An Expensive Problem

- Business fraud and abuse in the U.S. cost about $650 billion a year.
  - Government agencies lose an average of $90,000 per fraud scheme.
  - Average organization loses 5% of revenue or $8 a day per employee.

Fraud in Government: A Growing Problem

- Overview of the Chief Inspector Division
  - Audit local BOEs, Municipalities, County Commissions, Boards of Health and other small government agencies.
  - Due to the increased volume of fraudulent activity a separate section was formed to perform the following functions:
    1. Perform “agreed upon procedures” on entities with the local Purchasing Card.
    2. Respond immediately to fraud in local governments.
The Fraud Triangle

Inadequate or no:
- Supervision & review
- Segregation of duties
- Management approval
- System controls

Unrealistic deadlines
- Unrealistic performance goals
- Personal stress
- Employer/employee conflicts

A.K.A. Rationalization – reconciling behavior with commonly accepted notions of honesty & trust.

Types of Fraud

- Corruption
  - Bid Rigging
  - Kickbacks
  - Illegal Gratuities

- Financial Statement Fraud
  - Asset Revenue Overstatements
  - Improper Disclosures

- Asset Misappropriation
  - Can be related to Cash or Fraudulent Disbursements

How Occupational Fraud is Committed
Asset Misappropriation

- Skimming
- Non receipted revenue/substitution of checks for cash
- Lapping Schemes
- Write-off Schemes
- Shell Companies
- Personal Purchases (i.e. Credit or Purchasing Cards)
- Payroll Schemes (extra payrolls, falsified wages, excess leave payments, ghost employees, credit union)
- Expense reimbursement schemes (duplicate payments, fictitious expenses)
- Check tampering (altered payee, forged endorsement, concealed checks)
Fraud Detection and Prevention

• External Auditor Responsibility
  - SAS 99 (issued in 2002) says auditors should gather information to identify material misstatements due to fraud and:
    - Assess these risks with other evaluations.
    - Respond to these risks.
  - Brainstorming.
  - Congress also passed Sarbanes-Oxley (SOX—Publicly traded companies) in 2002:
    • Requires senior management to certify the accuracy of the financial statements.
    • Requires management to establish detailed internal controls and auditors to report on those controls.

<table>
<thead>
<tr>
<th>Year</th>
<th>Company</th>
<th>Auditor</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>Worldcom</td>
<td>Arthur Anderson</td>
<td>$1B moved from operating expenses to capital accounts.</td>
</tr>
<tr>
<td>2001</td>
<td>Enron</td>
<td>Arthur Anderson</td>
<td>Employees and investors lost $7B when the company declared bankruptcy; innovative accounting methods all designed to overstate earnings and keep debt off the books. Firm paid $52M in one year for audit and other services. Destroyed audit documents.</td>
</tr>
<tr>
<td>1998</td>
<td>Waste Management</td>
<td>Arthur Anderson</td>
<td>$1.7B in fake earnings through fake depreciation lives.</td>
</tr>
<tr>
<td>2002</td>
<td>Tyco</td>
<td>Price Waterhouse Coopers</td>
<td>CEO and CFO stole $150M (disguised as bonuses) and inflated earnings by $500M.</td>
</tr>
</tbody>
</table>

Did these measures work?
## Fraud Detection and Prevention

<table>
<thead>
<tr>
<th>Year</th>
<th>Company</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>Freddie Mac</td>
<td>Understated earning by $1B.</td>
</tr>
<tr>
<td>2005</td>
<td>AIG</td>
<td>Bid rigging, stock price manipulation, booked loans as revenue. Government bailout after a $61B loss in 2008. Execs then received $165M in bonuses.</td>
</tr>
<tr>
<td>2008</td>
<td>Lehman Brothers</td>
<td>Loans disguised as sales (of toxic assets) to banks in Cayman Islands</td>
</tr>
</tbody>
</table>

### Figure 11: Initial Detection of OccupationalFrauds

![Graph showing initial detection of occupational frauds](image1)

### Figure 12: Median Loss and Median Duration by Detection Method

![Graph showing median loss and median duration by detection method](image2)
Anti-Fraud Controls at the Victim Organization

Figure 20: Frequency of Anti-Fraud Controls

Figure 21: Number of Perpetrators — Frequency and Median Loss

Criminal History

Source: Association of Certified Fraud Examiners, Report to the Nation on Occupational Fraud & Abuse
Pressure

- Personal Vices – Drug addiction, GAMBLING
- Sudden Changes in Lifestyle due to the economy, the loss of financial provider.

Opportunity

- Who is watching the store?
- Inadequate internal controls due to the size of the entity.
- Lack of organizational integrity.
- Test the system. Start small and if nobody notices, then expand operations.
- It can be ANYONE!
Signs of a Fraudster

• RED Flags
  – Living beyond their means.
  – Conflicting job responsibilities.
  – Organization cannot meet obligations (usually starts with payroll).
  – Excessive Gambling.
  – Avoidance of an audit.
  – Missing /Lost Records.
  – Refusal to take Sick/Annual Leave.
  – Overriding Internal Controls.
  – Cashing personal checks/can’t reconcile cash drawer.
  – Large # of account write-offs.
  – Bank accounts not reconciled.
  – Charges without supporting documents.

– Companies that are not normal routine vendors of the entity.
– Payments (outside of payroll) to employees for reimbursements.
– Large amounts of credit card transactions with lack of adequate control.
– Large time lapses from the time of collection to the ultimate deposit of revenue.
– Purchases that bypass normal procedures such as approved purchase orders.
– Unmonitored overtime.
– Complaints about nonpayment notices from customers.
– Unauthorized bank accounts.

Fraud Engagements

• Meet with Officials and ask A LOT of questions.
• Identify areas of concern.
• Meet with Prosecutor/Law Enforcement to coordinate activity and objectives.
• May look into allegations during the course of a regular audit.
• Statutory Authority:
  – WV Code §6-9-7 authorizes the Chief Inspector to examine into all of the fiscal affairs of any local government and issue subpoenas.
• Perform procedures utilizing "forensic accounting" techniques.
• Forensic Accounting is defined as the application of specialized accounting, auditing, finance, economics and statistics (as well as skills in various aspects of law, research and investigative methods) in the collection, analyses and communication of evidential matters and related findings.
• Staff – Accredited Fraud Investigation Classes and Certification and Certified Fraud Examiners.
  – Understanding the rules of evidence.
  – Quantitative Tools such as data mining.
  – Computer examination techniques.

• Fraud Theory Approach - scientific method of:
  1. Analyzing the data.
  2. Creating a hypothesis.
  3. Testing the hypothesis.
  4. Refining and amending the hypothesis.
  5. Accepting or rejecting the hypothesis.

Brainstorming.

• Meetings:
  – Length of Service.
  – Insurance/Bonded.
  – Computer.
  – Define objectives/ongoing and dynamic process.
  – Subpoenas/Search Warrants (photocopy of deposits).
  – FEIN # to local banks.
  – Gather Information.
  – Prepare a Report.
  – Assist Prosecutors/Provide Supporting Documentation(evidence)/Testify.
  – Help question suspected perpetrators.
Anatomy of a Report

• Background and Methodology. Details the procedures and conclusions and provides support for the conclusions.
• Schedule of Comments – Provides internal control/compliance findings and recommendations related to the work performed.
• Frequently this report can be used as a basis for insurance reimbursement (if available).
• Considered confidential and issued only to the prosecutor.

Examples

Case #2 – What a Great Credit Union
An employee in a small town was responsible for performing payroll functions which included calculating payroll, filling out tax forms and remittances and issuing checks to agencies. Another person in the office was suspicious of her but lacked the expertise to verify payroll transactions. It was determined that she was paying herself the proper rate of pay throughout the time period. The auditor increased the scope of testing in payroll since there was not adequate oversight and found that she had regularly depositing amounts to her employees credit union accounts however her credit union account was receiving much more than was withheld from her pay.

Over time, it gradually increased to the point the town could not meet legitimate obligations. It was determined she deposited over $10,000 extra into her credit union account and also paid over $7,000 in AFLAC premiums to her account.

Case #4 – I need confetti
A long time employee of a small town embezzled over $30,000 over a 4 year period. The culprit collected and posted water/sewerage revenue. The falsified payments posted to customer accounts agreed with deposit. However, the auditor noted that they had paid the water/sewerage collectors and substituting them for cash collectors. She would then pocket the cash and “adjust” the legitimate posting journal. She consistently told the customers that they had paid their bills and eventually began to “adjust” customers who had not been billed. She would then deposit the “extra” cash she had pocketed into her bank account. However, she brought home the contents from the shredder at the office so her daughter could use it as confetti. They noticed the pieces that looked like utility stubs and painstakingly “reconstructed” the stubs. The auditor contacted the computer software vendor who assisted in reconstructing the adjustment journal. Confirmations were sent to customers and the adjustments were determined to be fraudulent.
Case #7 – No one is watching the store

- A Director at a SWA was the only employee that worked at the Authority. The SWA has an annual budget of approximately $75,000 per year. The Director had complete control and the board did not even convene for regular scheduled board meetings. Over a period of 4 years, the Director had embezzled the following amounts:

<table>
<thead>
<tr>
<th>Expense Type</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Illegitimate Petty Cash</td>
<td>$18,176</td>
</tr>
<tr>
<td>Excess Payroll</td>
<td>$21,641</td>
</tr>
<tr>
<td>Fraudulent Expense Reimbursements</td>
<td>$16,961</td>
</tr>
<tr>
<td>Cell Phone Bills</td>
<td>$2,021</td>
</tr>
<tr>
<td>Credit Cards</td>
<td>$19,750</td>
</tr>
<tr>
<td>Pay Pal Account</td>
<td>$3,190</td>
</tr>
<tr>
<td>Total</td>
<td>$81,639      (27% of Budget)</td>
</tr>
</tbody>
</table>

To make matters worse, the Director stopped paying the payroll withholdings...AND stopped paying the insurance company that they were bonded with so some cash could be freed up!

Case #8 - Two is company

- 2 Employees in a medium size city conspired to steal over $210,000 from the Town over a 2 year period. The manager and clerk cashed checks to the Town's General Fund; took the checks to the bank; endorsed the back and pocketed the cash. They also received paychecks in one of the fiscal years instead of the customary 26. They paid sick leave to themselves for time they had not accumulated. Some expenses were paid from multiple sources including, checks to the general fund, checks to themselves, and Purchasing Card transactions. The Purchasing Card was used for excessive meal and gasoline charges even though the employee was provided a car and gas and all the meals were within the City limits.
Examples

Case #11 – The Business and Occupation Tax Festival

A clerk for a small city opened an account for a festival held in the town. She collected donations for the festival. She also decided she would begin depositing business and occupation tax revenue into the account as well. The disbursements from the account were written to her and she made off with $24,000 over a 14 month period.

STATUS

- Currently have 16 ongoing fraud investigations.
- Are considering the implementation of a local government fraud hotline.

THE END

Questions?

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