

Fraud Investigation & Prevention

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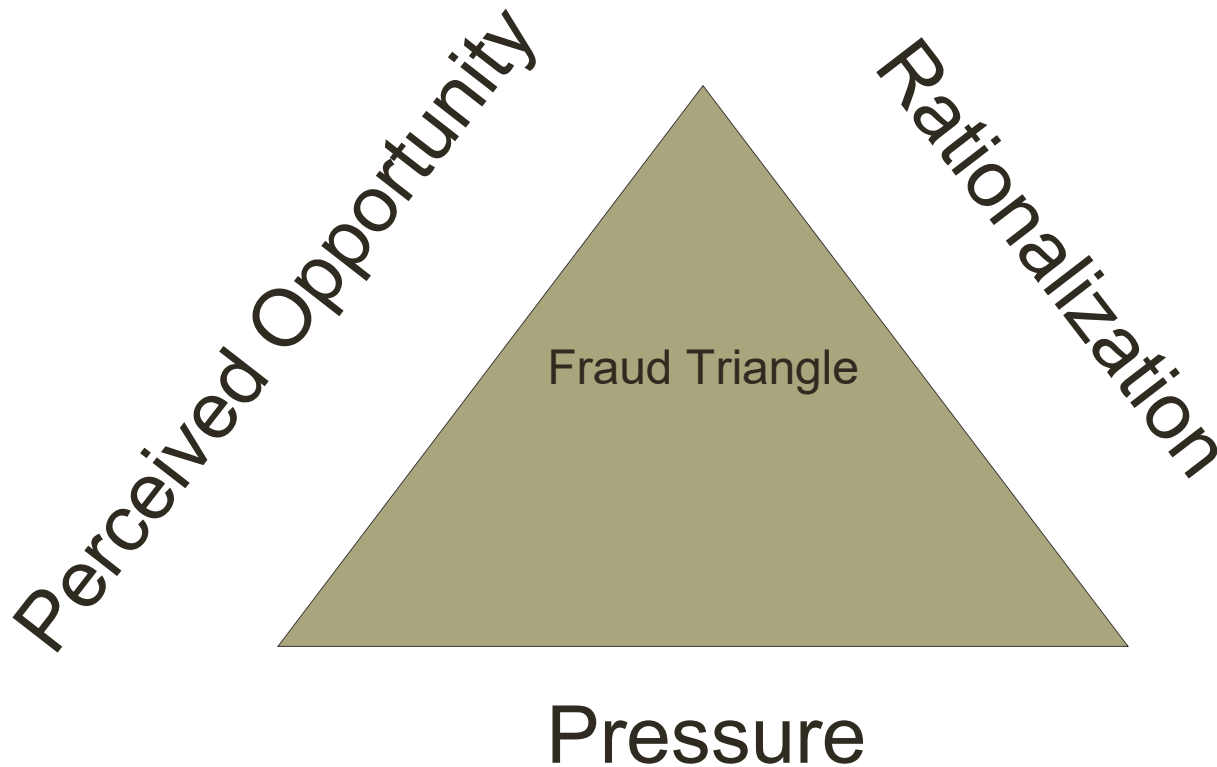
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Key Points

- Why are they committing fraud?
- Fraud Audits vs Fraud Investigations
- What are the types of internal frauds?
- What are the red flags of internal frauds?

The Fraud Triangle



Fraud Triangle Defined

- When asked why they stole when they did, as opportunity had been apparent before:
 - “There was no need for it like there was at this time.”
 - “The idea never entered my head.”
 - “I thought it was dishonest then, but this time it did not seem dishonest at first.”

Pressures That Cause Fraud

- Crisis in personal life
- Financial pressures
- Gambling, drugs or other vices
- Life situation changes
- Career or job pressures
- Peers / family
- GREED

Rationalizations

- They owe me.
- No one will notice or get hurt.
- I deserve it.
- I see others doing it, why not?
- I need it more than they do.
- Subtle – comes when least expected!
- Conscious decision to place needs above needs of others.
 - In summary – can always be rationalized!

Opportunities - Internal

- Lack of segregation of duties
- Lack of internal controls
- Lack of appropriate system of approval hierarchy
- Overrides not controlled
- Lack of vacation policies
- Attitude of management / employees
- Lack of understanding of processes

Fraud Audits vs Fraud Investigations

Fraud Audits

- Pro-Active Approach
- Procedures designed to detect fraud in business transactions performed as part of an audit.
- Procedures are performed to assess managements' internal control over fraud prevention and detection.
- Must think evil!

Fraud Investigations

- Re-active to allegation
- Procedures designed to gather information regarding a specific allegation.
- Procedures are performed with the purpose of bringing legal actions.
- Must think evil!

I Think I Found Fraud...Now What?

- How do you start an investigation?
 - Must think evil!
 - There are no audit programs for a fraud investigation
- Start gathering the evidence
 - Document all documents received – log into an inventory control log
 - Who from
 - Where from
 - Date received
 - Preserve if possible that fingerprints will be needed

Questions to Ponder.....

- What functions could the employee perform?
 - Most investigations start off with one area...but branch out to others
- What system accesses did the employee have?
 - Run reports under employee ID to see what transactions they have performed
- Could there be more than one employee involved?
 - Look for transactions performed outside of normal business hours?

Evidence..

- Gather all necessary information regarding the event:
 - Statements from involved staff – record the interviews or make notes
 - Timeline of events – start to piece this together
 - All related documents and computer files
 - Financial and accounting records
 - Related policies and procedures
 - Proof of loss

Who Else Needs to Know?

- What else should you be doing as you perform the investigation?
 - Employment Issues
 - SAR?
 - Insurance company?
 - Local Authorities?
 - Lawyer?

Contacting the Authorities

- Who do you call?
 - Federal vs State vs Local
- When do you call them in?

Report

- What is the purpose?
 - Informational for Board and Supervisory Committee
 - Can usually do a status report / findings to date to keep them informed without a large amount of details
 - Can even present the internal control failures and management's response
 - Litigation – Civil Case
 - Will need to summarize all dollar amounts you are seeking to recover
 - Prosecution – Criminal Case
 - What laws have they broken / What are we prosecuting?
 - Bond Claim – with insurance carrier
 - Throw it all in!!

Report Contents

- State the facts, just the facts!
 - Leave opinions / conclusions out – if for trial – judge and jury need to decide
 - Conclusions needed for bond claims – summaries of dollar amounts
- Include how it happened!
 - What internal controls failed
 - How to prevent any future events

Sections of the Report

- Introduction – purpose of report – describe the “assignment”
- Summary of results
 - How much do we think has been stolen / misappropriated
- Procedures Performed
 - Spell out exactly what steps have been taken
 - Reports obtained – from whom
 - Date ranges for items that were reviewed
 - Initial discovery of impropriety – how/when
- Exhibits

Exhibits

Paper:

- Usually include charts that then summarize / total back to report
- By type of theft
- By person
- By date
- Original reports

Electronically:

- Usually for bond claims – need to include all original reports

Fraud By Type for Financial Services

Type of Fraud	#	%
Corruption	161	46
Cash on Hand	49	14
Check & Payment tampering	49	14
Cash Larceny	39	11
Non-Cash	39	11
Financial Statement Fraud	39	11
Skimming	35	10
Billing	35	10
Expense Reimbursements	28	8
Disbursements / Payroll	21	6

Corruption

- Employees use their influence in the business to gain a direct or indirect benefit, in a way that is a violation to their employer
- Bribery, kickbacks, conflicts of interest

Headline – Fake Loan Scam

- VP of business banking authorized millions in business loans in exchange for kickbacks from a real estate developer
- \$4 million loan fraud conspiracy
- He approved loans far in excess of the cu's loan policies
- Received \$134,773 in kickbacks
- Paid to a front company
- Also received free use of a home constructed by the developer's company
- Free use of a BMW

Corruption

Internal Controls:

1. Annual ethic statement
2. Training of employees
3. Review of employee accounts
4. Rotation of duties in loan and purchasing departments

Cash on Hand

- Stealing of money from teller drawers or vault
- Red Flags:
 - Multiple cash short and over entries
 - Cash entries into non-cash G/L accounts
 - Multiple transactions between the vault and drawers

Credit Union VP Gets 30 Months

- Stole \$826,000 from CU over 14 years
- Purchased toys for her husband
- First – took cash from her drawer or vault – false tickets
- Also issued over the counter checks, for less than \$10,000, making them appear as though they came from members accounts
- She created fake cash-in tickets for her drawer and the vault
- Whenever she was audited – she created a transfer entry between her drawer and the vault after the first one was counted and before the next one was counted

Headline – CU Head Teller Confesses to Theft via Text Message

- In the early morning hours, then head teller sent a text to his supervisor
- He admitted that he stole more than \$100,000 and replaced it with so-called Hollywood prop money
- He did this on a Saturday, and texted his boss before the branch opened on Monday.
- Was not found – believed he ran to Mexico

Long Time CEO steals \$1.9 million

- Stolen from cu vault
- 433 times in 17 years she stuffed money in her pockets
- Then recorded the withdrawal through the accounting system
- Looked like it was transferred to corporate account
- She did not reconcile corporate account, so had to reduce the account when time to reconcile

Cash on Hand

Internal Controls:

1. Dual control over cash shipments received / ATM replenishment.
2. Dual control over vault access.
3. Surprise cash counts
4. Full reconciliation of cash to general ledger – including tickets for sales and purchases
5. Review of all non traditional entries to cash

Cash Larceny

Stolen *after* money is on books -
embezzlement

- Red Flags:
 - Reconciliations late or contain many items
 - Large deposits in transit
 - Large write-offs
 - Cash short and over excessive
 - Irregular entries to cash account
 - Entries to dormant accounts
 - Large # of no-mail accounts

Headlines....CEO and MSR

- President / CEO and a customer service rep – guilty of stealing \$2 million from CU
- Wrote checks from the credit union's financial accounts to pay for family personal expenses
- Created negative balances – then altered books to show fake deposits, bringing balances back to positive

Headlines – Mail Room Clerk

- Embezzled \$5.4 million from a \$7.7 billion CU
- His job in the mailroom included the issuing of checks to replenish the postage meter
- He would issue the checks every week for the postage meter
- Would also issue a check to buy large amounts of postage stamps
- Would ship the stamps to Ben Art Stamp Co and be paid by check
- Between 2007 and 2017, Ben Art paid him more than \$3.6 million

Headline - \$670,000 stolen from dormant accounts

- Shifted money between 16 dormant or rarely used high balance accounts
- Hid it from examiners by continually shifting the funds
- Received 51 months in jail – ordered to pay \$13,066 monthly until debt paid off

Cash Larceny

Internal Controls:

1. Controls over dormant accounts / no-mails.
2. Reconciliations of all internal accounts.
3. Clear segregation of duties in loan processing area.
4. Clear definitions of stale items.
5. Review of employee accounts.

Cash Larceny

Internal controls:

6. Segregation of collateral valuation from loan area.
7. Data mining:
 - a) Address T/B review - PO Boxes
 - b) Debit entries to expense accounts – source of entries
 - c) Entries made to dormant accounts
 - d) Non-financial transaction report

Billing

- Types:
 - Issuing a false payment – shell companies
 - Inflated invoices – falsified / collusion
 - Personal purchases disguised
- Red flags:
 - Changes in purchasing patterns
 - Increase in new vendor usage
 - Increase in expense categories
 - Checks going to employee addresses

Headline: Feds go after Former CU CEO

- Multimillion – Dollar Embezzlement
- Ordered to repay \$9,890,375 to Municipal Credit Union
- Employees were afraid to challenge him
 - Follow his instructions or risk getting fired
 - Call him Mr. Wong only
- He was an addict – gambling and drugs
 - Spent \$5.5 million in NY lottery tickets
 - Daily drug cocktail at his desk of opiates, hydrocodone pills, and a codeine – laced syrup
- Set a tone at the top that failed to value compliance, ethics and morals; rewarded those that kept their heads down and traded favors

Mr. Wong continued...

- Presented phony invoices for dental work he never had done
- \$7.7 million in cash payments for long-term disability payments, which he was not entitled to
- \$2 million in fake tax reimbursement payments
- Fake repair bills for luxury cars
- Educational, housing and living expenses for relatives
- Cash advances – tens of thousands
- \$2 million in ATM withdrawals
- Hundreds of thousands in cash payments in place of 320 sick days he was not entitled to

Mr. Wong....

- Got drugs from a supervisory committee member in exchange for funneling hundreds of thousands of dollars to the committee member's company
- Sentenced to more than five years in prison – 66 months
- Three years supervised release
- Forfeit / restitution of \$9.8 million

CEO Sentenced for Embezzlement

- Set up an Amazon vendor account under his wife's name
- Purchased supplies on his own, and then resold them through his wife's vendor account
- Used his corporate credit card for the purchases
- CU could only account for 15% of the total purchases on his card
- Purchased 2 battery operated towers for computers for about \$200 – resold them to CU for more than \$900
- Got 2 years in prison and restitution of \$251,438 + 5 years supervised release

Billing

Internal Controls:

1. Segregation of duties over new vendor approval, set-up, purchasing, authorization, receiving and recording.
2. Monitor changes to vendor database.
3. Segregate returned checks from A/P function.
4. Data mining – run vendor addresses against employee payroll database.
5. Conflict of Interest Policy
6. Comparing prices of goods and services to outside vendors.

Conclusion

- There are no audit programs for fraud investigations!
- Have to first determine what they had access to
- Determine what they did
- Determine how they did it
- Report on the investigation
- Determine who to communicate the results to
- Types of frauds and internal controls

QUESTIONS?



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