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# MMA Trade Show

Conducting an Investigative Audit

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# Association of Certified Fraud Examiners 2016 Global Fraud Study



Figure 1. Statistics (ACFE, 2016).

# Association of Certified Fraud Examiners 2016 Global Fraud Study

39.1% of cases were detected through tips by employees.

Most commonly victimized industries:

- Banking and financial services
- Government and public administration
- Manufacturing

Presence of anti-fraud controls was correlated with both lower fraud losses and quicker detection.

# Occupational Fraud

“The use of one’s occupation for personal enrichment through the deliberate misuse or misapplication of the organization’s resources or assets” (ACFE, 2016).

# Occupational Fraud Schemes

All occupational fraud schemes have four key elements in common. The activity:

1. Is clandestine;
2. Violates the perpetrator's fiduciary duties to the organization;
3. Is committed for the purpose of direct or indirect financial benefit to the perpetrator; and
4. Costs the employing organization assets, revenue, or reserves.

# Categories of Fraud

- Corruption
  - 35.4% of cases
  - \$200,000 median loss
- Financial Statement Fraud
  - 9.6% of cases
  - \$975,000 median loss
- Asset Misappropriation
  - 83.5% of cases
  - \$125,000 median loss

(ACFE, 2016)

# Corruption

Any scheme in which an employee misuses his or her influence in a business transaction to obtain an unauthorized benefit contrary to that person's duty to his or her employer.

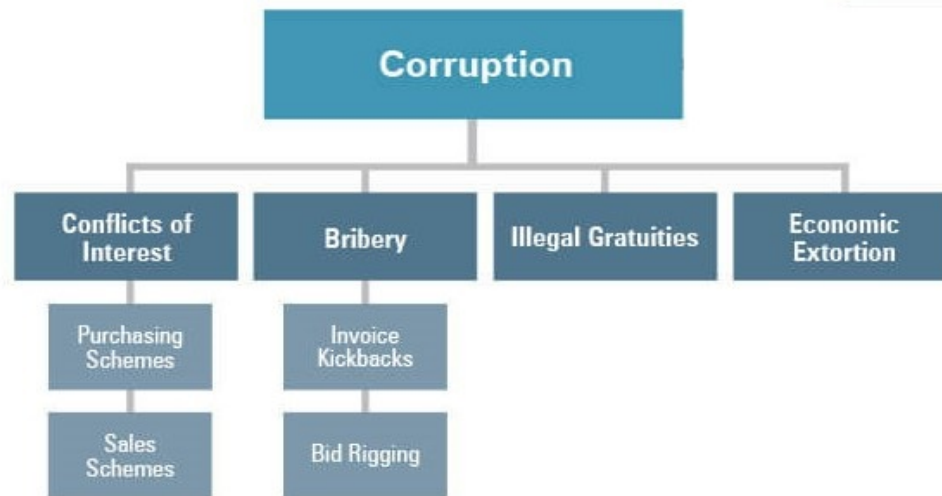


Figure 2. Corruption (ACFE, 2016).

# Financial Statement Fraud

Falsification of an organization's financial statements to make the organization appear more favorable than actuality.



Figure 3. FS Fraud (ACFE, 2016).



# Recording Expenditures/Liabilities in the Wrong Period

- No department may incur a liability in excess of their voted appropriation
- Any Town having unpaid bills of previous years which are unenforceable due to insufficient appropriation must seek additional appropriations

# Asset Misappropriation

Any scheme involving the theft or misuse of an organization's assets.

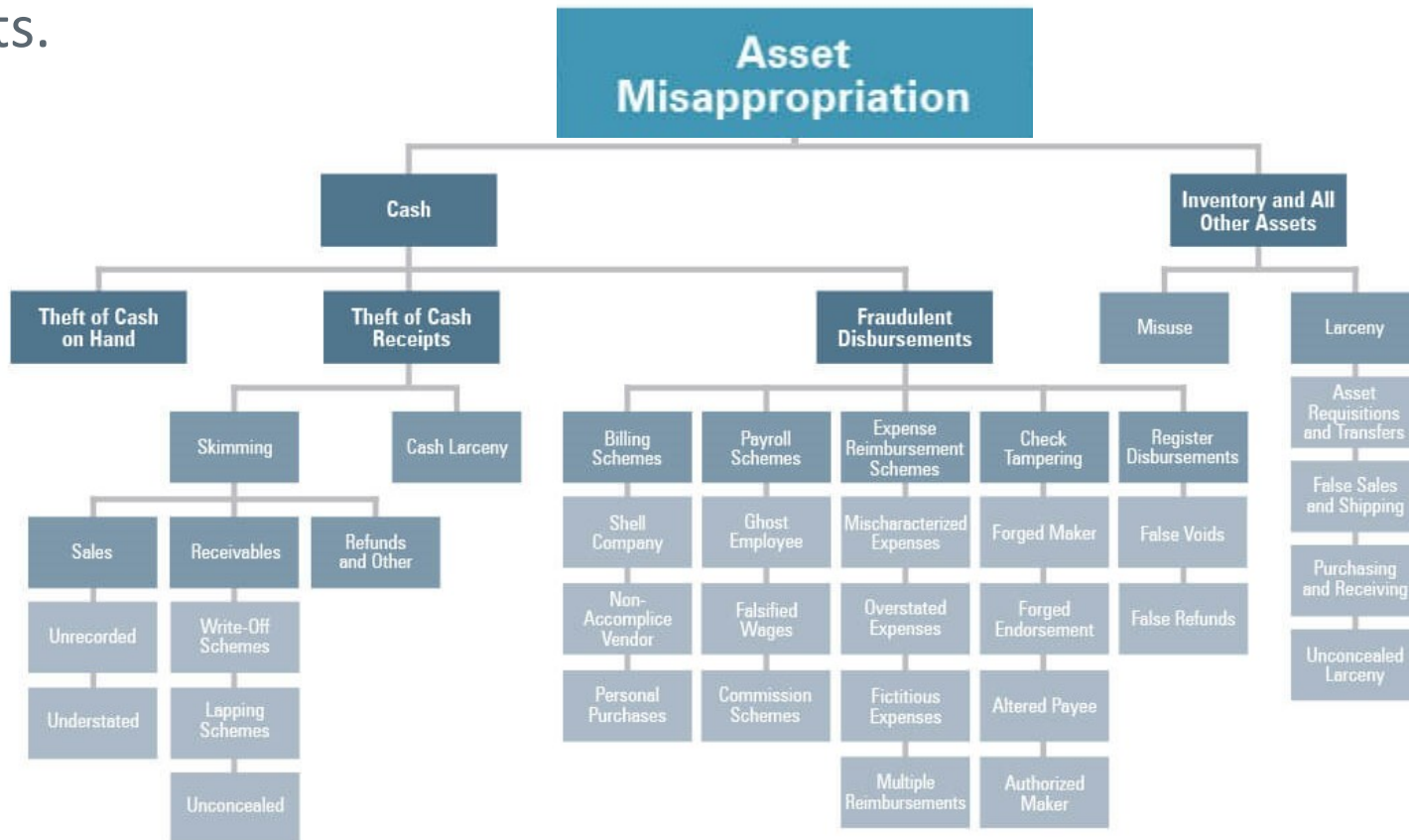


Figure 4. Misappropriation (ACFE, 2016).

# Theft of Cash on Hand and Cash Receipts

## Theft of Cash on Hand:

Misappropriation of cash kept on hand at the victim organization's premises, such as petty cash.

## Skimming:

Cash receipts stolen from an organization *before* it is recorded on the organization's books and records.

## Cash Larceny:

Cash receipts stolen from an organization *after* it is recorded on the organization's books and records.

# Fraudulent Disbursement Schemes

- Billing
- Payroll
- Expense Reimbursement
- Check Tampering
- Wire Transfers
- Cash Register Disbursements
- Petty Cash Disbursements

# Non-Cash Misappropriations

- Larceny and Misuse of:
  - Inventory
  - Supplies
  - Equipment
  - Information
  - Software

# Red Flags - Receipts

- 🚩 Change in timeliness of deposits
- 🚩 Decrease in the amount of deposits.
- 🚩 Decrease in the amount of currency in deposits
- 🚩 Incorrect cutoff
- 🚩 Inconsistent deposit dates



# Red Flags - Payroll

- 🚩 Checks paid for an unreasonable amount of hours worked
- 🚩 More than one employee with the same bank account number, SSN, or address
- 🚩 Employees with no deductions for benefits
- 🚩 Blank social security numbers for employees on payroll
- 🚩 A terminated employee still on the payroll

# Red Flags - Disbursements

- 🚩 Invoices that appear unusual
- 🚩 Complaints from employees or vendors
- 🚩 Vendors with the same address as employees
- 🚩 Internal invoices
- 🚩 Photocopied invoices
- 🚩 Self approved reimbursements
- 🚩 Missing, incomplete or altered documentation



# Off Book Bank Accounts

- Student Activity Account - \$6M
- Friends of Library - \$800K
- Friends of Senior Center - \$30K
- Petty Cash Checking - \$400K

# Fraud Detection

## How?

### Passive methods

- Confession
- Accident
- Notified by Police

### Potentially Active or Passive

- Tip (most common)
- External Audit

### Active methods

- Surveillance/Monitoring
- IT Controls
- Account reconciliation
- Internal Audit
- Document Examination
- Management Review

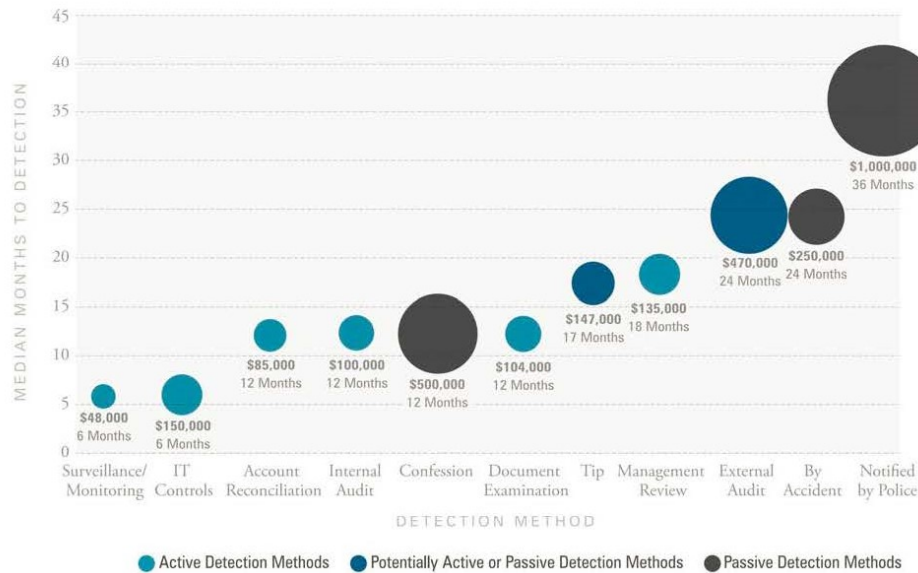


Figure 6. Detection (ACFE, 2016).

# Fraud Detection Sources of Tips

## Insiders

- Employee
- Governing Board
- Management

## Outsiders

- Auditor
- Bank
- Vendor
- Customer
- Citizen

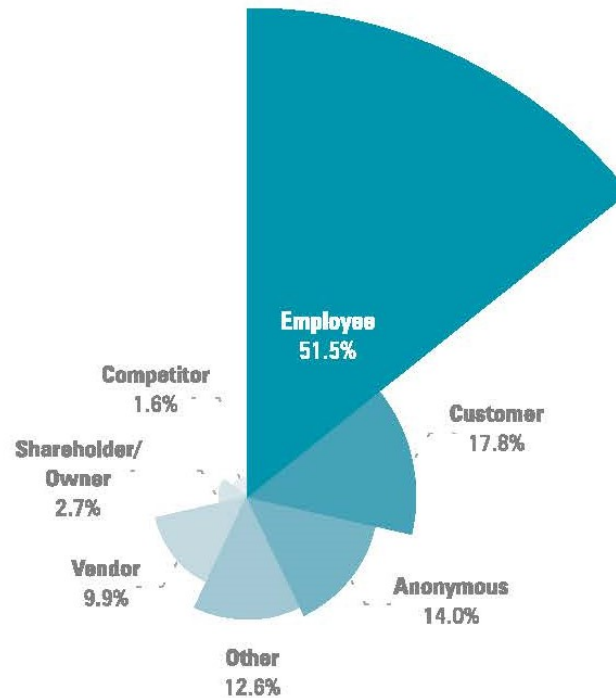


Figure 7. Tips (ACFE, 2016).

# Fraud Detection Behavioral Red Flags

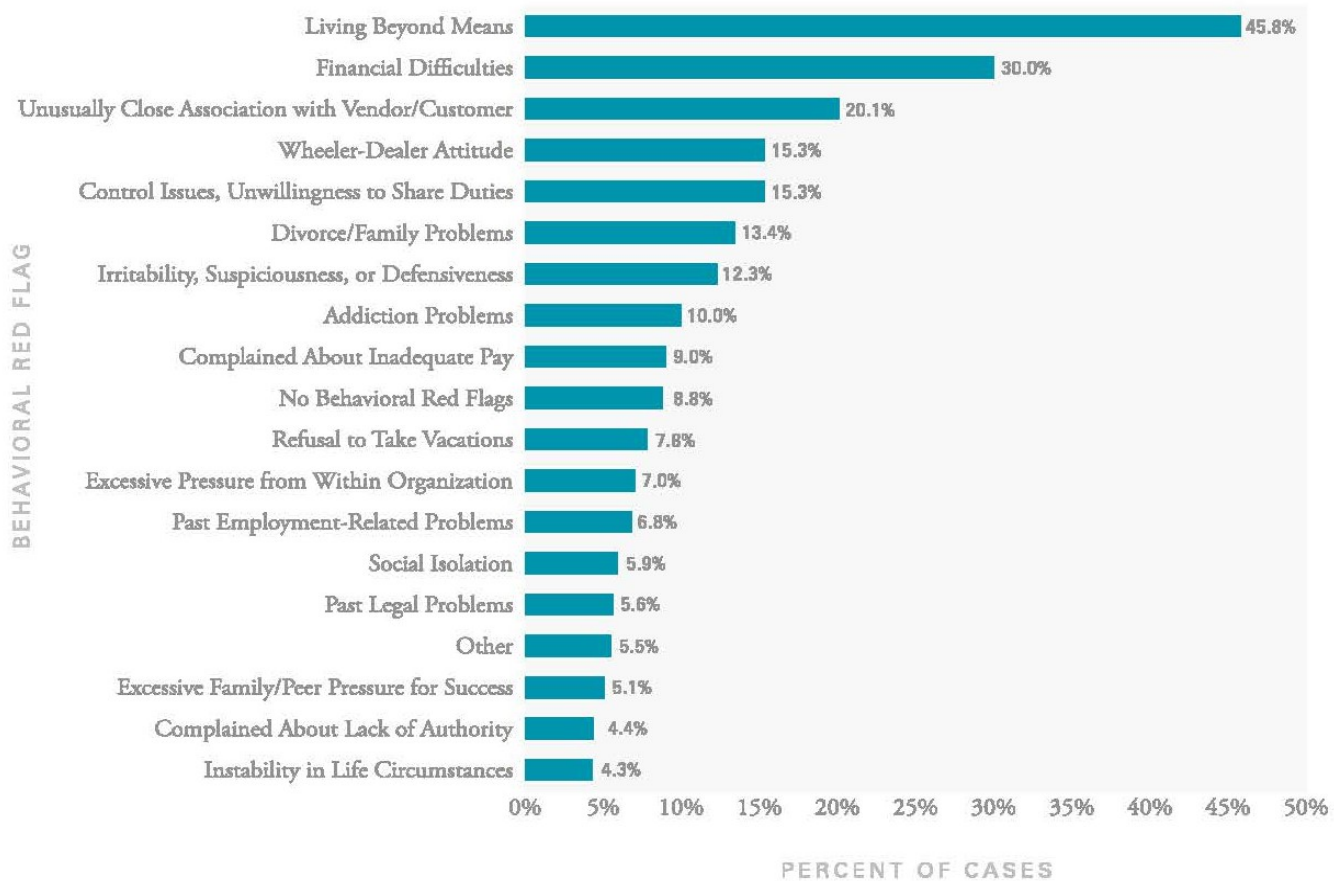


Figure 8. Red Flags (ACFE, 2016).

# WHEN TO INVESTIGATE

- Investigations are conducted when adequate predication exists, thus indicating a fraud has occurred.



# What is Predication

- The belief based on facts known that a reasonable person will come to the conclusion that an act has occurred which justifies an investigation.
  - Protect Employees Rights and Avoid Harassment Charges
  - Evaluate Credibility of Tips and Accusations
  - Seek and Review Evidence

# INTERNAL OR EXTERNAL INVESTIGATION

- In-House Resources
- Expertise
- Independence and Conflicts
- Notification to Local Police
- Inform Legal Council
- Inform Your Auditors

# WHEN TO CONFRONT EMPLOYEE

## Early in the Investigation

- Advantages
  - Likelihood of Confession?
  - Obtain Key Information
- Disadvantages
  - Alerts Suspect
  - Ability to Destroy or Alter Evidence
  - Influence Potential Witnesses



# WHEN TO CONFRONT EMPLOYEE

## LATE IN THE INVESTIGATION

- The more known about the evidence the better to detect lies or misinformation
- Ability to challenge defensive responses
- The devil is in the detail
- More likely to obtain a confession

# PROTECT EMPLOYEE RIGHTS

- Place on Leave
- Miranda Rights
- Right to Counsel or Union Rep
- Right to Privacy
- Right to Safety (non-threatening)
- Right to Due Process

# PRESERVATION OF EVIDENCE

- Chain of Custody
- Secure Records
- Where to Store Records
- **DO NOT** Mark on or Write on Originals
- Secure Originals Retain Copies for Files

# References

- Association of Certified Fraud Examiners (ACFE). (2016). *Report to the Nations on Occupational Fraud and Abuse: 2016 Global Fraud Study*. Austin, TX: ACFE Global Headquarters.