

Understanding Fraud Risk & Prevention Strategies

Presented by Karen Webber CPA, CFE & Tim Doyle, CPA

Big firm capability. Small firm personality.

THE BONADIO GROUP
CPAs, Consultants & More

Overview



Introductions /
Background & Practice
Areas



Fraud Overview: Facts &
Trends



ACFE Global Fraud
Report



The Personal Side of
Fraud



Fraud Risks in a Post-
COVID Environment



Strategies organizations
can implement to
mitigate fraud risk

Introductions / Background

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Karen Webber, CPA, CFE

Practice Areas: Fraud & Forensic

• For Organizations

- Investigation of asset misappropriation by employees or vendors
- Partnership and corporation disputes
- Insurance claim support and evaluations
- Shareholder disputes
- Professional negligence
- Contract disputes
- Government investigations and disclosures

• For Individuals

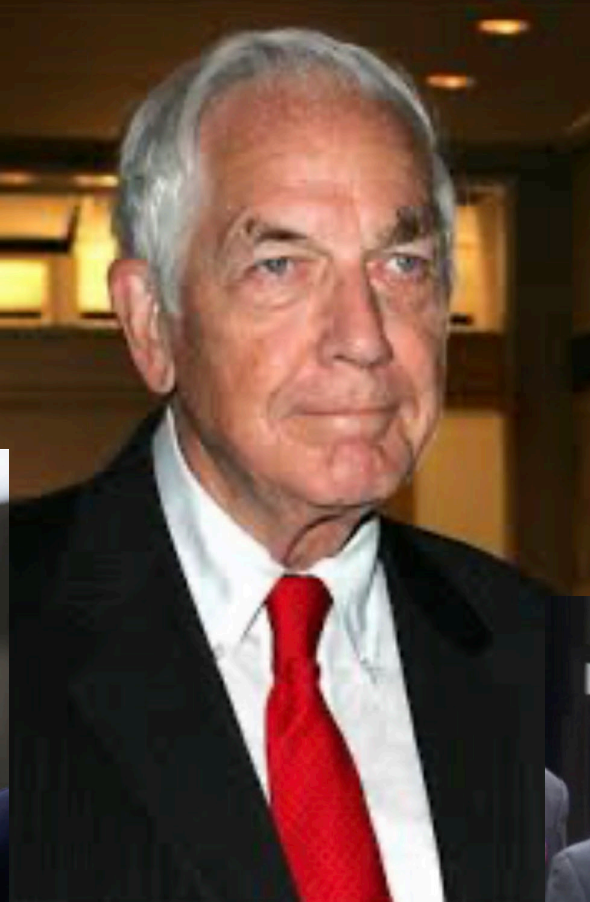
- Divorce/matrimonial disputes
- Trust/estate litigation
- Financial exploitation
- Guardianship/conservatorship
- Personal injury claims

Practice Areas: Internal Controls

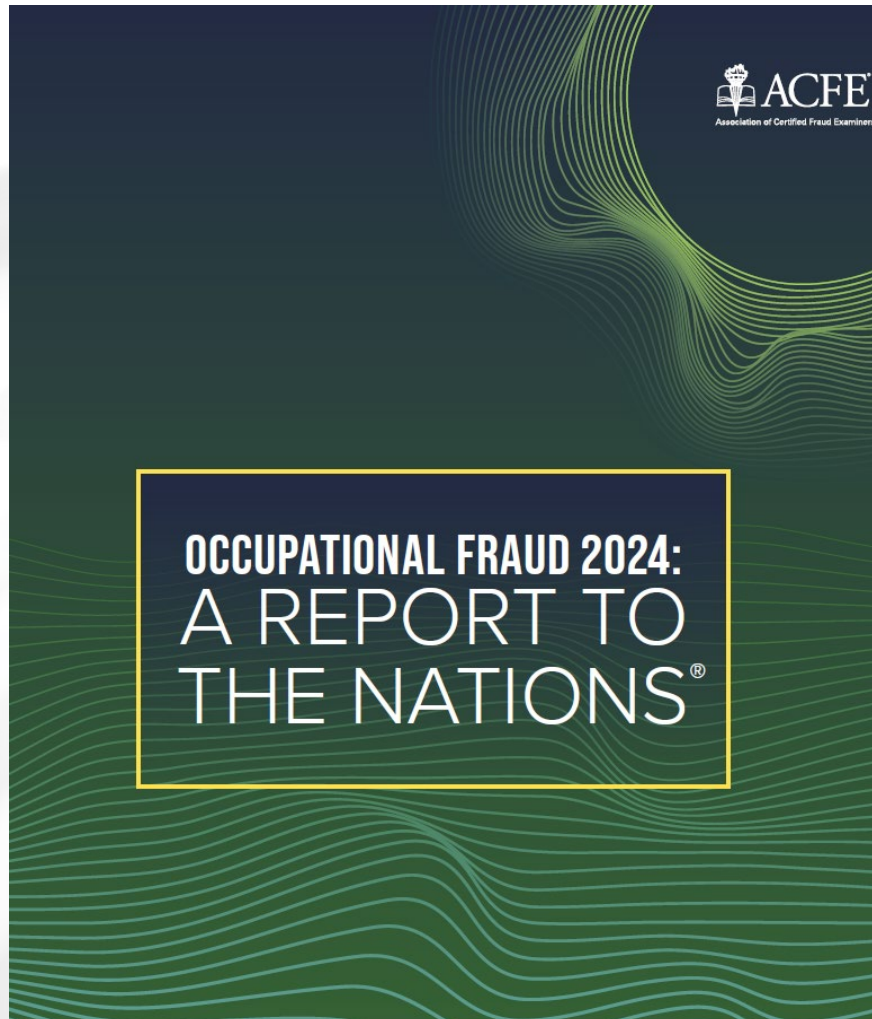
- For Organizations (Privately Held, Public and Non-Profit) Government Entities and Child Welfare Departments
 - Operational Reviews
 - Internal Control / Risk and Control Assessments
 - Audit-Readiness
 - Ongoing Monitoring



Can you spot the fraudsters?



ACFE Report to the Nations

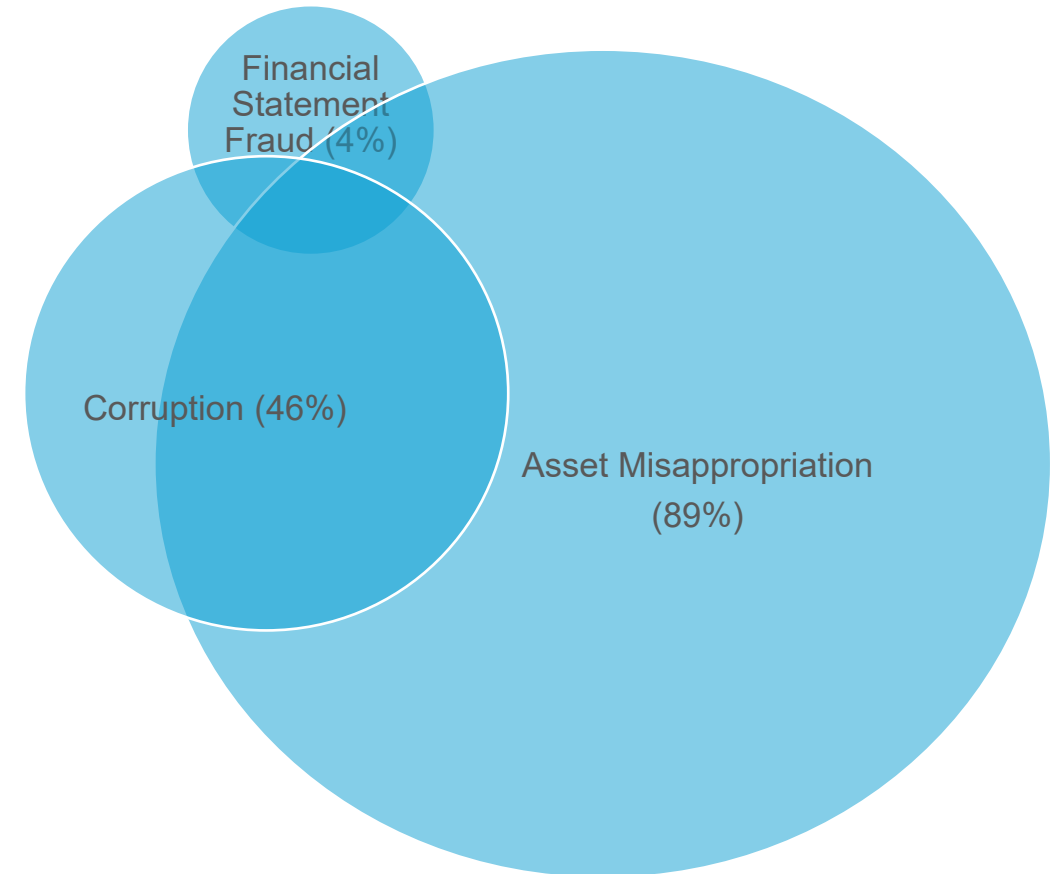


- 1,921 cases
 - 138 countries/territories
 - \$3.1 billion reported losses
-
- <https://www.acfe.com/-/media/files/acfe/pdfs/rtnn/2024/2024-report-to-the-nations.pdf>

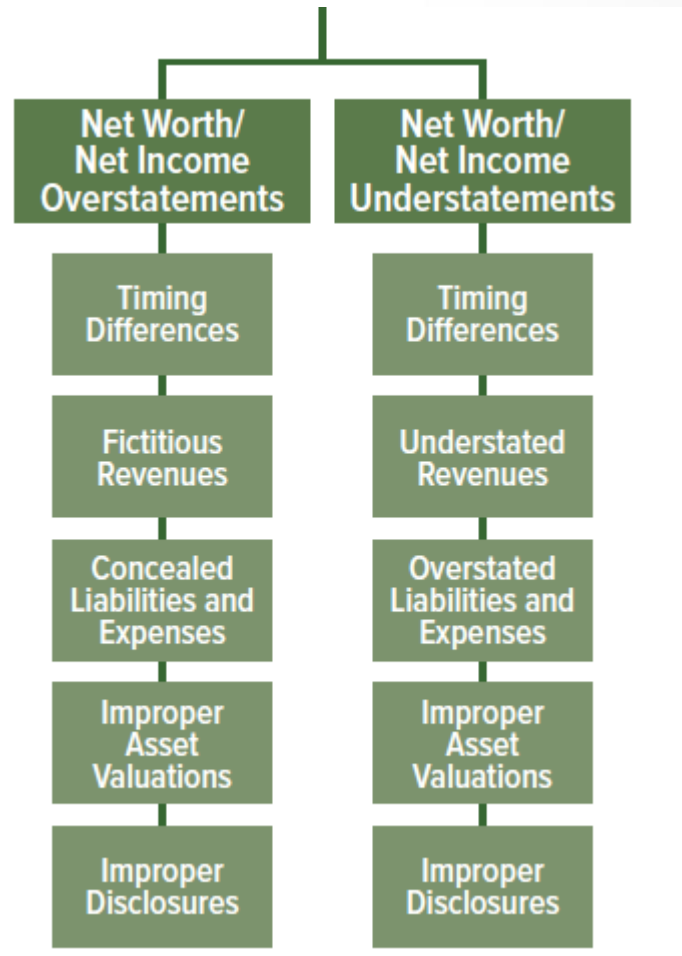
What do we mean when we say “fraud”?

Enriching oneself through the deliberate abuse of power.

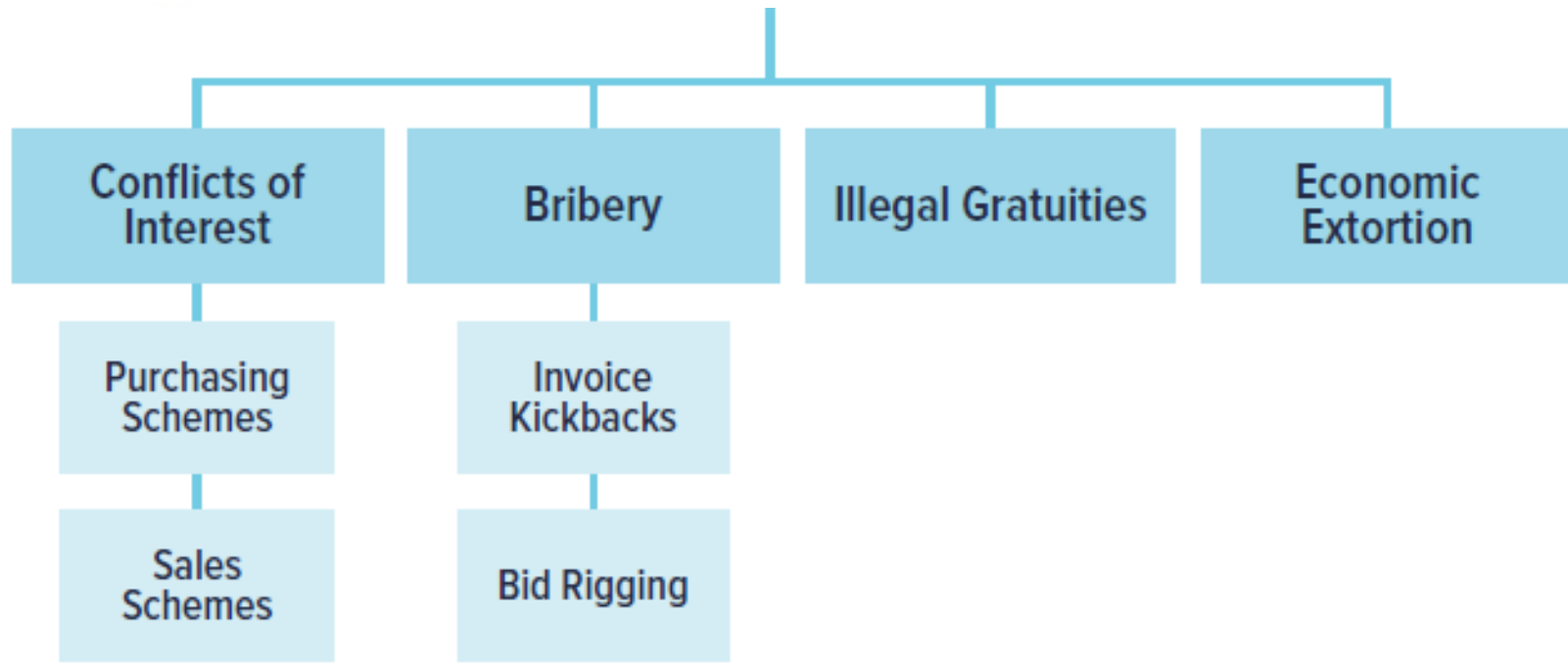
ABDULLAHI, R. & Mansor, N. (2015). “Fraud Triangle Theory and Fraud Diamond Theory. Understanding the Convergent and Divergent For Future Research”. *International Journal of Academic Research in Accounting, Finance and Management Sciences*. 5.10.6007/IJARAFMS/v5-i4/1823.



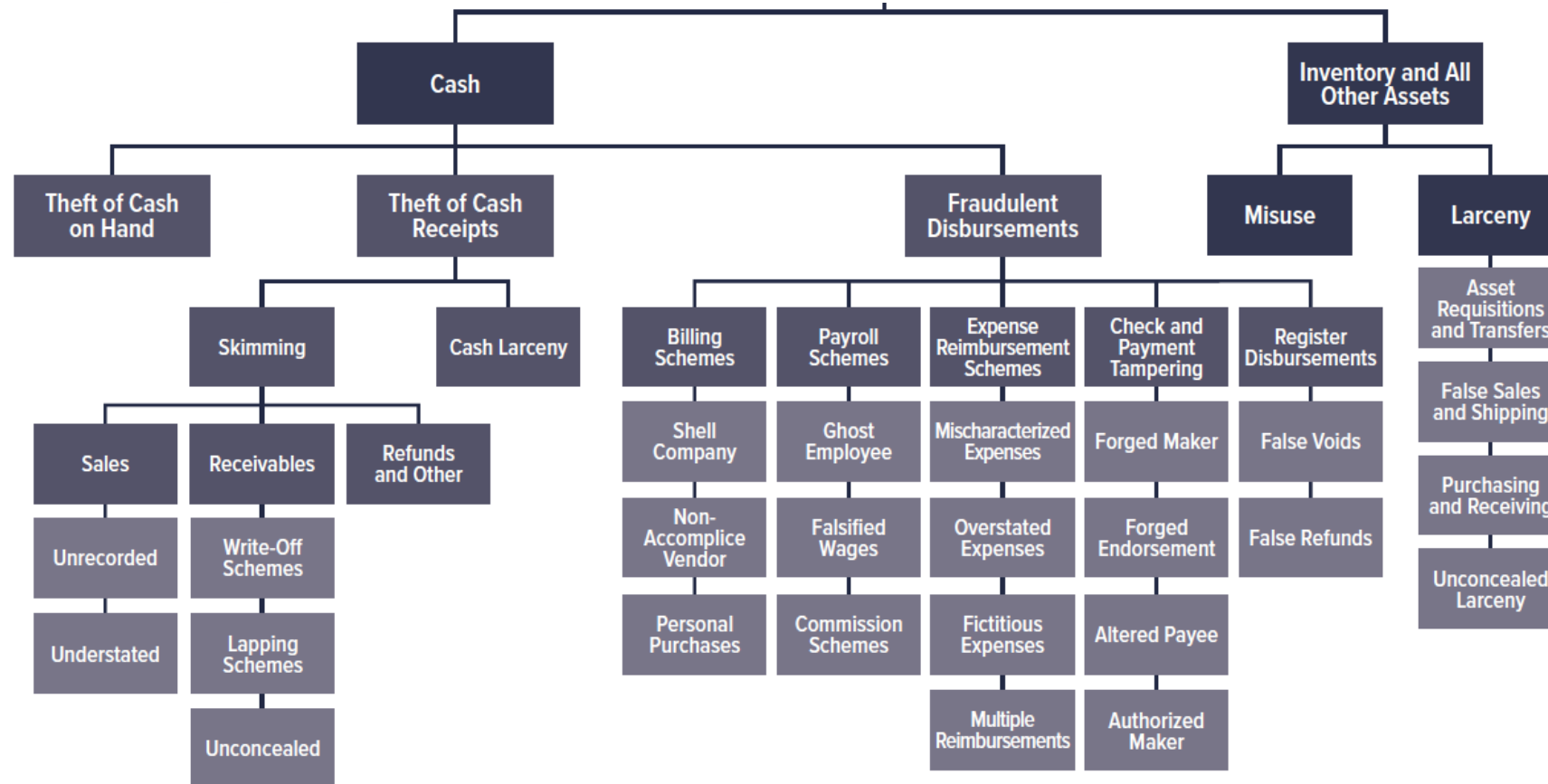
Financial Statement Fraud



Corruption



Asset Misappropriation



Test Your Knowledge: Who Commits Organizational Fraud

Higher or lower levels of authority?

Owners or managers?

Which departments?

Gender (binary)?

High school or college education?

Older or younger?

Test Your Knowledge: Who Commits Organizational Fraud

Higher or lower levels of authority?	Lower
Owners or managers?	
Which departments?	
Gender (binary)?	
High school or college education?	
Older or younger?	

Test Your Knowledge: Who Commits Organizational Fraud

Higher or lower levels of authority?	Higher
Owners or managers?	Managers/other employees
Which departments?	
Gender (binary)?	
High school or college education?	
Older or younger?	

Test Your Knowledge: Who Commits Organizational Fraud

Higher or lower levels of authority?	Higher
Owners or managers?	Managers/other employees
Which departments?	Operations, Accounting, and Sales
Gender (binary)?	
High school or college education?	
Older or younger?	

Test Your Knowledge: Who Commits Organizational Fraud

Higher or lower levels of authority?	Higher
Owners or managers?	Managers/other employees
Which departments?	Operations, Accounting, and Sales
Gender (binary)?	Men, 74% of the time
High school or college education?	
Older or younger?	

Test Your Knowledge: Who Commits Organizational Fraud

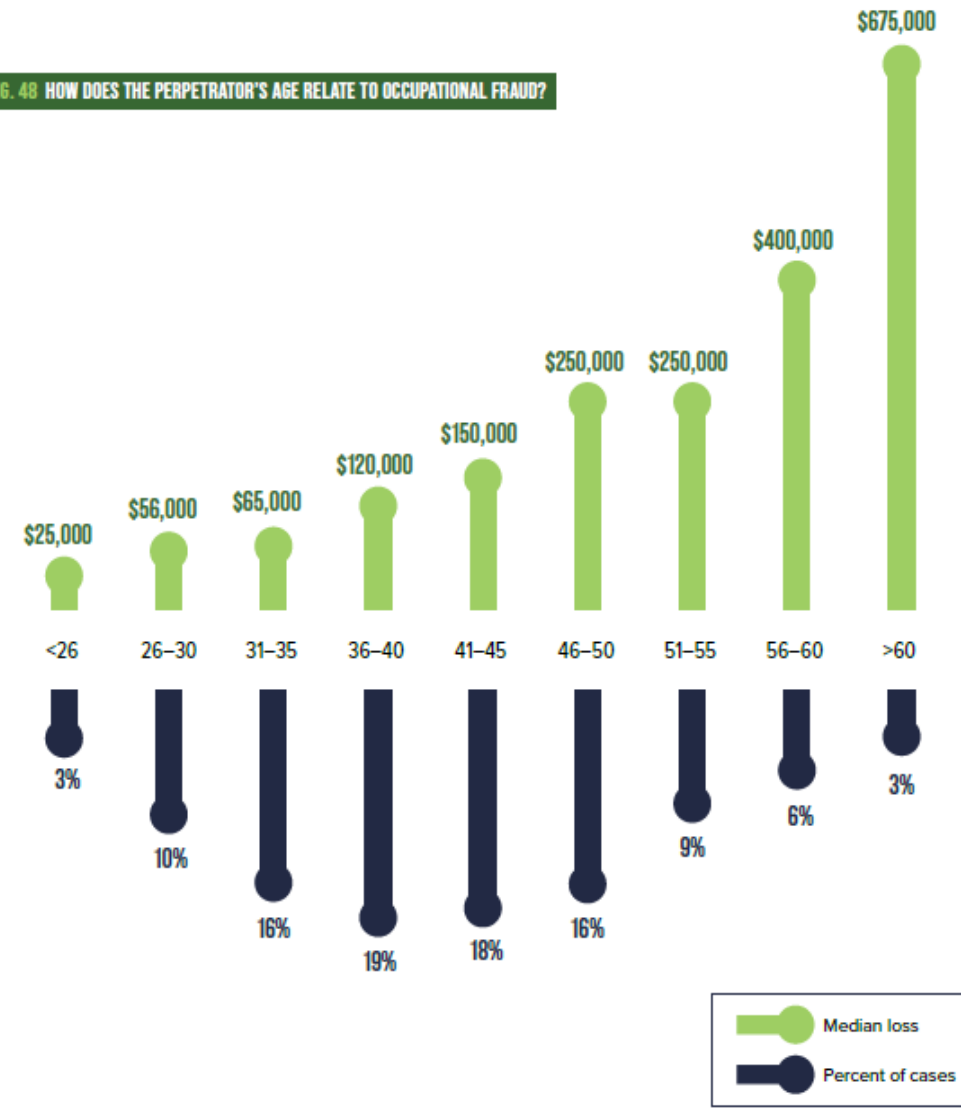
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Test Your Knowledge: Who Commits Organizational Fraud

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Which departments?	Operations, Accounting, and Sales
Gender (binary)?	Men, 74% of the time
High school or college education?	College or higher
Older or younger?	31-50 years old, 69% of the time

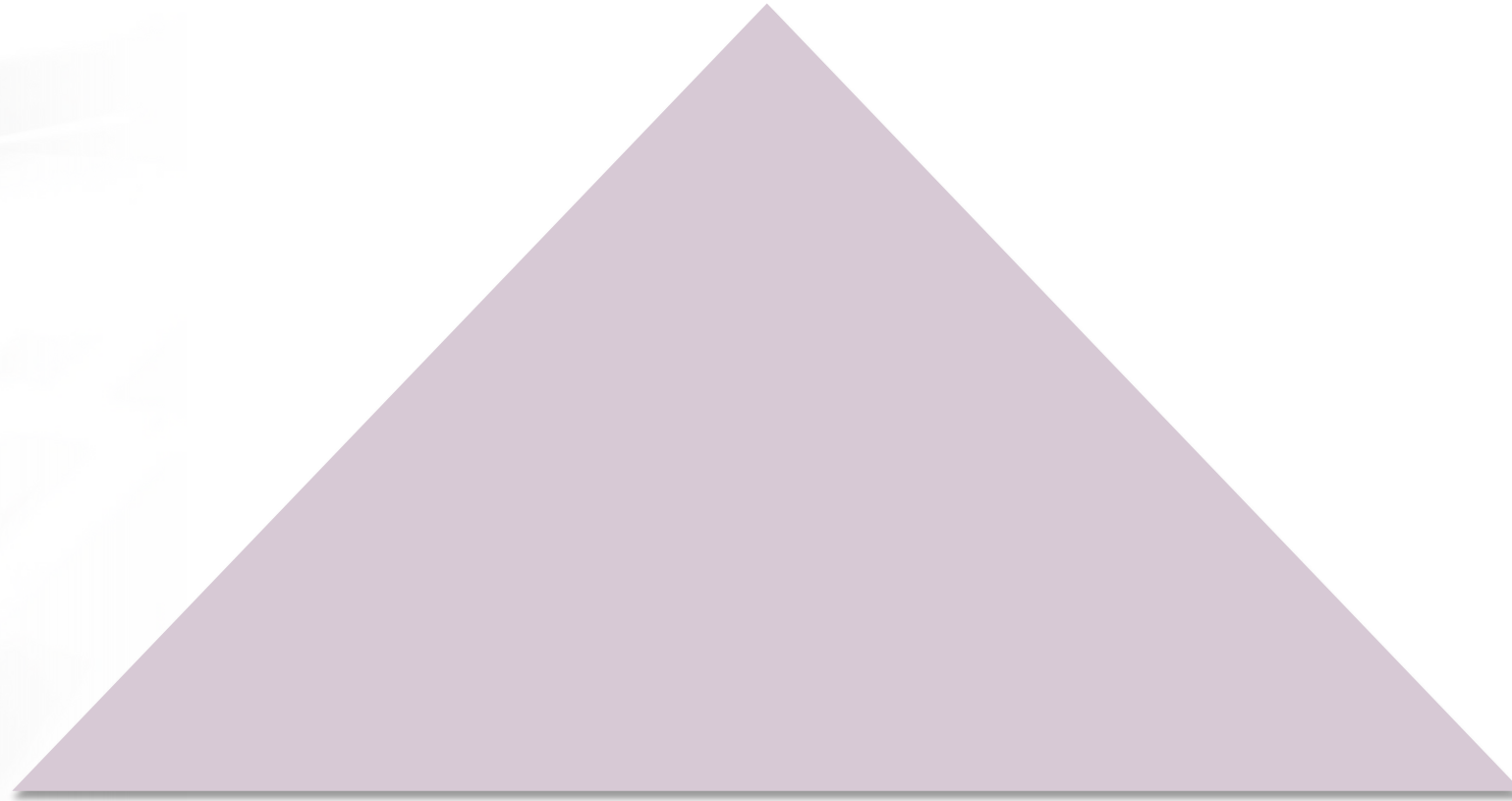
Age is More Than Just a Number!

FIG. 48 HOW DOES THE PERPETRATOR'S AGE RELATE TO OCCUPATIONAL FRAUD?



Cressey's Fraud Triangle

Opportunity



Pressure

Rationalization

Opportunity

- Position(s) of trust
- Poor internal controls and segregation of duties
- Organizations cut costs or don't invest in non-revenue generating departments
 - Compliance
 - Internal audit
- Introduction of the remote work environment
- Executive Level employees are left with too much authority and limited oversight



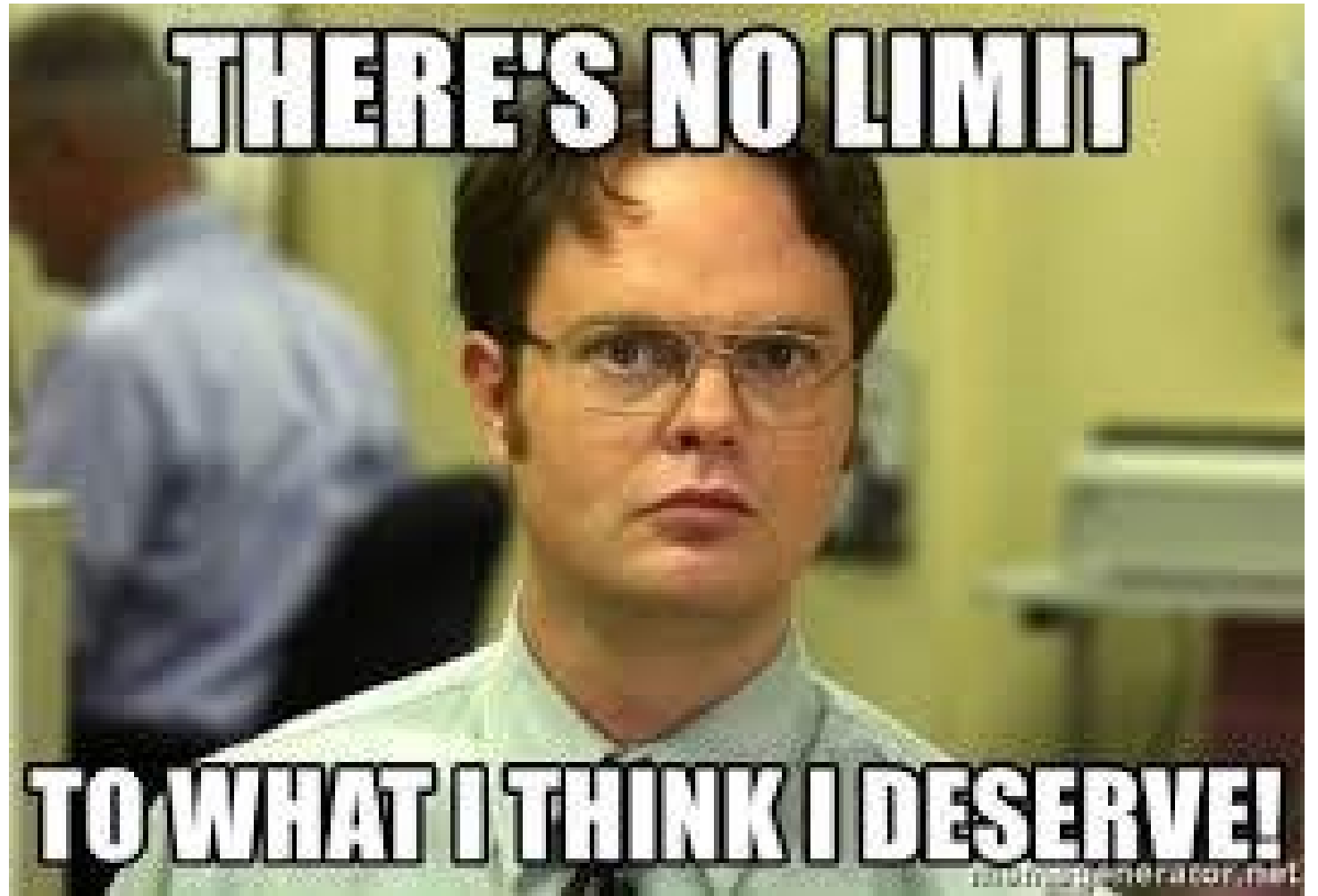
Under Pressure

- “Non-shareable personal problem”:
 - Spouse loses job
 - Paycuts – can’t keep up with living standard
 - Family members lose job and need financial support
 - Caregiver stress (child and adult)
 - Medical issues
 - Addiction



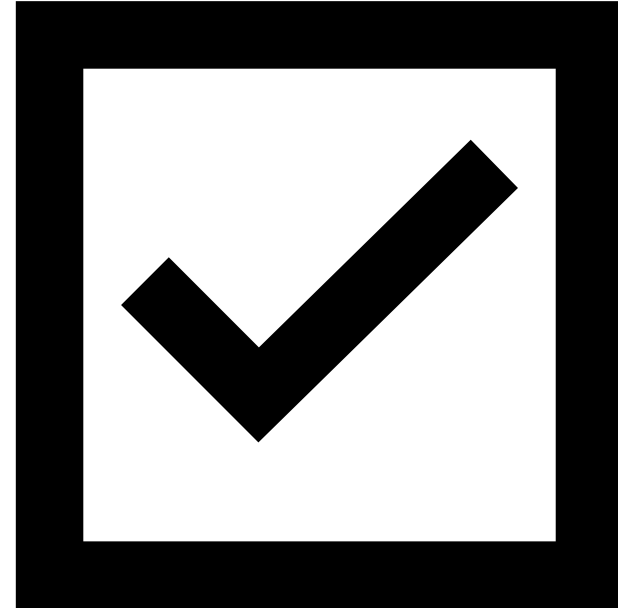
Rationalization/ Justification

- “I’m only borrowing the money”
- “I deserve this money for all I do around here”
- “It’s a freakin’ pandemic man!!”
- “This organization is not taking care of us and the owners just keep getting richer”
- “The ‘bank’ will just write it off”
- Victimless crime – tax money, donations, government funds, dormant accounts



What % of revenue do organizations lose each year to fraud?

- 1%
- 5%
- 7%
- more than 10%



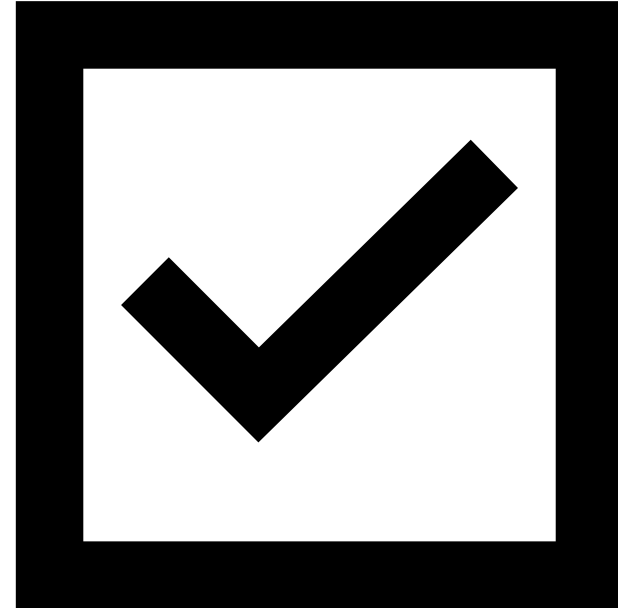
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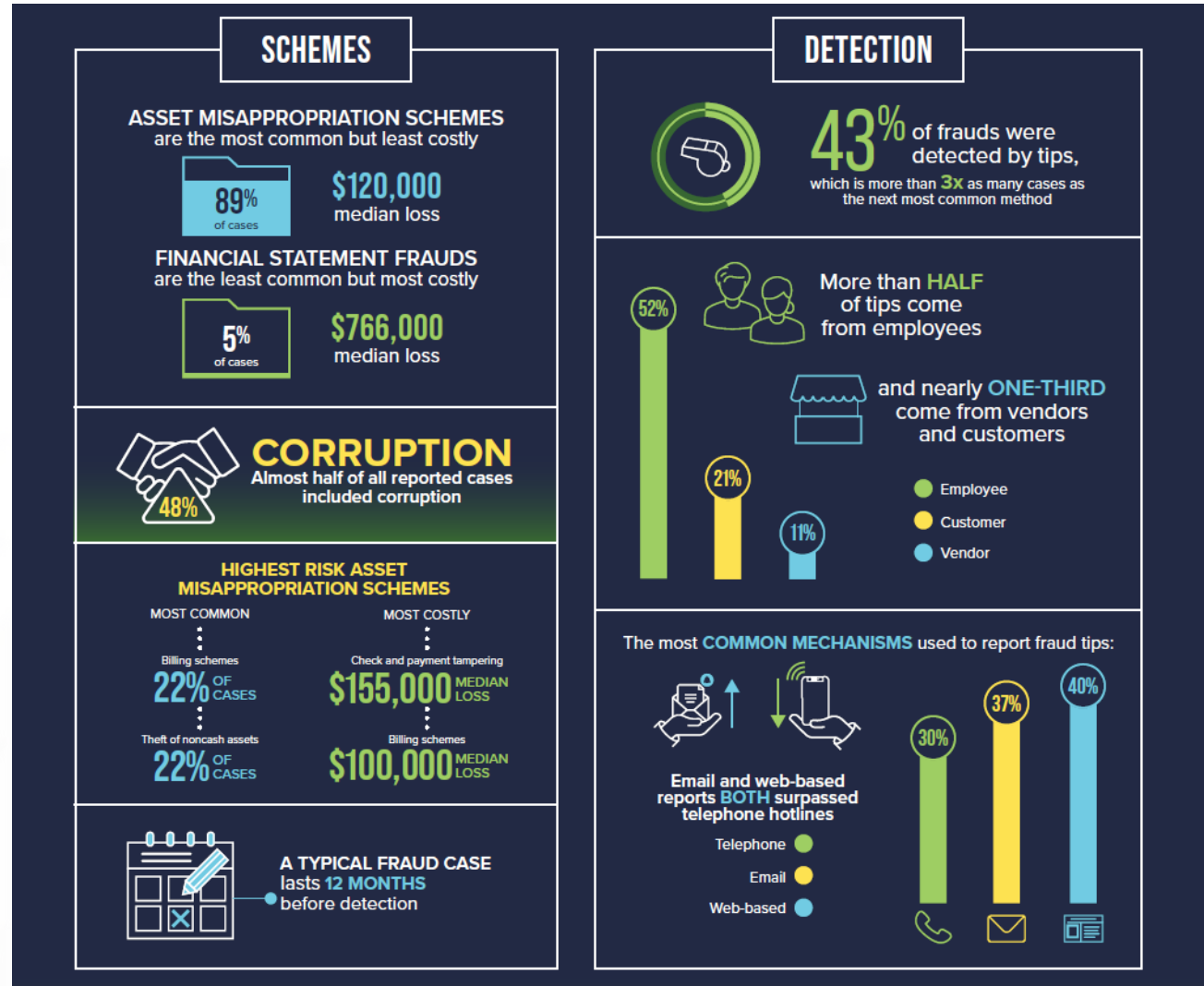
5%

7%

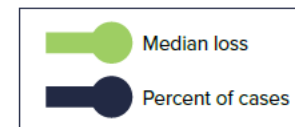
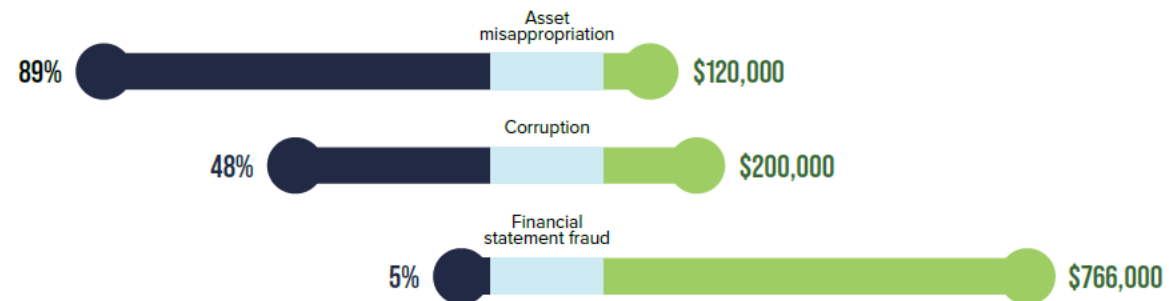
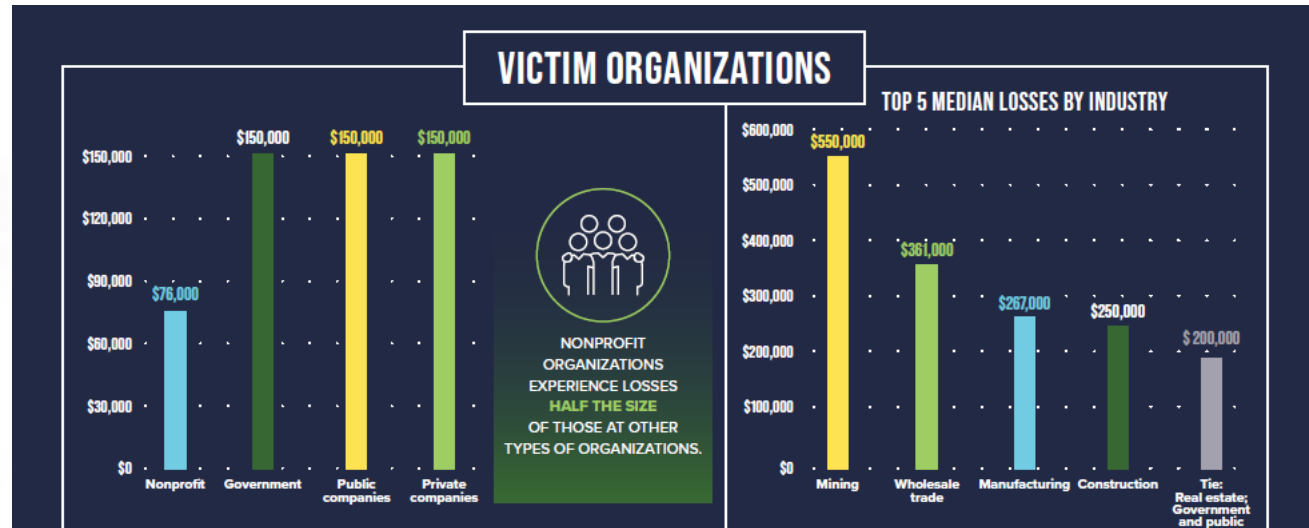
more than 10%



ACFE Report to the Nations



ACFE Report to the Nations



Misappropriation of Assets

By Definition

Cash Receipts: Theft of money that has *already appeared* on an organization's books (larceny) or stealing cash that has *not been recorded* on the books

In Practice

- Employee fails to record alcohol sales in the register and pockets the cash
- Employee with custody of cash steals cash after it has been recorded in accounting system but before it has been deposited in bank

Misappropriation of Assets

By Definition

Fraudulent Disbursement:

{The most common form of asset misappropriation}

An employee makes a disbursement of company funds for an inappropriate purpose

In Practice

- Employee adds a fictitious vendor, submits a false invoice and issues payment to himself
- Supervisor colludes with an employee and authorizes OT pay

Misappropriation of Assets

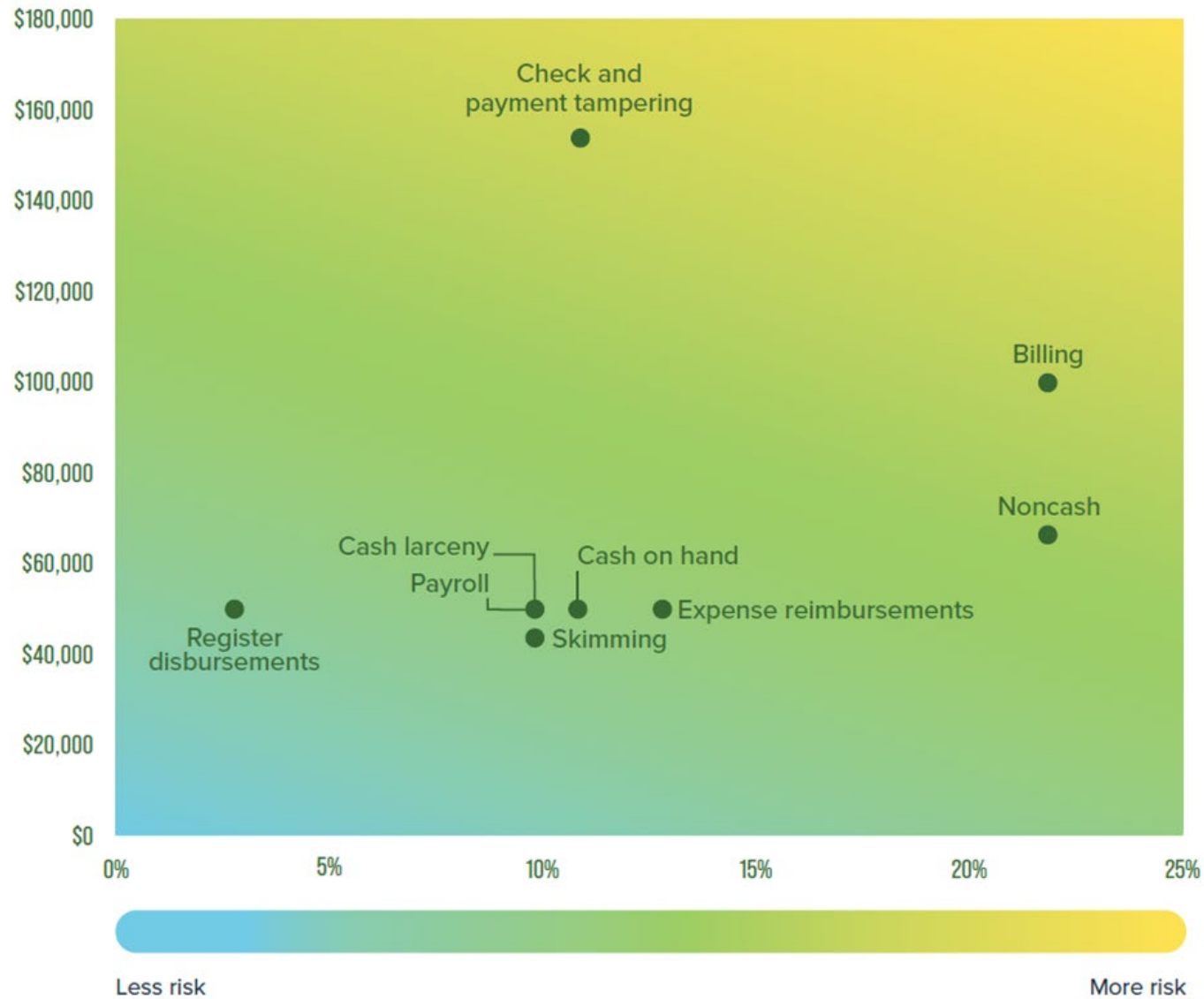
By Definition

- **Inventory and Other Assets:** Employees target inventory, equipment and other noncash assets for theft

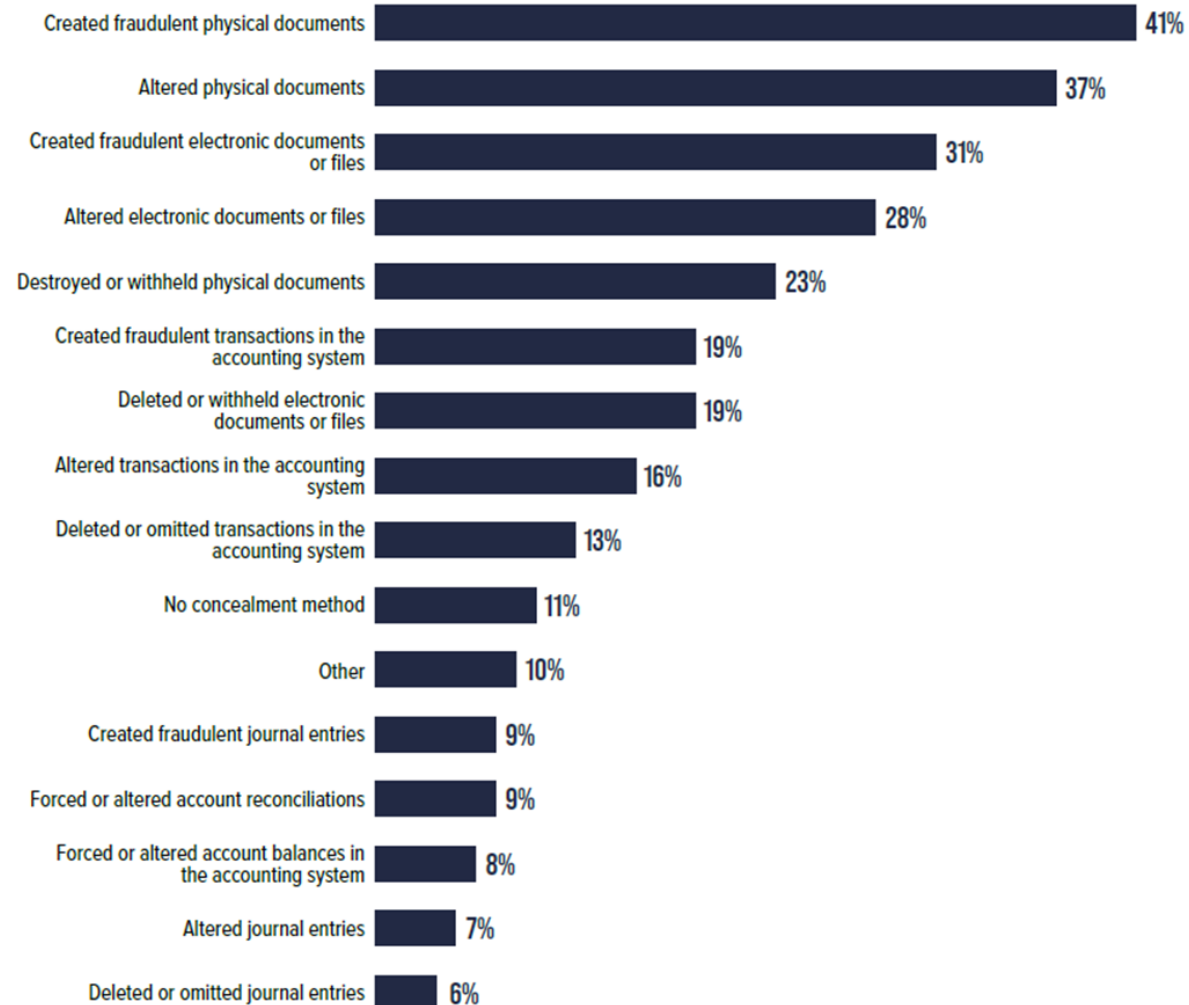
In Practice

- Warehouse personnel confiscate items
- College faculty member takes lab equipment and computers on her last day of employment
- Employee steals 10 items from shipment of 100 and falsifies incoming shipping documents so receipt agrees to inventory system

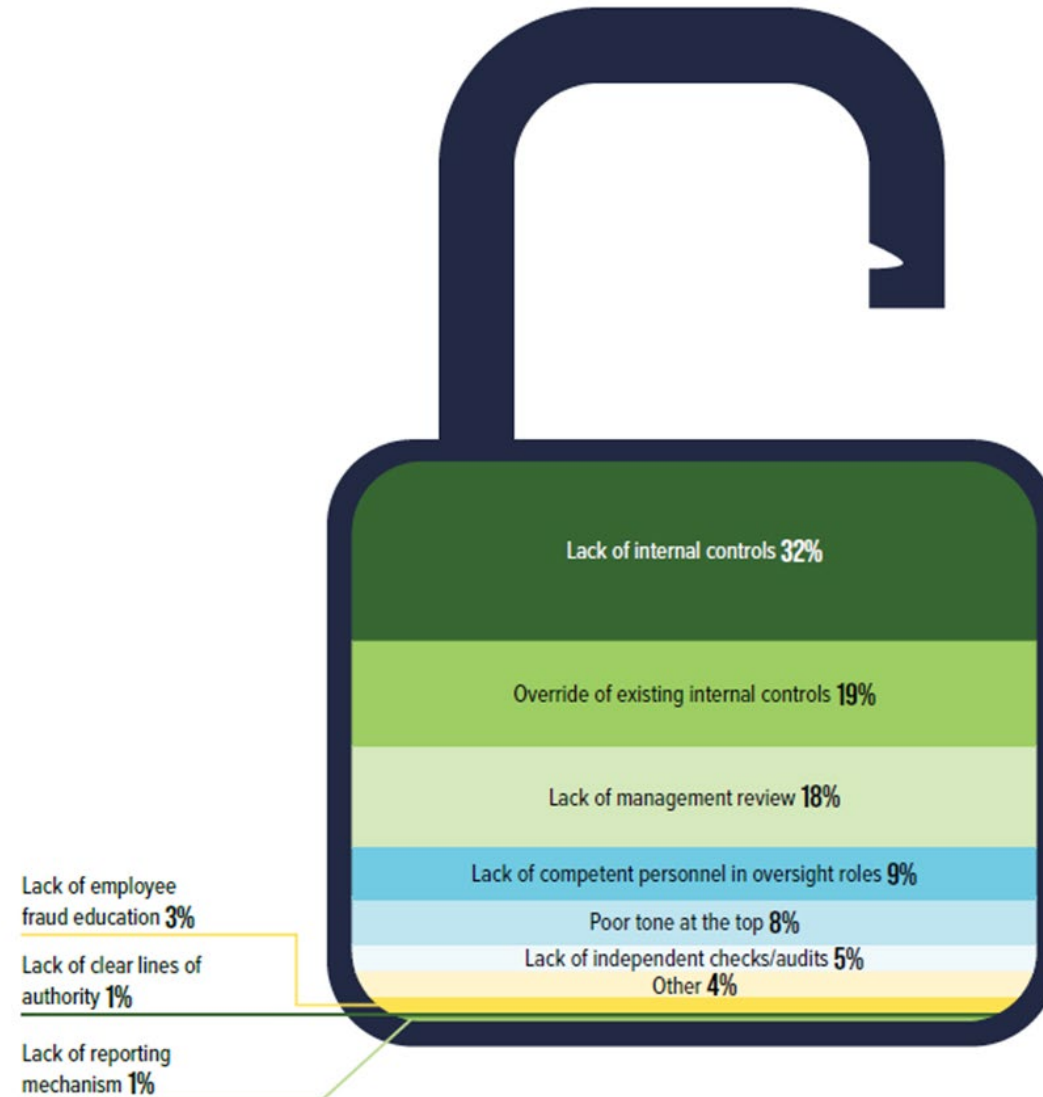
ACFE Report to the Nations



Covering Their Tracks



How It Happens



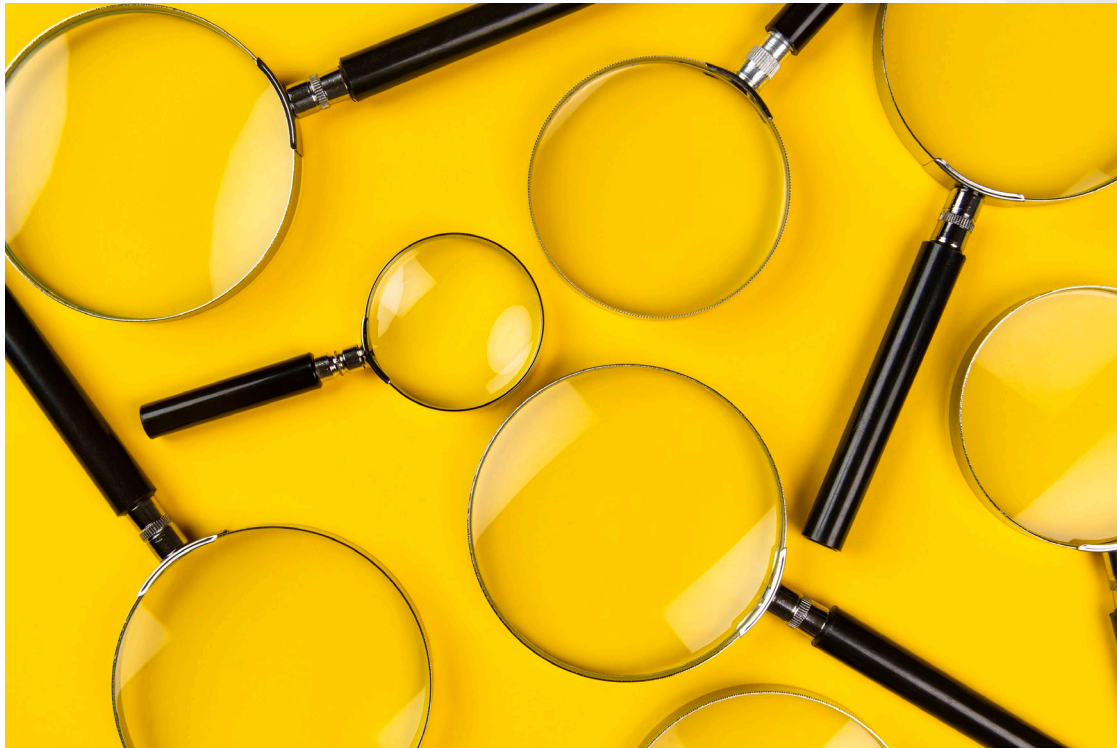
Methods for Detection

FIG. 19 DETECTION STATISTICAL ANALYSIS TABLE

Category	DETECTION METHOD				
	Cases	25 th percentile	Median (50 th percentile)	75 th percentile	Mean*
Tip	716	\$28,000	\$155,000	\$693,000	\$1,518,000
Internal audit	238	\$17,000	\$100,000	\$500,000	\$1,267,000
Management review	224	\$28,000	\$125,000	\$700,000	\$1,569,000
Document examination	103	\$25,000	\$133,000	\$766,000	\$1,510,000
Account reconciliation	90	\$13,000	\$118,000	\$1,000,000	\$1,257,000
By accident	83	\$31,000	\$110,000	\$1,000,000	\$1,646,000
External audit	52	\$53,000	\$227,000	\$1,179,000	\$2,157,000
Automated transaction/data monitoring	46	\$13,000	\$83,000	\$325,000	\$873,000
Surveillance/monitoring	35	\$16,000	\$65,000	\$800,000	\$2,826,000
Notification by law enforcement	30	\$62,000	\$675,000	\$6,115,000	\$6,109,000
Confession	25	\$15,000	\$121,000	\$833,000	\$2,292,000

*Mean amounts were calculated using loss data that was winsoized at 5% (i.e., assigned all cases in the top 2.5% and bottom 2.5% the same value as the 97.5th percentile and 2.5th percentile, respectively).

Poll the Audience: How have you seen a fraud concealed?



The Personal Side: Fraud Against Individuals



SCAMS



FINANCIAL
EXPLOITATION

Financial Exploitation

In Theory

The illegal or improper use of an elder's funds, property, or assets.

- <https://ncea.acl.gov/Suspect-Abuse/Abuse-Types.aspx#financial>

In Practice

- Stealing cash, jewelry, other items of value
- Improper access to benefit checks, ATM or credit cards
- Forging elder's signature
- Charging excessive fees for basic care services
- Obtaining money/property by coercion, misrepresentation, fraud, undue influence

Scams

- Sweepstakes Scams
- Romance Scams
- Grandparent Scams
- Money Mules
- Investment Scams

Rise in Crime: Cryptocurrency

According to the Federal Trade Commission (FTC) in its publication *Data Spotlight: Reports show scammers cashing in on crypto craze*,¹ cryptocurrency has become an increasingly popular way for fraudsters to steal money.

The FTC found that:

- ▶ Since the start of 2021, more than 46,000 people have reported losing over \$1 billion in crypto to scams.



Reporting an Instance of Fraud

Where to Report	When to Report
Immediate supervisor	You see questionable behavior from someone you work with
Fraud hotline	You see questionable behavior from someone who works at your Organization
Board of directors	You're a member of management who reports to the Board
Legal counsel	You're a member of management who seeks legal advice for the Org. based on concerns or discoveries
Regulatory authority	You have identified a reporting obligation based on investigatory procedures/findings
Adult Protective Services	You suspect an individual over 18 is being harmed or at risk of harm by another individual
Local law enforcement	You suspect fraud by an individual other than a fellow employee
Attorney General	You suspect fraud by a business other than your employer

Role of the Forensic Accountant

Big firm capability. Small firm personality.

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What is Forensic Accounting?

The identification, interpretation and communication of the evidence of economic transaction and reporting events

Forensic Accounting is a “specialty” practice area within the accounting discipline that describes engagements, which result from actual or anticipated disputes or litigation

Branches of Forensic Accounting

- **Investigative Forensic Accounting** – focuses on the investigation of criminal or civil matters related to asset misappropriation, securities or financial statement fraud, insurance fraud, etc.
- **Litigation Support** – providing accounting assistance in litigation matters. Can often deal with the quantification of economic damage, explaining a fraudulent scheme or providing an expert opinion related to accounting matters

What Does a Forensic Accountant Do?

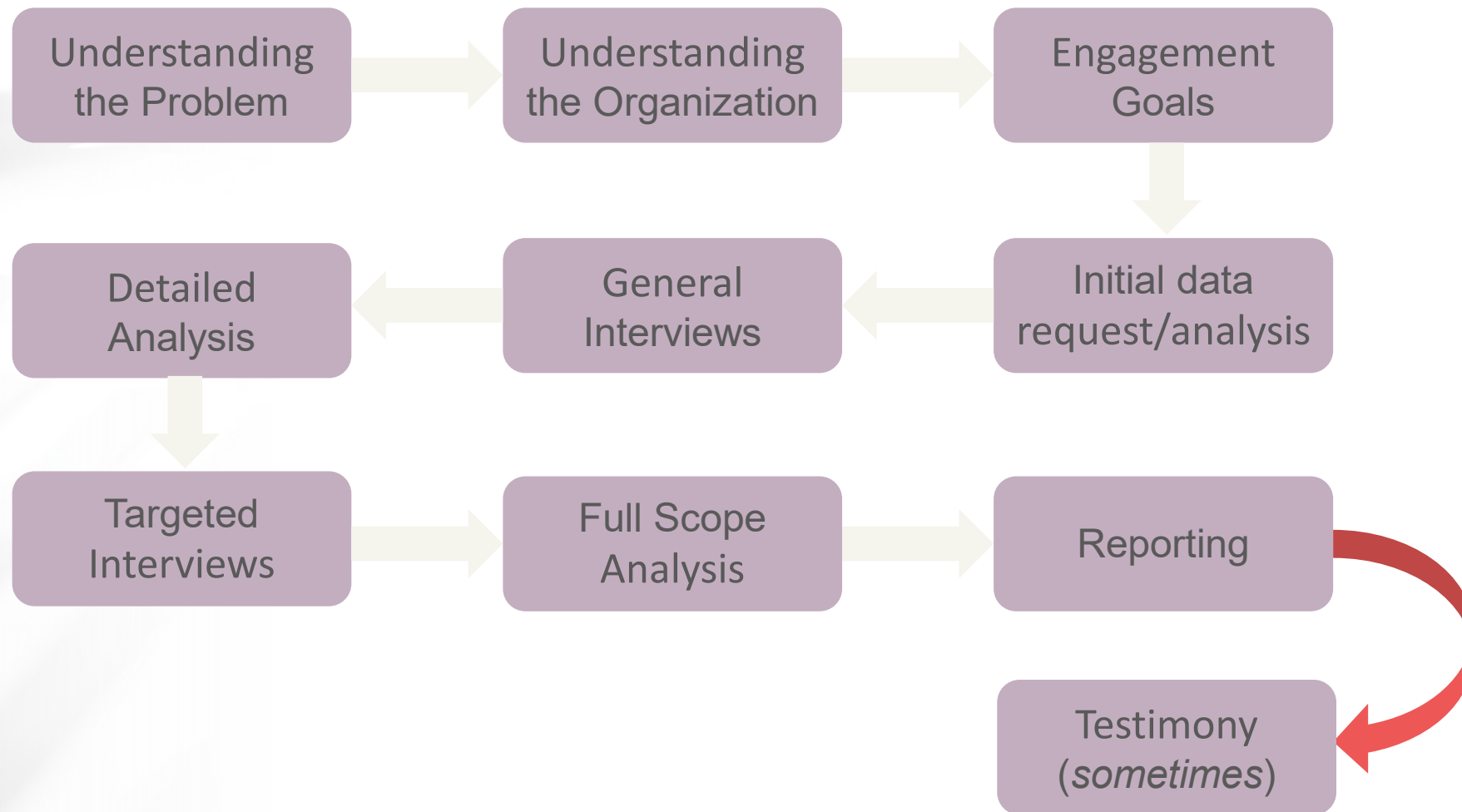
Investigating and analyzing	Investigating and analyzing financial evidence and interview dialogue
Developing	Developing databases, software program tools and testing procedures to assist in analyzing and presenting the results of the investigation.
Communicating	Communicating findings in deposition, reports, exhibits and document collections.
Supporting	Supporting litigation or legal proceedings as an expert witness. Providing testimony and preparing visual aids for the courtroom.

Forensic Accounting Engagement Examples

- Investigation of asset misappropriation
- Partnership and Corporation Disputes
- Insurance Claim support and evaluations
- Shareholder disputes
- Divorce proceedings and matrimonial disputes
- Professional Negligence
- Personal injury claims (business interruption)
- Contract disputes
- Government investigations and Disclosures



How are Fraud and Investigative Engagements Conducted?



Fraud Update

Common Themes post COVID:

- Increase in fraud and suspected fraud across all types of industries and categories (non-profit, government, elder care, and for-profit, privately held and public organizations)
- Simple (not sophisticated) fraud schemes
- Lean staff = Organizations less likely to implement Segregation of Duties in critical areas

Fraud Update

Common Themes post COVID:

- Too trusting of a long tenured employee
- People's rationalization change based on personal life
- Lack of awareness and knowledge around user access in critical systems
 - accounting
 - electronic banking
 - Point of Sale (POS)



Poll: What has changed in your work since COVID?



Recent examples of fraud investigations & related control gaps

Example #1

- **Fraudster:** Elected Official
- **Length of Time Fraud Undetected:** 10+ years
- **Amount of Money Stolen:** \$500k (investigation ongoing)
- **Fraud:** Skimmed daily deposits
 - Had unlimited access to cash
 - Prepared deposit slip
 - Brought cash to bank



Recent examples of fraud investigations & related control gaps

Example #1 (continued)

- **Detection Method:** Complaints regarding late payments from outside agencies
- **Controls Not in Place:** Segregation of Duties
 - Deposit Prep
 - Custody / locked bank bag
 - Reconciliation

Recent examples of fraud investigations & related control gaps

Example #2

- **Fraudster:** Appointed County Position
- **Length of Time Fraud Undetected:** 1.5 years
- **Amount of Money Stolen:** ~ \$525k
- **Fraud:** Unlimited access to online banking platform & lack of seg. duties
 - Wired themselves money
 - Started with small amounts, but progressed to larger disbursements
- **Detection Method:** Bank flagged transactions
- **Controls Not in Place:** Dual authorization, Limited access to create new vendors, overall awareness and knowledge around electronic banking

Recent examples of fraud investigations & related control gaps

Example #3



- **Fraudster:** Patron Service Manager at Concert Venue
- **Length of Time Fraud Undetected:** Unknown- 2+ years
- **Amount of Assets Stolen:** Investigation still ongoing ~ \$50+ in beer and alcohol
- **Fraud:** Manipulated the POS system after the items were received to reflect a quantity greater than ordered and paid for
- **Detection Method:** our internal cash handling review
- **Controls Not in Place:**
 - Segregation of duties between purchasing, receiving and custody functions
 - Consistent and routine physical inventories
 - Appropriate access controls

Recent examples of fraud investigations & related control gaps

Example #4

- **Fraudster:** Appointed Official and right-hand employee
- **Length of Time Fraud Undetected:** 7 years
- **Amount of Money Stolen:** \$39k
- **Fraud:** Stole vacation time
 - Collusion
 - Approved each other's contract amendments
 - One had timekeeping system override authority

Recent examples of fraud investigations & related control gaps

Example #4 (continued)

- **Detection Method:** Interim official identified non-standard contract terms at severance
- **Controls Not in Place:**
 - Loose oversight by board
 - No segregation of duties
 - No reporting mechanism for code of conduct violations

Fraud Prevention Checklist

- Is ongoing anti-fraud training provided to all employees of the organization?
- Is an effective fraud reporting mechanism in place?
- Are proactive measures taken and publicized to employees to increase employee's perception of detection?
- Is the management climate/tone at the top one of honesty and integrity? Establishing a tone of integrity should permeate across all levels
- Are fraud risk assessments performed to proactively identify and mitigate vulnerabilities to internal and external fraud?
- Are strong anti-fraud controls in place and operating effectively to eliminate or greatly reduce a likely fraudster's opportunity?

Fraud Prevention Checklist (cont.)

- Are employee support programs in place to assist employees struggling with addiction, mental/emotional health, family or financial problems?
- Is an open-door policy in place that allows employees to speak freely about pressures, providing management the opportunity to alleviate such pressures before they become acute?
- Are anonymous surveys conducted to assess employee morale?
- Does the internal audit department have adequate resources and authority?
- Does the hiring policy include items such as past employment verification, background checks, drug screening etc.?

Critical Fraud Prevention Strategies

Management should take these critical steps to prevent and detect criminal activity

- Get familiar with regularly generating access reports to your critical systems including
 - **Vendor Management**
 - **Payroll / HR**
 - **Banking**
 - **Inventory / Point of Sale (POS) systems**

Critical Fraud Prevention Strategies

Ensure people don't have conflicting or excessive access right.

Just because it's not within someone's job responsibilities to perform a conflicting task, doesn't mean they don't have access to do it.



Critical Fraud Prevention Strategies *Vendor Management*

Establish a clear policy/procedure for adding new vendors

Review your vendor file regularly to ensure its accurate and up to date. Inaccurate or incomplete records can result in duplicate payments

Remove older, duplicative and questionable vendors

Cross reference vendor addresses to employee address

Critical Fraud Prevention Strategies *Payroll / HR*

- GHOST employee fraud
 - Difficult to detect
 - Require multiple levels of approval to add, remove and edit payroll information to prevent this scheme
 - Review payroll change reports
 - Review a sample of active employees to verify status and pay rate



Critical Fraud Prevention Strategies

Payroll /HR (continued)

Compare commission expenses to sales figures to verify linear correlation

Ensure segregation of duties in calculation of commission amounts



Critical Fraud Prevention Strategies *Procurement/Inventory*

- ✓ Segregate purchasing, receiving and inventory related responsibilities
- ✓ Is the frequency of your inventory sufficient?
- ✓ In lieu of purchasing department, implement purchase approval matrix which outlines who is authorized to purchase goods

Activities	Limit (US\$)	CEO	Head of Procurement	Procurement Officer
Procurement				
Vendor Selection	Your text here	Your text here	Approves	Initiate
Performance Evaluation of Vendors	Your text here	Your text here	Reviews	Your text here
Purchase Request review	Up to US \$500	Your text here	Approves	Initiate
	Above US \$500	Approve	Review / validate	Initiate
Selection of purchasing mode. Cash purchases, tenders, Direct orders	Your text here	Approve	Support / input	Your text here

Critical Fraud Prevention Strategies *Credit Cards*

- Limit number of cards issued and assign cards to single users
- Establish credit card policy
- Require support for every purchase and ensure purchase adheres to policy (how many meals can a manager purchase for their staff a year)
- Reconcile monthly statements to supporting documentation
- Restrict card usage to approved vendors
- Secure cards in safe location

Critical Fraud Prevention Strategies *Banking & Disbursements*

- Require dual authorization for ACH and wire disbursements. One to initiate the payment and another to approve/release payment
- Separate individuals should be responsible for maintaining payment templates, entering and approving payments
- Limit who can open a new bank account. Periodically, review statements to verify intercompany transfers
- Implement Positive Pay for high volume check transactions

Critical Fraud Prevention Strategies *Banking & Disbursements*

- Bank statements should be reconciled and reviewed by more than 1 person
- Review the check register for checks payable to employees
- Use electronic payment services for large vendor and financing payments

Questions



Thank you! Don't enable a fraudster!

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