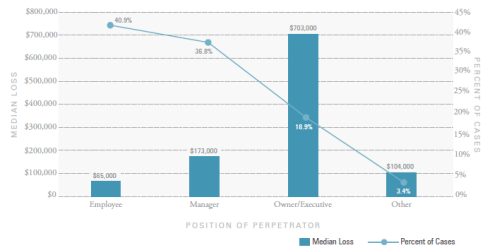
Fraud Trivia – 2016 2014 2012 2010 {2008} (2006)

- 55.7% 53.9% 55.2% 57.2% (59%) (61%) – Male
- 44.3% 46.1% 44.8% 42.8% (41%) (39%) – Female
- 45.3% 46.5% 43% 42.1% (39.7%) (41.2%) – Employee;
- 31.1% 31.9% 34.3% 41.0% (37.1%) (39.5%) – Manager;
- 19.9% 17.3% 18.5% 16.9% (23.3%) (19.3%) – Executive
- Fewer cases involving older individuals; but, larger \$\$
- The higher the degree, the fewer cases; but, more \$\$ involved



Source: Association of Certified Fraud Examiners, Inc.

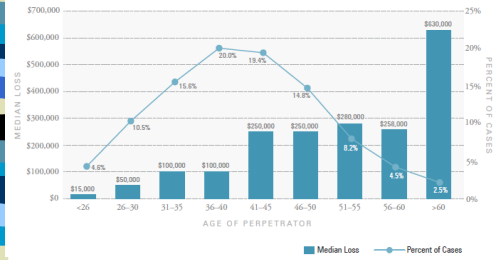
Position of Perpetrator: Frequency & Median Loss



Source: Association of Certified Fraud Examiners, Inc.

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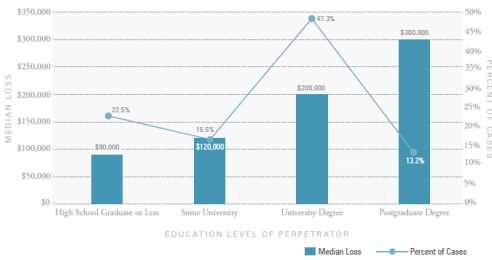
Age of Perpetrator: Frequency & Median Loss



Source: Association of Certified Fraud Examiners, Inc.

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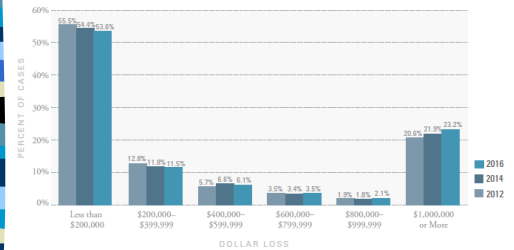
Education Level of Perpetrator: Frequency & Median Loss



Source: Association of Certified Fraud Examiners, Inc.

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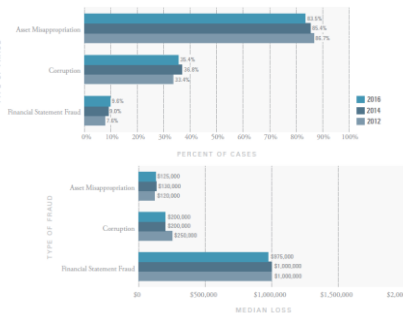
Distribution of Dollar Losses



Source: Association of Certified Fraud Examiners, Inc.

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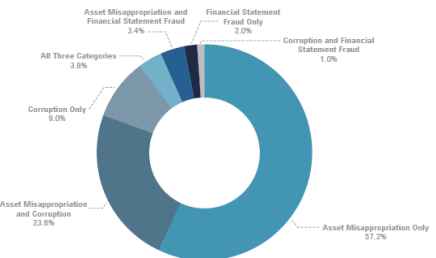
Occupational Frauds: Frequency & Median Loss



Source: Association of Certified Fraud Examiners, Inc.

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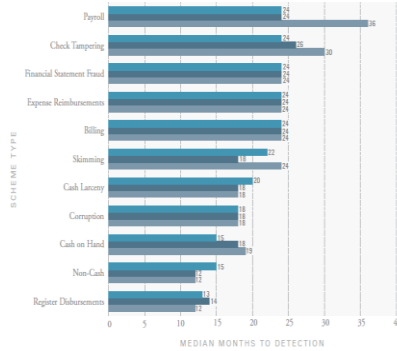
Overlap of Fraud Schemes:



Source: Association of Certified Fraud Examiners, Inc.

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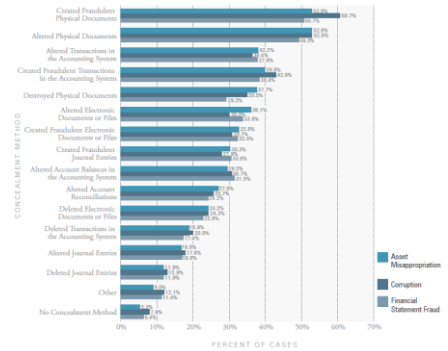
Median Duration of Fraud Based on Scheme Type



Source: Association of Certified Fraud Examiners, Inc.

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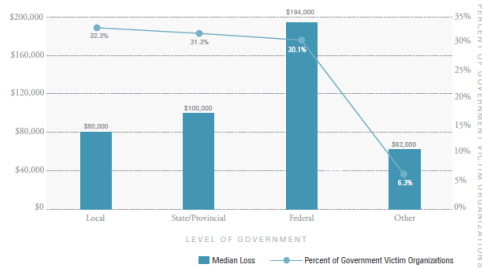
Concealment Method by Scheme Type



Source: Association of Certified Fraud Examiners, Inc.

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Level of Government: Frequency & Median Loss



Source: Association of Certified Fraud Examiners, Inc.

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Fraud Trivia, cont....

Tenure – 2016 2014 2012 2010 {2008} (2006):

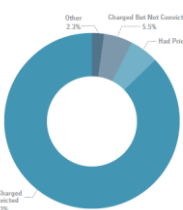
- 10 years+ – 22.9% 25.4% 25.3% 25.4% {27.5%} (37.7%)
- 5-10 years – 26.5% 23.2% 27.2% 23.2% {24.6%} (26.3%)
- 1-5 years – 42.4% 45.7% 41.5% 45.7% {40.5%} (25.7%)
- Under 1 year – 8.2% 5.9% 5.7% {7.4%} (10.2%)

Criminal History – 2016 2014 2012 2010 {2008} (2006):

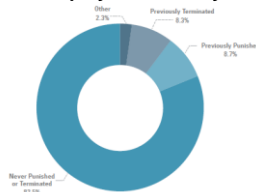
- Never charged or convicted before – 88.3% 86.6% 87.3% 85.7% {87.4%} (87.9%)
- Prior conviction(s) – 5.2% 5% 5.6% 6.7% {6.8%} (7.7%)
- Charged but not convicted – 5.5% 7.2% 5.9% 7.7% {5.7%} (4.4%)

Source: Association of Certified Fraud Examiners, Inc.

Fraud Perpetrator's Criminal History



Fraud Perpetrator's Employment History



Source: Association of Certified Fraud Examiners, Inc.

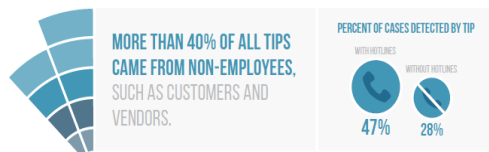
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Fraud Trivia: 2016 2014 2012 2010 {2008} (2006)

How discovered:

- Tip – 39.1% 38.4% 43.1% 37.8% {46.2%} (34.2%)
- Internal controls – 25.9% 33.2% 27% 32.4% {23.3%} (19.2%)
- Internal audit – 16.5% 13.1% 11.7% 13.7% {19.4%} (20.2%)
- By accident – 5.6% 8.2% 7.8% 9.3% {20.0%} (25.4%)
- External audit – 3.8% 4% 3.5% 4.2% {9.1%} (12.0%)
- Notified by police – 2.4% 2% 3.8% 1.9% {3.2%} (3.8%)

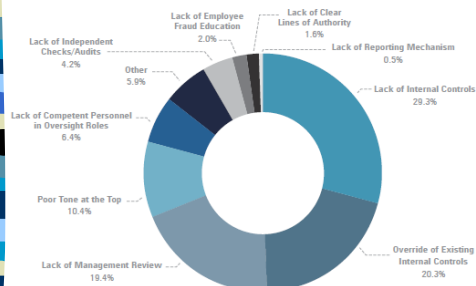
Source: Association of Certified Fraud Examiners, Inc.



Source: Association of Certified Fraud Examiners, Inc.

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Primary IC Weaknesses Observed



Source: Association of Certified Fraud Examiners, Inc.

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Source: Association of Certified Fraud Examiners, Inc.

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Red Flags



Behavioral Organizational Document

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Red Flags: Behavioral

- Never takes a vacation
- Comes in early, leaves late
- Lifestyle doesn't seem to match salary or a lifestyle that suddenly increases substantially.
- High personal debt
- Behavioral change

Note – partial list on red flags.

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Red Flags - Organizational

- Lack of ethical tone at the top.
- Lack of documented policies and procedures.
- Low employee morale.
- High employee turnover.
- Lack of cooperation with auditor.

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Financial Document Red Flags

- Missing documents
- Information only provided after unreasonable delay
- Only photocopies, faxes, or scanned documents available
- Alterations and discrepancies in documentation
- Handwritten documents are provided instead of computerized documents
- Invoices not folded for envelope
- Unusual billing addresses
- Address of employee same as vendor
- Questionable handwriting or authorization
- Duplicate payments
- Odd, unusual or different transactions

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The Demise of “Paper Checks”...A Fraudster’s Dream as Opportunities of Duplicate Payments Increase!!!

- Wire Transfer
- ACH Fraud
 - Use Positive Pay
 - Use ACH Filter/Block (blocks debits)
- P-Cards
- Paying from Statements
- Petty Cash
- Payment of Travel Reimbursements

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The Demise of “Paper Checks” Best Practices...

- Limit payment type from statements (i.e.: P-Card only)
- Make sure POs are extinguished whenever a payment is made.
- Make sure invoices are entered in a standard coding format
- Make sure standard coding format is used for vendor name & invoice when field is not long enough
- Standard payment timing policy adhered to by everyone
- Use technologies...(i.e.: 3-way match – invoices to POs to receiving documents; duplicate invoice # to date to vendor name/address)

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An economic down turn increases our risk of fraud (ACFE 2009 Study on Fraud & Economy)



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Fraud Happens



Jefferson County, Alabama

- Municipal Bond Market Fraud
- Construction Fraud
- Bribery
- Jefferson County Commissioners
- Bankruptcy in 2011

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Mississippi Dept. of Corrections Commissioner Chris Epps



- Single Source Contracts worth Millions
<http://www.mississippian.com/story/1178976-two-miss-businessmen-entire-efile-in-epps-bribery-case>
- Contract kickbacks

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Judicial Bribery: Scruggs, Balducci, Langston, & former State Auditor, Steve Patterson



found at 35,000.00 per
month that I have received
for 600.00
P. J. Apple
Nov. 28, 2000



- Dickie Scruggs
- Steve Patterson
- Tim Balducci
- Joey Langston
- Presley L. Blake
- Judge Henry Lackey (the good guy)

"we were in the Holy Land seeking edification and returned home to this mess," Deborah Patterson (wife of Steve)

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Alcorn County Supervisor Jimmy Dal Nelms

- <http://www.myfoxmemphis.com/clip/11828766/former-alcorn-co-supervisor-sentenced>
- Stealing Public Funds
- Embezzlement
- Bought junk equipment and sold it to the county at inflated prices
- Charged for work never performed
- Falsified bids and invoices to make a profit
- Sentenced to 12 years
- Restitution of \$308,000
- Fines of \$5,000

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Warren County Administrator Shelly Ashley-Palmtreee

0 <http://www.warrentimes.com/content/local/mississippi/warren-county-court-clerk-pleads-guilty-to-embezzlement/2011/03/04>

- Embezzlement Of \$818,252
- 5-year sentence
- Restitution \$1.04 million



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Neshoba County Administrator Benjie Coats



- Overtime payments scam (30,000 hours)
- Restitution of \$1.3 million from four employees:
 - Benjie Coats (administrator)
 - Tommy Gomillion (payroll clerk)
 - Julie Faye Russell (purchasing clerk)
 - Jill Watkins (comptroller)

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National Guard Youth Program

Hattiesburg Restaurateur, Jerry Howard

- Stole food and used in his home & restaurant, Jerry's Seasoned Food
- 17-year employee
- Large quantities of invoiced food never appeared on the menu
- Yearly totals increased significantly (\$216K to \$306K) over 6 years yet numbers being served annually did not change
- Restitution - \$157,385.40



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Dept. of Health Information Clerk (WIC Program) Kenyatta Smith



- Added a fictitious child to the WIC system and received food benefits 14 times over 2 years
- Restitution - \$3,671.10

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In place you might not expect...

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How the Georgia Tech Case
"Looked" on TV

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Hotline (Tip Line) Characteristics...

- | | |
|-------------------------|--------------------------------|
| • Tip Input | • Internal Control Review |
| • Anonymity | • Employee Awareness |
| • Availability | • Organizational Placement |
| • Multilingual | • Responsibility for Follow-up |
| • Case Management | • Audit Trail |
| • Compliance Monitoring | |

Source: LeBlanc, JGA, August 2013

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Rationalizing Dilemmas Away:

- "Everybody else does it"
- "If we don't do it, someone else will"
- "That's the way it has always been done"
- "We'll wait until the lawyers tell us it is wrong" or "The law doesn't say we can't do it"

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Rationalizing Dilemmas Away:

- "It really doesn't hurt anyone"
- "The system is unfair"
- "It's a gray area"
- "I was just following orders"
- "We all don't share the same ethics"

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Best Practice Tips:

- Define employee theft
- Track fixed assets
- Background checks
- Surprise audits
- Anonymous reporting – tip line
- Checks and balances
- Monitoring of Internet activities
- Comprehensive policy regarding employee theft


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Limitations of Internal Control

- Not a cure all
- Suitability of objectives used in establishing IC system
- Cannot ensure entity's success or survival
- Cannot ensure entity will achieve operation, financial reporting, and compliance objectives
- Effectiveness limited by human judgment, hasty & faulty decision making
- External events beyond entity's control

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- 
- System can breakdown due to misunderstandings, mistakes in judgment, or errors committed due to carelessness, distraction, or fatigue
 - Only as effective as the people who are responsible for its functioning
 - Collusion can result in control failure
 - Limited resources (cost/benefit)
 - excessive control is costly & counterproductive
 - too little control presents undue risk to entity

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Everyone in an Organization Has Some Responsibility for Internal Control;
However, **MANAGEMENT** Is Responsible!

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Most Common Reason Fraud Occurs

Blind Trust...One person is given **complete control** of the financial process without any oversight or monitoring from the supervisor or department head.

(simply signing does not = oversight)

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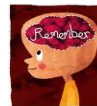
In a time of budget cuts be careful to consider the internal control impact.



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TO



Three Things To Remember...

...even if you forget most of what we've discussed today...

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...the #1 deterrent to fraud is...

...the perception of detection....

raise this and you lower your risk of fraud.



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#2 thing to remember...

...controls matter in detering fraud and achieving success.

You are an educator for internal controls.

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#3 thing to remember...

...the "Tone at the Top" (and middle) *really does matter*, but what you do matters more than what you say or a written policy.



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The Survivor



In Africa every morning, a gazelle awakens knowing it must outrun the fastest lion if it wants to stay alive.

Every morning, a lion awakens knowing it must run faster than the slowest gazelle or it will starve to death.

It makes no difference whether you are a lion or a gazelle; when the sun comes up, you better start running.

~Author Unknown~

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Questions?

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