

The Risks And Perils of Occupational Fraud

Jacqueline Eckman, CPA
CliftonLarsonAllen LLP



Occupational Fraud

Presentation Focus: **Occupational Fraud**

Definition: The use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets.

Occupational Fraud is far and away the largest source of fraud loss

Source – 2012 Report to the Nation on Occupational Fraud and Abuse

Objectives

At the end of this session, you will be able to:

- Understand the latest fraud risks affecting nonprofit entities
- Be aware of the impact fraud has on your organization
- Identify methods that will help mitigate your fraud risks
- Gain a deeper understanding of the risks and consequences of insider theft of sensitive information

How 'big' is Fraud? Typical organization loses 5% of revenues per year due to fraud. Translates to estimated \$3.5 Trillion Worldwide*

** Source – 2012 Report to the Nation on Occupational Fraud and Abuse*

Reference Materials

- To research your organization's likely risks given industry and size look to **The 2012 ACFE Report to the Nation**
 - Best source to research organizational exposure by industry and firm size; 2012 version available online free at http://www.acfe.com/uploadedFiles/ACFE_Website/Content/rtnn/2012-report-to-nations.pdf

Example of Fraud at a Car Wash

- Bill owns a company that manufactures and installs car wash systems
- Bill's company installed a car wash system in Florida
- These are complete systems, including the money changer and money taking machines

Car Wash Example, Cont.

- The problem started when the new owner complained to Bill that he was losing significant amounts of money from his coin machines each week
- He went as far as to accuse Bill's employees of having a key to the boxes and ripping him off!
- Bill just couldn't believe that his people would do that, so he set up a camera to catch the thief in action.
- Well, they caught him (or her)!

Car Wash Example, Cont.

- Another amazing thing is that it was not just one bird -- there were several working together
- Once they identified the thieves, they found over \$4,000 in quarters on the roof of the car wash and more under a nearby tree.

Car Wash Example, Cont.

This gives a new twist to the term "nest egg."

Car Wash Example, Cont.

And to think the phrase “bird brain” is associated with being dumb.

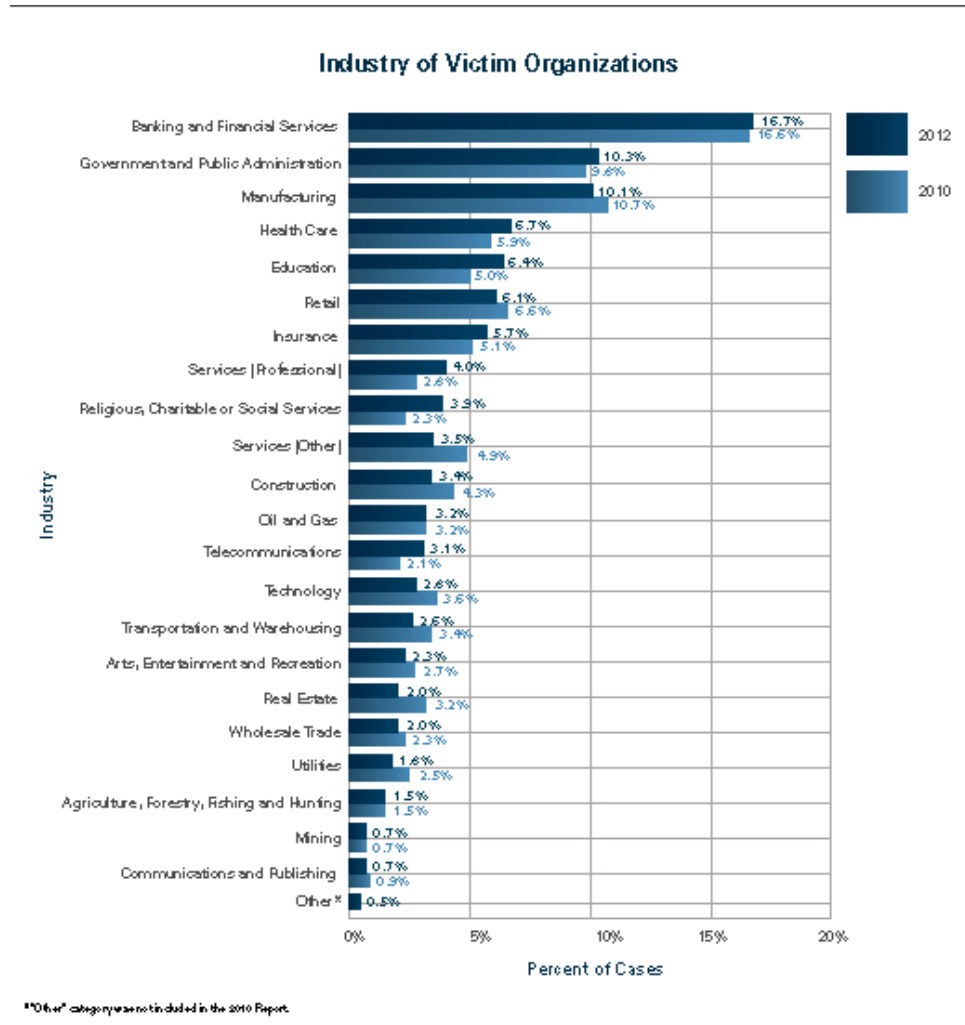
Types of Occupational Fraud - Definitions

- Occupational Fraud can be broken down into three main categories:
 - *Corruption* schemes, in which an employee misuses his or her influence in a business transaction in a way that violates his or her duty to the employer in order to gain a direct or indirect benefit (e.g., schemes involving bribery or conflicts of interest)
 - *Financial statement fraud* schemes, in which an employee intentionally causes a misstatement or omission of material information in the organization's financial reports (e.g., recording fictitious revenues, understating reported expenses or artificially inflating reported assets)
 - *Asset misappropriation* schemes, in which an employee steals or misuses the organization's resources (e.g., theft of company cash, false billing schemes or inflated expense reports)

Who Commits Fraud (All Industries)?

- Male or female?
- Over 40 or under 40?
- Employees, managers, or executives?
- What was the most common position held by the fraudster?
- High school graduate and some college, bachelor's degree, or post-graduate degree?

Types of Frauds and Frequency by Industry



Source – 2012 Report to the Nation on Occupational Fraud and Abuse

Types of Frauds and Frequency – Local Governments

Government and Public Administration 141 Cases		
Scheme	Number of Cases	Percent of Cases
Corruption	50	35.5%
Billing	33	23.4%
Non-Cash	27	19.1%
Skimming	25	17.7%
Expense Reimbursements	19	13.5%
Payroll	18	12.8%
Check Tampering	15	10.6%
Cash on Hand	12	8.5%
Cash Larceny	10	7.1%
Financial Statement Fraud	9	6.4%
Register Disbursements	4	2.8%

Source – 2012 Report to the Nation on Occupational Fraud and Abuse

Fraud Schemes – Education

Education 88 Cases		
Scheme	Number of Cases	Percent of Cases
Billing	28	31.8%
Expense Reimbursements	23	26.1%
Corruption	21	23.9%
Skimming	19	21.6%
Payroll	13	14.8%
Check Tampering	11	12.5%
Cash on Hand	11	12.5%
Cash Larceny	8	9.1%
Non-Cash	7	8.0%
Register Disbursements	5	5.7%
Financial Statement Fraud	4	4.5%

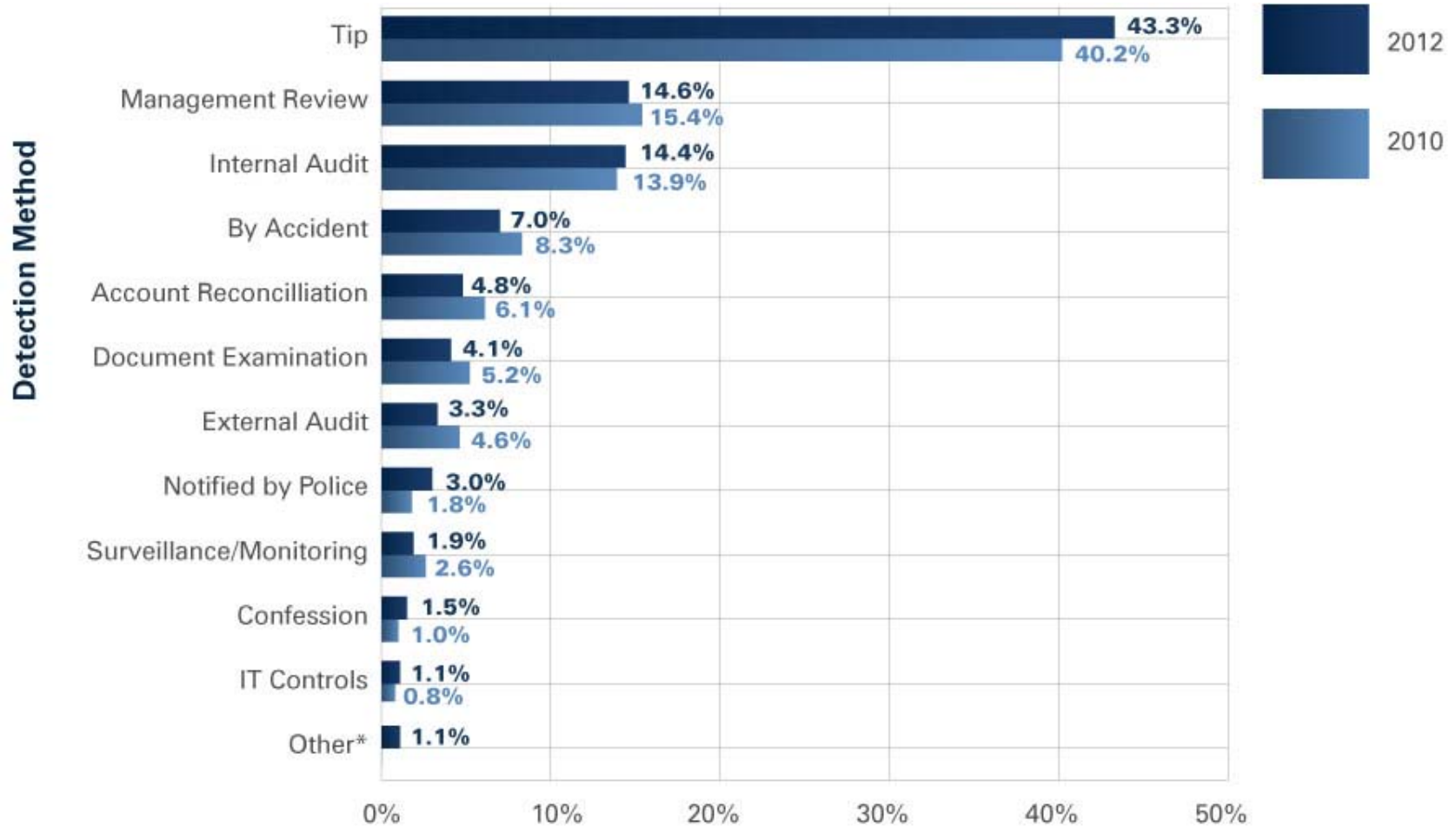
Source – 2012 Report to the Nation on Occupational Fraud and Abuse

Fraud Schemes – Religious, Charitable & Social Services

Religious, Charitable or Social Services 54 Cases		
Scheme	Number of Cases	Percent of Cases
Billing	29	51.9%
Check Tampering	18	33.3%
Expense Reimbursements	17	31.5%
Skimming	12	22.2%
Corruption	12	22.2%
Cash Larceny	11	20.4%
Payroll	9	14.8%
Cash on Hand	7	13.0%
Non-Cash	6	11.1%
Register Disbursements	3	5.6%
Financial Statement Fraud	3	5.6%

Source – 2012 Report to the Nation on Occupational Fraud and Abuse

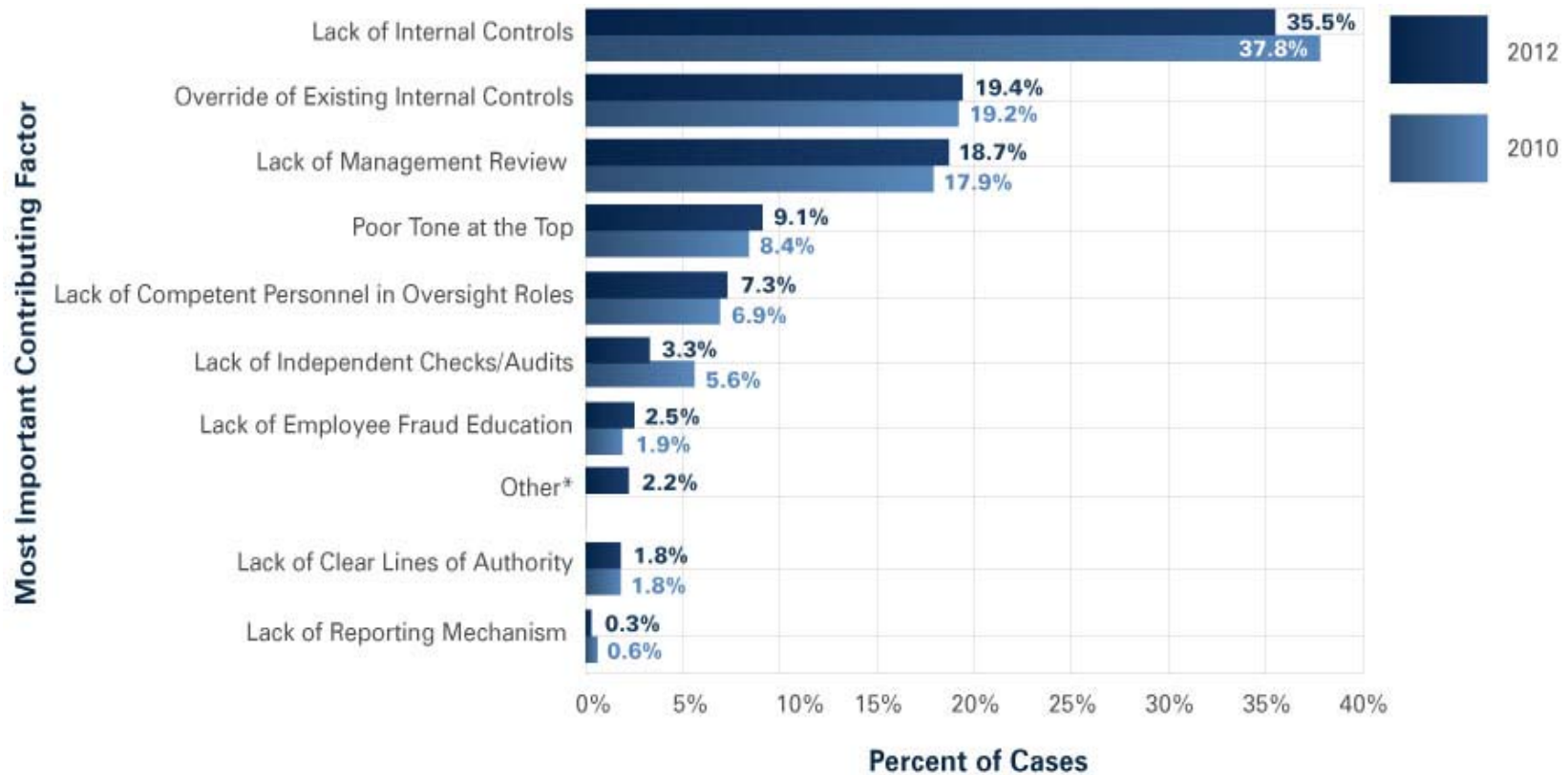
Anti-Fraud Measures



Source – 2012 Report to the Nation on Occupational Fraud and Abuse

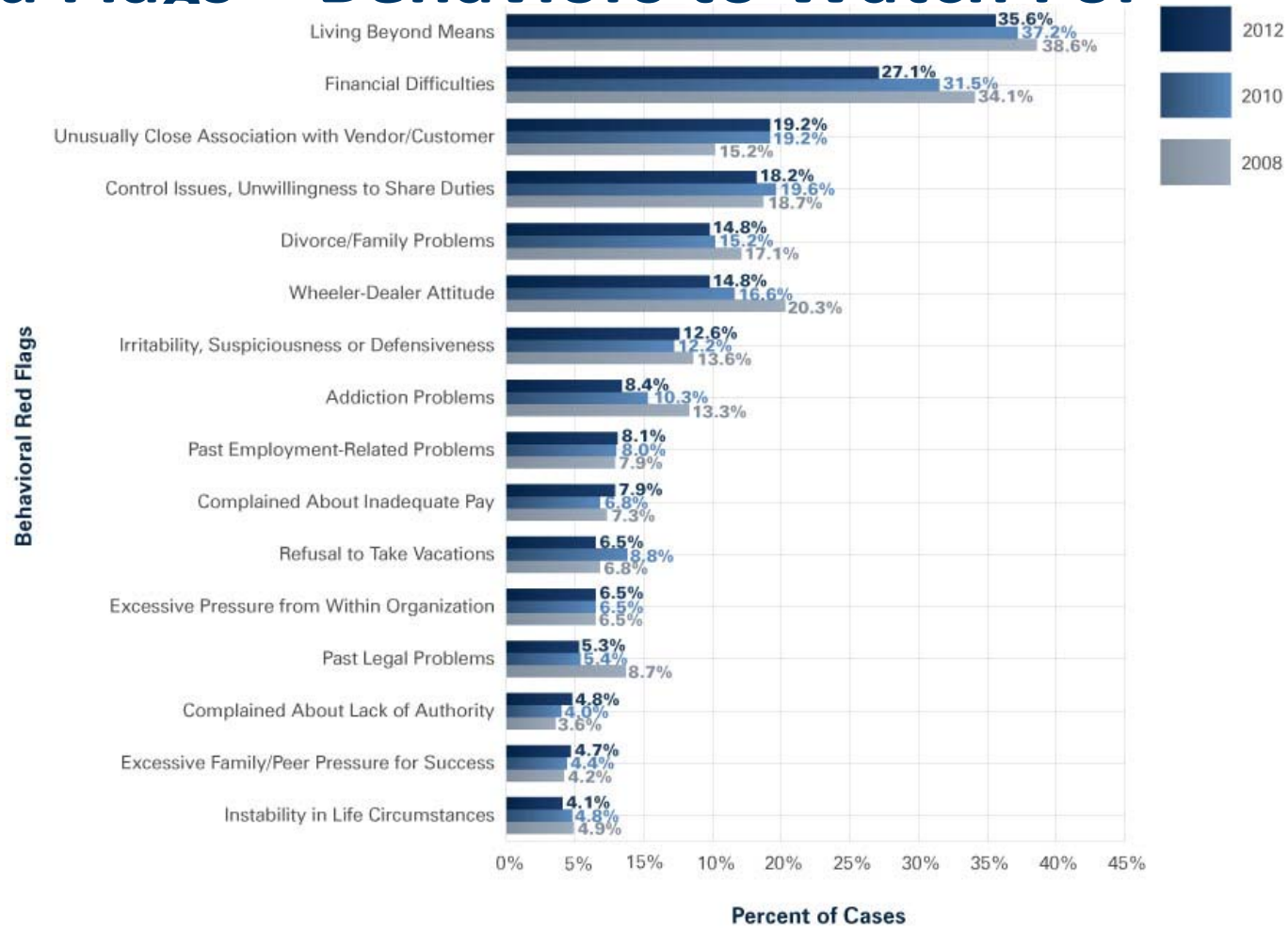
Factors that Contribute to/Allow Fraud

- Primarily internal control weaknesses:



Source – 2012 Report to the Nation on Occupational Fraud and Abuse

Red Flags – Behaviors to Watch For



Source – 2012 Report to the Nation on Occupational Fraud and Abuse

Anti-Fraud Measures (Used vs. Used Successfully)

- Across all organizations, **Occupational Frauds are more likely to be detected by a tip** than by other means such as internal audits, external audits or internal controls
- Make detection easier – have an anonymous tip line

Why Should We Care?

Why Should Nonprofits and Local Governments Be Concerned About Fraud?

“Newsworthy” Story #1

- Stealing quarters apparently isn’t just for the birds

Another city employee pleads guilty to stealing from Buffalo parking meters

Is 3rd to admit pilfering meters

“Newsworthy” Story #1

- Francis Tronolone, parking meter mechanic, admitted to stealing \$9,000 over 10 year period
- All thefts have amounted to at least \$234,000
- Lawrence Charles admitted to stealing \$15,000 in quarters over an 8 year period (sentenced to 6 months in prison)
- Charles blamed his wrongdoing on a “culture of corruption” that existed in the parking enforcement division
- Discovery: review of parking meter revenues revealed a dramatic disparity between \$\$\$ collected from individual meters and \$\$\$ collected from pay-and-display machines

Story #1 – Takeaways

- Better tone at the top!
- Anonymous tip line
- Periodic analytical reviews of revenues received from various sources and investigate anomalies
- Minimize cash collections with no means of reconciliation
- Employee background checks

Scenario #2 – the House of *Dis*Grace

- The House of Grace of the Adirondacks, a Glens Falls, N.Y. non-profit provides in-home hospice care to patients battling terminal illness
- From its website: “House of Grace receives no funding. As a nonprofit organization, we are totally dependent on the generosity of our community for support. We do request a room donation. With that support House of Grace will continue its much needed mission”

Scenario #2 – the House of *Dis*Grace

- Robert Spratt's job was supposed to be to raise money and awareness for the House of Grace
- According to Glens Falls Police, Pratt stole more than \$26,000 between October 2011 and June of this year. He reportedly falsified checks written to himself, claiming to have paid for a range of services and then sought to be reimbursed

Scenario #2 – What Did We Learn

- Evaluate expense reimbursement policy
- Ensure all checks written for payment are supported by adequate documentation
- Ensure proper approval on all check disbursements
- Financial analytical review analysis (periodic budget to actual and prior period to current period comparisons)

Scenario #3 – The Bellringer

- Monroe, LA police arrested a 32-year-old woman after she allegedly misused credit cards issued to the local Salvation Army to accumulate more than \$30,000 in charges
- Routine accounting procedures noted a spike in the monthly credit card bills and initiated a fraud audit

Scenario #3 – The Bellringer

- A former food services director of the Salvation Army in Joplin, MO pleaded guilty Monday to fraudulent use of credit cards belonging to the charity organization
- Stephen D. Lewallen, 35, was charged in December 2011 after it was discovered that the limit had been exceeded on one of the organization's charge cards with Wal-Mart
- Charges on a statement with an end date of Nov. 29, 2011, totaled \$2,656.15. But the business manager told police at the time that for the card to be over its limit, about \$18,000 in fraudulent charges would have had to have been made, according to the affidavit

Scenario #3 – What We Learned

- Reduce or eliminate high-level individuals with credit cards
- Strengthen oversight and review of credit cards
- Evaluate whether controls can be circumvented around credit cards
- How many card holders are there at your organization?

“Newsworthy” Story #4

- Johnson City, TN scandal:
 - Danny Davis had worked for Johnson City more than 30 years when the investigation into what prosecutors called a fake company got him fired. That company, Gray Home Improvements, had submitted an unusually high number of winning bids in a federally funded program to assist low-income homeowners make residential repairs. After Gray Home Improvements won the bid, Davis hired other subcontractors at a lower price to do the work and pocketed the difference.

Story #4 – Takeaways

- Review internal controls over procurement process
 - Is there adequate segregation of duties over the evaluation and approval process
 - Is there a written set of policies and procedures surrounding the procurement process? Is it monitored to ensure policies are followed?
 - Are thresholds for approval process appropriately set?

Scenario #5 – The HR Nightmare

- Mission: To serve individuals with intellectual and developmental disabilities throughout Mercer County through vocational rehabilitation programs, housing programs, camping and recreational programs and other support services

Scenario #5 – The HR Nightmare

- The Arc Mercer's human resources director has been arrested and charged with stealing more than \$100,000 from the nonprofit organization over three months
- Christopher English, 32, of Delran continued to generate paychecks for employees who had resigned or were terminated and deposited the checks into a bank account, the prosecutor's office said

Scenario #5 – The HR Nightmare

- Arc Mercer officials said they were transitioning to a new payroll vendor in January when management uncovered some irregularities
- In recent weeks they identified several payments to employees who should not have been on the payroll, being sent via direct deposit to a single account, the statement said

Scenario #5 – What We Learned

- Prompt removal of terminated employees from the payroll system
- Remove administrative access rights to those in a supervisory capacity (Payroll Manager, HR Director, etc.)
- Review of pay register each pay period by someone other than preparer

“Newsworthy” Story #6 – Close to Home

- City of Tuscan, AZ scandal:
 - Former city Transportation Department employees Kurt Hough and Bobby Palomarez have been indicted by a Pima County grand jury on multiple felony counts including fraud, theft and criminal enterprise
 - Hough and Palomarez were among five transportation supervisors and workers who resigned or were fired on Sept. 6 after an investigation into allegations they misappropriated thousands of dollars' worth of city materials and equipment for use on private construction jobs, many of which were performed by city workers on city time.

“Newsworthy” Story #6

- In August 2010, Hough ordered the construction for \$7,883 of an unauthorized concrete motorcycle pad at the city's west lot near East Ajo Way and South Park Avenue because he and his "motorcycle buddies" didn't like parking on asphalt.
- In February 2009, Hough ordered Palomarez to deliver 15 tons of city dirt to help a friend, Ken Kelly, owner of Kelly Electric, build a BMX track at another friend's home in Vail at a cost of \$600.
- Between October 2006 and July 2007, Hough ordered at least five city workers, plus equipment and materials, to build a retaining wall and pave the parking lot at Kelly Electric, 1144 W. Miracle Mile.

Story #6 – Takeaways

- Segregation of duties required; involve more individuals in the review and approval process relating to repair, maintenance, and improvement projects
- Identification of potential related parties or conflicts of interest

Scenario #7 – Don't Click That Link!!

- The Metropolitan Entertainment & Convention Authority (MECA) is a nonprofit organization responsible for the operation of CenturyLink Center Omaha, TD Ameritrade Park Omaha and Omaha Civic Auditorium

Scenario #7 – Don't Click That Link!!

- Mission: Relieve the burdens of government through management and operation of government owned convention, sports and entertainment facilities located in Omaha, Nebraska

Scenario #7 – Don't Click That Link!!

- Cyberthieves reportedly funneled \$217,000 from MECA
- An employee at MECA fell for a phishy e-mail that unleashed a malware attack that subsequently provided hackers with access to the organization's payroll system
- From there, cyberthieves hijacked the system's login and password credentials, allowing them to add their own hires to the payroll. Those hired individuals or money mules, once on the payroll, received payment transfers from MECA's bank account

Scenario #7 – Don't Click That Link!!

- Before the attack, MECA allegedly passed on security options offered by First National Bank of Omaha, including one option that required two employees to sign off on every funds transfer
- "We had declined some of the security measures offered to us," Lea French, MECA's chief financial officer, reportedly told Krebs. "We thought that would be administratively burdensome, and I was more worried about internal stuff, not somebody hacking into our systems."

Scenario #7 – What We Learned

- Implement security features offered by your bank, even if construed as administratively burdensome
- Use positive pay lists for both payroll and non-payroll disbursements, if possible
- Implement an incident response plan
- Educate employees about taking proper information security measures
- Periodically perform vulnerability assessments



Jacqueline Eckman, CPA
Principal

CliftonLarsonAllen LLP
(602) 604-3538 (office)

Jackie.Eckman@cliftonlarsonallen.com