Fraud Prevention and Early Detection

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Three Categories

Misappropriation / Theft
Manipulated Results
Corruption / Shadow Deals

Examples: Results Reporting

1. Financial
   a) Revenue and income ‘schemes’
   b) Tax collection, remittance & reporting

2. Program results
   a) Grantees
   b) Poverty, education
   c) Number served

3. Operating and market statistics
4. Product or service safety, quality or use
America's Biggest Teacher and Principal Cheating Scandal Unfolds in Atlanta
The Christian Science Monitor

In February 2009, Atlanta Superintendent Beverly Hall was named 2009 Superintendent of the Year in San Francisco. Ms. Hall stepped down from her post on June 30, days before the release of a report that documented widespread cheating by teachers and administrators in the 55,000-student Atlanta Public School District.

(Paul Sakuma / AP / File)

By Patrik Jonsson, Staff writer / July 5, 2011 at 5:37 pm EDT

Three Levels

MACRO

Micro

Systemic

Internal Audit

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CPA Audit Engagements

Your Concerns?

Fraud Risk Management Campaign
Fraud Risk Management

1. Deterrence and Prevention
2. Early Detection
3. Effective Handling

ORGANIZATIONS MUST BE PREPARED AT ALL THREE LEVELS

Level 1:
Deterrence and Prevention

Five Proven Anti-Fraud Actions
ACTIONS 1

Effective Internal Controls

Infrastructure Behavior

Controls Infrastructure
1. Leadership words and deeds
2. Policies, procedures and systems
3. Culture of quality
4. Effective screening (and re-screening)
5. Finance and accounting knowledge
6. Exposure assessment
7. Limited access
8. Transaction review and approval protocols

Controls Behavior
1. Competence, integrity, interest
2. Daily prevention-based behaviors
3. Pause at the moment of approval
4. “HDIK?” is the norm
5. Culture of Doubting
6. Daily detection-based behaviors
7. Real oversight and analysis
8. Coaching
ACTION 2

Policy on Fraud Responsibilities

1. Positive message
2. Manager and staff responsibilities
3. Exposure awareness
4. Procedures to prevent
5. Procedures to detect
6. What to do / what not to do
7. Emphasis on SUSPECTED acts
ACTION 3

Fraud Prevention Skills Training

Which of the four options below would make the most significant impact on helping your organization be more effective in fighting fraud, misconduct, and wrongdoing?

- Implementing a Fraud Policy: 14%
- Conducting an organization-wide Comprehensive Fraud Exposure Analysis, including the creation of a Fraud Risk Inventory: 14%
- Providing awareness, prevention and early Detection Skills Training for managers and staff: 62%
- Catching and Prosecuting Wrongdoers: 10%
Anti Fraud Skills

What fraud skills are needed:
- General knowledge of fraud risks
- Why soft controls are as important as hard controls
- What can happen in their areas
- What it will look like when it happens
- Suggestions on preventing
- Suggestions on prompt detection when prevention fails

Anti Fraud Skills

Who needs these skills:
- Every supervisor and manager
- Every executive
- Many employees

Fraud Prevention Skills Training
1. Group live
2. Technology-based
   - Webinars
   - Video
3. Written
4. 1 on 1 coaching
Look for Fraud Indicators

- Most fraud leaves clues in the records or behavior.
- Know and look for these clues.
- Look in management exception reports, in complaints, in shortages, in variances, in month end cost center reports.
- Auditors should look using targeted audit program steps.

Use “How Do I Know”

- Verify important details.
- Utilize a “show me how you…” rather than a “do you…” approach to verifying details.
- Before signing-off on journal entries, exceptions, disbursements, reconciliations and other documents, make sure people know that they're responsible for the results.
When in Doubt, Doubt

- If something looks or feels wrong to you in your area of responsibility, it probably is. You are in the best position to know.
- Choose to follow up to determine the cause of indicators and behaviors that concern you.
- If you’re not sure, check details.
- If you’re still not sure, get help! Refer suspicions to others for resolution.

ACTION 5

Fraud Response in Place

- Be ready to respond to fraud incidents before they surface.
- Identify the skills and relationships that might be needed, and assemble them in advance.
- Think through what message to deliver to employees, customers, the press and others. Craft the basics of that message now.
- Know who will be authorized to investigate, handle requests for information, and interface with any outside authorities.
Level 2: Early Detection

How Fraud is Detected
1. Managers and staff
2. Internal auditors
3. External auditors
4. Other third parties
5. The fraudster
6. Luck or accident

The Three C’s
Commission
Conversion
Concealment
Fraud Detection Steps

1. Think like a thief
   a) Individual and group brainstorming

2. Use discovery techniques aggressively
   a) Discovery-based tests
   b) Targeted interviews
   c) Continuous monitoring

3. Determine the cause of all fraud symptoms, indicators and red flags surfaced
   a) Root Cause Analysis

Issue

Brainstorming
Fraud Risks:
Thinking Like A Thief

Fraud Risks

Cash Disbursements
“Fake Vendor Scheme”
Detection

- Independent verification of all first-time payments
- Periodic verification of "little known" suppliers
- Focus on service providers
- Verify receipt of goods or services prior to payment
- Use purchase orders
- Segregate duties
- Build in duplication
- Limit access

Reconcile all bank accounts immediately upon receipt of the bank statement

Examine all cancelled checks

Periodically review all vendors and contractors for existence and legitimacy

Use Computer Data Mining Techniques to Surface Fraud Indicators

Cash Disbursements – Fake Vendor:

- Fake documents are introduced into the payments system,
- The invoice is from a "consultant" for "services rendered"
- Approval signatures are forged
- Funds are disbursed
- The transaction is charged to Consulting Expenses in the accounting system

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Fraud Risk

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Audit Program Steps

- Look for indicators
- Test prevention control
- Test detection control

NATURE, TIMING and EXTENT of AUDIT PROCEDURES

Fraud

Control

Audit Program Steps

- Look for indicators
- Test prevention control
- Test detection control

HARD CONTROLS

Soft Controls
Monitoring

Root Cause Analysis

If a condition exists is interesting

Why it exists is important
SAS 99: Consideration of Fraud

Required audit team brainstorming session

SAS 99: Consideration of Fraud

Introduces “Human Psychology” into the audit process

Lessons from Psychology

- We self-correct for information that does not fit our assumptions
- Our perceptions about those we audit probably are incomplete
- “Categories” allow us to quickly analyze data – sometimes incorrectly
  - Past history
  - Personal experience
  - Training and culture

Lessons from a Famous Case
Professional Doubter

Create ‘Valid’ Audit Tests

1. There are only two types of samples:
   - Valid
   - Invalid
2. Constant focus on the ‘purpose’ of the test
3. Should answer “Do we have this issue?”
4. Make sure every sample chosen has a ‘valid’ chance of success

100% testing produces reliable results.
Plan Effectively

Data analysis with sufficient lead time to react

Plan Effectively

Valid samples

Level 3: Effective Handling
SPECIAL CHALLENGES

Third Party Relationships
Override / Collusion
Shadow Deals
Time

Risk of Management Override

Fraud Risk Management

1. Deterrence and Prevention
2. Early Detection
3. Effective Handling

ORGANIZATIONS MUST BE PREPARED AT ALL THREE LEVELS
The Destination Must Be Clear

Some is not a number; soon is not a time.

"Switch: Leading Change When Change is Hard"
Chip Heath & Dan Heath

Major Fraud Initiative

LOOK
ASK
DOUBT
RESOLVE
Three Things

1. There is a Need
2. You are the Expert Solution
3. You Must Act

6 Simple Steps
to

“P”

of

Extraordinary
Results

STEP 5
Consistent Daily Action

Bring the HEAT
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