

Fraud! Fraud! Everywhere!

Stories from the Fraud Frontline

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Introduction



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Today's Learning Objectives

- Discuss the current landscape of fraud in government, including the common types of fraud, how these frauds can occur and the impact on a government
- Gain an understanding of internal controls and other considerations that can help detect existing fraud and mitigate the risks of fraud in the future
- Learn from real life examples how small frauds can become big problems

Fraud in government – ACFE Report to the Nations

2018 Global Study on Occupational Fraud and Abuse



ACFE 2018 Report to the Nations – Key Findings

- Government is the 3rd highest risk industry for fraud
 - 16% of all fraud cases
 - Median loss of \$118,000
 - 57% of government fraud occurs at the state and local level
 - 89% of cases are asset misappropriation schemes
 - Only 4% of perpetrators had a prior fraud conviction
 - Majority of victims recovered nothing

ACFE 2018 Report to the Nations – Key Findings (cont.)

- Top concealment methods used by fraudsters
 - Creation of fraudulent documents (physical and electronic)
 - Alteration of original documents (physical and electronic)
 - Creation of fraudulent transactions and journal entries in accounting system
 - Alteration of legitimate transactions in accounting system
 - Destruction/deletion of documents (physical and electronic)

ACFE 2018 Report to the Nations – Key Findings (cont.)

What is the likelihood that external auditors will discover fraud?

4%

ACFE 2018 Report to the Nations – Key Findings (cont.)

Fig. 18 How does the presence of anti-fraud controls relate to median loss?

Control	Percent of cases	Control in place	Control not in place	Percent reduction
Code of conduct	80%	\$ 110,000	\$250,000	56%
Proactive data monitoring/analysis	37%	\$ 80,000	\$ 165,000	52%
Surprise audits	37%	\$ 75,000	\$ 152,000	51%
External audit of internal controls over financial reporting	67%	\$100,000	\$200,000	50%
Management review	66%	\$100,000	\$200,000	50%
Hotline	63%	\$100,000	\$200,000	50%
Anti-fraud policy	54%	\$100,000	\$190,000	47%
Internal audit department	73%	\$108,000	\$200,000	46%
Management certification of financial statements	72%	\$109,000	\$192,000	43%
Fraud training for employees	53%	\$100,000	\$ 169,000	41%
Formal fraud risk assessments	41%	\$100,000	\$ 162,000	38%
Employee support programs	54%	\$100,000	\$ 160,000	38%
Fraud training for managers/executives	52%	\$100,000	\$ 153,000	35%
Dedicated fraud department, function, or team	41%	\$100,000	\$ 150,000	33%
External audit of financial statements	80%	\$120,000	\$ 170,000	29%
Job rotation/mandatory vacation	19%	\$100,000	\$ 130,000	23%
Independent audit committee	61%	\$120,000	\$ 150,000	20%
Rewards for whistleblowers	12%	\$ 110,000	\$ 125,000	12%

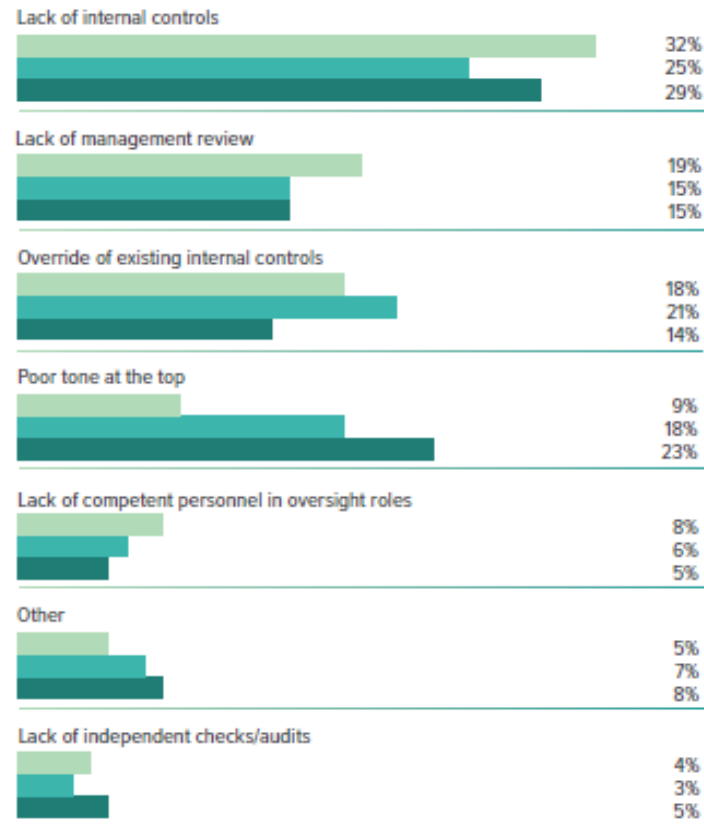
ACFE 2018 Report to the Nations – Key Findings (cont.)

Fig. 19 How does the presence of anti-fraud controls relate to the duration of fraud?

Control	Percent of cases	Control in place	Control not in place	Percent reduction
Proactive data monitoring/analysis	37%	10 months	24 months	58%
Surprise audits	37%	11 months	24 months	54%
Internal audit department	73%	12 months	24 months	50%
Management certification of financial statements	72%	12 months	24 months	50%
External audit of internal controls over financial reporting	67%	12 months	24 months	50%
Management review	66%	12 months	24 months	50%
Hotline	63%	12 months	24 months	50%
Anti-fraud policy	54%	12 months	24 months	50%
Fraud training for employees	53%	12 months	24 months	50%
Fraud training for managers/executives	52%	12 months	24 months	50%
Formal fraud risk assessments	41%	12 months	24 months	50%
Rewards for whistleblowers	12%	9 months	18 months	50%
Independent audit committee	61%	12 months	23 months	48%
Code of conduct	80%	13 months	24 months	46%
Job rotation/mandatory vacation	19%	10 months	18 months	44%
Dedicated fraud department, function, or team	41%	12 months	20 months	40%
External audit of financial statements	80%	15 months	24 months	38%
Employee support programs	54%	12 months	18 months	33%

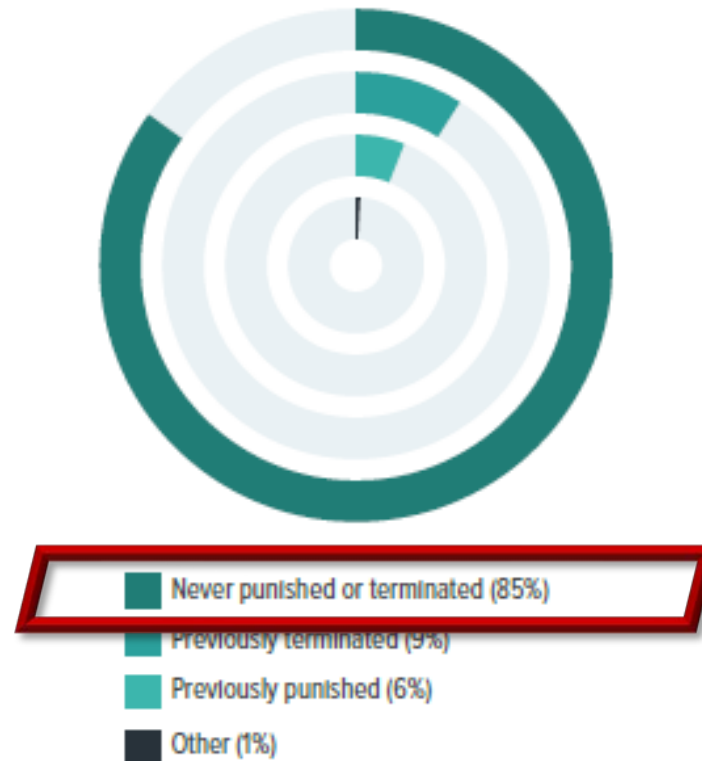
ACFE 2018 Report to the Nations – Key Findings (cont.)

FIG. 23 How do internal control weaknesses vary by scheme type?

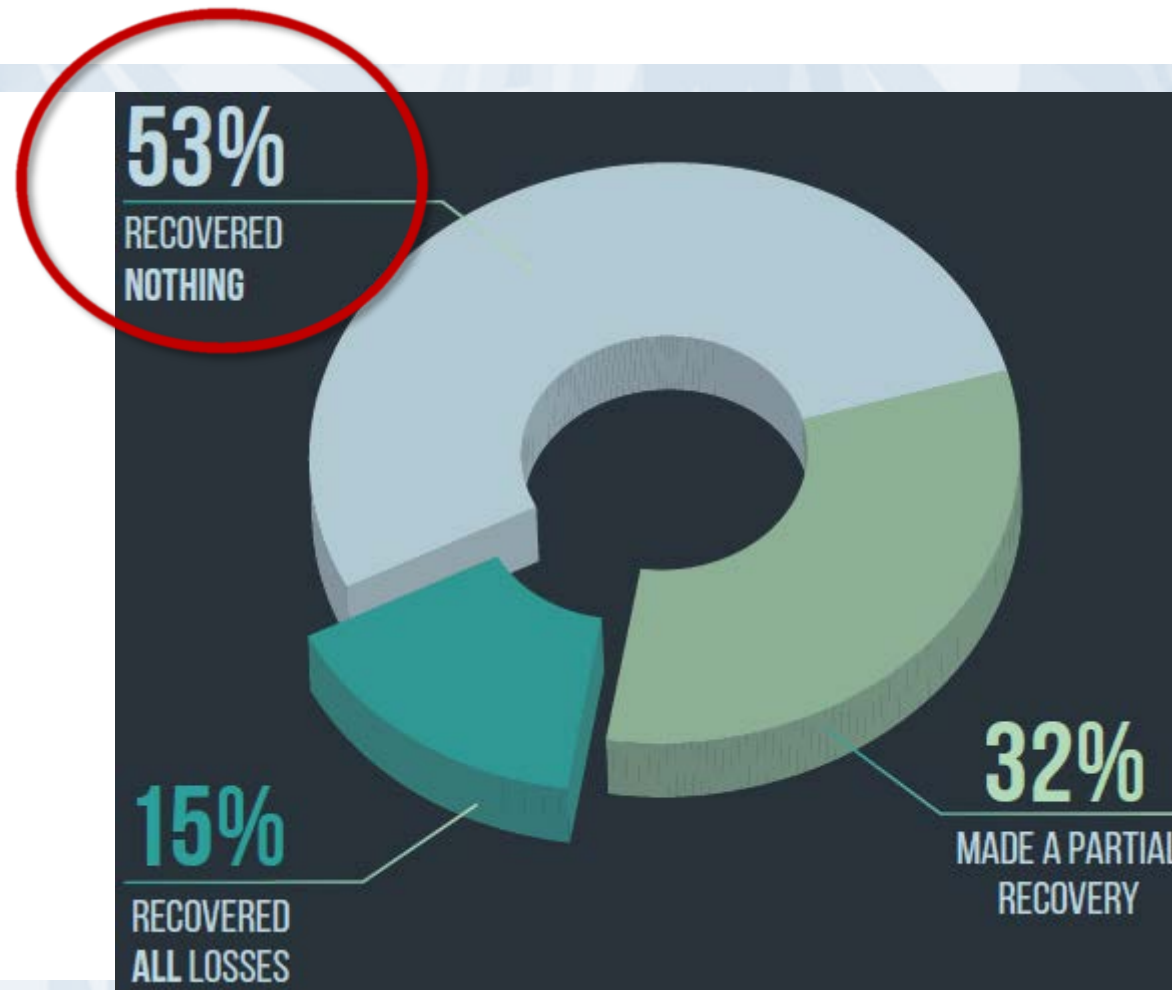


ACFE 2018 Report to the Nations – Key Findings (cont.)

FIG. 37 Do perpetrators tend to have prior employment-related disciplinary actions for fraud?

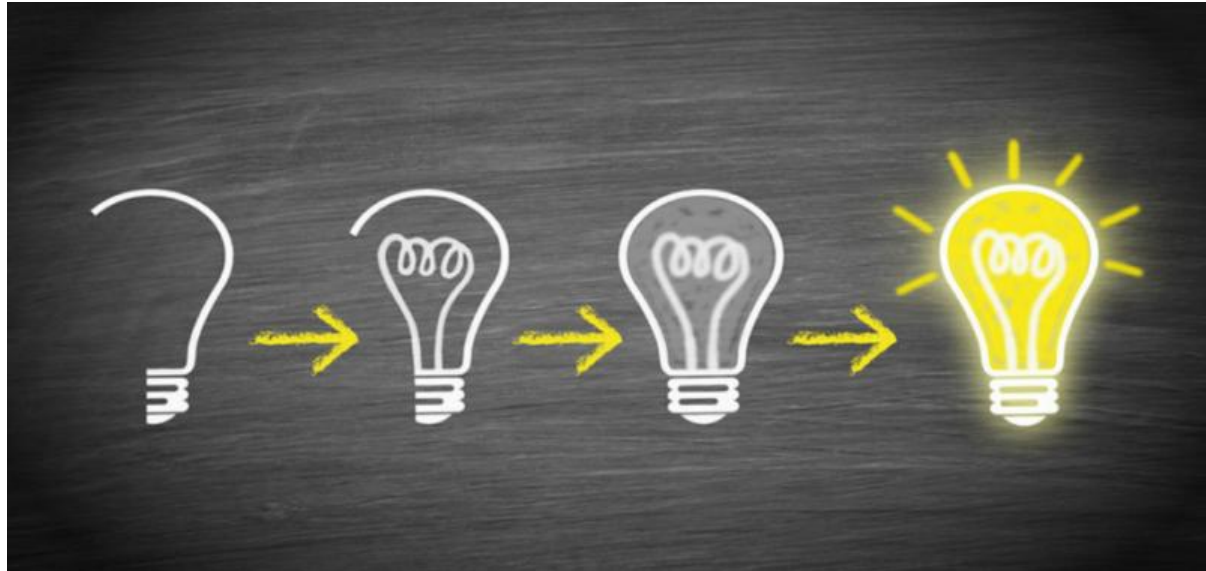


ACFE 2018 Report to the Nations – Key Findings (cont.)



ACFE 2018 Report to the Nations – Key Findings (cont.)

What's the biggest takeaway from the Report to the Nations?



Risk of Fraud

Risk of fraud cannot be eliminated, but action can be taken to reduce the **impact** and **likelihood** of fraud taking place at your organization





**KEEP
CALM**

AND

LOVE

INTERNAL CONTROLS

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Internal Control Best Practices

- Why are governments susceptible to fraud?
 - Management and governing body are often too trusting
 - Cost restrictions may result in:
 - Limited or no segregation of duties due to understaffing
 - Limited resources to develop risk assessments and maintain anti-fraud programs and controls
 - Lack of internal audit and/or anti-fraud departments in-house
 - A lack of financial expertise and natural turnover in governing bodies
 - A belief that external financial audits will catch all fraud

Internal Control Best Practices (cont.)

- No matter the size of an organization, internal controls must and can be put in place
- Even a small amount of internal controls can go a long way
- There are many internal control opportunities and numerous ways to mitigate risk

Internal Control Best Practices (cont.)

- Examples of Internal Control
 - Segregation of duties
 - Multiple layers of reviews, approvals and signatures
 - Maintain backup documentation
 - Board/Council involvement/oversight
 - Automated controls
 - Access restrictions
 - Conduct background checks
 - Encourage whistleblowers
 - Educate employees using discussion of fraud risks and internal controls

Internal Control Best Practices (cont.)

What can a small government with limited staffing and resources do to mitigate risk?

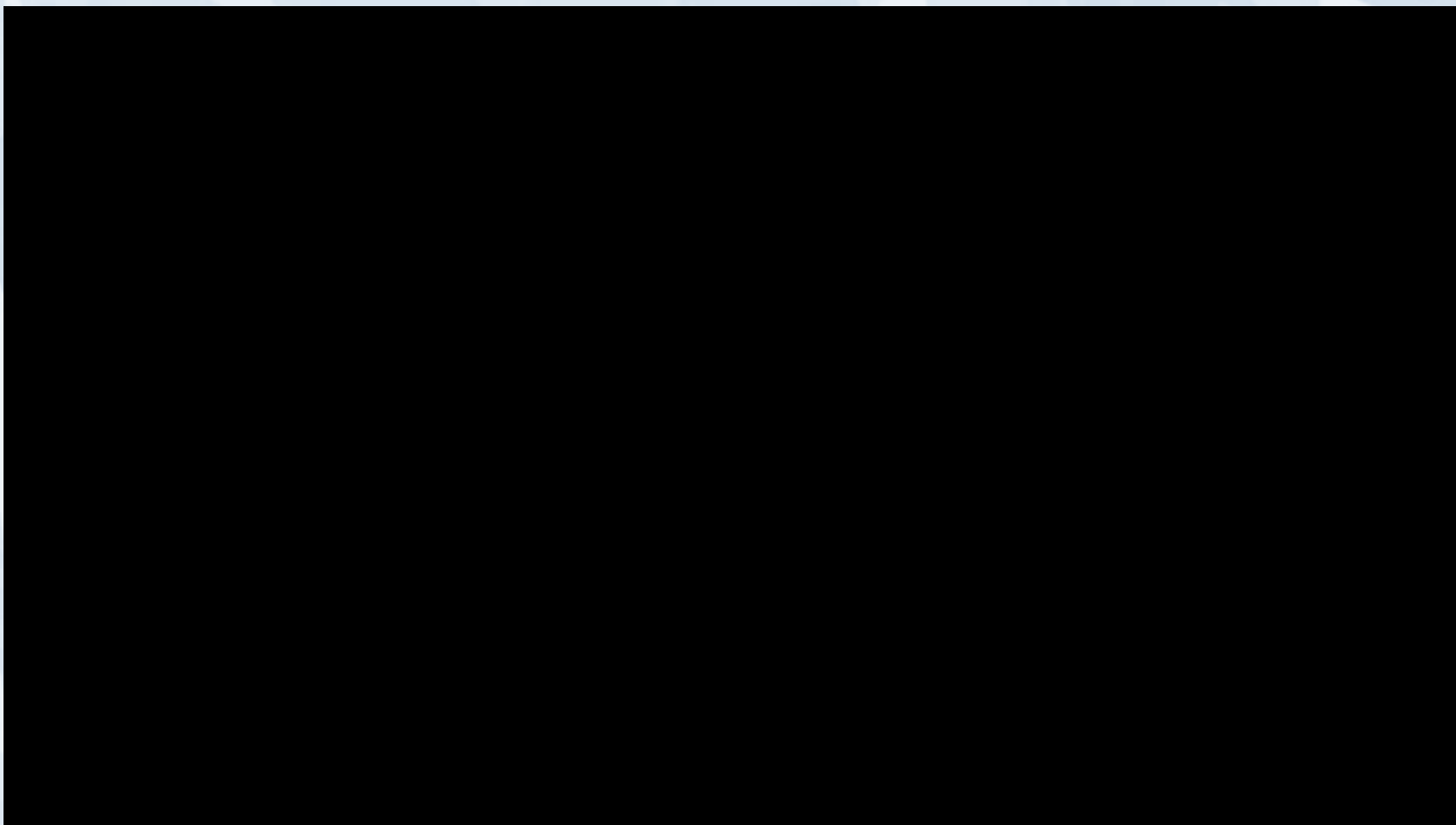
Alternative Procedures

Internal Control Best Practices (cont.)

- Examples of alternative procedures
 - Review of payroll change log reports
 - Utilize third party services, like positive pay or other online banking tools, to “outsource” controls
 - Automated “workflow” system controls ensuring approver is different from preparer
 - Increased board/council oversight (such as review of detailed billing registers to ensure continuity of check sequence)

Fraud in Real Life: How Does it Happen and How Can You Stop It

It's Story
TIME



The Case of the Million Dollar Locker Parts



The Case of the Million Dollar Locker Parts (cont.)

- The Details

- A custodian set up a fictitious company and initiated purchase orders to this company for locker parts
- Individual created fake invoices, which were approved by supervisor and business office
- Individual offered to pick up parts to circumvent receipting process
- New administrative assistant thought invoice looked strange and was bothered that packing slips could not be reconciled like other purchases
- Local police and USPS set up sting at PO box and caught individual collecting payments
- Fraud was committed over 20 years and totaled \$1.1 million

The Case of the Million Dollar Locker Parts (cont.)

- The Opportunity
 - Although controls were in place, review of invoices was not critically examined
 - No process existed around the government's vendor listing
 - No assessment of whether W-9s were available
 - No due diligence to ensure company existed
 - Exceptions to receipting process were allowed

The Case of the Million Dollar Locker Parts (cont.)

How could this have been prevented?



The Case of the Million Dollar Locker Parts (cont.)

- Preventative Measures
 - Review/approvals should be completed with a skeptical, critical eye
 - Process to validate vendors with payments made to a P.O. box
 - Periodic review of vendor listing, including long-standing vendors, to ensure validity of vendor
 - Separate receipting of goods from purchase initiation

Time for Some Timecard Trickery

			OUT	TOTAL DAILY HOURS	B
11	M	9a	5p		
12	T	9a	5p	8.0	
13	W	9a	5p	8.0	
14	T	9a	5p	8.0	
15	F	9a	5p	8.0	X
			5p	8.0	X
				8.0	X
				40 hrs	X

Time for Some Timecard Trickery (cont.)

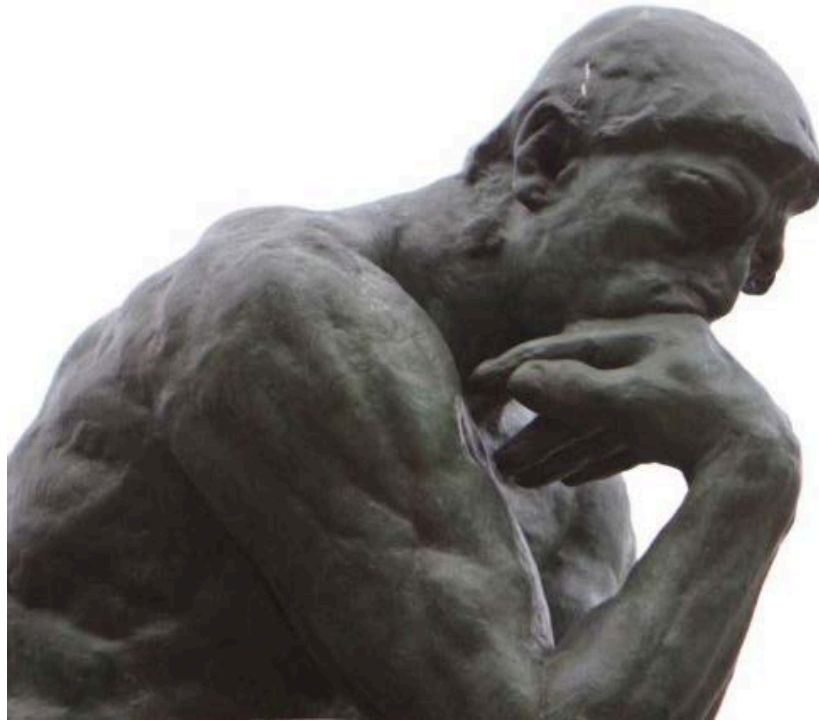
- The Details
 - Firefighter failed to report vacation/sick/comp time taken and reported overtime when it was not worked
 - When individual was not at work, other firefighters were “field promoted” for the day and received additional compensation
 - Over a 5-year period, it was accused that individual received over \$50K in pay for days not actually worked
 - No formal action ever taken, but accuser and accused left government
 - Accused individual sued the government for defamation
 - Several members of management were pushed out for not taking swift action

Time for Some Timecard Trickery (cont.)

- The Opportunity
 - Multiple documents were maintained to track time for firefighters and no reconciliation of documents or formal review was completed
 - Secretary responsible for entering timecard data into payroll system often made data entry errors and did not assess timecards for reasonableness, clouding potential red flags
 - Erroneous time entry was a known issue never addressed
 - No oversight or periodic assessments of processes by management

Time for Some Timecard Trickery (cont.)

How could this have been prevented?



Time for Some Timecard Trickery (cont.)

- Preventative Measures
 - Documented reviews and reconciliations of timecards to shift sheets
 - Proper training for individual responsible for entering time into payroll system or placement of responsibility with knowledgeable employee
 - Implementation of an automated time entry system that interacts with payroll system
 - Periodic reviews of accuracy of time entry by management

Taking Your Kid's Lunch Money



Taking Your Kid's Lunch Money (cont.)

- The Details
 - Finance office manager was responsible for recording cash receipts into the general ledger
 - Individual also collected lunch money from cafeterias and reconciled before deposits were made
 - Money was skimmed from daily cash collections and never entered into general ledger
 - Journal entries were made to “spread” impact of skimmed funds across various revenue accounts
 - Fraud discovered in two ways:
 - Management became suspicious as daily collections increased when she was on vacation and her behavior had become erratic
 - Auditors reviewed her “spread” entry and she could not provide explanation and became confrontational when pushed
 - Fraud occurred over 7 years and totaled more than \$100K

Taking Your Kid's Lunch Money (cont.)

- The Opportunity
 - Lack of segregation of duties in the cash receipt process
 - Individuals handling cash should be separate from those entering revenues into general ledger and reviewing daily deposit reconciliations
 - Trust placed into a long-time employee, resulting in too much authority with one individual
 - No review of journal entries by management

Taking Your Kid's Lunch Money (cont.)

How could this have been prevented?



Taking Your Kid's Lunch Money (cont.)

- Preventative Measures
 - Required independent review and approval of journal entries
 - Individuals handling cash should never be responsible for entering revenues into general ledger or reconciling deposits to register reports
 - Reconciliation of cafeteria registers with meal system and deposit slips to ensure all money is accounted for
 - Complete trend analysis and budgetary comparisons for local cash receipts and investigate unexplainable underperformance on a periodic basis

From Right Under Their Noses



From Right Under Their Noses (cont.)

- The Details
 - Police department takes payment for fines and fees at a decentralized location
 - Cashier was responsible for handling cash receipts, reconciling to the daily deposit, and had access to modify receipting system to write-off fines and fees
 - Cashier took payments and failed to provide receipt to customer
 - Money was not entered into receipting system and not included in deposit reconciliations

From Right Under Their Noses (cont.)

- The Details
 - Cashier kept the skimmed cash and checks in her purse
 - Suspicions arose as customers complained about not receiving receipts and, in some cases, receiving notices of unpaid fines
 - Cashier had not consistently written-off skimmed funds
 - Officer looked through her belongings and found stolen cash and checks
 - Fraud totaled \$4,500
 - Cashier is suing the government to get her job back due to “illegal search” of her property

From Right Under Their Noses (cont.)

- The Opportunity
 - No segregation of duties – cashier had full access and responsibility for the cash receipting process
 - Decentralized location and lack of oversight over collections
 - Ability to circumvent cash register system and not generate receipts in conjunction with ability to manually modify billing ledger without review/approval
 - Complaints and confusion related to “unpaid” fees and fines addressed by cashier

From Right Under Their Noses (cont.)

How could this have been prevented?



From Right Under Their Noses (cont.)

- Preventative Measures
 - Individuals collecting and handling cash should have no access to billing system
 - Elimination of decentralized cash collection points, if possible
 - Periodic independent review of manual adjustments made to receivable ledger

Questions?

