


Fraud & Forensic Accounting Update for CPAs

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CPA & BUSINESS ADVISORS

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Background

- **Eide Bailly LLP**
 - Top 25 CPA firm in the nation (Est. 1917)
 - More than 49,000 clients, 1,300 professionals, 22 offices (10 states)
- **Forensic & Valuation Services**
 - Forensic accounting
 - Computer forensics (recently acquired Calvin Weeks & Associates)
 - Business valuation, economic damage calculations, transaction services (due diligence)
 - Employment backgrounds

For more information: www.eidebailly.com/services/forensic-valuation

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Agenda

- Recent Fraud Trends/Top Fraud Schemes
- Phases of a Fraud Investigation
- Investigative Techniques and Tips
- Case Studies
- Fraud Prevention

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How Wide Spread is Fraud?

Recent Fraud Trends



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Fraud Survey

- 75% of businesses are victims of fraud
- 5% of Total Revenue
- 18 months before detection
- Less than 100 employees, most vulnerable
 - Highest median loss except for companies with over 10,000 employees
 - Median loss per incident = \$160,000
- #1 Reason for Fraud?

Poor, Circumvented or Non-existent Internal Controls

Source: ACFE 2012 Report to the Nation

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Fraud Profile

- Median loss attributed to owner/executives was \$573,000.
 - \$180,000 for managers
- 87% of fraudsters had no prior fraud conviction.
- 81% of fraudsters displayed one or more behavioral red flags. Top 4 being:
 - Living beyond means
 - Financial difficulties
 - Close association with vendors or customers
 - Excessive control issues

Source: ACFE 2012 Report to the Nation

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Why are Fraud Investigations Important?

- Median losses by type of scheme:
 - Asset theft: **\$120,000**
 - Corruption: **\$250,000**
 - Fraudulent statements: **\$1,000,000**

\$3.5 trillion lost globally to fraud annually.
\$994 Billion lost to fraud annually in the U.S.

Source: ACFE 2012 Report to the Nation

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How do People Steal

Top Fraud Schemes



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Skimming

- Taking assets BEFORE recorded on the books.
 - Cash receipts
 - Unrecorded sales
 - Inventory off of dock
 - Lapping

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False Voids

- No receipt to customers
- Transaction voided
- Cash removed

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Billing

- Fictitious vendor
- Overpayment
- Pay & Return
- Personal Invoices

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Payroll

- Ghost Employees
- Overtime
- Theft of Time

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Expenses

- Unauthorized expenses
- Inflated expenses
- Fictitious receipts
- Claim others

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Phases of a Fraud Investigation

1. Understand controls over cash flows
2. Identify internal control weaknesses
3. Generate fraud theories
4. Collect and evaluate evidence
5. Identify losses
6. Report findings

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Investigative Methods

- **Theft Act** – attempt to catch the perpetrator in the act or to gather information about the actual thefts
- **Concealment** – Focus on records, documents, computer programs and servers and other places where perpetrators might try to conceal dishonest acts
- **Conversion** – Searching for ways in which perpetrators may have spent or used their stolen assets

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» Importance of Documentary Evidence

Unlike witnesses, documents don't forget, they can't be confused by attorneys, they can't commit perjury, and they never tell inconsistent stories on two different occasions. Documents contain valuable information for conducting fraud investigations.

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» Disposition of Income

Four things perpetrators do with ill-gotten proceeds:

- 1) Save it
- Increases assets
- 2) Buy assets
- Increases assets
- 3) Pay off debts
- Decreases liabilities
- 4) Spend it

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» The Financial Profile

Objective is to discover what suspect:

- Owns (assets)
- Owes (liabilities)
- Earns (income)
- Spends (expenditures)

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»» Tips When Examining Fraud Matters

- Everything you create could be discoverable in court.
 - Emails, workpapers, reports, other correspondence
- Don't create a report you are not prepared to defend and testify to.
 - Being cross-examined is not fun...I promise
- Even if there is no attorney involved, assume the matter will end up in court

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Case Studies



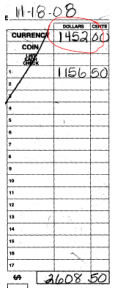
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»» Its Just Not "Fair"

Case 1	Scheme Details
Victim	State Fair
Perpetrator	Bookkeeper
Type of scheme	Theft of Cash Receipts
Detection	Dwindling Profits Prompted Forensic Examination
Total losses	\$647,900

»»» Cash Theft Example

11/20/2008 Deposit 2,608.50

Organization's Copy of Deposit Slip: 

Copy of Deposit Slip from Bank: 

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»»» Money Is Thicker Than Blood

Case 2	Scheme Details
Victim	Partner (Brother)
Perpetrator	Other Partner (Brother)
Type of scheme	Perpetrator transferred funds into a separate business account which he used to fund his lifestyle
Detection	Detected during due diligence review before sale of the victim's portion of the business
Total losses	Over \$2 million

»»» You Scratch My Back, I Take Your Money

Case 3	Scheme Details
Victim	Man with Autism
Perpetrator	Real Estate Investor/Neighbor
Type of scheme	Perpetrator offered victim a business deal and deceived him into investing his entire trust into his business
Detection	One of the victim's banks refused to release his assets
Total losses	Over \$2 million cash and \$3 million in calculated damages

Facilitation

- All of these cases had poor or non-existent internal controls
 - Lack of independent review
 - Lack of proper documentation
 - Lack of security over assets
 - Lack of segregation of duties
 - Lack of proper authorization

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Fraud Prevention

How to Reduce the Risk of Fraud



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Fraud Prevention

- *Basic principle:*
 - People rarely commit fraud if they think they will be caught.
- *Perception of detection:*
 - Most effective deterrent to fraud.
- People with increased pressure have an increased risk to commit fraud

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Increasing Perception of Detection

- Proactive policies
 - Surveillance
 - Fraud assessment questioning
 - Mandatory vacations
 - Surprise audits
- Vigorously pursue dishonest acts
- Reporting program (Hotline)
 - **Median loss amount is 2x more in companies without a hotline**

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Internal Controls

- Segregation of duties:
 - Authorization
 - Record keeping
 - Custody of assets
- Proper procedures for authorization
- Adequate documents and records
- Physical control over assets and records
- Independent checks on performance
- Positive Pay

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Internal Controls

- Develop policies/procedures
- Demand compliance
- Enforce violations
- Background investigations
- Promote operational efficiency
- Safeguard company assets
- Employee dishonesty insurance coverage

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»» Fraud Prevention

Prevention is easier than Detection

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Thank You!

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