


Government Agencies and Fraud Prevention;
Can they coexist?

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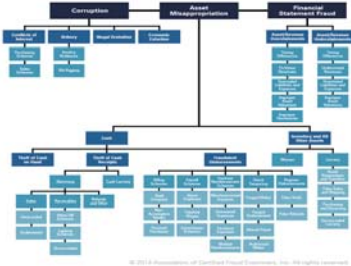
» Background

- **Eide Bailly LLP**
 - Top 20 CPA firm in the nation (Est. 1917)
 - 49,000 clients, 1,600 professionals, 26 offices (12 states)
 - 5 offices in Colorado
- **Self**
 - Over 27 years of law enforcement experience.
 - 9 years private sector fraud investigation experience.
 - Hold CFE, CFI, CFCI designations.
 - Hold Master of Science/Administration of Justice and Security and Master of Business Administration degrees

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Classification of Frauds

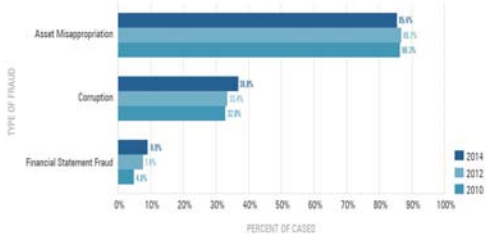
Figure 3: Occupational Fraud and Abuse Classification System (Fraud Tree)



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How Occupational Fraud is Committed

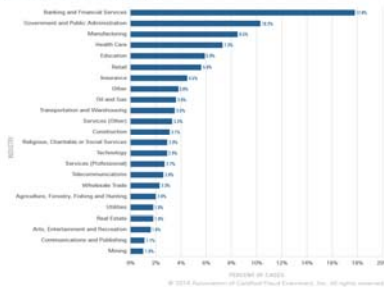
Figure 4: Occupational Frauds by Category — Frequency



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Industry of Victim Organization

Figure 22: Industry of Victim Organizations



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»» Fraud Prevention, even for Governmental Agencies

Prevention
is always easier
than **Detection**



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Pick the Crime

»»

Ever been asked, "What does a criminal look like?"






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Match the suspect to the crime ?

USING A WHIZZINATOR FOR DRUG TEST	BATTERY ON LAW ENFORCEMENT	ATTEMPTED STRANGULATION	EMBEZZLEMENT	BURGLARY
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ATTEMPTED STRANGULATION	EMBEZZLEMENT	USING A WHIZZINATOR FOR DRUG TEST	BATTERY ON LAW ENFORCEMENT	BURGLARY
ATTEMPTED STRANGULATION	EMBEZZLEMENT	USING A WHIZZINATOR FOR DRUG TEST	BATTERY ON LAW ENFORCEMENT	BURGLARY

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?	?	?	?	?
Match the embezzlement suspect to the crime				
Human Resource Theft	Contractor Theft	City Finance Theft	Rental Scam	Stole From PTA

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Stole From PTA	Rental Scam	Contractor Theft	City Finance Theft	Human Resource Theft
Human Resource Theft	Contractor Theft	City Finance Theft	Rental Scam	Stole From PTA

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»» Fraud Profile

- Median loss attributed to owner/executives was **\$500,000**.
 - **\$130,000** for managers
- 77% of frauds were committed by individuals in one of six departments.
 - Accounting, operations, sales, executive/upper management, customer service and purchasing.



Source: ACFE 2014 Report to the Nation

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»» Fraud Profile-continued

- 86.6% of fraudsters had no prior fraud conviction.
- 92% of fraudsters displayed one or more behavioral red flags. Top 4 being:
 - Living beyond means.
 - Financial difficulties.
 - Close association with vendors or customers.
 - Excessive control issues.



Source: ACFE 2014 Report to the Nation

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Why do Employees Steal?

Stepping into the Dark Side.



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Why People Steal

Pressure/Need "Greed" Opportunity

Fraud Triangle

Rationalization

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Will Workers Steal?

Response	Percentage
Will	30%
Might	30%
Won't	40%

Source: Association of Certified Fraud Examiners

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Fraud Survey

- ζ 75% of businesses are victims of fraud.
- ζ 5% of Total Revenue.
- ζ 18 months before detection.
- ζ Less than 100 employees, most vulnerable.
 - Highest median loss except for companies with over 10,000 employees.
 - Median loss per incident = **\$140,000**.
- ζ #1 Reason for Fraud?
Poor, Circumvented or Non-existent Internal Controls.

Source: ACFE 2014 Report to the Nation

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Perpetrator's Position

Figure 42: Median Duration of Fraud Based on Position

Position	Median Months to Detect
Employee	12
Manager	18
Owner/Executive	24
Other	16

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Is it really only money?

How much is normally taken?



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Why are Fraud Investigations Important?

Median losses by type of scheme:

- ζ Asset theft: **\$130,000**
- ζ Corruption: **\$200,000**
- ζ Fraudulent statements: **\$1,000,000**

\$3.7 trillion lost globally to fraud annually.



Source: ACFE 2014 Report to the Nation

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» \$994 Billion Perspective

- The United States spent a total of **\$940** Billion from 2001 to 2009 on the conflicts in Iraq and Afghanistan (combined).
- Companies in the United States lose **\$994** Billion each year to fraud related crimes.
- \$940 Billion divided by 8 = **\$117.5** Billion a year.
- \$994 Billion times 8 = **\$7.952** Trillion dollars.



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» Committee of Sponsoring Organizations

- Analysis of U.S. Public Companies from 1998 to 2007.
 - Financial Fraud affects companies of all sizes.
 - Median size company had revenue of **\$100M**.
 - Median lose in these companies was **\$12.1M**.
 - **30** companies lost **\$500M** or more.
 - CEO and CFO's (combined) were involved in **89%** of frauds examined.
 - Initial news of fraud resulted in a **16.7%** stock price decline.

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Fraud Triangle


What causes it to happen?



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» Pressure


- Lifestyle
- Personal debt:
 - Financial losses
 - Gambling
 - Drugs
 - Pornography
- Job dissatisfaction.
- Challenge to beat the system.



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» Pressure-continued


- The right amount of pressure can cause even honest people to commit fraud.
- Employees under lots of pressure should not be given the opportunity to commit fraud.



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» Opportunity

- The employee obtains a level of "trust" within the company.
- The employee has the ability to somehow "exploit" their job duties and responsibilities.



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Opportunity – Contributing Factors

- Lack of controls.
- Inability to judge the quality of work.
- Lack of access to information.
- No audit trail.
- Lack of discipline.
- Ignorance or apathy.
- No proper "Tone at the Top" has been set.



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Rationalization

- A "fraudster" must be able to justify the fraud in order to make the fraudulent actions consistent with his/her personal code of conduct.



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Common Rationalizations

- "I'm only borrowing the money; I'll pay it back."
- "Everyone does it, besides the company can afford it."
- "I'm not hurting anyone."
- "It's for a good purpose."
- "It's not that serious."
- "They owe it to me. I deserve to get paid more."



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Fraud; a walk on the dark side

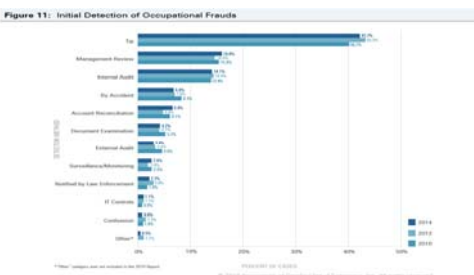
How are they uncovered or prevented??



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Detection of Fraud Schemes

Figure 11: Initial Detection of Occupational Frauds




Category	2014	2013	2012
Tax	52.2%	51.2%	50.2%
Management Review	23.2%	22.2%	21.2%
Internal Audit	18.2%	17.2%	16.2%
By Accused	12.2%	11.2%	10.2%
Account Reconciliation	10.2%	9.2%	8.2%
Management Examination	8.2%	7.2%	6.2%
External Audit	6.2%	5.2%	4.2%
Investigation & Enforcement	4.2%	3.2%	2.2%
Identified by Law Enforcement	2.2%	1.2%	0.2%
IT Controls	1.2%	0.2%	0.2%
Confidence	0.2%	0.2%	0.2%
Others	0.2%	0.2%	0.2%

Source: ACFE 2014 Report to the Nation

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Fraud Prevention


- *Basic principle:*
 - People rarely commit fraud if they think they will be caught.
- *Perception of detection:*
 - **Most** effective deterrent to fraud.



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» Increase Perception of Detection


- **“Tone at the Top”**
 - Managers need to communicate the idea that they are serious about their fraud detection and prevention efforts.
- **Employee Education**
 - Internal controls for monitoring employees.
 - Company fraud (ethics) policy.



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» Increase Perception of Detection

- Proactive audit policies:
 - Surveillance
 - Fraud assessment questioning
 - Mandatory vacations
 - Fraud Reviews
- Reporting program:
 - Hotline
 - Most frauds are uncovered by a tip.




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Internal Controls

»

What do they look like?



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» Internal Controls = Management Controls

- Organization’s policies and procedures that provide reasonable assurance that entities:
 - **Achieve intended program results.**
 - Use resources consistent with their mission.
 - Deter fraud, waste and mismanagement.
 - Follow laws and regulations.
 - Obtain and report accurate information.
 - **Resolve audit findings promptly.**

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» Management Control Objectives

- An integral component of an organization’s management that provides reasonable assurance that the following objectives are being achieved:
 - **Effectiveness and efficiency of operations,**
 - Proper “tone at the top” is being provided,
 - Reliability of financial reporting, and
 - Compliance with applicable laws and regulations

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» Practical Issues

- Number of staff
- Resources available
- Cost vs. Benefit



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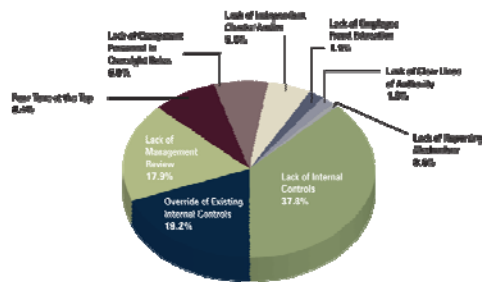
Internal Controls

- The objectives of effective internal controls are to:
 - Encourage compliance with the company's prescribed policies and procedures.
 - Promote operational efficiency.
 - Safeguard company assets.
 - Ensure accuracy and reliability of financial reporting system.



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Primary Internal Control Weaknesses



Source - 2014 ACFE Report to the Nations

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What Internal Controls Can Do

- Help achieve performance goals and objectives.
- Help prevent loss and resources.
- Help ensure reliable reporting.
- Help ensure compliance with laws and regulations.



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»» What Internal Controls **Cannot** Do

- Internal Controls can only help an entity achieve its goals and objectives.
 - They cannot change inherently poor management or shifts in government policy.
 - They cannot provide absolute assurance, only reasonable assurance.
 - They cannot prevent simple errors and mistakes.
 - **They can't stop someone from stealing, only make it more difficult.**

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»» Fraud Prevention Components

- Risk Assessment.
- Incorporation of additional I/C.
- Strong Polices with enforcement.
- Fraud Awareness Education.
- Whistleblower policy.
- Fraud Hotline.
- Internal Audit Department.



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»» Effective System of Internal Control

Segregation of duties:

- Authorization
- Record keeping
- Custody of assets



Physical control over assets and records

- Secured check stocks.
- Controlled access to inventory.

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Effective System of Internal Control

- **Independent checks** on performance
 - Review & follow-up of financial performance indicators.
 - Documentation of follow-up and resolution of issues.
- **Reporting program** (hotline, open-door policy)
 - How is program communicated to staff?
- **Vigorous pursue** dishonest acts
 - Criminal and/or Civil prosecutions



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Basic Internal Controls

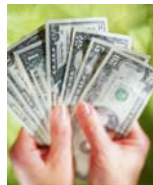
- Segregation of Duties:
 - Authorization
 - Record keeping
 - Custody of assets
- Proper procedures for authorization.
- Adequate documents and records.
- Physical control over assets and records.
- Independent checks on performance.



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Internal Controls: Cash Receipts

- Separate cash handling from record keeping.
- Two people should open mail:
 - First opens mail.
 - Second prepares cash remittance list.
- Deposit receipts ASAP.
- Reconcile deposit slips to cash remittance lists.



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Examples of Control Activities

- Change computer passwords.
- Periodic analysis.
- Require vacations.
- Cross train employees.
- Budget vs. actual review.



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Don'ts

- HAVE subordinates approve boss' travel or expense reimbursements.
- HAVE too many controls.
- HAVE inversely – not enough controls. (can be a fine line)
- HAVE no reconciliations.
- HAVE too much trust in one person.



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Fraud and Internal Controls

- Internal fraud schemes typically exploit one or more deficiencies in basic internal controls.
- Best way to prevent the schemes:
 - **Implement and adhere to basic internal controls**



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»» Fraud and Internal Controls

- Remember, **Fraud** is the product of one, or a combination, of the following three items:
 - Opportunity
 - Pressure
 - Rationalization
- **Effective internal controls** – many employees only do what you “inspect”, not what you “expect”
 - Internal controls cannot prevent fraud.
 - Internal controls only detect fraud in timely manner.

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»» Explaining a Fraud

- An accounting mind set or explanation **cannot** be used to explain a fraud.
- The numbers could match because the fraudster **LIED**.
- Every fraud has its own story to tell, they just need a good listener to understand them.
- Fraud, Embezzlement, Employee Theft (you pick the title) is a business for the fraudster and they work hard to steal **your** money on a daily basis.

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»» Why Don't Auditors Detect Fraud?

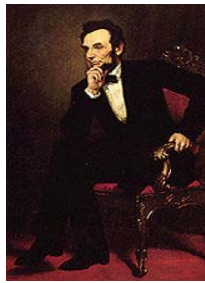
- Asset-Theft Fraud:
 - Financial statements are fairly presented.
 - Financial statement audits are not designed to uncover assets-theft frauds.
- Financial Statement Fraud:
 - Financial statements are not fairly presented.



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»» Keeping Honest People Honest

Management has an ethical and a legal responsibility to "safeguard" the organization's assets by implementing basic internal controls to make it difficult for employees to steal.



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Fraud in the News

Public Monies being used Incorrectly.



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»» Revenue collections embezzled

- **Garfield County, CO**- A former county employee was arrested for embezzling **\$194,603.50** from the Clerk and Records office. The funds were taken between 2013 and 2014.

- County population: 57,302

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City Employee involved in taking \$438,000

• **Chico, CA**- A former city employee and two family members involved is stealing **\$438,000** in city funds. Money taken from the city's employee health savings reimbursement account and cashing city checks not issued to them.

• City population: 86,290

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City Clerk gets 2 years for Embezzlement

• **Weybridge, VT**- Former town clerk asked for forgiveness after embezzling more that **\$400,000** in taxpayer funds over 6 years. The clerk was a 26 year employee of the town.

• Town population: 824

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Embezzlement hits 2 Fire Departments

• **Lincoln County, NC**- Former fire department employe misappropriates money from two (2) separate fire departments. Denver, NC Fire Department loses **\$3,934.98** and the East Lincoln Fire Department lost **\$17,818.74** to false invoices.

• Denver, NC population: 2,309
• East Lincoln, NC population: 78,265 (county)

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County Employee accused of taking \$140K

• **Orangeburg County, SC-** A former County Treasurer's office employee was arrested after an investigation uncovered she had taken **\$140,000**. The employee wrote personal checks to the county to cover the amounts she had taken from April 2 2012 to Jan, 14 2013.

• County population: 13,885

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County Treasurer sentenced for embezzlement

• **Texarkana, AR-** Elected official sentenced to prison for embezzling **\$282,036.87** in public funds. The official was responsible for collection and administration of all funds collected and dispersed within Lafayette County.

• County population: 7,252

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County Commissioner faces prison

• **St. Joseph, MI-** A former Berrien County commissioner is facing prison for embezzling **\$100,000**. The commissioner served as director of the North Berrien Senior Center. Money was used to support a gambling habit.

• County Population: 155,252

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»» City Comptroller arrested

- **Dixon, IL**- Former comptroller is accused of misappropriating more than **\$30 million** in city funds and using the money to support a "lavish lifestyle" including a farm with over 150 horses.
- City population: 15,333

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Finishing Up



Things to Remember



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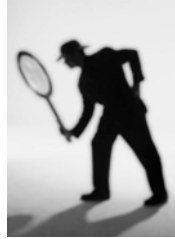
»» It can be this simple.

- "Trust but verify" is a great moto.
- "Trust" is NOT an internal control and employees whom were "trusted" took a lot of money from their employers.
- "Verifying" someone's work, helps keep them from being accused of doing things they didn't do.
- "Questioning" the things we don't understand, will help keep issues from being unresolved.
- "See something, say some thing" also works in the workplace and not just the airport.

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»» Even for Governmental Agencies

Prevention
is always easier
than **Detection and**
costs less



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First Question??

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»» 4 Frequent Questions I am asked

- Are you related to Johnny?
- Did you change your last name to work fraud?
- Does your middle initial stand for "embezzle?"
- What's the biggest difference between what you do now and when you were a detective?



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Thank you for allowing me to speak.

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