

INSPECTOR GENERAL INSTITUTE

TRAINING AND CERTIFICATION FOR INSPECTION
AND OVERSIGHT PROFESSIONALS

Fraud Awareness for Inspectors

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Course Objectives

- Identify potential fraud indicators.
- Apply fraud awareness principles when performing inspections.
- Know the actions to take when red flags are observed during an inspection.

Introduction

Black's Law Dictionary defines fraud as: "A knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment."

Fraud includes any intentional or deliberate act to deprive another of property or money by guile, deception, or other unfair means.

Source: ACFE Fraud Examiners Manual, 2020 U.S. Edition

Yes, fraud does occur in government!

Fla. Public Works Employee Arrested for Fuel Theft



Jury finds Batterson guilty of bribery charges in Orlando expressway board case



Florida Highway Patrol careers cut short by timesheet fraud



Palm Beach County Worker Accused of Cookin' the Books to Obtain Mortgage Through County

City investigators bust former DEP employees for alleged kickbacks



Theranos Fraud

The rise and fall of Theranos (therapy and diagnosis), the one-time multibillion-dollar healthcare company founded by Elizabeth Holmes. In 2003, Elizabeth Holmes dropped out of Stanford to start a company that was going to revolutionize healthcare. In 2014, Theranos was valued at \$9 billion, making Holmes, who was touted as “the next Steve Jobs,” the youngest self-made female billionaire in the world. Just two years later, Theranos was cited as a “massive fraud” by the SEC, and its value was less than zero.



The Original Internet God Father

Brett Johnson, referred to by the U.S. Secret Service as "The Original Internet Godfather" had been a central figure in the cybercrime world for over 20 years. He built and was leader of ShadowCrew, the precursor to today's darknet markets. He was instrumental in developing many areas of online fraud while helping design, implement, and refine modern Identity Theft, Account Take Over Fraud, Card Not Present Fraud, IRS Tax Fraud, and countless other social engineering attacks, breaches, and hacking operations. Upon his capture, U.S. Secret Service hired Johnson to work as a consultant and informant. Johnson worked with the Secret Service for several months before going on a cross country crime spree, being placed on the U.S. Most Wanted List, being captured again, sent to prison, escaping prison, being captured yet again, and finally accepting responsibility for his actions.

Today, Johnson works as a security consultant and public speaker. He is one of the world's foremost authorities on cybercrime and identity theft.

Source: ACFE 32 Annual Global Fraud Conference, Closing General Session, Guest Speaker, 21–23 June 2021

Fraud Schemes

Financial Statement Fraud – deliberate misrepresentation of the financial condition of an enterprise.

Identify Theft– a fraudster stealing an individual's personal information and pretending to be that individual.

Financial Institution Fraud – false accounting entries, unauthorized withdrawals, skimming

Payment Fraud – include fraudulent payment methods ranging from cash to bitcoin

Insurance Fraud – insurance companies generate a large steady flow of cash through premiums, a steady flow of cash can be easily diverted.

Health Care Fraud – the largest amount of insurance fraud is in health care; involves a deception or misrepresentation that an individual or entity makes resulting in a benefit to the individual, the entity or some other party; tens of billions of dollars lost annually.

Consumer Fraud – misleading practices related to advertising, marketing, or the selling of buying of goods and services; advance fees, debt consolidation, and diploma mills.

Computer and Internet Fraud – deliberate misrepresentation of fact or alteration of data to obtain or receive something of value that causes a financial loss to a person or organization.

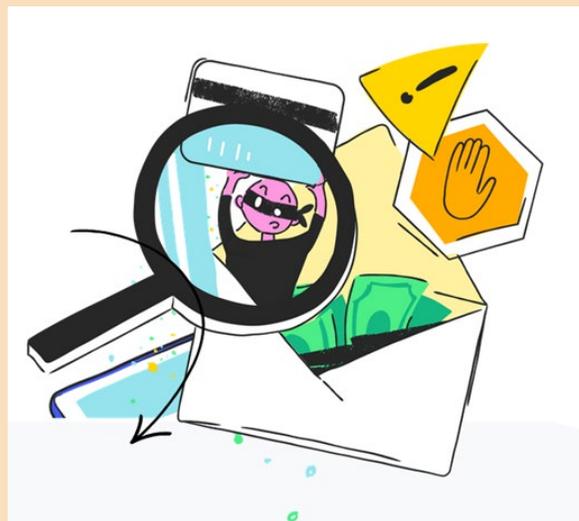
Contract and Procurement Fraud – collusion among contractors, between contractors and employees, pricing schemes, performance schemes, and change order abuse.

Source: ACFE Fraud Examiners Manual, 2020 U.S. Edition

Examples of Common Scams

Advance Fee Schemes: An advance fee scheme occurs when the victim pays money to someone in anticipation of receiving something of greater value such as a loan, contract, investment, or gift and then receives little or nothing in return.

Nigerian Letter or “419” Fraud: Nigerian letter frauds combine the threat of impersonation fraud with a variation of an advance fee scheme in which a letter mailed, or e-mailed, from Nigeria offers the recipient the “opportunity” to share in a percentage of millions of dollars that the author—a self-proclaimed government official—is trying to transfer illegally out of Nigeria.



Source: <https://www.fbi.gov/scams-and-safety/common-scams-and-crimes>

Examples of Common Scams

Ponzi Schemes: Promise high financial returns or dividends not available through traditional investments. Instead of investing the funds of victims, however, the con artist pays “dividends” to initial investors using the funds of subsequent investors.

Online Vehicle Sale Fraud : The FBI warns consumers that criminal perpetrators may post fraudulent online classified advertisements offering vehicles for sale that are not, nor have ever been, in their possession.



Source: <https://www.fbi.gov/scams-and-safety/common-scams-and-crimes>

Types of Fraud

- **Internal/Occupational Fraud**: The use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the organization's resources or assets.
- **External Fraud**: Is fraud against a company which covers a broad range of schemes. Dishonest vendors might engage in bid-rigging schemes, bill the company for goods or services not provided, or demand bribes from employees.



Who Commits Fraud

- Employees, Managers, Executives
- Vendors seeking government business
- Financial assistance recipients
- Government Contractors
 - Prime
 - Sub-contractors

Owners/executives
accounted for
a small percentage
of cases



but caused a
median loss of

\$850,000

Why Does Fraud Occur?

One of the most common and widely accepted model for explaining why fraud occurs is the Fraud Triangle developed by Dr. Donald R. Cressey, to explain the reasoning behind a worker's decision to commit workplace fraud.



Source: ACFE Fraud Examiners Manual, 2020 U.S. Edition

Why Does Fraud Occur?

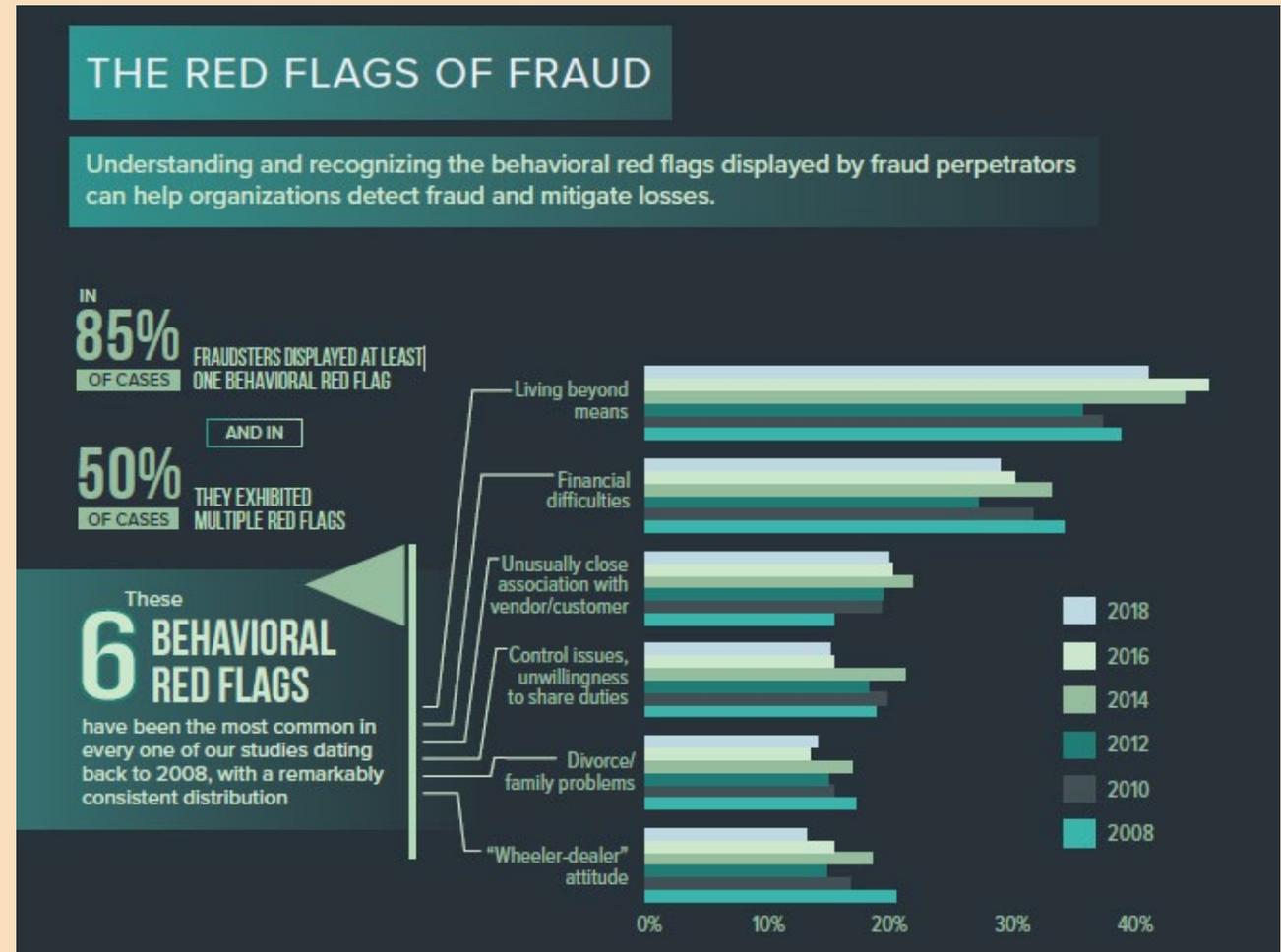
Cressey theorized that you need three elements to commit the fraud:

- **Rationalization** – the individual’s mindset and that it’s okay to commit the fraud or crime. *“I’ve been paying my premium for decades... it’s my turn to cash in.”*
- **Financial Pressure** – the motivation or reason to commit the fraud. Examples include financial distress, drug or gambling addiction, or the desire to maintain a lavish lifestyle.
- **Opportunity** – the ability to commit the fraud. Lack of business controls give fraudsters the opportunity to commit a crime.

Fraud Triangle–Pressure/Motive

Pressure/Motive Red Flags:

- High debt
- Significant financial losses
- Excessive alcohol, drugs or gambling
- Extramarital affair
- Perceived organizational inequities
- Job frustration or resentment



Fraud Triangle–Opportunity

Opportunity **Red** Flags:

- Familiarity with operations.
- Ability to override controls.
- No periodic rotation of key employees or employee who does not take time off.
- Lack of segregation of duties.
- Lack of independence of the Internal Audit function.

Fraud Triangle–Rationalization

Rationalization **Red** Flags:

- They owe me
- We don't receive raises or bonuses
- I'm overworked and underpaid
- They'll never miss it
- I'll just borrow it; I'll pay it back
- I'm not really hurting anyone
- Everyone is a little dishonest



Look for low morale and disgruntled employees

Profile of an Occupational Fraudster

- **Gender**–69% are male
- **Age**–38% are between the ages of 36 to 45
- **Education**–47% have a Bachelors degree
- **Criminal History** –89% have never been charged or convicted of fraud
- **Position**–44% Employees vs. Management/Executive
- **Department**–Accounting & Operational employees average 28%
- **Tenure**–44% 1 to 5 years

Profile of a Fraudster–Department

- Employees within the Accounting departments have the most frequent incidents of fraud.
- Executive Management incurred the greatest losses.

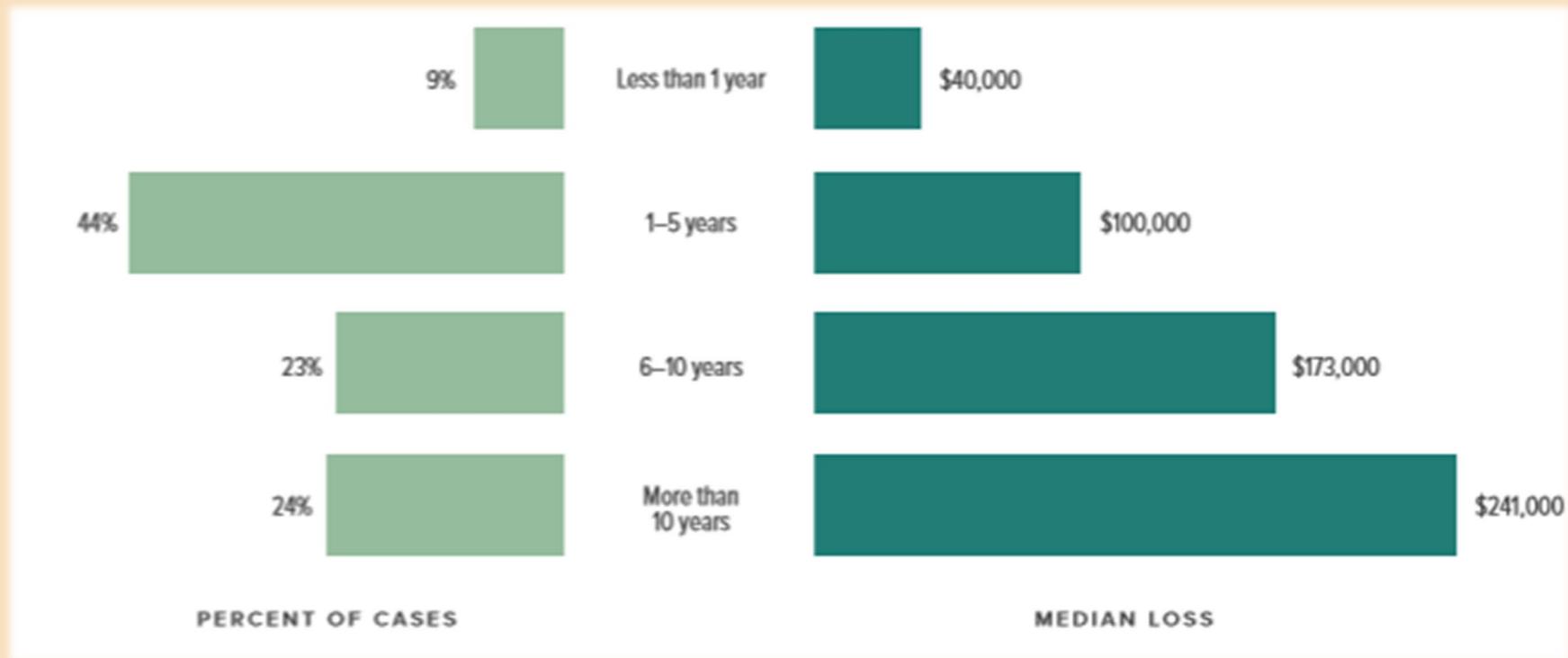
Department*	Percent of cases	Median loss
Accounting	14%	\$ 212,000
Operations	14%	\$ 88,000
Sales	12%	\$ 90,000
Executive/upper management	11%	\$ 729,000
Customer service	8%	\$ 26,000
Administrative support	8%	\$ 91,000
Other	6%	\$ 77,000
Finance	6%	\$ 156,000
Purchasing	5%	\$ 163,000
Facilities and maintenance	3%	\$ 175,000
Warehousing/inventory	3%	\$ 200,000
Information technology	3%	\$ 225,000
Marketing/public relations	2%	\$ 80,000
Manufacturing and production	2%	\$ 200,000
Human resources	1%	\$ 76,000

*Departments with fewer than ten cases were omitted.

2018 Report to the Nations. Copyright 2018 by the Association of Certified Fraud Examiners, Inc.

Profile of a Fraudster–Tenure

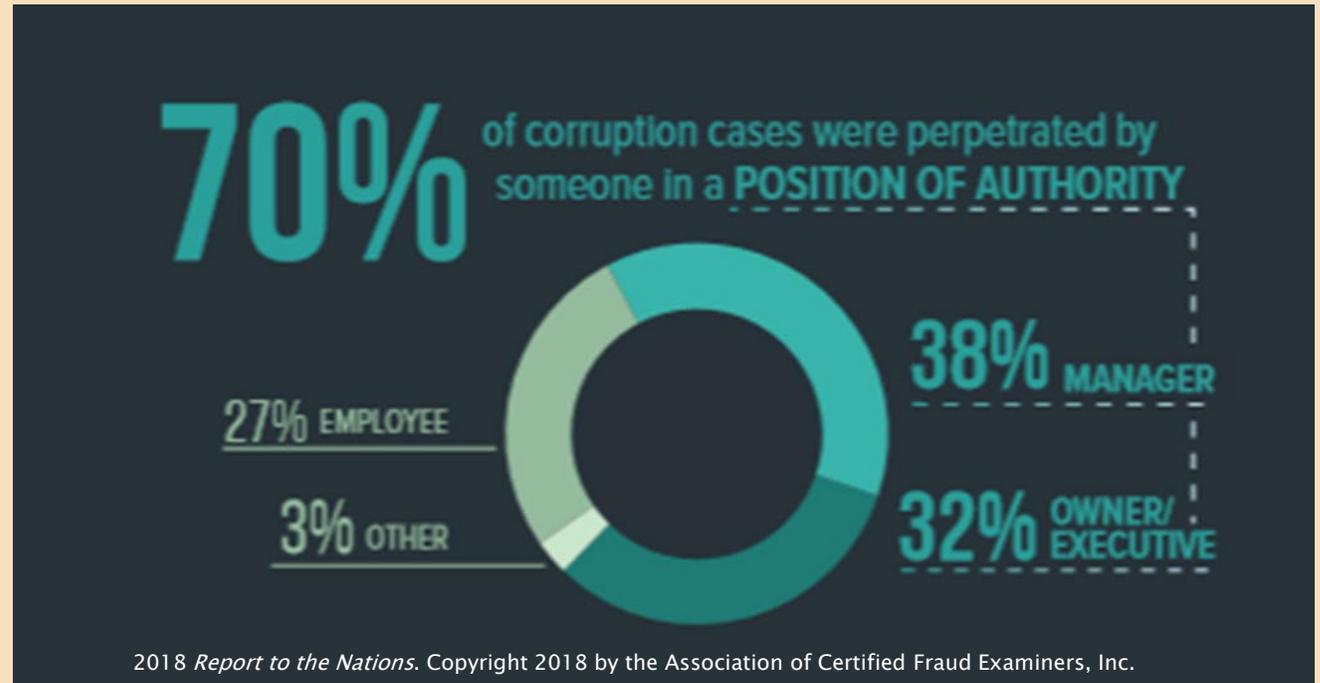
How does the fraudster's tenure relate to financial loss:



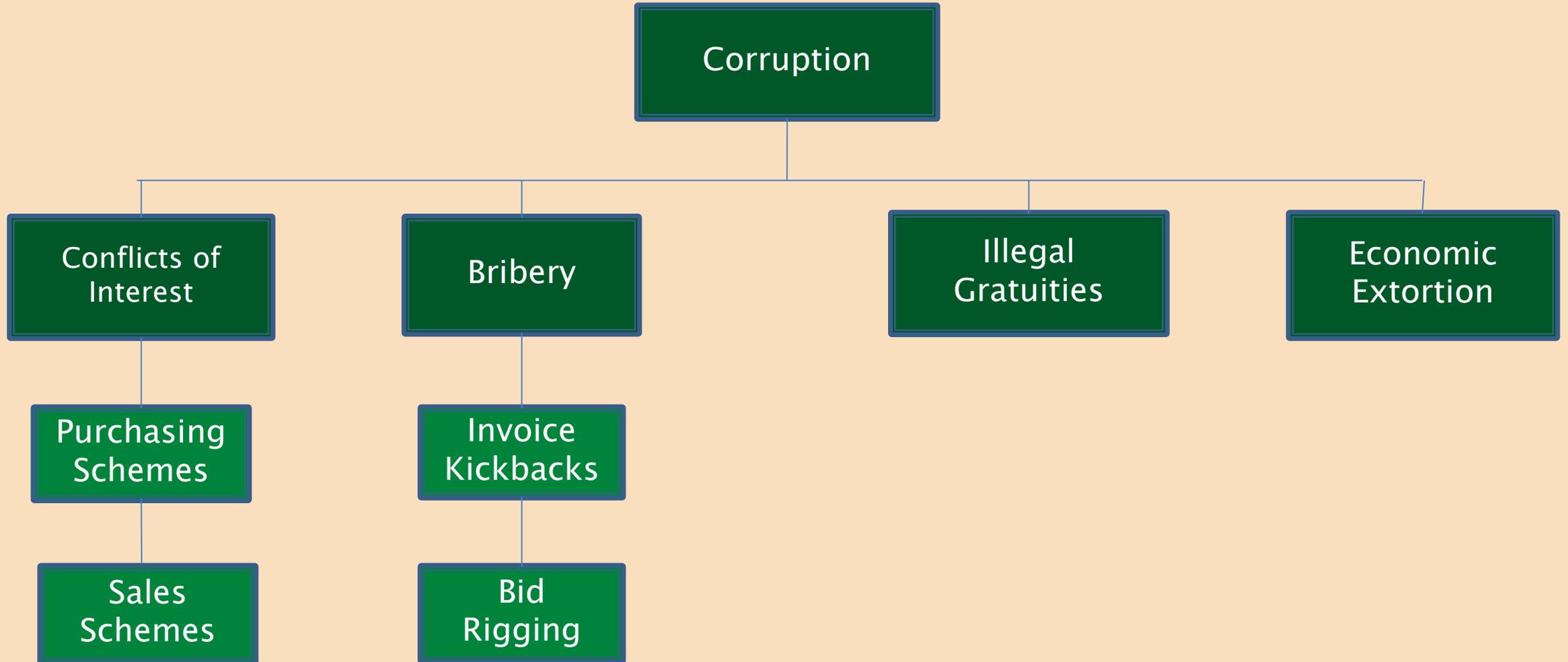
2018 *Report to the Nations*. Copyright 2018 by the Association of Certified Fraud Examiners, Inc.

Categories of Occupational Fraud

- 1) Corruption
- 2) Asset Misappropriation
- 3) Financial Statement



Corruption



Corruption

What to Look For:

- Restrictive or vague specifications
- Low number of bidders
- Regular bidders do not bid
- Same vendor(s) repeatedly winning bids
- Unable to confirm bids with losing vendors
- Lack of vendor contact information on bids
- Bidder's signature is the company name, not an individual
- Similar letterheads of bidders
- Large difference in bid amounts

FIG. 12 What types of organizations are victimized by occupational fraud?

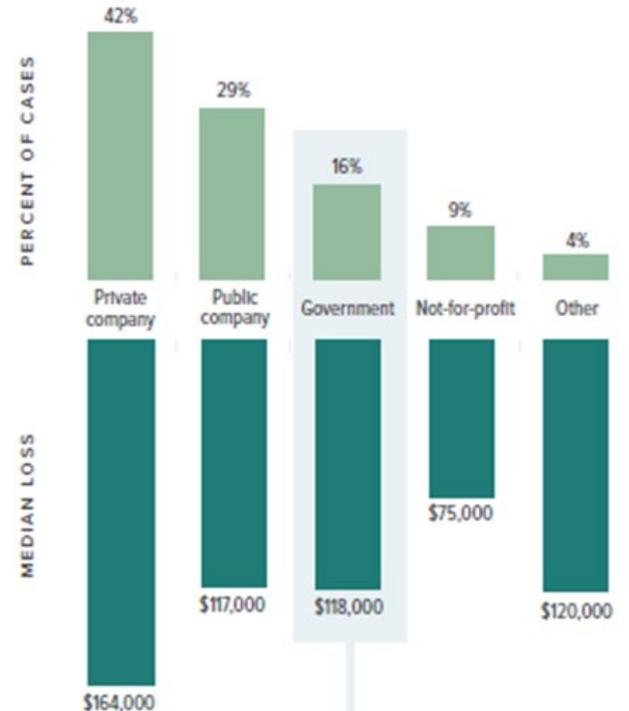
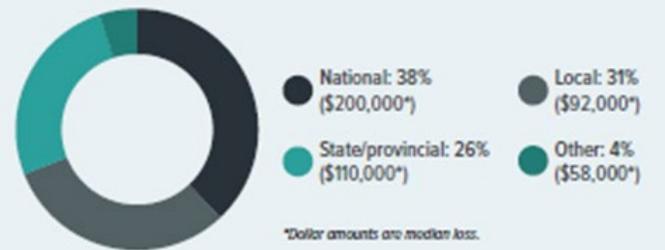


FIG. 13 What levels of government are victimized by occupational fraud?



Asset Misappropriation

Theft of Cash:

- Skimming
- Larceny



Asset Misappropriation cont.

What to Look For:

Shell Companies:

- You have never heard of this company
- Company receives many small dollar payments
- Company name includes initials or personal name
- Company sells intangible services difficult to confirm

Payroll Schemes:

- Singular employee works longer hours than others in same position
- Home address is a PO Box



Asset Misappropriation cont.

What to Look For

Expense Reimbursement Schemes:

- Same leave and return times on multiple trips
- Plane tickets with matching last names
- Shipping address differs from billing address
- Charges made on weekends or around holidays
- Charges for the same amount

Check & Payment Tampering:

- Lack of independence in the Internal Audit function
- Round amounts or amounts under approval levels
- Missing or no supporting documents



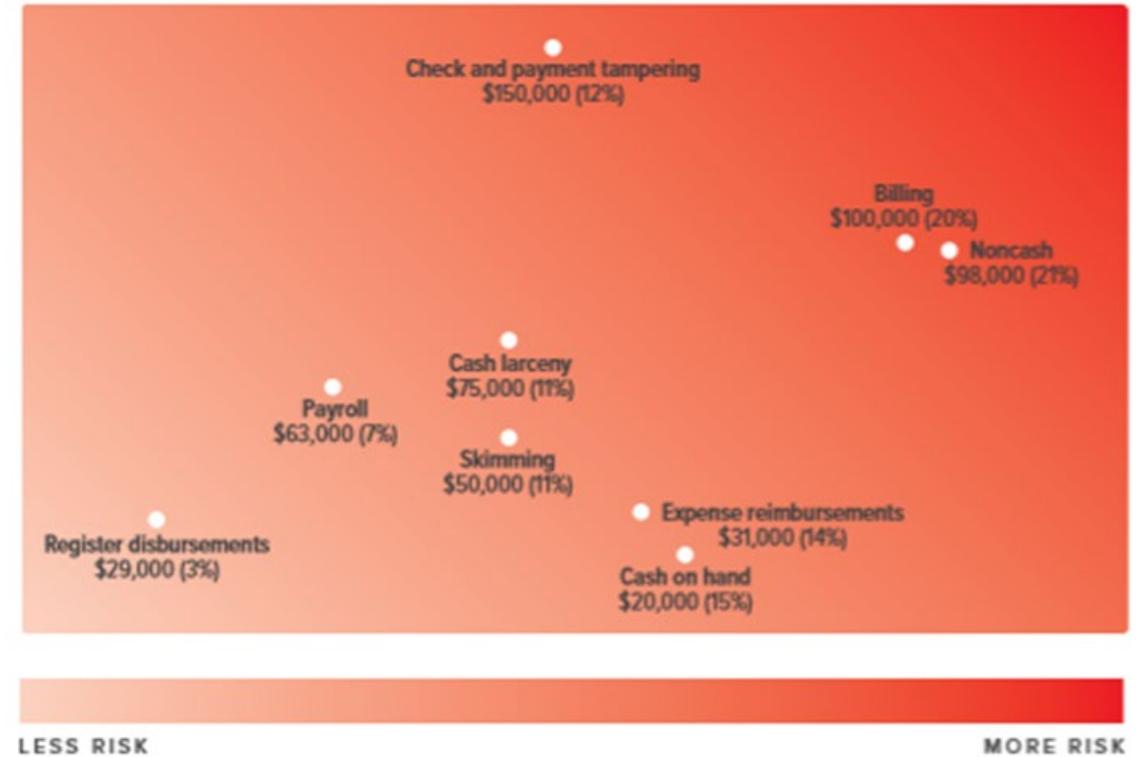
Asset Misappropriations

What to Look For

Inventory & All Other Assets:

- Unrestricted access to inventory
- No minimum, maximum or reorder levels for inventory
- Lack of regular physical inventory counts
- Goods different than purchased (e.g., different model or serial numbers)

Asset Misappropriations Schemes & Risks



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Financial Statement Fraud

- Net Worth/Net Income Overstatements
 - Timing Differences
 - Fictitious Revenues
- Net Worth/Net Income Understatements
 - Understated Revenues
 - Improper Asset Valuations



Financial Statement Fraud

What to Look For

- Unwillingness or unusual delays in providing needed data/information
- Limited access to people
- Missing data



How Fraud Is Concealed

CONCEALING FRAUD

An act of fraud typically involves not only the commission of the scheme itself, but also efforts to conceal the misdeeds. Understanding the methods fraudsters use to cover their crimes can help organizations better design prevention mechanisms and detect the warning signs of fraud.

TOP 8 CONCEALMENT METHODS USED BY FRAUDSTERS



Created fraudulent physical documents



Altered physical documents



Created fraudulent transactions in the accounting system



Altered transactions in the accounting system



Altered electronic documents or files



Destroyed physical documents



Created fraudulent electronic documents or files



Created fraudulent journal entries

Fraud Detection

Tips from employees are the most common fraud detection method.

Management Reviews is the 3rd highest method of detection.

FIG. 9 How is occupational fraud initially detected?

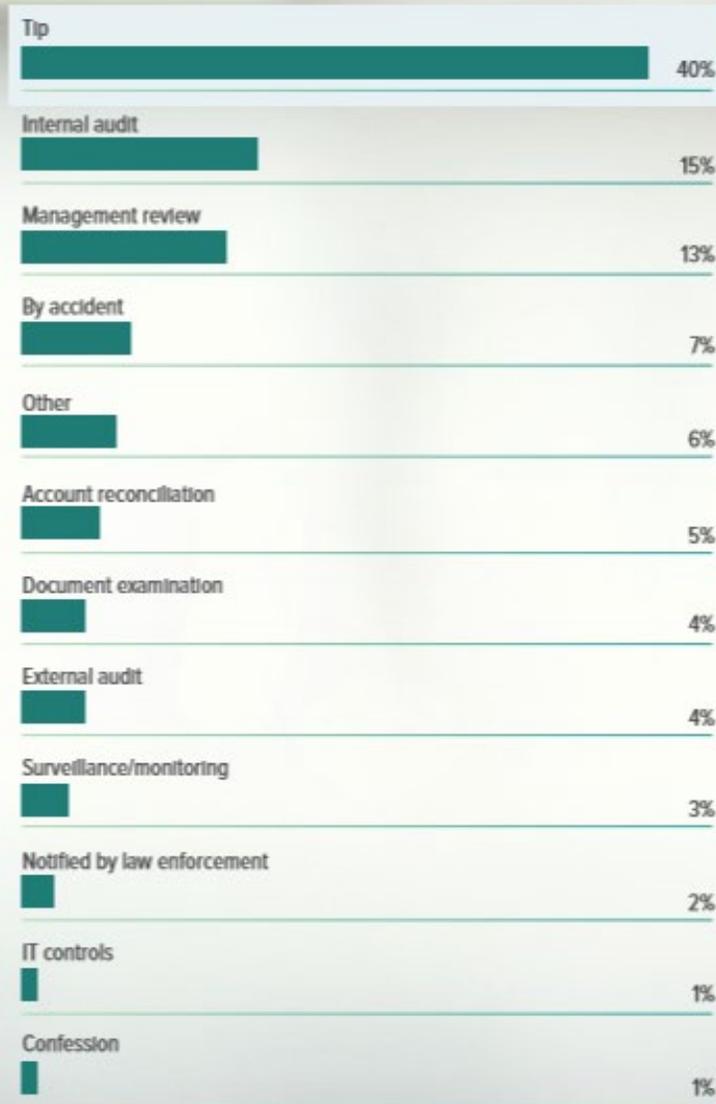
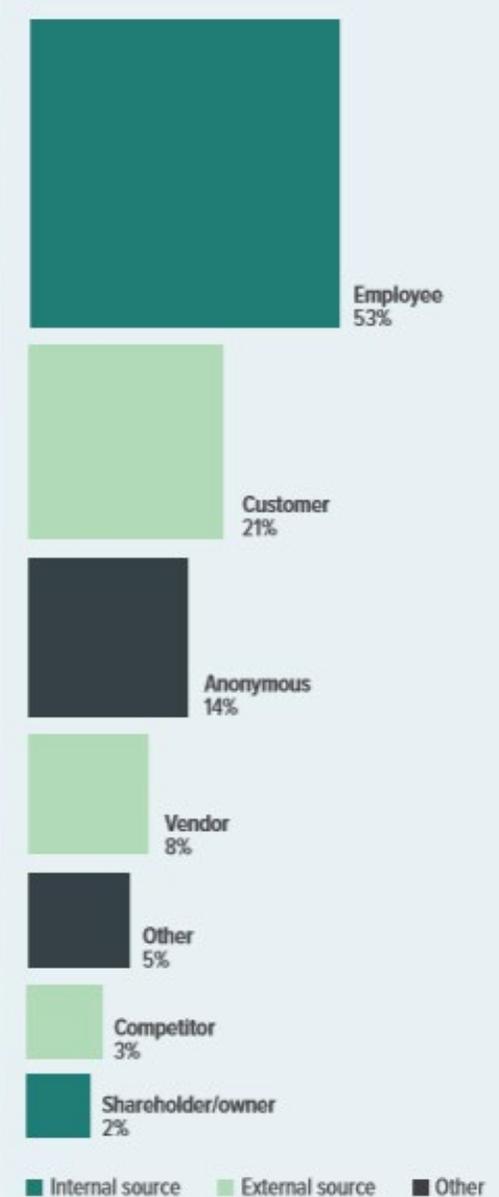


FIG. 10 Who reports occupational fraud?



Fraud Detection & Duration

How does the fraudster's level of authority relate to scheme duration and detection?

- Employee level staff....Averages 12 months until detection
- Manager level staff..... Averages 18 months until detection
- Owner/Executive.....Averages 24 months until detection



Duration of Fraud Schemes

The longer the fraud occurs the larger the scheme and losses will be suffered.

Most fraudsters tend to start small and increase rapidly over the first three years.



Fraud Awareness

Principles to Follow while conducting an Inspection/Review:

- Verify and confirm all pertinent information (Professional Skepticism).
- Keep eyes open and ear to the ground.
- Examine original documents, when available.
- Look for patterns (Employee time cards are 8:00 am to 5:00 pm *EVERYDAY*).
- If you see/hear something...dig a little deeper.
- What is the Tone at the Top?
- Does the organization offer Fraud training?



Fraud Red Flags

What to do if Fraud Red Flags are Discovered:

- 1) Follow your OIG policy/directives
- 2) Notify your supervisor and/or Notify Investigations Div
- 3) Preserve evidence
- 4) Maintain confidentiality
- 5) Document the following in detail:
 - a) How you discovered the information
 - b) When you discovered the information
 - c) Who was present when you discovered the information
 - d) Describe what you found and why it was considered a Red Flag



Questions? Comments?



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