

**Fraud Prevention Awareness  
For Managers  
State of Montana**

**Ralph Q. Summerford, CPA, ABV, CFF, CFE, CIRA**

**Forensic/Strategic Solutions, PC**

**Birmingham, Al**

**[www.forensicstrategic.com](http://www.forensicstrategic.com)**

# Profile of the White Collar Criminal

# Congratulations Montana!

- International Fraud Awareness Week, November 6-12, 2011
- A Week Dedicated to Fraud Awareness, Detection and Prevention
- Fraud Prevention Awareness for Managers of the State of Montana

# Interesting Fraud Facts

- Involves confidence
  - Distinguishes fraud from other crimes
  - Best vendor/best employee/best friend
- Involves all ways to gain advantage
- Includes surprise, trick, cunning, deceiving or any method to cheat another

# Four Elements to Fraud

- Cause
  1. Material misstatement (a lie)
  2. Reliance
- Effect
  3. Knowledge of misstatement
  4. Damages suffered

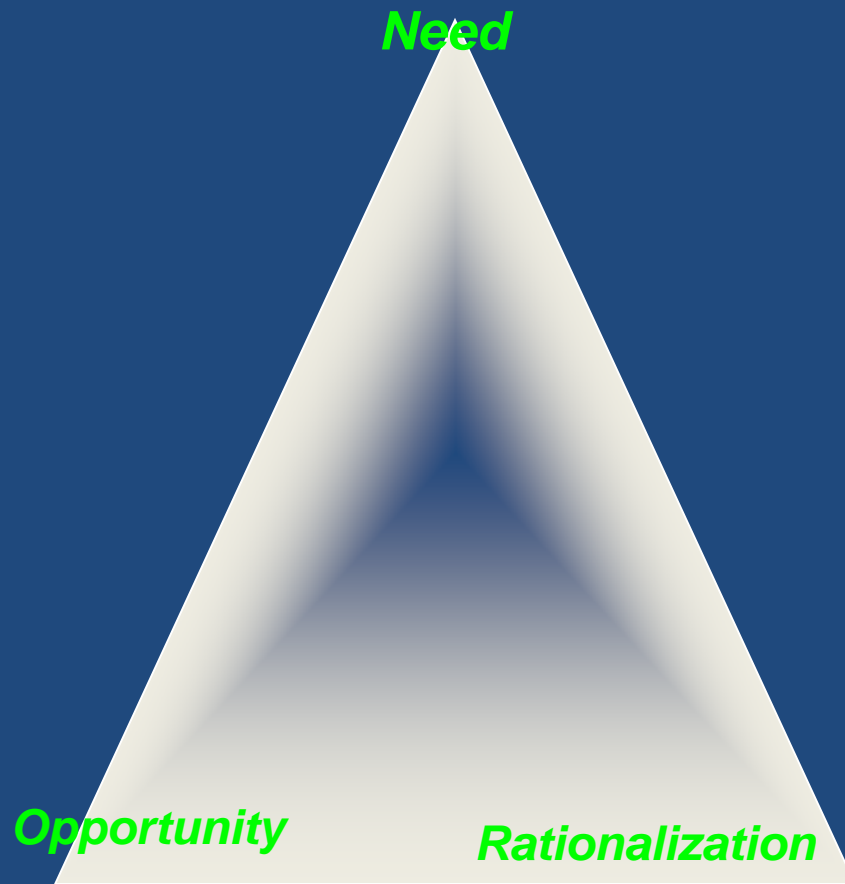
# Interesting Fraud Facts

- Fraud is limited
  - Greed
  - Time
- Perpetrators never save
- No dead bodies – only symptoms
- All frauds start small

# Interesting Fraud Facts

- No small fraud
- \$700+ Billion
- Levels of honesty decreasing
- Always show up in numbers
- Usually show up in behavior
- Surveys on fraud

# Why Is Fraud Committed?



- Situational Pressures
- Opportunity to commit fraud
- Belief -- Won't get caught



# How Fraud is Discovered

- Tips and complaints (40%)
- Accident (12%)
- Audit (15%/5%)
  - “Where were the accountants?”
  - “Not my responsibility”
- Who is responsible?



# How Do You Know It's Fraud & What Do You Report?

- Fraud
- Waste
- Abuse

# Footprints of the Beast



**Fraud**

**Waste**

**Abuse**



# Behavioral Red Flags

<b>Living beyond means</b>	<b>43</b>
<b>Financial difficulties</b>	<b>36</b>
<b>Control issues (share duties)</b>	<b>23</b>
<b>Close with vendor</b>	<b>22</b>
<b>Wheeler dealer attitude</b>	<b>19</b>
<b>Divorce/family issues</b>	<b>18</b>
<b>Irritability, suspiciousness, defensiveness</b>	<b>14</b>
<b>Addiction</b>	<b>12</b>

# Behavioral Red Flags

Refusal to take vacations	10
Past employment problems	9
Complaints - inadequate pay	8
Excessive pressure	8
Legal problems	6
Instability in life circumstances	6
Peer/family pressure	5
Complaints - lack authority	5

Source: ACFE 2010 Report to the Nations

# Montana Fraud Hotline

# 800-222-4446

- The Legislative Auditor administers
- Enables state employees and public to report
  - **Illegal acts**
  - **Misuse or abuse of state property or time**
  - **Gross misconduct, incompetence or inefficiency**



# SCHEMES



- Bribery
- Illegal Gratuities
- Economic Extortion
- Conflicts of Interest

# BRIBERY



- Giving or receiving (or offering or soliciting)
- Any “thing of value”
- To influence
- An official act

# Title 18, USC Section 201

Prohibits a government employee from directly or indirectly receiving or soliciting anything of value in exchange for being influenced in the performance or non-performance of any official act, including giving testimony, or in exchange for committing fraud.

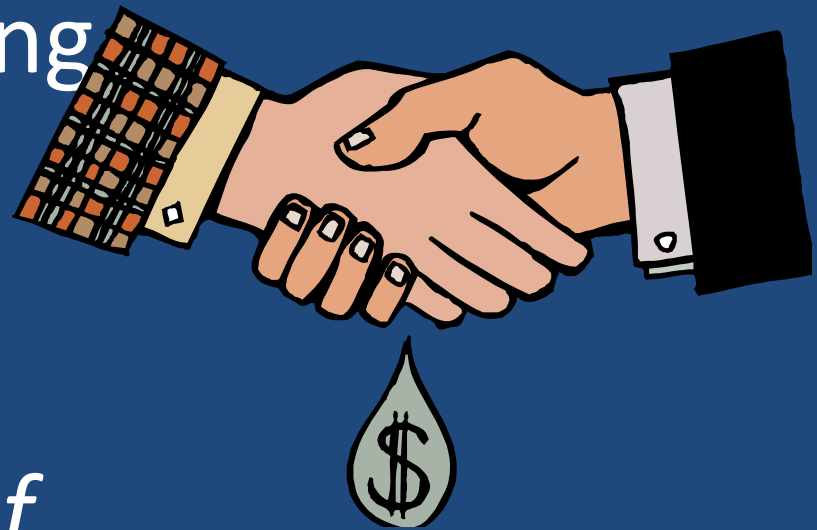
# COMMERCIAL BRIBERY

- Giving or receiving
- Any thing of value
- To influence
- *A business decision*
- *Without the employer's knowledge and consent*



# Illegal Gratuity

- Giving or receiving
- Any “thing of value”
- *For or because of*
- An official act



# CORRUPTION

- Economic Extortion
  - Demand of payment
  - To refrain from discrimination against
  - A business decision
- Conflict of Interest & Kickbacks
  - An agent taking an interest in a transaction
  - Which is actually or potentially adverse to the principal
  - Without disclosure to the principal

# METHODS OF MAKING ILLEGAL PAYMENTS

- Gifts, travel and entertainment
  - Wine and liquor
  - Clothes and jewelry
  - Sexual favors
  - Lavish entertainment
  - Paid vacations
  - Free transportation
  - Free use of resort facilities
  - Gifts of briber's inventory and services



# METHODS OF MAKING ILLEGAL PAYMENTS



- 💰 Cash payments
- 💰 Checks
- 💰 Hidden interest
- 💰 Other methods
  - ◀ Loans
  - ◀ Payment of credit cards
  - ◀ Transfer at other than fair market
  - ◀ Favorable treatment



# Fraudulent Disbursements

- Billing Schemes
- Shell companies
- Overbilling involving existing vendors
- Personal purchases
- Motive good or bad
  - Budgeted funds
  - Budget cuts

# Fraudulent Disbursements

## Expense Reimbursement

- Mischaracterized
- Overstated
- Fictitious
- Multiple

# Fraudulent Disbursements

## Payroll

- Ghost employees
- Falsified hours and salary
- Commission schemes

What Risk Managers Tell You to  
Watch For & WHY

# Segregation of Duties

# Man Who Brought Down Barings Bank

Nick Leeson made unauthorized trades in financial currencies that resulted in \$1.3 billion losses and the collapse of one of the world's largest banks.



# Rogue Trader Hits Firm

UBS AG said a rogue trader racked up as much as \$2 billion in losses using the firm's own money, a dramatic admission that raised new questions about the ability of one of the world's largest banks to manage risk and global regulators' ability to monitor it.

The losses stemmed from unauthorized derivatives-trading bets.

*Wall Street Journal Blog*  
9/15/2011



Kweku  
Adoboli

# What Risk Managers Tell You to Watch For & WHY

- Rotate job responsibilities
- Lifestyle Symptoms
  - When people steal, they spend
- Physical safeguards
- Independent checks
- Review authorizations

# What Risk Managers Tell You to Watch For & WHY

- Override of controls
- Inadequate accounting system



# Detection – Red Flags

- Complaints from employees or other vendors
- After bids are rejected as too high, the same bidders re-bid in the same bid rank.
- Bid prices drop when a new bidder submits a bid.
- Qualified contractors refrain from bidding.
- Certain contractors always bid against each other or never bid against each other

# Detection – Red Flags

- Successful bidder subcontracts to losing bidders
- Geographical or rotational pattern to winning bidders
- Different bidders make same mathematical or spelling errors

# Detection – Red Flags

- Bidders frequently change prices by comparable amounts at about same time
- Competitors regularly socialize, hold meetings, visit each others' offices, travel together
- Statements acknowledging territories, such as, “we do not bid in ‘X’ county”

# Detection – Red Flags

- Winning vendor always last to bid
- New vendors receive disproportionate number of winning bids
- Unusual or “one time” extra charges
- Expenses increased considerably for no apparent reason

# Detection – Red Flags

Unusual number of invoices submitted on same day

**Wake County Public  
Schools – North Carolina**

**Table of Invoices From Barnes Motor and Parts Where Over 50  
Invoices Were Submitted On One Day**

<b>Date On Invoices</b>	<b>Total of Invoices</b>	<b>No. Invoices Submitted This Date</b>
5/8/2002	\$226,945.69	113
1/9/2003	146,667.97	76
5/26/2003	53,108.59	50
6/2/2003	144,766.59	74
6/4/2003	550,262.68	282
6/5/2003	173,395.40	91
6/6/2003	701,979.40	348
6/9/2003	479,341.09	236
6/10/2003	909,266.47	466
6/11/2003	122,277.30	68
2/9/2004	75,330.12	65
2/12/2004	191,411.84	104
2/19/2004	76,509.21	60
3/1/2004	71,614.04	64
4/6/2004	76,312.23	53
5/14/2004	69,931.86	53

**Table of Invoices From Barnes Motor and Parts  
Where Over 50 Invoices Were Submitted On One  
Day**

<b>Date On Invoices</b>	<b>Total of Invoices</b>	<b>No. Invoices Submitted This Date</b>
<b>5/18/2004</b>	<b>108,385.68</b>	<b>80</b>
<b>5/19/2004</b>	<b>135,584.65</b>	<b>103</b>
<b>5/20/2004</b>	<b>125,868.41</b>	<b>87</b>
<b>5/24/2004</b>	<b>267,257.65</b>	<b>150</b>
<b>5/26/2004</b>	<b>168,728.63</b>	<b>124</b>
<b>6/9/2004</b>	<b>619,387.29</b>	<b>397</b>
<b>6/10/2004</b>	<b>406,594.44</b>	<b>198</b>
<b>6/11/2004</b>	<b>267,317.66</b>	<b>304</b>

# Detection – Red Flags

**Invoice numbers in unbroken  
consecutive sequence**

**Wake County Public Schools**



Invoice Date	Total of Invoices	Number of Invoices	% Consecutive
6/4/2003	550,262.68	282	99%
6/6/2003	701,979.40	348	97%
6/9/2003	479,341.09	236	96%
6/10/2003	909,266.47	466	98%
5/24/2004	267,257.65	150	89%
5/26/2004	168,728.63	124	90%
6/9/2004	619,387.29	397	93%
6/10/2004	406,594.44	198	91%
6/11/2004	267,317.66	304	98%

# Positioning to Turn

– into +

- *“Wake school system receives positive audit”*
- *“Wake Auditors say the school system already has a program to check against fraud”*

# Detection – Red Flags

- Shortages
- Invoices from vendor consistently just under the threshold for higher review and approval
- Vendor salespersons make frequent unexplained visits to purchasing employees
- Quality of goods declines



*Final Quote for the Day*

**“I trust everybody –  
but I always want to  
cut the cards!”**

*Mark Twain*

# Let's Go to the Beach

