Fraud Investigation: Do You Have a Clue?

Dawn Williford, Partner, Risk Advisory Services
Jesse Daves, Managing Director, Forensic Accounting & Investigations
Dawn Williford, CIA, CRMA  
Partner, Risk Advisory Services

Dawn has over 20 years of internal audit, vendor construction audit and SOX compliance and other consulting experience. Dawn has been heavily involved in all aspects of business process evaluation and documentation, corporate governance, SOX readiness and ongoing SOX compliance, risk assessments, root-cause analysis and internal audit outsourcing and co-sourcing. Dawn assists clients with the development of their internal audit department and serves as the Chief Audit Executive for her outsourced Internal Audit clients. Dawn has managed construction audits, vendor audits, joint venture audits, franchise audits, and large scale multi-vendor audit programs that have identified millions of dollars in cost recoveries for her clients. Dawn has participated in fraud investigations, identified root causes and internal control breakdowns that led to the fraud and has redesigned processes and controls to help clients prevent future instances of fraud.

Jesse Daves, CPA/CFF, CFE  
Managing Director, Forensic Accounting & Investigations

Jesse Daves has over 20 years of experience providing audit, forensic accounting and investigative services to clients across a wide range of industries. Mr. Daves has conducted fraud-related investigations involving numerous issues, including alleged violations of the Foreign Corrupt Practices Act (FCPA), embezzlement, kickbacks, Ponzi schemes, conflicts of interest and employment matters. He has worked directly with all levels of management, general and outside counsel as well as the Harris County District Attorney’s Office, the United States Attorney’s Office, the Federal Bureau of Investigation and the Securities and Exchange Commission.
DISCUSSION THEMES

- Fraud stats and schemes
- Building the “perfect” perp
- Anti-fraud tips
- Learning from the lessons of others
- The impact of fraud on company culture
Occupational frauds are those schemes in which a person defrauds his or her employer.
COMMON ELEMENTS OF FRAUD

**MOTIVE/PRESSURE**
- Financial pressures
- Unrealistic expectations
- Addiction
- Greed

**OPPORTUNITY**
- Lack or circumvention of internal controls
- Turnover at key positions
- Related party transactions
- Significant use of estimates

**RATIONALIZATION**
- “The company owes me.”
- “It’s only a loan; I’ll pay it back.”
- “It’s for a good cause.”
- “No one will notice.”

Source: Donald R. Cressey, *Other People’s Money* (Montclair: Patterson Smith, 1973)
THE COST OF FRAUD

- 5% of annual revenue lost to fraud
- Median loss of $130,000 per scheme
- Median duration of 16 months

Source: ACFE’s 2018 Report To The Nations On Occupational Fraud and Abuse
Copyright 2018 by the Association of Certified Fraud Examiners, Inc.
HOW FRAUD IS COMMITTED

Occupational Frauds by Category - Frequency

Financial Statement Fraud

- 2014: 9.0%
- 2016: 9.6%
- 2018: 10.0%

Corruption

- 2014: 36.8%
- 2016: 35.4%
- 2018: 38.0%

Asset Misappropriation

- 2014: 85.4%
- 2016: 83.5%
- 2018: 89.0%

Source: ACFE’s 2016 and 2018 Report To The Nations On Occupational Fraud and Abuse
Copyright 2016 and 2018 by the Association of Certified Fraud Examiners, Inc.
HOW FRAUD IS COMMITTED

Occupational Frauds by Category - Median Loss

- Financial Statement Fraud: $1,000,000, $975,000, $800,000
- Corruption: $200,000, $200,000, $250,000
- Asset Misappropriation: $130,000, $125,000, $114,000

Source: ACFE’s 2016 and 2018 Report To The Nations On Occupational Fraud and Abuse
Copyright 2016 and 2018 by the Association of Certified Fraud Examiners, Inc.
### COMMITTING MORE THAN ONE SCHEME

<table>
<thead>
<tr>
<th>Scheme Description</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset misappropriation only</td>
<td>57%</td>
</tr>
<tr>
<td>Asset misappropriation and corruption</td>
<td>23%</td>
</tr>
<tr>
<td>Corruption only</td>
<td>9%</td>
</tr>
<tr>
<td>Corruption, asset misappropriation, and financial statement fraud</td>
<td>4%</td>
</tr>
<tr>
<td>Asset misappropriation and financial statement fraud</td>
<td>3%</td>
</tr>
<tr>
<td>Financial statement fraud only</td>
<td>1%</td>
</tr>
<tr>
<td>Corruption and financial statement fraud</td>
<td>1%</td>
</tr>
</tbody>
</table>

Source: ACFE’s 2018 Report To The Nations On Occupational Fraud and Abuse  
Copyright 2018 by the Association of Certified Fraud Examiners, Inc.
DETECTION OF FRAUD SCHEMES

Initial Detection of Occupational Frauds

Source: ACFE’s 2016 and 2018 Report To The Nations On Occupational Fraud and Abuse
Copyright 2016 and 2018 by the Association of Certified Fraud Examiners, Inc.
## Median Loss Based on Presence of Anti-Fraud Controls

<table>
<thead>
<tr>
<th>Control</th>
<th>Percent of Cases</th>
<th>Control in Place</th>
<th>Control Not in Place</th>
<th>Percent Reduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Code of Conduct</td>
<td>80%</td>
<td>$110,000</td>
<td>$250,000</td>
<td>56%</td>
</tr>
<tr>
<td>Proactive Data Monitoring/Analysis</td>
<td>37%</td>
<td>$80,000</td>
<td>$165,000</td>
<td>52%</td>
</tr>
<tr>
<td>Surprise Audits</td>
<td>37%</td>
<td>$75,000</td>
<td>$152,000</td>
<td>51%</td>
</tr>
<tr>
<td>External Audit of ICOFR</td>
<td>67%</td>
<td>$100,000</td>
<td>$200,000</td>
<td>50%</td>
</tr>
<tr>
<td>Management Review</td>
<td>66%</td>
<td>$100,000</td>
<td>$200,000</td>
<td>50%</td>
</tr>
<tr>
<td>Hotline</td>
<td>63%</td>
<td>$100,000</td>
<td>$200,000</td>
<td>50%</td>
</tr>
<tr>
<td>Anti-Fraud Policy</td>
<td>54%</td>
<td>$100,000</td>
<td>$190,000</td>
<td>47%</td>
</tr>
<tr>
<td>Internal Audit Department</td>
<td>73%</td>
<td>$108,000</td>
<td>$200,000</td>
<td>46%</td>
</tr>
<tr>
<td>Management Certification of Financial Statements</td>
<td>72%</td>
<td>$109,000</td>
<td>$192,000</td>
<td>43%</td>
</tr>
<tr>
<td>Fraud Training for Employees</td>
<td>53%</td>
<td>$100,000</td>
<td>$169,000</td>
<td>41%</td>
</tr>
<tr>
<td>Formal Fraud Risk Assessments</td>
<td>41%</td>
<td>$100,000</td>
<td>$162,000</td>
<td>38%</td>
</tr>
</tbody>
</table>

Source: ACFE’s 2018 Report To The Nations On Occupational Fraud and Abuse
Copyright 2018 by the Association of Certified Fraud Examiners, Inc.
ANTI-FRAUD TIPS

- Prepare a comprehensive fraud risk assessment
- Perform proactive data analytics
- Educate management, employees, vendors and customers
- Remember: Trust is NOT an internal control
BUILDING THE “PERFECT” PERP
Who Could it be?

THE OFFICE
Number of Perpetrators - Frequency and Median Loss

Source: ACFE’s 2018 Report To The Nations On Occupational Fraud and Abuse
Copyright 2018 by the Association of Certified Fraud Examiners, Inc.
Gender Of Perpetrator - Frequency

Source: ACFE's 2016 and 2018 Report To The Nations On Occupational Fraud and Abuse
Copyright 2016 and 2018 by the Association of Certified Fraud Examiners, Inc.
AGE

Age of Perpetrator - Frequency

Source: ACFE’s 2014, 2016 and 2018 Report To The Nations On Occupational Fraud and Abuse
Copyright 2014, 2016 and 2018 by the Association of Certified Fraud Examiners, Inc.
Education Level of Perpetrator - Median Loss

- High School Graduate or Less
- Some University
- University Degree
- Postgraduate Degree

Source: ACFE’s 2014, 2016 and 2018 Report To The Nations On Occupational Fraud and Abuse
Copyright 2014, 2016 and 2018 by the Association of Certified Fraud Examiners, Inc.
Position of Perpetrator - Frequency

Source: ACFE’s 2014, 2016 and 2018 Report To The Nations On Occupational Fraud and Abuse
Copyright 2014, 2016 and 2018 by the Association of Certified Fraud Examiners, Inc.
Department of Perpetrator - Frequency

Source: ACFE’s 2014, 2016 and 2018 Report To The Nations On Occupational Fraud and Abuse
Copyright 2014, 2016 and 2018 by the Association of Certified Fraud Examiners, Inc.
Tenure of Perpetrator - Frequency

- More than 10 years
- 6 - 10 years
- 1 - 5 years
- Less than 1 year

Source: ACFE’s 2014, 2016 and 2018 Report To The Nations On Occupational Fraud and Abuse
Copyright 2014, 2016 and 2018 by the Association of Certified Fraud Examiners, Inc.
Criminal Background of Perpetrator - Fraud Related

- 89% Never charged or convicted
- 6% Charged but not convicted
- 4% Had prior convictions
- 1% Other

Source: ACFE’s 2018 Report To The Nations On Occupational Fraud and Abuse
Copyright 2018 by the Association of Certified Fraud Examiners, Inc.
BUILDING THE “PERFECT” PERP

- **Number of Perpetrators:** One
- **Gender:** Male
- **Age:** 36-45
- **Education Level:** Degree
- **Position:** Employee (staff)
- **Department:** Accounting
- **Tenure:** 1-5 Years
- **Criminal Background:** Clean
MOST LIKELY PERPETRATOR
RED FLAGS

Top 10 Behavioral Red Flags of Perpetrators

1. Living beyond means
2. Financial difficulties
3. Unusually close association with vendor/customer
4. No behavioral red flags
5. Control issues, unwillingness to share duties
6. Divorce/family problems
7. “Wheeler-dealer” attitude
8. Irritability, suspiciousness or defensiveness
9. Addiction problems
10. Complained about inadequate pay

Source: ACFE’s 2018 Report To The Nations On Occupational Fraud and Abuse
Copyright 2018 by the Association of Certified Fraud Examiners, Inc.
STORY TIME: “A CEO IN CRISIS”

Lessons Learned
- Appearance doesn’t always equal truth
- Culture impacts can be felt everywhere
- Bullying doesn’t just take place on the playground

Internal Audit Plan - “Survey on Culture”
- Corporate Office
- Interviews / Surveys
- Evaluation of ELCs
- Review of key metrics
- International Divisions

- Unhappy employees
- Secrecy
- Significant Pressure
- Controlling
- Overly Critical
- Half Truths

- Lack of talent
- Paranoia
- Errors/Mistakes
- CEO

- Restatements
- Internal Control Breakdowns

Tips
- Lies
- Cover - Ups
- Finger Pointing

CEO

- Code of Conduct
- Policies and Procedures
- Proper Oversight
- Hotline
“WHO’S WATCHING IT?”

Mobile Phone Provider

Mobile phones purchased

Mobile phones shipped to company

Employee Fraudster

Submits Altered Invoices

Submits Payment

FedEx shipments

PayPal/Wire payments

New York Merchant

Accounts Payable Department

Submits Invoice for Payment
LET ME COUNT THE WAYS

International corporate office

US subsidiary

Finance Director

Paid $6M

Fictitious vendor

Scheme & Concealment methods

Changed registration docs

Altered vendor transaction details

Super user rights

Asset instead of expense

President’s signature stamp

Separate check runs

Used dormant entity / bank account

Periodic adjustment

Reconciliation

General Ledger

Inventory account

Perpetual Inventory System
WHAT DOES A POOR CULTURE COST?

Productivity = $14k per employee*

Market Value = $1b +

Consumer Confidence

Reputation = $500m +

Fines/Settlements = $150m +

Fraud = 5% of revenue

*Source: Science Daily
CULTURE: THE “MORAL FABRIC” OF AN ORGANIZATION

Organizational culture encompasses values and behaviors that "contribute to the unique social and psychological environment of an organization".
CULTURE ORGANIZATION

Formal policies, systems and practices

Information practices and symbolic actions

Beliefs, values & attitudes

Only 4% of problems are known to top managers

9% of problems are known to middle management

74% of problems are known to supervisors

100% of problems are known to front-line employees
INTERNAL AUDIT TO DOS

- Gain Support - Build the relationships, respect and support necessary to discuss difficult concerns about culture

- Communicate - Discuss the importance of auditing culture with management, the audit committee and throughout the organization

- Build an Approach - Be it small, focused audit areas or an overall, holistic review, decide how your department will undertake a culture assessment

- Fact Find - Over time, gather information that can be used to evaluate an organization’s culture - look outside the traditional objective methods that are “comfortable” to us as auditors
Culture change is NOT like a lightning strike

Culture change is more like planting a seed and nurturing it and watching it grow.

Time is measured in years before you get a fully functional, aligned culture.
CHALLENGES & SOLUTIONS

- Eliminate Learn/Forget Cycle - make change sticky
- Heart Transformation - people doing the right things for the right reasons
- Develop & Conduct Periodic & On-going Verifications

- Drive and Manage Change via Corrective Action
- Structuring Very High Standard Internal and External Audits
- Instill within all employees on a daily basis the Organizational Vision
WHAT CAN WE CLARIFY?