

Fraud Risk Management

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Your guide forward



Agenda

Why Fraud Occurs

Statistics

Fraud in the News

Impact on the Public Sector

Managing Fraud

Materiality

Questions

Who said this?



If the confidence of the public in the integrity of the accountants' report is shaken, their value is gone.

-Arthur Andersen in a 1932 lecture on business ethics

Our View of Risk

Fraud Occurs Primarily Because...

Unseen Risk –
Blindsided

Unmanaged Risk

Controls Failed

Note that fraud most often occurs without the aid of collusion and could have been prevented by looking at a few key areas.

What is Fraud?

Fraud is defined by Black's Law Dictionary as: *A knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment.*¹

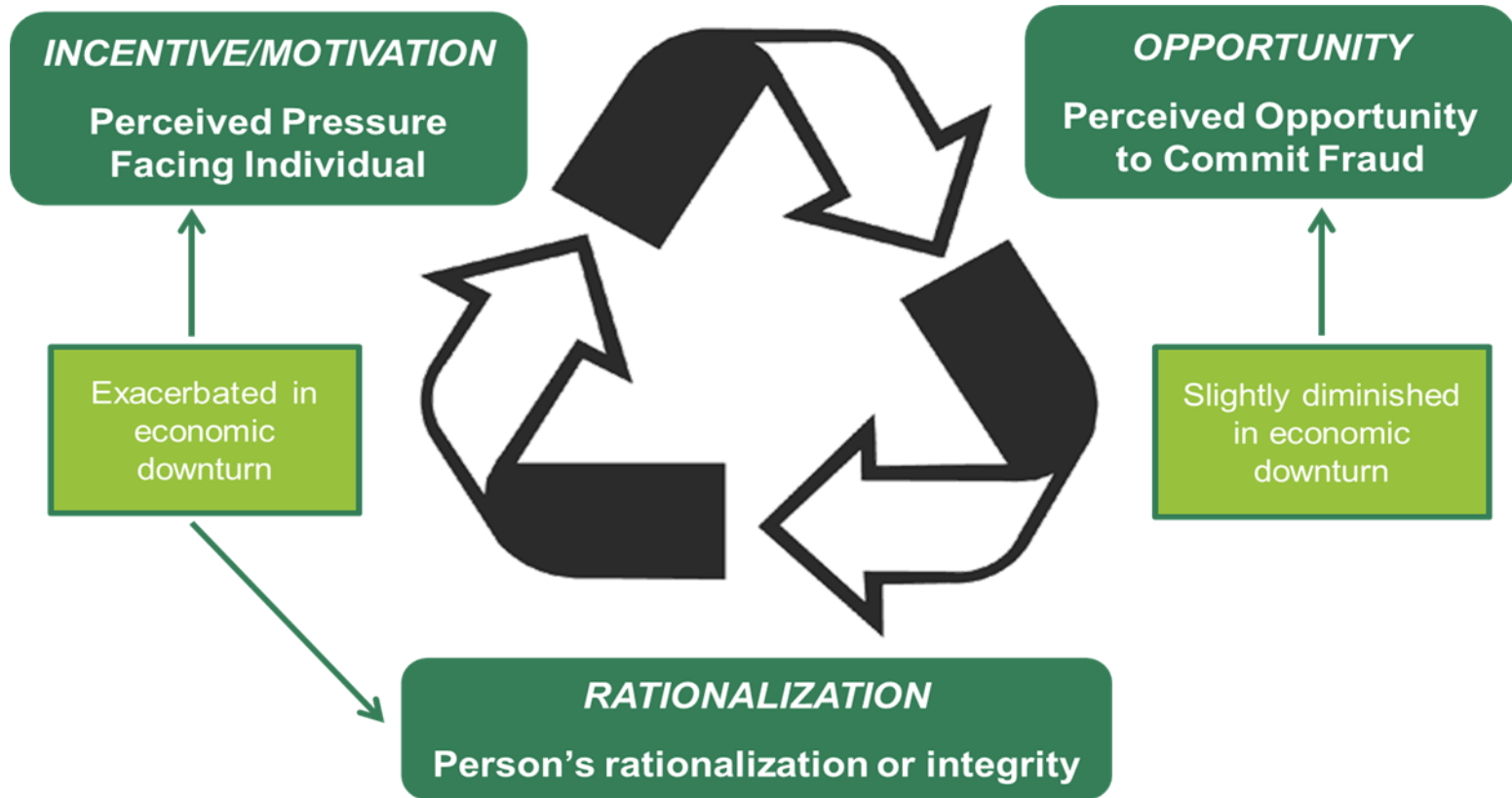
Consequently, fraud includes any intentional or deliberate act to deprive another of property or money by guile, deception, or other unfair means.²



¹ Bryan Garner, ed., *Black's Law Dictionary. 8th Ed. (2004)*, s.v., "fraud."

² According to Association of Certified Fraud Examiners (ACFE).

Fraud Theory & the Good Person



Fraud Statistics

A typical organization loses 5% of its revenues to fraud each year

Corruption and billing schemes pose the greatest risks to organizations

Most commonly victimized industries:

- **Banking and financial services**
- **Manufacturing**
- **Government and public administration sectors**

Report to the Nations, 2018 Global Study on Occupational Fraud and Abuse -- Association of Certified Fraud Examiners

Fraud Statistics

Internal control weaknesses were responsible for nearly half of all frauds

A majority of the victims recovered nothing

Referrals to prosecution declined over the past 10 years. Top reason for non-referral was fear of bad publicity

Report to the Nations, 2018 Global Study on Occupational Fraud and Abuse -- Association of Certified Fraud Examiners

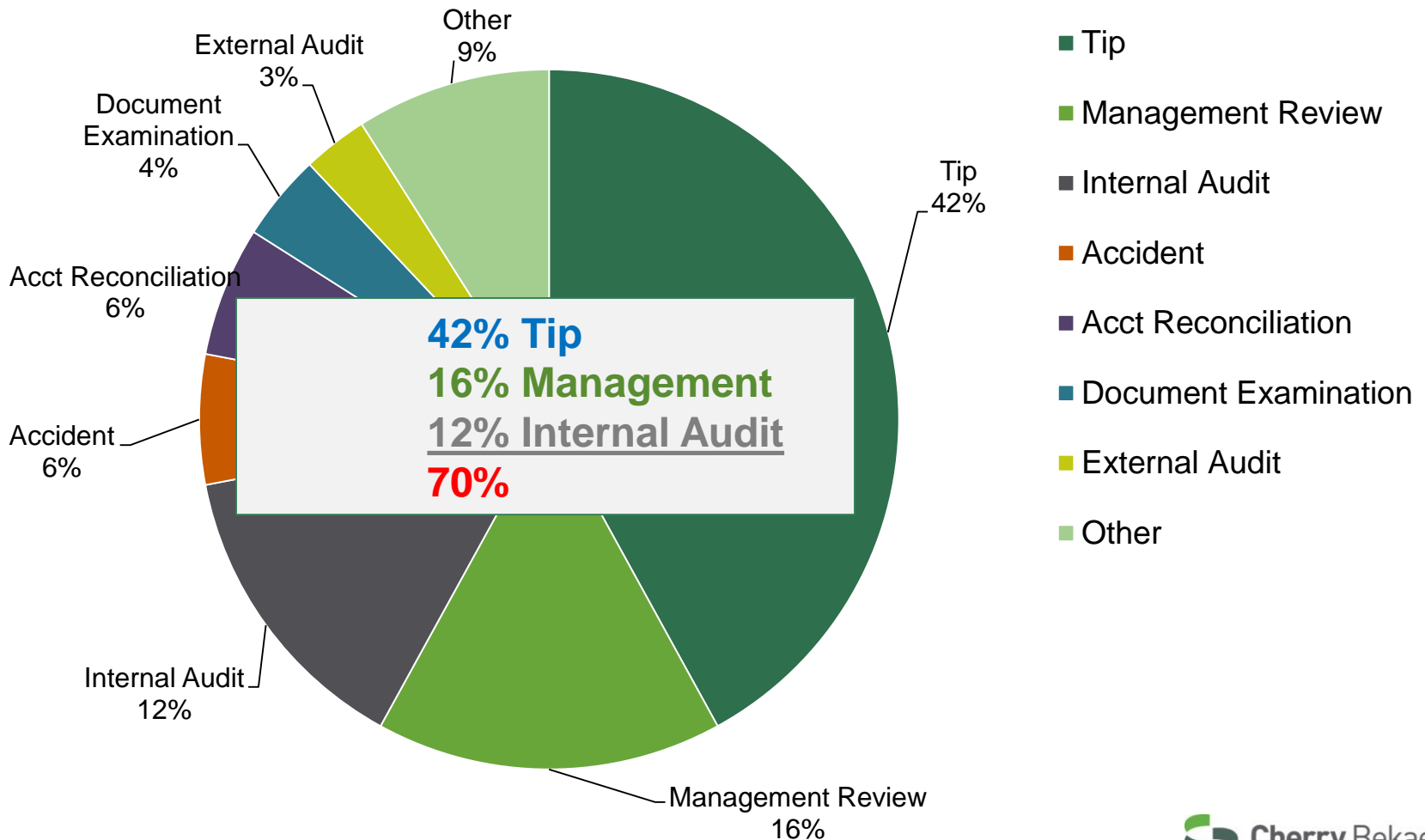
12 States with Largest Embezzlements

Number of Cases

- | | |
|---------------------|----------------------|
| 1. CA (12.3%) | 7. NC (3.6%) |
| 2. VA (6.0%) | 8. NY (3.6%) |
| 3. IL (4.5%) | 9. TX (3.4%) |
| 4. MI (4.5%) | 10. MA (2.9%) |
| 5. PA (4.5%) | 11. CT (2.5%) |
| 6. MO (3.6%) | 12. GA (2.5%) |

Source: 2013 Marquet Report on Embezzlement

How is Fraud Discovered?



Fraud in the News

Vassar College (NY) –

Former Vassar construction project manager and wife charged with stealing ~\$2 million over 5 years. The couple set up a fictitious construction company and made fraudulent transfers from school's \$90 million construction capital account. Uncovered when the school noticed irregularities in records pertaining to his work.

(Daily Mail, April 2011)



Fraud in the News

La Salle U. (PA) –

During 2009/2010 fiscal year, a theft was uncovered by an employee of the food services operations. The then manager had created a fake company and was billing La Salle for goods never provided. This had taken place over a 20 year period, totaling approx. \$5 million.

(Chronicle, April 2013)



Fraud in the News Wake County School Board

Raleigh NC — Cars, vacation cottages, golf carts and jet skis were just some of the kickbacks that a group from Wake County public schools and an auto parts company were enjoying in 2004.



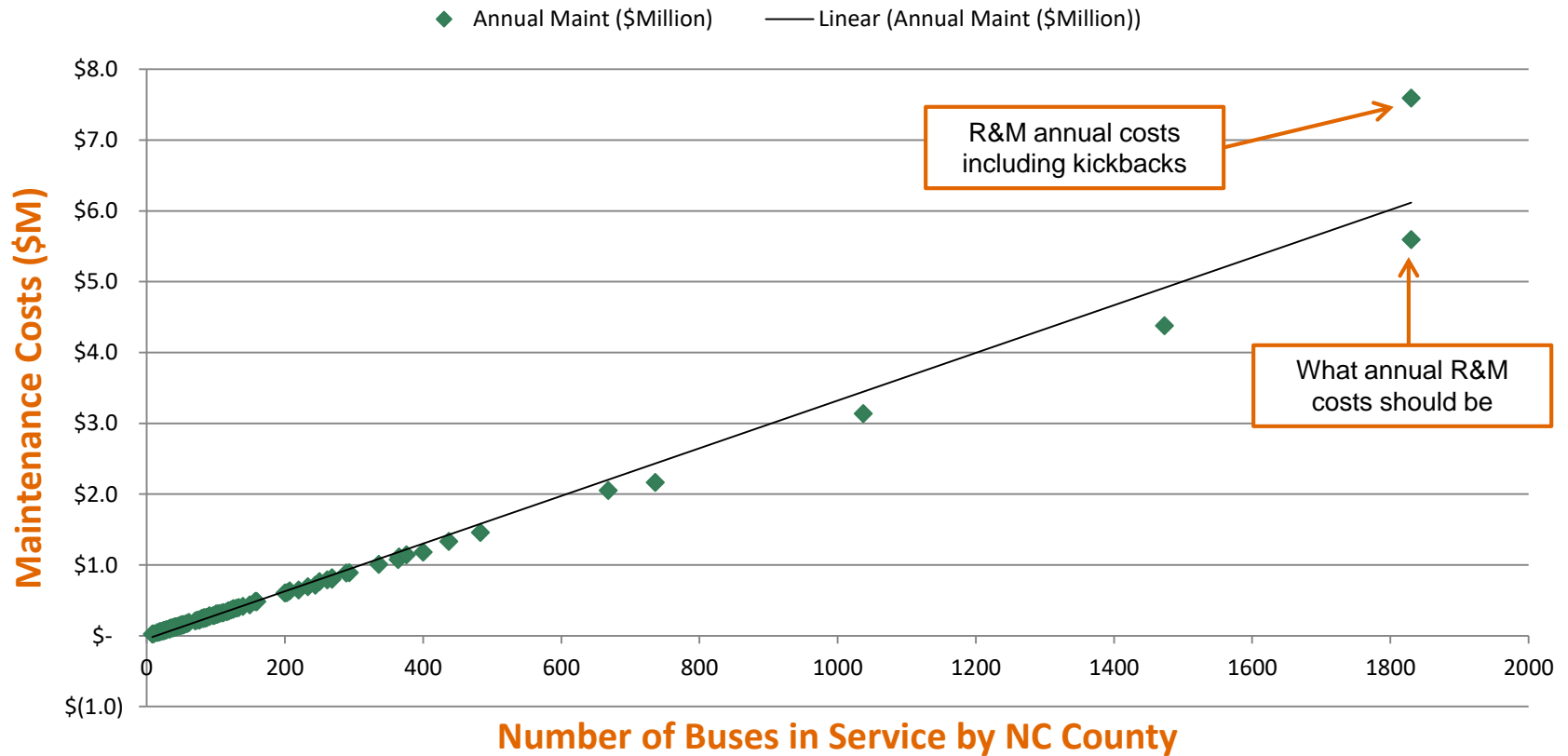
Wake County School Board

- ▶ The school system **estimates approximately \$5 million** was diverted from the Wake school system in an automotive parts scheme involving then-employees of the school system's transportation department and a automotive parts company.
- ▶ Schools' budget records show the transportation department paid one vendor \$206,611 during the 2000-01 school year, increasing to \$4.3 million in 2003-04.
- ▶ Investigators said the suspects submitted fake orders for auto parts and bought gift cards, trucks, boats, trailers and other high-priced items for themselves.
 - On some days, receiving over **200** invoices from the same vendor
 - Clustering of invoice amount just under approval limit for purchase orders
- ▶ Seven people, **including five former school system employees** and two former vendor employees were convicted and sentenced for terms ranging from 60 days to 15 years in prison.

Data Analytics Linear Regression

Wake County Schools

Annual County School System Bus Maintenance (\$Million)



A King Klein's Ransom

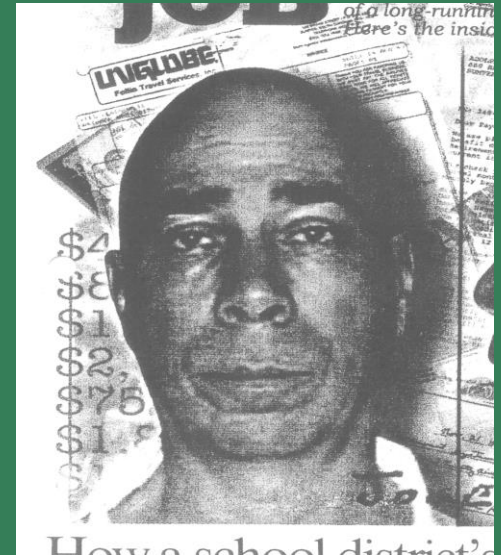
Finance Director

Sumter 17 School Board Sumter, South Carolina

Over two decades he stole and/or diverted at least \$3.5 million dollars from school activity funds and capital projects funds.

Created over 15 fake companies and invoices.

Paid deposits on school field trips, then cancelled the trips.



The “Fajita Bandit”, Audits & Materiality

The Fraud Examiner

LESSONS LEARNED FROM THE FAJITA BANDIT



Ron Cresswell, J.D., CFE
Research Specialist, Association of Certified Fraud Examiners



The case of the fajita bandit



In 2017, a Texas man was arrested for stealing more than \$1.2 million worth of fajita meat from his government employer. The man was quickly nicknamed “the fajita bandit,” a phrase that proved irresistible to headline writers. Dozens of news outlets picked up the story, and the fajita bandit gained brief, widespread notoriety. The case made news again in April 2018 when the fajita bandit was sentenced to 50 years in prison for his crime.

While it is a strange story, the case of the fajita bandit contains useful lessons about fraud and internal controls.

The “Fajita Bandit” Case

In Discussing the Fajita Bandit Case....

First, someone at the detention center was paying the invoices for fajita meat despite the fact that the center did not serve fajitas. That sort of mistake is often caused by a failure to review all underlying documentation before paying invoices. Procurement employees should review all documentation for every transaction; that is a basic internal control.

Second, while there was an audit procedure in place, the auditors did not discover the improper orders and payments for the fajita meat. Auditors should always review the entire transaction, including what was delivered. Apparently, that did not occur in this case.

Finally, the fact that the fajita scam continued for nine years suggests that the internal controls and audit procedures were not adequately tested during that time period. An organization’s fraud prevention systems should be tested periodically to ensure they are working.

Risks to the Public Sector

**Corruption &
billing schemes
with vendors**

**Fraudulent
expense reports &
p-card abuse**

**Theft of cash &
property**

Cyber crimes

**Student financial
aid fraud & abuse
schemes**

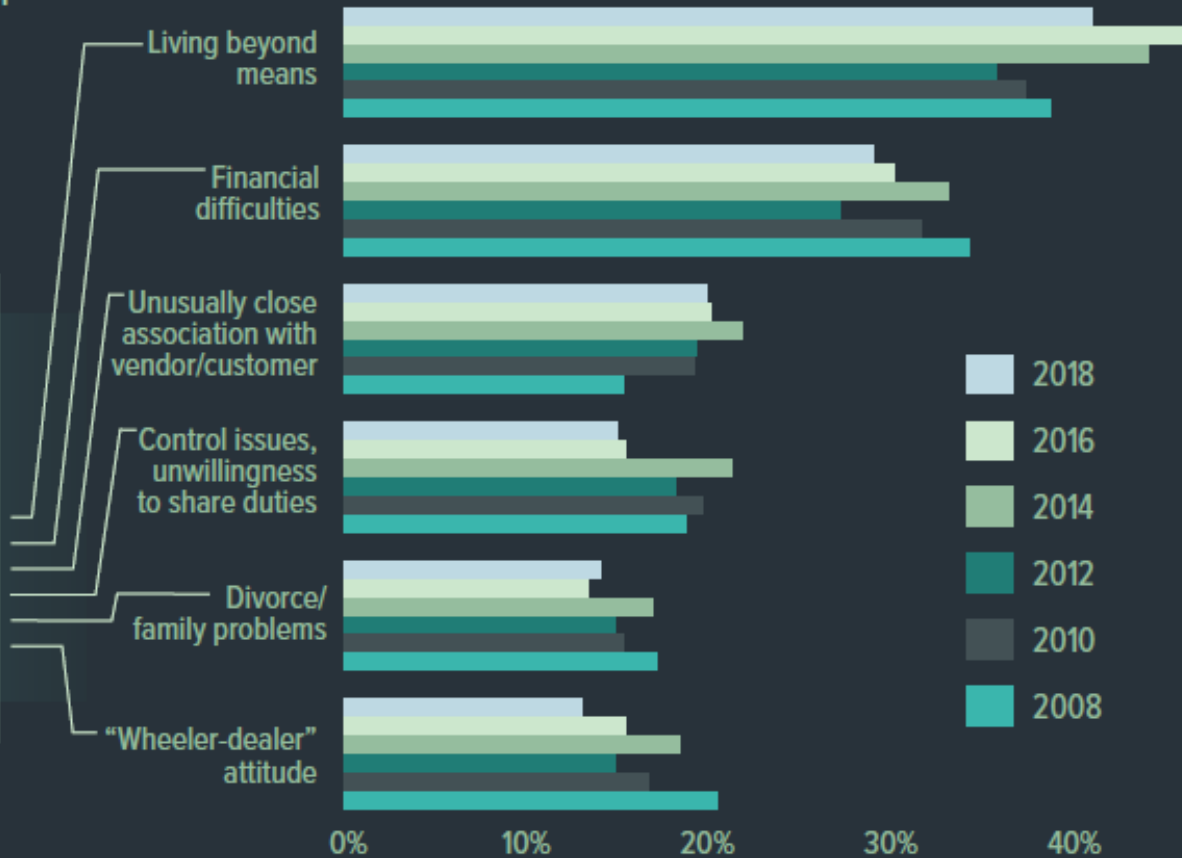
The Red Flags of Fraud

IN **85%** OF CASES FRAUDSTERS DISPLAYED AT LEAST ONE BEHAVIORAL RED FLAG

AND IN **50%** OF CASES THEY EXHIBITED MULTIPLE RED FLAGS

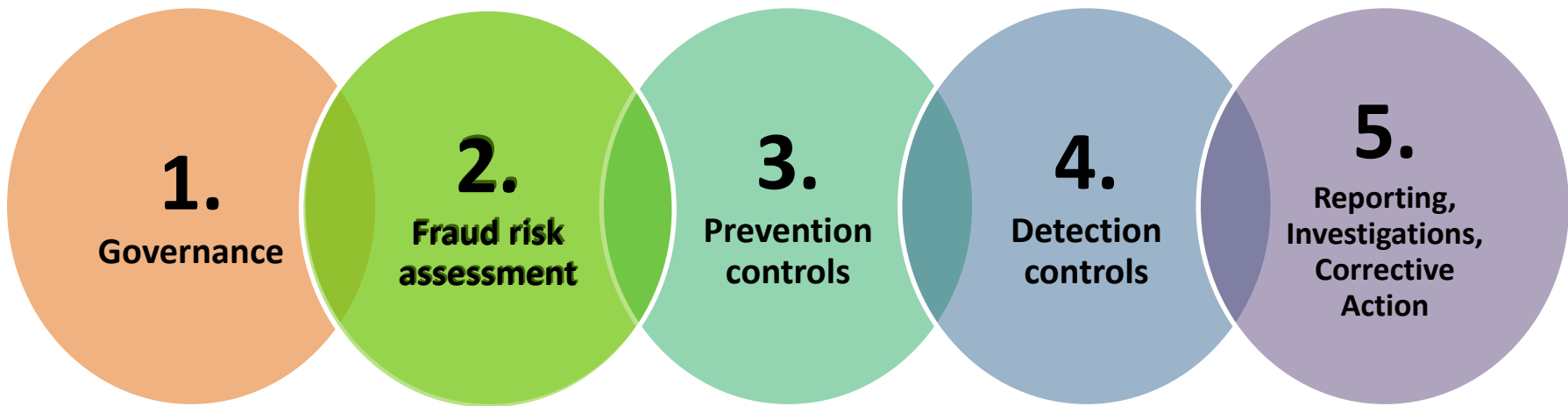
These **6 BEHAVIORAL RED FLAGS**

have been the most common in every one of our studies dating back to 2008, with a remarkably consistent distribution



5 Key Principles to Manage Fraud

“Trust is not a control and hope is not a strategy”



If you could only accomplish 1 principle what is most important?

FREE *Managing the Business Risk of Fraud: A Practical Guide* Joint Study conducted by The Institute of Internal Auditors, the American Institute of CPAs and the Association of Certified Fraud Examiners. Published July 2008

What About Materiality?

Do you expect the auditors to catch fraud?

Does the board expect the auditors to catch fraud?

Losses due to fraud can be immaterial

It's Not All About the Benjamins

Beyond the direct
monetary damages...

- ▶ Reputational Harm
 - Local and national media coverage
- ▶ Stakeholder Confidence
 - Taxpayers
 - Grants
 - Employees
 - Capital Markets



Dana Cope - SEANC



- ▶ CEO for State Employees Association of NC (SEANC)
- ▶ Cope was CEO for 15 years

Dana Cope - SEANC



- ▶ Tip from former Treasurer
- ▶ Treasurer went to media first
- ▶ Newspaper published a story on Sunday
- ▶ Monday, Wake County DA announced that she had requested an NCBI investigation
- ▶ Wednesday, Cope resigned

Dana Cope - SEANC

- ▶ SEANC Counsel, the CFO and the Board never questioned Cope formally regarding the allegations
- ▶ The weekend that the story broke, the Counsel, CFO and a quickly empaneled “Ethics Committee” determined that Cope had done *nothing* wrong and put its findings on the website after 2 days of looking at credit card receipts and internal documents
- ▶ The Board allowed Cope to resign with a \$200,000 severance package
- ▶ He created documents to cover his tracks during the days leading up to his resignation.

“He did nothing wrong...”

- ▶ \$77,000: landscaping at his residence
- ▶ \$4,565: trip to Bermuda
- ▶ \$5,700: shutters/shades
- ▶ \$3,000: iron fence
- ▶ \$3,200: pool / patio furniture
- ▶ \$3,613: audio system / DJ mixer
- ▶ \$2,200: a sofa
- ▶ \$1,400: garage shelving
- ▶ \$618: massages at a resort



Dana Cope - SEANC

▶ Questionable Credit Card Charges: **\$457,500**

- Included: Plastic surgery, vacations, hotels, clothing, jewelry and home renovations



▶ Fraudulent Check Purchases: **\$113,346**

- Included: Flying lessons, vacations and landscaping



Impact:

- ▶ Cope was charged with 2 Class C Felony charges > \$100,000
- ▶ He pled guilty
- ▶ He paid \$165,000 in restitution at the time of the guilty plea
- ▶ Ordered to pay \$510,500 in restitution
- ▶ He received active jail time: 50-82 months (4-7 years)
- ▶ CFO resigned
- ▶ In-house counsel resigned

What was the reputational damage to the organization?



Capabilities Needed

Investigators and
expert
interviewers

Forensic
accountants and
industry experts

Forensic
technologists and
business system
experts

Internal control
specialists

Public relations
assistance

Questions? Thoughts?

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