


**Fraud DetectiOn & Incident Response**

**Association of Inspector Generals**  
August 10 & 11, 2020

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www.JohnHallSpeaker.com




H. R. 3763

**One Hundred Seventh Congress  
of the  
United States of America**


**AT THE SECOND SESSION**  
*Began and held at the City of Washington on Wednesday,  
the twenty-third day of January, two thousand and two.*

**An Act**

*To protect investors by improving the accuracy and reliability of corporate disclosure  
made pursuant to the securities laws, and for other purposes.*

*Be it enacted by the Senate and House of Representatives  
of the United States of America in Congress assembled,*

**SECTION 1. SHORT TITLE; TABLE OF CONTENTS.**  
(a) **SHORT TITLE.**—This Act may be cited as the “Sarbanes-  
Oxley Act of 2002.”





**\$2B Medicare fraud scheme gets busted by Feds**

Federal agents cracked an alleged scheme that exploited seniors' curiosity about genetic medicine by enticing them to get their cheeks swabbed. Fraudsters preyed on people's fears.

3/81 < >

**\$461,646 in Pay for One Worker: M.T.A. Overtime Scrutinized by Prosecutors**

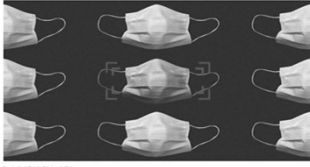
Handwritten bookkeeping is still in use at the Long Island Rail Road. Now the practice is the subject of a federal inquiry.



**The New York Times**  
Saturday, May 18, 2019

**AXIOS**  
June 15

Coronavirus fraud is everywhere



Criminals are getting busy — and creative — with an onslaught of new frauds preying on people's fears and anxieties about the coronavirus pandemic.

**The big picture:** Desperate people are finding their unemployment checks and stimulus payments are being used for personal financial information.

**The New York Times**

**\$10,000 in a Coffee Cup: 8 Swept Up in N.J. Political Corruption Cases**

The separate accusations, taken together, offered a striking picture of entrenched small-time corruption.



Clockwise from top left: Earl Washington Jr., James O'Donnell, John Conner, John Venezia, Andrew Tomasi, Kenneth Robinson, Peter Longpré and James Galante, New Jersey Office of the Attorney General

By Michael Gault  
Oct. 24, 2019

**Cyber Attacks**



THE PRESIDENCY,  
Federal Republic of Nigeria, Aso, Rock Villa Abuja.

Attention Beneficiary,

(PAYMENT NOTIFICATION BY ATM MASTER CARD (\$6.5 M))

This is to inform you that your fund Worth of ( \$6.5 Million have been credited into ATM MASTER\_CARD which will enable you to make a withdrawal of your fund at any ATM PAYING MACHINE CENTER around you.

Note that your maximum withdrawal is valued at \$10,000 per day until you finish your total Remittance. Here is your 05050 ATM SECRET PIN CODE which will enable you to withdraw your fund at any ATM machine around you.

Now you are advised to contact Rev James Olorah, now who is in charge of Delivering your ATM MASTER\_CARD to you. Contact him with your personal information as follows, your full name, your Delivering Home Address and your Direct Telephone Number. Once you contact him with the above information your ATM MASTER\_CARD will be delivered to you without any delay.

Contact Rev James Olorah, with this information Below:  
Name Rev James Olorah,  
EMAIL: [100banksnoncontact@gmail.com](mailto:100banksnoncontact@gmail.com)  
Tel Phone+2348165810775.

Regards,  
Dr Mrs Stella Charles  
New Director Of Foreign  
Remittance

**Received July 2020**

**What do we mean by fraud?**

- Wrongdoing
- Misconduct
- Theft
- Cheating
- Lying

**FACT**  
**For Fraud to Occur,  
Lying Is Required**



**Fraud: A Working Definition**

An intentional act or omission designed to deceive others, resulting in the victim suffering a loss and/or the perpetrator achieving a gain.

- Clandestine
- Violates the perpetrator's fiduciary duties
- Committed for the purpose of financial benefit
- Costs the organization assets, revenue or reserves

**THE BIG QUESTION**

**What is  
our role?**

***"Be aware of fraud risks"***  
**is imprecise and  
leads to  
confusion and  
uncertainty**



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

Believers & Doubters

***We are  
Professional  
Doubters***

Believers & Doubters

***Doubters  
Check Facts***

**Precision & Clarity**

- Thinking
- Planning
- Actions
- Solutions

***4 Units***

***Unit 1:  
Our Role in  
Deterrence & Prevention***

***Unit 2:  
Three-Step  
Fraud Detection***

**Unit 3:**  
**Deep Dive into**  
**Recurring Business**  
**Fraud Risks**

**Unit 4:**  
**Our Role in**  
**Fraud Incident Response**



**But First:**  
**Foundation for Discussion**

Foundation  
**Focus on**  
**Solutions**

Foundation  
**List Actions**

Build Your "I Must..." List



How can  
I use this?  
HCIUT?

TRY B4 TOSS

Foundation

**One question  
I have about  
fraud is:**

Foundation

**From this  
fraud seminar  
I want to be  
*Better!* able to:**

Foundation

**Avoid Mistakes**

**FOUR AREAS**



- a) **Misappropriation**
- b) **Manipulated  
Results**
- c) **Corruption**

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- d) **Technology**

**Theft Examples**





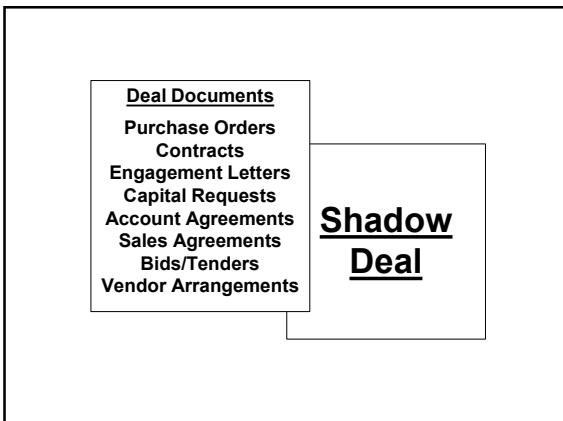
**Cooking Results**

- ❖ Financial Results
- ❖ Operating Results

- Financial Results**
1. Overstatement of earnings
  2. Fictitious earnings
  3. Understatement of expenses
  4. Overstatement of assets
    - a) Understatement of allowances
    - b) Overstatement of inventory
    - c) Overstatement of real estate values
    - d) Creation of fictitious assets
  5. Any transaction improperly moving costs between financial statements

- Non-Financial Results**
1. Legal and regulatory compliance
  2. Market conduct
  3. Product safety
  4. Environmental compliance
  5. "Fitness for Use"
  6. Customer satisfaction
  7. Volume activity stats
  8. KRI achievement





- Corruption & Shadow Deals**
1. Kickbacks
  2. Excessive Gifts / Entertainment
  3. Bribery
  4. Extortion
  5. Collusion
  6. Tailoring specifications or timing
  7. Throw out qualified bids
  8. Inappropriate sole source



**POP QUIZ**

**What types of fraud account for most of the losses you see in your work?**

**Fraud Loss Scorecard**

1		
2		
3		
4		
5		
6		
7		
8		

**Fraud Loss Scorecard**

1	Disbursements	
2	Inventory	
3	Construction/Facilities	
4	Health Care Costs	
5	Payroll	
6	T&M contracts	
7	T&E reimbursement	
8	Other – Unique to You	
	<b>TOTAL</b>	



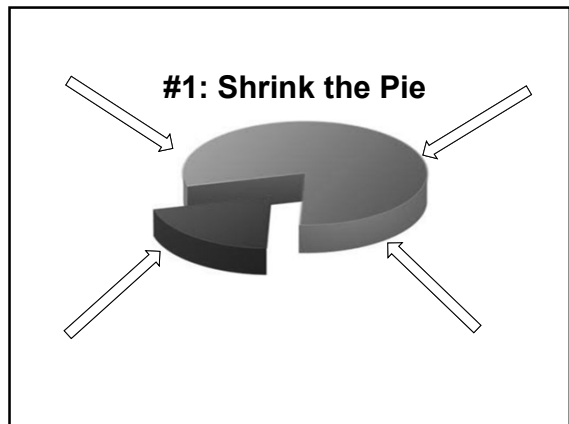
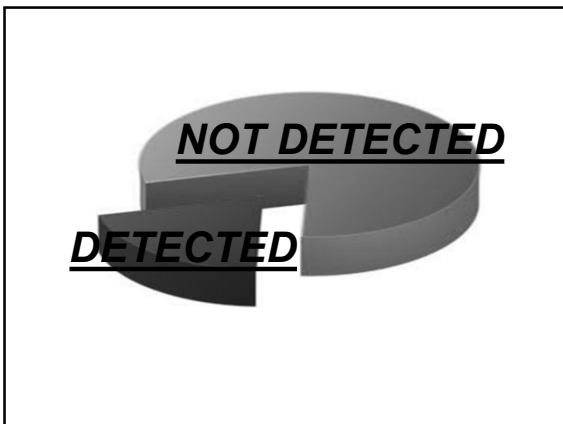
### Fraud Loss Scorecard

		HIGH	LOW
1	Disbursements	\$ XXX	\$ XXX
2	Inventory		
3	Construction/Facilities		
4	Health Care Costs		
5	Payroll		
6	T&M contracts		
7	T&E reimbursement		
8	Other - Unique to You		
	<b>TOTAL</b>	<b>\$ XXX</b>	<b>\$ XXX</b>



### Fraud Loss Scorecard

		HIGH	LOW
1	Disbursements	\$ XXX	\$ XXX
2	Inventory		
3	Construction/Facilities		
4	Health Care Costs	2%	1%
5	Payroll		
6	T&M contracts		
7	T&E reimbursement		
8	Other - Unique to You		
	<b>TOTAL</b>	<b>\$ XXX</b>	<b>\$ XXX</b>



#2: Find More of What's Left  
FASTER



**PURPOSE: Precision and Clarity**  
**EVERY ORGANIZATION**  
**CAN IMPROVE THE**  
**PROBABILITY**

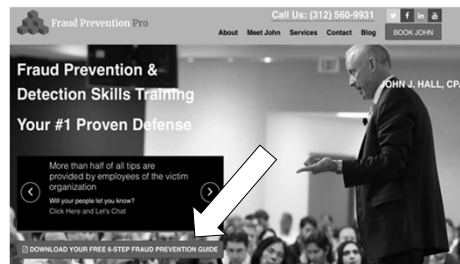
*Deterrence, Prevention,  
Prompt Detection, and  
Efficient Handling*

**Fraud Risk Management  
Campaign**

**Program Purpose**

**Structure**  
**Blueprint**  
**Road Map**  
**Framework**

**www.FraudPreventionPro.com**



**Answer**  
**THE BIG QUESTION**  
**What is**  
**our role?**

***Unit 1:***  
***Our Role in***  
***Deterrence & Prevention***

**Fraud Risk Management Framework**


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

**ORGANIZATIONS MUST BE PREPARED AT ALL THREE LEVELS**

**6 Critical Actions**

1. Visible & Vocal Leadership – At Every Level
2. Policies on Fraud Responsibilities
3. Active Ongoing Fraud Risk Brainstorming
4. Anti-Fraud Controls
5. Anti-Fraud Daily Behaviors
6. Anti-Fraud How-To Employee Skills Training

**Visible & Vocal Leadership**




It's not their job to know what's expected of them.

Tell them how to think about fraud and the impact on their work.

Tell them how this work will benefit them.

**Every employee must be recruited into anti-fraud efforts**

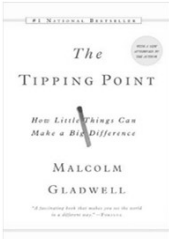
**Guardians at the Gate**



**HANDOUT**

**Discussion of Anti-Fraud Expectations**

**Handout Page 1**



**Never underestimate the pull of Context**  
**What are others in my peer group doing?**

- ### 6 Critical Actions
1. Visible & Vocal Leadership – At Every Level
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- ### Fraud Policies
1. Positive message
  2. Manager and staff responsibilities
  3. Exposure awareness
  4. Procedures and behaviors to prevent
  5. Procedures and behaviors to detect
  6. What to do / what not to do
  7. Emphasis on *SUSPECTED* acts
  8. Periodic certification (?)

- ### Fraud Policies
1. Positive message
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  4. Procedures and behaviors to prevent
  5. Procedures and behaviors to detect
  6. What to do / what not to do
  7. Emphasis on *SUSPECTED* acts
  8. Periodic certification (?)
  9. Balance is critical

Essential Policy Content

**Every manager is responsible for:**

**Knowing the exposures to wrongdoing and fraud in their areas**

Essential Policy Content

**Every manager is responsible for:**

**Doing their best to prevent or deter incidents**

Essential Policy Content

**Every manager is responsible for:**

**Promptly detecting suspicious transactions and events**

Essential Policy Content

**Every manager is responsible for:**

**Immediately referring suspicions to those responsible for follow-up**

Essential Policy Content

**Clear Instructions**

**Do Not Ensure**

**Clear Actions**

***But it's a good start***

### **New Client Assessment Question**

Has the organization established a way to report suspected ethical violations or wrongdoing without fear of retribution?

*(Do employees trust it?)*

### **BUSINESS FRAUD LESSONS**

**In virtually every business ethics case, someone knew or strongly suspected BUT STAYED SILENT**

### **Make it Easy to Report**

1. Make it as positive as possible
2. Fraud 'Hotline' in place and trusted
3. Consider retaining a third-party service to administer your hotline
4. Tell everyone exactly how the hotline works

### Why People Don't Speak Up

1. They have never been told to do so
2. They have never been asked to do so
3. It's none of my business
4. It's not my job!
5. There's no upside for me – only problems
6. I won't fit in anymore
7. Schoolyard mindset
8. Fear – real or imagined



1. Prevent what you can
2. Catch what slips through
3. Speak up about the SOC!

### 6 Critical Actions

1. Visible & Vocal Leadership – At Every Level
2. Policies on Fraud Responsibilities
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### THE CHALLENGE

## Fraud Risk Brainstorming Think Like A Thief

*(when we don't know how)*

Three Question Script

1. How could someone exploit weaknesses in our controls and daily behaviors?
2. How could someone override or circumvent our controls?
3. How could someone conceal their wrongful actions?

Ask and Answer

**W.C.G.W.**

*What Could Go Wrong*

**W.W.I.L.L.**

*What Would It Look Like*

Precision & Clarity  
from asking three  
*“Hey Boss!”*  
Questions

THE SECRET SAUCE

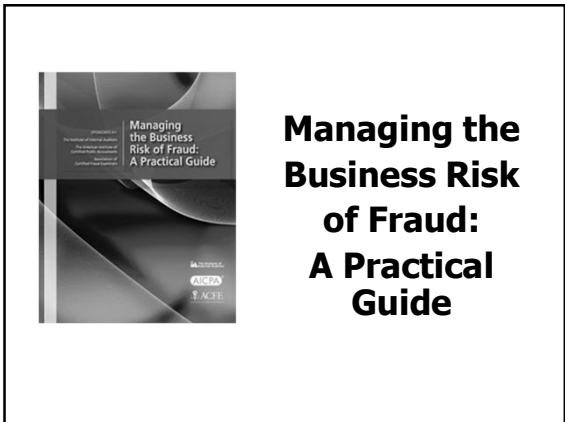
...begin (plan)  
with the  
**PRESUMPTION**  
that a fraud event  
has already occurred

THE SECRET SECRET SAUCE

Assume you  
are committing  
the fraud

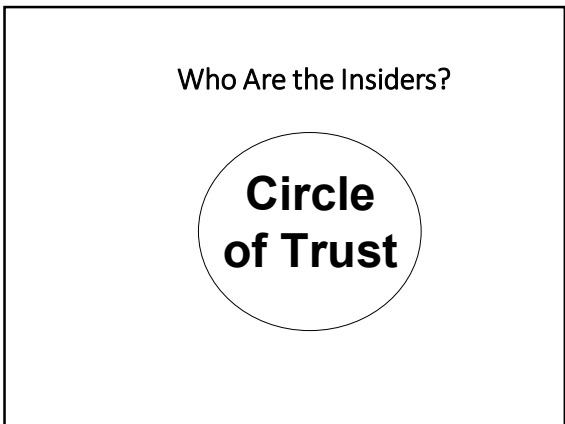
THE THREE C's

**Commit**  
**Convert**  
**Conceal**



**Managing the Business Risk of Fraud: A Practical Guide**

**LESSON #1**  
**Greatest threat is inside the "Circle of Trust"**



**Be Sure to Address**  
**Third-Party Risk**

**Be Sure to Address**  
**Black Swan Risk**

***'Black Swan Events'***  
Events that could cause disaster

- High Significance / Impact
- Low Probability / Likelihood

Covid-19 Disruption

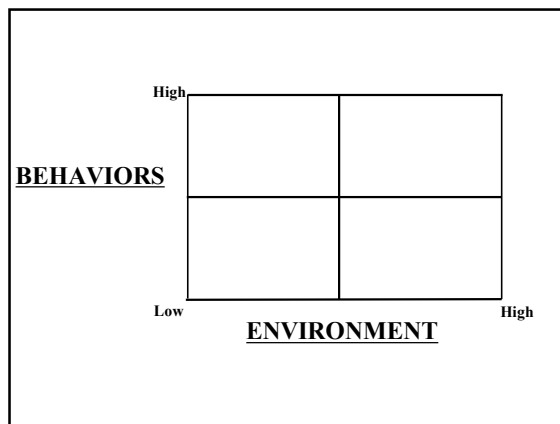
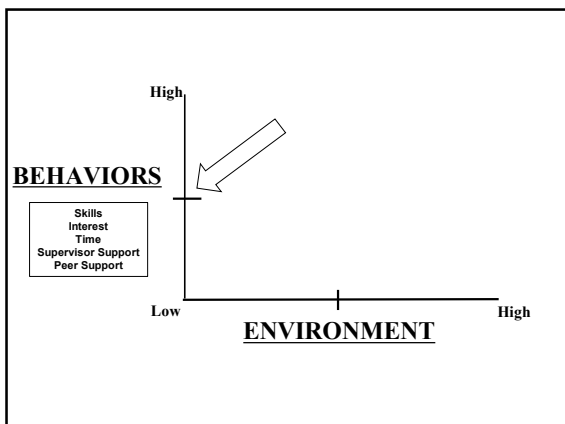
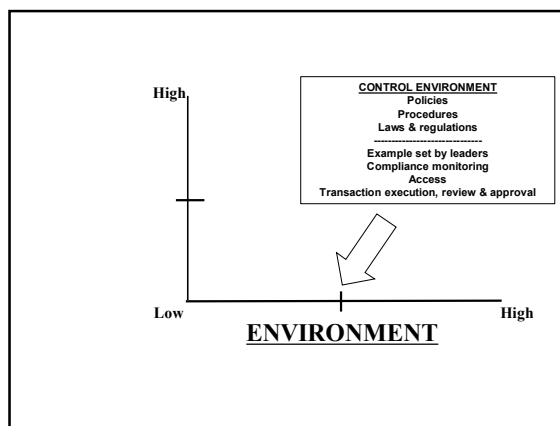
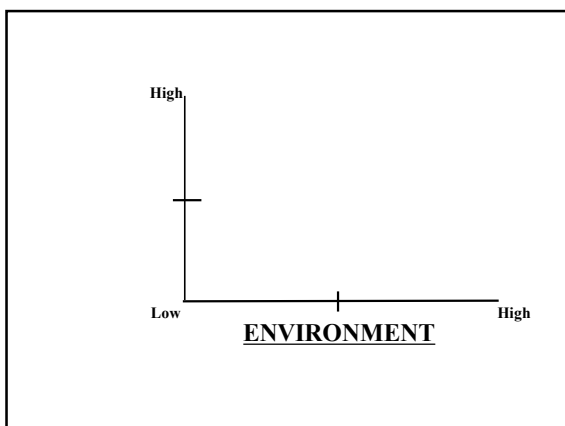


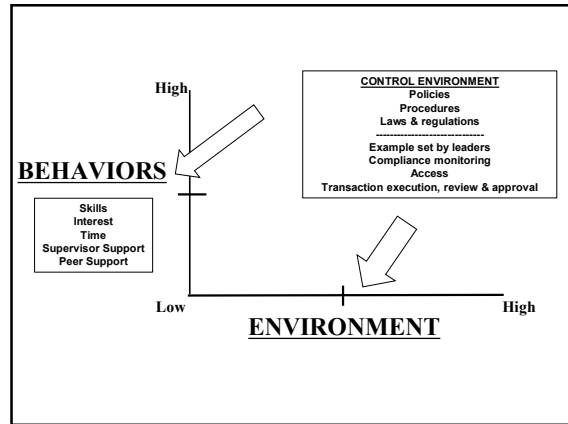
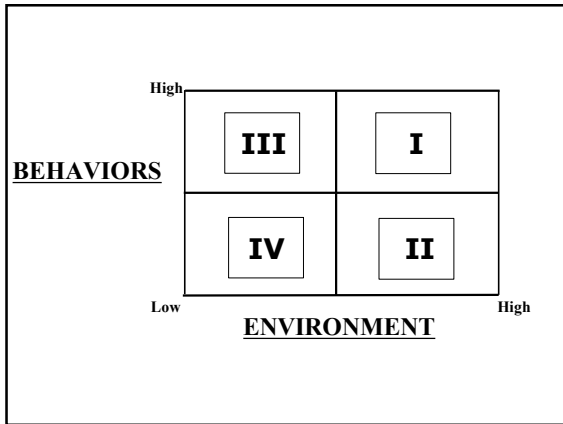
### 6 Critical Actions

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## Effective Internal Controls

- ✓ Procedures
- ✓ Behaviors






**NEVER FORGET**  
**Procedures  
 alone are not  
 ‘internal controls’**

**NEVER FORGET**  
**Effective daily  
 execution of  
 procedures is  
 essential**

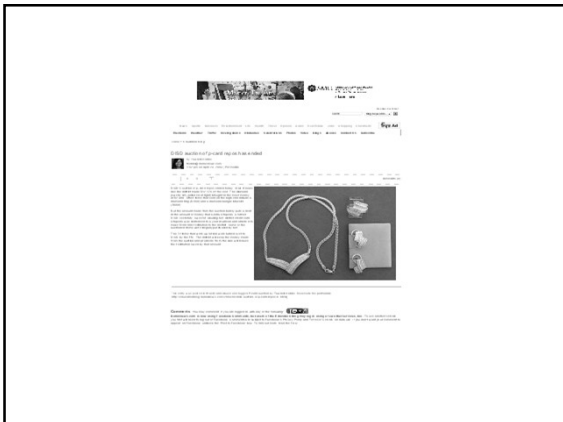
**10 Reasons Controls Break Down**  
 1. Blind trust

**Dallas ISD Purchasing Cards**



**“Secretary  
 charges  
 \$383,788,  
 has no receipts”**

Dallas Morning  
 News  
 July 2, 2006



### 10 Reasons Controls Break Down

1. **Blind trust**
2. **Willful blindness**



### 10 Reasons Controls Break Down

1. **Blind trust**
2. **Willful blindness**
3. **Not having the information needed to assure transactions are proper**
  - ✓ Physical distance
  - ✓ Time difference
  - ✓ Third-party has the key records
  - ✓ Simply not supplied
  - ✓ Don't understand available information

### 10 Reasons Controls Break Down

1. **Blind trust**
2. **Willful blindness**
3. **Not having the information needed to assure transactions are proper**
4. **Culture of not questioning the strange, odd and curious**

### The Fruit Tree Caper

VENDOR #616458

QUANTITY	DESCRIPTION	UNIT PRICE	AMOUNT
1 LOT	FRUIT TREES		19,990.00

- ✓ Valid business license and TIN
- ✓ Sent one low value item →
- ✓ UPS receipt – False security

### 10 Reasons Controls Break Down

1. **Blind trust**
2. **Willful blindness**
3. **Not having the information needed to assure transactions are proper**
4. **Culture of not questioning the strange, odd and curious**
5. **Situational incompetence**

### A QUESTION to PONDER

Call to mind a situation  
Where a failure occurred  
due to 'lack of skill' or  
'incompetence'  
by the approving manager.

- ✓ What happened?
- ✓ Be specific.

### 10 Reasons Controls Break Down

6. **The process mentality**



bosh (noted transit enthusiast) @boshj · 21h  
someone just put down a fresh coat of yellow paint on the subway platform edge..... at 9:30 on a wednesday morning. this platform is going to be a mess of yellow footprints by the end of the day. what is going on



bosh (noted transit enthusiast) @boshj · 21h  
update: the results have been as expected

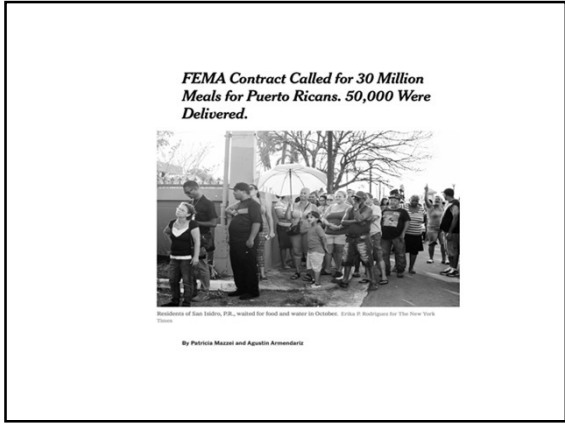
### 10 Reasons Controls Break Down

6. **The process mentality**
7. **Not enough time to do the control procedures**

**NOT ENOUGH TIME**  
**Contract Billing**  
**Review**  
**Example**  
*300 pages of support*

**AIA G702**

**AIA G703**



- 10 Reasons Controls Break Down**
6. The process mentality
  7. Not enough time to do the control procedures
  8. Not enforcing documentation requirements

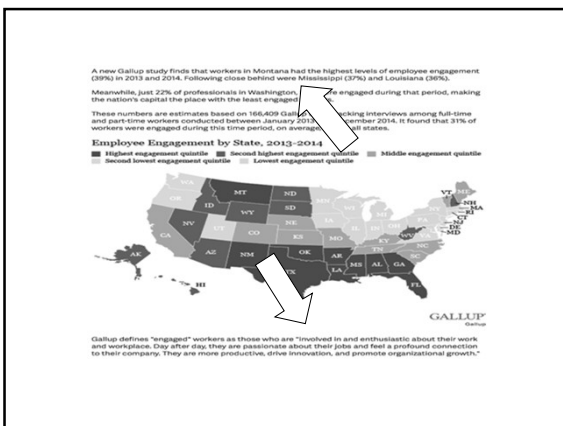


### 10 Reasons Controls Break Down

- 6. The process mentality
- 7. Not enough time to do the control procedures
- 8. Not enforcing documentation requirements
- 9. Intentional override

### 10 Reasons Controls Break Down

- 6. The process mentality
- 7. Not enough time to do the control procedures
- 8. Not enforcing documentation requirements
- 9. Intentional override
- 10. Acceptance of the situation



### 1 More Reason

- 6. The process mentality
- 7. Not enough time to do the control procedures
- 8. Not enforcing documentation requirements
- 9. Intentional override
- 10. Acceptance of the situation
- 11. Dumb things we all do




### Potentially Dumb Things

- 1. Signing without knowing
- 2. Trusting without verifying
- 3. Not reviewing control reports
- 4. Expectations without skills

**Controls do not prevent fraud.**  
**Controls make a fraudster change their method.**

- 6 Critical Actions**
1. Visible & Vocal Leadership – At Every Level
  2. Policies on Fraud Responsibilities
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  4. Anti-Fraud Controls
  5. Anti-Fraud Daily Behaviors
  6. Anti-Fraud How-To Employee Skills Training



**High-Leverage Behaviors**  
*A few simple but critical behaviors*

“Quiet Leadership”  
David Rock

- Four Daily Behaviors**
1. Look for fraud indicators
  2. Ask “How do I know?”
  3. When in doubt, doubt
  4. Resolve or refer suspicions

- Look for the SOC**
1. Most fraud leaves clues in the records or behavior. Know and look for these clues.
  2. Look in management reports, complaints, shortages, variances, month end cost center reports.
  3. If it looks odd to you, it probably is... you are in the best position to know.



**When in Doubt, Doubt**

1. Again, if something looks or feels wrong to you in your area, it probably is. You're in the best position to know.
2. Choose to follow up to determine the cause of indicators and behaviors.
3. If you're not sure, check details.
4. If you're still not sure, get help!  
Refer suspicions for resolution.



**LOOK  
ASK  
DOUBT  
RESOLVE**

**Quality = Right the First Time**

**It's Not  
Extra Work.  
It's Core Work.**

The Core Issue

**Managers, supervisors and  
key control employees  
want to be part of the solution –  
*but often don't know how***

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 <u>Fraud Policy</u>	<b>A</b>
Conducting an organization-wide <u>Comprehensive Fraud Exposure Analysis</u> , including the creation of a Fraud Risk Inventory	<b>B</b>
Providing awareness, prevention and early <u>Detection Skills Training</u> for managers and staff	<b>C</b>
Catching and <u>Prosecuting Wrongdoers</u>	<b>D</b>

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 <u>Fraud Policy</u>	<b>10%</b>
Conducting an organization-wide <u>Comprehensive Fraud Exposure Analysis</u> , including the creation of a Fraud Risk Inventory	<b>11%</b>
Providing awareness, prevention and early <u>Detection Skills Training</u> for managers and staff	<b>70%</b>
Catching and <u>Prosecuting Wrongdoers</u>	<b>9%</b>



### 6 Critical Actions

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6. Anti-Fraud How-To Employee Skills Training

### What Skills Are Needed

1. General knowledge of fraud risks
2. What can happen in their areas
3. Suggestions on prevention
4. Suggestions on prompt detection when prevention fails
5. What to do and avoid with suspicions
6. What it looks like in documents, reports and behaviors they see



**FRAUD**

**NOT ON MY WATCH**

**MGM Resorts**

- 6,000 supervisors & managers in Las Vegas
- 60 minute program
- 18 sessions in 5 days
- 3 additional sites – 1 day each

Hotline Result?

### How Do We Deliver Training?

1. Group live
2. Technology-based
  - ✓ Teleseminars
  - ✓ Webinars
  - ✓ Video
3. 1 on 1 coaching by supervisors
4. 1 on 1 coaching by fraud examiners and auditors
5. Written

### Newsletter Article Ideas

- Good Questions Before Approving:
1. Invoices from suppliers
  2. Out of pocket cost reimbursement
  3. Purchasing card transactions
  4. Time sheets
  5. Invoices from contractors
  6. One time wire transfers
  7. Journal entries

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### John’s Five Filters

1. What are the rules?
2. What are my personal beliefs as they relate to those rules?
3. What is my ‘micro context’?
4. Will I get caught?
5. Will I get punished?

### The Sixth Filter

1. What are the rules?
2. What are my personal beliefs as they relate to those rules?
3. What is my ‘micro context’?
4. Will I get caught?
5. Will I get punished?
6. How severe is the punishment?

### Perception Exercise What Role Does Fear of Punishment Play?

	Permitted, But Not Encouraged	Warning	Loss of Job	Report to Authorities	Notes
Item	(1)	(2)	(3)	(4)	
A					
B					
C					
D					
E					
F					
G					
H					

**Handout Page 10**

	Permitted, But Not Encouraged	Warning	Loss of Job	Report to Authorities	Notes
Item	(1)	(2)	(3)	(4)	
A			✓		
B		✓			
C				✓	
D					
E					
F					
G					
H					

**Case Situation A**

An employee commits fraud by overstating out of pocket travel expenses to cover a \$25.00 lost wager with a supplier on a football game.

**Case Situation B**

An employee commits fraud by overstating out of pocket travel expenses by \$100.00 to cover of drinks while on a business trip.

The organization's policy prohibits reimbursement for alcohol.

**Case Situation C**

Setting up and authorizing payments to a fictitious vendor for goods or serviced never received.

**Case Situation D**

Having a vendor divide a \$98,000 equipment purchase into four equal invoices of \$24,500 each, so that each invoice will fall below the requesting manager's approval level of \$25,000.

**Case Situation E**

Ordering maintenance supplies from a specific vendor because that vendor gives gifts and prizes directly to the ordering employee.

The price and quality are comparable to what is available from other vendors.

**Case Situation F**

Ordering maintenance supplies from a specific vendor because that vendor gives gifts and prizes directly to the ordering employee.

The prices are high and quality is poor compared to what is available from other vendors.

**Case Situation G**

Intentionally altering division-level accruals and reserves at the end of an accounting period specifically to 'manage income' to headquarters expectations.

**Case Situation H**

After being hired, it's discovered that our new employee does not have the required education, experience or certified training required for the job.

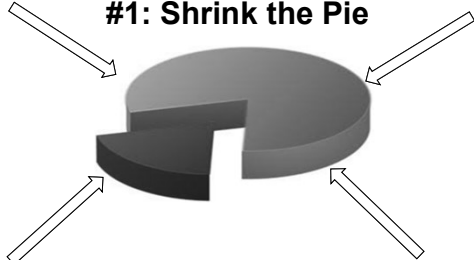
**Case Situation H**

After being hired, it's discovered that our new employee does not have the required education, experience or certified training required for the job.

The employee is an aircraft engine mechanic.

A	B	C	D	E	F
Item	Permitted, But Not Encouraged (1)	Warning (2)	Loss of Job (3)	Report to Authorities (4)	Notes
A					
B					
C					
D					
E					
F					
G					
H					

**#1: Shrink the Pie**




**#2: Find More of What's Left FASTER**



### How Fraud is Found

1. Managers and staff
2. Internal audit, compliance, fraud specialists
3. External auditors
4. Other third parties
5. The thief (fraudster)
6. Luck or accident

### Build Your "I Must..." List



How can I use this?  
**HCIUT?**

**TRY B4 TOSS**

## Unit 2:

### Three-Step Fraud Detection

### Fraud Risk Management Framework

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

**ORGANIZATIONS MUST BE PREPARED AT ALL THREE LEVELS**

### Fraud Risk Management Framework

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

**ORGANIZATIONS MUST BE PREPARED AT ALL THREE LEVELS**

#### Former Cox Communications VP sentenced for embezzlement

May 31, 2018, 5:20am EDT


Janet West, a former vice president at Cox Communications, was sentenced to two years, one month in federal prison for her part in an embezzlement scheme that cost the company millions of dollars.

West, 49, was in charge of a nationwide field marketing plan to bring gigabit speed connections to markets throughout the U.S. Beginning in 2011, West directed her assistant to make payments, on the assistant's corporate credit card, to a third-party company for supposed marketing services. In reality, a significant portion of the marketing services never occurred and the majority of the payments for the services were covertly transferred back to the defendant. The defendant caused Cox Communications to make payments to the third party, totaling \$2.4 million.

"This greedy defendant misused her high-ranking position to deceive and steal millions of dollars from her employer," said U.S. Attorney Brung J. "Stacy" Pak. "She then used the money to fund her own lifestyle, including paying for two houses she owned."

The prison time will be followed by three years of supervised release. West was also ordered to forfeit her interest in the two properties and to pay full restitution to the victim.

Mark Mullins  
Executive Editor  
Atlanta Business Chronicle



**Atlanta Business Chronicle**

THE UNITED STATES ATTORNEY'S OFFICE  
DISTRICT OF NEW HAMPSHIRE

HOME NEWS MEET THE U.S. ATTORNEY DIVISIONS PROGRAMS FAQ

U.S. Attorney's Office - District of New Hampshire » News

Department of Justice  
U.S. Attorney's Office  
District of New Hampshire

MEDIATE RELEASE Friday, December 11, 2019

**Former United Way Vice President Convicted of Participating in Fraud and Money Laundering Scheme**

CONCORD – United States Attorney Scott W. Murray announced that U.S. District Judge Joseph Laplante found Imran Alrai, 45, of Windham, New Hampshire, guilty of wire fraud, money laundering, and transportation of stolen funds after a two-day bench trial.


According to the trial evidence, Alrai was an information technology ("IT") professional at the United Way of Massachusetts Bay and Merrimack Valley in Boston, Massachusetts. Between 2012 and June 2018, Alrai obtained approximately \$6.7 million in payments for IT services supposedly provided to United Way by an independent outside contractor, Digitalnet Technology Solutions, Inc. Evidence at trial shows that Alrai misrepresented material facts about Digitalnet and fraudulently concealed that he owned and controlled Digitalnet. In early 2013, Alrai rigged the bidding process for a major contract to provide managed IT services at the United Way so that Digitalnet was chosen. Alrai then gave fake references and false information about Digitalnet to United Way.

For the next five years, while serving as United Way's Vice President for IT Services, Alrai steered additional IT work to Digitalnet, so that his company soon became UW's second-largest outside vendor, receiving more than \$1 million annually. Alrai concealed from his colleagues that he had anything to do with Digitalnet. He routinely sent emails with attached invoices from a fictitious person to himself at United Way. After the fraud came to light, in June 2018, officials at United Way confronted Alrai and terminated him. Federal agents executed search and seizure warrants and seized incriminating documents and data from Alrai's home office in Windham, as well as approximately \$2.2 million in fraud proceeds in bank and investment accounts. During the scheme, Alrai wired \$1.2 million in fraud proceeds to a Digitalnet bank account in Lahore, Pakistan.

According to expert testimony at the trial, United Way lost at least \$3.1 million as a result of Alrai's crimes due to Digitalnet's excessive billing, duplicate billing, and billing for services not delivered. The same expert calculated that Alrai personally enriched himself in the amount of \$3.7 million. The evidence further showed that in 2013-14 Alrai perpetrated a similar scheme at the Robert Allen Group in Foboro, Massachusetts, where Alrai was CIO, and induced that company to pay Digitalnet more than \$400,000. The total amount involved in the scheme was approximately \$7 million.

**\$461,646 in Pay for One Worker: M.T.A. Overtime Scrutinized by Prosecutors**

Handwritten bookkeeping is still in use at the Long Island Rail Road. Now the practice is the subject of a federal inquiry.



The New York Times  
Saturday, May 18, 2019

One worker at the Long Island Rail Road, asserting that he logged about 74 hours of overtime every week atop his regular duty, was paid \$461,646 last year — more than the combined salaries of Gov. Andrew M. Cuomo and Mayor Bill de Blasio.

Officials at the authority say many Long Island Rail Road workers are paid based on handwritten documents they submit listing the number of hours claimed, with little to no review before payment.

The New York Times  
Saturday, May 18, 2019

Modern machines, better able to detect fraud, were installed but not used because, managers said, they feared pushback by employees. Some areas of New York City Transit, which oversees subways and buses, use timecards with mechanical punch-clocks, technology that dates to the early 20th century.

Five years ago, the Long Island Rail Road installed about 120 biometric clocks, which would require employees to sign in with their thumbprints at the start and end of shifts. Despite this, the paper time keeping system remains in use for union workers in the department that maintains tracks, signals, buildings and bridges.

The New York Times  
Saturday, May 18, 2019

Management feared that insisting on the use of the automated clocks would have "an adverse impact on employee productivity," according to an internal memo by the transit agency's inspector general, which was described to The Times.

Maintainers at the railroad have the lowest productivity among maintainers at the five biggest commuter rail lines in the country, according to a report published in April by the Citizens Budget Commission.

The New York Times  
Saturday, May 18, 2019

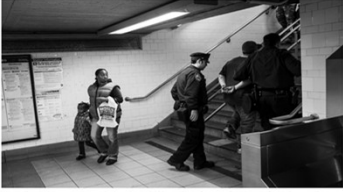
Employees of the railroad are, by far, the highest paid of any workers at the region's transit agencies; 19 people whose pay rate was around \$50 an hour or less made \$300,000 or more with overtime in 2018.

John Samuelsen, the international president of the Transport Workers Union, which represents city subway and bus workers, said he was unaware of a criminal investigation.

"There is no evidence of systematic abuse or criminality or fraud at New York City Transit," Mr. Samuelsen said in an interview. "This is putting the cart before the horse."

**The New York Times**  
Saturday, May 18, 2019

## \$2.75 FARE EVASION



The Police Department arrested more than 55,000 people on fare evasion charges in 2016, according to MTA data. *Kristen Lee for The New York Times*

**55,000 / 365 days = 151 / day = 6 / hour = 1 every 10 minutes**  
**Total Fare Revenue Loss = \$151,250**

K120084      Cafeteria Workers Stole Nearly \$500,000 in Lunch Money From Schools, Police Say - The New York Times

**The New York Times**

### *Cafeteria Workers Stole Nearly \$500,000 in Lunch Money From Schools, Police Say*

By Sarah Marzoni  
Aug. 14, 2018

In the well-to-do town of New Canaan, Conn., families pay top dollar to live on picturesque New England streets, frequent the area's upscale boutiques and send their children to some of the best schools in the state.

But in recent years, a scandal had quietly been brewing at a couple of those schools: Someone had been taking the children's lunch money — after it had been paid.

For years, cash was disappearing from cafeteria registers at the high school and middle school, apparently unbeknownst to school officials. Nearly \$500,000 was pilfered from 2012 through 2017, the authorities said.

On Monday, the New Canaan Police Department announced that it had arrested two women: sisters who worked in the cafeteria system.

Joanne Pasquarelli, 61, and Marie Wilson, 67, turned themselves in over the weekend and were released on \$50,000 bond. They are accused of underreporting how much cash had been collected and taking the remainder. Each was charged with larceny.

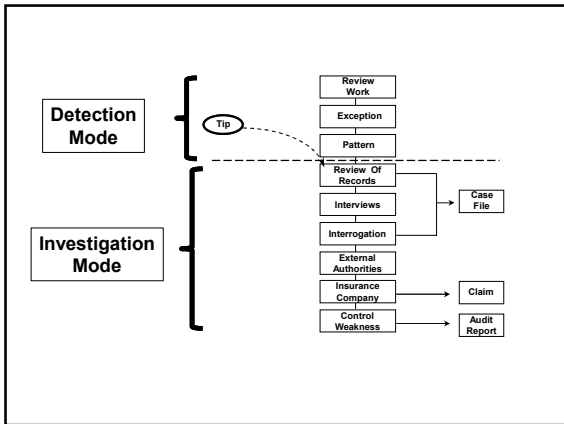
## QUESTION

# Who should have caught these frauds?

# HANDOUT

## Audit / Investigation Flow Diagram


Handout Page 2



**HANDOUT**  
**Three-Step  
Fraud Detection**

**Handout Page 3**

**Three-Step Fraud Detection**

- 
1. **Think like a thief**
    - a) Individual and group brainstorming
  2. **Use discovery techniques aggressively**
    - a) Discovery or attribute testing
    - b) Detection-Focused interviews
    - c) Data Analysis and Monitoring
  3. **Determine the cause of all indicators**
    - a) Root Cause Analysis

**Ask and Answer**

**W.C.G.W.**

*What Could Go Wrong?*

**W.W.I.L.L.**

*What Would It Look Like?*

**THE SECRET SAUCE**

**...begin (plan)**

**with the**

**PRESUMPTION**

**that a fraud event  
has already occurred**

**THE SECRET SECRET SAUCE**

**Assume you  
are committing  
the fraud**

**EXERCISE**

**Brainstorming  
Risks and Exposures**

**Handout Page 4**

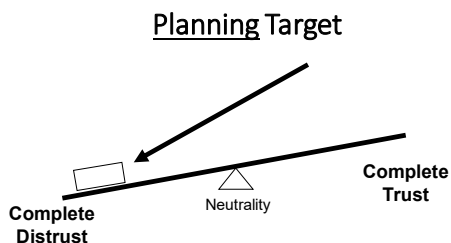
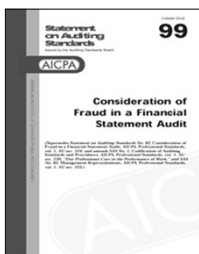


**THE THREE C's**

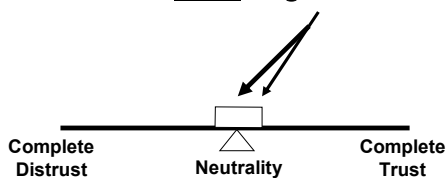
**Commit  
Convert  
Conceal**



**Sometimes the Original is Best**



Work Target



**Back End of Brainstorming**

- **Nature**
- **Extent**
- **Timing**

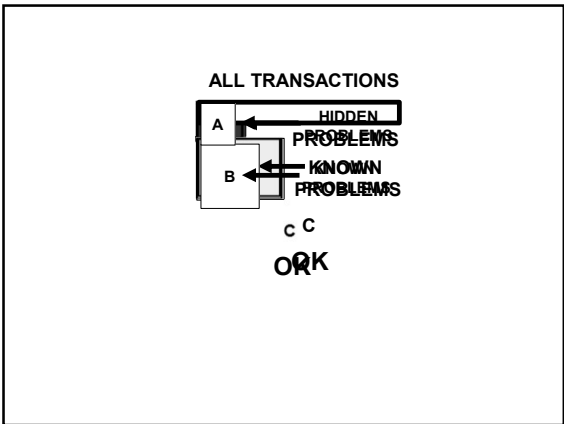
**Increasing Detection  
Probability**  
  
**2 x Sauce**  
**+ 3C + N.E.T.**

- ### Three-Step Fraud Detection
1. **Think like a thief**
    - a) Individual and group brainstorming
  2. **Use discovery techniques aggressively**

- a) Discovery or attribute testing
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    - a) Root Cause Analysis

## Discovery- Based Tests

- ### Choose 'Valid' Samples
1. There are only two types of samples:
    - ✓ Valid
    - ✓ Invalid
  2. Should support test 'purpose'
  3. Should answer "Do we have this issue?"
  4. Every sample item chosen should have a 'valid' chance of success



Probability of 1 in Sample, if population = 100,000

Sample Size	Number of Problem Transactions				
	10	15	25	<b>50</b>	100
25	0.002	0.004	0.006	0.012	0.025
50	0.005	0.007	0.012	0.025	0.049
100	0.010	0.015	0.025	0.049	0.095
250	0.0250	0.037	0.061	0.118	0.221
500	0.049	0.072	0.118	0.222	0.394
1000	0.096	0.140	0.222	0.395	0.634

**100% testing  
produces  
reliable results**

**Fraud Risk**

**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 by check,
- The check is deposited into the personal checking account of a volunteer
- The transaction is charged to Consulting Expenses in the accounting system

<p style="text-align: center;"><b>Fraud Risk</b></p> <p><b>Cash Disbursements – Fake Vendor:</b></p> <ul style="list-style-type: none"> <li>• Fake documents are introduced into the payments system,</li> <li>• The invoice is from a "consultant" for "services rendered"</li> <li>• Approval signatures are forged</li> <li>• Funds are disbursed by check,</li> <li>• The check is deposited into the personal checking account of a volunteer</li> <li>• The transaction is charged to Consulting Expenses in the accounting system</li> </ul>	<p><b>Indicators</b></p> <div style="border: 1px solid black; padding: 10px; width: 80px; margin: 20px auto;"> <p><b>What would it LOOK like?</b></p> </div>
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<p style="text-align: center;"><b>Fraud Risk</b></p> <p><b>Cash Disbursements – Fake Vendor:</b></p> <ul style="list-style-type: none"> <li>• Fake documents are introduced into the payments system,</li> <li>• The invoice is from a "consultant" for "services rendered"</li> <li>• Approval signatures are forged</li> <li>• Funds are disbursed by check,</li> <li>• The check is deposited into the personal checking account of a volunteer</li> <li>• The transaction is charged to Consulting Expenses in the accounting system</li> </ul>	<p style="text-align: center;"><b>Indicators</b></p> <ul style="list-style-type: none"> <li>• Generic invoice</li> <li>• Unknown vendor or contractor</li> <li>• Address:             <ul style="list-style-type: none"> <li>✓ Same as employee</li> <li>✓ PO Box</li> <li>✓ "UPS Store" or mail drop service</li> <li>✓ Prison</li> <li>✓ Hold check for pickup</li> </ul> </li> <li>• No phone number on invoice</li> <li>• Unknown charges on reports</li> <li>• Check:             <ul style="list-style-type: none"> <li>✓ Clears too fast</li> <li>✓ Unusual endorsements</li> <li>✓ Geography (AICPA, ACFE, IIA, others)</li> </ul> </li> </ul>
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<p style="text-align: center;"><b>Fraud Risk</b></p> <p><b>Cash Disbursements – Fake Vendor:</b></p> <ul style="list-style-type: none"> <li>• Fake documents introduced into the payments system,</li> <li>• Invoice is from a "consultant" for "services rendered"</li> <li>• Approval signatures are forged</li> </ul>	<p style="text-align: center;"><b>Indicators</b></p> <ul style="list-style-type: none"> <li>• Generic invoice</li> <li>• Unknown vendor or contractor</li> <li>• Address:             <ul style="list-style-type: none"> <li>✓ Same as employee</li> <li>✓ Mail drop service</li> <li>✓ Prison...</li> <li>✓ Hold for pickup</li> </ul> </li> <li>• No phone number on invoice</li> <li>• Unknown charges on reports</li> <li>• Other</li> </ul>	<p style="text-align: center;"><b>Detection Steps</b></p> <div style="border: 1px solid black; padding: 5px; width: 30px; margin: 20px auto; text-align: center;">A</div> <p style="font-size: 24px; font-weight: bold; transform: rotate(-15deg); text-align: center;"><i>Look For The Indicators</i></p>
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<p style="text-align: center;"><b>Fraud Risk</b></p> <p><b>Cash Disbursements – Fake Vendor:</b></p> <ul style="list-style-type: none"> <li>• Fake documents introduced into the payments system,</li> <li>• Invoice is from a "consultant" for "services rendered"</li> <li>• Approval signatures are forged</li> </ul>	<p style="text-align: center;"><b>Indicators</b></p> <ul style="list-style-type: none"> <li>• Generic invoice</li> <li>• Unknown vendor or contractor</li> <li>• Address:             <ul style="list-style-type: none"> <li>✓ Same as employee</li> <li>✓ Mail drop service</li> <li>✓ Prison...</li> <li>✓ Hold for pickup</li> </ul> </li> <li>• No phone number on invoice</li> <li>• Unknown charges on reports</li> <li>• Other</li> </ul>	<p style="text-align: center;"><b>Detection Steps</b></p> <ul style="list-style-type: none"> <li>• Reconcile bank accounts immediately upon receipt of the bank statement</li> <li>• Examine cancelled checks</li> <li>• Periodically review all vendors &amp; contractors for existence and legitimacy</li> <li>• REVIEW MONTH END TRANSACTION REPORTS "Positive Pay"</li> <li>• Use Computer Data Mining Techniques to Surface Fraud Indicators</li> </ul>
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## Interview or Interrogation

Interview – non-accusatory, structured, dialog-based, question and answer, held for a specific purpose

Interrogation – accusatory, held when there is sufficient evidence to accuse the suspect of fraud and seek a confession

## EXERCISE

### Travel Expense Interview

Handout Page 5

## For Consideration

1. Most people we interview believe telling the truth is the morally right thing to do.
2. We have all learned that lying might help us to avoid punishment.

## “Behavioral Norm”

1. Ask background questions that result in truthful answers
2. Probe short and long term memory
3. Ask questions that require creative responses
4. Look for behaviors that do not make sense relative to the words spoken
5. Look for body movements and analyze in relation to what was just said

## Impact of Increased Tension

1. Deception causes anxiety
2. Behavior symptoms are revealed as anxiety in the subject increases
3. Be aware of techniques used – intentionally or unintentionally – to release tension and anxiety
4. A deceptive person, if given the choice, will usually choose to reduce anxiety within their response

## Signs of Deception - Nonverbal

1. Change in pattern of eye contact
2. Increased breathing, perspiration or swallowing
3. Change in coloring or facial tone
4. Posture becomes closed, stiff or defensive
5. Movement away from the interviewer
6. Reluctance to physically handle documents or other evidence presented
7. Passive reaction to direct accusation
8. Grooming gestures & physical adjustments

### Signs of Deception - Verbal

1. Denial confined to only to specific aspects of the issue
2. Delayed, evasive, or vague answers
3. Uses reinforcements in answers
4. Fragmented or incomplete sentences
5. Mixture of unusually poor and exact memory
6. Answers consistently lack detail
7. Answers start with repeating the question

### Signs of Deception - Verbal

8. Question or challenge factual information
9. Mental blocks
10. Throat clearing or coughing
11. Mumbling
12. Swearing, oaths or religious statements
13. Inappropriate laughter
14. Passive or weak denial

### Four Magic Words

“Tell me what happened”

### Powerful Follow-Up Question

“How could we prove that?”

### REID.COM



### ACFE Self-Study

“Finding the Truth”  
www.ACFE.com


Finding the Truth: Effective Techniques for Interview and Communication



CPE Credit: 16  
Course Level: Basic  
Prerequisite: None

**Three-Step Fraud Detection**

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  - a) Individual and group brainstorming
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  - b) Detection-Focused interviews
  - c) Data Analysis and Monitoring
3. **Determine the cause of all indicators**
  - a) Root Cause Analysis



**Data Analysis and Monitoring**

1. Standard reconciliations
2. Poor performance
3. Top performance
4. Timing differences
5. Suspense and clearing accounts
6. Complaints
7. Overtime by employee type
8. Top travelers and earners

**Data Analysis and Monitoring**


9. Consulting and other third party services billing
10. Warranty activity
11. Adjustments and overrides:
  - Sales prices
  - Receivable accounts
  - Cash accounts
  - Inventory
12. Closing entries
13. Failures

**Data Analysis and Monitoring**

14. Common names and addresses for refunds or credits
15. Goods purchased in excess of needs / slow turnover
16. Duplicate payments
17. Regular meetings with key executives in departments that handle fraud-like issues

**Three-Step Fraud Detection**

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**Determine the Real Cause of Indicators**

**Root Cause Analysis**

1. What happened
2. Why did it happen

-----



**Root Cause Analysis**

1. What happened
2. Why did it happen

-----

**V  
A  
L  
U  
E**

3. What options are available
4. The cost/benefit of each option
5. The best option

**Three-Step Fraud Detection**


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**EXERCISE**

**Other  
Methods of Discovery**

**Handout Page 6**

Build Your "I Must..." List



How can I use this?  
**HCIUT?**

**TRY B4 TOSS**

**Unit 3:**

**Deep Dive into  
Recurring Business  
Fraud Risks**



**Go DEEP**



**READY?**

**Risk Significance**

1. **MACRO**
2. **Micro**
3. **Systemic**

**CHALLENGES of SYSTEMIC FRAUD**

**The extra cost of control isn't believed to be worth it**

**CHALLENGES of SYSTEMIC FRAUD**

**What if all expense reimbursement was fraud?**

**CHALLENGES of SYSTEMIC FRAUD**

**What if all P-Card transactions were fraud?**

**Risk Significance**

1. **MACRO**
2. **Micro**
3. **Systemic**

**Four Step Response**

**Four Step Response**

1. **State the rules**
2. **Data analysis**
3. **Identify a worst offender**
4. **Make an public example**

**Four Step Response**

1. **State the rules**
2. **Data analysis**
3. **Identify a worst offender**
4. **Make an public example**

**THE THREE C's**

**Commit**

**Convert**

**Conceal**

**Cash Theft**



©2018 The New York Times

**Cafeteria Workers Stole Nearly \$500,000 in Lunch Money From Schools, Police Say**

By Sarah Horvath

Aug. 14, 2018

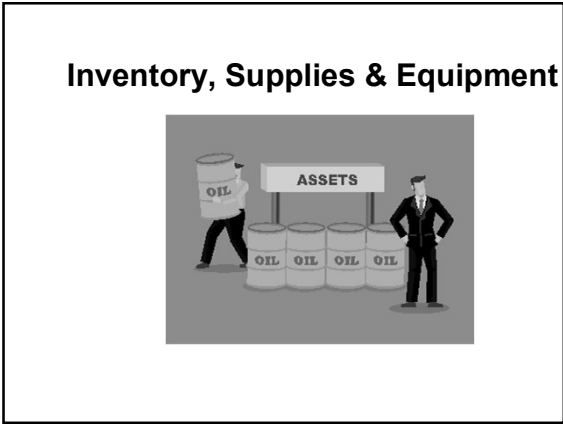
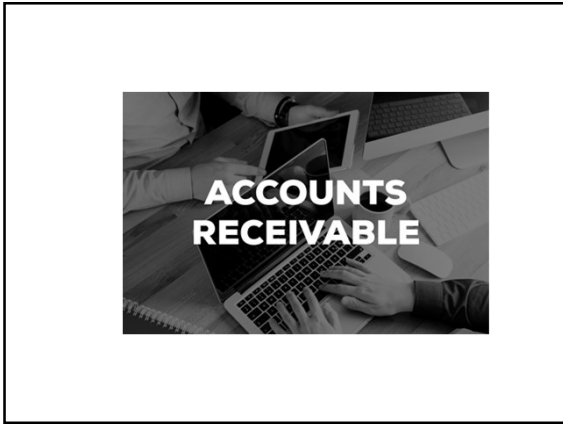
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**Expense  
Reimbursement**



In hearing held via Zoom before the U.S. District Court for the Eastern District of Michigan, Mr. Jones admitted filing expense reports to the U.A.W. that concealed his use of union funds.

"While some of these expenditures related to union activities, others were personal in nature and did not relate to union business," he said. "I recognize that my actions violated the law as well as my sworn obligation to my fellow union members."

### Expense Reimbursement - #1

For a block of time, build a spreadsheet with all available detail from travel expense reports and other sources

- ✓ Include the date and day of the week
- ✓ Include local holidays and major local events
- ✓ Include who was present (cross check their costs)
- ✓ Account for 100% of the time and all activities
- ✓ Include direct bill charges
- ✓ Include any petty cash and similar reimbursements
- ✓ Include any advances and subsequent accounting

### Expense Reimbursement - #2

For all of your employees who appear as being entertained on others' expense reports, cross match all information looking for duplication or other unusual patterns

- ✓ Costs of approver on employee's expense report
- ✓ Costs of employee on approver or co-worker expense report

### Expense Reimbursement - #3

Analyze travel for employees and others incurring the most travel costs

### Expense Reimbursement - #4

Confirm hotel bills including all details on the hotel bill

- ✓ Room charges
- ✓ Tax calculations
- ✓ Meals (restaurants and room service)
- ✓ Entertainment
- ✓ Transportation
- ✓ Bar
- ✓ Mini-bar
- ✓ Laundry & dry cleaning
- ✓ Spa and similar services
- ✓ Gratuities

### Expense Reimbursement - #5

Confirm transportation costs directly with airlines, limousine companies and other service providers

### Expense Reimbursement - #6

Confirm restaurant charges directly with the restaurant, especially:

- ✓ Number of meals / entrees served
- ✓ Liquor, wine and other liquid refreshment
- ✓ Alcohol / food split
- ✓ Entertainment included (dinner theater)

### Expense Reimbursement - #7

Compare travel date and time charges with airline boarding passes, rental car receipts, telephone records, building and parking lot access logs, and machine printed taxi, UBER, toll and parking receipts

- ✓ Research date and/or time conflicts

### Expense Reimbursement - #8

Confirm entertainment directly with those entertained

- ✓ Make certain you have approval
- ✓ Consider reputational issues

**CAUTION**

### Expense Reimbursement - #9

Recalculate restaurant charges

- ✓ Verify tax rates and basis
- ✓ Recalculate taxes charged
- ✓ Review gratuity and service charges for reasonableness
- ✓ Low gratuity or tax may indicate alteration

### Expense Reimbursement - #10

Confirm transaction and expense report approval directly with the approver

### Expense Reimbursement - #11

For vehicles:

- ✓ Double check distance for reimbursed mileage
- ✓ Check fuel quantity purchases for reasonableness
- ✓ For company vehicles, verify odometer readings to expense reports
- ✓ Check reasonableness of fuel purchase locations
- ✓ If license plate shown on fuel receipts, verify ownership of vehicle

### Expense Reimbursement - #12

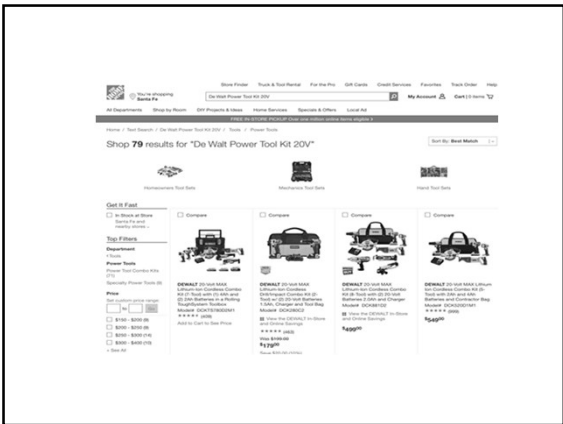
Audit travel and entertainment reimbursement to third-parties

**Expense Reimbursement - #13**  
 Verify air travel for a trip that could be driven

**Expense Reimbursement - #14**  
 Review passenger logs and manifests for private aircraft

**Expense Reimbursement - #15**  
 Other:

- ✓ Unsigned credit card receipts
- ✓ Age and reconcile travel advances
- ✓ Reconcile all credits for cancelled trips
- ✓ Verify directly with airlines that tickets were actually used, the exact flights and times of the flights taken
- ✓ Verify directly with airlines the class of actual travel
- ✓ Recalculate foreign currency charges
- ✓ Double-check items purchased using supplier websites



## Salaries, Wages, Time Reporting & Benefits



### **\$461,646 in Pay for One Worker: M.T.A. Overtime Scrutinized by Prosecutors**

Handwritten bookkeeping is still in use at the Long Island Rail Road. Now the practice is the subject of a federal inquiry.



The New York Times  
Saturday, May 18, 2019

United States Department of Justice

THE UNITED STATES ATTORNEY'S OFFICE  
DISTRICT OF MONTANA

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SHARE

FOR IMMEDIATE RELEASE Monday, March 30, 2020

#### **Ex-Blackfeet Tribal leader sentenced to prison for Head Start program fraud**

GREAT FALLS – The former chairman of the Blackfeet Tribe today was sentenced to 10 months in prison and two years of supervised release along with being ordered to pay \$15,000 restitution for his role in an overtime pay scheme that stole federal funds from the tribe's Head Start child assistance program, U.S. Attorney Kurt Alme said.

### Inflated Labor Hours



### Bovis Lend Lease 8 Plus 2

THE FBI FEDERAL BUREAU OF INVESTIGATION

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New York Field Office

Home » New York » Press Releases » 2012 » Construction Giant Lend Lease (Bovis) Charged with Defrauding Clients in Three Schemes

This is archived material from the Federal Bureau of Investigation (FBI) website. It may contain outdated information and links may no longer function.

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#### **Construction Giant Lend Lease (Bovis) Charged with Defrauding Clients in Three Separate Schemes and Will Pay Over \$50 Million and Institute Comprehensive Reforms**

Former Principal in Charge of Bovis' New York Office Pleads Guilty to Fraud Charge, Faces up to 20 Years in Prison

U.S. Attorney's Office Eastern District of New York  
April 24, 2012 (718) 524-7000

### Time, Payroll, Benefits - #1

Using data mining and analysis, look for duplicate bank account numbers in:

- ✓ Payroll / direct deposit
- ✓ Medical reimbursement
- ✓ Expense reimbursement
- ✓ Pension payments
- ✓ Tuition reimbursement
- ✓ Relocation reimbursement
- ✓ Time off, sabbatical and 'leave' programs
- ✓ Vendor payment master files

### Time, Payroll, Benefits - #2

Using data mining and analysis, look for unusual reporting of:

- ✓ Base hours compared to others doing the same position (peer group)
- ✓ Overtime compared to peer group
- ✓ Total time compared to common sense
- ✓ Travel and other reimbursement compared to peer group

### Time, Payroll, Benefits - #3

Using data mining and analysis, look for duplicate physical addresses in:

- ✓ Payroll files
- ✓ Pension files
- ✓ Vendor files

### Time, Payroll, Benefits - #4

Confirm unusual overtime directly and in-person with the approver

### Time, Payroll, Benefits - #5

Confirm all details of final pay

- ✓ Timing
- ✓ Accrued time off
- ✓ Bonus
- ✓ Separation payments
- ✓ Seasonal hires
- ✓ Account numbers for direct deposit
- ✓ Pull and review final check
- ✓ Review W-2 complaints

### Time, Payroll, Benefits - #6

Compare annual compensation for current year compared to prior year. Review any above normal changes

### Time, Payroll, Benefits - #7

List top 25:

- ✓ Earners organization-wide
- ✓ Earners compared to peer group
- ✓ Earners compared to prior year
- ✓ Earners in each job classification
- ✓ Overtime earners by job classification



**Time, Payroll, Benefits - #8**

Download & review employee benefits elections for:

- ✓ Employees who declined 'normal' employee benefits
- ✓ Employees who have only 'default' benefits

**Time, Payroll, Benefits - #9**

Verify bonuses and executive compensation to appropriate meeting minutes or other authoritative approval support

- ✓ Recalculate bonuses

**Time, Payroll, Benefits - #10**

For tuition reimbursement, verify course completion and amounts paid directly with the educational organization

For relocation reimbursement, recalculate amounts reimbursed plus any tax gross-up

**Time, Payroll, Benefits - #10**

For tuition reimbursement, verify course completion and amounts paid directly with the educational organization

For relocation reimbursement, recalculate amounts reimbursed plus any tax gross-up

Verify that everyone exists and performs work

**Third-Party  
Risk**

**PROCUREMENT**

- 18 Procurement Fraud Risks**
1. Conflict of interest
  2. Phantom vendor or contractor
  3. Purchases for personal use
  4. Information theft
  5. Small PO or split purchases
  6. Secret commissions and kickbacks
  7. Inappropriately tailored specs
  8. Time limitations
  9. Unnecessary purchases

- 18 Procurement Fraud Risks**
10. Collusive bidding, bid rigging
  11. Change order abuse
  12. Commingling of contracts
  13. Duplicate contract payments
  14. Defective pricing
  15. False invoices
  16. False representations
  17. Front end loading / advance payments
  18. Product / equipment substitution

**THE THREE C's**

**Commit**  
**Convert**  
**Conceal**



**Procurement Challenge**

**Wrongdoing**  
**and**  
**Bad Practices**  
**Often Look The Same**



# My Favorite Phantom or Fake Vendor

# Eagle County Colorado Rotary Club Theft

 Handy Search  
www.handysearch.com

June 26, 2013

**Eagle County man pleads guilty to ripping off Rotary Club**



**EAGLE** — Like his father before him, Henry Komar was treasurer of the Vail Rotary Club. Unlike his father, Komar embezzled at least \$275,000 from the local Rotarians, while also stealing another \$100,000 from his employer, Crystal Blue Oil and Gas. Komar pleaded guilty Monday in two counts of felony theft in District Court. He admitted stealing from the Vail Rotary Club, as well as his employer's Crystal Blue Oil and Gas. The Rotarians were also paying Komar to be their treasurer, said Barb Siegel, this year's Vail Rotary Club president. During their investigation, prosecutors found that Komar embezzled at least \$275,000 from the club, prosecutors said. Komar cried when he stood at the podium, trying to explain himself to District Court Judge Fred Caswell. "There is nothing I can say today, or ever, that can change what I have done," Komar said. "I will do anything I can. I will work hard to repay what I stole. No amount of apologies will fix anything, but I will do my best to repay."

**What he faces**  
Komar's attorney argued for probation, saying it was the quickest road to retribution. Judge Caswell did not agree.

"Under the circumstances and I believe that the defendant, Komar, is a good person. Caswell said he could find appropriate circumstances in which he could serve a prison sentence up to six years, but said he probably won't do that either."

"Prosecutors got 180 Rotarians' names signed, which he will do... every year," Caswell said. Komar could be sentenced by community connections, when he could work and begin to repay the money that he stole, Caswell said.

For stealing \$120,000 from the Vail Rotary Club, Komar faces up to six years in state prison and fines up to \$250,000.

For stealing \$155,000 from Crystal Blue Oil and Gas, Komar faces up to six years in state prison and fines up to \$250,000.

Caswell will sentence Komar at 10 a.m. Sept. 4. The judge sent him directly to jail without bond Monday, when he will stay until he is sentenced.

A civil suit is ongoing to determine who gets what part of the \$375,000 Komar has in a local bank.

**What he did**  
Komar's father, who suffers from Parkinson's disease, resigned as treasurer of the Vail Rotary Club, and Vail Rotarians named the club's treasurer to his son Henry.

"We thought it was in the family income," Siegel said.

It wasn't long before some of the club's members began approaching officers to ask why they had not been paid.

"We know what we did after it hit our account. We have no idea how much was stolen before that," Siegel said.

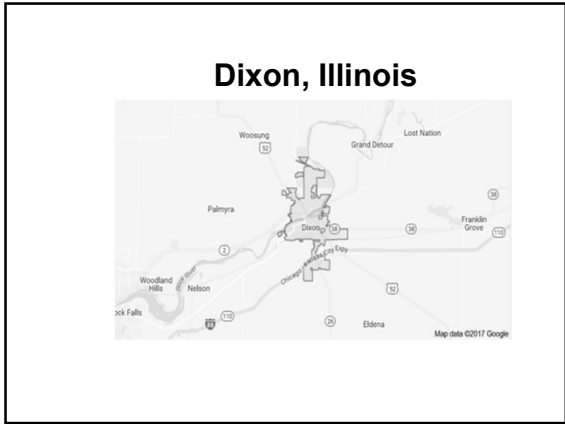
The investigation found that he stole, Komar began setting checks from the Rotary Club account to charity companies he controlled. Among them was FIVE Enterprises LLC, which has discovered its name misused.

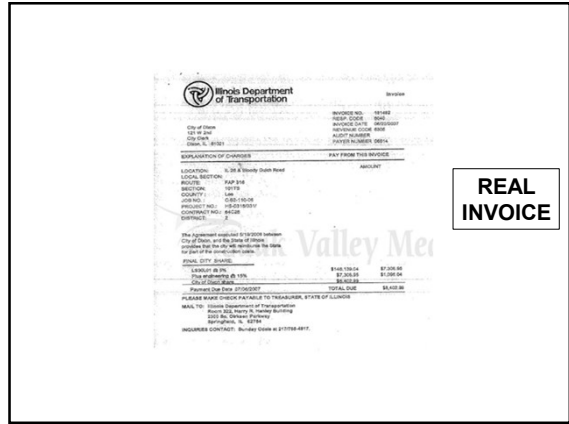
"A man like this is a threat to our community. I would ask for the stiffest penalty so he never has the opportunity to ever do this again. We all work for a living and we have families like this thinking we're all just gonna be good from," Siegel said.

Komar taught accounting at Colorado Mountain College. He started with Crystal Oil and Gas in 2007, as a bookkeeper and accountant.

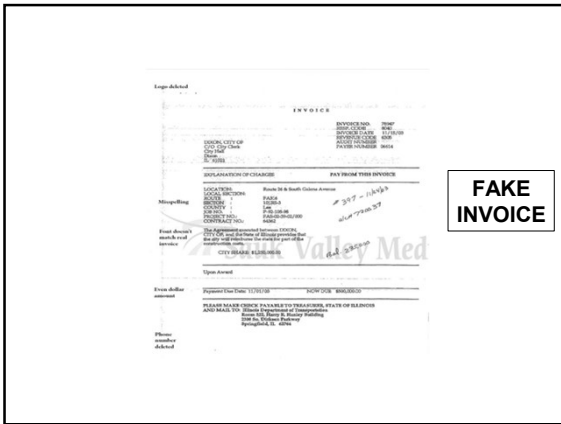


# The Shared Service Center Charity Adams +2 = \$540,000





**REAL INVOICE**



**FAKE INVOICE**



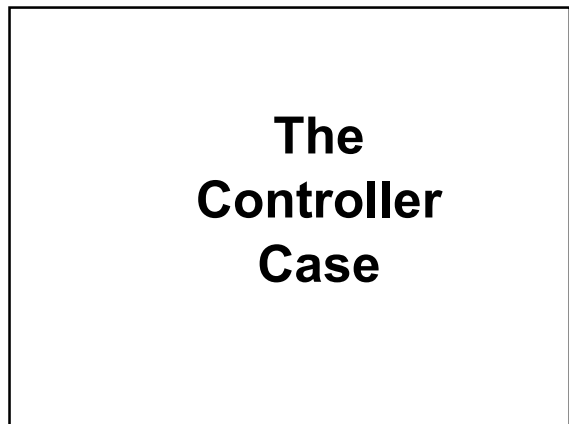
**Only One Supplier**

### The Fruit Tree Caper

VENDOR #616458

QUANTITY	DESCRIPTION	UNIT PRICE	AMOUNT
1 LOT	FRUIT TREES		19,950.00

- ✓ Valid business license and TIN
- ✓ Sent one low value item →
- ✓ UPS receipt – False security



### Organization Background

- Manufacturing
- \$2.5 billion sales
- Publicly traded
- 8,500 employees
- Over 75 US locations

### What Happened

- \$3.5 million stolen over seven years
- 3 parts:
  1. Payments sent to a janitorial services company owned by the controller and his wife
  2. Work on two homes and a beach condo charged to company
  3. \$100,000 in gift cards from a national warehouse club retailer
- Month end journal entries were routinely used to move costs to under budget accounts
- Financial performance deteriorated over the life of the scheme

### Who Did It

- 63 year old controller
- Male, married with grandchildren
- Poor health
- Approaching retirement
- Marginal performer
- 25-year employee at time scheme started
- Could initiate, approve & post entries
- Month end authority allowed moving costs by journal entry

VENUE	ABSTRACT	NO.	DATE	AMOUNT	DEBIT	CREDIT	NET AMOUNT	VENUE	OF BAL.
100	1000000000	1000	01-10-04	1000			1000.00	100000	100000
100	1000000000	1001	01-10-04	1000			1000.00	100000	100000
100	1000000000	1002	01-10-04	1000			1000.00	100000	100000
100	1000000000	1003	01-10-04	1000			1000.00	100000	100000
100	1000000000	1004	01-10-04	1000			1000.00	100000	100000
100	1000000000	1005	01-10-04	1000			1000.00	100000	100000
100	1000000000	1006	01-10-04	1000			1000.00	100000	100000
100	1000000000	1007	01-10-04	1000			1000.00	100000	100000
100	1000000000	1008	01-10-04	1000			1000.00	100000	100000
100	1000000000	1009	01-10-04	1000			1000.00	100000	100000
100	1000000000	1010	01-10-04	1000			1000.00	100000	100000
100	1000000000	1011	01-10-04	1000			1000.00	100000	100000
100	1000000000	1012	01-10-04	1000			1000.00	100000	100000
100	1000000000	1013	01-10-04	1000			1000.00	100000	100000
100	1000000000	1014	01-10-04	1000			1000.00	100000	100000
100	1000000000	1015	01-10-04	1000			1000.00	100000	100000
100	1000000000	1016	01-10-04	1000			1000.00	100000	100000
100	1000000000	1017	01-10-04	1000			1000.00	100000	100000
100	1000000000	1018	01-10-04	1000			1000.00	100000	100000
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100	1000000000	1101	01-10-04	1000			1000.00	100000	100000
100	1000000000	1102	01-10-04	1000			1000.00	100000	100000
100									

### Lesson for Auditors

776	0403-00368	031904	03-15-04	1-26	525.00	95800
776	0401-00438	5470	01-21-04	1-23	127.50	93485
VENDOR TOTAL					1510.00	*
798	HERSCO INC.					
798	0405-00206	340763	03-25-04	5-20	187.74	97178
798	0403-00027	340543	02-17-04	3-03	368.72	94534
798	0401-00275	340269	01-05-04	1-20	196.87	92729
VENDOR TOTAL					753.33	*
808	ARBON EQUIPMENT CORP.					
808	0403-00538	1309832	03-17-04	3-31	1200.00	95711
808	0401-00281	1278547	12-19-03	1-20	1200.00	92177
VENDOR TOTAL					2400.00	*
813	GENERAL DELIVERY INC.					
813	0403-00005	200786	10-02-03	10-02	489.60	94016
813	0403-00004	200787	10-02-03	10-02	489.60	94016
3	0403-00003	200788	10-05-03	10-05	489.60	94016
.3	0403-00002	200895	10-06-03	10-06	495.64	94016
813	0403-00001	200896	10-08-03	10-08	512.64	94016
VENDOR TOTAL					2440.08	*

- ### Symptoms, Red Flags, Indicators
- Missing documents
  - Journal entries
  - Large budget variances
  - Poor financial performance
  - Missed closing deadlines
  - Known related party
  - Dramatic change in lifestyle
  - Unusual behavior
  - Unqualified accounting assistant

- ### Lessons for Management
- Greatest threat from inside
  - Real oversight
  - True variance analysis
  - True performance analysis
  - Related party monitoring
  - Spend monitoring
  - Use "How Do I Know"
  - When in doubt, DOUBT



- ### 20 Procurement Red Flags
1. Missing, inadequate or altered documents
  2. Business expenses submitted for restaurants near an employee's home, or on weekends or holidays when no legitimate work was scheduled
  3. Meal descriptions of 'business meal' without further description
  4. Even dollar 'meals' – that might indicate actually refilling gift cards

- ### 20 Procurement Red Flags
5. Duplicate charges for meals, transportation and accommodations
  6. Counts of supplies, equipment or other assets show a pattern on missing items
  7. Unusually high labor hours or rates – especially compared to a baseline norm
  8. Unusual quantity or type of supplies, tools, or other small-dollar items

**20 Procurement Red Flags**

- 9. Change in banking or other payment information for existing suppliers and contractors (especially for low-frequency or inactive/dormant entities)
- 10. Charges from unknown suppliers found on management reports
- 11. Unexpected charges in excess of budgeted or otherwise planned amounts
- 12. Goods or services purchased in excess of needs or normal volumes

**20 Procurement Red Flags**


- 13. Amounts of invoices fall just below the threshold for review
- 14. Employee handles all matters related to a vendor even though it might be outside or below his or her normal duties
- 15. Vendors with an unusual business volume for no apparent reason
- 16. 'Customer', employee and third-party complaints (including credit card charges)

**20 Procurement Red Flags**

- 17. Adjustments that override original transactions
- 18. Cash over or under
- 19. Common names or addresses for refunds or credits (including bank accounts)
- 20. Significant unexplained items in reconciliations

**CHALLENGE OF SHADOW DEALS**

**Those involved or compromised can't speak up**



**Vendor Assurance Audits**

**EXERCISE**

**Procurement & Contracting Risks**

**Handout Page 7**

## What Could Go Wrong?

1. ~~Determination of needs~~
2. Documenting deliverables
3. Develop internal budget
4. Identify potential suppliers / contractors
5. Solicit bids
6. Negotiate and finalize terms
7. Award the work
8. The work itself
9. Administration, billing and payment review
10. Closeout and final settlements

# CONTRACTING

## High Level Exposures

1. **Inherent exposures**
  - a) Perception of "commodity service"
  - b) Uncertainty (both contractor and owner)
  - c) Blind trust
  - d) Labor & materials availability and quality
  - e) Cash flow and growth
2. Potentially conflicting priorities
3. Industry history and reputation
4. Contingencies and uncertainties
5. Minimal meaningful contract audit coverage
6. Shadow deals

## Fraud Exposures in Contracting

- A. Establishment of Contract Prices and Other Terms
- B. Cost of the Work Issues
  - ✓ Cost pass-thru contracts
- C. Specific Fraud Exposures
- D. Cost Accounting Exposures

## Cost Accounting Exposures

1. Labor and Burden
  - ✓ Labor rates
  - ✓ Payroll taxes
  - ✓ Insurance
  - ✓ Other charges
  - ✓ Application errors
2. Non-Reimbursable Costs
3. General Conditions
4. Falsification of Records

## Contract Basis

1. Unit Price
2. Lump-sum
3. Cost-plus
4. Cost-plus GMAX



**Contract Basis**

1. **Unit Price**
2. **Lump-sum**
3. **Cost-plus**
4. **Cost-plus GMAX**

**Lump Sum Contract Exposures**

1. Specified quality of materials not used
2. Specified methods not used
3. Specified services not provided
4. Specified labor not used
5. Contract quantities not installed
6. Owner provided materials not reconciled
7. Required insurance or bonds not obtained
8. Percentage of completion manipulated



**Contract Basis**

1. **Unit Price**
2. **Lump-sum**
3. **Cost-plus**
4. **Cost-plus GMAX**

**Contract Basis**

1. **Unit Price**
2. **Lump-sum**
3. **Cost-plus**
4. **Cost-plus GMAX**

**Example  
Cost-Plus Audit  
Executive  
Summary**

### Simple Executive Summary

	A	B	C	D	E	F	G	H	I
							BUDGET	PER AUDIT	DIFFERENCE
1	<b>GUARANTEED MAXIMUM PRICE:</b>								
2	General Conditions						1,250,000.00		
3	Direct Costs						24,750,000.00		
4	Committed (Subcontracts)						1,260,000.00		
5	Self-Performed						195,650.00		
6	Other Direct Costs						252,180.00		
7	Subguard Insurance						24,000.00		
8	General Liability Insurance						124,580.00		
9	Performance & Payment Bond						350,000.00		
10	Contingency						28,206,410.00		
11	Contractor Fee						705,160.25		
12	ORIGINAL GMP						28,911,570.25		
13	Change Orders: 1 thru 12								
14	Direct Work / GMP Line Items						1,946,400.00		
15	Special Expediting Contingency - Add						300,000.00		
16	Contract Contingency - C. O. #11						(451,150.00)		
17	Contractor Fee						44,881.25		
18	Revised GMP						30,751,701.50		

Major Costs

### Simple Executive Summary

	A	B	C	D	E	F	G	H	I
							BUDGET	PER AUDIT	DIFFERENCE
1	<b>GUARANTEED MAXIMUM PRICE:</b>								
2	General Conditions						1,250,000.00		
3	Direct Costs						24,750,000.00		
4	Committed (Subcontracts)						1,260,000.00		
5	Self-Performed						195,650.00		
6	Other Direct Costs						252,180.00		
7	Subguard Insurance						24,000.00		
8	General Liability Insurance						124,580.00		
9	Performance & Payment Bond						350,000.00		
10	Contingency						28,206,410.00		
11	Contractor Fee						705,160.25		
12	ORIGINAL GMP						28,911,570.25		
13	Change Orders: 1 thru 12								
14	Direct Work / GMP Line Items						1,946,400.00		
15	Special Expediting Contingency - Add						300,000.00		
16	Contract Contingency - C. O. #11						(451,150.00)		
17	Contractor Fee						44,881.25		
18	Revised GMP						30,751,701.50		

5% of GMP

### Simple Executive Summary

	A	B	C	D	E	F	G	H	I
							BUDGET	PER AUDIT	DIFFERENCE
1	<b>GUARANTEED MAXIMUM PRICE:</b>								
2	General Conditions						1,250,000.00		
3	Direct Costs						24,750,000.00		
4	Committed (Subcontracts)						1,260,000.00		
5	Self-Performed						195,650.00		
6	Other Direct Costs						252,180.00		
7	Subguard Insurance						24,000.00		
8	General Liability Insurance						124,580.00		
9	Performance & Payment Bond						350,000.00		
10	Contingency						28,206,410.00		
11	Contractor Fee						705,160.25		
12	ORIGINAL GMP						28,911,570.25		
13	Change Orders: 1 thru 12								
14	Direct Work / GMP Line Items						1,946,400.00		
15	Special Expediting Contingency - Add						300,000.00		
16	Contract Contingency - C. O. #11						(451,150.00)		
17	Contractor Fee						44,881.25		
18	Revised GMP						30,751,701.50		

1.3% of GMP

### Simple Executive Summary

	A	B	C	D	E	F	G	H	I
							BUDGET	PER AUDIT	DIFFERENCE
1	<b>GUARANTEED MAXIMUM PRICE:</b>								
2	General Conditions						1,250,000.00		
3	Direct Costs						24,750,000.00		
4	Committed (Subcontracts)						1,260,000.00		
5	Self-Performed						195,650.00		
6	Other Direct Costs						252,180.00		
7	Subguard Insurance						24,000.00		
8	General Liability Insurance						124,580.00		
9	Performance & Payment Bond						350,000.00		
10	Contingency						28,206,410.00		
11	Contractor Fee						705,160.25		
12	ORIGINAL GMP						28,911,570.25		
13	Change Orders: 1 thru 12								
14	Direct Work / GMP Line Items						1,946,400.00		
15	Special Expediting Contingency - Add						300,000.00		
16	Contract Contingency - C. O. #11						(451,150.00)		
17	Contractor Fee						44,881.25		
18	Revised GMP						30,751,701.50		

### Simple Executive Summary

	A	B	C	D	E	F	G	H	I
							BUDGET	PER AUDIT	DIFFERENCE
1	<b>GUARANTEED MAXIMUM PRICE:</b>								
2	General Conditions						1,250,000.00		
3	Direct Costs						24,750,000.00		
4	Committed (Subcontracts)						1,260,000.00		
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6	Other Direct Costs						252,180.00		
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10	Contingency						28,206,410.00		
11	Contractor Fee						705,160.25		
12	ORIGINAL GMP						28,911,570.25		
13	Change Orders: 1 thru 12								
14	Direct Work / GMP Line Items						1,946,400.00		
15	Special Expediting Contingency - Add						300,000.00		
16	Contract Contingency - C. O. #11						(451,150.00)		
17	Contractor Fee						44,881.25		
18	Revised GMP						30,751,701.50		

# Materials

### Reimbursable Material Costs

Cost-Plus & T&M Contracts

1. **Price billed exceeds actual costs or exceeds normal costs**
2. **Quantity billed exceeds quantity delivered**
3. **Quality billed exceeds quality delivered**
4. **Rebates and credit/trade/volume discounts not credited on purchases**
5. **Inflated costs on materials from 'stock'**
6. **Failure to credit unused materials**

## Labor

### Labor and Related Burden

- a) **Raw labor**
  - > Hours variances
  - > Rate Variances
- b) **Labor Burden**
  - > Payroll taxes
  - > Insurance
  - > Benefits
- c) **Fully loaded rates**
- d) **"Errors" in methodologies**

### Methodology Error Examples

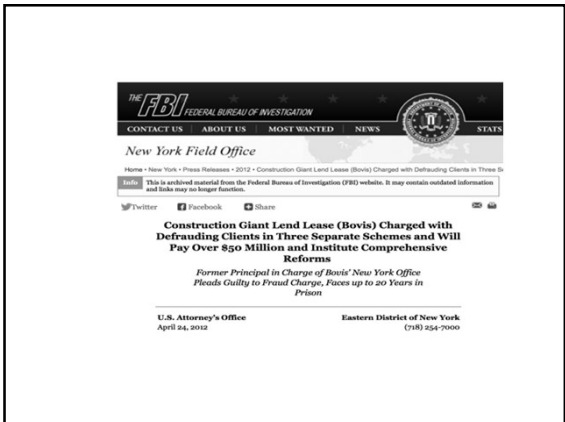
- ❖ **Allocation of indirect costs to direct cost pool**
- ❖ **Application of correct rates to incorrect base**  
*(example: union fringe benefits)*
- ❖ **Incorrect application of method**  
*(example: overhead rates)*

## Inflated Labor Hours

**Inflated Labor Hours**



**Bovis Lend Lease 8 Plus 2**



# Inflated Labor & Burden Rates

**Inflated Labor Rates**

Rate Burden	Each	10 Hour Rate
BASE RATE (including vacation)	5	45.87
<b>FRINGE BENEFITS</b>		<b>5</b> 18.50
ADDP/PROPERTY/OVERHEAD	0.00%	0
LABEL TOLLS	0.00%	0
CONSULANCES	0.00%	0
<b>Total Fee</b>	<b>0.00%</b>	<b>0</b> 3.07
<b>PERCENT TAXES (on Net Tax Rate)</b>		
State Property Tax	7.50%	3.51
State Unemployment Compensation	0.50%	0.23
Federal Unemployment Compensation	0.80%	0.37
State Corp. Tax Rate	5.3%	2.43
<b>TOTAL TAXES</b>		<b>6.54%</b> 3.00
<b>INSURANCE</b>		
Medical Compensation Rate	7.50%	3.49
General Liability & Auto. Insurance	7.33%	3.31
Workers' Comp. Rate	0.00%	0.00
<b>Total Insurance</b>	<b>14.83%</b>	<b>6.79</b>
<b>TOTAL STRAIGHT TIME BILLING RATE</b>		<b>5</b> 78.11
<b>Time and 1/2 Premiums:</b>		
Time and 1/2 Base Rate	5	23.46
Unemployment Insurance	0	0.00
Payroll Taxes	0	0.00
Subcontract	0	0.00
<b>TOTAL TIME AND 1/2 BILLING RATE</b>		<b>5</b> 101.57
<b>Subcontract Premiums:</b>		
Unemployment Insurance	0	0.00
Payroll Taxes	0	0.00
Subcontract	0	0.00
<b>TOTAL SUBCONTRACT BILLING RATE</b>		<b>5</b> 101.57

# Subcontracts

- ## Subcontract Exposures
- Cost-Plus & T&M Contracts
1. Subcontract cost may be excessive
  2. Work not performed in accordance with contract specifications
  3. Change Order pricing
  4. Subs not 'back-charged' when appropriate
  5. Allowances in subcontracts not reconciled

## Example Allowances

Account	Description	Amount
2203	Furnish, install and maintain erosion control	30,000
2006	All labor, equipment and materials to furnish and install on-site and off-site project utilities, including storm, sewer, fire lanes, and potable water lines at rooftop terraces	128,700
2809	All labor, equipment and materials to furnish and install all site furnishings including ash urns, bench receptacles and benches	15,000
4002	All labor, equipment and materials to furnish and install all project pavers including the asphalt/concrete/curbstone pavers	555,520
6500	All labor, equipment and materials to furnish and install all mechanical pipe and out guards at the parking garages	18,000
10440	All labor, equipment and materials to furnish and install all project code required signage	55,000
13861	All labor, equipment and materials to furnish and install required structure, finishes, pumps, filters, plumbing, electrical, and lighting for a concrete water feature in entry drive area	70,000
15400	All labor, equipment and materials to furnish and install a storm water retention system	80,000
15400	All labor, equipment and materials to furnish and install an emergency drain sump pump in garage	3,500
16000	Supply, tax and freight included all unit light fixtures	199,500
16000	Supply, tax and freight included parking garage and common area light fixtures	70,000
16000	Supply, tax and freight included landscape and site light fixtures	55,000
<b>Total GMAX Allowances</b>		<b>1,330,220</b>

### Example Committed Cost Report

Vendor	Commitment	Contract Amount	Change Orders	Revised Contract	Amount Invoiced	Amount Paid
<b>643 AGCO, Inc</b>		0.01	59,984.99	59,985.00	59,985.00	59,985.00
Hvac						
Change Order #1		503	23,780.00			
Change Order #2		503	35,204.99	613107		
Total CO's			59,984.99			
<b>707 AMERICAN NURSERIES</b>		390,277.50	47,215.00	437,492.50	437,492.50	437,492.50
LANDSCAPE & LAWN SERVICE						
Change Order #1		503	24,453.00			
Change Order #2		503	22,762.00	613107		
Total CO's			47,215.00			
<b>4452 APOLLO POOL SERVICE</b>		145,118.00	18,873.00	173,991.00	173,991.00	173,991.00
SWIMMING POOLS						
Change Order #1		503	7,388.00			
Change Order #2		503	11,485.00	310207		
Change Order #3		503	647.00	613107		
Total CO's			19,520.00			
<b>3127 ARS FLOORING</b>		355,000.00	50,203.00	355,203.00	355,203.00	355,203.00
CARPET & RESILIENT						
Change Order #1		503	130,400.00			
Change Order #2		503	27,875.00	102008		
Change Order #3		503	25,928.00	1011096		
Change Order #4		503	1,250.00	1211408		
Change Order #5		503	1,750.00	509407		
Change Order #6		503	2,000.00	711167		
Total CO's			50,203.00			

### The Crawford Case

Department of Justice  
U.S. Attorney's Office  
Western District of Pennsylvania

SHARE

FOR IMMEDIATE RELEASE Wednesday, June 5, 2013

**Contractor Pleads Guilty To Fraud, Filing False Tax Returns**

PITTSBURGH, Pa. – A construction company executive pleaded guilty in federal court to an Information charging him with mail fraud and filing false tax returns, United States Attorney David J. Hickton announced today.

Robert E. Crawford, 54, of Pittsburgh, Pa., pleaded guilty to two counts before United States District Judge David S. Cercone.

### Project Background

1. Renovation of two existing client facilities
2. Collusion between client executive and long-term trusted construction company executive (25-year relationship)
3. Sole source contract award (no bid)
4. Not managed by construction department
5. Overcharges of over \$3 million on contract value of \$14.5 million (21%)

### Case Details

1. Overbilling through real and fictitious sub-contractors
  - a) Internal project budget
  - b) Contract value
  - c) Schedule of values
2. \$250,000 kickback paid to owner executive
3. Fabricated Change Orders
4. Architect knowingly approved inflated costs
5. Insurance claim for activities of owner company executive

### "Job Cost Report"

CO#	REF #	LN	DATE	DOCUMENT	DESCRIPTION	LABOR	MATERIAL	SUBCON	EQUIP	OTHER	PAID	TOTAL
Cost Code 1016: EIF S/ase Blip (Exterior Insulation Finishing System)												
1015	894-0001	AP	8/27/07	In# SC2-10-15-6038	ABC Construction		125,000.00				125,000.00	
1015	290-0001	AP	9/16/07	In# B3333-6038	Diamond Stone		46,163.00				46,163.00	
1015	894-0002	AP	9/26/07	In# SC2-10-15-6038	ABC Construction		25,000.00				25,000.00	
1015	551-0001	AP	9/26/07	In# SC2-10-15-6038	Venue Contractors Inc.		80,956.54				80,956.54	
1015	422-0001	AP	10/26/07	In# B3335-6038	Diamond Stone		27,555.00				27,555.00	
1015	960-0025	AP	12/26/07	In# SC-01-6038	Diamond Stone		1,545.00				1,545.00	
1015	940-0001	AP	2/28/08	In# SC2-10-15-6038	ABC Construction		7,100.00				7,100.00	
1015	891-0002	AP	3/25/08	In# B3332-6038	Diamond Stone		879.50				879.50	
						0.00	307,103.50	0.00	157,058.54	0.00	464,162.04	314,198.54
Cost Code 1022: Structural / Beam Work												
1028	819-0004	AP	7/24/07	In# SC01-10-28-6038	ABC Construction		70,000.00				70,000.00	
1028	185-0001	AP	8/16/07	In# 07-07611-6038	Kaiser Metal Fabricators		62,000.00				62,000.00	
1028	894-0006	AP	9/26/07	In# SC2-10-28-6038	ABC Construction		170,300.00				170,300.00	
1028	499-0005	AP	10/26/07	In# 3277-6038	Structural Imaging LLC		475.00				475.00	
1028	237-0004	AP	2/19/08	In# SC-0073-6038	ABC Construction		-7,000.00				-7,000.00	
						-	213,300.00	-	62,475.00	0.00	275,775.00	

### Sort by Cost Code

CO#	REF #	LN	DATE	DOCUMENT	DESCRIPTION	LABOR	MATERIAL	SUBCON	EQUIP	OTHER	PAID	TOTAL
Cost Code 1016: EIF S/ase Blip (Exterior Insulation Finishing System)												
1015	894-0001	AP	8/27/07	In# SC2-10-15-6038	ABC Construction		125,000.00				125,000.00	
1015	290-0001	AP	9/16/07	In# B3333-6038	Diamond Stone		46,163.00				46,163.00	
1015	894-0002	AP	9/26/07	In# SC2-10-15-6038	ABC Construction		25,000.00				25,000.00	
1015	551-0001	AP	9/26/07	In# SC2-10-15-6038	Venue Contractors Inc.		80,956.54				80,956.54	
1015	422-0001	AP	10/26/07	In# B3335-6038	Diamond Stone		27,555.00				27,555.00	
1015	960-0025	AP	12/26/07	In# SC-01-6038	Diamond Stone		1,545.00				1,545.00	
1015	940-0001	AP	2/28/08	In# SC2-10-15-6038	ABC Construction		7,100.00				7,100.00	
1015	891-0002	AP	3/25/08	In# B3332-6038	Diamond Stone		879.50				879.50	
						0.00	307,103.50	0.00	157,058.54	0.00	464,162.04	314,198.54
Cost Code 1022: Structural / Beam Work												
1028	819-0004	AP	7/24/07	In# SC01-10-28-6038	ABC Construction		70,000.00				70,000.00	
1028	185-0001	AP	8/16/07	In# 07-07611-6038	Kaiser Metal Fabricators		62,000.00				62,000.00	
1028	894-0006	AP	9/26/07	In# SC2-10-28-6038	ABC Construction		170,300.00				170,300.00	
1028	499-0005	AP	10/26/07	In# 3277-6038	Structural Imaging LLC		475.00				475.00	
1028	237-0004	AP	2/19/08	In# SC-0073-6038	ABC Construction		-7,000.00				-7,000.00	
						-	213,300.00	-	62,475.00	0.00	275,775.00	

### Sort by Subcontractor

SOFT CODE	REF #	JR	DATE	DOCUMENT	DESCRIPTION	LABOR	MATERIAL	SUBCON	ESUP	OTHER	PAID TOTAL
<b>Cost Code 1016: EIF S-Base Blip (Exterior Insulation Finishing System)</b>											
1015 894-0001	AP		8/27/07	IME SC01-10-15 6038	ABC Construction		125,000.00				125,000.00
1015 280-0001	AP		9/18/07	IME E3333 6038	Diamond Stone		48,163.00				48,163.00
1015 894-0002	AP		9/26/07	IME SC02-10-15 6038	ABC Construction		25,000.00				25,000.00
1015 051-0001	AP		9/30/07	IME 302112 6038	Venus Construction Inc.		89,996.54				89,996.54
1015 422-0001	AP		10/30/07	IME E3335 6038	Diamond Stone		27,050.00				27,050.00
1015 966-0025	AP		12/28/07	IME SC-01 6038	Diamond Stone		1,543.00				1,543.00
1015 940-0001	AP		2/28/08	IME SC03-10-15 6038	ABC Construction		7,100.00				7,100.00
1015 851-0002	AP		3/25/08	IME E3352 6038	Diamond Stone		879.50				879.50
						0.00	0.00	187,100.00	0.00	187,099.04	312,199.04
<b>Cost Code 1028: Structural / Beam Work</b>											
1028 819-0004	AP		7/28/07	IME SC01-10-28 6038	ABC Construction		70,000.00				70,000.00
1028 165-0001	AP		8/1/07	IME 07-87611 6038	Kidder Mass Fabricators		62,000.00				62,000.00
1028 894-0008	AP		9/26/07	IME SC02-10-28 6038	ABC Construction		170,300.00				170,300.00
1028 498-0005	AP		10/30/07	IME 3277 6038	Structural Im-aging LLC		475.00				475.00
1028 257-0004	AP		2/19/08	IME SC-073 6038	ABC Construction		-7,000.00				-7,000.00
						0.00	0.00	273,300.00	0.00	62,475.00	265,775.00

### Duplicate Charges Surface

SOFT CODE	REF #	JR	DATE	DOCUMENT	DESCRIPTION	LABOR	MATERIAL	SUBCON	ESUP	OTHER	PAID TOTAL
<b>Cost Code 1016: EIF S-Base Blip (Exterior Insulation Finishing System)</b>											
1015 894-0001	AP		8/27/07	IME SC01-10-15 6038	ABC Construction		125,000.00				125,000.00
1015 280-0001	AP		9/18/07	IME E3333 6038	Diamond Stone		48,163.00				48,163.00
1015 894-0002	AP		9/26/07	IME SC02-10-15 6038	ABC Construction		25,000.00				25,000.00
1015 051-0001	AP		9/30/07	IME 302112 6038	Venus Construction Inc.		89,996.54				89,996.54
1015 422-0001	AP		10/30/07	IME E3335 6038	Diamond Stone		27,050.00				27,050.00
1015 966-0025	AP		12/28/07	IME SC-01 6038	Diamond Stone		1,543.00				1,543.00
1015 940-0001	AP		2/28/08	IME SC03-10-15 6038	ABC Construction		7,100.00				7,100.00
1015 851-0002	AP		3/25/08	IME E3352 6038	Diamond Stone		879.50				879.50
						0.00	0.00	187,100.00	0.00	187,099.04	312,199.04
<b>Cost Code 1028: Structural / Beam Work</b>											
1028 819-0004	AP		7/28/07	IME SC01-10-28 6038	ABC Construction		70,000.00				70,000.00
1028 165-0001	AP		8/1/07	IME 07-87611 6038	Kidder Mass Fabricators		62,000.00				62,000.00
1028 894-0008	AP		9/26/07	IME SC02-10-28 6038	ABC Construction		170,300.00				170,300.00
1028 498-0005	AP		10/30/07	IME 3277 6038	Structural Im-aging LLC		475.00				475.00
1028 257-0004	AP		2/19/08	IME SC-073 6038	ABC Construction		-7,000.00				-7,000.00
						0.00	0.00	273,300.00	0.00	62,475.00	265,775.00

### Summary of Losses

Billed and Paid Costs	Actual Costs	Total Overcharge
A - \$10,110,000	\$8,660,000	\$1,450,000
B - \$4,410,000	\$2,825,000	\$1,585,000
<b>Total - \$14,520,000</b>	<b>\$11,485,000</b>	<b>\$3,035,000</b>

Plus:  
 30% Penalty \$910,000  
 Audit and legal costs \$250,000

# Change Orders

- ### Why Change Orders Occur
1. Design errors, discrepancies, omissions
  2. Undisclosed or unknown conditions
  3. Change in designer preference
  4. Value engineering
  5. Change in external requirements
    - Building code, zoning, fire, ADA
  6. Change in market conditions
  7. Owner initiated changes in scope

- ### 9 Change Order Exposures
1. Not priced in accordance with contract
  2. Markups for fee billed incorrectly
  3. Material prices do not reflect actual cost due to trade discounts & other issues
  4. Material quantity estimates not accurate
  5. Labor hours overstated due to poor estimating techniques

### 9 Change Order Exposures

- 6. Labor rate and/or burden exceeds actual
- 7. Improper charges for overtime versus premium time
- 8. Buyouts of lower-tiered subcontractors not disclosed
- 9. Change orders for work already included in the base contract

### Inadequate Change Support

*Provide a complete hardware package (less P/A-P/D hardware and both in same and both for 1.166 price) for the [redacted] [redacted] Project per the attached Exhibit How 2-6-14*

*\$ 93,000.00*

**CONTRACT CHANGE ORDER AUTHORIZATION**  
SABRY CONSTRUCTION LTD.

General Contractor: Sabry Construction, Inc. Change Order: [redacted]  
 Address: [redacted] Contract No: 1528-0000  
 Phone: [redacted] Date: [redacted]

Project Name: [redacted] Original Contract Amount: [redacted]  
 Project Address: [redacted] Add: [redacted]

Item	Description	Quantity	Unit	Rate	Amount
1	1.0000	1	EA	200.00	200.00
2	2.0000	2	EA	100.00	200.00
3	3.0000	3	EA	100.00	300.00
4	4.0000	4	EA	100.00	400.00
5	5.0000	5	EA	100.00	500.00
6	6.0000	6	EA	100.00	600.00
7	7.0000	7	EA	100.00	700.00
8	8.0000	8	EA	100.00	800.00
9	9.0000	9	EA	100.00	900.00
10	10.0000	10	EA	100.00	1000.00
11	11.0000	11	EA	100.00	1100.00
12	12.0000	12	EA	100.00	1200.00
13	13.0000	13	EA	100.00	1300.00
14	14.0000	14	EA	100.00	1400.00
15	15.0000	15	EA	100.00	1500.00
16	16.0000	16	EA	100.00	1600.00
17	17.0000	17	EA	100.00	1700.00
18	18.0000	18	EA	100.00	1800.00
19	19.0000	19	EA	100.00	1900.00
20	20.0000	20	EA	100.00	2000.00
21	21.0000	21	EA	100.00	2100.00
22	22.0000	22	EA	100.00	2200.00
23	23.0000	23	EA	100.00	2300.00
24	24.0000	24	EA	100.00	2400.00
25	25.0000	25	EA	100.00	2500.00
26	26.0000	26	EA	100.00	2600.00
27	27.0000	27	EA	100.00	2700.00
28	28.0000	28	EA	100.00	2800.00
29	29.0000	29	EA	100.00	2900.00
30	30.0000	30	EA	100.00	3000.00
31	31.0000	31	EA	100.00	3100.00
32	32.0000	32	EA	100.00	3200.00
33	33.0000	33	EA	100.00	3300.00
34	34.0000	34	EA	100.00	3400.00
35	35.0000	35	EA	100.00	3500.00
36	36.0000	36	EA	100.00	3600.00
37	37.0000	37	EA	100.00	3700.00
38	38.0000	38	EA	100.00	3800.00
39	39.0000	39	EA	100.00	3900.00
40	40.0000	40	EA	100.00	4000.00
41	41.0000	41	EA	100.00	4100.00
42	42.0000	42	EA	100.00	4200.00
43	43.0000	43	EA	100.00	4300.00
44	44.0000	44	EA	100.00	4400.00
45	45.0000	45	EA	100.00	4500.00
46	46.0000	46	EA	100.00	4600.00
47	47.0000	47	EA	100.00	4700.00
48	48.0000	48	EA	100.00	4800.00
49	49.0000	49	EA	100.00	4900.00
50	50.0000	50	EA	100.00	5000.00
51	51.0000	51	EA	100.00	5100.00
52	52.0000	52	EA	100.00	5200.00
53	53.0000	53	EA	100.00	5300.00
54	54.0000	54	EA	100.00	5400.00
55	55.0000	55	EA	100.00	5500.00
56	56.0000	56	EA	100.00	5600.00
57	57.0000	57	EA	100.00	5700.00
58	58.0000	58	EA	100.00	5800.00
59	59.0000	59	EA	100.00	5900.00
60	60.0000	60	EA	100.00	6000.00
61	61.0000	61	EA	100.00	6100.00
62	62.0000	62	EA	100.00	6200.00
63	63.0000	63	EA	100.00	6300.00
64	64.0000	64	EA	100.00	6400.00
65	65.0000	65	EA	100.00	6500.00
66	66.0000	66	EA	100.00	6600.00
67	67.0000	67	EA	100.00	6700.00
68	68.0000	68	EA	100.00	6800.00
69	69.0000	69	EA	100.00	6900.00
70	70.0000	70	EA	100.00	7000.00
71	71.0000	71	EA	100.00	7100.00
72	72.0000	72	EA	100.00	7200.00
73	73.0000	73	EA	100.00	7300.00
74	74.0000	74	EA	100.00	7400.00
75	75.0000	75	EA	100.00	7500.00
76	76.0000	76	EA	100.00	7600.00
77	77.0000	77	EA	100.00	7700.00
78	78.0000	78	EA	100.00	7800.00
79	79.0000	79	EA	100.00	7900.00
80	80.0000	80	EA	100.00	8000.00
81	81.0000	81	EA	100.00	8100.00
82	82.0000	82	EA	100.00	8200.00
83	83.0000	83	EA	100.00	8300.00
84	84.0000	84	EA	100.00	8400.00
85	85.0000	85	EA	100.00	8500.00
86	86.0000	86	EA	100.00	8600.00
87	87.0000	87	EA	100.00	8700.00
88	88.0000	88	EA	100.00	8800.00
89	89.0000	89	EA	100.00	8900.00
90	90.0000	90	EA	100.00	9000.00
91	91.0000	91	EA	100.00	9100.00
92	92.0000	92	EA	100.00	9200.00
93	93.0000	93	EA	100.00	9300.00
94	94.0000	94	EA	100.00	9400.00
95	95.0000	95	EA	100.00	9500.00
96	96.0000	96	EA	100.00	9600.00
97	97.0000	97	EA	100.00	9700.00
98	98.0000	98	EA	100.00	9800.00
99	99.0000	99	EA	100.00	9900.00
100	100.0000	100	EA	100.00	10000.00

**CONTRACT CHANGE ORDER AUTHORIZATION**  
SABRY CONSTRUCTION LTD.

General Contractor: Sabry Construction, Inc. Change Order: [redacted]  
 Address: [redacted] Contract No: 1528-0000  
 Phone: [redacted] Date: [redacted]

Project Name: [redacted] Original Contract Amount: [redacted]  
 Project Address: [redacted] Add: [redacted]

**BOGUS**

### Non-Reimbursable Costs

### Project Management Software

Service Start Date	Project or Service Name	Due Date
9/1/2014	Annual Access	9/1/2014
Description		Amount
Access to Procore construction project management software for 12 months, commencing upon the invoice due date.		\$ 290.00

*3/28/15*

### The Fishing Trip(s)



1) Condo Levies - \$1221.00  
 2) Prostate Chart - \$1700.00  
 3) Prostate " - \$1700.00  
  
 Cash - \$500.00  
 2) Gas - \$200.00  
 3) Nuts & Bolts - \$14.98  
 4) Tools - \$88.76  
 5) Misc. Tools - \$23.40  
 6) Misc. Walnut - \$26.66  
 7) Misc. - \$18.50  
 8) Misc. - \$391.00

### Falsification of Records

4 Post-It Notes  
 3 yellow  
 1 pink



### 20 Contracting Red Flags

1. Unclear or unreasonable specifications
2. No audit terms in contract
3. Atypical 'application of payment' forms
4. Missing or disorganized backup
5. Failure to track or report use of allowances and contingencies
6. Undocumented workers on project
7. Changes in Schedule of Values without explanation

AIA G702



**CONTINUATION SHEET**

Page 2 of 2

Contract No. [REDACTED]

Contract Description: [REDACTED]

Contract Start Date: [REDACTED]

Contract End Date: [REDACTED]

Item No.	Description of Work	Quantity	Unit	Unit Price	Total Price	Material	Subcontract	Other	Notes
1	Excavation	100	sq. yd.	10.00	1000.00	1000.00			
2	Backfill	100	cu. yd.	10.00	1000.00	1000.00			
3	Gravel	100	cu. yd.	10.00	1000.00	1000.00			
4	Asphalt	100	sq. yd.	10.00	1000.00	1000.00			
5	Concrete	100	cu. yd.	10.00	1000.00	1000.00			
6	Rebar	100	lb.	10.00	1000.00	1000.00			
7	Formwork	100	sq. ft.	10.00	1000.00	1000.00			
8	Paint	100	gal.	10.00	1000.00	1000.00			
9	Electrical	100	hr.	10.00	1000.00		1000.00		
10	Plumbing	100	hr.	10.00	1000.00		1000.00		
11	Mechanical	100	hr.	10.00	1000.00		1000.00		
12	Roofing	100	sq. ft.	10.00	1000.00	1000.00			
13	Insulation	100	sq. ft.	10.00	1000.00	1000.00			
14	Drywall	100	sq. ft.	10.00	1000.00	1000.00			
15	Paint	100	gal.	10.00	1000.00	1000.00			
16	Trim	100	lb.	10.00	1000.00	1000.00			
17	Hardware	100	lb.	10.00	1000.00	1000.00			
18	Lighting	100	hr.	10.00	1000.00		1000.00		
19	Security	100	hr.	10.00	1000.00		1000.00		
20	Signage	100	hr.	10.00	1000.00		1000.00		
21	Site Work	100	hr.	10.00	1000.00		1000.00		
22	Final Inspection	100	hr.	10.00	1000.00		1000.00		
23	Project Closeout	100	hr.	10.00	1000.00		1000.00		
24	Final Report	100	hr.	10.00	1000.00		1000.00		
25	Project Summary	100	hr.	10.00	1000.00		1000.00		
26	Final Review	100	hr.	10.00	1000.00		1000.00		
27	Project Completion	100	hr.	10.00	1000.00		1000.00		
28	Final Payment	100	hr.	10.00	1000.00		1000.00		
29	Project Archival	100	hr.	10.00	1000.00		1000.00		
30	Final Report	100	hr.	10.00	1000.00		1000.00		

AIA G703

- ### 20 Contracting Red Flags
8. Subcontractor complaints about payments from general contractor
  9. Missing lien waivers
  10. Unusual bid patterns
  11. Bid losers hired as subcontractors
  12. Missing documents
  13. Undisclosed related parties

**“The money came in and the money went out, and now this is where we are...”**

- Developer

- ### 20 Contracting Red Flags
14. Material substitutions without approval
  15. Excess material purchases
  16. Change order manipulation
  17. Front end loading in billing
  18. Overstated units, hours, equipment used
  19. Undervalued deductive change orders
  20. Diverting lump sum work to T&M projects

- ### 20 Detection Suggestions
1. Analyze bids looking for patterns by vendor or purchasing agent
  2. Confirm losing bids, failure to respond
  3. Audit vendors - transactions, T&Es, 1099s
  4. Surprise inspect at receiving points
  5. Match PO, proof or receipt, & invoice
  6. Observe inventory held by others
  7. Observe highly tempting items

- ### 20 Detection Suggestions
8. For sole source suppliers, confirm existence, prove ownership, test prices, find other sources, analyze usage volume
  9. Reconcile inventory, purchases and usage of items subject to pilferage
  10. Audit rental of equipment (including equipment used by contractors)
  11. Verify accuracy of items stored in containers (gas, liquids, other)

**20 Detection Suggestions**


12. Audit areas where vendors come in, take stock, and replenish on their own
13. Audit purchases that do not go through normal purchasing procedures
14. Audit maintenance agreements
15. Audit property management agreements
16. Audit costs on cost-plus agreements to original documentation. Look for creative interpretations of the term "Cost"

**20 Detection Suggestions**

17. Pull D&B Reports and enter vendor names into press (Nexis) and legal (lexis) research databases
18. Use computer to look for multiple PO and split bills
19. Confirm delivery locations
20. Verify address and other master file changes directly with vendors

**MANIPULATED RESULTS**

**Manipulating Financial Results**



**The Financial Numbers Game**  
Charles Mulford & Eugene Comiskey

1. **Aggressive Accounting**
2. **Earnings Management**
3. **Income Smoothing**
4. **Fraudulent Financial Reporting**
5. **Creative Accounting Practices**

**Desired Rewards**

1. **Share-price inflation**
2. **Borrowing cost reduction**
3. **Compensation impact**
  - ✓ **Commissions**
  - ✓ **Bonuses**
  - ✓ **Stock options**
4. **Regulatory reserves impact**
5. **Tax planning**

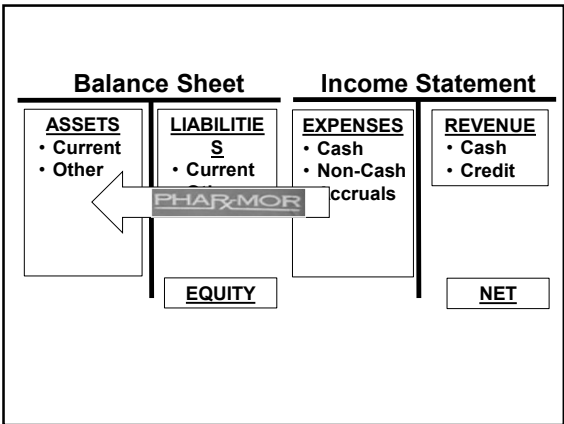
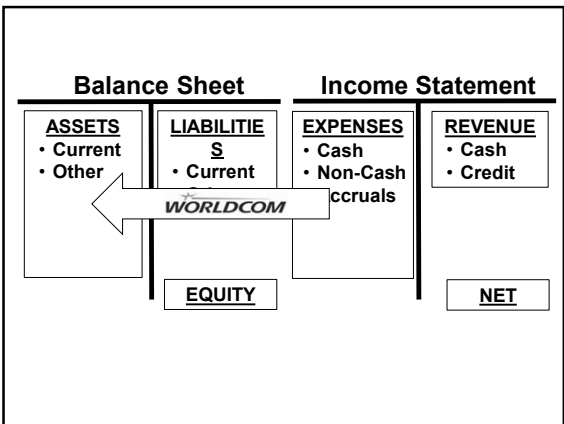
**THE THREE C's**

**Commit**

**Convert**

**Conceal**

- Results Manipulation**
1. **Overstatement of earnings**
  2. **Fictitious earnings**
  3. **Understatement of expenses**
  4. **Overstatement of assets**
    - a) Understatement of allowances
    - b) Overstatement of inventory
    - c) Overstatement of real estate values
    - d) Creation of fictitious assets
  5. **Any transaction improperly moving costs between financial statements**



H. R. 3763

One Hundred Seventh Congress  
of the  
United States of America

AT THE SECOND SESSION

*Began and held at the City of Washington on Wednesday,  
the twenty-third day of January, two thousand and two*

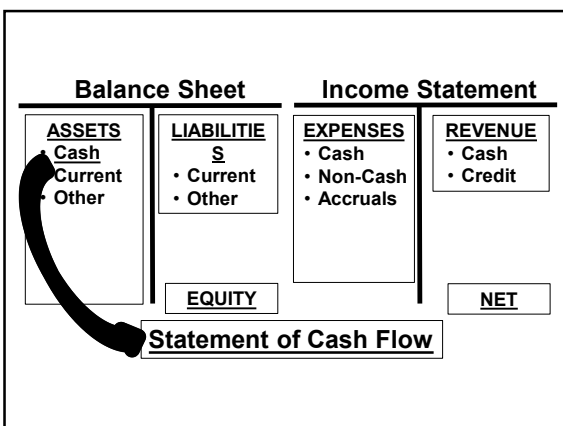
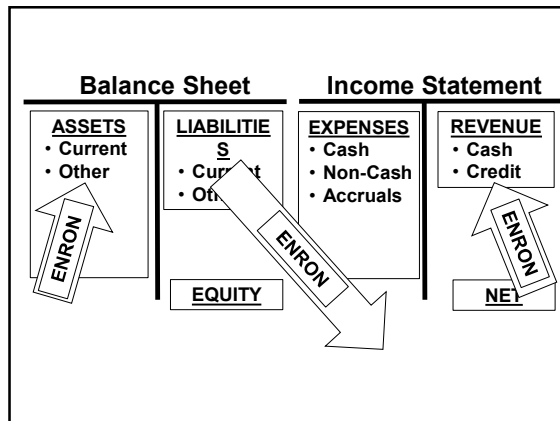
An Act

To protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the “Sarbanes-Oxley Act of 2002.”



**What About Materiality?**

Information is material if omitting, misstating or obscuring it could reasonably be expected to *influence the decisions* that primary users of general-purpose financial statements make on the basis of those financial statements.

Companies have always strived to present their financial results in the most flattering light. Now some are going a step further, presenting a new [customized] metric they are calling ebitdac: earnings before interest, tax, depreciation, amortisation — and coronavirus.

This week Schenck Process, a German manufacturing group, added back €5.4m of first-quarter profits that it said it would have made were it not for the hit caused by state-mandated lockdowns. Its operating profit for the period — “adjusted ebitdac” of €18.3m — was almost 20 per cent higher than the same period a year earlier, rather than 16 [percent] lower.

**Margins** | gusto  
onthemargins@gusto.com

**Preachers and little children see things as black and white. In the real world, there is nothing but a misty bell curve of gray.**

The Contractors  
Harry Hunsicker

## BUSINESS FRAUD LESSONS

In virtually every  
*financial reporting fraud case,*  
someone knew or  
strongly suspected  
BUT STAYED SILENT

## Revenue Recognition Risks

1. Channel Stuffing
2. Side Letters
3. Rights of Return
4. Related-Party Revenue
5. Bill & Hold Transactions
6. Multi-Period Service Contracts
7. Percentage of Completion Contracts
8. Completed Contract Method

## Expense Recognition Risks

1. Capitalizing Routine Maintenance Costs
2. Loss Allowance Reserves
3. Obsolescence Reserves
4. Advanced or Deferred Expense Recognition

## Balance Sheet Examples

1. Changing depreciation from accelerated to straight line
2. Changing useful lives of depreciable assets
3. Changing salvage value for depreciation purposes
4. Changing actuarial assumptions
5. Changing methods for calculating:
  - ✓ Receivable reserves
  - ✓ Loan reserves
  - ✓ Warranty reserves
  - ✓ Deferred taxes
  - ✓ Environmental obligations
  - ✓ Investment value impairment

As Old as Dirt

**Inventory**  
**Valuation**

## Physical Inventory Observation

1. Altering quantities of inventory not counted by the auditors
2. Reporting the same items in counts for different locations (including shifting the items between locations to fool auditors)
3. Altering or disguising the physical characteristics of inventory to make it appear larger quantities are present



## Physical Inventory Observation

1. Altering quantities of inventory not counted by the auditors
2. Reporting the same items in counts for different locations (including shifting the items between locations to fool auditors)
3. Altering or disguising the physical characteristics of inventory to make it appear larger quantities are present
4. Including inventory that simply does not exist

## Underreported Liabilities

1. Understating accounts payable by:
  - ✓ Deferring recording purchases into a subsequent period
  - ✓ Overstating purchase returns
  - ✓ Falsifying documents to appear that liabilities have been paid
2. Not mailing checks that have been written
3. Recognizing unearned revenue as current earned revenue
4. Failure to record debt or other obligations
5. Failure to recognize contingent liabilities
6. Underreporting future obligations (warranty costs)

## Complex Accounts

Accounts that:

1. Contain transactions that are complex or unusual in nature
2. Contain significant estimates
3. Contain period-end adjustments
4. Have been prone to errors or disagreements in the past
5. Have not been reconciled on a timely basis or contain unreconciled differences
6. Contain intercompany transactions
7. Have an identified risk of misstatement due to fraud

## Red Flags Symptoms & Indicators

1. Missing or inadequate documentation
2. Significant unexplained items in reconciliations
3. Missing assets
4. Transactions not recorded in a complete or timely manner
5. Transactions in violation of established policies
6. Unsupported or unauthorized balances or transactions
7. Last-minute adjustments that impact financial results
8. Checks do not clear in reasonable time periods
9. Checks clear that were not issued

## Red Flags Symptoms & Indicators

10. Adjustments to receivables after the end of the period
11. Cancellations of orders after the end of the period
12. Direct entries to sales or receivable 'sub-ledgers'
13. Lack of cash flow from operating activities
14. Sales prior to period end at unusually favorable terms
15. Sales with affiliates and other related parties
16. Pre-dated and post-dated transactions
17. Cookie jar adjustments
18. Big bath charges

### Red Flags Symptoms & Indicators

19. Complaints from customers
20. Complaints from suppliers
21. No proceeds from accounts sent out for collection
22. No proceeds from the disposition of assets
23. Anything physically impossible:
  - ✓ Hours billed
  - ✓ Miles driven
  - ✓ Quantities stored
  - ✓ Credits issued when no sale occurred
  - ✓ Credits in excess of transactions

## **EXERCISE**

**What Would  
You Do Next?**

**Handout Page 8**

## **Decision Delineators**

### 4 Common Rationalizations

- The activity is within reasonable ethical and legal limits – that is, it's not “really” illegal or immoral.
- The activity is in the individual's or organization's best interests –so the individual would somehow be expected to undertake the activity.

### 4 Common Rationalizations

- The activity helps the organization, so leadership will condone it and even protect the person who engages in it.
- The activity is “safe” as it will never be found out or publicized – the classic crime-and-punishment issue of discovery.

**1992**  
**!!!**

# 2020 ???

- ### 10 Good Questions to Ask
1. What could go wrong in results reporting?
  2. Exactly how could actual results be manipulated to produce results that differ from reality?
  3. What would it look like if it happened?
  4. What accounts would be used – consider both debits and credits?
  5. What forms would need to be completed?

- ### 10 Good Questions to Ask
6. What approvals are necessary?
  7. What documentation would be needed to support the manipulated results?
  8. What management results or analysis might give the scheme away?
  9. How would they fool both the internal and external users of information?
  10. How would they fool the auditors (both internal and external)?

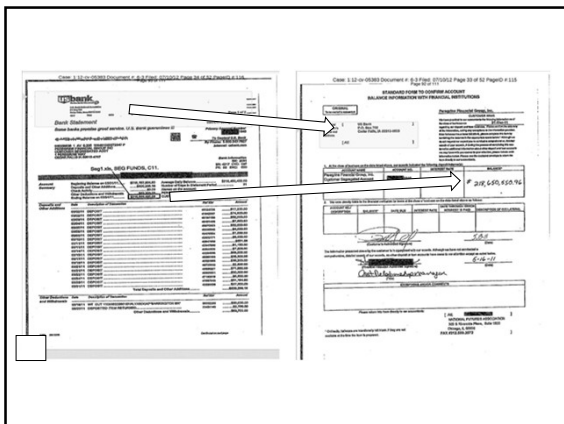
## Theft Plus Cooking the Books

### Peregrine Financial Group

### Peregrine Financial Group

**Russell Wasendorf Sr.**

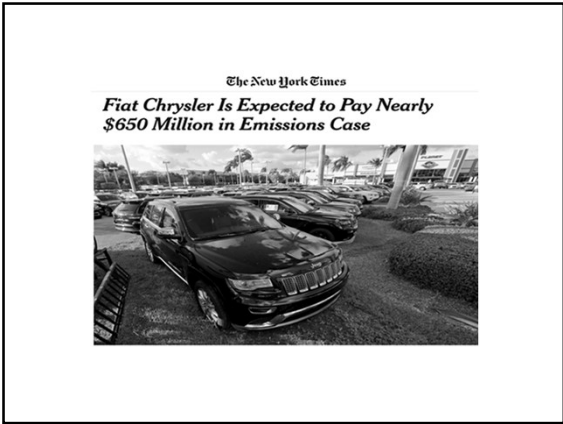
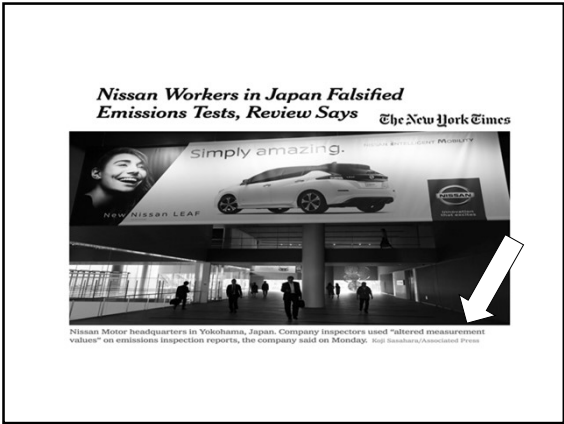
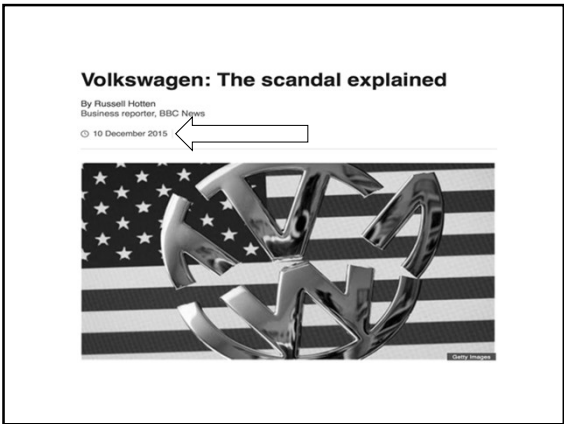
- \$215 Million Theft
- Misleading Auditors
- 50 Years in Prison

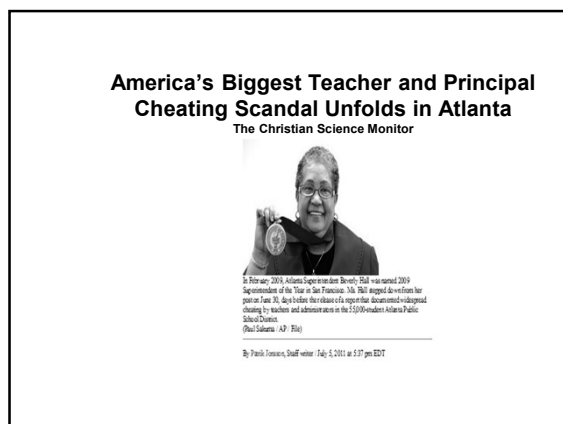
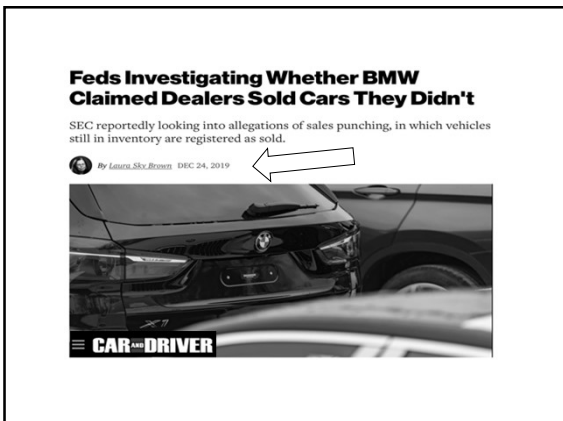




# Manipulating Operational & Other Non-Financial Results

- ## Non-Financial Results
1. Regulatory compliance
  2. Market conduct
  3. Product safety
  4. Environmental compliance
  5. "Fitness for Use"
  6. Customer satisfaction
  7. Volume activity stats
  8. KRI achievement





**Family Connections:  
The Death of a Nonprofit**

Austin American-Statesman  
([www.statesman.com](http://www.statesman.com))

- Organization Background**
- 1) \$3.1 million Austin based non-profit
  - 2) Created as merger of two nonprofits
  - 3) Early childhood education and support
  - 4) Served 32,000 children and adults
  - 5) Parenting classes, mental health counseling for mothers, child care referrals, health education
  - 6) 30 full-time employees
  - 7) 11 member board of directors

**Executive Director**

- 1) 51 years old
- 2) 1982 accused of writing fraudulent checks
- 3) 1987 convicted of theft – 4 year sentence, served 4 months
- 4) 1990 while on probation, hired in finance department of nonprofit agency
- 5) Handled billing, invoices and payments
- 6) 1992 filed for bankruptcy
- 7) 1994 promoted to executive director
- 8) 2004 appointed executive director of merged nonprofits


**What Happened**

- 1) Theft of over \$327,000 to private bank accounts 2004 to 2009 (\$33,000 Dec 09 to Feb 10)
- 2) In 2004 wrote \$80,000 in checks to EAC
- 3) Paid personal car loan
- 4) Paid \$150,000 of mortgage
- 5) Falsified financial audits and filed with government agencies and others
- 6) Kept all financial records on thumb drive
- 7) \$130,000 from Texas Association of Child Care Resources - volunteer Treasurer

**Other Inflated Results**

- Resource library helped 6,500 families
- Actual closer to 3,700
- Child care locating service helped 3,500 families
- Actual 860
- Parenting classes for 2,300
- Actual 1,000

Build Your “I Must...” List



How can I use this?  
**HCIUT?**

**TRY B4 TOSS**

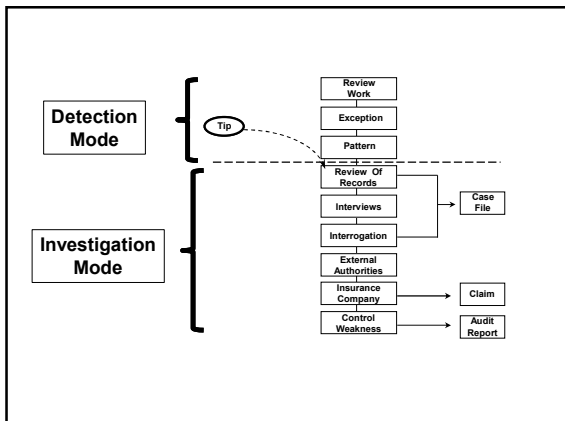
**Unit 4:**

***Our Role in Fraud Incident Response***

**Fraud Risk Management Framework**

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

ORGANIZATIONS MUST BE PREPARED AT ALL THREE LEVELS



- ### Effective Fraud Handling
1. Response mechanism
  2. Investigation
  3. Loss recovery
  4. Control weaknesses
  5. External authorities
  6. Publicity
  7. Morale and HR concerns

- ### Fraud Response Challenges
1. Uncertainty and fear
  2. Response readiness
  3. Loss recovery
  4. Reporting to the authorities
  5. Learning from fraud events
  6. Morale and HR
  7. Publicity
  8. Correcting weaknesses

## EXERCISE

### Investigations: What Could Go Wrong?

**Handout Page 9**

- ### Investigative Resources
1. Experienced investigators
  2. Forensic accountants
  3. Information technology experts
  4. Computer forensics specialists
  5. Other technical specialists
  6. Security
  7. Internal auditors
  8. Human resources
  9. Legal and Compliance

- ### What We Can Expect
1. Denial–Dismay–Anger–Empathy
  2. Confusion
  3. Fear
  4. In some – thought and action paralysis

### What We Need to Provide

1. **Calm, objective leadership**
2. **Protection of the innocent**
3. **Certainty**
4. **Consistency**
5. **Resources**

### Investigations Include

1. **Are we authorized**
2. **Can we handle it**
3. **Do we want to handle it**
4. **Fraud or error**
5. **Who is involved**

### Investigations Include

6. **What happened**
7. **How did it happen**
8. **Where did it happen**
9. **When did it happen**
10. **How much was lost**
11. **Internal control implications**

### Investigations Include

12. **Documentation for:**
  - ✓ **Management**
  - ✓ **Authorities**
  - ✓ **Insurers**
  - ✓ **Others**
13. **Follow through with:**
  - ✓ **Criminal prosecution**
  - ✓ **Civil litigation**
  - ✓ **Recovery of losses**

### Communicate Consequences

1. **Deterrent effect**
2. **People should know what to expect if they commit wrongful acts**
3. **Discipline including termination and reporting**
4. **No surprises**
5. **Can enhance morale**

### Report to the Authorities?

1. **"It's best not to..."**
2. **"They won't do anything"**
3. **Fraud by management**
4. **Fraud for the organization**
5. **Confidential information**
6. **Fear of litigation**

**Get Qualified Advice  
Be Consistent**

**What if the Press Finds Out?**

1. **Be clear: who talks to the press**
2. **Craft the message in advance**
3. **Don't be pulled into speculation**
4. **Make sure all employees know what to do (and what to avoid) if approached by the press**
5. **It's OK to smile politely, say nothing, and walk away**

**What About the Employees?**

1. **Our first priority is protection of the innocent – including you**
2. **Share at the appropriate time**
3. **Emphasize the lessons learned**
4. **Assure handling is professional, fair and respectful**
5. **Take confident action and do the right thing – for them**

***Program Summary:***

***So what... are we to do with this information?***

***Program Summary:***

***So what questions do you have at this point?***

***Program Summary:***


***So what are we to do with this information?***

**Foundation**

**Focus on  
Solutions**

## Foundation List Actions

Build Your "I Must..." List



How can I use this?  
**HCIUT?**

**TRY B4 TOSS**

### Fraud Loss Scorecard

	HIGH	LOW
1 Disbursements	\$ XXX	\$ XXX
2 Inventory		
3 Construction/Facilities		
4 Health Care Costs	2%	1%
5 Payroll		
6 T&M contracts		
7 T&E reimbursement		
8 Other - Unique to You		
<b>TOTAL</b>	<b>\$ XXX</b>	<b>\$ XXX</b>

## Unit 1: Our Role in Deterrence & Prevention

- ### Fraud Risk Management Framework
1. **Deterrence and Prevention**
  2. **Early Detection**
  3. **Effective Handling**
- ORGANIZATIONS MUST BE PREPARED  
AT ALL THREE LEVELS

- ### 6 Critical Actions
1. Visible & Vocal Leadership – At Every Level
  2. Policies on Fraud Responsibilities
  3. Active Ongoing Fraud Risk Brainstorming
  4. Anti-Fraud Controls
  5. Anti-Fraud Daily Behaviors
  6. Anti-Fraud How-To Employee Skills Training

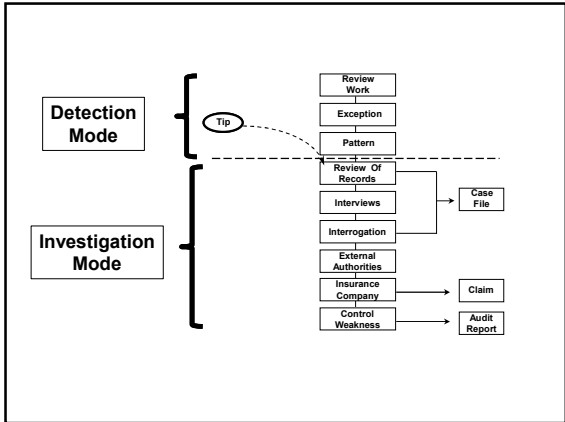
**Unit 2:**  
**Three-Step  
Fraud Detection**

- Three-Step Fraud Detection**
1. **Think like a thief**
    - a) Individual and group brainstorming
  2. **Use discovery techniques aggressively**
    - a) Discovery or attribute testing
    - b) Detection-Focused interviews
    - c) Data Analysis and Monitoring
  3. **Determine the cause of all indicators**
    - a) Root Cause Analysis

**Unit 3:**  
**Deep Dive into  
Recurring Business  
Fraud Risks**

**THE THREE C's**  
**Commit**  
**Convert**  
**Conceal**

**Unit 4:**  
**Our Role in  
Fraud Incident Response**





Alex Mendossian  
**Ordinary Things  
Consistently Done  
Can Produce  
Extraordinary Results**

**It's a Campaign,  
Not an Event  
CUMULATIVE  
EFFECT**



***Fraud Prevention Pro  
Challenge***  
– ON OUR WATCH –  
we will simply no longer tolerate  
Lies, Deception,  
Wrongdoing, Misconduct,  
Theft, or Outright Fraud

**Questions, Comments, Feedback,  
Arguments, or Anything Else**

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**Thank You**  
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