Fraud in Today's Economic Environment

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Economic Uncertainty





What is Fraud?

- A misrepresentation of a material fact relied upon by someone to their detriment, or
- Concealed, improper conversion of another's assets to one's own benefit.



Types of Fraud

Third party fraud

Occupational fraud (employee fraud)

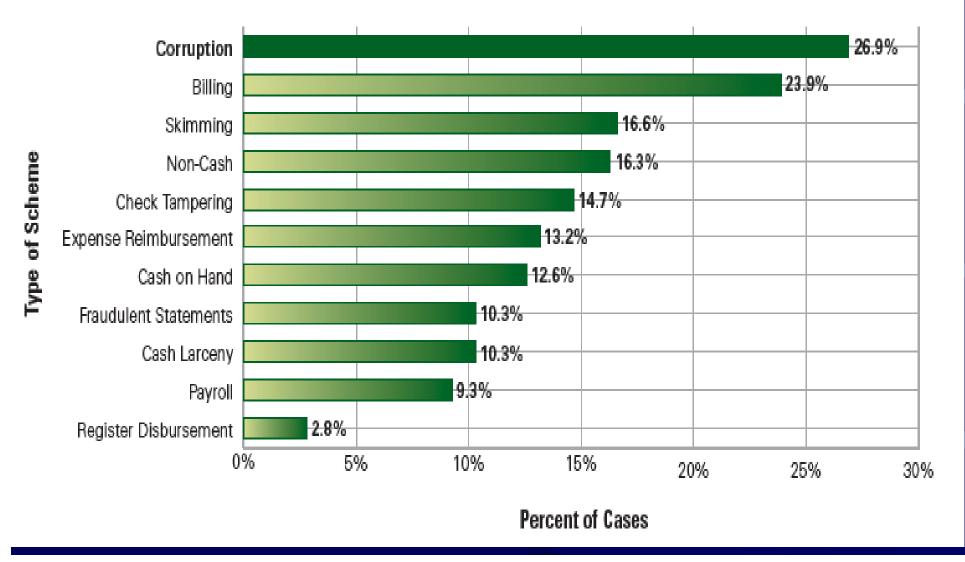


Three Primary Categories of Occupational Fraud...

- Asset misappropriation
- Corruption
- Financial statement fraud

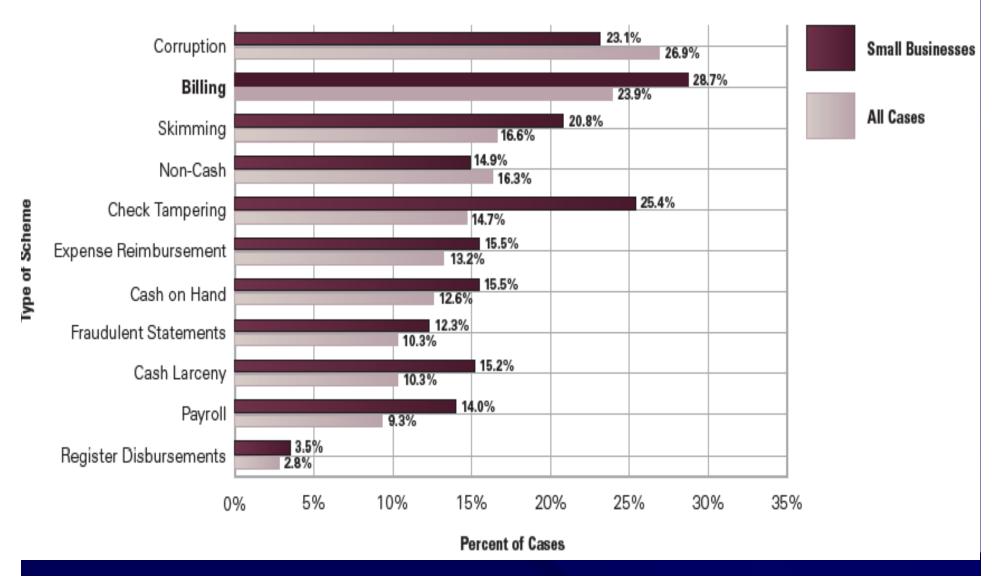


Breakdown of All Occupational Fraud Schemes — Frequency³





Methods of Fraud — Small Business Cases vs. All Cases¹⁰





Billing Schemes

Former Shriners Hospital CFO Pleads Guilty to Stealing More Than \$828,000 from Shriners Hospital

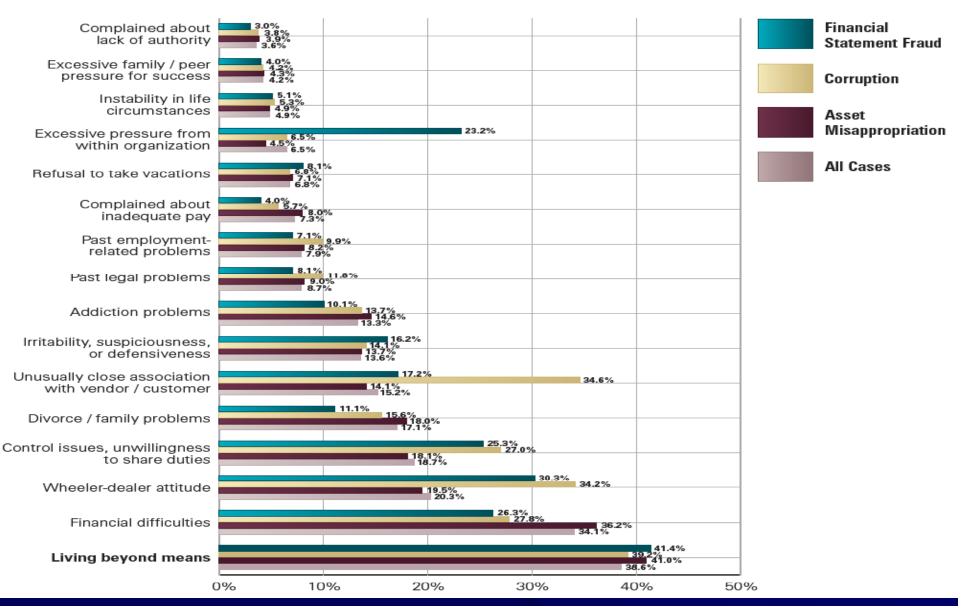
St. Louis, MO: Robert Steven Brodzin pled guilty to a scheme to defraud Shriners Hospital for Children of more than \$828,000, United States Attorney Catherine L. Hanaway announced today.

Brodzin used his position as CFO at Shriners to establish three "dummy" companies as qualified vendors of Shriners, and then obtained unauthorized payments from Shriners by presenting checks for approval and payment in these three companies' names. Brodzin further admitted to secretly obtaining and using an unauthorized Shriners' credit card for his personal expenses.

Brodzin used the stolen money from Shriners to buy luxury automobiles; a condominium in St. Petersburg, Florida; vacation travel and related expenses in Las Vegas, Nevada, and other locations; golf and health club memberships; season tickets for the games of assorted professional sports teams in St. Louis, Missouri, and also to fund his personal small business opportunities.



Behavioral Red Flags Present During Fraud Scheme²⁴





Why be concerned?

Annual cost of fraud to U.S. organizations

\$1 trillion.



Why be concerned?

- Fraud costs U.S. organizations \$1 trillion annually.
- Potential perpetrators are desperate, creative, and have technology at their disposal.



Fraud Triangle **Motive / Pressure**



Pressures to Commit Fraud

Financial Pressures

Personal Habits

Work-Related Factors



Pressures to Commit Financial Statement Fraud

Firm A Firm B

Which firm will have the higher stock price?





Rationalization

Motive / Pressure



Rationalization to Commit Fraud

Integrity

 Most important factor in keeping a person from committing fraud.



Fraud Triangle

Opportunity



Motive / Pressure



Opportunities to Commit Fraud

Internal controls are weak



Payroll Schemes

Payroll manager gets 18 months for stealing from employer

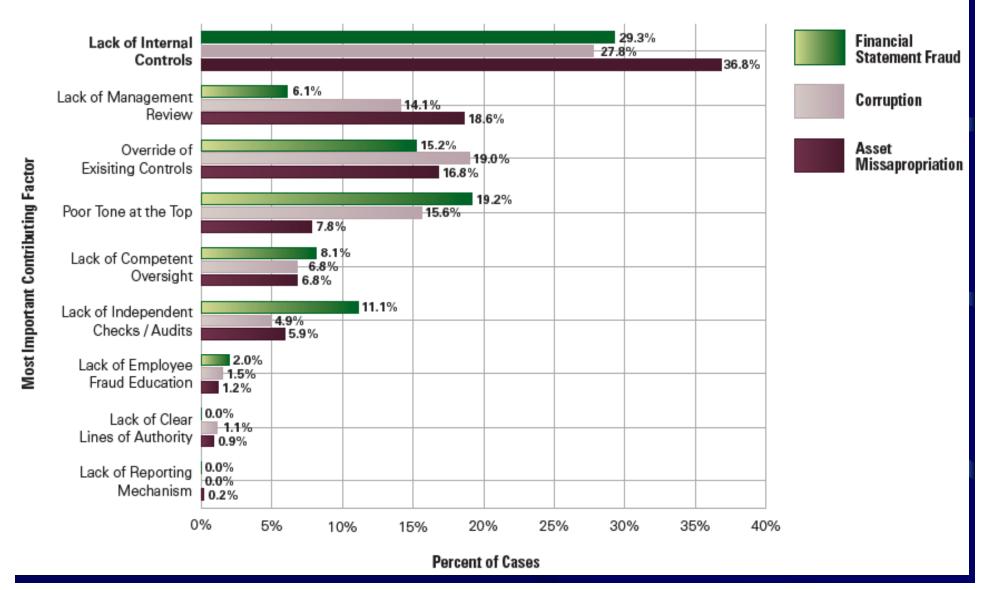
A trucking company payroll manager was sentenced to 18 months in federal prison for stealing almost \$370,000 from his employer, prosecutors said.

Kenneth R. Timmons, 43, of St. Louis, pleaded guilty to a single felony charge of wire fraud in October and admitted transferring the pay of former employees, after their termination, into his own account from May 2005 to January 2008.

Timmons was a human resources and payroll manager for a St. Louis – based transportation company, and will have to repay the money.



Breakdown of Primary Internal Control Weaknesses by Scheme Type





Opportunities to Commit Fraud

Internal controls are weak

Excessive levels of trust

Lack of fraud risk management plan



Developing a Fraud Risk Management Program



Fraud Risk Management Program Phases

Planning & Assessment

Design

Implementation

Monitoring & Improvement



Planning & Assessment

Documented Fraud Policy

Fraud Risk Assessment Fraud Scenario Brainstorming



Documented Fraud Policy

- Concise but comprehensive
 - Addresses corruption, asset misappropriation, and financial statement frauds
- Consistent with "Tone at the Top"
 - Code of Ethics and Business Principles
- Communicated and acknowledged



Fraud Risk Assessment

- Systematic and recurring assessments
 - Integrate with overall organizational risk assessment
- Performed by a qualified team
 - Includes personnel from throughout the organization
 - External specialists



Fraud Risk Assessment

- Identify inherent fraud risks
 - Significant amounts of cash and checks
 - Readily marketable inventory
 - Information technology
 - Foreign operations



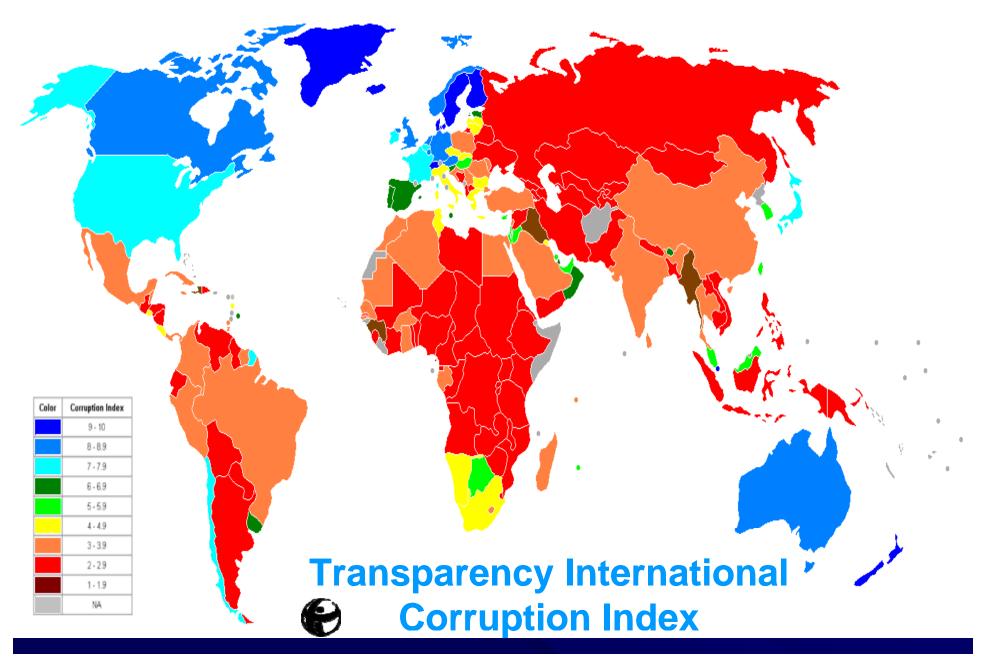
Foreign Operations

Foreign Corrupt Practices Act

International Anti-Corruption Laws

UN Private Rights of Action







Fraud Risk Assessment

- Identify inherent fraud risks
 - Significant amounts of cash and checks
 - Readily marketable inventory
 - Information technology
 - Foreign operations
- Identify pressures and opportunities
 - Incentive compensation metrics
 - Ability of management to override controls



Fraud Scenario Brainstorming

- Specific fraud scenarios
 - Check forgery, fictitious employees, etc.
- Specific motives and pressures
- Specific opportunities
 - Known control weaknesses
 - Prior incidents
- Information technology



Information Technology Threats

Common computer fraud methods include

- Unauthorized access
- System penetration
- Data leakage
- Malware & spyware
- Phishing (emails, letters, etc)



Fraud Risk Management Program Phases

Planning & Assessment

Design

Implementation

Monitoring & Improvement



Design

Prevention Controls

Detection Controls

Reporting & Resolution Procedures



Prevention Controls

- Fraud awareness
 - Documented anti-fraud policy and training
- Background investigations
 - Employees, suppliers, customers and other business partners
- Proper internal controls



Prevention Controls

Internal Controls

- Segregation of duties
- Procedures manual
- Timely financial reporting
- Mandatory vacations
- Cash controls
- IT controls



Information Technology Prevention Controls

IT prevention controls include:

- Strong IT general controls
- Continuous monitoring (email, web)
- Intrusion prevention system
- Penetration & vulnerability assessment
- IT Security awareness training



Cash Disbursements

Bookkeeper Admits She Embezzled Money at Her Job

KANSAS CITY, Mo. - There's an argument about how much, but no dispute that a woman embezzled thousands of dollars from her employer.

Shanna M. Hutchens worked at Sugar Creek Hauling Company. Hutchens wrote company checks to herself or her husband and forged the business owner's signatures, according to news release from the U.S. Attorney's Office in Kansas City. Hutchens would cash the checks or deposit them in a bank account. She also stole money from the business using cashier's checks.

The crimes went on for nearly four years. Investigators say Hutchens took at least \$760,000 from the business, but that number is in dispute. That issue will be decided at her sentencing. Hutchens faces up to 30 years in federal prison without parole and a fine of up to \$1 million.



Detection Controls

- Fraud hotline
- Proactive controls:
 - Audits (internal / external)
 - Financial analysis
 - Identify relationships among people, organizations and events
- IT controls



Information Technology Detection Controls

IT detection controls include:

- IT Security Audit
- Intrusion detection system
- 3rd party reviews data mining
- Use of Computer Assisted Audit Tools (CAAT)



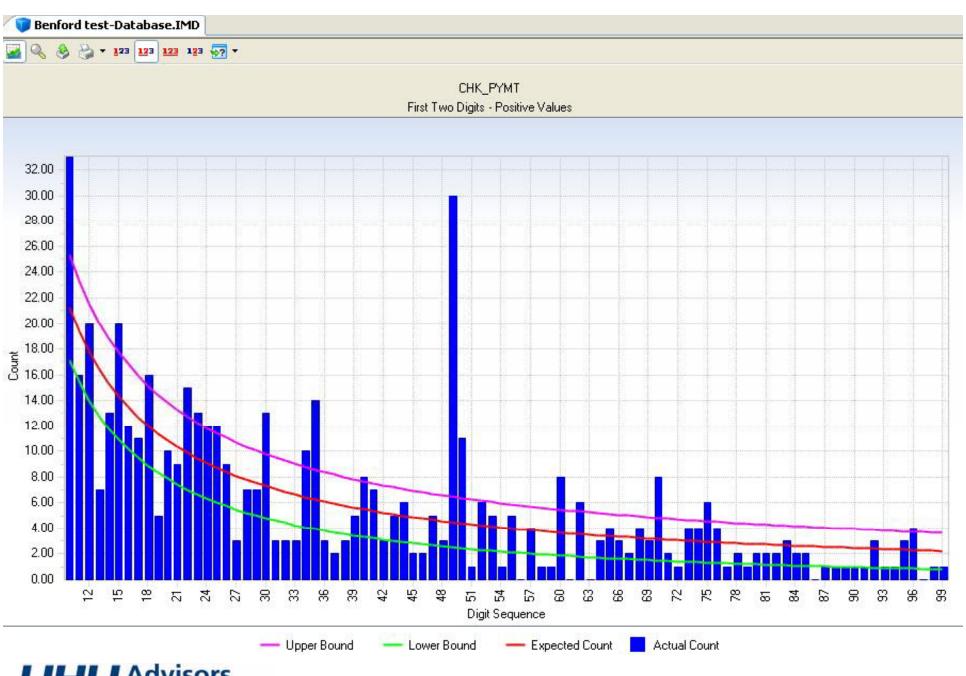
Information Technology Detection Controls

Using CAAT to detect fraudulent activity

- Interactive Data Extraction and Analysis (IDEA)
 - Comparison tests (SSN, account numbers, addresses, etc)
 - Filter out data based upon criteria reduces scope
 - Review access logs for unusual items (weekends, hours)
 - Benford test
- Audit Command Language (ACL)

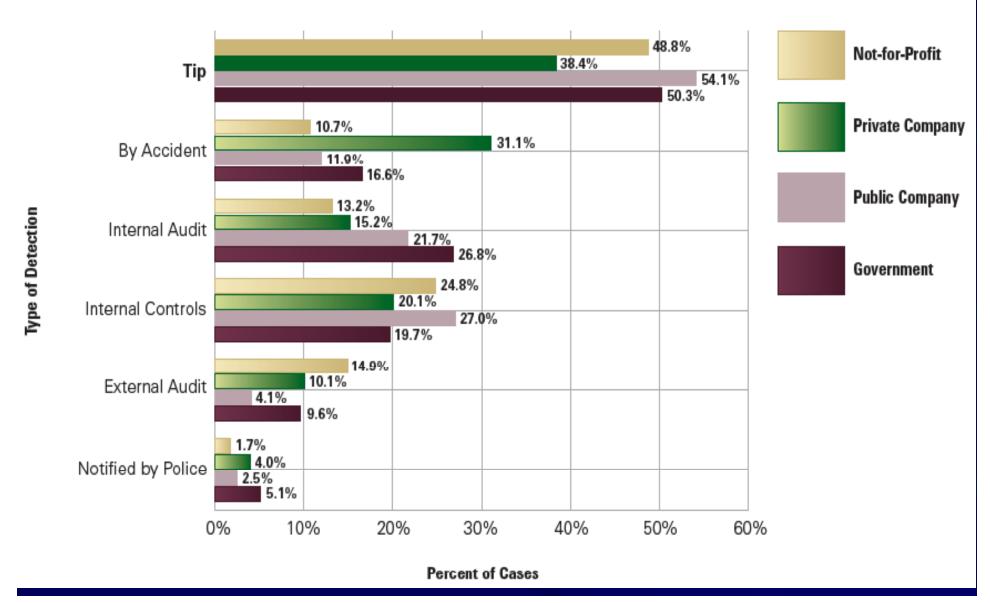








Initial Detection Method by Organization Type⁸





Reporting & Resolution

- Solicit input on potential fraud
- Methodology to investigate
 - Legal issues
- Corrective actions
 - Criminal and civil
 - Disciplinary action
 - Insurance claims



Fraud Risk Management Program Phases



Implementation

Monitoring & Improvement



Implementation

Fraud Policy & Awareness Training

Change Management Implementation Feedback



Implementation

- Training
 - Creates an organizational knowledge baseline
 - Demonstrates commitment
- Change Management
 - Reallocation of responsibilities
 - Ensure new controls operate effectively
- Feedback
 - Opportunity to improve future implementations



Fraud Risk Management Program Phases

Planning & Assessment

Design

Implementation

Monitoring & Improvement



Monitoring & Improvement

Fraud Hotline

Internal Audits

Surveys & Questionnaires



Monitoring & Improvement

- Fraud hotline reporting and analysis
- Planned and surprise audits
- Employee and stakeholder surveys
- Annual fraud policy communication and acknowledgment



Key Elements

Establish
Tone at the
Top

Document & Communicate Fraud Policy

Segregation of Duties



If You Suspect Fraud...

Immediately consult your advisors (CFE, CPA, attorney)

Do not confront the suspect on your own

Contact your insurance company



Other Considerations

Review hiring process

Evaluate vendor/customer relationships

Review insurance coverage



Fraud is easier to prevent than to detect.



Thank You!



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