Fraud Awareness
Today’s Topics

<table>
<thead>
<tr>
<th>Fraud</th>
<th>Fraud Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Defined</td>
<td>What Happened</td>
</tr>
<tr>
<td>Statistics</td>
<td>How Much</td>
</tr>
<tr>
<td>Trivia</td>
<td>Who Perpetrated</td>
</tr>
<tr>
<td>Faces</td>
<td>Behavioral Red Flags</td>
</tr>
</tbody>
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CPAs and Professional Consultants
Elements of a Fraud

- A representation
- About a material point
- Which is false
- Intentionally or recklessly so
- Relied upon by the victim
- To the victim’s damage
Donald R. Cressey

- Known for his studies of organized crime
- Served as organized crime consultant to the President’s Commission on Law Enforcement and Administration of Justice in 1966 and 1967
- Cressey’s hypothesis later became known as the “Fraud Triangle”
The Fraud Triangle

- PRESSURE
- OPPORTUNITY
- RATIONALIZATION
Association of Certified Fraud Examiners

- Founded in 1988 by Dr. Joseph T. Wells, CFE, CPA
- 70,000 members in > 150 countries
- Report to the Nations (occupational fraud)
- Issued every other year since 1996
- 2,690 Fraud cases in 2018 (10th edition)
- Cases included more than 125 countries in 2018

http://www.acfe.com/
Have you ever been the victim of occupational fraud?

1. Yes
2. No
3. What is occupational fraud?
Do you know anyone who has been the victim of occupational fraud?

1. Yes
2. No
3. What is occupational fraud?
Occupational Fraud Defined

The use of one’s occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization’s resources or assets.
Classifications of Fraud

Occupational Fraud and Abuse Classification System

Corruption | Asset Misappropriation | Financial Statement Fraud
Corruption

Conflicts of Interest
- Purchasing Schemes
- Sales Schemes

Bribery
- Invoice Kickbacks
- Bid Rigging

Illegal Gratuities

Economic Extortion

**Obtained from 2014 Certified Fraud Examiners report "2014 Report to the Nation on Occupational Fraud and Abuse"**
Asset Misappropriation

Cash

Theft of Cash Receipts
- Skimming
- Cash Larceny
- Refunds and Other
  - Sales
  - Receivables
  - Unrecorded
  - Understated
  - Unconcealed
  - Write-Off Schemes
  - Lapping Schemes

Fraudulent Disbursements
- Billing Schemes
- Payroll Schemes
- Expense Reimbursement Schemes
- Check and Payment Tampering
- Register Disbursement
  - Shell Company
  - Ghost Employee
  - Mischarged Expenses
  - Forged Maker
  - False Voids
  - Non Accomplice Vendor
  - Falsified Wages
  - Overstated Expenses
  - Forged Endorsement
  - False Refunds
  - Personal Purchase
  - Commission Schemes
  - Fictitious Expenses
  - Altered Pay
  - Multiple Reimbursements
  - Authorized Maker

Inventory and All Other Assets

CPAs and Professional Consultants
## Financial Statements

### Financial Statement Fraud

<table>
<thead>
<tr>
<th>Type</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Worth/Net Income Overstatements</td>
<td></td>
</tr>
<tr>
<td>Timing Differences</td>
<td></td>
</tr>
<tr>
<td>Fictitious Revenues</td>
<td></td>
</tr>
<tr>
<td>Concealed Liabilities and Expenses</td>
<td></td>
</tr>
<tr>
<td>Improper Asset Valuations</td>
<td></td>
</tr>
<tr>
<td>Improper Disclosures</td>
<td></td>
</tr>
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<td>Improper Asset Valuations</td>
<td></td>
</tr>
<tr>
<td>Improper Disclosures</td>
<td></td>
</tr>
</tbody>
</table>
2018 Key Findings

$7 BILLION+

$130,000

22%

$1 MILLION+

Median duration of a fraud scheme

16 MONTHS

CORRUPTION was the most common scheme in every global region

2,690 real cases of occupational fraud

from 125 countries

in 23 industry categories
2018 Key Findings

Asset Misappropriation Schemes
- are the most common and least costly
  - $114,000 median loss
  - 89% of cases

Financial Statement Fraud Schemes
- are the least common and most costly
  - 10% of cases

$800,000 median loss
2018 Key Findings

DATA MONITORING/ANALYSIS and SURPRISE AUDITS were correlated with the largest reductions in fraud loss and duration.

- 52% LOWER LOSSES
- 58% FASTER DETECTION

Yet only 37% of victim organizations implemented these controls.

85% OF FRAUDSTERS DISPLAYED AT LEAST ONE BEHAVIORAL RED FLAG OF FRAUD
What is the most common method of initial detection of Fraud?

1. External Audit
2. Tip
3. Internal Audit
4. By Accident
2018 Key Findings

**TIPS** are by far the most common initial detection method

- **TIPS**: 40%
- **INTERNAL AUDIT**: 15%
- **MANAGEMENT REVIEW**: 13%

**EMPLOYEES** provide over half of tips, and nearly 1/3 come from **OUTSIDE PARTIES**

**ORGANIZATIONS WITH HOTLINES** detect fraud by tips more often

- 46% of cases detected by tip
- 30% of cases detected by tip

**HOTLINES**

**NO HOTLINES**
## Initial Detection of Occupational Frauds

<table>
<thead>
<tr>
<th>Tip</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal audit</td>
<td>40%</td>
</tr>
<tr>
<td>Management review</td>
<td>15%</td>
</tr>
<tr>
<td>By accident</td>
<td>13%</td>
</tr>
<tr>
<td>Other</td>
<td>7%</td>
</tr>
<tr>
<td>Account reconciliation</td>
<td>6%</td>
</tr>
<tr>
<td>Document examination</td>
<td>5%</td>
</tr>
<tr>
<td>External audit</td>
<td>4%</td>
</tr>
<tr>
<td>Surveillance/monitoring</td>
<td>4%</td>
</tr>
<tr>
<td>Notified by law enforcement</td>
<td>3%</td>
</tr>
<tr>
<td>IT controls</td>
<td>2%</td>
</tr>
<tr>
<td>Confession</td>
<td>1%</td>
</tr>
</tbody>
</table>
Size of Victim Organization - Median Loss

- <100 employees: 28% (Median Loss: $200,000)
- 100–999 employees: 22% (Median Loss: $100,000)
- 1,000–9,999 employees: 26% (Median Loss: $100,000)
- 10,000+ employees: 24% (Median Loss: $132,000)
Fraud in Small Businesses

Median loss:

- **<100 EMPLOYEES**: $200,000
- **100+ EMPLOYEES**: $104,000

Frauds detected by tip:

- **<100 EMPLOYEES**: 29%
- **100+ EMPLOYEES**: 44%

Frauds caused by lack of internal controls:

- **<100 EMPLOYEES**: 42%
- **100+ EMPLOYEES**: 25%

Frauds perpetrated by an owner/executive:

- **<100 EMPLOYEES**: 29%
- **100+ EMPLOYEES**: 16%
Fraud in Small Businesses

- Corruption: 32% (100+ employees), 43% (<100 employees)
- Billing: 18% (100+ employees), 29% (<100 employees)
- Check and payment tampering: 8% (100+ employees), 22% (<100 employees)
- Expense reimbursements: 11% (100+ employees), 21% (<100 employees)
- Skimming: 8% (100+ employees), 20% (<100 employees)
- Cash on hand: 14% (100+ employees), 20% (<100 employees)
- Noncash: 16% (100+ employees), 22% (<100 employees)
- Financial statement fraud: 7% (100+ employees), 16% (<100 employees)
- Cash larceny: 9% (100+ employees), 14% (<100 employees)
- Payroll: 5% (100+ employees), 13% (<100 employees)
- Register disbursements: 2% (100+ employees), 3% (<100 employees)

Percent of cases
Duration of Fraud

PERCENT OF CASES

- 6 months or less: 27%
- 7-12 months: 19%
- 13-18 months: 10%
- 19-24 months: 13%
- 25-36 months: 11%
- 37-48 months: 5%
- 49-60 months: 6%
- More than 60 months: 8%

MEDIAN LOSS

- $30,000
- $75,000
- $125,000
- $200,000
- $400,000
- $425,000
- $500,000
- $715,000

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Duration of Fraud by type

- Payroll: 30 months
- Check and payment tampering: 24 months
- Financial statement fraud: 24 months
- Expense reimbursements: 24 months
- Billing: 24 months
- Cash larceny: 24 months
- Corruption: 22 months
- Skimming: 18 months
- Noncash: 18 months
- Cash on hand: 12 months
- Register disbursements: 12 months
More occupational fraud originated in the accounting department than in any other business unit. 16.6%

Only 5.2% of perpetrators in this study had previously been convicted of a fraud-related offense.
FRAUD TRIVIA

Who Stole a Piece of The Pie?
Fraud Trivia

1. Sandy Jenkins
2. Kay Jenkins
3. Mr. Collin
4. Sandy & Kay Jenkins
Collin Street Bakery Embezzlement

So Who are Sandy & Kay Jenkins?

- 64 & 63 years old, from Corsicana
- Sandy was Corporate Controller for the Collin Street Bakery (1998 – 2013)
- Fired for alleged fraud on June 21, 2013
- Indicted, along with his wife Kay, for mail fraud, conspiracy to commit money laundering and making a false statement to a financial institution

Kay Jenkins
- Sentenced to five years probation
- Forced to write a letter of apology to the bakery
- 100 hours of community service

Sandy Jenkins
- 10 years in prison
Collin Street Bakery Embezzlement

What did Sandy & Kay Buy?

- 38 luxury vehicles
- Watch collection worth $3.5 million (98 watches)
- Vacation home in Santa Fe, NM ($658,000)
- 223 Trips-Addison-based N. Dallas Aviation – Chartered Jets (Santa Fe, Aspen, Napa) $500,000 for 43 flights
- Lavish wine collection (596 bottles)
- $11 million in charges on AmEx cards
- $1.2 million in Neiman Marcus charges
FRAUD TRIVIA

How Was The Fraud Perpetrated?
Fraud Trivia

1. Use of fictitious vendors
2. Duplicate payment of invoices
3. Check fraud
4. Payment of personal bills through CSB
5. All of the above
FRAUD TRIVIA

How Was The Fraud Uncovered?
Fraud Trivia

1. By accident
2. By an accounting clerk
3. By an accounting clerk who confronted Sandy
4. By Sandy admitting to the fraud
5. All of the above
Fraud Trivia

Why Did Sandy Do It?

1. Greed
2. Wanted to travel the world
3. To be something new & wonderful and revered
4. To have a lavish lifestyle
5. To be like Bob McNutt
Tenure of Perpetrator – Median Loss

- Less than 1 year: 9%, Median Loss: $40,000
- 1–5 years: 44%, Median Loss: $100,000
- 6–10 years: 23%, Median Loss: $173,000
- More than 10 years: 24%, Median Loss: $241,000
2018 Key Findings

**Fraudsters who had been with their company longer stole twice as much**

- More than 5 years’ tenure: $200,000 median loss
- Less than 5 years’ tenure: $100,000 median loss

**Only 4% of perpetrators had a prior fraud conviction**
Age of Perpetrator – Median Loss

<table>
<thead>
<tr>
<th>Age Group</th>
<th>Percent of Cases</th>
<th>Median Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;26</td>
<td>5%</td>
<td>$23,000</td>
</tr>
<tr>
<td>26–30</td>
<td>10%</td>
<td>$40,000</td>
</tr>
<tr>
<td>31–35</td>
<td>15%</td>
<td>$100,000</td>
</tr>
<tr>
<td>36–40</td>
<td>19%</td>
<td>$100,000</td>
</tr>
<tr>
<td>41–45</td>
<td>19%</td>
<td>$200,000</td>
</tr>
<tr>
<td>46–50</td>
<td>14%</td>
<td>$250,000</td>
</tr>
<tr>
<td>51–55</td>
<td>9%</td>
<td>$237,000</td>
</tr>
<tr>
<td>56–60</td>
<td>6%</td>
<td>$355,000</td>
</tr>
<tr>
<td>&gt;60</td>
<td>3%</td>
<td>$480,000</td>
</tr>
</tbody>
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Education of Perpetrator - Median Loss

<table>
<thead>
<tr>
<th>Education Level</th>
<th>Percent of Cases</th>
<th>Median Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>High school graduate or less</td>
<td>24%</td>
<td>$75,000</td>
</tr>
<tr>
<td>Some university</td>
<td>15%</td>
<td>$130,000</td>
</tr>
<tr>
<td>University degree</td>
<td>47%</td>
<td>$160,000</td>
</tr>
<tr>
<td>Postgraduate degree</td>
<td>14%</td>
<td>$230,000</td>
</tr>
</tbody>
</table>
Position of Perpetrator – Median Loss

- **Employee**
  - Male: 58% ($50,000)
  - Female: 42% ($50,000)

- **Manager**
  - Male: 73% ($165,000)
  - Female: 27% ($128,000)

- **Owner/executive**
  - Male: 86% ($295,000)
  - Female: 14% ($1,000,000)
Gender of Perpetrator - Frequency

- 2012: Male 65.0%, Female 35.0%
- 2014: Male 66.8%, Female 33.2%
- 2016: Male 69.0%, Female 31.0%
- 2018: Male 69.0%, Female 31.0%

Frequency:
- 2012: $150,000
- 2014: $185,000
- 2016: $156,000
- 2018: $89,000
FRAUD TRIVIA
Who is Thomas Coughlin?
Fraud Trivia

1. V.P Enron
2. V.P. WorldCom
3. V.P. Wal-Mart
4. V.P. 7-11
5. V.P. Macy’s
Fraud Trivia

- In 1978 hired as Director of Loss Prevention
- Worked his way up to the Vice Chairman, No. 2 Guy
- Was 57 years old
- Base salary of $1.03 million
- 2005 total compensation of $3.09 million
- Held $20 million in company stock
- In 2006 plead guilty to felony wire fraud and tax evasion for embezzlement of cash, gift cards and merchandise.
Fraud Trivia

HOW DID HE DO IT?

- For 5 years had subordinates create fictitious invoices for:
  - $700 for travel, but was for care of hunting dogs
  - $1,359 alligator boots
  - $2,590 dog pen
  - $2,695 for upgrades to 1999 Ford truck
  - $3,100 for check to be cashed for personal use
  - $6,500 to pay for private hunting lease
  - Fraudulently obtained “Gift Cards” to pay for:
    - Cooler
    - Cases of Smirnoff, Miller Light, Bottle of Jack Daniels and Carton of Tequila
Criminal Background of Perpetrator

- Never charged or convicted (89%)
- Charged but not convicted (6%)
- Had prior convictions (4%)
- Other (1%)
Result of Cases Referred to Law Enforcement

- Plead guilty/no contest: 53%
- Convicted at trial: 20%
- Declined to prosecute: 18%
- Other: 7%
- Acquitted: 1%
Reason(s) Case Not Referred to Law Enforcement

- Fear of bad publicity: 38%
- Internal discipline sufficient: 33%
- Too costly: 24%
- Private settlement: 21%
- Lack of evidence: 12%
- Other: 12%
- Civil suit: 4%
- Perpetrator disappeared: 2%
2018 Key Findings

Over the past 10 years, occupational fraud referrals to prosecution declined 16%.

Top reason for non-referrals was fear of bad publicity - 16%.
Background Check run on the Perpetrator

Did the check reveal existing red flags?

- Yes: 10%
- No: 90%

No - 48%
Yes - 52%
Background Check run on the Perpetrator prior to hiring

- Employment history: 78%
- Criminal checks: 75%
- Reference checks: 55%
- Education verification: 50%
- Credit checks: 36%
- Other: 4%
Recovering Fraud Losses

- **53%** recovered nothing.
- **15%** recovered all losses.
- **32%** made a partial recovery.

The more victims lose, the less likely they are to make a full recovery.

- LOST ≤$10,000: 30% recover all losses.
- LOST $10,000–$100,000: 16% recover all losses.
- LOST $100,001–$1,000,000: 13% recover all losses.
- LOST $1,000,000+: 8% recover all losses.
Hotlines and Reporting Mechanisms

46% of cases detected by tip with hotlines
30% of cases detected by tip without hotlines

63% of victim organizations had hotlines
Hotlines and Reporting Mechanisms

**Corruption** is particularly likely to be detected by tip

- **Corruption**: 50% detected by tip
- **Asset Misappropriation**: 38% detected by tip
- **Financial Statement Fraud**: 38% detected by tip
Hotlines and Reporting Mechanisms

Fraud losses were 50% smaller at organizations with hotlines than those without.

Organizations without hotlines were more than twice as likely to detect fraud by accident or by external audit.
Hotlines and Reporting Mechanisms

Telephone hotlines are most popular, but whistleblowers use various reporting mechanisms

- Telephone hotline: 42%
- Email: 26%
- Web-based/online form: 23%
- Mailed letter/form: 16%
- Other: 9%
- Fax: 1%

NOT ALL TIPS COME THROUGH HOTLINES

When a reporting mechanism is not used, whistleblowers are most likely to report to:

- DIRECT SUPERVISOR 32%
- EXECUTIVE 15%
- FRAUD INVESTIGATION TEAM 13%
- COWORKER 12%
- INTERNAL AUDIT 10%
The Red Flags of Fraud

IN 85% OF CASES, FRAUDSTERS DISPLAYED AT LEAST ONE BEHAVIORAL RED FLAG

AND IN 50% OF CASES, THEY EXHIBITED MULTIPLE RED FLAGS

These 6 BEHAVIORAL RED FLAGS have been the most common in every one of our studies dating back to 2008, with a remarkably consistent distribution:

- Living beyond means
- Financial difficulties
- Unusually close association with vendor/customer
- Control issues, unwillingness to share duties
- Divorce/family problems
- “Wheeler-dealer” attitude

Graphical data showing the percentage distribution for each red flag from 2008 to 2018.
The Red Flags of Fraud

**Red flags varied by PERPETRATOR’S POSITION**

- **Owner/Executive**
  - Unusually close association with vendor/customer: 24%
  - Control issues, unwillingness to share duties: 21%
  - "Wheeler-dealer" attitude: 22%
  - Irritability, suspiciousness, or defensiveness: 18%
  - Financial difficulties: 23%
  - Complained about inadequate pay: 4%

- **Employee**
  - Financial difficulties: 16%
  - Control issues, unwillingness to share duties: 8%
  - "Wheeler-dealer" attitude: 9%
  - Irritability, suspiciousness, or defensiveness: 10%
  - Financial difficulties: 35%
  - Complained about inadequate pay: 11%

**Red flags varied by PERPETRATOR’S GENDER**

- Financial difficulties: 39%
- Divorce/family problems: 20%
- Instability in life circumstances: 6%
- Unusually close association with vendor/customer: 24%
- "Wheeler-dealer" attitude: 16%
- Excessive pressure from within the organization: 8%
FRAUD TRIVIA

What is Operation Varsity Blues?
VARSITY BLUES PARENTS
WHAT TRIGGERED OPERATION VARSITY BLUES?

1. A denied parent
2. A university coach
3. A student
4. A teacher
5. An investment advisory
Tip Lead to Operation Varsity Blues
Stay in School and Learn to Spell
FRAUD AWARENESS

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Thank You!