



# Safeguarding Against Fraud

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# Learning Objectives

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

- Recall the definition of internal control
- Define fraud
- Discuss the fraud triangle
- Recall categories of fraud



# Fraud Happens.....

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U.S. Department of Education  
Office of Inspector General  
Investigative Reports

- **\$50,000** in school district funds used to build and operate an employee's side business
- **\$16,500** misappropriated school district funds used to pay an unapproved retirement stipend
- **\$14,000** of school district funds paid to employee by falsely describing it as compensation for unused vacation days



Who did it?

- Superintendent
- Accountant
- School principal
- Teacher

U.S. Department of Education  
Office of Inspector General  
Investigative Reports

**\$530,000** fraudulently obtained through placing orders with a fictitious company for books and educational materials that were never provided to the schools.



Who did it?

- Superintendent
- Accountant
- School principal
- Teacher

U.S. Department of Education  
Office of Inspector General  
Investigative Reports

**\$75,000 stolen** by replacing the names of legitimate vendors with those of fictitious vendors and then **forging the signature** on the checks



### Who did it?

- Superintendent
- Accountant
- School principal
- Teacher



# What is the story?

<https://www.youtube.com/watch?v=q57ZKn-C-To>





# Rita Crundwell

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- City of Dixon, Illinois; \$10 million operating budget
- Comptroller, 30 years
- Trusted Employee
- Built a horse breeding empire
  - Lavish motor home
  - Trucks and trailers
  - Horses worth \$775,000
- \$80,000 salary



# Rita Crundwell

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\$53.7 million dollars



# How was it detected?

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- Co-worker filling in for her found a previously hidden bank account
- FBI quietly watched Crundwell for six months
- During that time she stole \$3.2 million
- By time of arrest, City was \$22 million in debt
- Employees went years without raises
- City in fiscal crisis



# Recovering the Funds

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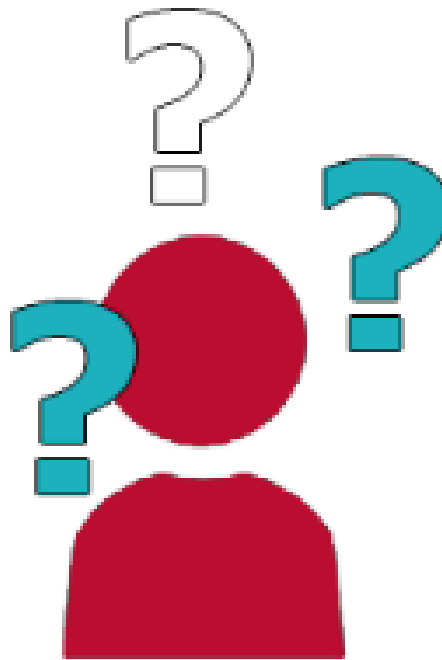
- Sold Crundwell's assets for \$9.5 million
- City sued auditors and bank for \$40 million
- \$107 million Crundwell owed for restitution and monetary judgment
- Garnished her pay in prison for \$65/mo
- Take her 124,359 years to pay back

# Questions for the group

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How was Rita able to perpetrate this fraud?

What do you think could have been done to prevent the fraud?





# Internal Controls Defined

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# Internal Control Definition

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Internal control is “a process, effected by an entity’s oversight body, management and other personnel, designed to provide reasonable assurance that the objectives of an entity will be achieved in the following categories:

Effectiveness and efficiency of operations

Reliability of financial reporting

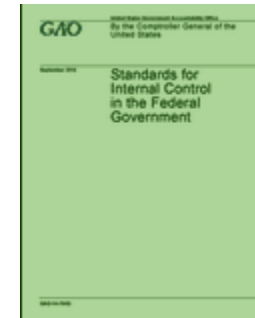
Compliance with applicable laws and regulations.”

# TWO OPTIONS



Committee of Sponsoring  
Organizations (COSO)

<http://www.coso.org/guidance.htm>



Standards for Internal Control in the  
Federal Government (Green Book)

<http://www.gao.gov/greenbook/overview>



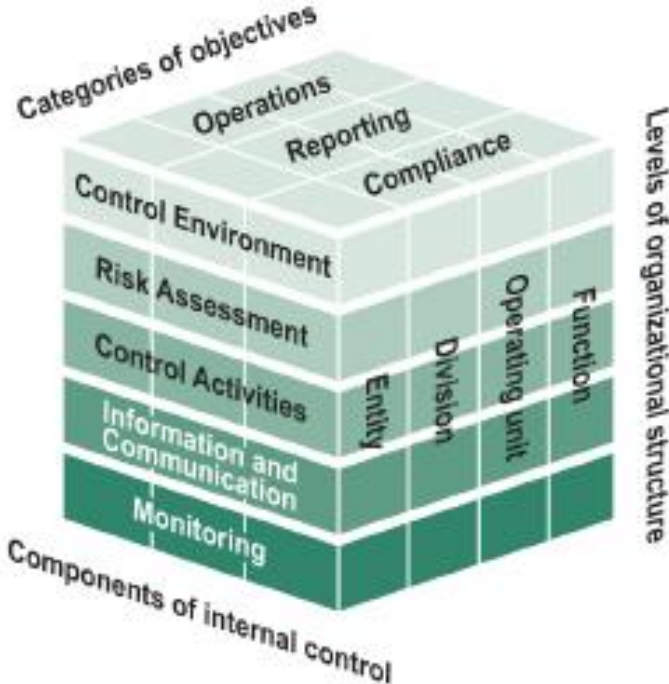


# COMPONENTS OF INTERNAL CONTROLS

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# Internal Control

Figure 4: The Components, Objectives, and Organizational Structure of Internal Control



Sources: COSO and GAO. | GAO-14-704G

# Control Environment

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## Principles

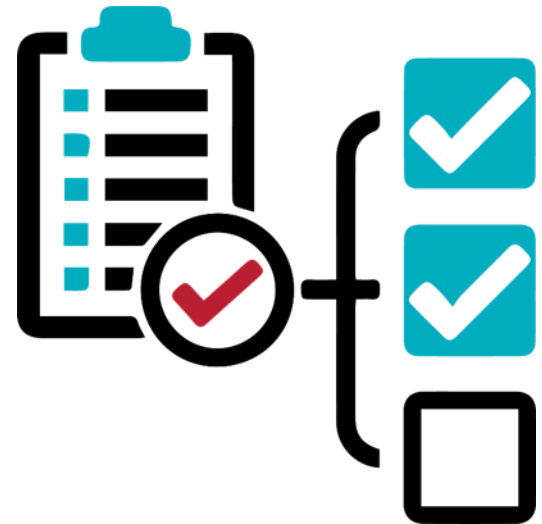
Integrity and ethical values

Parameters for governing body's oversight

Assignment of authority and responsibility

Process for attracting, developing and retaining competent individuals

Evaluate performance and hold individuals accountable



# Risk Assessment

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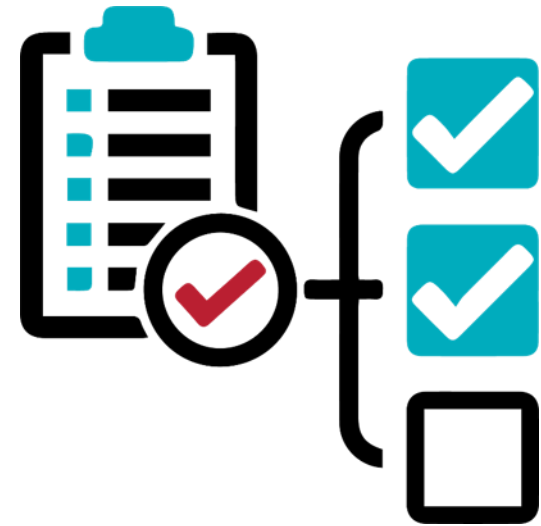
## Principles

Define objectives

Identify, analyze and respond to risks to achieving the objectives

Consider fraud when identifying, analyzing and responding to risks

Identify, analyze and respond to significant changes that could impact the internal control system



# Control Activities

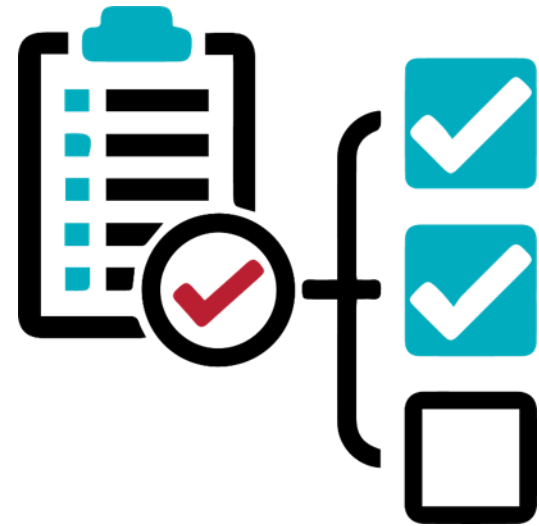
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## Principles

Design control activities to achieve objectives and respond to risks

Design information system and related control activities to achieve objectives and respond to risks

Implement control activities through policies



# Information and Communication

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## Principles

Use quality information to achieve objectives

Internally communicate the necessary quality information to achieve the entity's objectives

Externally communicate the necessary quality information to achieve the entity's objectives



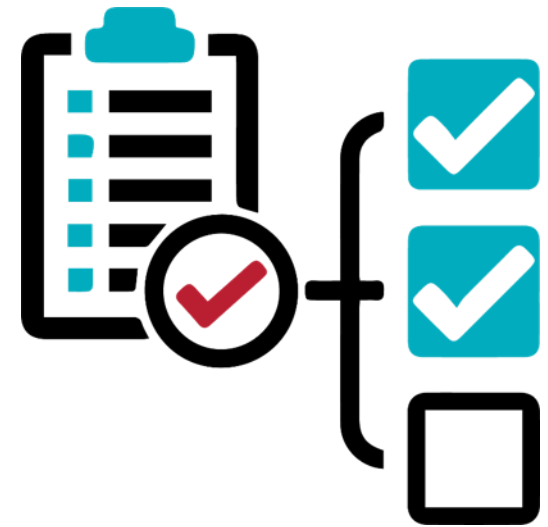
# Monitoring

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## Principles

Establish and operate monitoring activities to monitor the internal control system and evaluate the results

Remediate identified internal control deficiencies on a timely basis



# Fraud

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## An Overview



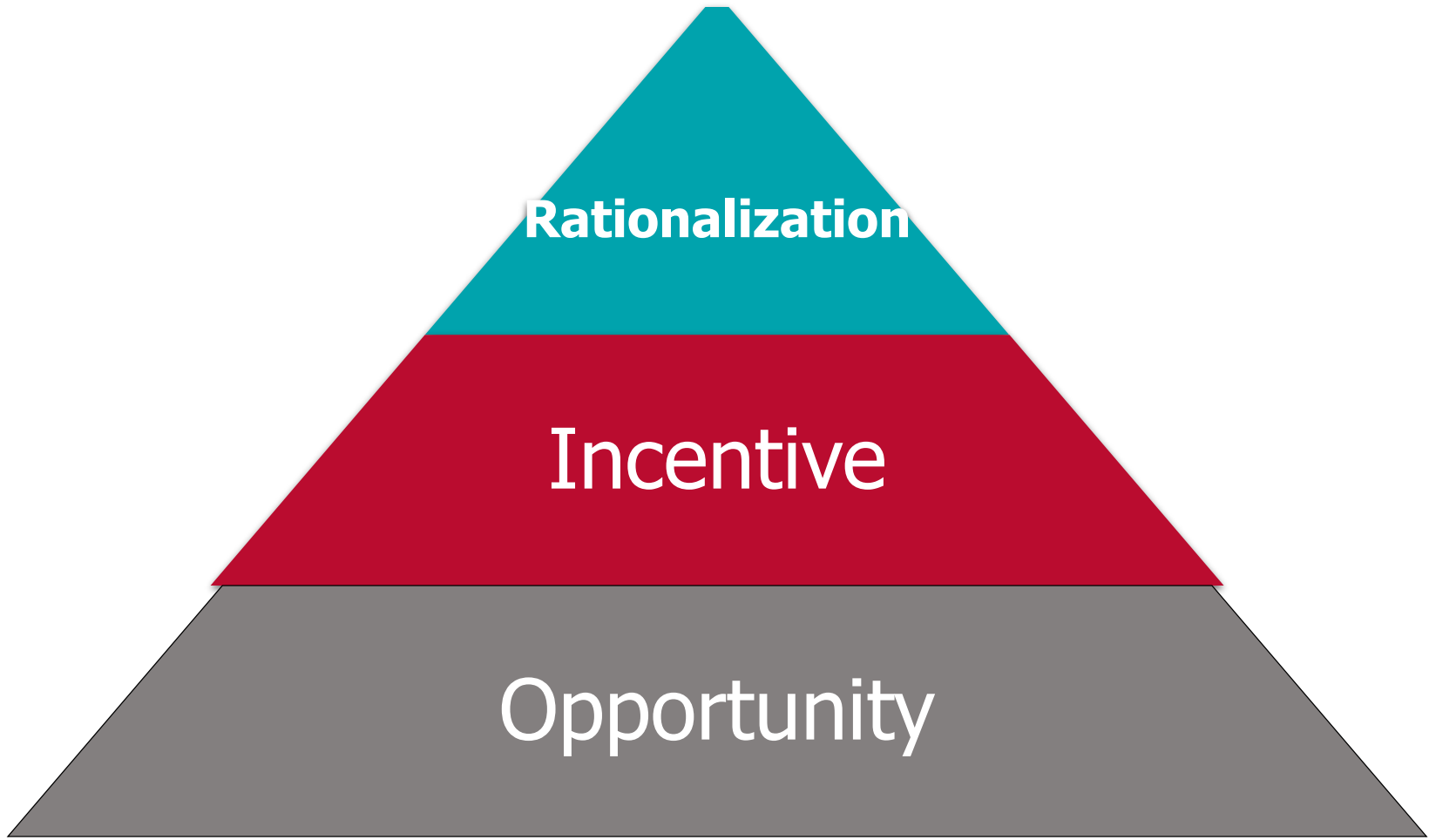


# Association of Certified Fraud Examiners (ACFE) Definition

*Fraud is the use of one's occupation for **personal enrichment** through the deliberate misuse or misapplication of the employing organization's resources or assets*

# Fraud Triangle

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# Rationalization

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Behaviors are logically justified

Examples include:

- “I get no respect and I will get even.”
- “Joe makes more money than I do and I have more experience.”
- “I only got a 2% raise this year – everybody else got more.”

# Incentive

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Something that motivates someone to commit fraud

Examples of incentives include:

Financial stress – Unpaid medical bills

Addictions – Gambling, drug, alcohol

Pathologies – Intellectual challenge



# Opportunity

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Not only permits fraud to occur, but actually promotes it

Lack of sound and comprehensive framework of internal controls

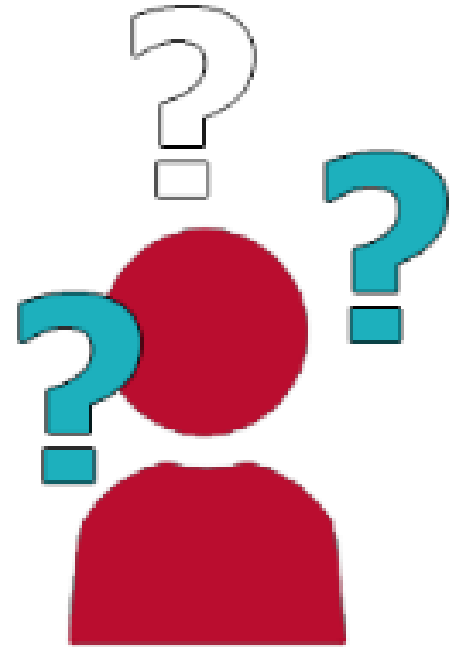


# Question

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Think out about the operations of a school. In which areas do you think opportunities might exist to commit fraud?

- ❖ Cash receipts
- ❖ Cash disbursements
- ❖ Capital assets
- ❖ Payroll
- ❖ Other areas - nonfinancial



# Fraud Categories

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# Three Fraud Categories

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- Asset Misappropriation
- Corruption
- Financial Statement Fraud





# Asset Misappropriation Examples

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- ❖ Theft of cash
- ❖ False billing schemes (e.g., fake invoices)
- ❖ Inflated expense reports



# Corruption Examples

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- Kickbacks to purchasing agent or elected official
- Bid rigging (government gives preference to one bidder; makes it appear that bidding occurred when it did not)
- Gratuities (favors or gifts provided to government official for particular actions)



# Financial Statement Examples

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- Increasing revenues with no justification or documentation
- Failing to post expenses
- Postponing transactions to future periods to avoid recognizing losses or going over budget

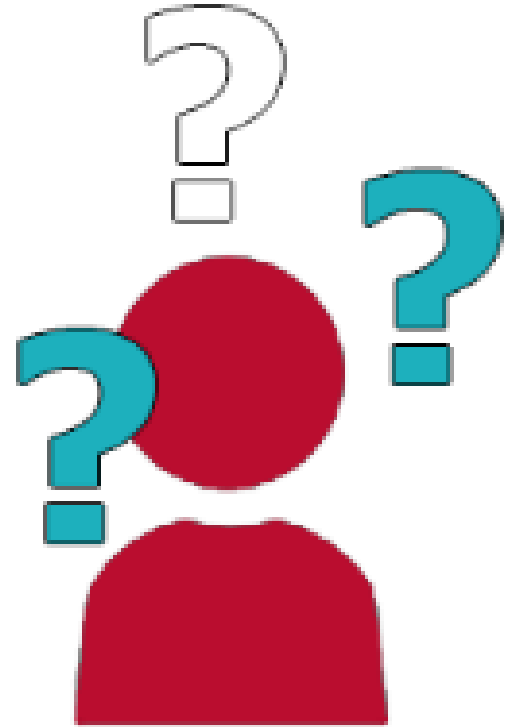


# Question

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Which category of fraud do you think is the largest?

- ✓ Asset Misappropriation
- ✓ Corruption
- ✓ Financial Statement Fraud





Report to the Nations  
2018 Global Study on Occupational Fraud and  
Abuse  
Association of Fraud Examiners  
[www.acfe.com](http://www.acfe.com)

## 2018 ACFE Fraud Survey

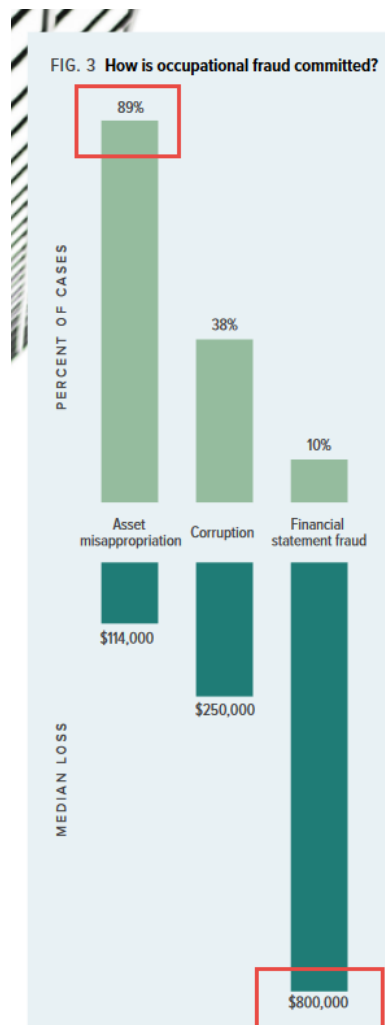
### Asset

#### Misappropriation

- Cash theft
- Fraudulent disbursements

### Corruption

- Conflicts of interest
- Bribery
- Extortion



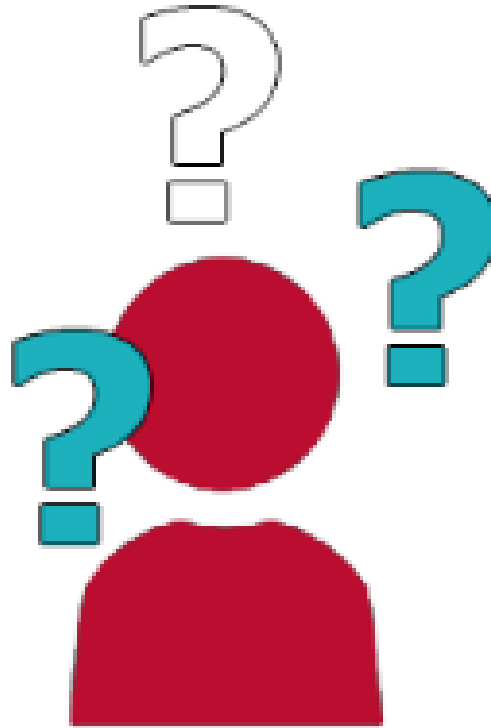
### Financial Statement Fraud

- Financial statement overstatement and understatement

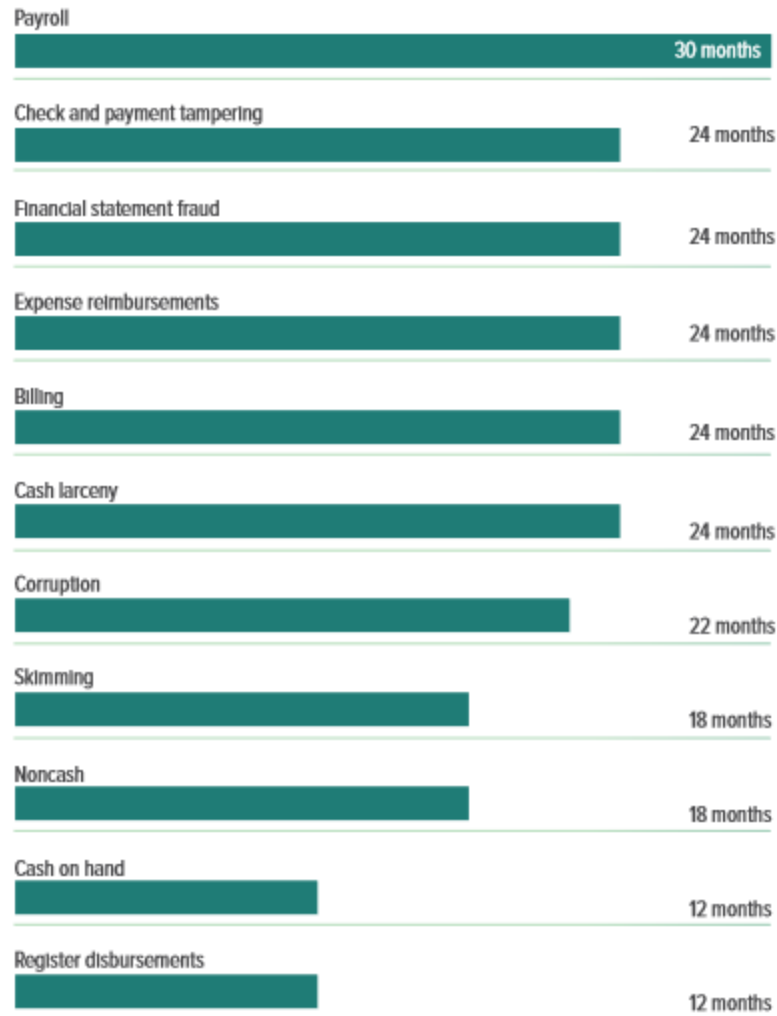
# Question

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What is the Average Life of Fraud Before Detection?



**FIG. 8 How long do different occupational fraud schemes last?**





# Fraud Prevention and Detection

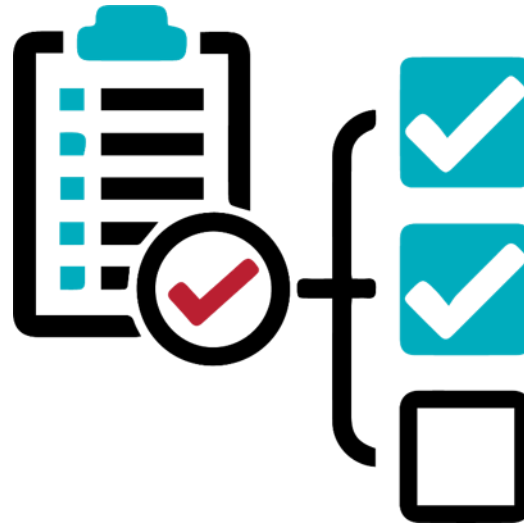
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# General Fraud Prevention

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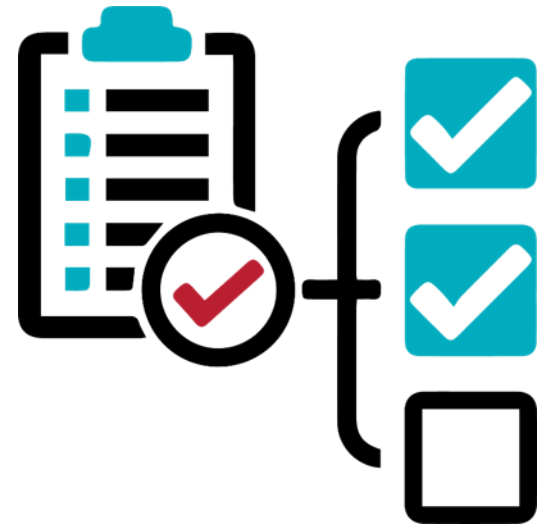
- ❖ Explain misconceptions about controls and audits
- ❖ Segregation of duties
- ❖ Whistleblower Programs



# Misconceptions

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- Clean audit opinion does not = no fraud
- Audit determines if financial statements are fairly presented
- Internal controls considered for audit procedures performed
- Internal control may have weakness that goes undetected that might lead to fraud



# Segregate the Following Duties

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No one person should perform the following duties:

Custody of Assets

Reconciliations

Authorization

Bookkeeping



# Segregation Test

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Custody

- E. Johnson

Reconciliation

- I. Cheatum

Authorization

- I. Cheatum

Bookkeeping

- Suzy Que



# Whistleblower Program

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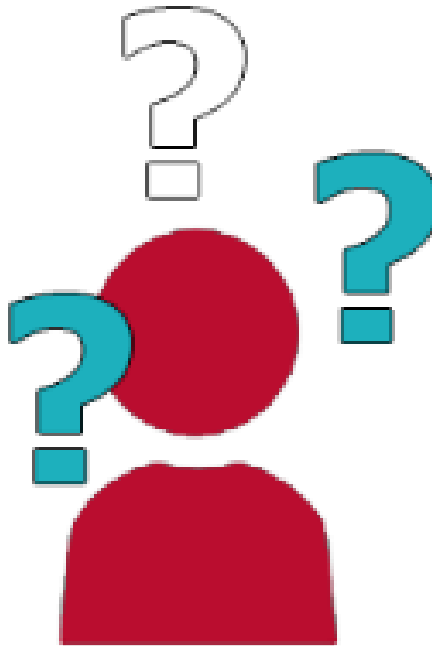
Providing an anonymous method to report suspicious activity

- Fraud hotline

# Question

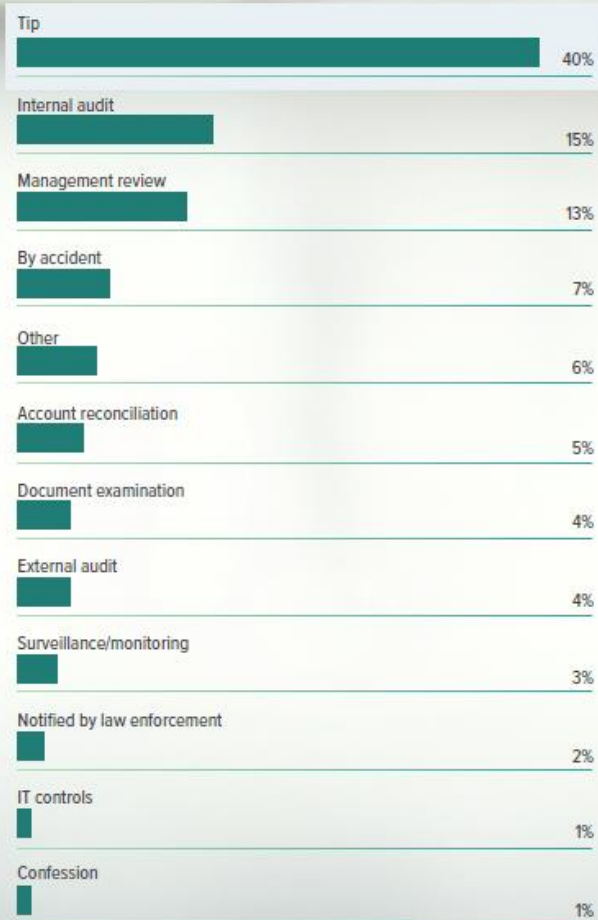
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What is the most common method of detecting fraud?



## 2018 ACFE Fraud Survey - Detection

FIG. 9 How is occupational fraud initially detected?





# Signs of Fraud – General

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# External Red Flags of Fraud

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- ❖ Unexplained increases in wealth
- ❖ Employee personal problems
- ❖ Employee living beyond his/her means
- ❖ Unusually close relationships with vendors



# Signs of Fraud and Controls – Payroll

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# Payroll Red Flags

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- ❖ Employee with Little or No Payroll Deductions
- ❖ Excessive Overtime Expenses
- ❖ Excessive Payroll Expenses When Compared to Budget



# Ghost Employee Example

- ❖ Employee A retires but remains in payroll system
- ❖ Payroll clerk changes Employee A's direct deposit number to his own bank account number
- ❖ Employee A's payroll is processed each week, the direct deposit goes to payroll clerk's personal bank account



# Inflating Pay Rate and Hours Worked

- ❖ Department head inflates his friend's hours worked and signs off on the departmental hours worked
- ❖ Payroll clerk inflates her pay rate in the master pay rate file



# Payroll Controls

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- ❖ Compare salaries to budget
- ❖ Compare salaries to prior year
- ❖ Immediately remove terminated employees from payroll system
- ❖ Review number of employees regularly paid
- ❖ Compare pay rates in computer to approved rates in personnel file
- ❖ Review recurring gross salary and hourly payments for reasonableness



# Signs of Fraud and Controls – Disbursements

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# Bribery Example

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- ❖ Vendor gives \$4,000 to a school purchasing clerk (as a bribe)
- ❖ The purchasing clerk awards the contract to vendor
- ❖ Vendor inflates invoices by \$10,000 and provides an inferior product to the school



# Fictitious Vendor Example

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- ❖ Accounts payable clerk adds a fictitious vendor to the vendor list
- ❖ The accounts payable clerk enters her own address (or a P.O. box) as that of vendor
- ❖ The accounts payable clerk creates a fictitious invoice and then enters the invoice into the accounts payable module
- ❖ Check is processed and mailed to AP clerk



# Fictitious Vendor Example

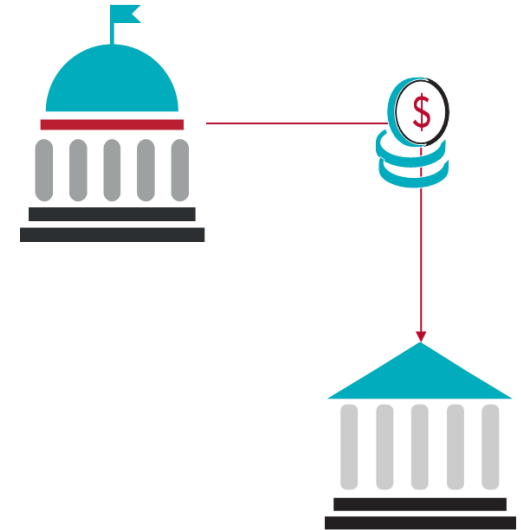
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- ❖ Accounts payable clerk sets up a bank account in the name of fictitious vendor
- ❖ She is the sole authorized check signer
- ❖ She deposits the check from the school
- ❖ She writes checks from the fictitious vendor bank account to herself



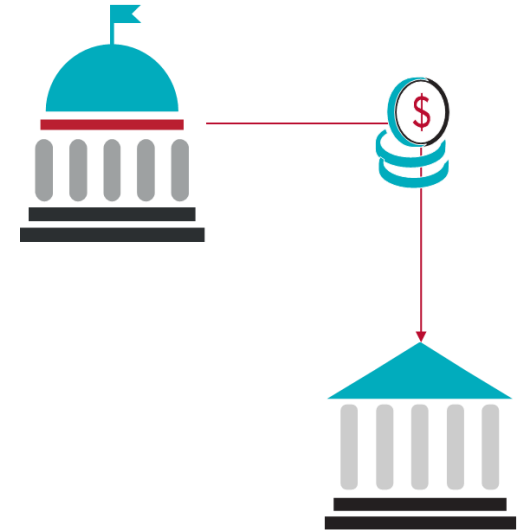
# Wire Transfer Controls

- ❖ Require two persons to complete external wire transfers
- ❖ If wire is by phone or fax, require bank to call back before transfer is made
- ❖ Limit personnel with wire capability and do not share passwords



# Wire Transfer Controls

- ❖ Require second person approval of the journal entry used to record the wire transfer
- ❖ Use all bank-provided wire transfer controls (if not, school may be liable)



# Signs of Fraud and Controls – Capital Assets

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# Capital Asset Red Flags

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- ❖ All Contractors Submit Consistently High Bids
- ❖ Qualified Contractors Not Submitting Bids
- ❖ Reports of Missing Capital Assets
- ❖ A Lack of Accountability for Capital Assets



# Capital Asset Controls

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- ❖ Create a bid policy
- ❖ Require sealed bids for all amounts over your government's threshold
- ❖ Open sealed bids in a public meeting
- ❖ Request bids from multiple companies
- ❖ For major construction projects, hire a construction monitor





# Signs of Fraud and Controls – Cash Receipts

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# Cash Receipts Overview

- ❖ Always use a pre-numbered receipt when possible
- ❖ Keep cash in a secure location accessible by limited staff
- ❖ Make deposits daily or at least weekly depending on amount on hand



# Cash Drawer Safety

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- ❖ No two people should work from one cash drawer
- ❖ Create receipts immediately
- ❖ Restrictively endorse (For Deposit Only) checks
- ❖ Personal checks (including employee checks) should not be cashed from cash drawers
- ❖ Balance cash and checks with receipts or report of transactions (such as lunches sold)
  - ❖ Supervisor should review cash deposit and supporting documentation



# Internal control will help you achieve your objectives

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# Know Your Risks and Take Action!

Internal control is a **process** in which the oversight body, management and employees participate

Purpose is to make it more likely to achieve your **objectives**  
**Objectives** related to reporting, compliance, and operations

First Step	Establish objectives
Second Step	Create a strong control environment
Third Step	Assess risk to achieving objectives
Fourth Step	Determine response to risk (accept, avoid, reduce)
Fifth Step	Create or refine control activities
Sixth Step	Communicate information
Seventh Step	Monitor

# Closing Thoughts

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