

The Face of Fraud: What We Should Do About It

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WELL? WHAT ARE YOU WAITING FOR?

A GOOD REASON TO DO THIS...

TWO WORDS, LUCK... RISK MANAGEMENT

OH, I THINK I'M GONNA NEED A LOT MORE WORDS THAN THAT

IF EVERYTHING GOES AS PLANNED, THEN WE'LL REAP THE REWARDS FOR CREATING THE GREAT NEW SPECTATOR SPORT OF HORSEBACK SKI JUMPING!

OH...AND WHAT ABOUT THE ALL-TOO-OBVIOUS DISASTER THAT'S WAITING TO HAPPEN?

THAT'S WHERE I MANAGE TO IGNORE THE RISKS

NOW WHAT?!?

TWO WORDS... BAIL OUT

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YOUR POWERPOINT
SLIDES IMPRESSED THE
EXECUTIVES SO MUCH
THAT THEY'RE CHANGING
OUR ENTIRE STRATEGY.



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THOSE SLIDES WERE
NOTHING BUT A BUNCH
OF GARBAGE DRESSED
UP TO LOOK GOOD.



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AND THAT'S WHAT
OUR NEW PRODUCT
LINE WILL BE!



OH.

MONDAY, MARCH 23, 2009

Former Finance Director Of DC Non-Profit Sentenced For \$400K Embezzlement

Earl Staubs, 63, of Arlington, Virginia, was sentenced Friday to 2 1/2 years in prison for embezzling some \$438,000 from the **Center for Applied Linguistics**, a DC-based non-profit organization. According to prosecutors, Staubs set up a bank account in the non-profit's name in 2005, with his home address, deposited checks into that account, and then used the funds for his own benefit. He plead guilty to wire fraud charges in September. Staubs, who is currently serving a 7 year state prison sentence for another embezzlement, faces up to 37 months in prison for the Applied Linguistics case.

Monday, November 24, 2008

Former Director of Breast Cancer Charity Pleads Guilty To Embezzlement

Mary E. Guinard, 35, of Meridian, Idaho, plead guilty today to embezzling more than \$100,000 from the Boise, Idaho affiliate of **Susan G. Komen for the Cure** for which she served as director. According to prosecutors, between June 2007 and August 2008, Guinard stole \$74,000 by writing some 20 unauthorized checks payable to herself and made \$42,000 in unauthorized credit card charges. She also took two laptop computers and a television, without authorization. Guinard, who was arrested August 25th and originally charged with two counts of grand theft and seven counts of forgery, pleaded guilty today to one count of grand theft and one count of forgery with a recommendation by the prosecutor that she be sentenced to 28 years in prison. Sentencing is set for January 5, 2009.

Session Objectives

- Understand impact of fraud in the US
- Learn statistics and factors contributing to fraud
- Recognize fraud schemes
- Implement reasonable best practices to prevent fraud
- Implement reasonable best practices to detect fraud

What is fraud?

Noun:

- deceit, trickery, or *breach of confidence*, perpetrated for profit or to gain some unfair or dishonest advantage.

www.dictionary.com

Occupational fraud:

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

Association of Certified Fraud Examiners (ACFE)

Occupational Fraud: Elements

- **Intent**
- **Effort to obscure from detection**
- **Violates perpetrator's fiduciary duties to the organization**
- **Committed to benefit perpetrator, organization, or both**
- **Costs victim organization assets, revenues or reserves**

Fraud Stats & Facts

- **Estimated to impact 7% of all organization revenues in US = \$994 Billion per year!**
- **Median duration of frauds is 18-24 months**
- **Only 7% of perpetrators had prior convictions**
- **Occupational fraud is far more likely to be detected by a tip than by audits, ICs or any other method! (48.8%)**
- **Fraud was most often committed by accounting staff or upper management**

Source: Association of Certified Fraud Examiners

Fraud Stats & Facts:

Non-profits

- **Median duration of fraud for nonprofits – 24 months**
- **Lack of balance between funding for stated mission of the organization and protection of the organization's assets**
- **Inordinate emphasis on ineffective controls**
- **Frequent lack of review of internal controls and fraud hotlines which lead to much longer periods to detect and larger median losses**

ACFE 2008 Report to the Nation: 14.3% of cases examined for report took place in nonprofits (134 cases)

Median Losses

- Private companies - \$278,000
- Public companies - \$142,000
- **Non-profits - \$109,000**
- Government agencies - \$100,000

Impact / Consequences:

Bad effects when bad things happen

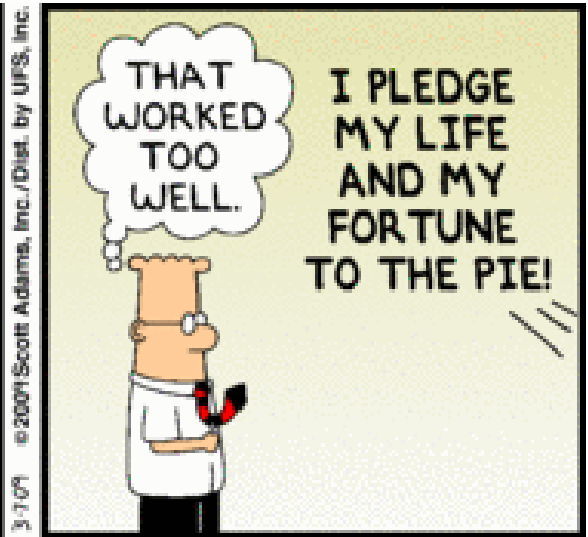
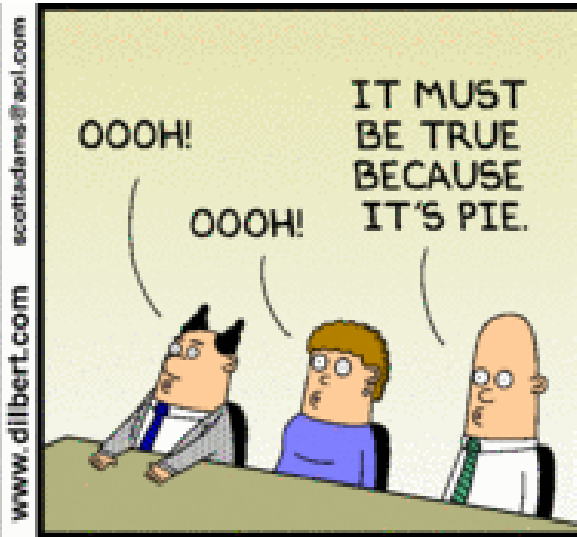
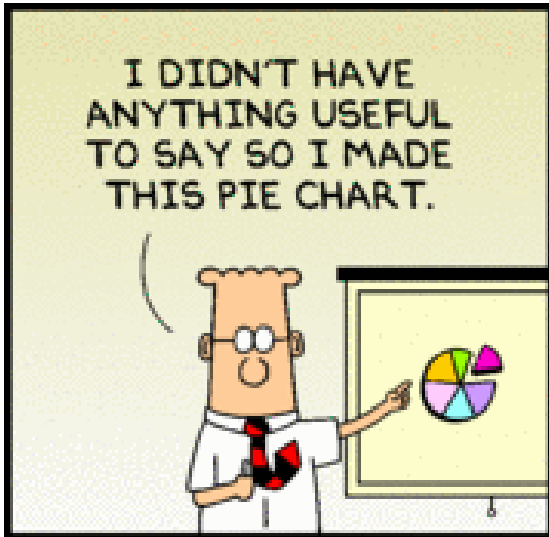


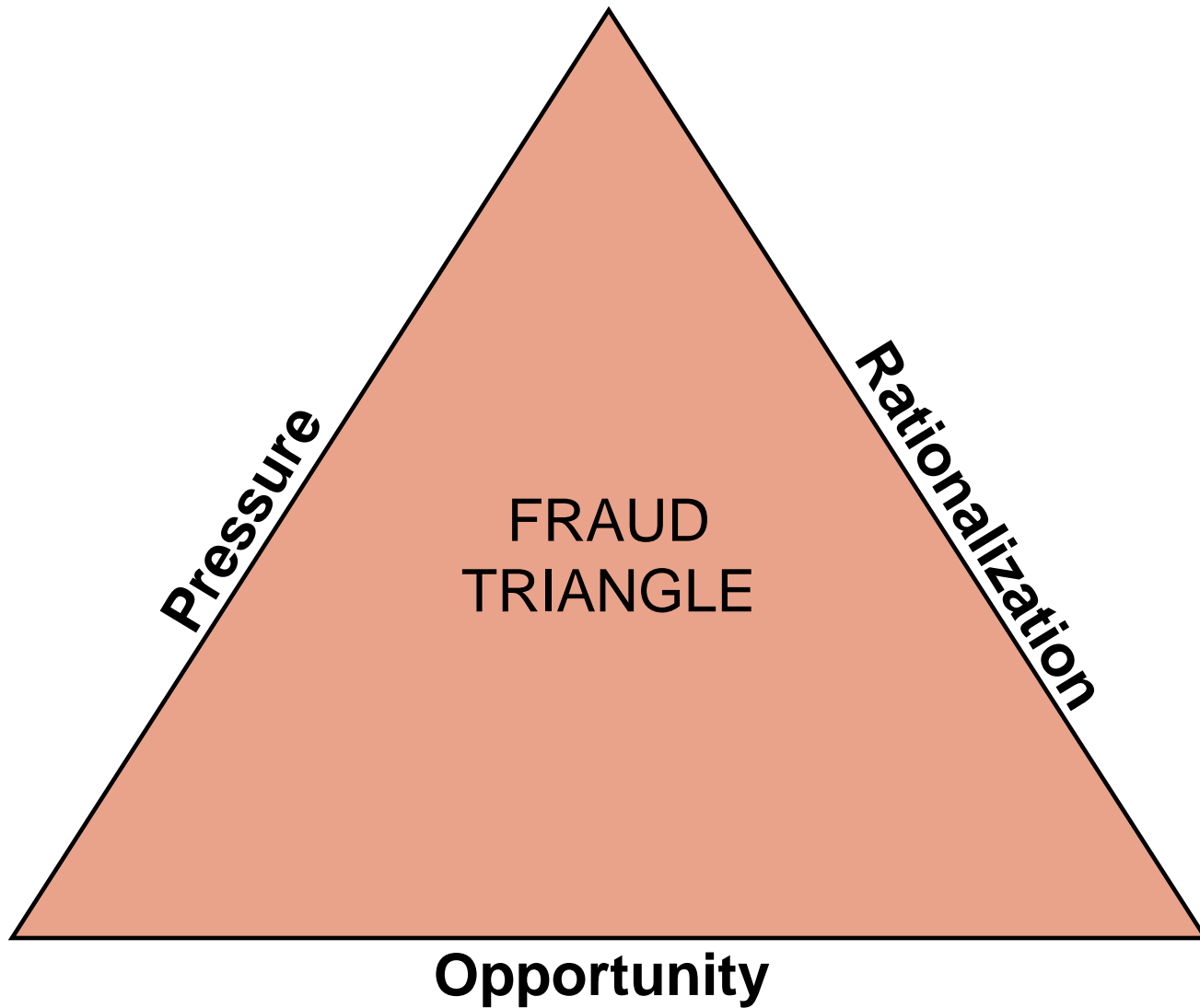
- Bad PR
- Loss of public trust (long-term bad PR)
- Loss of future funding
- Increased oversight/scrutiny
- Increased operating costs
- Damaged employee morale
- Loss / theft of funds and assets

Why is fraud a problem?

- Who commits occupational fraud?
- Dr. Donald Cressey
- Fraud Triangle







Leg 1 of Fraud Triangle: Pressure or “Non-shareable need”

Pressure

- Living beyond one's means
- Financial difficulties
- Medical/health issues
- Grief/loss
- Post-traumatic stress disorder (PTSD) symptoms
- Addictions to gambling, alcohol, drugs
- Marital/relationship conflicts
- Unachievable goals set by self/organization
- Societal expectations for status and desires

Rationalization

Opportunity

Leg 2 of Fraud Triangle: Rationalization or “Good person; bad circumstances”

Pressure

Rationalization

- **Just “borrowing” and plan to give back**
- **Lack of adequate pay (incl. volunteers)**
- **Lack of career ladder: “vertically challenged”**
- **Entitlement mentality**
- **Encouragement by “Tone at the top”**

Opportunity

Leg 3 of Fraud Triangle: Opportunity or “Perception of availability”

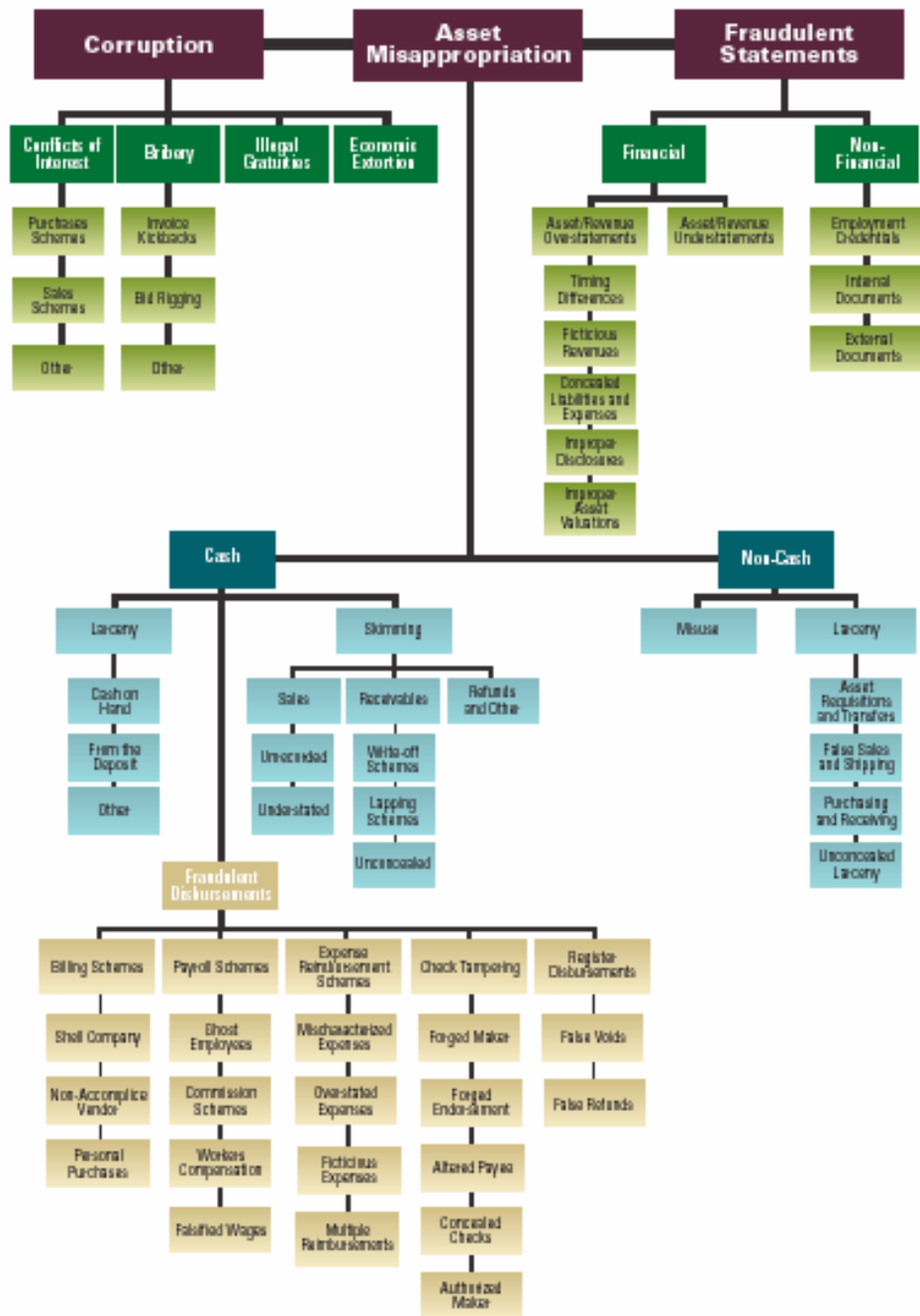
Pressure

- 10-10-80 rule
- Ease of access to funds and assets
- Relaxed control environment
- Low emphasis on support functions
- Repetitive processes without review/revision
- Lack of “perception of detection”

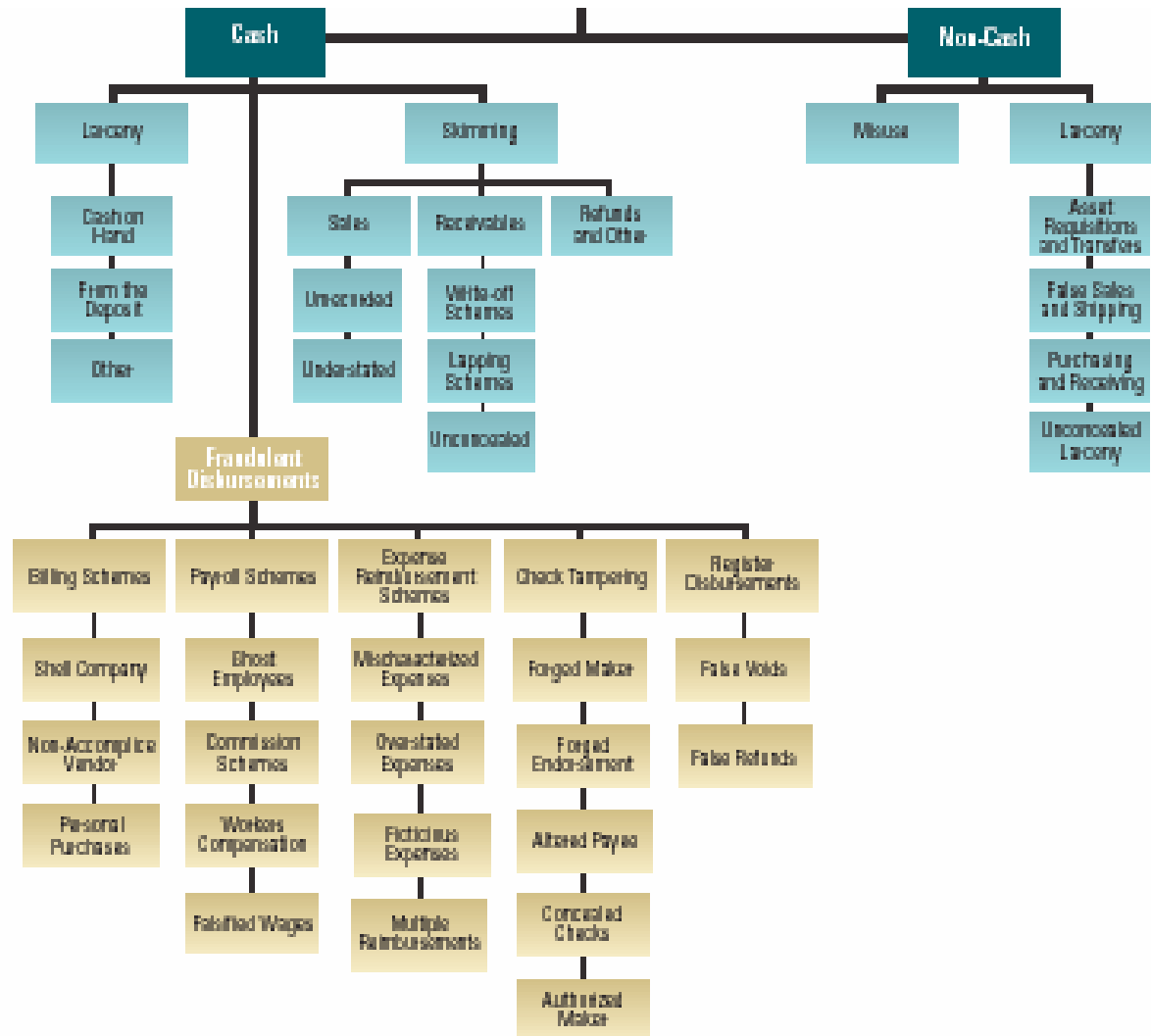
Rationalization

Opportunity

Occupational Fraud and Abuse Classification System



ASSET MISAPPROPRIATION



Occupational Fraud

- **Asset Misappropriation**
89% of occupational fraud cases
 - (1) Cash**
 - larceny
 - skimming
 - (2) Inventory**
 - abuse
 - larceny
- **Corruption (27%)** – bribes, conflict of interest
- **Fraudulent Statements (10%)** (low frequency, high severity)

Statistics from ACFE

Note: Total does not equal 100% since some fraud schemes reviewed comprised multiple classifications

Prevention:

an ounce = many pounds (or dollars)

- Code of conduct, ethics policy, fraud policy
- Documented policies and procedures for core functions
- Employee assistance program
- Background checks for employees
- Protect proprietary and confidential information
- Fraud hotline (internally or externally monitored)
- Risk assessment

Prevention:

an ounce = many pounds (or dollars)

- Segregation of duties
 - Record the transaction
 - Authorize the transaction
 - Custody of the transaction
 - Execute the transaction
- Required vacations
- Rotate responsibilities periodically and cross-train
- Review key controls
- Trust but don't over-delegate
- Secure assets and document custody transfer
- Management review of financial statements

Prevention:

Code of Conduct, ethics policy, fraud policy

- Comprehensive but applicable to all hierarchical levels of employees and stakeholders
- Align with organization's values and strategic objectives
- Broad dissemination to employees, volunteers, vendors, agents, Board, and stakeholders
- Provide ongoing awareness and education outreach (new employees, periodic reinforcement)
- Document receipt, understanding, and intent to comply
- Deliver translation for applicable languages
- Specify repercussions for non-compliance and enforce consistently

Prevention:

Background checks

- Research indicates that 67% of all résumés/applications contain material inaccuracies
- Periodically (i.e. annual) review position requirements and responsibilities to ensure continued relevance
- Reasonably verify disclosures:
 - Education
 - Employment experience
 - Professional references
 - Credit background (for financial & cash-handling positions)
 - Criminal background
 - Driving history (if applicable)

Prevention:

Other key controls

- Protect vendor and proprietary information (e.g. donors, employees)
- Strong Board participation and ask “hard questions”
- Audit Committee involvement and external audit assurance
- Fraud risk assessment:
 - Peer organization involvement
 - Top-down approach and participation
 - Organization evolution brings new risks
 - Scenario/scheme consideration

Common Fraud Schemes:

Misappropriation of assets: Incoming funds

- Checks and cash
 - Contributions/donations
 - Membership dues
 - Receipts for services, programs, conferences, etc.
 - Receipts for sales
- Donated property
- Prior to or after transaction recording

Prevention:

Segregation of Duties - Incoming funds

Frequently considered “impossible” due to inadequate staffing

- Segregate stages of receipts cycle:
 - Billing
 - Opening mail / receiving funds and immediate restrictive endorsement of checks
 - Recording receipts and revenue
 - Preparation of deposits
 - Posting receipts (i.e. offset of receivables)
 - Write-off of receivables
 - Acknowledgement of receipts to donors and/or confirmations
 - Reconciliation of accounts

Prevention:

Segregation of Duties - Incoming funds

Related controls to implement or consider:

- Use lockbox service
- Immediate restrictive endorsement of funds for deposit
- Use of permanent receipts log
- Timely deposits of all funds
- Properly secure any deposits held overnight
- Closely monitor write-offs, receivable credits, and aging of receivables
- Periodic reconciliation of receipts log to deposit records
- Receivables and payables should be fully segregated
- Use analytics to determine reasonableness of revenues

Prevention and Detection:

Donations of cash/checks:

- Posting pledges (or other reasonably anticipated receipts) as receivables
- Controls over printing of pledge solicitations and donation reply envelopes
- Use lockbox service for mail receipts
- Dual control over receipts at first receipt
- Rotate responsibilities and mandatory vacations for those involved in processing donations
- Periodically mail statements on donor activity
- Publish donor names and follow-up on ALL complaints of omissions of recognition or other indicators
- Reconcile business reply mail to # of receipt transactions

Prevention and Detection:

Membership dues:

- Use controls similar to contributions:
 - Posting receivables
 - Controls over printing of correspondence and reply envelopes
 - Use lockbox service for mail receipts
- Separation of duties for membership “benefits” from collection of dues
- Control membership roster and publish
- Develop appropriate detection methods unique to benefits
- Follow-up on ALL complaints of omitted benefits or member recognition
- Use of analytics to assess reasonableness

Prevention and Detection:

Receipts for services, conferences, programs, etc.:

- Controls over on-site payment for services
 - Use of pre-numbered “tickets” or other media
 - Separate funds collection from admission function
- Implement analytics for reasonableness of receipts

Prevention and Detection:

Receipts for sales:

- Use of pre-numbered receipts or register tape
- Control of returns and write-offs
- “Horizontal analysis” and “vertical analysis” for unusual fluctuations
- Implement analytics for reasonableness of receipts
- Follow-up on complaints of delays in payment posting to accounts or notice of late payments
- Rotate responsibilities for recording sales receipts, managing receivables, etc.

Common Fraud Schemes:

Misappropriation of assets: Outgoing funds

- **Billing fraud**
 - Phony vendors
 - Fraudulent payments (i.e. duplicate payments, overpayments, check tampering, refunds)
 - Conflicts of interest / inappropriate vendor selection
- **Travel & Expense fraud**
- **Personal purchases**
- **Payroll**

Prevention:

Segregation of Duties - Outgoing funds

- **Segregate stages of payments cycle:**
 - New vendor set-up
 - Purchase request
 - Purchase authorization
 - Receiving of purchased goods and supplies
 - Recording of payables
 - Check stock security and check runs
 - Posting of payment against payables ledger
 - Authorization of payments
 - Delivery / mailing of checks to vendors
 - Reconciliation of accounts

Prevention:

Segregation of Duties - Outgoing funds

- **Segregate functions of payroll:**
 - Entry of pay master data
 - Setting pay rates and changes
 - Entry of timekeeping information
 - Approval of timesheets
 - Processing payroll
 - Distribution of paychecks
 - Posting payroll to accounting system
 - Reconciling payroll accounts

Prevention:

Segregation of Duties - Outgoing funds

- **Related controls to implement or consider:**
 - Use of pre-numbered checks and sequential order
 - No pre-signing of checks permitted
 - Security of signature stamps and check stock
 - Prompt update of authorized signers
 - Careful review of check skips and returned checks
 - Conduct periodic confirmations with vendors
 - Review vendor addresses for PO boxes and compare to employee addresses

Prevention and Detection:

Duplicate invoicing and refund:

- Pay only original invoices, no statements or photocopies
- Match invoices with receiving report to identify duplicates
- Utilize purchase order system for proper authorization and invoice tracking
- Vendor confirmations on “random/sample” basis
- Verify endorsements on “random/sample” basis
- Identify budget variances and follow-up

Prevention and Detection:

Billing Frauds:

- Reconcile receiving reports with inventory records
- Match invoices to authorized purchase orders

Credit Card Frauds:

- “Empower” credit card administrator to suspend/cancel cards
- Control inventory of credit cards issued to employees
- Set appropriate credit limits for organization needs and adjust
- Outline policies for credit card use (i.e. restricted commodities, disallowed MCC code types, etc.)
- Require original invoices to support purchases (particularly when overlapping risk with travel/entertainment reimbursements)
- Prompt review of monthly statements by supervisor when authorizing payment

Prevention and Detection:

Fictitious or shell vendors:

- Segregation of duties for vendor set-up
- Obtain full information on all new vendors (address, EIN, etc.)
- Periodically delete dormant vendors
- Compare vendor information against employee information
- Flag vendors with PO Box address as sole contact, inconsistencies
- Confirm flagged vendors through direct contact, research inquiries, Sec. of State database, etc.

Prevention and Detection:

Ghost employees:

- Risk may include both fictitious and former employees
- Positive verification of employees when distributing paychecks
- Compare HR personnel records to pay records
- Review pay records for employees with minimal/null deductions (medical benefits, tax withholding, etc.)
- Identify duplicate addresses, SSNs, or direct deposit accounts
- Rotate responsibility for paycheck distribution
- Timely reconciliation of payroll accounts
- Review endorsements for possible alteration or third-party endorsement
- Review employees lacking leave use or pay-rate and other changes

Prevention and Detection:

Overstatement of hours or pay-rates:

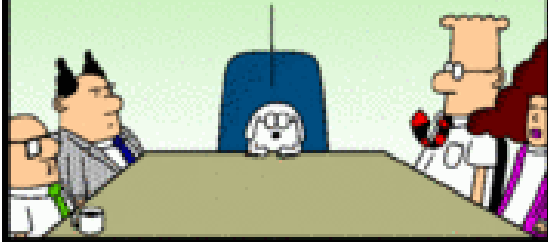
- Close review by supervisor or others with direct knowledge of work
- Control of timesheets following supervisor review
- Timely forwarding of timesheets to Payroll processing
- Limitation of changes and proper protocol for changes
- Segregating access for making pay-rate changes from authorization
- Segregating pay-rate changes from payroll processing

Commissions fraud:

- Connect commissions to sales system if possible
- Review of sales reports by supervisors with direct knowledge
- Compare sales reports for calculating commissions to sales documents and accounts receivable reports

DOGBERT THE CEO

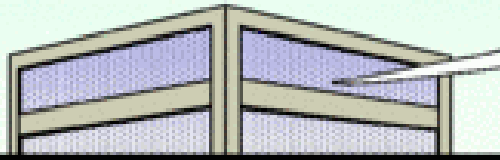
UNTIL THE COMPANY RETURNS TO PROFIT-ABILITY I WILL ONLY FLY COACH.



www.dilbert.com scottadams@aol.com

I'LL BOOK THREE COACH SEATS IN A ROW SO I CAN STRETCH OUT.

ONE OF YOU WILL BE A SHERPA FOR MY BEDDING.



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I'LL BRING MY OWN AIR MARSHAL TO PUNCH ANYONE WHO TALKS WHILE I'M NAPPING.

AND A VIDEOGRAPHER SO I CAN SEE THE PLAYBACK WHEN I WAKE UP.

Prevention and Detection:

Travel & Expenses:

- Centralize travel & expense review and comparison between expense reports
- Establish clear policies on reimbursable expenses
- Pre-approval of travel, dates, and expense limits
- Require timely expense reports (i.e. within 30 days)
- Closely monitor travel and entertainment budgets
- Meals/entertainment require documentation of all persons in attendance (name, title, organization)
- Require original, itemized supporting documentation and evidence of travel
- Monitor credit card statements for same period as expense report request (i.e. duplicate expenses)
- Approvals required from supervisor with direct knowledge of activity and travel schedules/plans and timesheets

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- Understand impact of fraud in the US
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Resources

- Non-Profit Risk Management Center:

www.nonprofitrisk.org

- Risk Management Policies tool:

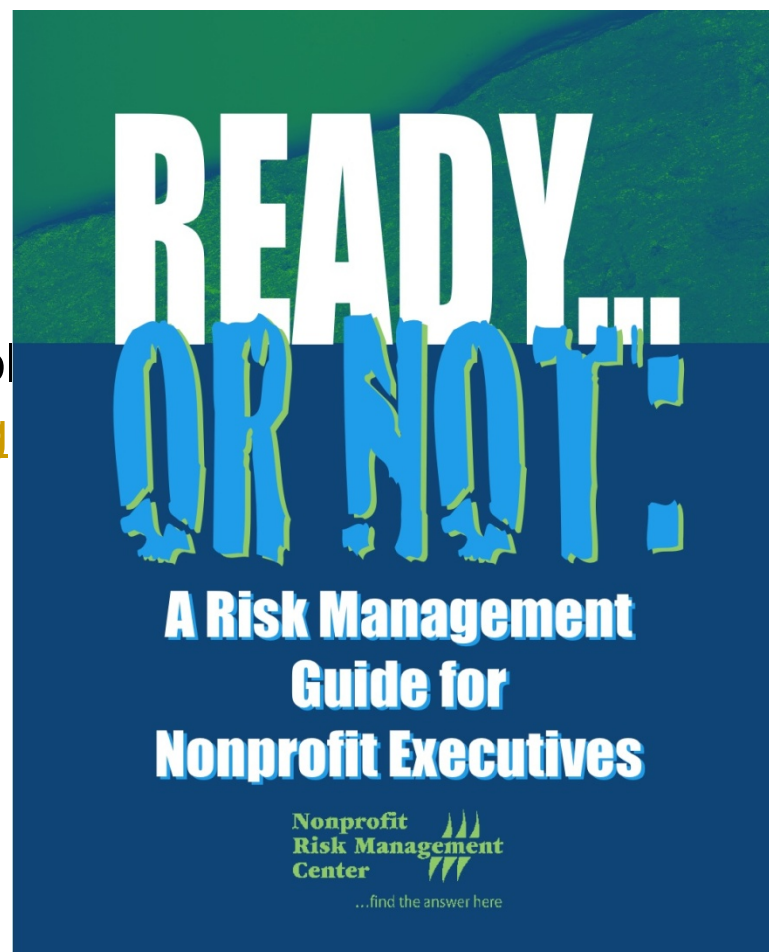
www.myriskmanagementpolicies.org

- Financial Management Planning tool:

www.myfinancialmanagementplan.org

- Institute of Internal Auditors:

www.theiia.org



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