FRAUD
Detection and Incident Response for Auditors

IIA Milwaukee Chapter
November 14, 2018

John@JohnHallSpeaker.com
## Fraud Loss Scorecard

<table>
<thead>
<tr>
<th>Category</th>
<th>HIGH</th>
<th>LOW</th>
</tr>
</thead>
<tbody>
<tr>
<td>Disbursements</td>
<td>$ XXX</td>
<td>$ XXX</td>
</tr>
<tr>
<td>Inventory</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Construction/Facilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Health Care Costs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payroll</td>
<td></td>
<td></td>
</tr>
<tr>
<td>T&amp;M contracts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>T&amp;E reimbursement</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other – Unique to You</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>$ XXX</strong></td>
<td><strong>$ XXX</strong></td>
</tr>
</tbody>
</table>
I’m at this seminar because I want to be Better! able to...
Program Purpose
Provide the Structure
Fraud Risk Management Framework

1. Deterrence and Prevention
2. Early Detection
3. Effective Handling

ORGANIZATIONS (and their auditors) MUST BE PREPARED AT ALL THREE LEVELS
Level 1: Deterrence and Prevention
Deterrence and Prevention

1. Visible and vocal leadership
2. Active ongoing fraud risk brainstorming
3. Policies on Fraud Responsibilities
4. Anti-fraud controls
5. Anti-fraud daily behaviors
6. Anti-fraud “How to” skills training
Deterrence and Prevention

Action 1

Visible and Vocal Leadership

At Every Level
Tone: Top, Middle & Bottom

Leaders At All Levels Must Talk About It Explicitly
Tone: Top, Middle & Bottom

Expectations
Openly
Discussed
Deterrence and Prevention

Action 2

Active

Fraud Risk

Brainstorming
Three Question Script

1. How could someone exploit weaknesses in our controls and daily behaviors?
2. How could someone override or circumvent our controls?
3. How could someone conceal their wrongful actions?
# Fraud Loss Scorecard

<table>
<thead>
<tr>
<th></th>
<th>HIGH</th>
<th>LOW</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Disbursements</td>
<td>$ XXX</td>
</tr>
<tr>
<td>2</td>
<td>Inventory</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Construction/Facilities</td>
<td></td>
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<tr>
<td>4</td>
<td>Health Care Costs</td>
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<td>5</td>
<td>Payroll</td>
<td></td>
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<tr>
<td>6</td>
<td>T&amp;M contracts</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>T&amp;E reimbursement</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Other – Unique to You</td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>$ XXX</td>
<td>$ XXX</td>
</tr>
</tbody>
</table>
Deterrence and Prevention

Action 3
Policies on Fraud
Responsibilities
Essential Content

Every manager is responsible for:

Knowing the exposures to wrongdoing and fraud in their areas.
Every manager is responsible for:

- Doing their best
- to prevent or deter incidents
Every manager is responsible for:

- Promptly detecting suspicious transactions and events
Every manager is responsible for:

Immediately reporting suspicions to those responsible for follow-up
Clear Instructions
Do Not Ensure
Clear Actions
But it’s a good start
Deterrence and Prevention

Action 4

Anti-Fraud Controls
Effective Internal Controls

Procedures

Behaviors
Deterrence and Prevention

Action 5

Anti-Fraud Behaviors
SIMPLICITY

The Anti-Fraud Moment
Four Daily Behaviors

1. Look for fraud indicators
2. Use “How do I know?”
3. When in doubt, doubt
4. Resolve or refer suspicions
LOOK
ASK
DOUBT
RESOLVE
Quality = Right the First Time

It’s Not Extra Work.

It’s Core Work.
Deterrence and Prevention

Action 6

Anti-fraud “How To” Skills Training
<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 internal controls over financial reporting</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>
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<tr>
<td>Formal fraud risk assessments</td>
<td>41%</td>
<td>$100,000</td>
<td>$162,000</td>
<td>38%</td>
</tr>
<tr>
<td>Employee support programs</td>
<td>54%</td>
<td>$100,000</td>
<td>$160,000</td>
<td>38%</td>
</tr>
<tr>
<td>Fraud training for managers/executives</td>
<td>52%</td>
<td>$100,000</td>
<td>$153,000</td>
<td>35%</td>
</tr>
<tr>
<td>Dedicated fraud department, function, or team</td>
<td>41%</td>
<td>$100,000</td>
<td>$150,000</td>
<td>33%</td>
</tr>
<tr>
<td>External audit of financial statements</td>
<td>80%</td>
<td>$120,000</td>
<td>$170,000</td>
<td>29%</td>
</tr>
<tr>
<td>Job rotation/mandatory vacation</td>
<td>19%</td>
<td>$100,000</td>
<td>$130,000</td>
<td>23%</td>
</tr>
<tr>
<td>Independent audit committee</td>
<td>61%</td>
<td>$120,000</td>
<td>$150,000</td>
<td>20%</td>
</tr>
<tr>
<td>Rewards for whistleblowers</td>
<td>12%</td>
<td>$110,000</td>
<td>$125,000</td>
<td>12%</td>
</tr>
</tbody>
</table>
What Skills Are Needed

1. General knowledge of fraud risks
2. What can happen in their areas
3. What it looks like in documents, reports and behaviors they see
4. Suggestions on prevention
5. Suggestions on prompt detection when prevention fails
How Do We Deliver Training?

1. Group live
2. Technology-based
   - Teleseminars
   - Webinars
   - Video
3. 1 on 1 coaching by supervisors
4. 1 on 1 coaching by auditors
5. Written
Good Questions Before Approving:
1. Invoices from suppliers
2. Out of pocket cost reimbursement
3. Purchasing card transactions
4. Time sheets
5. Invoices from contractors
6. One time wire transfers
7. Journal entries
Deterrence and Prevention

1. Visible and vocal leadership
2. Active ongoing fraud risk brainstorming
3. Policies on Fraud Responsibilities
4. Anti-fraud controls
5. Anti-fraud daily behaviors
6. Anti-fraud “How to” skills training
Fraud Risk Management Framework

1. Deterrence and Prevention

2. Early Detection

3. Effective Handling

ORGANIZATIONS (and their auditors) MUST BE PREPARED AT ALL THREE LEVELS
Level 2: Early Detection
#1: Shrink the Pie
#2: Find More of What’s Left

FASTER & SMALLER

DETECTED
How Fraud is Detected

1. Managers and staff
2. Internal audit professionals
3. External auditors
4. Other third parties
5. The thief (fraudster)
6. Luck or accident
For Auditors: Playing the Probabilities
Three-Step Fraud Detection

1. **Think like a thief**
   a) Individual and group brainstorming

2. **Use discovery techniques aggressively**
   a) Discovery or attribute testing
   b) Discovery focused interviews
   c) Monitoring for fraud indicators

3. **Determine the cause of all indicators**
   a) Root Cause Analysis
Three-Step Fraud Detection

1. **Think like a thief**
   a) Individual and group brainstorming

2. **Use discovery techniques aggressively**
   a) Discovery or attribute testing
   b) Discovery focused interviews
   c) Monitoring for fraud indicators

3. **Determine the cause of all indicators**
   a) Root Cause Analysis
THE CHALLENGE

Fraud Risk Brainstorming: Think Like A Thief

(when we don’t know how)
The Importance of Precision Clarity
The Simple Beauty of “Hey Boss!” Questions
Ask and Answer

W.C.G.W.

W.W.I.L.L.
‘The 3 C’s’
Commission
Conversion
Concealment
THE SECRET SAUCE

…begin (plan) with the presumption that a fraud event has already occurred.
Assume you are committing the fraud
My Favorite

Fake

Vendor
<table>
<thead>
<tr>
<th>Fraud Risk Description</th>
<th>SYMPTOMS</th>
<th>Detection Step</th>
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</table>
Fraud Risks and Response

Cash Disbursements

“Fake Vendor Scheme”
The Crawford Case

Department of Justice
U.S. Attorney’s Office
Western District of Pennsylvania

FOR IMMEDIATE RELEASE

Contractor Pleads Guilty To Fraud, Filing False Tax Returns

PITTSBURGH, Pa. - A construction company executive pleaded guilty in federal court to an Information charging him with mail fraud and filing false tax returns, United States Attorney David J. Hickton announced today.

Robert E. Crawford, 54, of Pittsburgh, Pa., pleaded guilty to two counts before United States District Judge David S. Cercone.
Project Background

1. Renovation of two existing client facilities
2. Collusion between client executive and long-term trusted construction company executive (25 year relationship)
3. Sole source contract award (no bid)
4. Not managed by construction department
5. Overcharges of over $3 million on contract value of $14.5 million (21%)
Case Details

1. Overbilling through real and fictitious sub-contractors
   a) Internal project budget
   b) Contract value
   c) Schedule of values

2. $250,000 kickback paid to owner executive

3. Fabricated Change Orders (relocate water line)

4. Architect knowingly approved inflated costs

5. Insurance claim for activities of owner company executive
# Duplicate Charges Surface

## Cost Code 1015: EIFS/Base Bldg (Exterior Insulation Finishing System)

<table>
<thead>
<tr>
<th>COST CODE</th>
<th>REF #</th>
<th>JR</th>
<th>DATE</th>
<th>DOCUMENT</th>
<th>DESCRIPTION</th>
<th>LABOR</th>
<th>MATERIAL</th>
<th>SUBCON</th>
<th>EQUIP</th>
<th>OTHER</th>
<th>PAYEE TOTAL</th>
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<tbody>
<tr>
<td>1015</td>
<td>894-0001</td>
<td>AP</td>
<td>8/27/07</td>
<td>Inv# SC01-1015 6038</td>
<td>ABC Construction</td>
<td>125,000.00</td>
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<td></td>
<td></td>
<td></td>
<td>125,000.00</td>
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<td>1015</td>
<td>280-0001</td>
<td>AP</td>
<td>9/16/07</td>
<td>Inv# ES333 6038</td>
<td>Diamond Stone</td>
<td>46,163.00</td>
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<td>46,163.00</td>
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<tr>
<td>1015</td>
<td>894-0002</td>
<td>AP</td>
<td>9/26/07</td>
<td>Inv# SC02-1015 6038</td>
<td>ABC Construction</td>
<td>25,000.00</td>
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<td>1015</td>
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<td>AP</td>
<td>9/30/07</td>
<td>Inv# 392112 6038</td>
<td>Venus Contractors Inc.</td>
<td>80,956.54</td>
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<td>1015</td>
<td>422-0001</td>
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<td>Inv# ES335 6038</td>
<td>Diamond Stone</td>
<td>27,555.00</td>
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<td>27,555.00</td>
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<td>966-0025</td>
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<td>2/28/08</td>
<td>Inv# SC03-1015 6038</td>
<td>ABC Construction</td>
<td>7,100.00</td>
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<td>7,100.00</td>
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<td>1015</td>
<td>851-0002</td>
<td>AP</td>
<td>3/25/08</td>
<td>Inv# ES352 6038</td>
<td>Diamond Stone</td>
<td>879.50</td>
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<td>879.50</td>
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</table>

|                  |        |    | 157,100.00 |        | 157,998.04 | 314,199.04 |

## Cost Code 1028: Structural / Seizmic Work

<table>
<thead>
<tr>
<th>COST CODE</th>
<th>REF #</th>
<th>JR</th>
<th>DATE</th>
<th>DOCUMENT</th>
<th>DESCRIPTION</th>
<th>LABOR</th>
<th>MATERIAL</th>
<th>SUBCON</th>
<th>EQUIP</th>
<th>OTHER</th>
<th>PAYEE TOTAL</th>
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<tbody>
<tr>
<td>1028</td>
<td>819-0004</td>
<td>AP</td>
<td>7/24/07</td>
<td>Inv# SC01-1028 6038</td>
<td>ABC Construction</td>
<td>70,000.00</td>
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<td></td>
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<td>70,000.00</td>
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<td>1028</td>
<td>165-0001</td>
<td>AP</td>
<td>8/1/07</td>
<td>Inv# 07-67611 6038</td>
<td>Kidder Metal Fabricators</td>
<td>62,000.00</td>
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<tr>
<td>1028</td>
<td>894-0008</td>
<td>AP</td>
<td>9/26/07</td>
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<td>ABC Construction</td>
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<td>10/9/07</td>
<td>Inv# 3277 6038</td>
<td>Structural Imaging LLC</td>
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<td>AP</td>
<td>2/19/08</td>
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<td></td>
<td>-7,000.00</td>
</tr>
</tbody>
</table>

|                  | -      |    | 233,300.00 | -      | 62,475.00   | 295,775.00 |

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*John J. Hall*
## Summary of Losses

<table>
<thead>
<tr>
<th>Billed and Paid Costs</th>
<th>Actual Costs</th>
<th>Total Overcharge</th>
</tr>
</thead>
<tbody>
<tr>
<td>A - $10,110,000</td>
<td>$8,660,000</td>
<td>$1,450,000</td>
</tr>
<tr>
<td>B - $4,410,000</td>
<td>$2,825,000</td>
<td>$1,585,000</td>
</tr>
<tr>
<td>Total - $14,520,000</td>
<td>$11,485,000</td>
<td>$3,035,000</td>
</tr>
</tbody>
</table>

Plus:
- 30% Penalty $910,000
- Audit and legal costs $250,000
Inflated Labor Hours
Inflated Labor Hours

Bovis Lend Lease 8 Plus 2
Inflated Labor and Burden Rates
The Wisconsin Contractor
## Inflated Labor Rates

<table>
<thead>
<tr>
<th>Rate Buildup</th>
<th>Basis</th>
<th>Millwright Level 4</th>
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<tbody>
<tr>
<td>BASE RATE (including vacation)</td>
<td>$ 45.87</td>
<td></td>
</tr>
<tr>
<td>FRINGE BENEFITS</td>
<td>$ 14.99</td>
<td></td>
</tr>
<tr>
<td>ADMIN/PROFIT/OVERHEAD</td>
<td>0.00%</td>
<td>$ -</td>
</tr>
<tr>
<td>SMALL TOOLS</td>
<td>4.00%</td>
<td>$ 1.83</td>
</tr>
<tr>
<td>CONSUMABLES</td>
<td>4.00%</td>
<td>$ 1.83</td>
</tr>
<tr>
<td><strong>Total Fee</strong></td>
<td><strong>8.00%</strong></td>
<td><strong>$ 3.67</strong></td>
</tr>
<tr>
<td>PAYROLL TAXES (At Net Tax Rates)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Social Security</td>
<td></td>
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<tr>
<td>(Gross Tax Rate = __% )</td>
<td>7.65%</td>
<td>$ 3.51</td>
</tr>
<tr>
<td>State Unemployment Compensation</td>
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<td></td>
</tr>
<tr>
<td>(Gross Tax Rate = __% )</td>
<td>6.55%</td>
<td>$ 3.00</td>
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<tr>
<td>Federal Unemployment Compensation</td>
<td></td>
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</tr>
<tr>
<td>(Gross Tax Rate = __% )</td>
<td>0.80%</td>
<td>$ 0.37</td>
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<tr>
<td><strong>Total Taxes</strong></td>
<td><strong>15.00%</strong></td>
<td><strong>$ 6.88</strong></td>
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<tr>
<td>INSURANCE</td>
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<tr>
<td>Worker's Compensation - Rate</td>
<td>7.45%</td>
<td>$ 3.42</td>
</tr>
<tr>
<td>General Liability &amp; Misc. Insurances</td>
<td>7.21%</td>
<td>$ 3.31</td>
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<td>Umbrella/Liability</td>
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<tr>
<td><strong>Total Insurance</strong></td>
<td><strong>14.66%</strong></td>
<td><strong>$ 6.72</strong></td>
</tr>
<tr>
<td>TOTAL STRAIGHT TIME BILLING RATE</td>
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</tr>
<tr>
<td></td>
<td>$ 78.13</td>
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<tr>
<td>Time and 1/2 Premium:</td>
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<tr>
<td>Time and 1/2 Base Rate</td>
<td>$ 22.94</td>
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</tr>
<tr>
<td>Umbrella/Liability Insurance</td>
<td>$ -</td>
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<tr>
<td>Payroll Taxes</td>
<td>$ 3.44</td>
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<tr>
<td><strong>Subtotal</strong></td>
<td>$ 26.38</td>
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<tr>
<td>TOTAL TIME AND 1/2 BILLING RATE</td>
<td>$ 104.51</td>
<td></td>
</tr>
<tr>
<td>Double Time Premium:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Double Time Base Rate</td>
<td>$ 45.87</td>
<td></td>
</tr>
<tr>
<td>Umbrella/Liability Insurance</td>
<td>$ -</td>
<td></td>
</tr>
<tr>
<td>Payroll Taxes</td>
<td>$ 6.88</td>
<td></td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td>$ 52.75</td>
<td></td>
</tr>
<tr>
<td>TOTAL DOUBLE TIME BILLING RATE</td>
<td>$ 130.89</td>
<td></td>
</tr>
</tbody>
</table>
Cost Accounting Exposures

1. Labor and Burden
   - Labor rates
   - Payroll taxes
   - Insurance
   - Other charges
   - Application errors

2. Non-Reimbursable Costs

3. General Conditions

4. Falsification of Records
Three-Step Fraud Detection

1. Think like a thief
   a) Individual and group brainstorming

2. Use discovery techniques aggressively
   a) Discovery or attribute testing
   b) Discovery focused interviews
   c) Monitoring for fraud indicators

3. Determine the cause of all indicators
   a) Root Cause Analysis
Discovery-Based Tests
<table>
<thead>
<tr>
<th>Fraud Risk Description</th>
<th>SYMPTOMS</th>
<th>Detection Step</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fake consulting firm registered formed using LegalZoom.com</td>
<td></td>
<td></td>
</tr>
<tr>
<td>New company registered with Secretary of State's office</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank account opened for company using authorization docs supplied in LegalZoom package</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fake consulting vendor set up documents prepared</td>
<td></td>
<td></td>
</tr>
<tr>
<td>New vendor approval signatures forged</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fake vendor entered into vendor master file system</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Invoice for services rendered submitted for payment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The transaction is charged to Consulting Expenses in the accounting system</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The transaction is charged to a cost center account controlled by the thief</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Approval signatures authorizing payment are forged</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Funds are disbursed by check mailed to remittance address in vendor set up</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The check is deposited into the business checking account of the fictitious company</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Month-end budget to actual cost center reports are reviewed and approved by the thief</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fraud Risk</td>
<td>Indicator</td>
<td>Detection Steps</td>
</tr>
<tr>
<td>--------------------------------------------------------------------------</td>
<td>---------------------------------------------------------------------------</td>
<td>--------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Cash Disbursements – Fake Vendor:</td>
<td>• Generic looking invoice</td>
<td>• Reconcile all bank accounts immediately upon receipt of the bank statement</td>
</tr>
<tr>
<td>• Fake documents are introduced into the payments system,</td>
<td>• Unknown vendor / contractor</td>
<td>• Examine all cancelled checks</td>
</tr>
<tr>
<td>• The invoice is from a “consultant” for “services rendered”</td>
<td>• Address:</td>
<td>• Periodically review all vendors and contractors for existence and legitimacy</td>
</tr>
<tr>
<td>• Approval signatures are forged</td>
<td>✓ Same as employee or volunteer</td>
<td>• REVIEW ALL MONTH END TRANSACTION REPORTS 100%</td>
</tr>
<tr>
<td>• Funds are disbursed by check,</td>
<td>✓ PO Box</td>
<td>• “Positive Pay”</td>
</tr>
<tr>
<td>• The check is deposited into the personal checking account of a volunteer</td>
<td>✓ Mailboxes, Etc.</td>
<td>• Use Computer Data Mining Techniques to Surface Fraud Indicators</td>
</tr>
<tr>
<td>• The transaction is charged to Consulting Expenses in the accounting system</td>
<td>✓ Prison…</td>
<td></td>
</tr>
<tr>
<td></td>
<td>✓ “Hold check for pickup”</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• No phone number on invoice</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Unknown charges on cost center reports</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Check:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>✓ Clears too fast</td>
<td></td>
</tr>
<tr>
<td></td>
<td>✓ Funny endorsements</td>
<td></td>
</tr>
<tr>
<td></td>
<td>✓ Geography</td>
<td></td>
</tr>
</tbody>
</table>
20 Detection Suggestions

1. Analyze bids looking for patterns by vendor or purchasing agent
2. Confirm losing bids, failure to respond
3. Audit vendors - transactions, T&Es, 1099s
4. Surprise inspect at receiving points
5. Match PO, proof or receipt, & invoice
6. Observe inventory held by others
7. Observe highly tempting items
20 Detection Suggestions

8. For sole source suppliers, confirm existence, prove ownership, test prices, find other sources, analyze usage volume

9. Reconcile inventory, purchases and usage of items subject to pilferage

10. Audit rental of equipment (including equipment used by contractors)

11. Verify accuracy of items stored in containers (gas, liquids, other)
20 Detection Suggestions

12. Audit areas where vendors come in, take stock, and replenish on their own
13. Audit purchases that do not go through normal purchasing procedures
14. Audit maintenance agreements
15. Audit property management agreements
16. Audit costs on cost-plus agreements to original documentation. Look for creative interpretations of the term “Cost”
20 Detection Suggestions

17. Pull D&B Reports and enter vendor names into press databases
18. Use computer to look for multiple PO and split bills
19. Confirm delivery locations
20. Verify address and other master file changes by vendors
Indicators, Symptoms, Red Flags

1. Unclear or unreasonable specifications
2. No audit terms in contact
3. Atypical ‘application of payment’ forms
4. Missing or disorganized backup
5. Failure to track or report use of allowances and contingencies
6. Undocumented workers on project
7. Sloppy safety, testing & quality control procedures
Indicators, Symptoms, Red Flags

8. Changes in schedule of values without explanation
9. Subcontractor complaints about payments from general contractor
10. Missing lien waivers
11. Unusual bid patterns
12. Missing documents
13. Undisclosed related parties
Indicators, Symptoms, Red Flags

14. Material substitutions without approval
15. Excess material purchases
16. Change order manipulation
17. Front end loading in billing
18. Overstated units, hours, equipment used
19. Undervalued deductive change orders
20. Diverting lump sum work to T&M projects
Three-Step Fraud Detection

1. Think like a thief
   a) Individual and group brainstorming

2. Use discovery techniques aggressively
   a) Discovery or attribute testing
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   c) Monitoring for fraud indicators

3. Determine the cause of all indicators
   a) Root Cause Analysis
Discovery
Focused
Interviews
THIEVES LIE

FACT

For Fraud to Occur, Lying Is Required
Interview or Interrogation

- **Interview** – non-accusatory, structured, dialog-based, question and answer, held for a specific purpose
- **Interrogation** – accusatory, held when there is sufficient evidence to accuse the suspect of fraud and seek a confession
For Consideration

1. Most people we interview believe telling the truth is the morally right thing to do.

2. We have all learned that lying successfully allows us to avoid punishment.
Fight or Flight: Impact of Increased Tension

1. Deception causes anxiety
2. Behavior symptoms are revealed as anxiety in the subject increases
3. Be aware of techniques used – intentionally or unintentionally – to release tension and anxiety
4. A deceptive person, if given the choice, will usually choose to reduce anxiety within their response
“Behavioral Norm”

1. Ask background questions that result in truthful answers
2. Probe short and long term memory
3. Ask questions that require creative responses
4. Look for behaviors that do not make sense relative to the words spoken
5. Look for gross body movements, and analyze in relation to what was just said
Signs of Deception - Nonverbal

1. Change in pattern of eye contact
2. Increased breathing, perspiration or swallowing
3. Change in coloring or facial tone
4. Posture becomes closed, stiff or defensive
5. Movement away from the interviewer
6. Reluctance to physically handle documents or other evidence presented
7. Passive reaction to direct accusation
8. Grooming gestures and physical adjustments
Signs of Deception - Verbal

1. Denial confined to only specific aspects of the issue
2. Delayed, evasive, or vague answers
3. Uses reinforcements in answers
4. Fragmented or incomplete sentences
5. Mixture of unusually poor and exact memory
6. Answers consistently lack detail
7. Answers start with repeating the question
Signs of Deception - Verbal

8. Question or challenge factual information
9. Mental blocks
10. Throat clearing or coughing
11. Mumbling
12. Swearing, oaths or religious statements
13. Inappropriate laughter
14. Passive or weak denial
Four Powerful Words

“Tell me what happened”
Three-Step Fraud Detection

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   a) Root Cause Analysis
Monitoring
Monitoring

1. Standard reconciliations
2. Top performance
3. Poor performance
4. Timing differences
5. Suspense and clearing accounts
6. Complaints
7. Overtime by employee type
8. Top travelers and earners
Monitoring

9. Consulting and other third party services billing
10. Warranty activity
11. Adjustments and overrides:
   - Sales prices
   - Receivable accounts
   - Cash accounts
   - Inventory
12. Closing entries
13. Failures
14. Common names and addresses for refunds or credits
15. Goods purchased in excess of needs / slow turnover
16. Duplicate payments
17. Regular meetings with key executives
Monitoring

14. Common names and addresses for refunds or credits
15. Goods purchased in excess of needs / slow turnover
16. Duplicate payments
17. Regular meetings with key executives
18. Other ideas?
Three-Step Fraud Detection

1. Think like a thief
   a) Individual and group brainstorming

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3. Determine the cause of all indicators
   a) Root Cause Analysis
Determine the Real Cause of Indicators
Root Cause Analysis

If a condition exists, is interesting,

Why it exists is important
Root Cause Analysis

1. What happened?
2. What were the root causes?
3. What options are available that will deal with the problem?
4. What is the cost of acting upon each of the available options?
5. Which decision options will provide the best solution?
Three-Step Fraud Detection

1. Think like a thief
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2. Use discovery techniques aggressively
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   b) Discovery focused interviews
   c) Monitoring for fraud indicators

3. Determine the cause of all indicators
   a) Root Cause Analysis
Results
Manipulation

- Financial
- Non-Financial
Cooking Financial Results
Books Cooking
&
Theft
(Peregrine Financial Group)
Russell Wasendorf Sr.  

- $215 Million Theft  
- Misleading Auditors  
- 50 Years in Prison  

A prominent futures-industry executive was sentenced to 50 years in prison on Thursday for embezzling from clients and misleading banks for two decades.

Russell Wasendorf Sr., the chief executive of the now-defunct brokerage firm the Peregrine Financial Group, stole more than $215 million, money that a judge said is likely never to be recovered.

Dressed in orange prison garb, his wrists and ankles shackled, Mr. Wasendorf sat expressionless as Judge Linda Reade of the United States District Court in Cedar Rapids, Iowa, handed down the maximum sentence recommended by the government.

"The lengthy prison sentence imposed today is just punishment for a con man who built a business on smoke and mirrors," said Sean Berry, acting United States attorney in Cedar Rapids.

Mr. Wasendorf's penalty is the latest in a string of stiff sentences handed down by judges for financial crimes. Bernard L. Madoff received 150 years for perpetrating the largest Ponzi scheme ever uncovered. Allen Stanford is serving a 110-year term after being convicted of swindling investors of nearly a $7 billion. Thomas J. Petters got a 50-year sentence for defrauding investors of nearly $4 billion.

Given the extremely lengthy sentences and advanced age of some of the defendants, many of these terms are largely symbolic, intended to reflect the gravity of the crimes and the need for retribution.

The fraud carried out by Mr. Wasendorf, 64, took place more than 1,000 miles from Wall Street, in Cedar Falls, Iowa. Federal regulators discovered the crime last summer after local police found Mr. Wasendorf unconscious in his car in Peregrine's parking lot, a hose running from the exhaust pipe into the passenger compartment. He left a detailed suicide note explaining his crimes.

Mr. Wasendorf stole millions of dollars from his customers at Peregrine, which also did business as PFGBest, by using laser printers and software like Photoshop and Excel to make near-perfect replicas of account statements from US Bank. He duped regulators by supplying them with a false post-office box address for sending forms to the bank, which he would then intercept and
Cooking
Other Results
Family Connections: The Death of a Nonprofit

Austin American-Statesman
April 22, 2010
(www.statesman.com)
Organization Background

- $3.1 million Austin based non-profit
- Created 2004 as merger of two non-profits
- Early childhood education and support
- Served 32,000 children and adults
- Parenting classes, mental health counseling for mothers, child care referrals, health education classes
- 30 full-time employees
- 11 member board of directors
Executive Director

• 51 years old
• 1982 accused of writing fraudulent checks
• 1987 convicted of theft – 4 year sentence, served 4 months
• 1990 while on probation, hired in finance department of nonprofit agency
• Handled billing, invoices and payments
• 1992 filed for bankruptcy
• 1994 promoted to executive director
• 2004 appointed executive director of merged nonprofits
Allegations

- Theft of over $327,000 to private bank accounts 2004 to 2009 ($33,000 Dec 09 to Feb 10)
- In 2004 wrote $80,000 in checks to EAC
- Paid personal car loan
- Paid $150,000 of mortgage
- Falsified financial audits and filed with government agencies and others
- Kept all financial records on thumb drive
- $130,000 from Texas Association of Child Care Resources - volunteer Treasurer for 10 years
Other Inflated Results

- Resource library helped 6,500 families
  - Actual closer to 3,700

- Child care locating service helped 3,500 families
  - Actual 860

- Parenting classes for 2,300
  - Actual 1,000
Fraud Risk Management Framework

1. Deterrence and Prevention
2. Early Detection
3. Effective Handling

ORGANIZATIONS (and their auditors) MUST BE PREPARED AT ALL THREE LEVELS
Level 3: Effective Handling
Audit Mode

Tip

Investigative Mode

Audit

Exception

Pattern

Review Of Records

Interviews

Interrogation

Law Enforcement

Insurance Company

Control Weakness

Case File

Bonding Claim

Audit Report
Effective Fraud Handling

1. Response mechanism
2. Investigation
3. Loss recovery
4. Control weaknesses
5. External authorities
6. Publicity
7. Morale and HR concerns
What We Can Expect

1. Denial–Dismay–Anger–Empathy
2. Confusion
3. In some – paralysis of thought and action
4. Fear
What We Need to Provide

1. Calm, objective leadership
2. Protection of the innocent
3. Certainty
4. Consistency
5. Resources
Investigative Resources

1. Experienced investigators
2. Forensic accountants
3. Information technology experts
4. Computer forensics specialists
5. Other technical specialists
6. Security
7. Internal auditors
8. Human resources
9. Legal and Compliance
Investigations Include

1. Are we authorized
2. Can we handle it
3. Do we want to handle it
4. Fraud or error
5. Who is involved
Investigations Include

6. What happened
7. How did it happen
8. Where did it happen
9. When did it happen
10. How much was lost
11. Internal control implications
Investigations Include

12. Documentation for:
   ✓ Management
   ✓ Authorities
   ✓ Insurers
   ✓ Others

13. Follow through with:
   ✓ Criminal prosecution
   ✓ Civil litigation
   ✓ Recovery of losses
Communicate Consequences

1. Deterrent effect
2. People should know what to expect if they commit fraud
3. Discipline including termination and reporting
4. No surprises
5. Can enhance morale
Report to the Authorities?

1. “It’s best not to…”
2. “They won’t do anything”
3. Fraud by management
4. Fraud for the organization
5. Confidential information
6. Fear of litigation

Get Competent Advice
Be Consistent
What if the Press Finds Out?

1. Be clear: who talks to the press
2. Craft the message in advance
3. Don’t be pulled into speculation
4. Make sure all employees know what to do (and what to avoid) if approached by the press
5. It’s OK to smile politely, say nothing, and walk away
What About the Employees?

1. Our first priority is protection of the innocent
2. Share what we can at the appropriate time
3. Emphasize the lessons learned
4. Assure that the handling is professional, fair and respectful
5. Take confident action and do the right thing – for them
Fraud Risk Management Framework

1. Deterrence and Prevention
2. Early Detection
3. Effective Handling

ORGANIZATIONS (and their auditors) MUST BE PREPARED AT ALL THREE LEVELS
Quality = Right the First Time

It’s Not Extra Work.

It’s Core Work.
Better! Practices

1. Brainstorm fraud risks – Think like a thief
2. Teach all employees what they need to know to be more effective
3. Where appropriate, look for indicators.
4. Use a ‘show me how you…’ approach
5. When in doubt, doubt
6. Resolve or refer all suspicions
7. Sponsor or conduct meaningful ‘how-to’ anti-fraud skills training
Remember, it’s a Campaign CUMULATIVE EFFECT
Fraud Prevention Tip #50: The Three Key Components of an Anti-Fraud Program

Somewhere out there, your organization is probably being targeted for fraud right now. Internet-based hackers, international organized crime organizations, and even a small percentage of employees all see your assets and information as too tempting to ignore.

But what are the three most important things you must do to deter these barbarians at the gate – or already inside your
Questions, Comments, Feedback

Let me know how I can help!

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(970) 926 0355