




***The “F” Word – Fraud
Fraud Basics and Methods to
Reduce Fraud In The Workplace***




Charles A. Albert, CPA/CFE
Curtis Blakely And Co, PC, CPAs
calbert@cbandco.com



Qualifications


- ❖ Curtis Blakely And Co, CPAs, PC has been serving the utility industry for over 50 years.
- ❖ We audit over 100 companies including their subsidiaries.
- ❖ RUS Approved Accounting Firm
- ❖ CBCo has clients in Arizona, New Mexico, Texas, Louisiana, Oregon, Oklahoma, Florida, Colorado, California as well as Mexico.
- ❖ Two individuals hold their Certified Fraud Examiner (CFE) certification – Charles Albert, CPA-CFE, and Tessa Fowler, CPA-CFE
- ❖ We perform monthly accounting assistance for numerous telecommunications firms (act as contract controller in some cases). We know the “nuts and bolts” of telcom accounting.

 **Technology and Fraud**

Technology Will Increase the Sophistication of Fraud Schemes
 This is an existing trend that will accelerate in the future. More and more companies are reacting to reports of fraud with “how did they do that”?

It’s a reflection of schemes becoming more complex and capitalizing on technology, including some of the new technology deployed by companies in the interest of improving efficiency.

While simple frauds still exist, we are seeing a distinct proliferation of more complex fraud schemes.




What is Fraud?

“Fraud is the second oldest profession in the world. If there is money, there is money to steal”

Fraud (Definition)

Black’s Law Dictionary states that fraud is “a generic term, embracing all multifarious means, which human ingenuity can devise, and which are resorted to by one individual to get advantage over another by false suggestions or by suppression of truth, and includes all surprise, trickery, cunning, dissembling, and any unfair way by which another is cheated.”

The intentional (deliberate) deception resulting in injury to another person. It is a deliberate misrepresentation which causes another person to suffer damages, usually monetary damages.



What is Embezzlement?

Embezzlement

The fraudulent appropriation of property by one lawfully entrusted with its possession.

To “embezzle” means willfully to take, or convert to one’s own use, another’s money or property, of which the wrongdoer acquired possession lawfully, by reason of some office or employment or position of trust.



Asset Misappropriation Subcategories

Skimming – Any scheme in which cash is stolen from an organization before it is recorded on the organization’s books.

Cash Larceny – Any cash which is stolen from an organization after it has been recorded on the organization’s books and records.

Billing – Any scheme in which a person causes his employer to issue a payment by submitting invoices for fictitious goods or services, inflated invoices or invoices for personal purchases.

Expense Reimbursements – Any claim in which an employee makes a claim for reimbursement of fictitious business expenses.

Check Tampering – Any scheme in which a person steals his employer’s funds by intercepting, forging or altering a check drawn on the organization’s account.



Asset Misappropriation Subcategories

Payroll – Any scheme in which an employee causes his employer to issue a payment by making false claims for compensation.

Cash on Hand Misappropriations – Any scheme in which the perpetrator misappropriates cash kept on hand at the victim organization's premise.

Noncash Misappropriations – Any schemes in which an employee steals or misuses noncash assets of the victim organization.



Who Commits Fraud?

5% of the population will commit fraud regardless of the circumstances.

85% of the population will commit fraud given certain conditions. (Pressure, Rationalization and Opportunity)

10% of the population will not commit fraud under any circumstances.

90% of the population will commit fraud.....





Profile of a Fraudster

Based on demographic information of 1,400 occupational fraudsters:

- 67% Male, 33% Female [Loss Attributable to Males Were 123% Higher Than Those Committed By Females]
- 52% Between 31-45 Years Of Age. The Older The Fraudster, The Larger The Loss
- 7% First Year Employee, 53% +5 Years With Organization

Position Held:

- 42% Employee [Average Loss = \$75,000]
- 36% Manager [Average Loss = \$130,000]
- 19% Owner/Executive [Average Loss = \$500,000]

The Fraud Triangle

The Fraud Triangle (attributed to Donald Cressey) describes three factors that are present in every situation of fraud:



The Fraud Triangle

Motive or Pressure – the need for committing fraud (need for money, etc.)

Rationalization – The mindset of the fraudster that justifies them to commit the fraud.

Opportunity – the situation that enables fraud to occur (often weak internal controls)



Who Commits Fraud?



- Sandy Jenkins (2014) Corsicana Street Bakery
- **\$16,649,786** total documented embezzlement
- Annual salary of \$50,000
- Assistant discovered a check made out to an unfamiliar bank



Who Commits Fraud?



- Rita Crundwell (2012) Dixon, Illinois Comptroller
- **\$53,700,000** total documented embezzlement
- Annual salary of \$80,000
- Another city employee filled in during her vacation



The Art of Accounting.....

- Luca Pacioli gave us debits and credits in 1494. Some of us learned the “old fashioned” way – a ledger. This taught the user the true flow of the accounting process.....
- Often bookkeeping seems completely automated. The transactions flow where they need to, generating monthly reports, supporting schedules, financial statements, invoices, payroll and other accounting information.
- An employee may only see one area of the company’s accounting activities and not be aware of what function they play in the overall financial functions of the organization.
- Without an understanding of the transaction flow and the “big picture” by knowledgeable personnel and management, a fraudster may be able to hide his fraud with relative ease.



Auditor’s Responsibility

In an audit conducted in accordance with generally accepted auditing standards (GAAS), the independent auditors objective is to express an opinion on how fairly the financial statements present—in all material respects—financial position, results of operations and cash flows in conformity with generally accepted accounting principles (GAAP)



Auditor's Responsibility

A financial statement audit is **not** designed to detect immaterial fraud. However, any fraud encountered during a financial statement audit should be reported to management or the board of directors.

Example: Auditor requests invoices exceeding their planning materiality threshold for Individually Significant Items (ISI) when reviewing the plant activity for the year. The audit planning materiality calculation determined that invoices over \$10,000 should be selected. The fraudster wrote 4 checks to himself ranging from \$3,000 – 7,500, coding the disbursements to other vendors and to several different plant accounts.

The auditor may not uncover these fraudulent disbursements by simply vouching items over scope. Cash disbursements testing and a sample may uncover one or more of the amounts.



Interesting Fraud Statistics

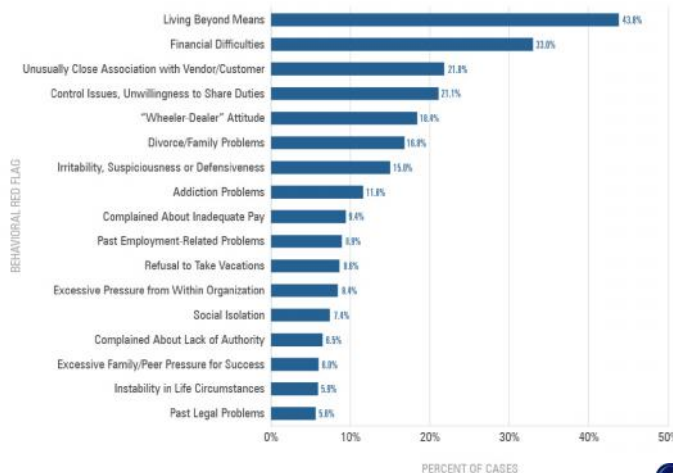
- The typical organization loses 5% of its revenue to fraud annually.
- The median loss is \$140,000.
- A typical fraud lasts 18 months before detection.
- The most frequent method to uncover fraud is by a tip.
- **81%** of the cases reported, the fraudster displayed one or more

Behavioral Red Flags.



Behavioral Red Flags Displayed By Perpetrators

Figure 71: Behavioral Red Flags Displayed by Perpetrators



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The Fraud Triangle Refresher

Fraud Triangle



Pressure
Rationalization
Opportunity

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Pressure To Commit Fraud

1. Living Beyond Means
2. Addiction or Legal Problem
3. Life Changing Event
4. Relationship Issues

Pressure is sometimes referred to as incentive or motivation.



Methods to Reduce **Rationalization**

1. Managers should set an example by promoting honesty in the accounting area.
2. **Management should practice what it preaches.**
3. Dishonest acts by management, even if directed to someone outside of the organization, can create a dishonest environment.
4. Consequences of violating the rules, including punishment should be clear and carried out.
5. Sound ethical culture

Examples:

- **Borrowing:** "I'm in a bind this month. I'll just borrow it until next payday"
- **Entitlement:** "I am overworked and underpaid. That's all this is – a raise"
- **Management:** "The manager wrote off his cruise as a seminar? This little amount does not even compare to what they do!"



Methods to Reduce Opportunities

1. Maintain accurate and complete accounting records
2. Carefully monitor business transactions and interpersonal relationship of vendors and those involved in your organization.
3. Establish a physical security system to secure company assets, including cash, equipment, tools and other valuable items.
4. Segregate duties between employees ensuring that no one single employee has total control of one area.
5. Maintain accurate personnel records, including background checks and references.
6. Encourage strong supervisory and leadership within groups.



Case "A": The Social Butterfly

A. Nonprofit Organization Fundraising Chair – Theft of Approximately \$12,000

1. Organization paid amounts submitted based on online order summary that she intentionally printed and did not order everything, not invoice. [Control: Pay based on actual invoice, not PO or order summary]
2. Invoices were duplicated on a copier, with fraudulent amounts using a word processor on the invoices. [Control: Request copy of cancelled check, review invoices for reasonableness and revision]

Ultimately the treasurer of the organization noticed that the specific fundraiser was over budget, and subsequently began looking over invoices. We assisted them with documentation. Fundraising Chair admitted to the fraud and paid restitution.



Case “A”: The Social Butterfly

A. Nonprofit Organization Fundraising Chair – Theft of Approximately \$12,000

1. **Pressure** – Marital issues, living beyond means, socio-economic issues
2. **Rationalization** – Felt she was entitled to payment for “organizing”, this was a “loan”
3. **Opportunity** – Poor internal controls. Others did not review support in a timely manner.



Case “B”: Income Down The Drain

B. Local Water Supply Company – Theft of Approximately \$63,000

1. A **Customer Service Representative** (CSR) would take cash payments through a special register (believed to be inactive), apply the payment to the customer account, print the customers a receipt, then skim the funds (remove cash from drawer) once the customer left. A deposit was never prepared from the separate terminal/drawer. The terminal was supposed to remain inactive.
2. The **General Manager** (GM) would take the daily deposit from the CSR, scan in checks and make a deposit of checks only. The cash was then placed in a safe. Only the GM and a board member had access to the safe. An armored carrier was supposed to pick up the cash deposit several times a week. The GM would remove the entire cash deposit on some dates, or a portion of the cash deposit.
3. CBCo assisted, resulting in recovery of \$63,000 due to insurance.



Case “B”: Income Down The Drain

B. Local Water Supply Company – Theft of Approximately \$63,000

1. **Pressure** – Both the GM and CSR involved had “significant other” issues and financial issues.
2. **Rationalization** – Both felt they were underpaid and overworked. The GM was hired at significantly less than the prior GM and the CSR felt her duties and responsibilities were overlooked and unappreciated by the BOD.
3. **Opportunity** – Poor internal controls. No reconciliation of accounts monthly.



Case “B”: Income Down The Drain

B. Local Water Supply Company – Theft of Approximately \$63,000

Other Information on Case “B”

- BOD members were not familiar with accounting. While they approved the monthly financial statements, there were no formal reconciliations, no true financials (they questioned cash disbursements over minor expenses)
- The BOD had been made aware of the material weaknesses in the controls for several years during the audit but failed to act.
- The GM was new, had experience, and one of the BOD indicated that they heard she had been fired from a previous water utility for theft, but she had accepted their low starting salary.
- The CSR's boyfriend had contacted the GM and said the CSR was stealing money. He recanted once they reconciled.



Case "B": Income Down The Drain

B. Local Water Supply Company – Theft of Approximately \$63,000

Other Information on Case "B"

- The CSR had turned in a prior GM for theft a few years ago. The BOD chose not to press charges, but terminated the previous GM.
- Due to the location, the Sheriff Department was involved initially. The secret service became involved later, and participated in interviews.
- CBCo's support enabled the company to recover 100% of the funds from insurance and was instrumental in the case built on the 2 fraudsters. The detectives said our work was the most detailed and thorough he had seen in all of his cases.
- CSR admitted to the theft under questioning. The GM case is ongoing, but law enforcement is confident she is involved. We heard that some of the amounts deposited in her personal account matched the approximate date and total stolen from the safe.



Case "C": The Missing "Dough"

C. Pizza Chain – Theft of Over \$425,000


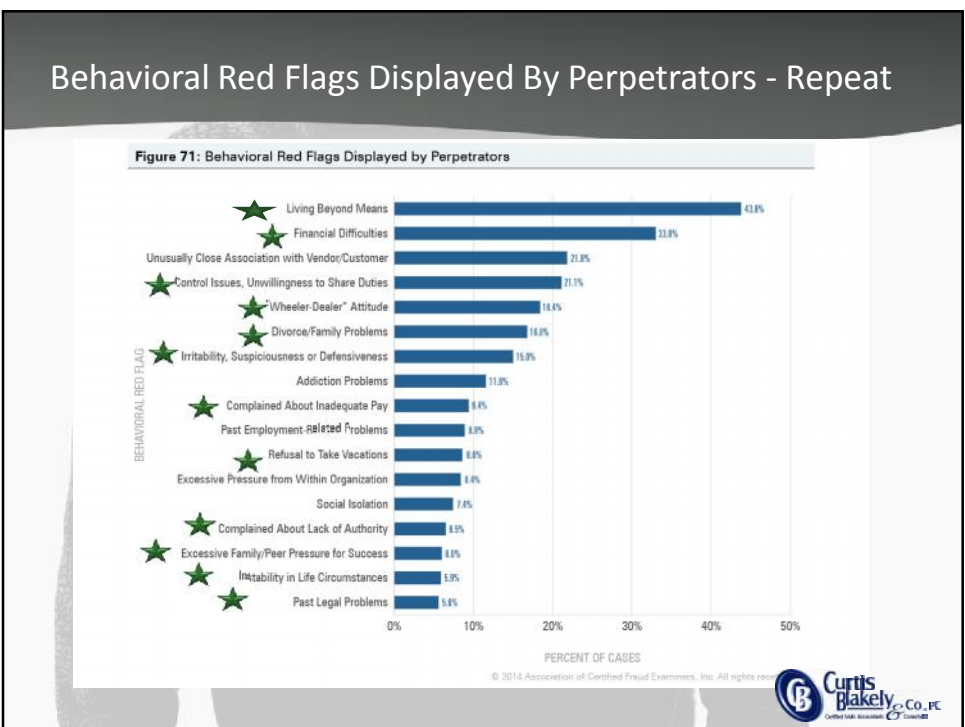
1. A **Bookkeeper** began taking small amounts by paying her personal credit card through the company. Her personal card was paid online, while the company credit card was paid via check.
2. The bookkeeper began diverting funds to her personal paypal account.
3. The amounts were debited to a prepaid asset on the general ledger. The franchise owner was more concerned with the "bottom line", or income from each store location (13 locations).
4. The bookkeeper would then amortize the prepaid asset over 36 months to each store location, with minimal effect on each store.
5. The bookkeeper hid the actual bank statements, using the online statement as support for her reconciliation. The online statement simply showed "American Express Payment", while the actual bank statement listed "American Express Payment – Elizabeth Embezzler"



Case "C": The Missing "Dough"

C. Pizza Chain – Theft of Over \$425,000

6. The bookkeeper refused to take time off, saying she was too busy.
7. She bullied other employees to get her way.
8. She was well known for giving expensive gifts to others.
9. While her home was basic, the back yard was an oasis, with nice furnishing throughout. Boxes of HSN purchases were unopened.
10. The fraud was uncovered when she gave herself a travel advance, other employees who had been bullied previously noticed the advance and questioned it.
11. CBCo assisted in the investigation. The FBI was involved after the initial investigation uncovered the magnitude of the fraud.
12. The bookkeeper pled guilty, was sentenced to federal prison with restitution.

Case "C": The Missing "Dough"

C. Pizza Chain – Theft of Over \$425,000

1. **Pressure** – Bookkeeper was addicted to online shopping, was known for generous gifts, had marital issues .
2. **Rationalization** – Bookkeeper felt she was underpaid with little benefits.
3. **Opportunity** – Poor internal controls. Lack of segregation of duties. Owner did not adequately review or question financials.

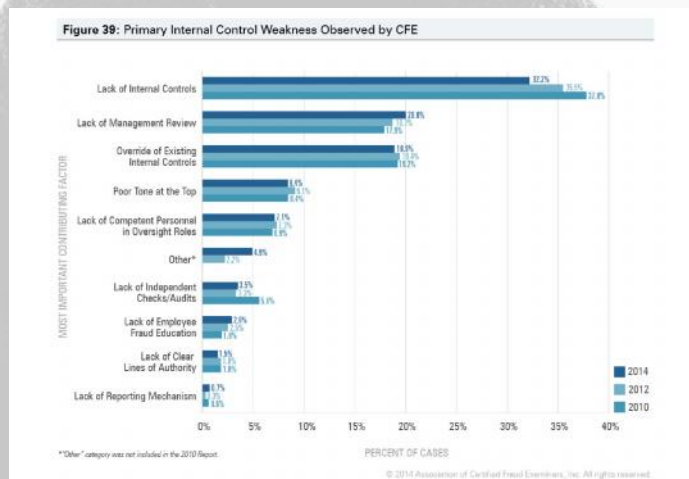
Tips Lead to Fraud Examination

Figure 13: Source of Tips

Source of Tips	Percent of Tips
Employee	49.3%
Customer	21.8%
Anonymous	14.4%
Vendor	10%
Other	3.4%
Shareholder/Owner	4.3%
Competitor	1.8%

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Control Weaknesses Contributing to Fraud



Questions or Comments?

The End – Thank You!