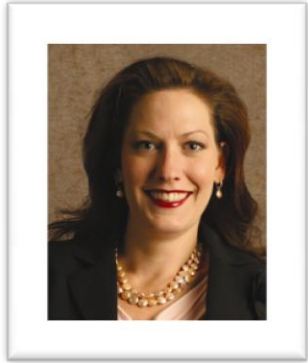




# Stop Fraud in its Tracks

Alyssa G. Martin, CPA





## Alyssa G. Martin, CPA

- Partner in Charge of Weaver's Risk Advisory Services
- Has over 22 years experience in public accounting
- Specialize in the areas of:
  - Internal control compliance and monitoring
  - Risk and business management consulting
  - Fraud Prevention
  - Technology consulting
  - Strategic planning
  - Operational analysis
  - Internal audit
  - IT audit



- **Definition of Fraud**
- **Primary Categories of Fraud**
- **How Fraud Threatens a Company's Existence/Credibility**
- **Effective Elements of Fraud Prevention & Detection**






# Definition of Fraud

“... any illegal act characterized by deceit, concealment, or violation of trust. These acts are not dependent upon the threat of violence or physical force. Frauds are perpetrated by parties and organizations to obtain money, property, or services; to avoid payment or loss of services; or to secure personal or business advantage.”

# Primary Categories Of Fraud

# Primary Categories of Fraud

Asset Misappropriation	Corruption	Financial Statement Fraud
Strikes large and small companies	An individual benefits in a manner contrary to that person's fiduciary responsibilities and duties	Falsified to provide an inaccurate view of company performance
<b>Most Common</b>	<b>Less Frequent</b>	<b>Most Rare</b>
		



- Payroll fraud
  - Payment to fictitious employees
  - Overpayment to existing employees – Collusion
  - Issuing payroll checks to employees who no longer work for the company
- Payments to phantom vendors
- Credit/Procurement card fraud
  - Use of company cards for personal purchases
  - Use of procurement cards to circumvent competitive bid requirements
- Travel/Expense reimbursement fraud
  - Reimbursement of undocumented expenses
  - Reimbursement for luxury accommodations
  - Reimbursement for travel expenses of employee's family members
- Revenue skimming
  - Embezzlement of cash receipts or activity funds
- Theft of materials, supplies, merchandise
- Unauthorized use of company assets
- Inappropriate use of bond funds



- Kickbacks and bribes
  - Cash or non-cash gifts from vendors accepted by company personnel
  - Cash or non-cash gifts from vendors accepted by board directors
- Failure to hold competitive bidding
  - Purchasing in smaller increments to avoid the bidding process
- Competitive bid rigging
  - Preferential treatment of vendors during the award selection process
  - Establishing selection criteria that give vendors an unfair advantage
  - Profiteering as a result of insider knowledge of company activities
- Failing to disclose conflicts of interest
  - Awarding contracts to parties related to individuals involved in the decision making process
- Forgery or falsification of documents
  - Falsification of contracts and other 3<sup>rd</sup> party agreements
  - Falsification of reporting of compliance activity



- Hiding losses/expenses and manipulating fund balances
- Falsifying revenue
- Improper recording of the period expenses occur
- Recording pending transactions as completed transactions
- Inappropriately carrying over unused appropriated funds from one year to the next
- Intentional reporting of inaccurate financial results
- Falsification of official documents or reports
- Altering or creating documents with the intent to defraud
- Destruction or disappearance of records



# **How Fraud Threatens Your Company's Existence/Credibility**



# Current State

Despite aggressive prosecutions, fraud in the workplace is alive and well in this economic downturn

- From the Mailroom to the Boardroom
- Now, more than ever, it is imperative that companies consider fraud implications and implement preventative measures
- Your company can become part of the overwhelming fraud statistics
- Don't leave your company's fraud prevention to chance

<b>% or \$</b>	<b>Fraud Victims/Areas</b>
7%	Annual revenues lost of all U.S. entities
\$994 Billion	Lost annually by U.S. entities and their stakeholders
\$1,000,000 +	Lost in over 25% of cases investigated
<b>Median Loss</b>	<b>Fraud Victims/Areas</b>
\$2,000,000	Financial statements
\$375,000	Corruption schemes
\$200,000	Organizations with 100 employees or less
\$150,000	Asset misappropriation schemes



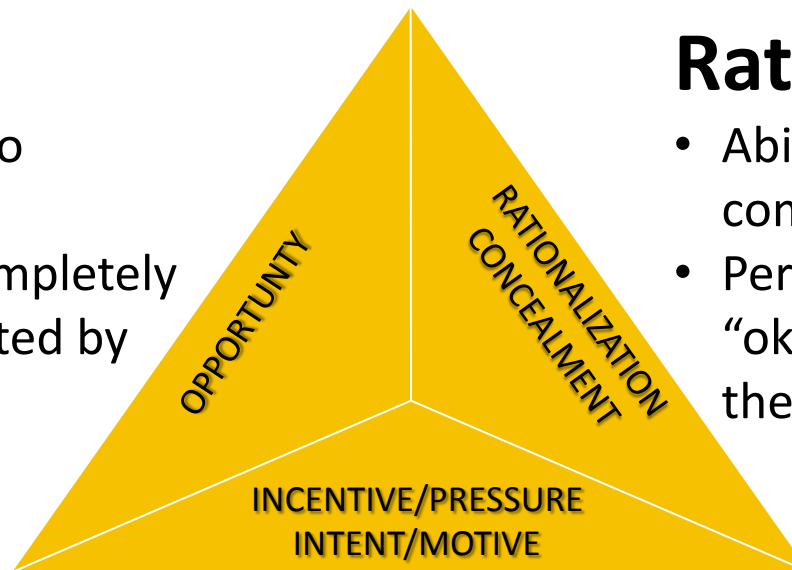
# Fraud Impact on Companies

- The financial costs alone are staggering
  - Fraud/theft of funds or other assets
  - Cost of investigation
  - Increase in accounting fees/audit fees/legal fees
  - Court costs
- Business disruption / loss of staff productivity
- Long-term loss of confidence and trust in the company, upper management, and board of directors
  - Conveys the wrong message to employees and the public
  - Economic impact to the local community due to the reputation of the company
- Terminations
  - Unanticipated employee terminations
  - Potential termination of personnel
  - Potential removal of members of the Board of Directors
- Loss of investment or grant funding

*An increase in any element in the triangle increases the risks of fraud*  
*Anti-fraud controls are built to deter or prevent access and incentive for fraud*

## Opportunity

- Must gain access to assets/records
- The only factor completely controlled/prevented by the company



## Rationalization

- Ability to follow through and commit the fraud
- Perpetrator has to make it “okay” internally to perform the fraudulent act

## Incentive/Pressure

- The more incentive, the easier it is to justify
- Financial or personal problems, financial pressure, mental instability

- Poor Controls 59%
- Management Override 36%
- High Risk Industry 34%
- Third Party Collusion 33%
- Employee Collusion 23%
- Lack of Ethics Policies 7%
- Lack of Board of Trustee Control 6%
- Other 2%



# **Effective Elements of Fraud Prevention & Detection**

## Assessment and monitoring plan is key to identification, prevention and detection:

- Brainstorm to uncover possible fraud schemes and scenarios
- Assess gaps in accounting that could be used for misappropriation
- Evaluate control design and operations
- Work **now** on prevention, rather than detection and improve safeguards



## Best Practices Approach to Fraud Prevention

- Create a company-wide culture of integrity from the Boardroom and throughout Operations
- Fraud Risk Assessments should be conducted on a regular basis
- A Deterrence Plan should be developed in response to the Fraud Risk Assessment



## Best Practices Approach to Fraud Prevention

- Fraud prevention measures should include:
  - Committing company resources
  - Prosecuting offenders
  - Ensuring appropriate segregation of duties
  - Performing regular internal audits to deter fraud
  - Implementing IT controls
  - Implementing a fraud hotline & investigating fraud tips
  - Establishing checks and balances for ongoing monitoring



# Cost Effective Approach

- Prevention is the most cost effective approach to fraud management.
- Losses are almost impossible to recoup.
- Improve your company's internal controls and retain company funds for the intended use, educating students.



# Elements of Effective Fraud Prevention

- **Segregation of duties**

- Foundational element of prevention
- Establishes natural checks and balances
- Reduces errors
- Includes IT controls, access and management

- **Perceived opportunity is a common driver**

- Tone at the top
- Use a hotline - Investigate tips
- Segregation of Duties is “built in”
- Fraud prevention policies as part of code of ethics



## Addressing these IT general controls provides continual deterrence against fraud:

- **Logical Security** – firewalls, software for blocking viruses and spyware, virtual private networks, password security etc.
- **Change Management** – policies and procedures that control unauthorized installations or changes to hardware and/or software
- **Database Administration** – restrictions/limitations for database access and actions
- **Data Storage** – control and location of data storage including archives and backups
- **Data Encryption** – ensures that crucial information remains in unusable format if access controls fail

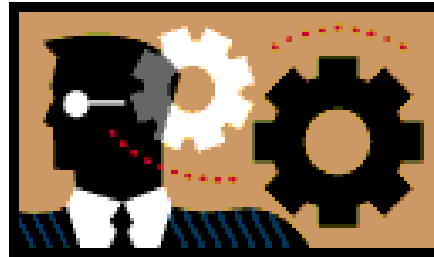
# Elements of Effective Fraud Detection

When proving fraud, focus on the five elements:

Intent



Motive



Opportunity



Repetitive Acts



Concealment





# Analytical Techniques For Fraud Detection

**A number of analytical techniques, commonly known as data mining or IT forensics, have been proven highly effective in detecting fraud:**

## **Statistical Analysis Techniques**

- Calculation of statistical parameters to identify outlying transactions
- Stratification of numeric values to identify excessively high or low values
- Gap testing to identify missing numbers in sequential data
- Digital analysis using Benford's Law to identify statistically unlikely occurrences of specific digits in randomly occurring data sets
- Summing of numeric values to check control totals that may have been falsified

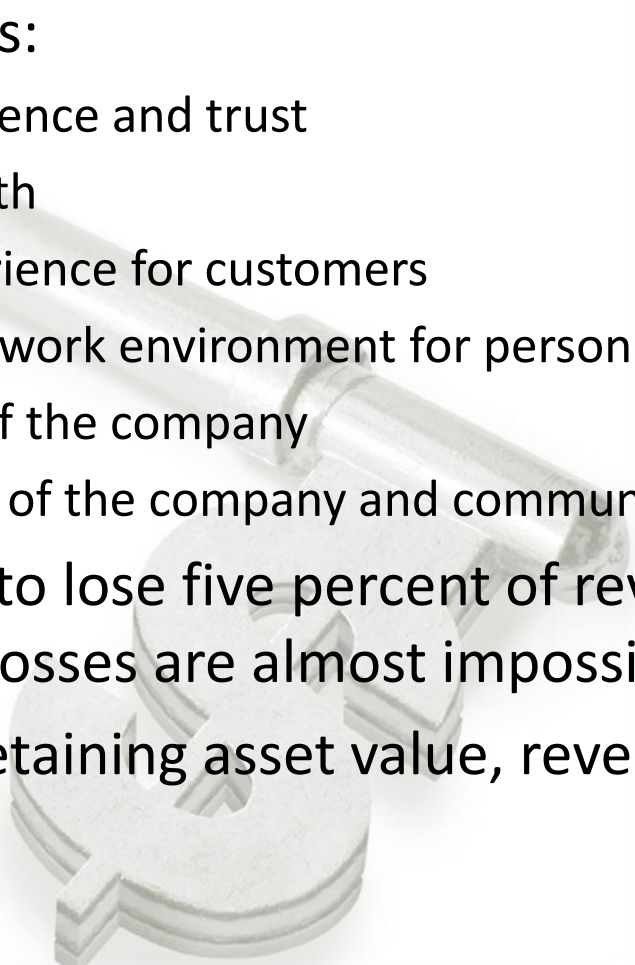


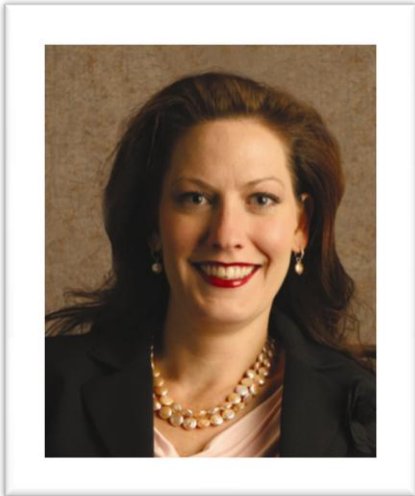
# Analytical Techniques For Fraud Detection (Continued)

## Classification, Verification and Validation Techniques

- Classification to find patterns and associations among groups of data elements
- Joining different data sources to identify inappropriately matching values such as names, addresses and account numbers in disparate systems
- Duplicate testing to identify simple and/or complex duplications of transactions such as payments, payroll, claims or expense report line items
- Validating data entry dates to identify postings or data entry times that are inappropriate or suspicious

# Prevention is Key!

- Lack of proactive fraud management could threaten your company's long-term goals:
    - Maintaining public confidence and trust
    - Managing company growth
    - Providing a positive experience for customers
    - Providing a high integrity work environment for personnel
    - Safeguarding the assets of the company
    - Protecting the reputation of the company and community
  - Companies cannot afford to lose five percent of revenues - that is the hidden cost of fraud (losses are almost impossible to recoup)
  - **Prevention** is the key to retaining asset value, revenue and profitability!
- 
- A large, faint, 3D-rendered key and a stack of coins are visible in the background of the slide. The key is positioned diagonally across the center, and the stack of coins is located below it. The background is a light gray gradient.



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