



WEDNESDAY'S
News You Can Use

Preventing and Detecting Fraud

Presented by

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Carl Vinson
Institute of Government
UNIVERSITY OF GEORGIA



Today's Presenter



Samuel Latimer is a certified public accountant with Rushton, LLC, with offices in Gainesville, Carrollton, and Cumming, Georgia. The firm specializes in auditing and consulting with local governments, authorities and nonprofits. He is an audit partner in the firm's governmental and nonprofit division.

Samuel has over 15 years of experience working with local governments of all sizes assisting them with financial statement audits, internal controls, compliance, Single Audits, bond issuances, chart of accounts and other governmental areas. He is a frequent presenter at the annual GGFOA Conference and has assisted many governments throughout Georgia.

Samuel is a graduate of the University of North Florida and Auburn University. He holds a B.B.A in Accounting and a Master of Accountancy. He is a member of the Georgia Society of CPAs, Government Finance Officers Association (GFOA), Georgia Government Finance Officers Association (GGFOA), Association of Certified Fraud Examiners (ACFE), and the American Institute of Certified Public Accountants (AICPA), including their Governmental Audit Quality Center.

Learning Objectives

In this session, you will:

- Learn about the fraud triangle
- Learn common fraud schemes in local governments
- Learn where governmental fraud happens most often
- Understand that fraud is committed by honest, ordinary people
- Identify anti-fraud controls that your government can use to deter, prevent, and detect fraud

Fraud

In General

What is fraud?

- Occupational Fraud - According to the ACFE, “The use of one’s occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization’s resources or assets.”
- Asset misappropriations are by far the most common type of occupational fraud. Per ACFE Report to the Nation, occurs in over 90% of all cases.

Elements of Fraud

- A representation
- About a material point
- Which is false
- And intentionally or recklessly so
- Which is believed
- And acted upon by the victim
- To the victim's damage

Fraudsters

What does a fraudster look like?

Profile of a FRAUDSTER

Our study includes demographic information on more than **1,400** occupational fraudsters from more than **100** countries.



Knowledge Check

What percentage of fraudsters are male?

- A. 23%
- B. 51%
- C. 12%
- D. 67%

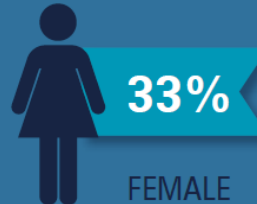
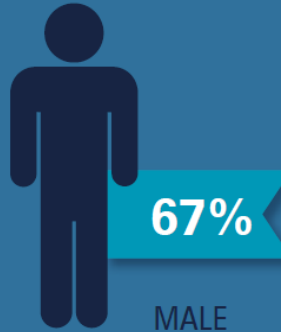
Fraudsters

- What do they look like?
- No psychological profile
- Usually male
- Usually a first-time offender

Fraudsters

GENDER

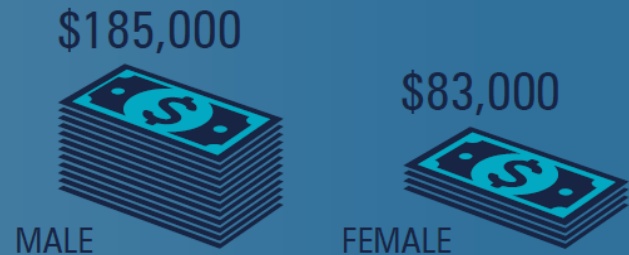
Male fraudsters outnumbered females two to one.



Fraudsters

MEDIAN LOSS BY GENDER

Losses attributed to males were **123%** higher than losses caused by females.



Fraudsters

POSITION

The majority of occupational frauds were committed by staff at the employee or managerial level.



EMPLOYEE



MANAGER



OWNER/EXECUTIVE

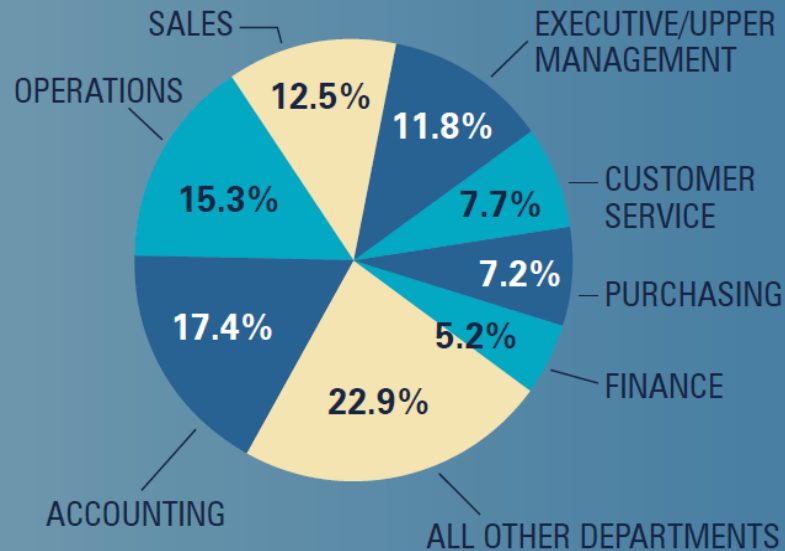
Fraudsters



Fraudsters

DEPARTMENT

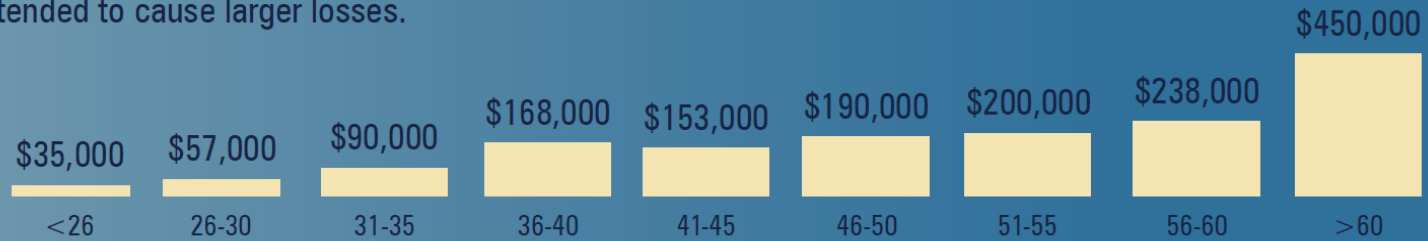
77% of all occupational frauds originated in one of seven organizational departments: accounting, operations, sales, executive/upper management, customer service, purchasing and finance.



Fraudsters

AGE

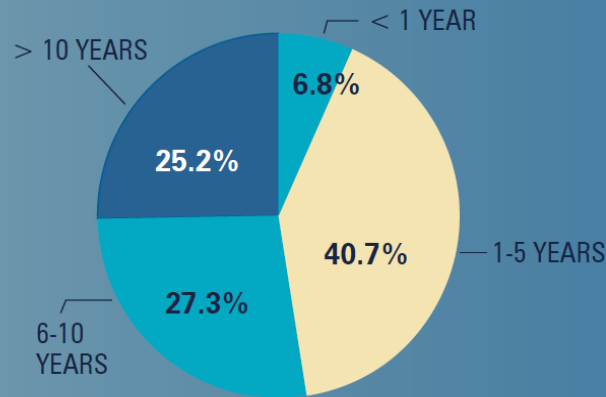
52% of fraudsters were between 31 and 45 years old, but older fraudsters tended to cause larger losses.



Fraudsters

TENURE

7% of perpetrators committed fraud during their first year on the job. 53% had been with their organizations for more than five years.



Fraudsters

MEDIAN LOSS BY TENURE

The longer a fraudster had worked for a company, the more harm he or she was likely to cause.

• \$ • \$51,000

< 1 YEAR

• \$ • \$100,000

1-5 YEARS

• \$ • \$200,000

6-10 YEARS

• \$ • \$220,000

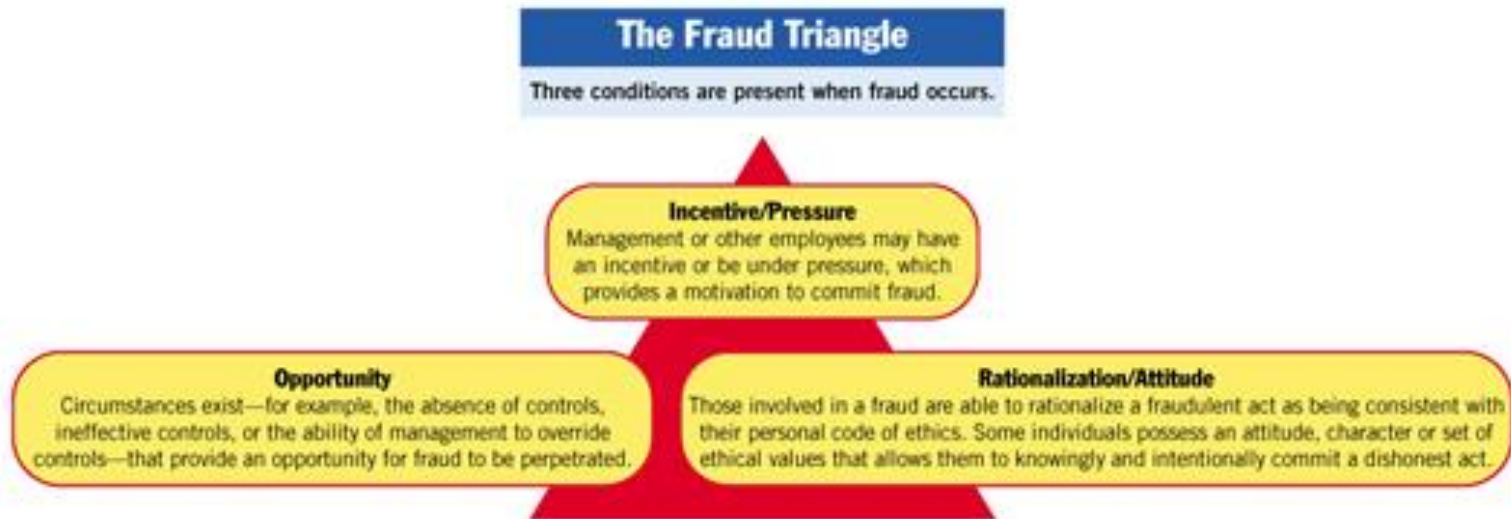
> 10 YEARS



Why Does Fraud Happen?

- Opportunity!!!
- Trusting – we trust too much
- Often a “I can’t believe it” or “They would never do that” response
- Greed – rules many decisions
- The perpetrator is not the only one

Fraud Triangle



Fraud Triangle - Pressure

Typical pressures include:

- Debt
- Addictions: alcohol, gambling, drugs
- Family problems: health, marital



Fraud Triangle – Rationalization

Rationalization might include:

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



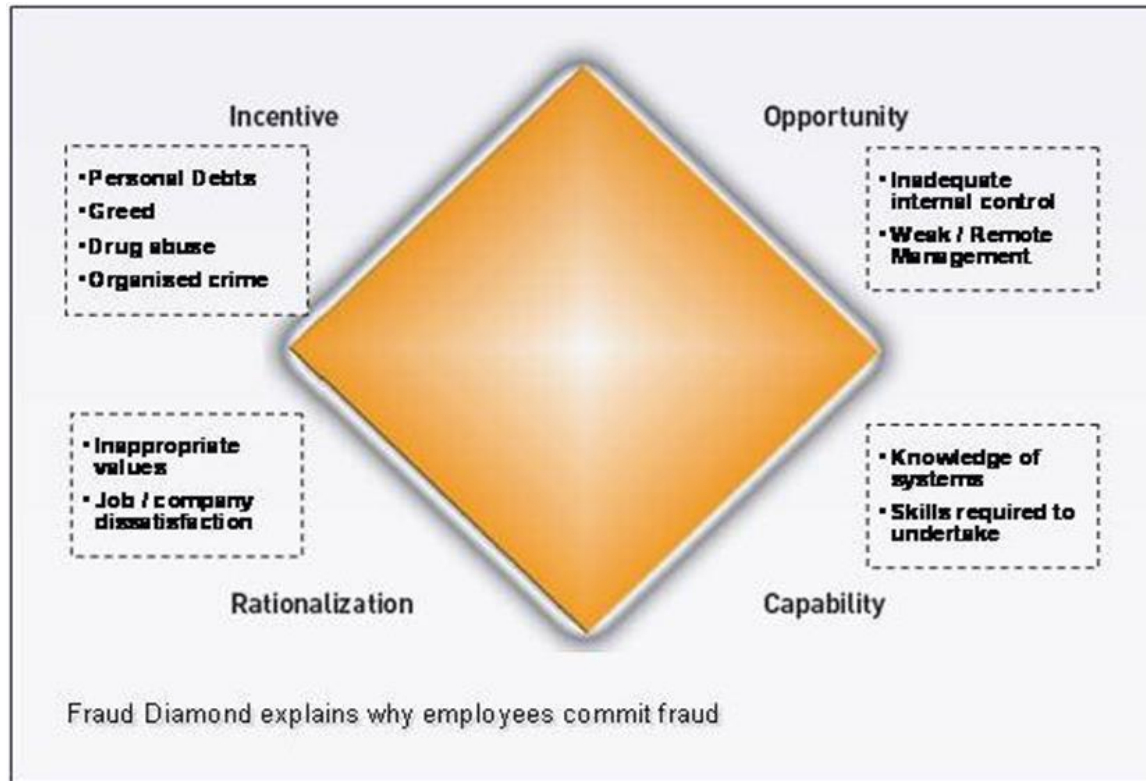
Fraud Triangle - Opportunity

Opportunity includes...

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



Fraud Diamond



Red Flags

- In approximately 85% of cases of occupational fraud, red flags exist.
- Knowing red flags will give you a huge advantage to detecting fraud.

Red Flags

3 types of red flags

- Behavioral
- Organizational
- Document

Red Flags - Behavioral

- Lifestyle doesn't seem to match salary or a lifestyle that suddenly increases substantially.
- Financial Issues/high personal debt.
- Control issues/not sharing duties.
- Unusual close association with vendors.

Red Flags - Behavioral

- Wheeler dealer attitude
- Addictions, family problems
- Never takes a vacation
- Comes in early, leaves late
- Behavioral change
- Instability

Red Flags - Organizational

- Lack of ethical tone at the top.
- Lack of documented policies and procedures.
- Failure to follow policies & procedures.
- Low employee morale.
- High employee turnover.

Red Flags - Document

- 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

Red Flags - Document

- 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

Fraud Risk Factors

Events or conditions that...

- Indicate an incentive or pressures to perpetuate fraud
- Provide an opportunity to commit fraud
- Indicate attitudes or rationalizations to justify a fraudulent action

Fraud Risk Factors

Possible responses to risk

- 1. Avoid it.
- 2. Live with it.
- 3. Share it (or transfer it to someone else).
- 4. Attempt to manage it.

What contributes to fraud occurring?

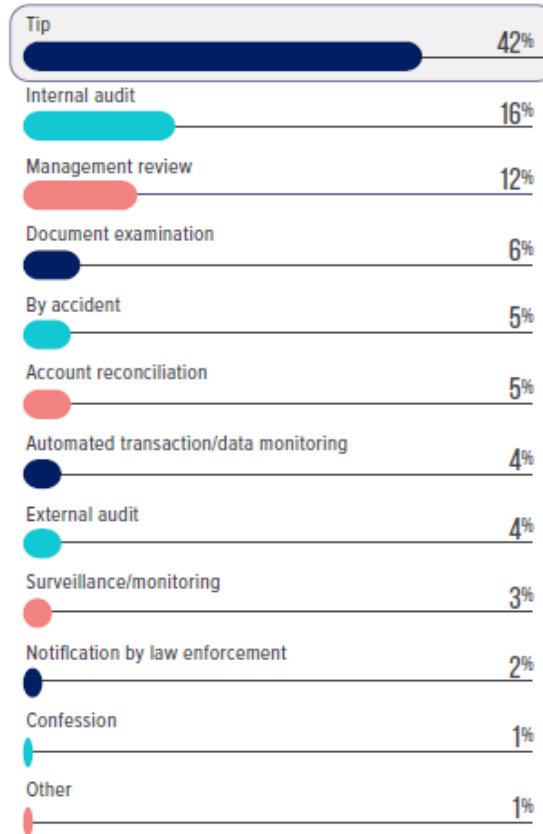
- Lack of internal controls
- Lack of management review
- Override of existing control
- Poor tone at the top
- Lack of competent oversight

Fraud Prevention

Who is responsible for fraud prevention?

How is fraud detected?

FIG. 10 HOW IS OCCUPATIONAL FRAUD INITIALLY DETECTED?



AU-C Section 315 – Understanding the Entity and Its Environment and Assess RMM

- Should obtain a sufficient understanding of the entity and its environment including internal control
- to assess the risk of material misstatement due to fraud or error
- to design the nature timing and extent of audit procedures
- Should assess fraud risk factors

AU-C Section 240 Consideration of Fraud in a Financial Statement Audit

- Identify and assess the risks of material misstatement of the financial statements due to fraud or error.
- Obtain sufficient appropriate audit evidence regarding assessed risks of material misstatement due to fraud – through designing and implementing appropriate responses
- Respond appropriately to fraud or suspected fraud.

Auditor's Responsibility

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

Management's Responsibility

Responsibilities of Management and Those Charged With Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about XYZ Not-for-Profit Organization's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Knowledge Check

How is fraud usually detected?

- A. Internal Auditors
- B. Tip
- C. Employees
- D. Accident

Fraud Prevention

What can we do to prevent fraud?

What can we do?

- Opportunity is the side of the triangle that organizations can best impact.
- #1 contributor to fraud occurring is lack of internal controls.
- Have you ever been to an organization that has one person in complete control of a process?

Internal Control

COSO Model



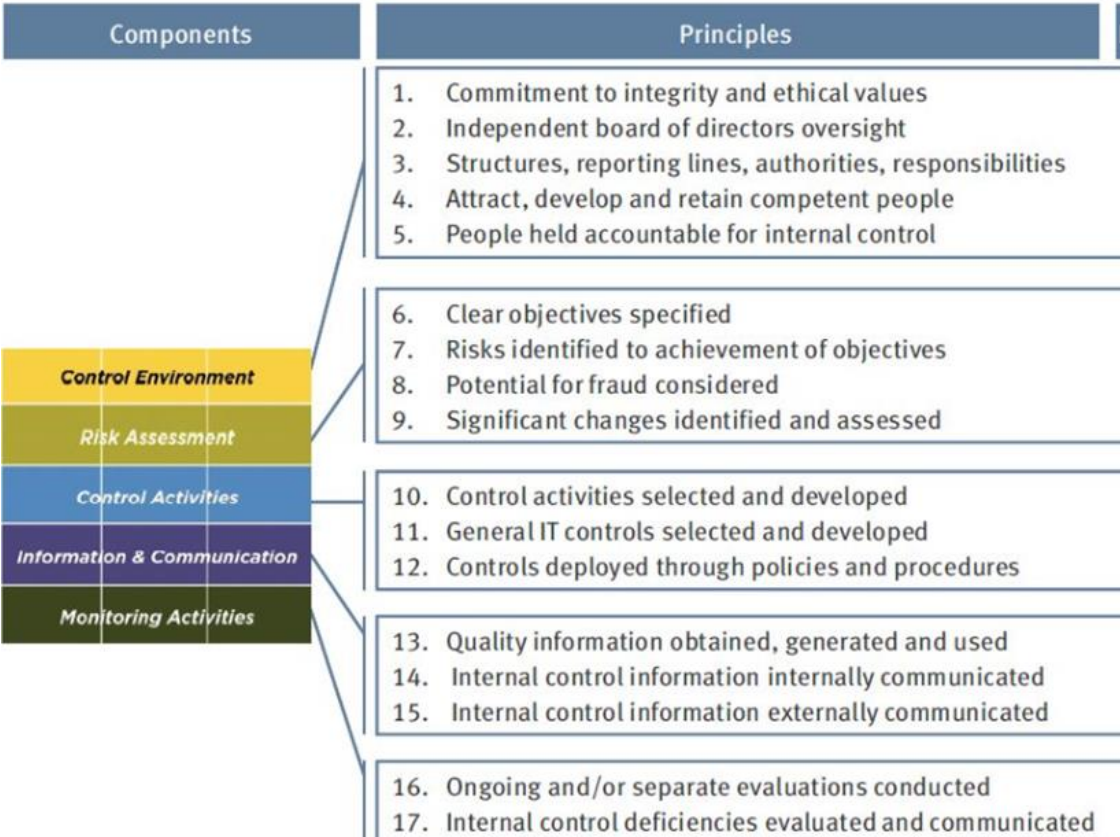
Internal Control

When auditors & accountants talk about internal control.....



Internal Control

COSO Model



Internal Control

Find the 5 Elements of Internal Control



Most Common Reason Fraud Occurs

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

Internal Control – What can we do?

Perform a risk assessment

- Ignore the employee and consider the position
- Your question during this process should be “could an employee steal” and not “would that employee steal?”
- Adopt a worst-case scenario. Imagine that the employee wants to steal

Internal Control – What can we do?

Perform a risk assessment

- Ask employees about weak areas. Where things could go wrong
- Controls are for the protection of both the organization and the employee
- Costs should not outweigh the benefits

Internal Control – What can we do?

- Set a strong example for the expectation of ethical behavior, compliance with laws/policies, and communicate your expectations routinely to your unit's personnel.
- Never sign something you don't understand.
- Limit signature authority and don't let anyone sign your name (an employee should sign their own name). Never use a signature stamp.

Internal Control – What can we do?

- If something doesn't make sense, ask questions about it until it does. Pay attention to what your employees are doing.
- Be familiar with policies and procedures. Be willing to call and ask questions.
- Consider unique risks your unit may have (i.e. cash collections, contracts and grants, etc.) and ensure additional oversight is provided.

Internal Control – What can we do?

- Ensure accounts are reconciled monthly and review this reconciliation for any unusual transactions. (This should include a review of payroll and leave reports.)
- Don't let one employee have complete control of any process.

Internal Control – What can we do?

- Keep offices and labs locked to protect property, data, and other resources. (Remember to shred paper documents with identifying information.)
- Processes change, positions replaced or not replaced, new threats emerge – evaluating controls and performing risk assessment is not a one-time thing!! It is a continuous process.

Cash Disbursement Cycle

Review Invoices

Invoices should be reviewed by department heads or someone with knowledge of related charges prior to being entered into the general ledger by the accountant. The check signer should review the related invoices for approval when reviewing and signing checks.

Review Employee Reimbursements

Employee reimbursements and credit cards should be reviewed by an employee's superior. The Executive management's reimbursement or credit card should be reviewed by someone on the finance committee monthly. This review can be performed after payment to speed up processing if it is already being reviewed by the accountant upon entering the expense into the general ledger.

Cash Disbursement Cycle

Review Payroll Reports

Payroll reports should be reviewed by the person outside of the payroll preparation function prior to cash being transferred to the payroll account/processing company. During the payroll report review, the reviewer should review for gross pay compared to approved wage rates and reasonableness of deductions.

Cash Disbursement Cycle

Limit Accountant Authority

Prohibit the accountant from being the authorized signer on:

- Checking account
- Investment accounts
- Line of credit

Cash Receipt Cycle

Receipt of Funds

- Numbered receipts for all payments/sales
- Reconcile receipts with deposits daily
- Daily deposits
- Do not leave receipts unattended

Cash Receipt Cycle

Cash Registers

- Ring all sales into register
- Use cash/check function
- Review voids or over-rings
- Honest report of over/short each day

Cash Receipt Cycle

Checks

- Endorse check for deposit as received
- Cash personal checks or 3rd party checks?
- Amount over purchase?
- Made out to public entity (e.g., not “cash”)
- Employee initials on checks received
- Nsf check policy

Month End Closing and Financial Reporting

Review Monthly Statements Outside of Accounting Department

The review of monthly bank reconciliations and statements should be performed by someone outside of the bookkeeper/accountant position or outside of accounting (for an organization that only has one employee in the accounting department). This review could be performed by the authorized check signer as that person would have visibility into what significant checks were written during the month.

Month End Closing and Financial Reporting

Create a Month-End Close Checklist

Create a month-end close checklist that lists all month-end controls such as account reconciliations, financial statement preparation, review of manual journal entries, the check register, and payroll reports. The list should contain two columns for preparer and reviewer signoff. Each task would be initialed and dated by the reviewer and preparer. This review process can be performed by another person in accounting or the City or County manager, or other trust worth member of management outside of the accounting function that has the skill, knowledge, and experience to perform review.

Month End Closing and Financial Reporting

Review Monthly Financial Reports to Statements

Review monthly financial reports, including the balance sheet and budget, to actual statement of activities by department budget managers who are responsible for approving expenses.

Fraud

Case Studies

Who IS THIS?

Rita Crundwell

Fraud Perpetrator
City of Dixon, Illinois



Rita Crundwell

Embezzled \$54 million over 22 years

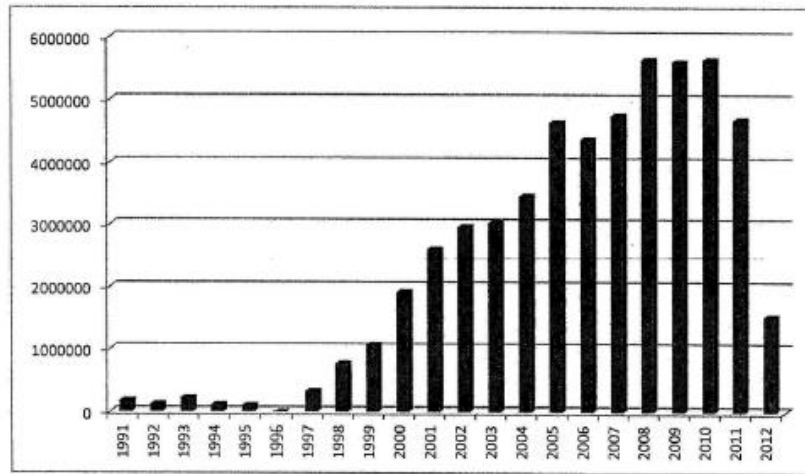
Sentenced to 19 ½ years in prison



City of Dixon, Illinois

City of Dixon - Losses by Year
 PO Box 386, RSCDA, Dixon, IL 61021
 Fifth Third Bank - A/C #4003609530 - Losses **

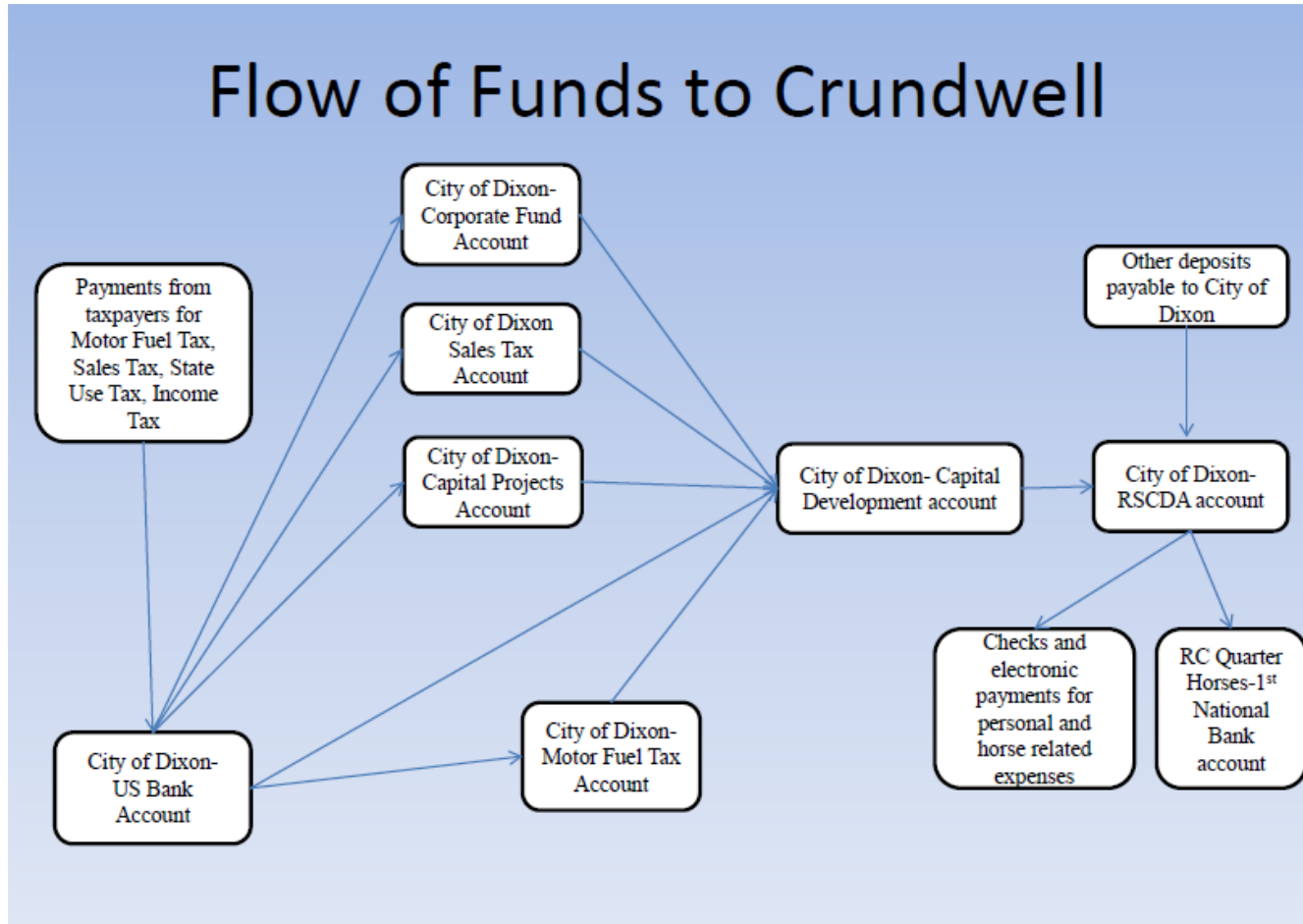
Year	Loss
1991	181,000.21
1992	121,367.90
1993	225,287.67
1994	117,281.04
1995	103,664.92
1996	-
1997	328,622.36
1998	767,487.58
1999	1,069,479.88
2000	1,916,676.21
2001	2,603,208.92
2002	2,964,461.56
2003	3,023,120.22
2004	3,458,701.34
2005	4,645,032.54
2006	4,379,004.05
2007	4,753,898.96
2008	5,637,546.34
2009	5,599,247.94
2010	5,640,518.85
2011	4,683,873.31
2012	1,520,913.01
<hr/>	
53,740,394.81	



** Missing bank account information from November 1995, all of 1996, and January through March of 1997.
 (Highlighted years are missing one or more months of data)



City of Dixon, Illinois



Case Study

- Sheriff Office in GA
- Seizure funds on hand
- Analytical - large reduction in funds held
- weak internal control structure
- One person performing multiple duties
- Employee gambling problem
- Impact – loss of > \$40K, arrest and prosecution of employee

Case Study

- Probate Court in GA
- Custodial fund
- Unable to produce audit requests
- Deleted transactions, complexity, diversion
- Reported to GBI
- Impact – >\$100K loss, arrest and prosecution of employee

Case Study

- Housing Authority located in GA
- Grant funding for housing improvement project
- Noted during our testing that the homeowner, grant administrator, and contractor had the same last name
- Conflict of interest policy
- Impact – Granting agency disallows reimbursement of expenditures, cost >\$100K

Case Study

- Sheriff Office in GA
- Flash roll fund
- Checks written personally to police officers and to “cash”
- No accountability for funds
- Impact – improvement in policies and procedures/internal control structure

CASE STUDIES –TAKE AWAYS

What do all these cases have in common?

- Lack of internal control
- Employee given the opportunity – this is the number one way we can prevent fraud.
- Trusting – we trust too much
- Segregation of duties
 - Don't let one employee have complete control of any process.

CASE STUDIES –TAKE AWAYS

.Separation of duties: Divide responsibilities between different people so one individual doesn't control all aspects of a transaction.

.Authorization and approvals: Be sure that only a person with delegated authority approves or authorizes transactions.

CASE STUDIES –TAKE AWAYS

- .Security of assets: Safely secure equipment, cash, inventory, and resources. Reduce the risk of unauthorized use. Count periodically and compare with amounts shown on control records.
- .Review and reconciliation: Regularly examine transaction records against official university records to verify accuracy, appropriateness, and proper compliance.

Fraud Prevention

Key Takeaways

Knowledge Check

Who is responsible for fraud prevention?

- A. External Auditors
- B. Management
- C. Employees
- D. Internal Audit

Top Ten Internal Controls

- **Control 1 – Dual Signatures**
- **Control 2—Bank Statement Reconciliations**
- **Control 3—Eliminate Cash**
- **Control 4—Approved List of Vendors**
- **Control 5—Tightly Control the Payroll List**

Top Ten Internal Controls

- **Control 6—Control Expense Reimbursements**
- **Control 7—Take Physical Inventories**
- **Control 8—Rely on Budgets**
- **Control 9—Competitive Bidding**
- **Control 10—Obtain Grant Administration Knowledge**

Preventing Fraud: What Should We Do?

- Train employees so they understand internal controls. Put in a context that the organizational culture will understand.
- Train employees so they understand their role and fiduciary responsibilities.
- Raise your perception of detection – managers and supervisors are the MOST important factor in this.

Preventing Fraud: What Should We Do?

- Be consistent in handling problems when they arise. The grapevine is a powerful thing.
- Tone at the top (and middle) matters in both what is said and also what is observed.
- Make sure employees know how to report problems.

Preventing Fraud: What Should We Do?

Never put any one in the position of having total control of a process.

QUESTIONS?



Thank You!



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