

13th Annual Local Government Officials' Conference
March 9, 2012

Consideration of Fraud in Financial Audits



Course Description

This course is designed to bring awareness of the government's risks related to fraud in the eyes of an auditor of financials statements.

We will also discuss who is committing these frauds, and what fiscal officers and management should be looking out for.



Fraudsters are Everywhere

- 🔍 Outside the organization
 - contractors, vendors, etc.
- 🔍 Inside the organization
 - occupational fraud – employees
- 🔍 Both impact financial audits
- 🔍 Both keep audit costs higher because of new audit regulations



Occupational Fraud

- Majority of fraud involving governments happen within – ie, employees



Impact of Recession

- Current recession has a direct impact on fraud risk

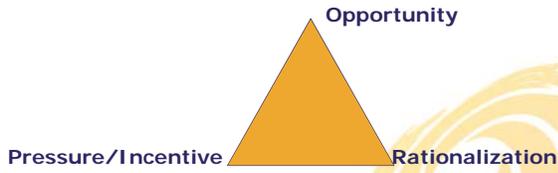


Kessler Survey

- 66% of employees will steal if they see others do it without consequence.
- 13% will steal regardless.
- 21% will not steal under any circumstance.



Cressey's Fraud Triangle



Source: ACFE 2010 Report to the Nations on Occupational Fraud and Abuse

Pressure/Incentive

- ☞ Lost job by family member
- ☞ Reduced pay/benefits/insurance
- ☞ Additional responsibility caused by R.I.F.
- ☞ Addictions
- ☞ Debt: mortgage, car, credit card
- ☞ Romance/lust

Opportunities

Impact of cutbacks:

- ☞ Knowledge is lost
- ☞ Less segregated duties created by R.I.F.
- ☞ Less review by supervisory team
- ☞ Established controls not being used
- ☞ IT security controls overridden without being detected
- ☞ New vendors not investigated

Rationalization

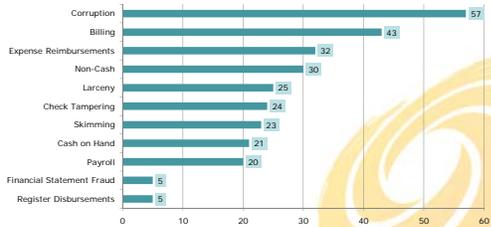
- ☞ They owe me
- ☞ I deserve it
- ☞ I'll pay it back
- ☞ It's not their money anyway
- ☞ They don't need it
- ☞ It won't hurt anyone
- ☞ I have no other choice

Inherent High Risk Areas

- ☞ Fees Receipts
- ☞ Income Tax Receipts
- ☞ Court Fines Receipts
- ☞ Recreation Receipts
- ☞ Utility Department Receipts
- ☞ Credit/Purchase Card Expenses
- ☞ Central Garage or Other Storage Locations
- ☞ Fake Vendors
- ☞ Payroll With-holdings

Types of cases at risk

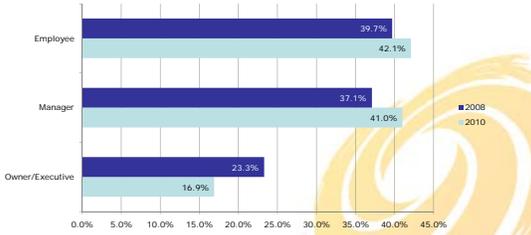
Government & Public Administration-176 Cases



Source: ACFE 2010 Report to the Nations on Occupational Fraud and Abuse

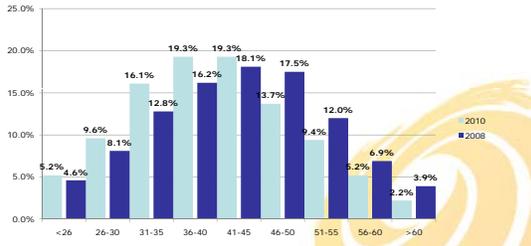
Who are the perpetrators?

Position of Perpetrator-Frequency



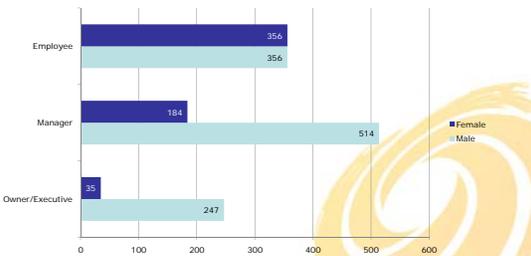
Source: ACFE 2010 Report to the Nations on Occupational Fraud and Abuse

Perpetrator's Age



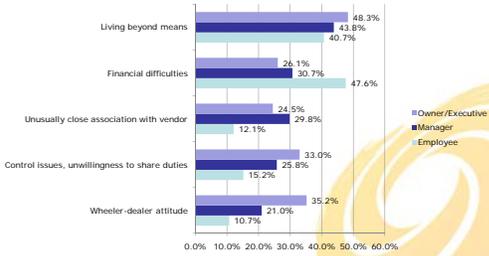
Source: ACFE 2010 Report to the Nations on Occupational Fraud and Abuse

Perpetrator's Gender



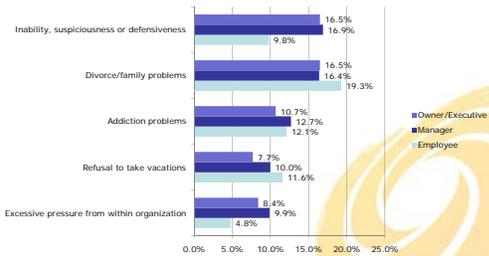
Source: ACFE 2010 Report to the Nations on Occupational Fraud and Abuse

Behavioral Red Flags Based on Perpetrator's Position



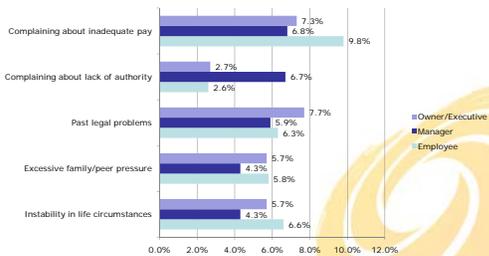
Source: ACFE 2010 Report to the Nations on Occupational Fraud and Abuse

Behavioral Red Flags Based on Perpetrator's Position (Cont.)



Source: ACFE 2010 Report to the Nations on Occupational Fraud and Abuse

Behavioral Red Flags Based on Perpetrator's Position (Cont.)



Source: ACFE 2010 Report to the Nations on Occupational Fraud and Abuse

Behavioral Red Flags - USA

Behavioral Red Flag	Number of Cases	Percent of Cases
Financial difficulties	392	44.7%
Living beyond means	391	44.6%
Control issues	205	23.4%
Divorce/family problems	201	22.9%
Wheeler-dealer attitude	173	19.7%
Unusually close association with vendor	141	16.1%
Inability, suspiciousness	127	14.5%

Source: ACFE 2010 Report to the Nations on Occupational Fraud and Abuse

Behavioral Red Flags – USA (Cont.)

Behavioral Red Flag	Number of Cases	Percent of Cases
Addiction problems	124	14.2%
Past-employment-related problems	85	9.7%
Refusal to take vacations	74	8.4%
Complaining about inadequate pay	64	7.3%
Instability in life circumstances	54	6.2%
Excessive pressure from within organization	51	5.8%

Source: ACFE 2010 Report to the Nations on Occupational Fraud and Abuse

Billing Schemes

- False invoicing through a shell company
- Personal purchases with government funds
- False invoicing through an established vendor

False Invoicing

🔔 Fake invoice – no service or product exchange

🔔 www.customerreceipts.com



Fake invoices many times lack information

🔔 Street address – PO box only

🔔 Phone number

🔔 Good description

🔔 Logo

🔔 Packing slip for products purchased

🔔 Shipping destination for products

🔔 Invoice numbers are sequential



Vendor Files

🔔 What needs done to vendor's files

→ Clean vendor file annually

→ Vendor approval process

→ Training

→ Google new vendor requests

→ IT controls limiting access



Employee Expense Reimbursements – What to look for:

- ☞ Lack of invoice
- ☞ Fake invoices
- ☞ Lack of detail on invoices
- ☞ Wrong mileage
- ☞ False mileage
- ☞ Personal expenses
- ☞ Alcohol
- ☞ Per diems with no detailed receipts required



What Controls are Needed?

- ☞ Strong detailed policy
- ☞ Education
- ☞ Review by Board for Executives



Steps to Reduce Fraud Risk

- ☞ Fraud risk analysis performed
- ☞ Educate
- ☞ Establish whistle-blower hotlines
- ☞ Rotation of job duties
- ☞ Zero tolerance
- ☞ Background checks for new hires – don't hire crooks
- ☞ Keep eyes and ears open regarding employee behavior
- ☞ Discuss concerns with auditors
- ☞ Establish effective Internal Audit division
- ☞ Use of Data Mining Software
- ☞ Surprise audits



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Questions?