MMA Trade Show

Conducting an Investigative Audit

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Association of Certified Fraud Examiners 2016 Global Fraud Study

**Figure 1.** Statistics (ACFE, 2016).

CFEs estimate the typical organization loses 5% of annual revenues to fraud.

The median loss from a single case of occupational fraud was $150,000.

More than 23% of occupational fraud cases resulted in a loss of at least $1 million.

Our study analyzed 2,410 occupational fraud cases that caused a total loss of more than $6.3 billion.
Association of Certified Fraud Examiners 2016 Global Fraud Study

39.1% of cases were detected through tips by employees.

Most commonly victimized industries:
- Banking and financial services
- Government and public administration
- Manufacturing

Presence of anti-fraud controls was correlated with both lower fraud losses and quicker detection.
Occupational Fraud

“The use of one’s occupation for personal enrichment through the deliberate misuse or misapplication of the organization’s resources or assets” (ACFE, 2016).
Occupational Fraud Schemes

All occupational fraud schemes have four key elements in common. The activity:

1. Is clandestine;
2. Violates the perpetrator’s fiduciary duties to the organization;
3. Is committed for the purpose of direct or indirect financial benefit to the perpetrator; and
4. Costs the employing organization assets, revenue, or reserves.
Categories of Fraud

- **Corruption**
  - 35.4% of cases
  - $200,000 median loss

- **Financial Statement Fraud**
  - 9.6% of cases
  - $975,000 median loss

- **Asset Misappropriation**
  - 83.5% of cases
  - $125,000 median loss

(ACFE, 2016)
Corruption

Any scheme in which an employee misuses his or her influence in a business transaction to obtain an unauthorized benefit contrary to that person’s duty to his or her employer.

Figure 2. Corruption (ACFE, 2016).
Financial Statement Fraud

Falsification of an organization’s financial statements to make the organization appear more favorable than actuality.

Figure 3. FS Fraud (ACFE, 2016).
Recording Expenditures/Liabilities in the Wrong Period

• No department may incur a liability in excess of their voted appropriation

• Any Town having unpaid bills of previous years which are unenforceable due to insufficient appropriation must seek additional appropriations
Asset Misappropriation

Any scheme involving the theft or misuse of an organization’s assets.

Figure 4. Misappropriation (ACFE, 2016).
Theft of Cash on Hand and Cash Receipts

Theft of Cash on Hand:
Misappropriation of cash kept on hand at the victim organization’s premises, such as petty cash.

Skimming:
Cash receipts stolen from an organization before it is recorded on the organization’s books and records.

Cash Larceny:
Cash receipts stolen from an organization after it is recorded on the organization’s books and records.
Fraudulent Disbursement Schemes

- Billing
- Payroll
- Expense Reimbursement
- Check Tampering
- Wire Transfers
- Cash Register Disbursements
- Petty Cash Disbursements
Non-Cash Misappropriations

- Larceny and Misuse of:
  - Inventory
  - Supplies
  - Equipment
  - Information
  - Software
Red Flags - Receipts

- Change in timeliness of deposits
- Decrease in the amount of deposits.
- Decrease in the amount of currency in deposits
- Incorrect cutoff
- Inconsistent deposit dates
Red Flags - Payroll

- Checks paid for an unreasonable amount of hours worked
- More than one employee with the same bank account number, SSN, or address
- Employees with no deductions for benefits
- Blank social security numbers for employees on payroll
- A terminated employee still on the payroll
Red Flags - Disbursements

- Invoices that appear unusual
- Complaints from employees or vendors
- Vendors with the same address as employees
- Internal invoices
- Photocopied invoices
- Self approved reimbursements
- Missing, incomplete or altered documentation
Off Book Bank Accounts

- Student Activity Account - $6M
- Friends of Library - $800K
- Friends of Senior Center - $30K
- Petty Cash Checking - $400K
Fraud Detection
How?

Passive methods
• Confession
• Accident
• Notified by Police

Potentially Active or Passive
• Tip (most common)
• External Audit

Active methods
• Surveillance/ Monitoring
• IT Controls
• Account reconciliation
• Internal Audit
• Document Examination
• Management Review

Figure 6. Detection (ACFE, 2016).
Fraud Detection
Sources of Tips

Insiders
• Employee
• Governing Board
• Management

Outsiders
• Auditor
• Bank
• Vendor
• Citizen

Figure 7. Tips (ACFE, 2016).
Fraud Detection
Behavioral Red Flags

Figure 8. Red Flags (ACFE, 2016).
WHEN TO INVESTIGATE

• Investigations are conducted when adequate predication exists, thus indicating a fraud has occurred.
What is Predication

• The belief based on facts known that a reasonable person will come to the conclusion that an act has occurred which justifies an investigation.
  – Protect Employees Rights and Avoid Harassment Charges
  – Evaluate Credibility of Tips and Accusations
  – Seek and Review Evidence
INTERNAL OR EXTERNAL INVESTIGATION

• In-House Resources
• Expertise
• Independence and Conflicts
• Notification to Local Police
• Inform Legal Council
• Inform You Auditors
WHEN TO CONFRONT EMPLOYEE

Early in the Investigation

• Advantages
  – Likelihood of Confession?
  – Obtain Key Information

• Disadvantages
  – Alerts Suspect
  – Ability to Destroy or Alter Evidence
  – Influence Potential Witnesses
WHEN TO CONFRONT EMPLOYEE

LATE IN THE INVESTIGATION

• The more known about the evidence the better to detect lies or misinformation
• Ability to challenge defensive responses
• The devil is in the detail
• More likely to obtain a confession
PROTECT EMPLOYEE RIGHTS

- Place on Leave
- Miranda Rights
- Right to Counsel or Union Rep
- Right to Privacy
- Right to Safety (non-threatening)
- Right to Due Process
PRESERVATION OF EVIDENCE

• Chain of Custody
• Secure Records
• Where to Store Records
• **DO NOT** Mark on or Write on Originals
• Secure Originals Retain Copies for Files
References