

THE BONADIO GROUP

CPAs, Consultants & More



Understanding Fraud Risks and Fraud Prevention Strategies

Cornell Municipal Clerks School
July 16, 2014

Overview

I. Types of Fraud

II. The Fraud Triangle

III. Which Employees Steal

IV. Fraud Theories and Definitions

V. Most Common Types of Fraud

VI. Fraud in Local Government

VII. Red Flags of Fraud

VIII. Fraud Prevention Strategies



Types of Fraud

- Financial statement fraud
(*Wall Street Journal* cases)
- Misappropriation
(Our Focus for today)
- Identity Theft
(Personal and Corporate)



Cost of Fraud

According to a 2012 Fraud Survey:

- Organizations lose 5% of annual revenue to fraud (*down 2% from 2008*).
- Nearly one-quarter of the cases caused at least \$1 million in losses.
- Fraud costs U.S. companies \$994 billion annually (*up \$342 billion from 2006*).



Cost of Fraud

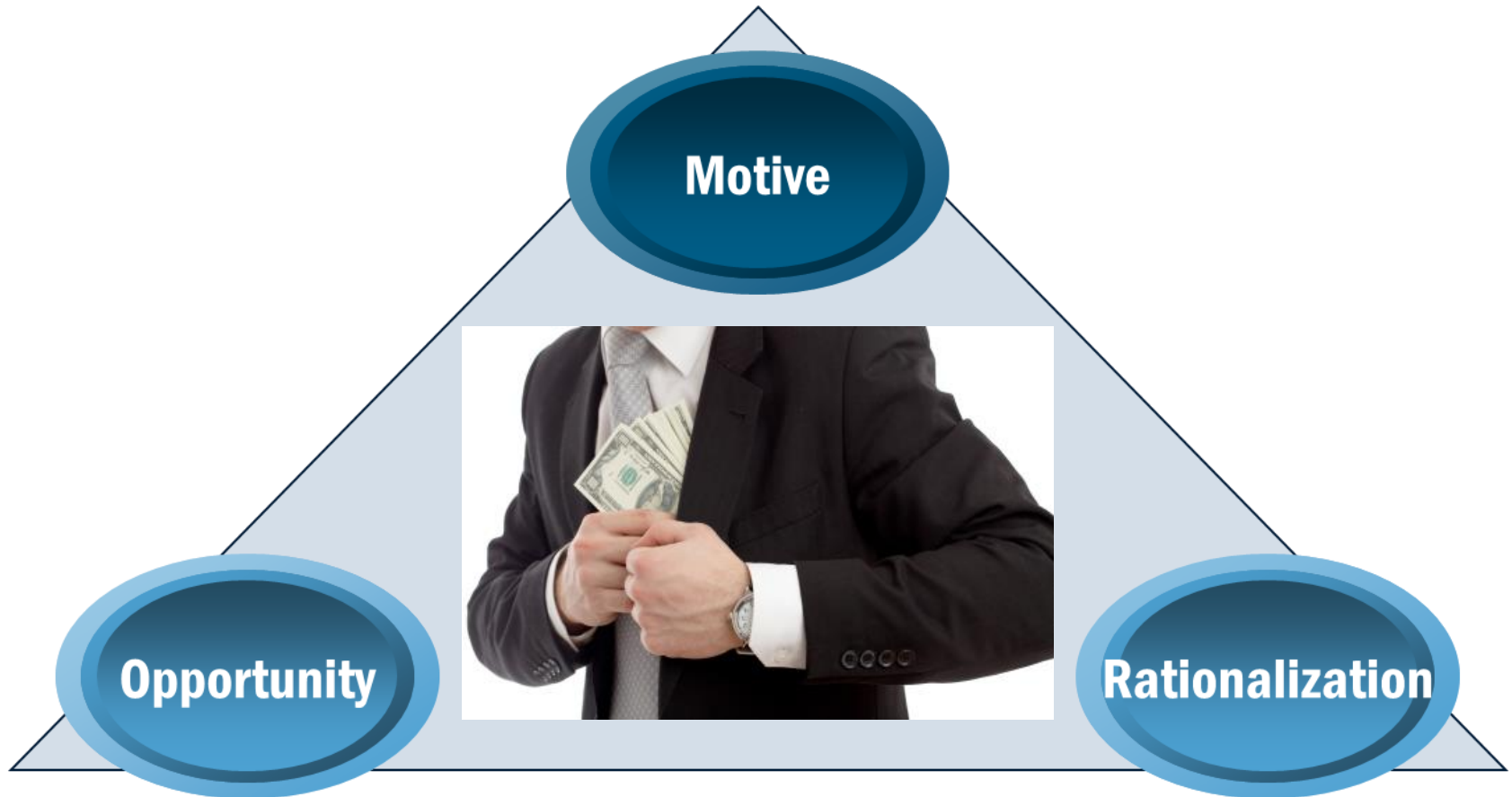
Average Armed
Robbery
Yields \$250



Average White Collar
Crime
Yields \$500,000

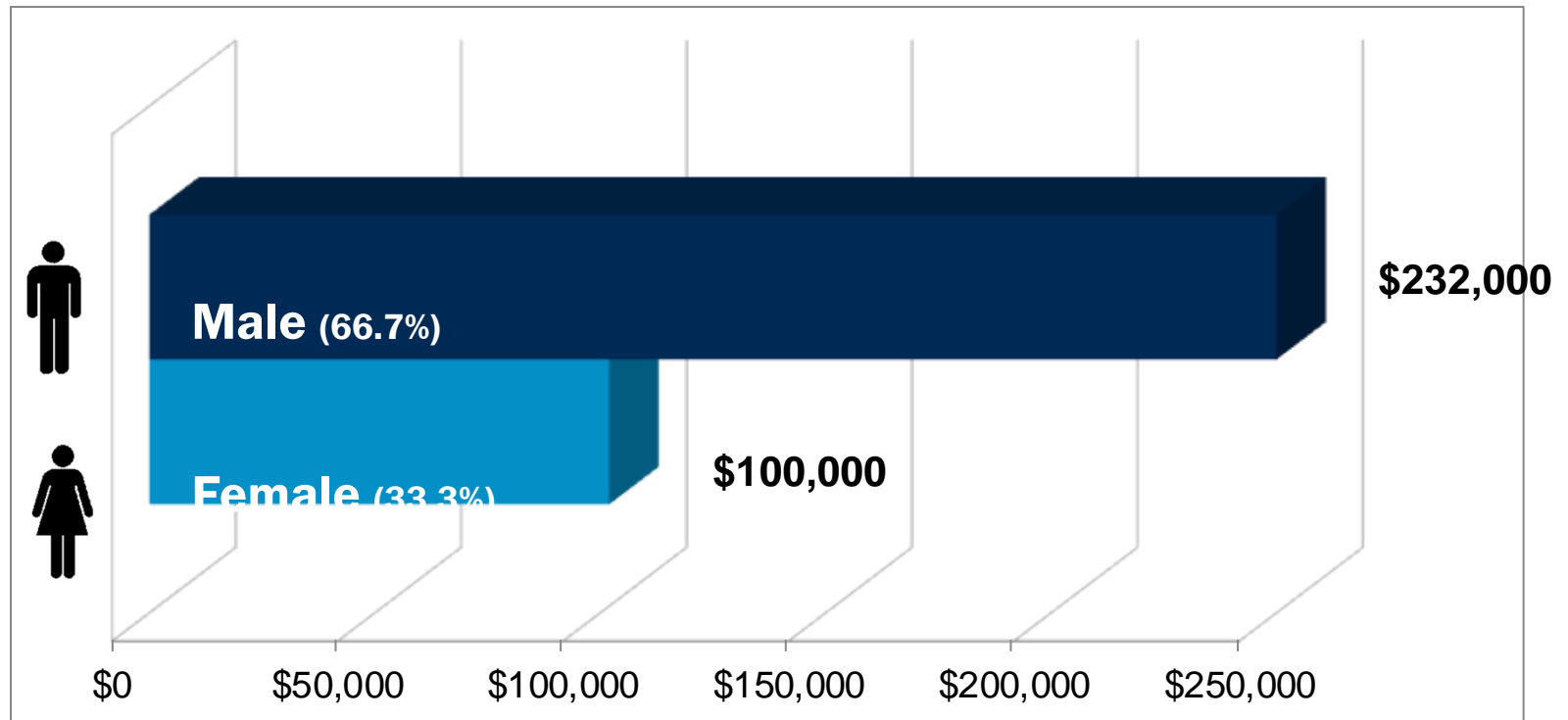


Cressey Fraud Triangle



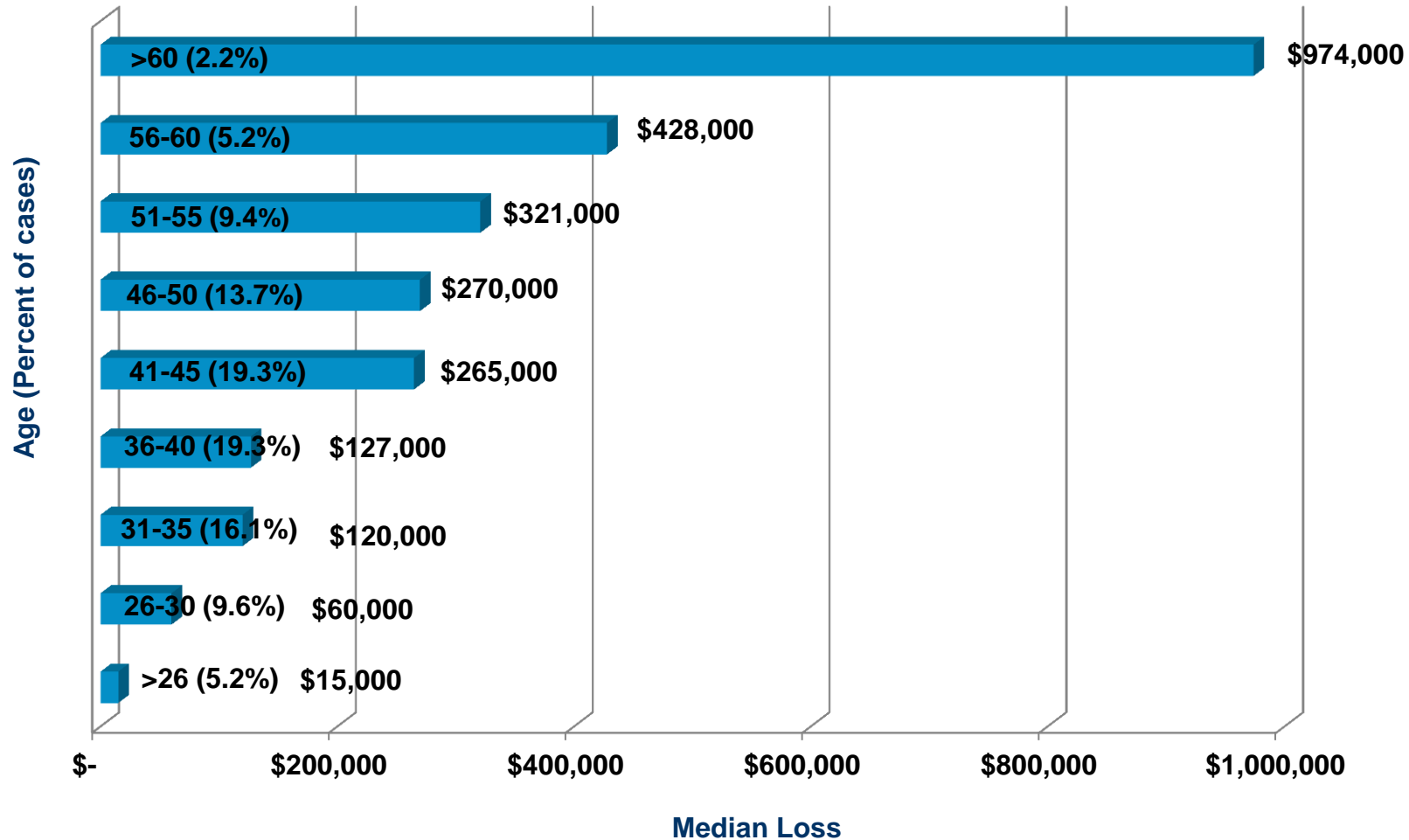
Gender of Perpetrator

Gender/Percent of Cases

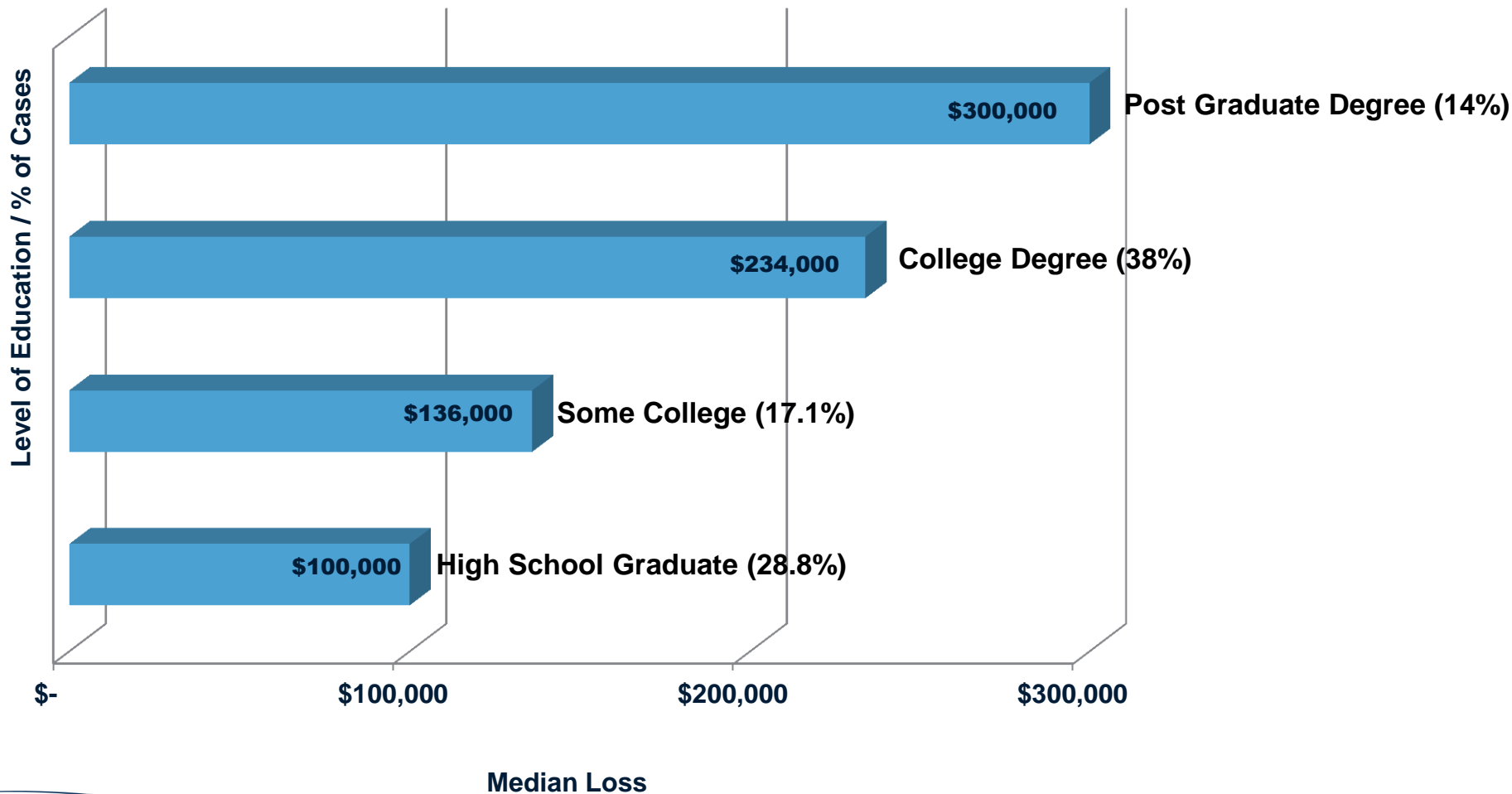


Median Loss

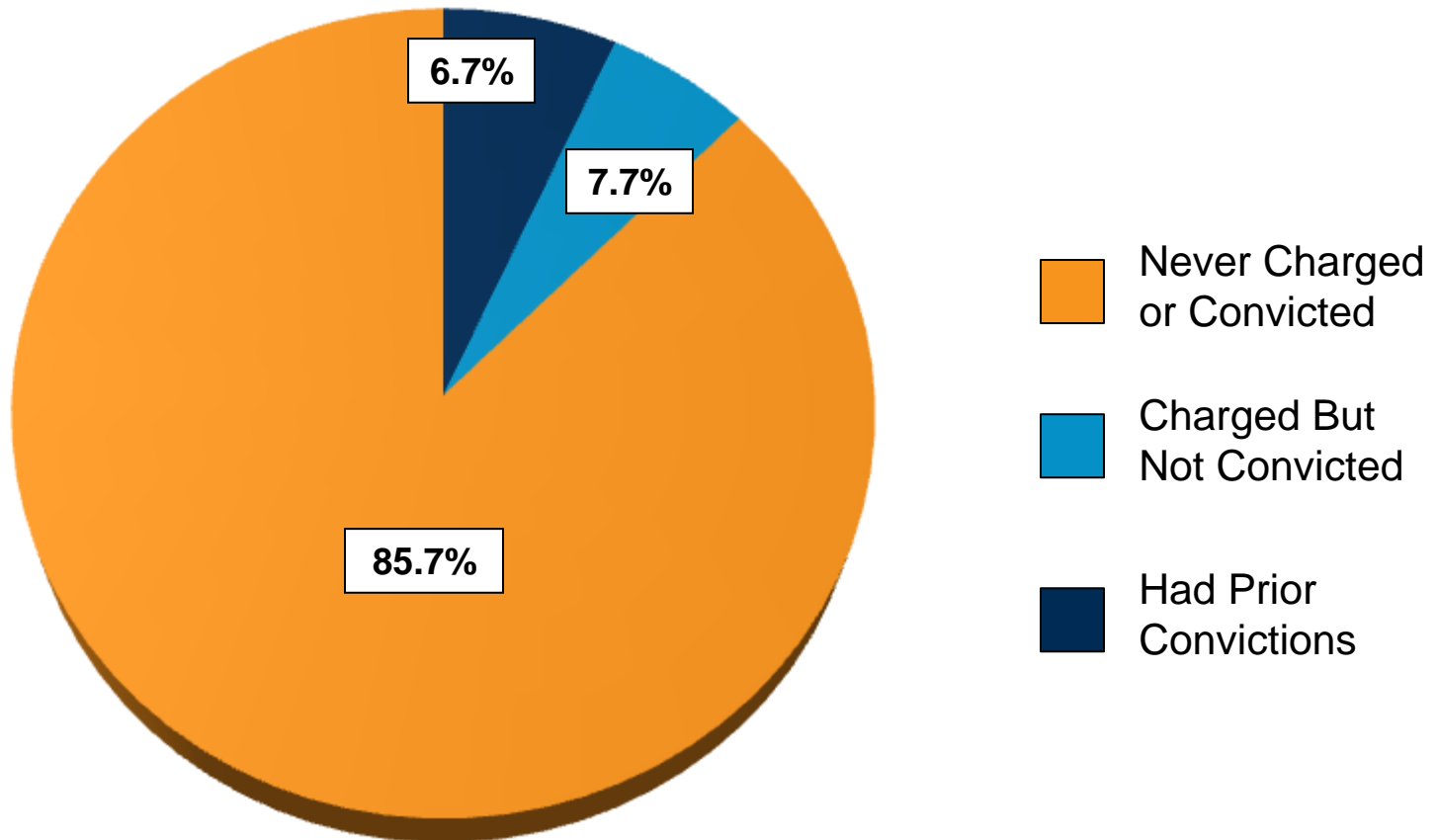
Age of Perpetrator



Loss By Education



Criminal History of Perpetrator



Fraud Theories and Definitions



Watch Out!

Fraud is common, pervasive,
and probably exists at your
organization.

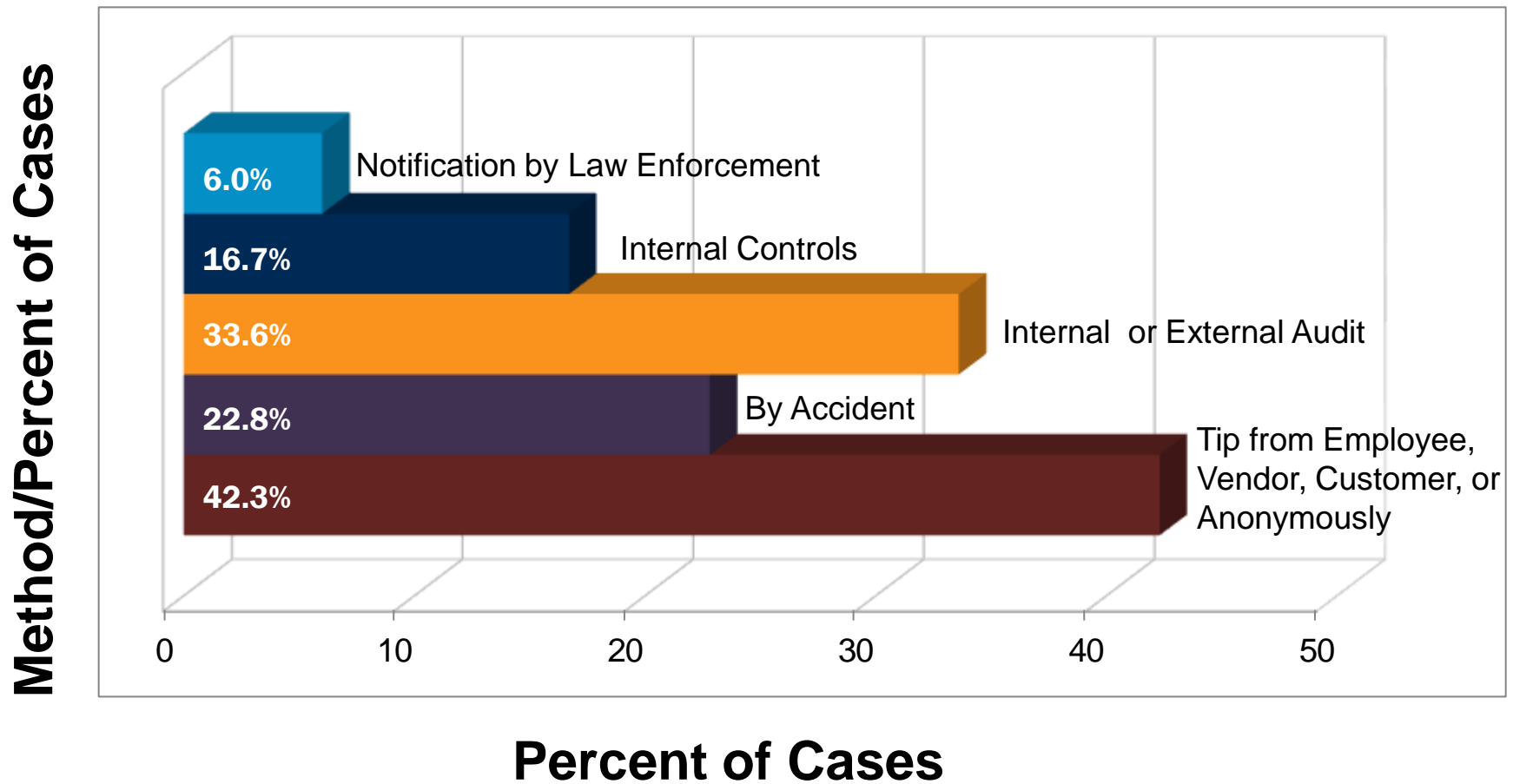
Definition



Fraud is any method employed by one person to deceive another. The elements are:

- Intentional false representation of a material fact
- That induces someone to part with his property
- To his financial detriment

Initial Detection of Frauds



***Total exceeds 100% because some participants cited more than one method of initial discovery of fraud.**

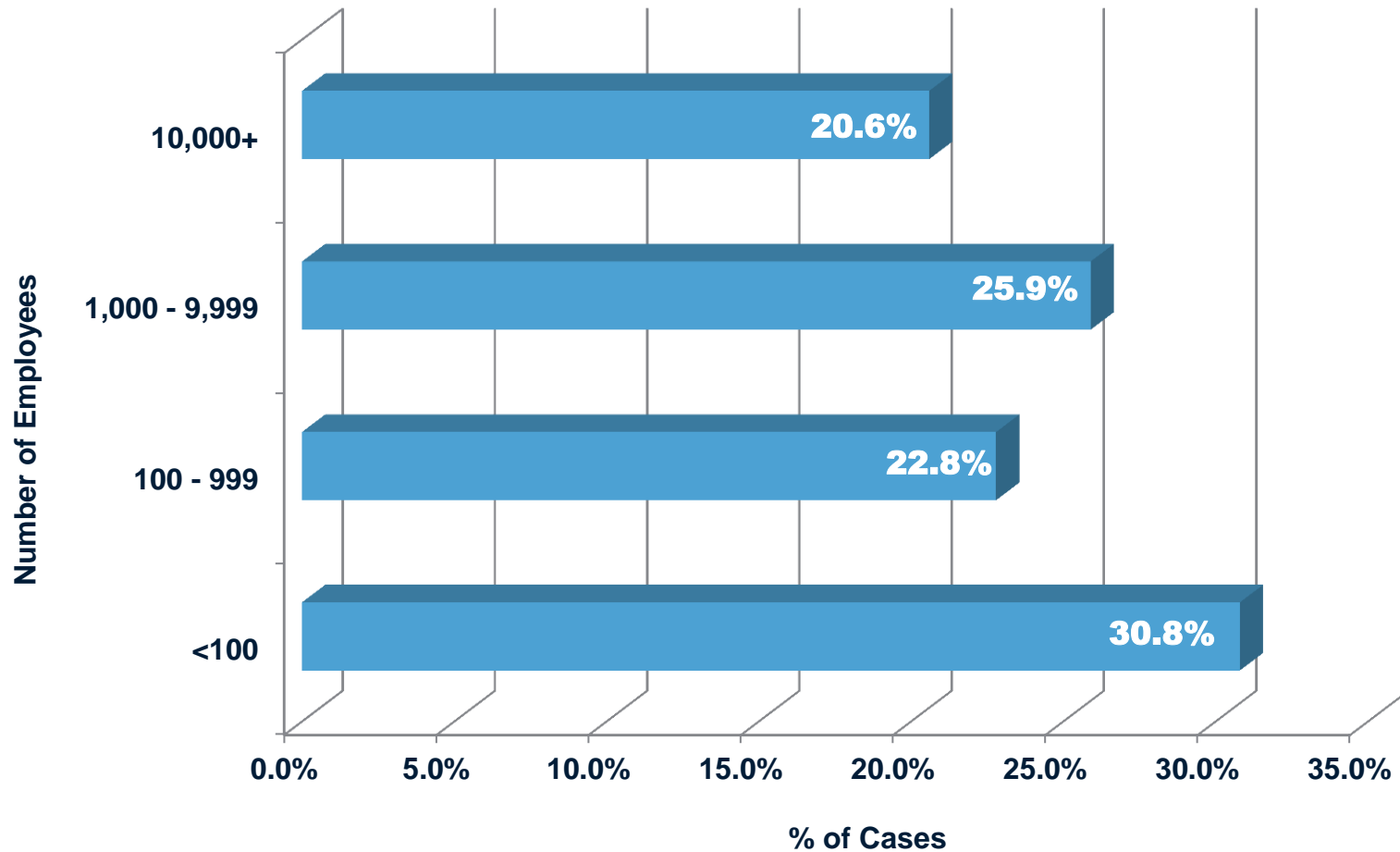
Victims

Organizations with 100 or fewer employees were the most vulnerable to fraud.

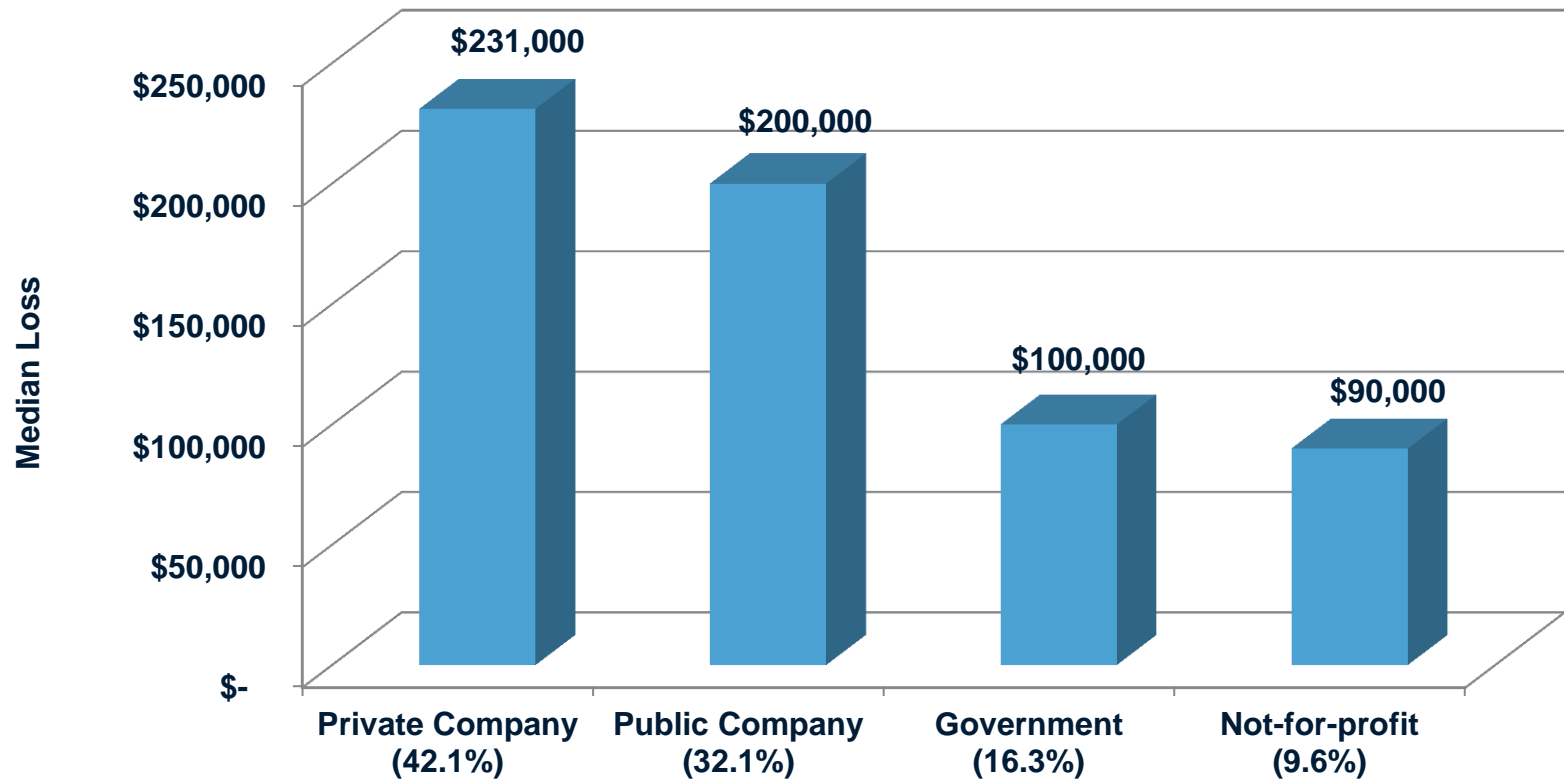
- Less than 10% of small organizations have anonymous fraud reporting systems.
- Less than 20% have internal audit departments, or train employees on fraud.



Size of Victim Organizations



Types of Organizations



Summary

- Fraud is a very serious problem.
- Fraud is vastly underreported.
- There is a direct correlation between the perpetrator's age, gender, position, and the median loss due to fraud.
- The expansion of computers and e-commerce will increase losses due to fraud.
- The rate of fraud will likely rise.

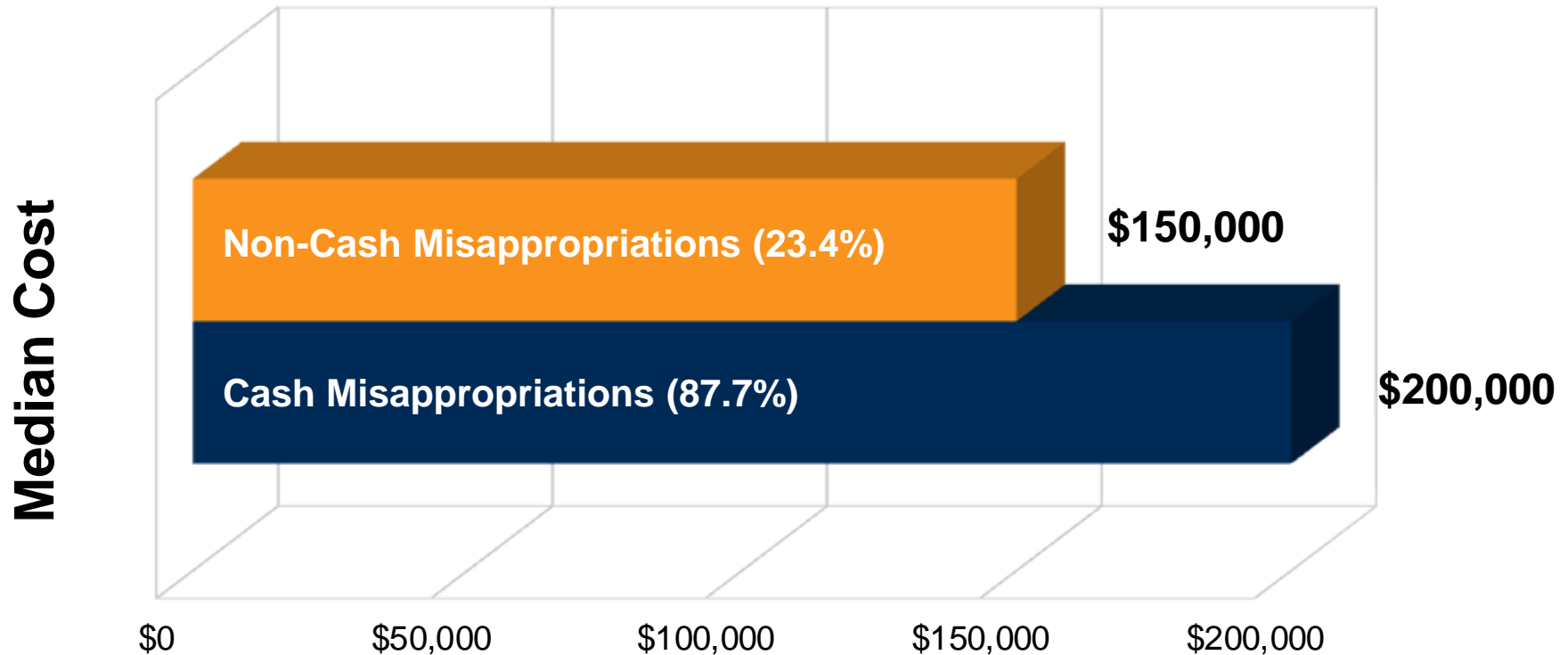


Most Common Types of Fraud

- Cash disbursements
- Cash receipts/billing
- Payroll
- Inventory/Physical assets



Breakdown of Asset Misappropriations



Scheme Type/Percent of Cases

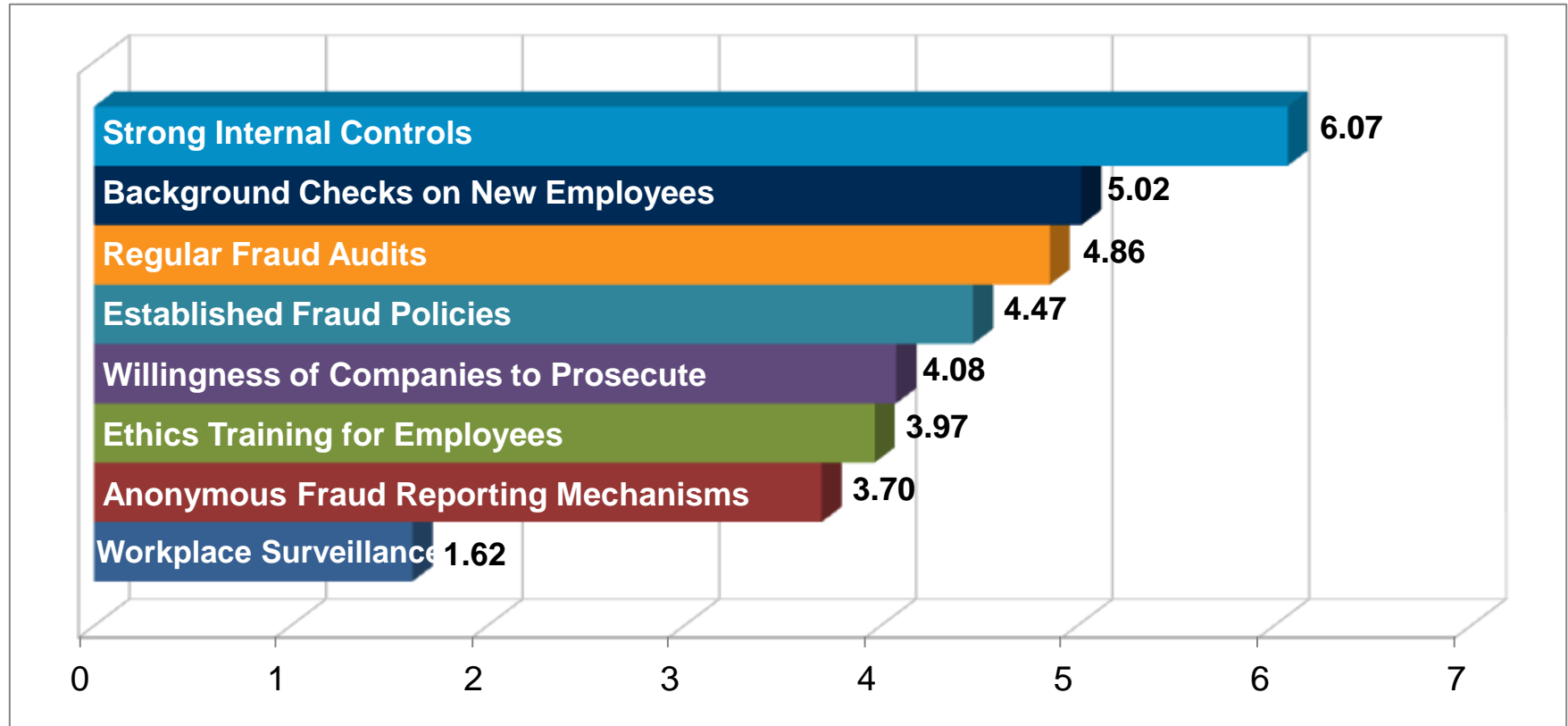
*Total exceeds 100% because some participants cited more than one method of initial discovery of fraud.

Breakdown of Fraudulent Disbursements

- Billing **(28.3%)**
- Expense Reimbursements **(19.5%)**
- Check Tampering **(17.1%)**
- Payroll **(13.2%)**
- Wire Transfers **(6.5%)**
- Register Disbursements **(1.7%)**



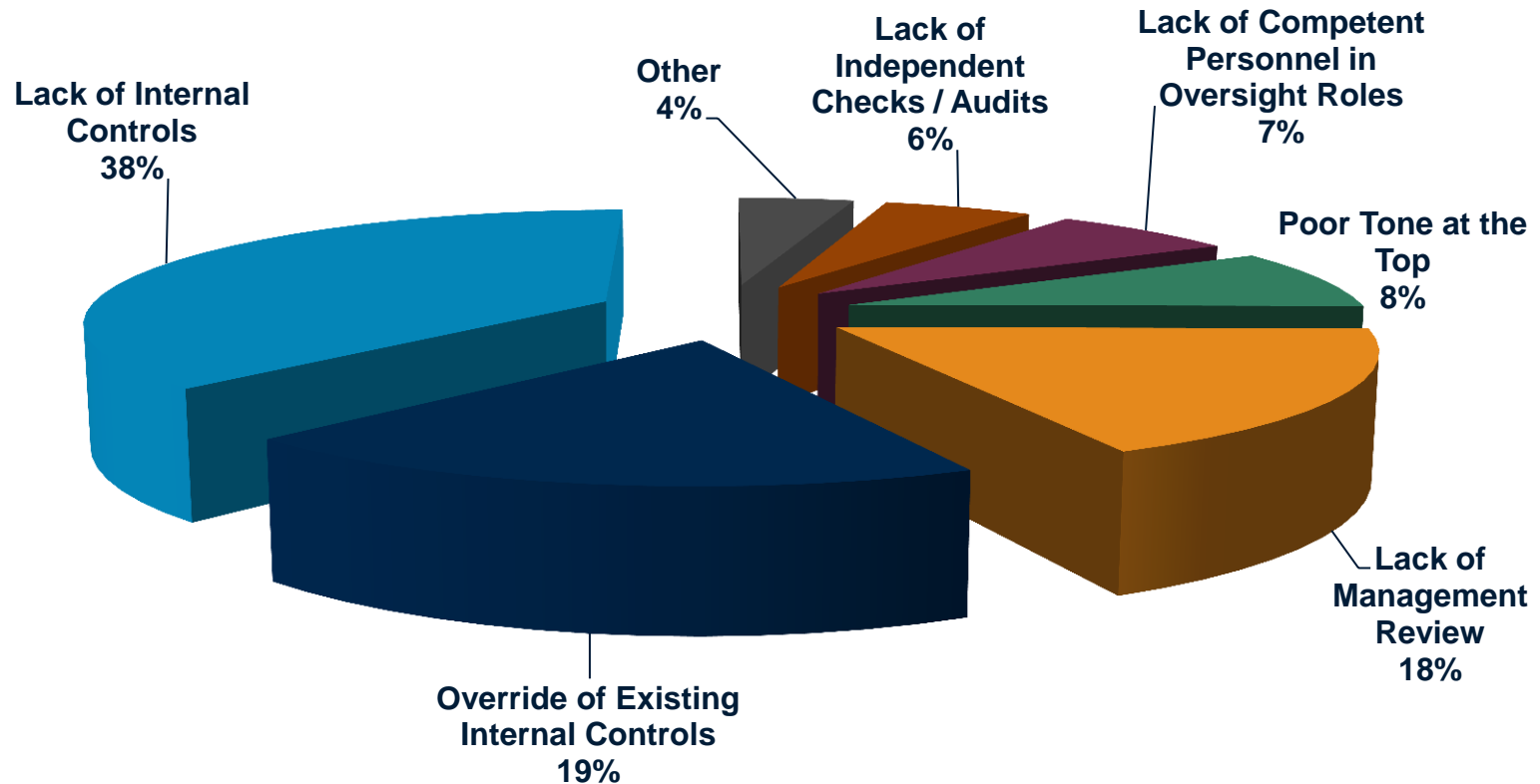
Which Measures Are Most Effective in Preventing Fraud?



Least Effective

Most Effective

Primary Internal Control Weaknesses Observed by CFE's



2010 Fraud Reports

- County of Monroe, Airport Director \$20,000
 - Town of Fairfield, Supervisor's wife \$377,976
 - Aurora Colden Fire District Treasurer \$331,813
 - Bolivar Joint FD, Treasurer \$119,976
 - Town of Ticonderoga, Highway Supt. \$92,000
 - Town of W Seneca, Youth Bur Director \$74,108
 - Town of Sodus, Town Clerk \$53,148
 - Town of Turin, Justice \$37,199
 - Town of Islip Town Clerk \$12,250
 - Village of Port Henry, Clerk-Treasurer \$150,000
 - Village of Andover, Clerk Treasurer \$14,418
- <http://www.osc.state.ny.us/localgov/audits/typeindex.htm>

2013/2014 Fraud Reports

- City of Corning, Clerk \$5,000
- Fund Town of Fishkill, Rec Director \$50,000
- Town of Altona, Bookkeeper \$23,500
- Village of Altmar, Clerk/Treasurer \$100,000
- City of Kingston, Fire Chief \$23,000
- Town of Argyle, Clerk \$8,000
- Village of Old Field, Treasurer \$60,000
- Town of Erin, Highway Superintendent \$50,000
- MET Council of Jewish Poverty, Finance Officer \$9,000,000
- West Seneca Fire District, Treasurer \$55,000
- Crystal Beach Fire Department, Treasurer \$50,000

Personal Experiences—Nick Mazza

“It will never happen to me.”

- City of Syracuse - Payroll Fraud
- City of Cortland – Misappropriation
- Livingston County – Time/Attendance

Red Flags of Fraud

Conditions and symptoms that exist creating an increase in the risk of fraud.



Categories of Red Flags



- Environmental
- Internal Control
- Financial Statement
- Personal

Environmental Red Flags

- Type of Management
- Financial Conditions at Organization
- Communications
- Opportunities for Advancement
- Political Environment



Internal Control Red Flags

- Poor Segregation of Duties
- Weak Management Oversight
- No Job Descriptions
- Management Override
- Lack of Enforcement of Policies



Financial Statement Red Flags



- Unexplained Changes in Revenue
- Changes in Fund Balance
- Changes in Expenses
- Inventory Shortages



Personal Red Flags

- Financial
- Habits
- Feelings
- Others



Financial Red Flags

Need for Money

- Health
- Life Event
- Support of Ex-Spouse and Children
- Maintenance of Life Style



Habit Red Flags



- Drugs
- Alcohol
- Gambling
- Investing
(Day Trader)
- Life Style



Feeling Red Flags

Pressure to Succeed or Keep

- Internal
- Family
- Peer



Feeling Red Flags

Perception of Unfair Treatment By Employer

- Raise
- Promotion
- Perks
- Responsibility
- Discrimination

Resentment of Supervisors

- Inappropriate Treatment
- Greater Competence Than Supervisor
- “Member of Family”

Job Frustration

Depression



Other Red Flags



Abruptly Changed Behavior

- Work Hours
- Eating Habits
- Displays of Wealth
- Attitude Toward Work/
Coworkers
- Secrecy
- Possessiveness



Purchasing Red Flags

- No telephone number on invoice
- No street address on invoice
- Dollar range of invoices is narrow and limited
- Only one person is the contact with vendor
- No independent review of bank statements (unopened)



Purchasing Red Flags

- One person prepares or approves budget
- Same person selects vendor
- Same person approves invoices
- Same person signs receiving reports for materials
- Same person signs checks



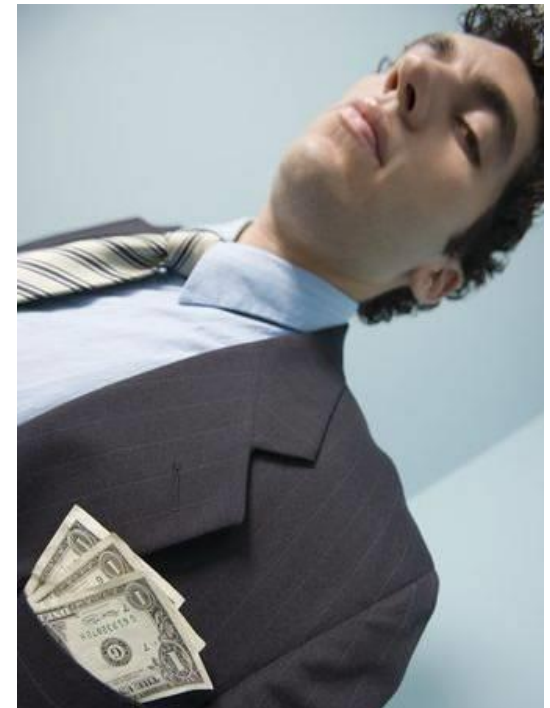
Purchasing Red Flags

- Payments sent to a P.O. Box
- Name of company has initials in it
- Similarity in initials to employee
- Invoices are for services and not materials
- No company conflict of interest policy



Payroll Red Flags

- One person hires employees
- Same person prepares/approves budget
- Same person schedules work
- Employees do not sign time sheets
- Same person reviews/ approves total labor hours
- Multiple locations with no direct supervision
- Same person reviews/approves job performance reports
- Certain employees only work for one supervisor



Kickbacks Red Flags

- One person selects vendors
- Same person approves prices for equipment/materials/supplies
- No competitive bidding
- No independent review of prices/costs
- No company policy re: conflict of interest
- No company policy re: accepting of gifts



Billing/Cash Receipts Red Flags



- One person prepares invoices and handles cash receipts
- Same person opens the mail
- Same person can write off a bad debt
- Same person handles customer complaints
- No review or supervision over invoicing
- Poor control over inventory

Behavioral Red Flags During Fraud Scheme Asset Misappropriation



Should You Focus on Prevention or Detection?

Answer: Both

- Take proactive steps to prevent
- Be skeptical, informed, and alert in order to detect as quickly as possible



Median Loss Based on Presence of Anti-Fraud Controls

Control	Percent of Cases Implemented	Control in Place	Control NOT in Place	Percent Reduction
Hotline	48.6%	\$ 100,000	\$ 245,000	59.2%
Employee Support Programs	44.8%	100,000	244,000	59.0%
Surprise Audits	28.9%	97,000	200,000	51.5%
Fraud Training for Employess	39.6%	100,000	200,000	50.0%
Fraud Training for Managers/Execs	41.5%	100,000	200,000	50.0%
Job Rotation/Mandatory Vacation	14.6%	100,000	188,000	46.8%
Code of Conduct	69.9%	140,000	262,000	46.6%
Anti-Fraud Policy	39.0%	120,000	200,000	40.0%
Management Review	53.3%	120,000	200,000	40.0%
External Audit of ICOFR	59.3%	140,000	215,000	34.9%
Internal Audit/FE Department	66.4%	145,000	209,000	30.6%
Independent Audit Committee	53.2%	140,000	200,000	30.0%
Management Certification of F/S	58.9%	150,000	200,000	25.0%
External Audit of F/S	76.1%	150,000	200,000	25.0%
Rewards for Whistleblowers	7.4%	119,000	155,000	23.2%

How Do You Minimize The Risk of Fraud?

- Set the tone at the top
- Have a written code of ethics
- Check employee references
- Examine the bank statements
- Strong internal controls
- Create a positive work environment
- Have a hotline
- Consult a certified fraud examiner





Any Questions?