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# Fraud in Today's Economic Environment

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# Economic Uncertainty



# What is Fraud?

- A misrepresentation of a material fact relied upon by someone to their detriment, or
- Concealed, improper conversion of another's assets to one's own benefit.

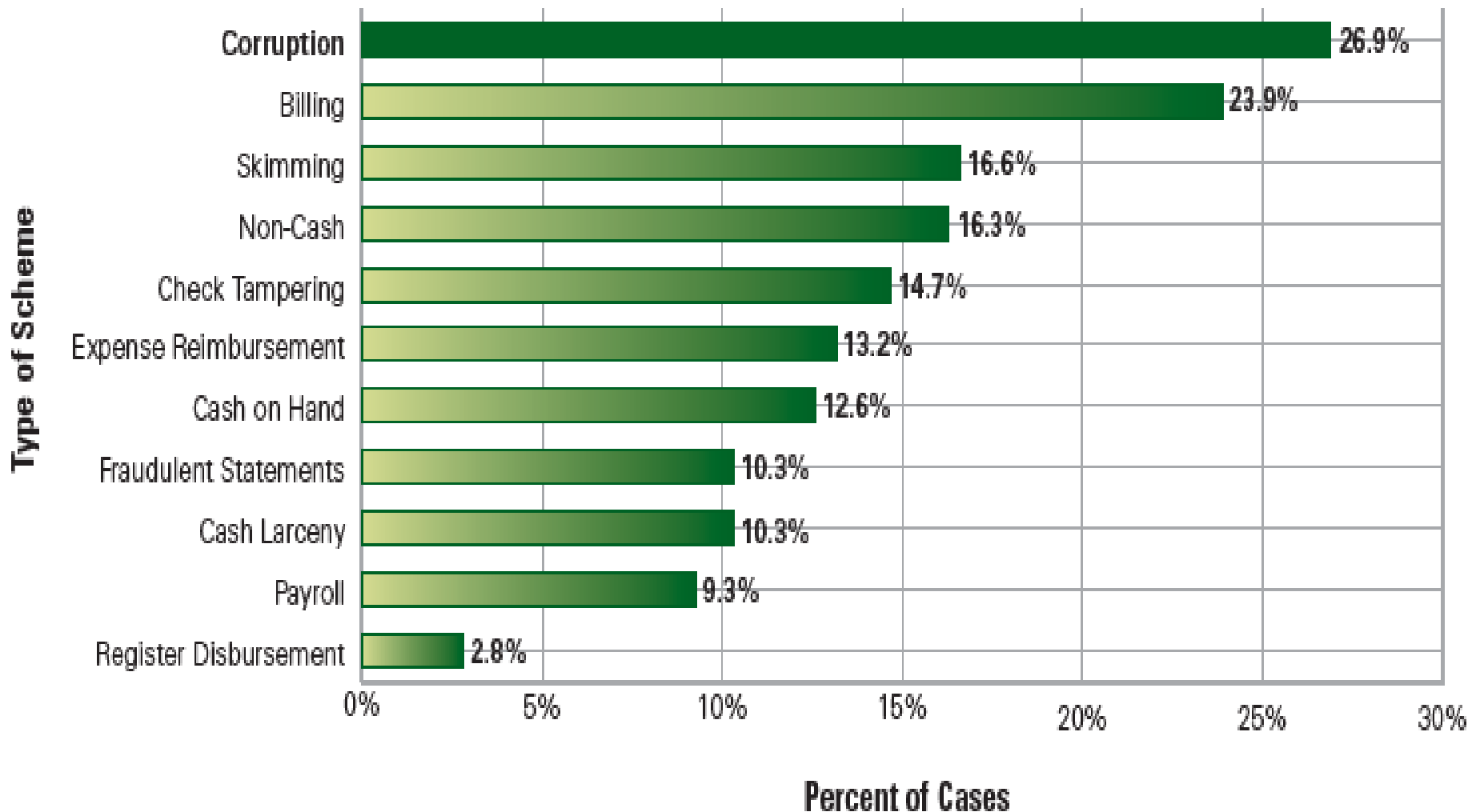
# Types of Fraud

- Third party fraud
- Occupational fraud (employee fraud)

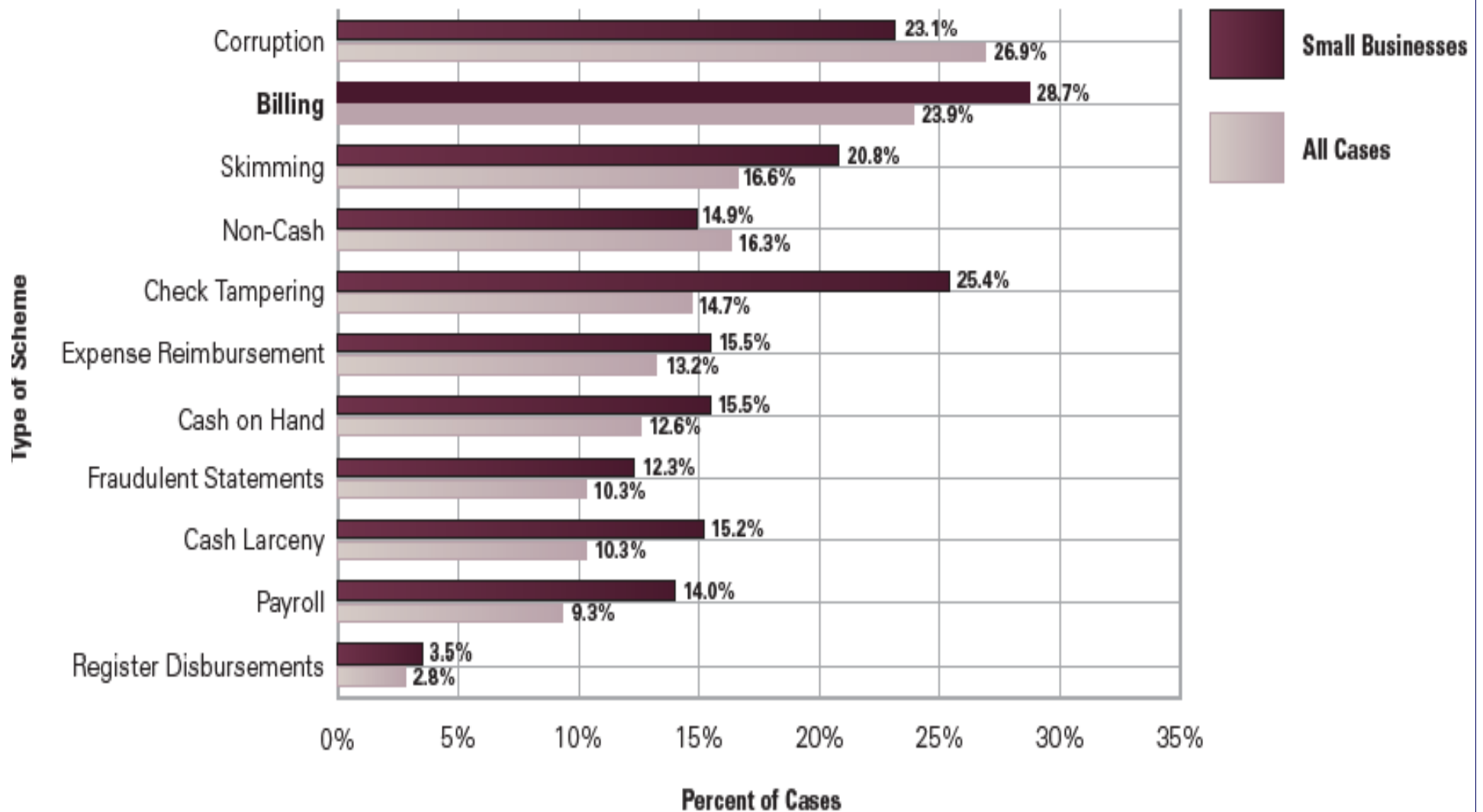
# Three Primary Categories of Occupational Fraud...

- Asset misappropriation
- Corruption
- Financial statement fraud

## Breakdown of All Occupational Fraud Schemes — Frequency<sup>3</sup>



## Methods of Fraud — Small Business Cases vs. All Cases<sup>10</sup>



# Billing Schemes

## Former Shriners Hospital CFO Pleads Guilty to Stealing More Than \$828,000 from Shriners Hospital

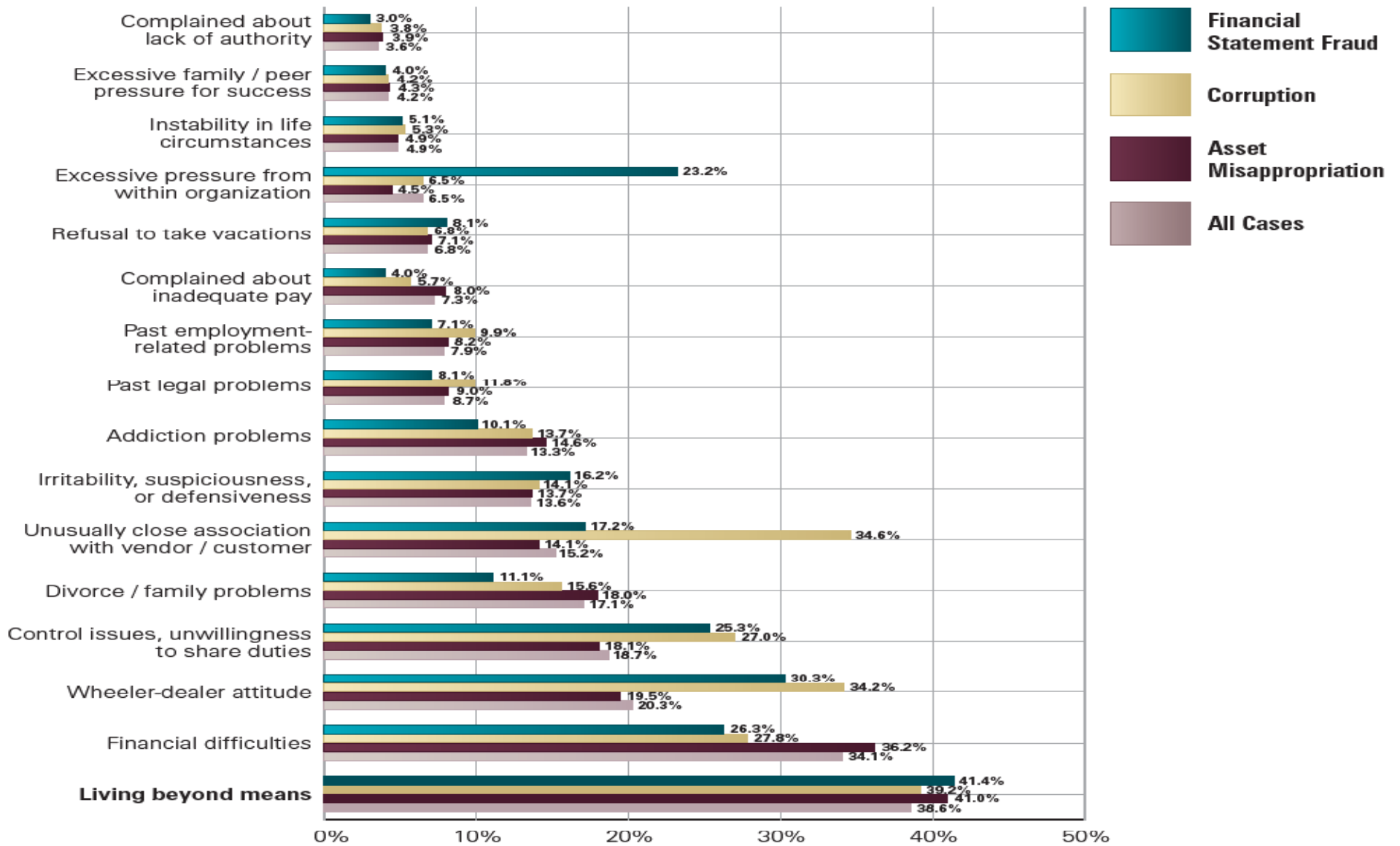
St. Louis, MO: Robert Steven Brodzin pled guilty to a scheme to defraud Shriners Hospital for Children of more than \$828,000, United States Attorney Catherine L. Hanaway announced today.

Brodzin used his position as CFO at Shriners to establish three “dummy” companies as qualified vendors of Shriners, and then obtained unauthorized payments from Shriners by presenting checks for approval and payment in these three companies’ names. Brodzin further admitted to secretly obtaining and using an unauthorized Shriners’ credit card for his personal expenses.

Brodzin used the stolen money from Shriners to buy luxury automobiles; a condominium in St. Petersburg, Florida; vacation travel and related expenses in Las Vegas, Nevada, and other locations; golf and health club memberships; season tickets for the games of assorted professional sports teams in St. Louis, Missouri, and also to fund his personal small business opportunities.



## Behavioral Red Flags Present During Fraud Scheme<sup>24</sup>



# Why be concerned?

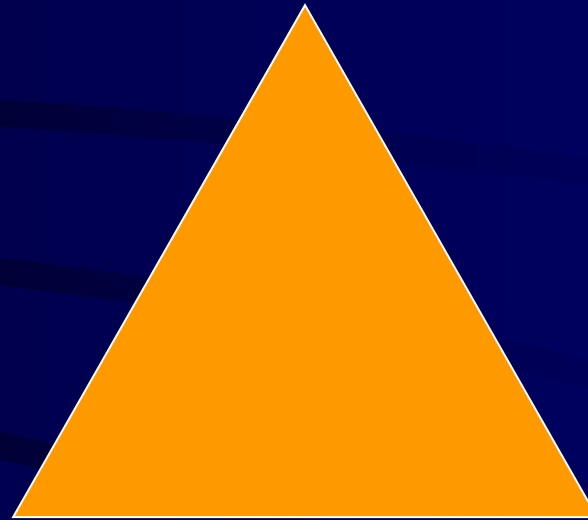
- Annual cost of fraud to U.S. organizations

**\$1 trillion.**

# Why be concerned?

- Fraud costs U.S. organizations \$1 trillion annually.
- Potential perpetrators are desperate, creative, and have technology at their disposal.

# Fraud Triangle



Motive / Pressure

# Pressures to Commit Fraud

- Financial Pressures
- Personal Habits
- Work-Related Factors

# Pressures to Commit Financial Statement Fraud

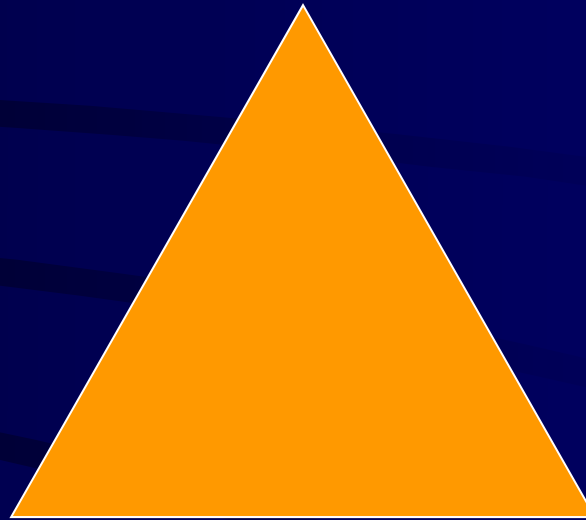
Firm A

Firm B



Which firm will have the higher stock price?

# Fraud Triangle



**Rationalization**

**Motive / Pressure**

# Rationalization to Commit Fraud

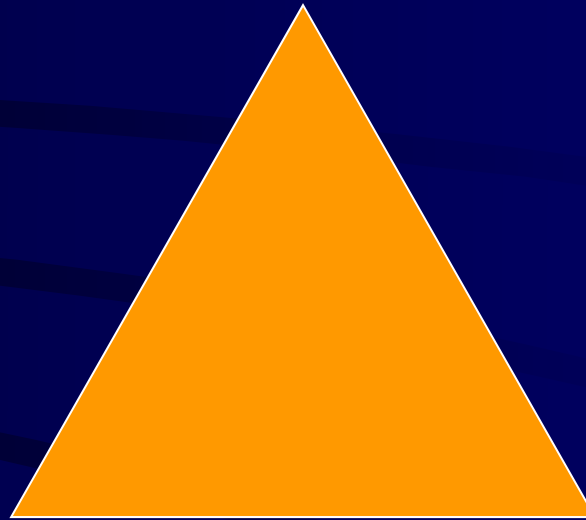
## Integrity

- Most important factor in keeping a person from committing fraud.



# Fraud Triangle

Opportunity



Rationalization

Motive / Pressure

# Opportunities to Commit Fraud

- Internal controls are weak

# Payroll Schemes

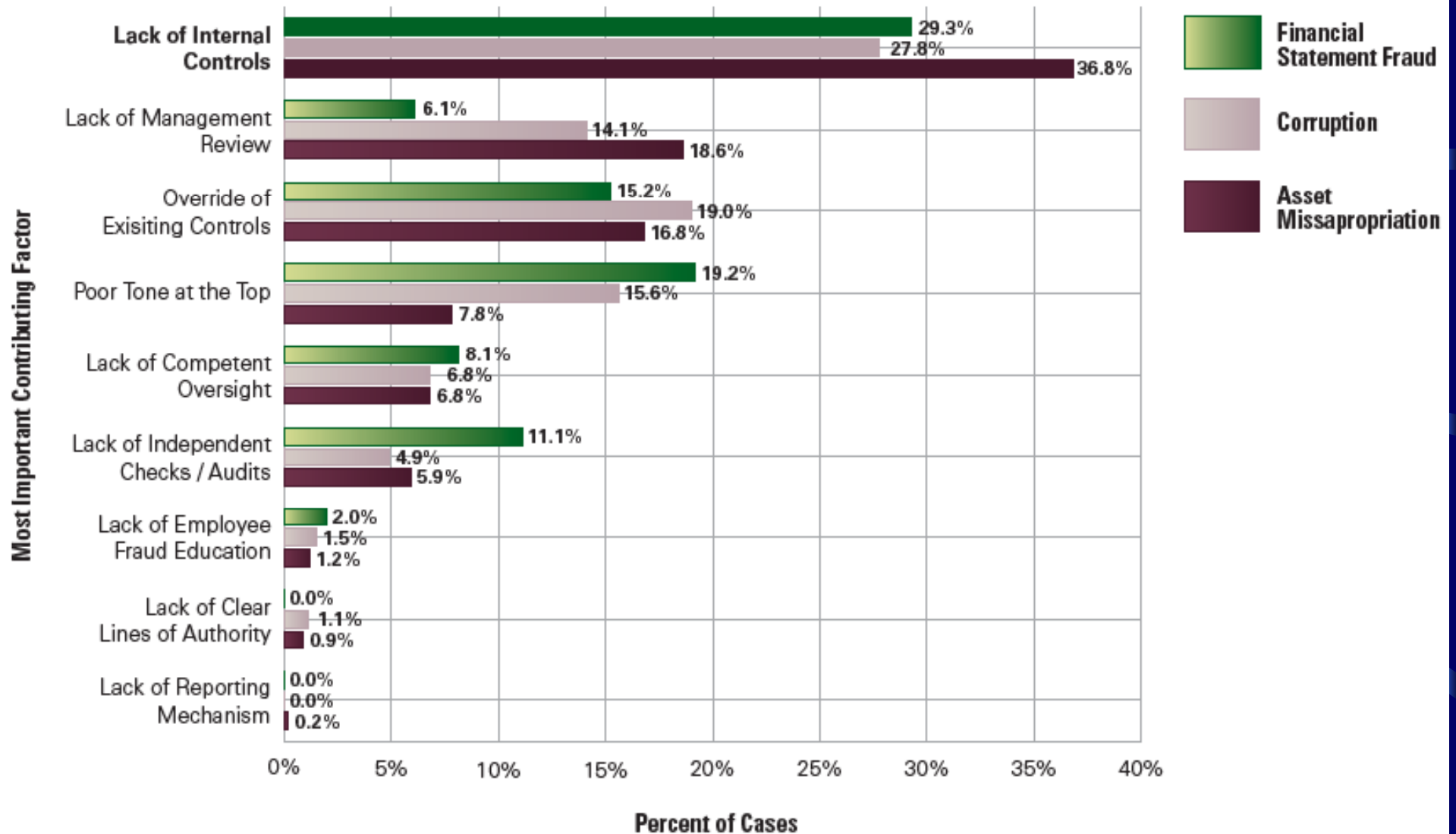
## Payroll manager gets 18 months for stealing from employer

A trucking company payroll manager was sentenced to 18 months in federal prison for stealing almost \$370,000 from his employer, prosecutors said.

Kenneth R. Timmons, 43, of St. Louis, pleaded guilty to a single felony charge of wire fraud in October and admitted transferring the pay of former employees, after their termination, into his own account from May 2005 to January 2008.

Timmons was a human resources and payroll manager for a St. Louis – based transportation company, and will have to repay the money.

## Breakdown of Primary Internal Control Weaknesses by Scheme Type



# Opportunities to Commit Fraud

- Internal controls are weak
- Excessive levels of trust
- Lack of fraud risk management plan

# Developing a Fraud Risk Management Program

# Fraud Risk Management Program Phases

Planning & Assessment

Design

Implementation

Monitoring & Improvement

# Planning & Assessment

Documented  
Fraud Policy

Fraud Risk  
Assessment

Fraud  
Scenario  
Brainstorming



# Documented Fraud Policy

- Concise but comprehensive
  - Addresses corruption, asset misappropriation, and financial statement frauds
- Consistent with “Tone at the Top”
  - Code of Ethics and Business Principles
- Communicated and acknowledged

# Fraud Risk Assessment

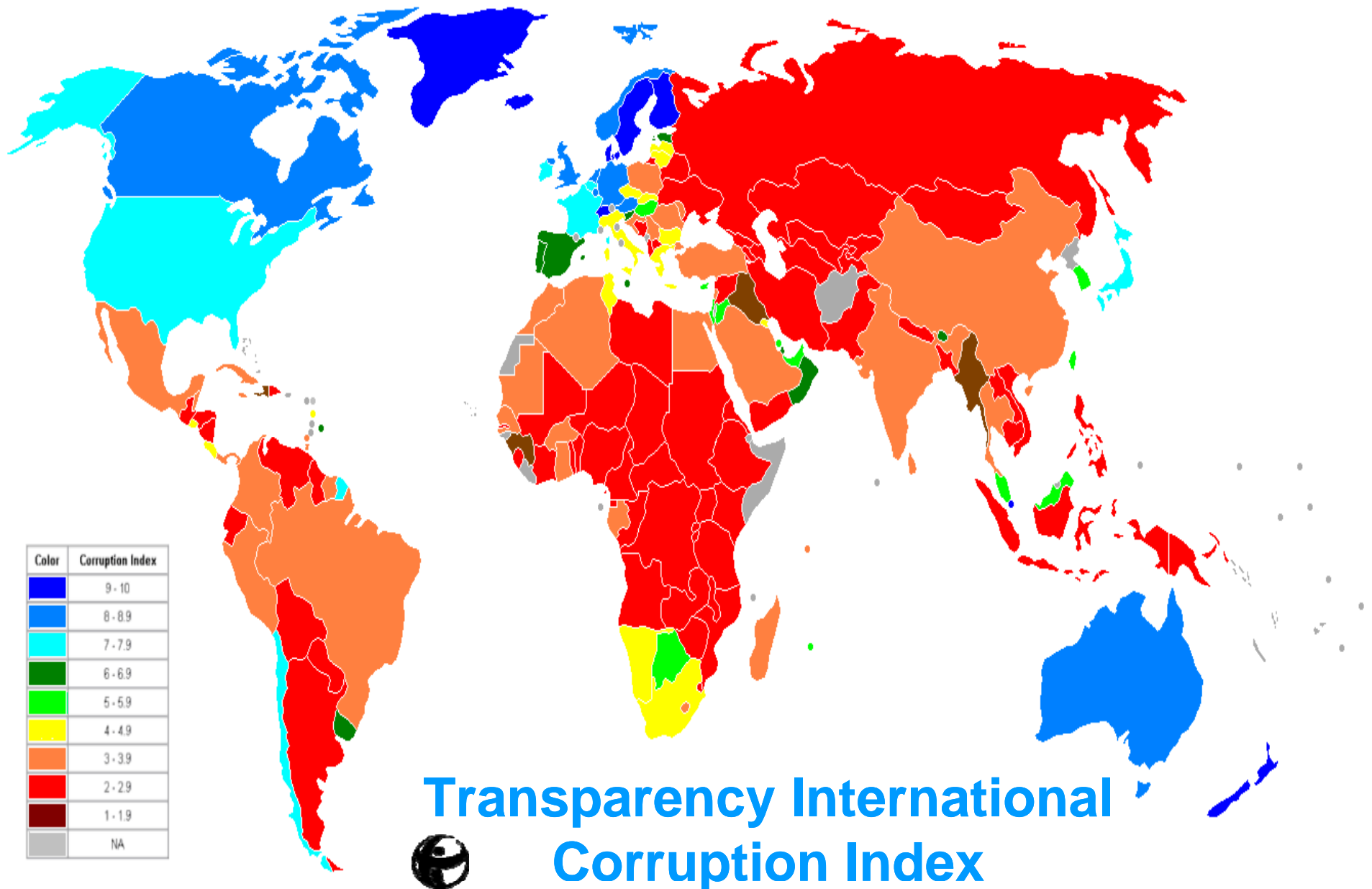
- Systematic and recurring assessments
  - Integrate with overall organizational risk assessment
- Performed by a qualified team
  - Includes personnel from throughout the organization
  - External specialists

# Fraud Risk Assessment

- Identify inherent fraud risks
  - Significant amounts of cash and checks
  - Readily marketable inventory
  - Information technology
  - Foreign operations

# Foreign Operations

- Foreign Corrupt Practices Act
- International Anti-Corruption Laws
- UN Private Rights of Action



# Fraud Risk Assessment

- Identify inherent fraud risks
  - Significant amounts of cash and checks
  - Readily marketable inventory
  - Information technology
  - Foreign operations
- Identify pressures and opportunities
  - Incentive compensation metrics
  - Ability of management to override controls

# Fraud Scenario Brainstorming

- Specific fraud scenarios
  - Check forgery, fictitious employees, etc.
- Specific motives and pressures
- Specific opportunities
  - Known control weaknesses
  - Prior incidents
- Information technology

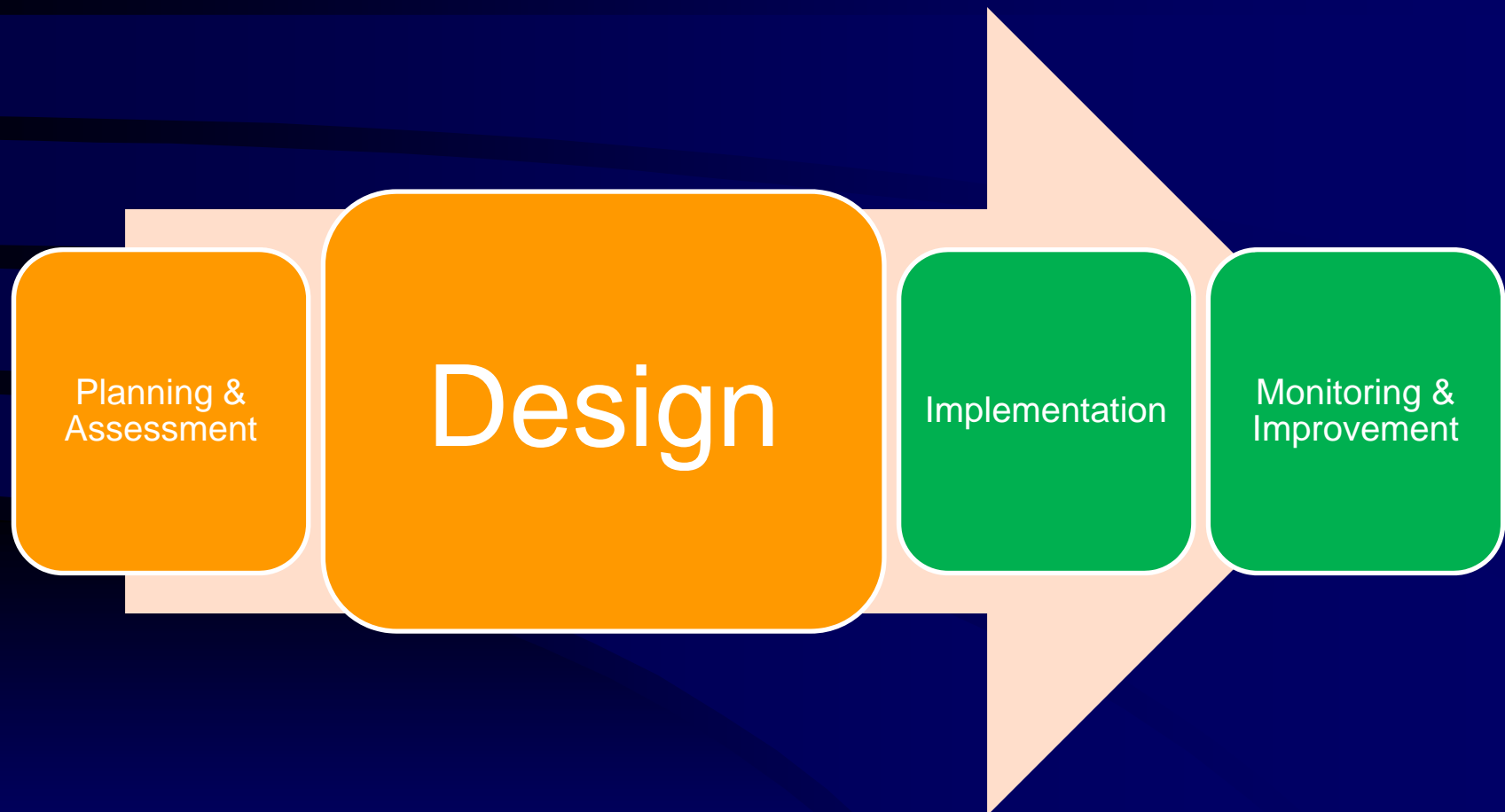
# Information Technology Threats

Common computer fraud methods include

- Unauthorized access
- System penetration
- Data leakage
- Malware & spyware
- Phishing (emails, letters, etc)



# Fraud Risk Management Program Phases



# Design

Prevention  
Controls

Detection  
Controls

Reporting  
&  
Resolution  
Procedures

# Prevention Controls

- Fraud awareness
  - Documented anti-fraud policy and training
- Background investigations
  - Employees, suppliers, customers and other business partners
- Proper internal controls

# Prevention Controls

## Internal Controls

- Segregation of duties
- Procedures manual
- Timely financial reporting
- Mandatory vacations
- Cash controls
- IT controls

# Information Technology Prevention Controls

IT prevention controls include:

- Strong IT general controls
- Continuous monitoring (email, web)
- Intrusion prevention system
- Penetration & vulnerability assessment
- IT Security awareness training

# Cash Disbursements

## Bookkeeper Admits She Embezzled Money at Her Job

KANSAS CITY, Mo. - There's an argument about how much, but no dispute that a woman embezzled thousands of dollars from her employer.

Shanna M. Hutchens worked at Sugar Creek Hauling Company. Hutchens wrote company checks to herself or her husband and forged the business owner's signatures, according to news release from the U.S. Attorney's Office in Kansas City. Hutchens would cash the checks or deposit them in a bank account. She also stole money from the business using cashier's checks.

The crimes went on for nearly four years. Investigators say Hutchens took at least \$760,000 from the business, but that number is in dispute. That issue will be decided at her sentencing. Hutchens faces up to 30 years in federal prison without parole and a fine of up to \$1 million.

# Detection Controls

- Fraud hotline
- Proactive controls:
  - Audits (internal / external)
  - Financial analysis
  - Identify relationships among people, organizations and events
- IT controls

# Information Technology Detection Controls

IT detection controls include:

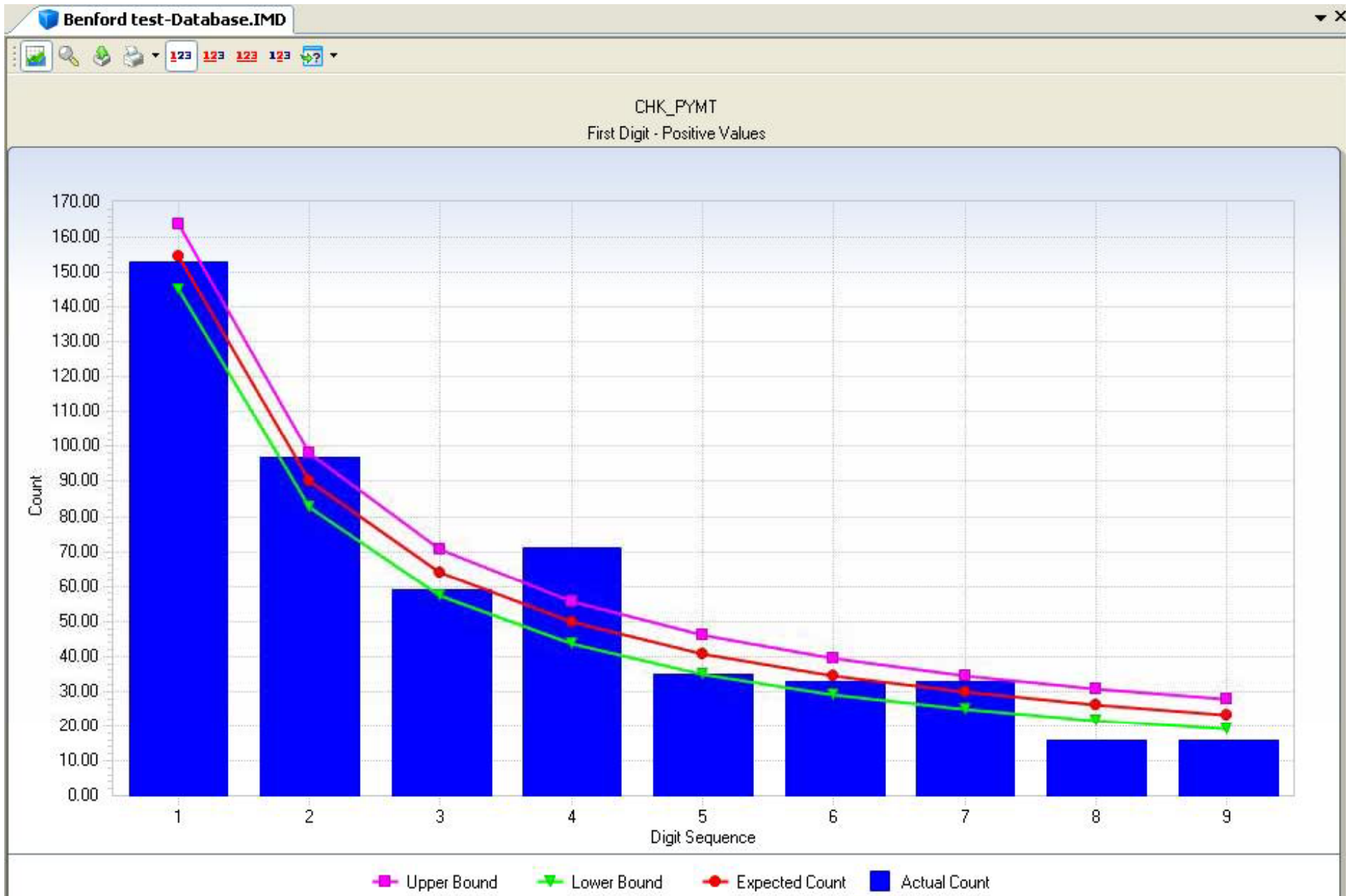
- IT Security Audit
- Intrusion detection system
- 3<sup>rd</sup> party reviews – data mining
- Use of Computer Assisted Audit Tools (CAAT)



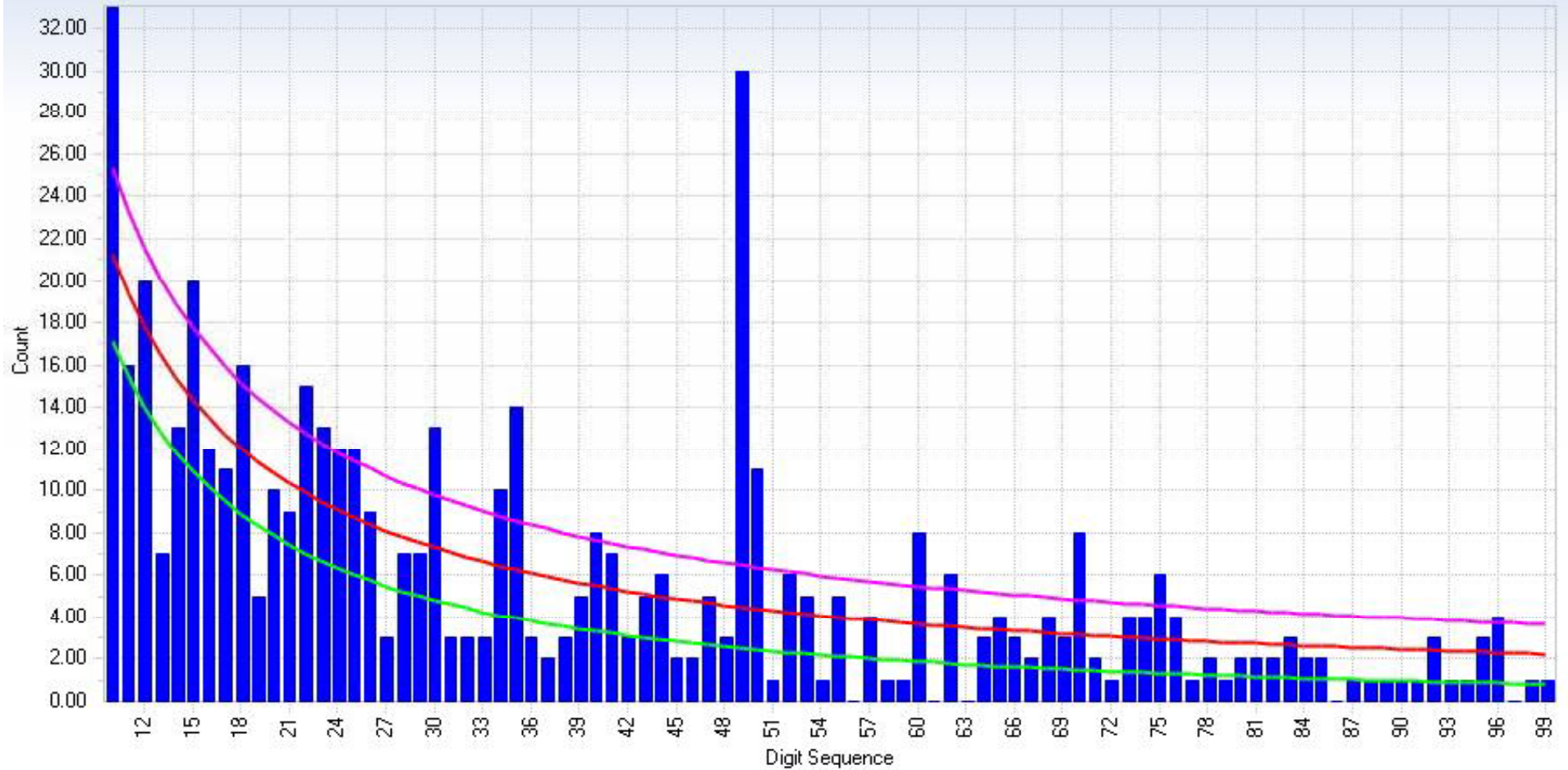
# Information Technology Detection Controls

## Using CAAT to detect fraudulent activity

- Interactive Data Extraction and Analysis (IDEA)
  - Comparison tests (SSN, account numbers, addresses, etc)
  - Filter out data based upon criteria – reduces scope
  - Review access logs for unusual items (weekends, hours)
  - Benford test
- Audit Command Language (ACL)

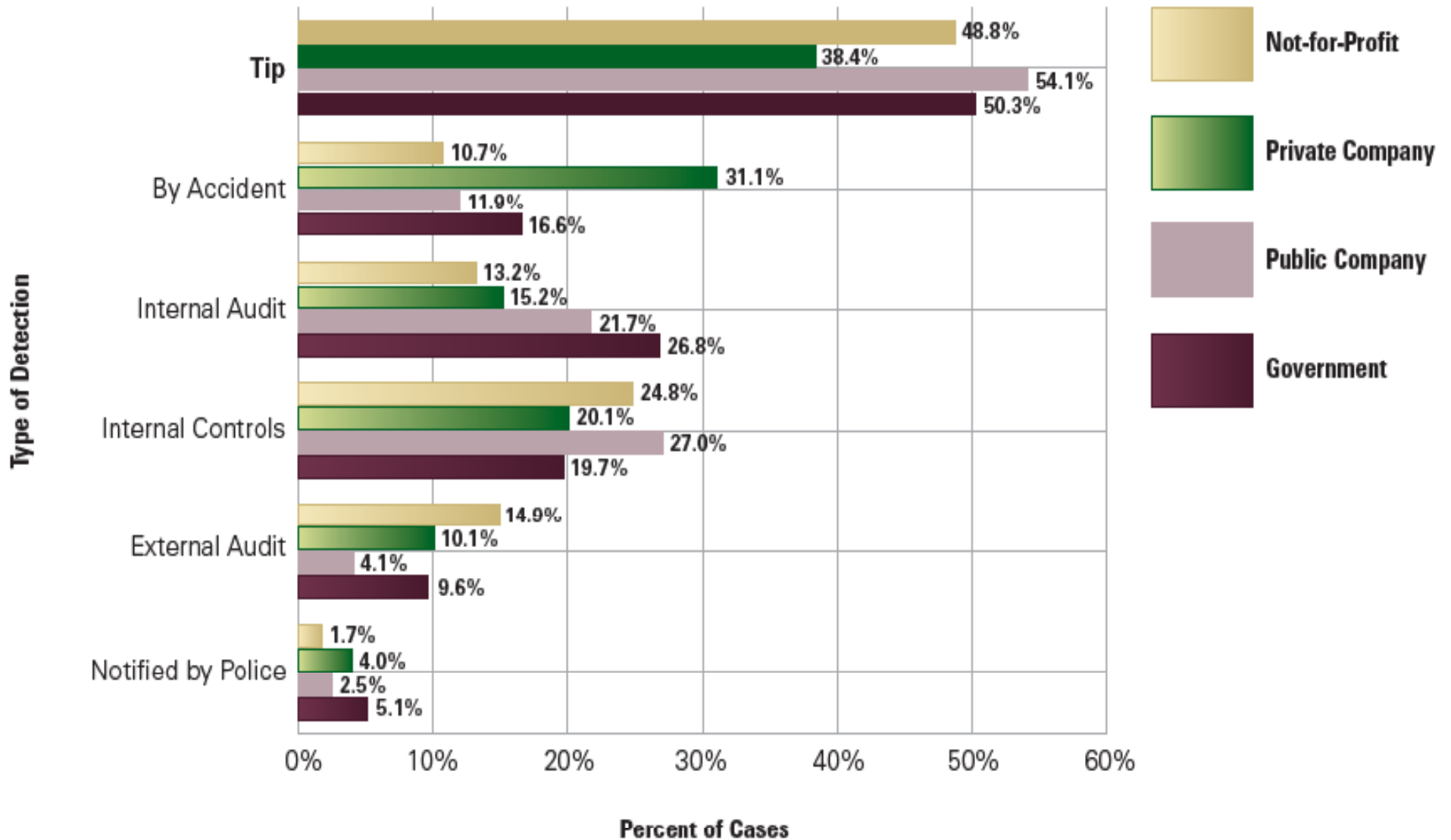


CHK\_PYMT  
First Two Digits - Positive Values



— Upper Bound — Lower Bound — Expected Count ■ Actual Count

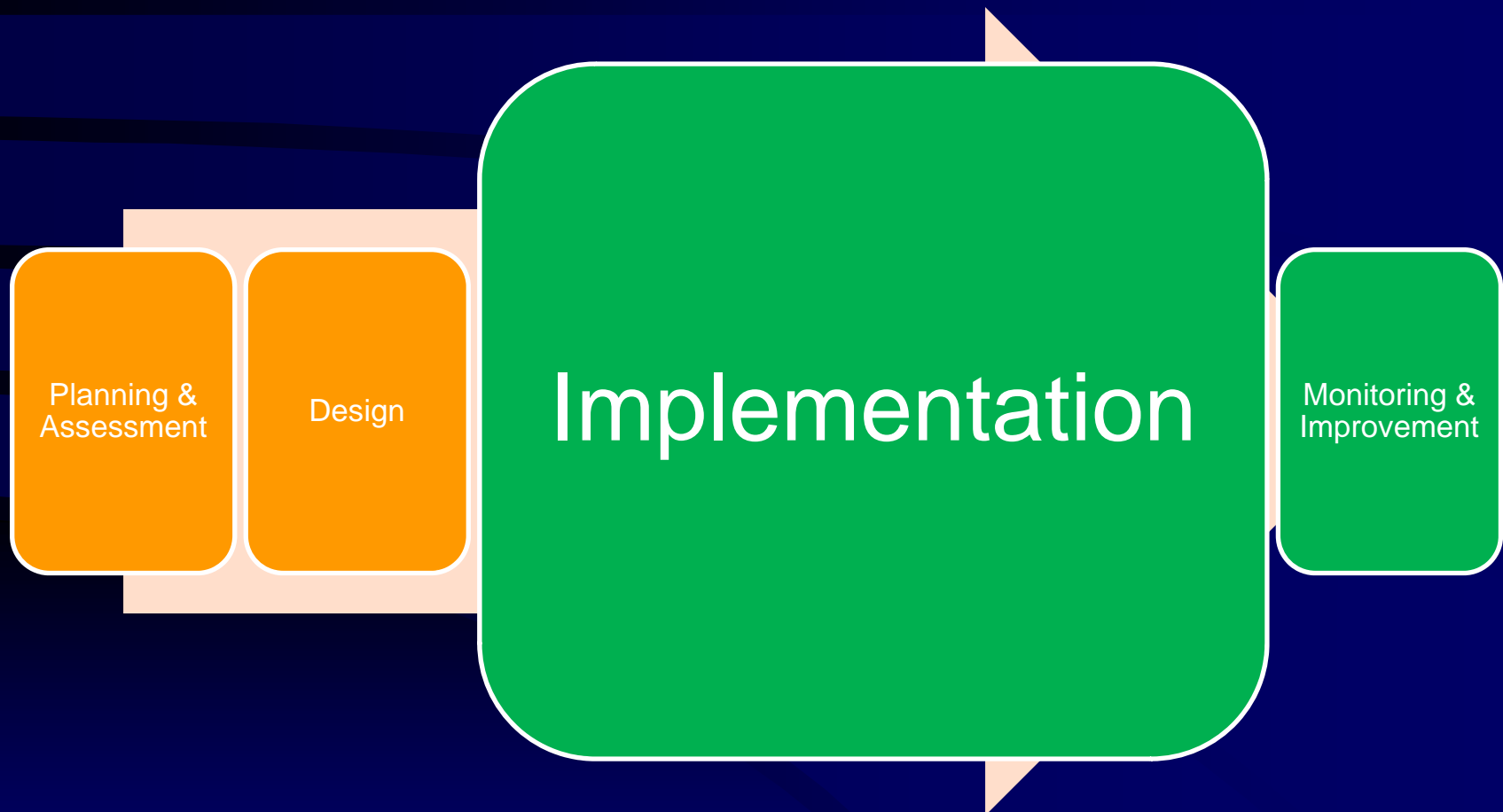
## Initial Detection Method by Organization Type<sup>8</sup>



# Reporting & Resolution

- Solicit input on potential fraud
- Methodology to investigate
  - Legal issues
- Corrective actions
  - Criminal and civil
  - Disciplinary action
  - Insurance claims

# Fraud Risk Management Program Phases



# Implementation

Fraud Policy &  
Awareness  
Training

Change  
Management

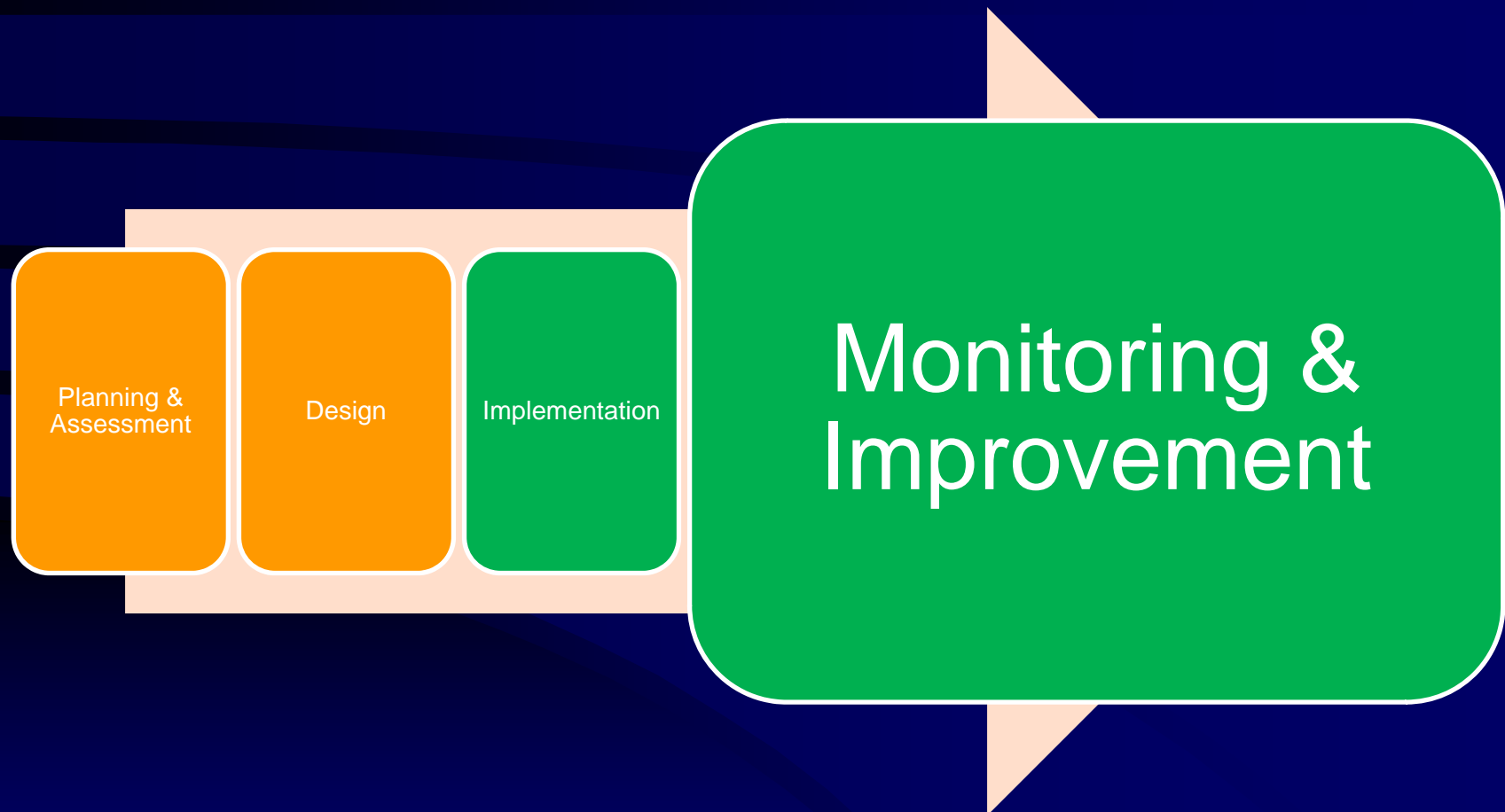
Implementation  
Feedback

# Implementation

- Training
  - Creates an organizational knowledge baseline
  - Demonstrates commitment
- Change Management
  - Reallocation of responsibilities
  - Ensure new controls operate effectively
- Feedback
  - Opportunity to improve future implementations



# Fraud Risk Management Program Phases



# Monitoring & Improvement

Fraud Hotline

Internal Audits

Surveys &  
Questionnaires

# Monitoring & Improvement

- Fraud hotline reporting and analysis
- Planned and surprise audits
- Employee and stakeholder surveys
- Annual fraud policy communication and acknowledgment

# Key Elements

Establish  
Tone at the  
Top

Document &  
Communicate  
Fraud Policy

Segregation  
of Duties

# If You Suspect Fraud...

- Immediately consult your advisors (CFE, CPA, attorney)
- Do not confront the suspect on your own
- Contact your insurance company

# Other Considerations

- Review hiring process
- Evaluate vendor/customer relationships
- Review insurance coverage

Fraud is easier to prevent  
**\$1 TRILLION**  
than to detect.

**Thank You!**



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