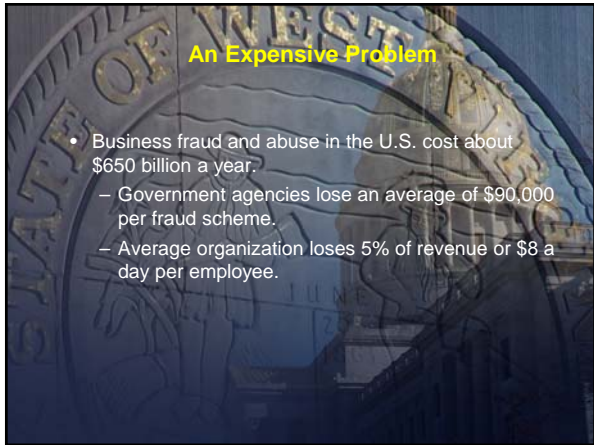
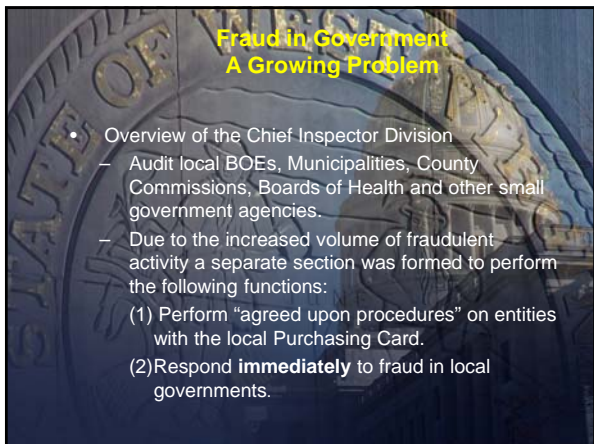


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West Virginia State Auditor's Office
Charleston, WV



An Expensive Problem

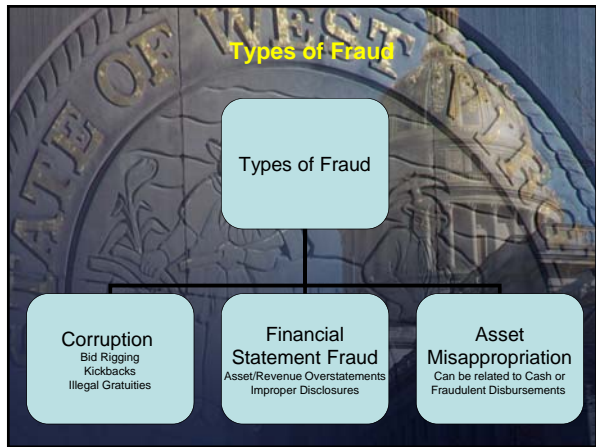
- Business fraud and abuse in the U.S. cost about \$650 billion a year.
 - Government agencies lose an average of \$90,000 per fraud scheme.
 - Average organization loses 5% of revenue or \$8 a day per employee.

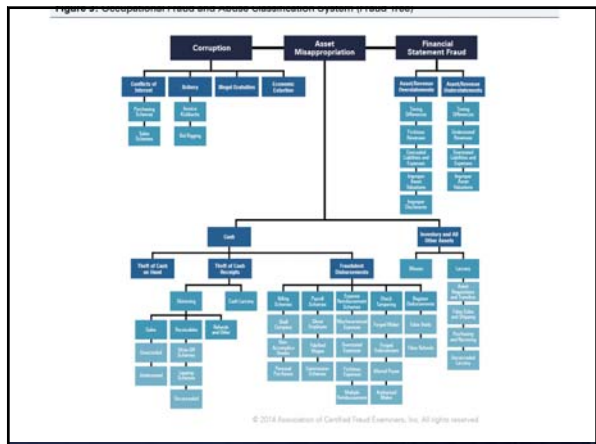


Fraud in Government A Growing Problem

- Overview of the Chief Inspector Division
 - Audit local BOEs, Municipalities, County Commissions, Boards of Health and other small government agencies.
 - Due to the increased volume of fraudulent activity a separate section was formed to perform the following functions:
 - (1) Perform "agreed upon procedures" on entities with the local Purchasing Card.
 - (2) Respond **immediately** to fraud in local governments.







Asset Misappropriation

- Skimming.
- Non received revenue/substitution of checks for cash.
- Lapping Schemes.
- Write-off Schemes.
- Shell Companies.
- Personal Purchases (i.e. Credit or Purchasing Cards).
- Payroll Schemes (extra payrolls, falsified wages, excess leave payments, ghost employees, credit union).
- Expense reimbursement schemes (duplicate payments, fictitious expenses).
- Check tampering (altered payee, forged endorsement, concealed checks).

Figure 4: Occupational Frauds by Category — Frequency

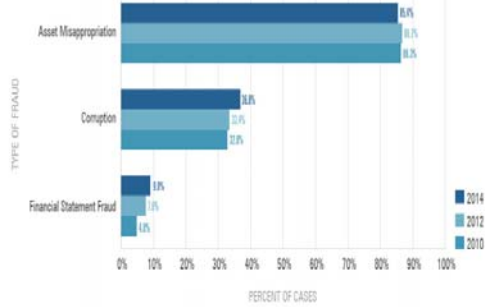
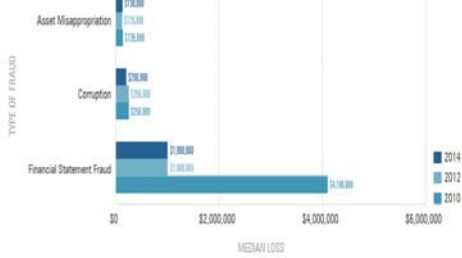


Figure 5: Occupational Frauds by Category — Median Loss



Fraud Detection and Prevention

- External Auditor Responsibility
 - SAS 99 (issued in 2002) says auditors should gather information to identify material misstatements due to fraud and:
 - Assess these risks with other evaluations.
 - Respond to these risks.
 - Brainstorming.
 - Congress also passed Sarbanes-Oxley (SOX-Publicly traded companies) in 2002:
 - Requires senior management to certify the accuracy of the financial statements.
 - Requires management to establish detailed internal controls and auditors to report on those controls.

Fraud Detection and Prevention

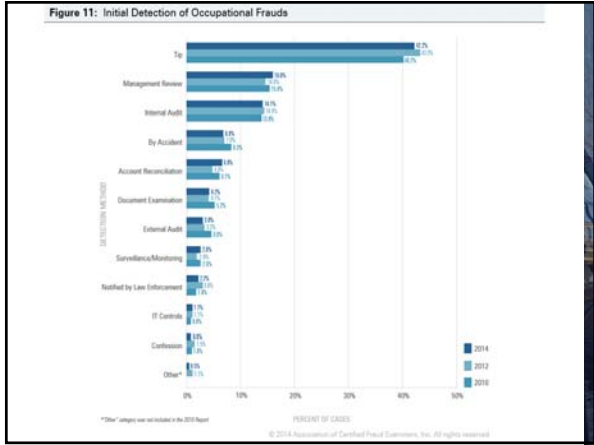
Year	Company	Auditor	Description
2002	Worldcom	Arthur Anderson	11B moved from operating expenses to capital accounts.
2001	Enron	Arthur Anderson	Employees and investors lost 74B when the company declared bankruptcy; innovative accounting methods all designed to overstate earnings and keep debt off the books through "controlled" companies. Firm paid \$52M in one year for audit and other services. Destroyed audit documents.
1998	Waste Management	Arthur Anderson	1.7 B in fake earnings through false depreciation lives.
2002	Tyco	Price Waterhouse Coopers	CEO and CFO stole 150M (disguised as bonuses) and inflated earnings by 500M

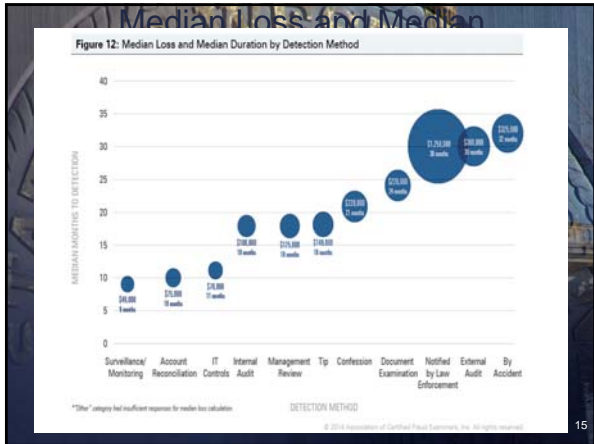
Fraud Detection and Prevention

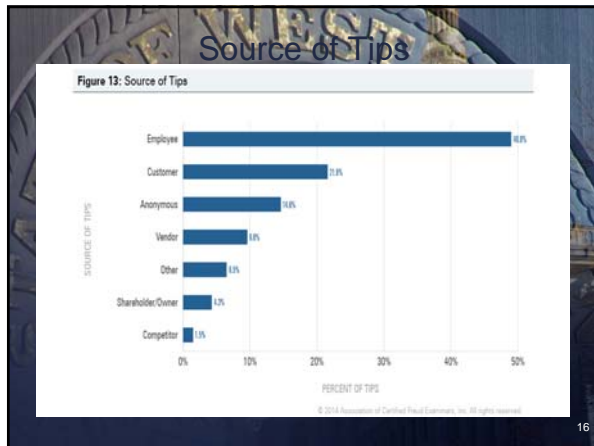
- Did these measures work?

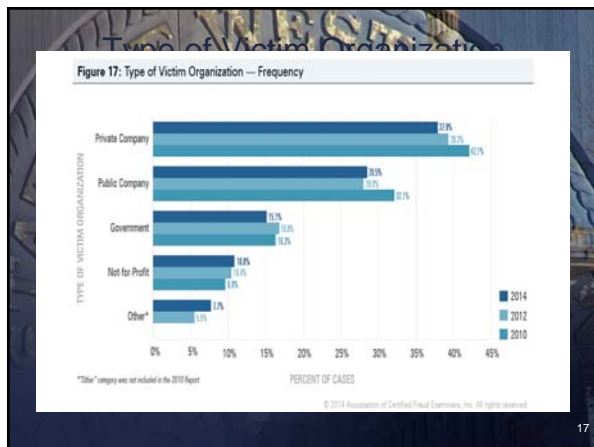
Fraud Detection and Prevention

Year	Company	Description
2003	Freddie Mac	Understated earning by 5B.
2005	AIG	Bid-rigging; stock price manipulation. Booked loans as revenue. Government bailout after a 61B loss in 2008. Execs then received 165M in bonuses.
2008	Lehman Brothers	50B in loans disguised as sales (of toxic assets) to banks in Cayman Islands







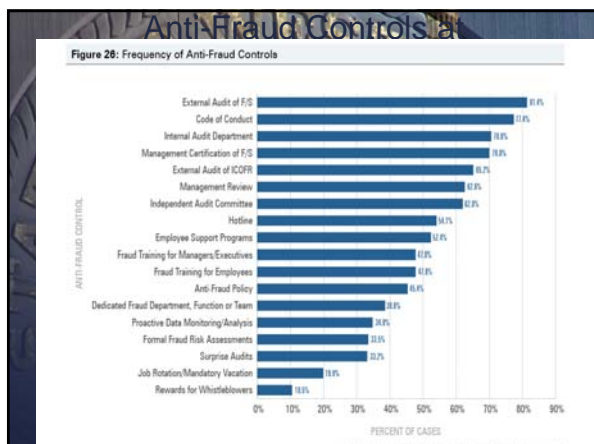


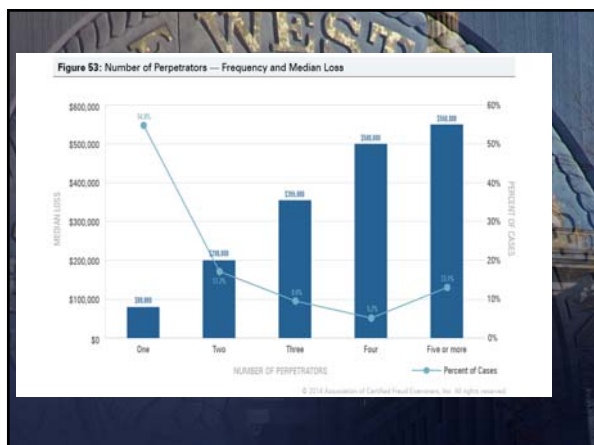
Industry of Victim Organizations (Sorted by Median Loss)

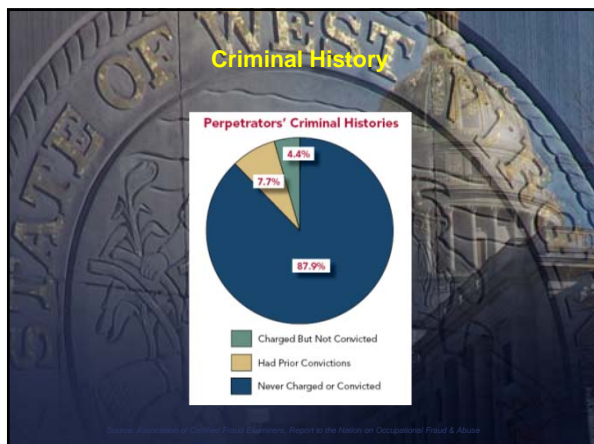
Figure 23: Industry of Victim Organizations (Sorted by Median Loss)

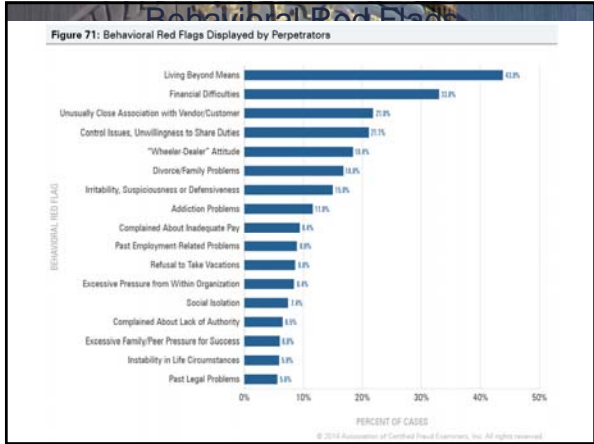
Industry	Number of Cases	Percent of Cases	Median Loss
Mining	13	1.0%	\$900,000
Real Estate	24	1.8%	\$555,000
Oil and Gas	49	3.8%	\$450,000
Wholesale Trade	31	2.2%	\$375,000
Technology	39	2.9%	\$250,000
Manufacturing	118	8.9%	\$250,000
Construction	43	3.1%	\$245,000
Agriculture, Forestry, Fishing and Hunting	29	2.0%	\$242,000
Transportation and Warehousing	48	3.5%	\$202,000
Banking and Financial Services	244	17.8%	\$200,000
Services (Professional)	37	2.7%	\$190,000
Health Care	100	7.3%	\$179,000
Arts, Entertainment and Recreation	22	1.6%	\$168,000
Other	52	3.8%	\$130,000
Services (Other)	45	3.2%	\$125,000
Telecommunications	36	2.6%	\$120,000
Utilities	25	1.8%	\$100,000
Insurance	62	4.5%	\$93,000
Religious, Charitable or Social Services	40	2.9%	\$80,000
Government and Public Administration	141	10.3%	\$64,000
Education	89	6.6%	\$58,000
Retail	77	5.6%	\$54,000
Communications and Publishing	15	1.1%	\$50,000

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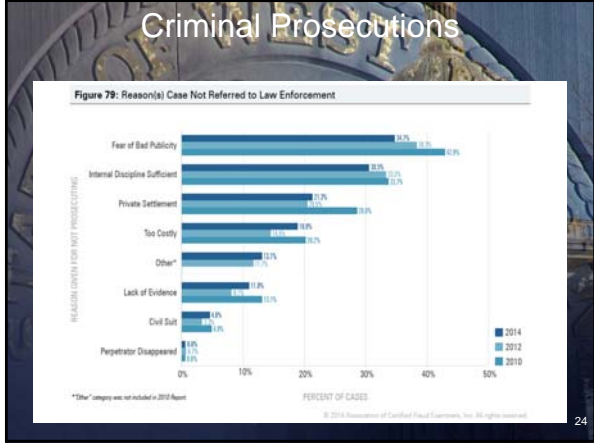












Criminal Prosecutions

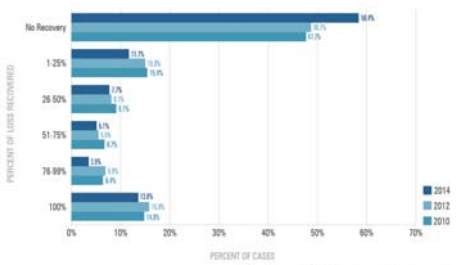
Figure 78: Result of Cases Referred to Law Enforcement



25

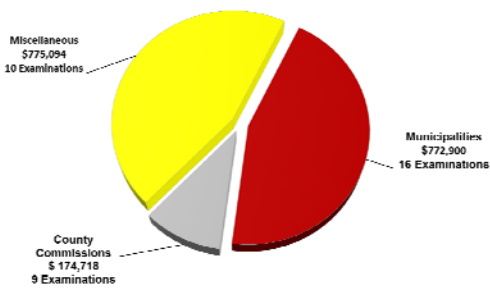
Recovery of Losses

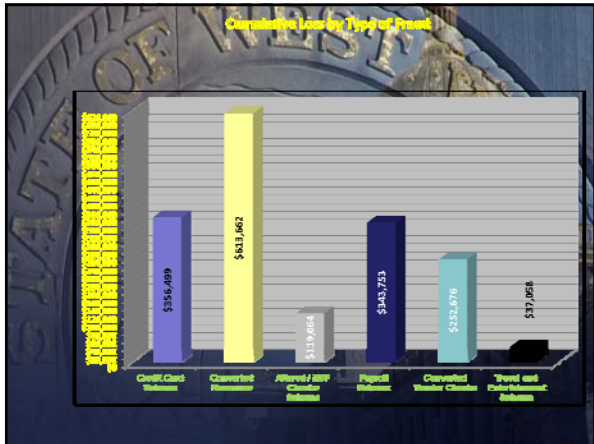
Figure 82: Recovery of Victim Organization's Losses



26

Cumulative Fraud Loss by Entity Type





Pressure

- Personal Vices – Drug addiction, GAMBLING
- Sudden Changes in Lifestyle due to the economy, the loss of financial provider.

Opportunity

- Who is watching the store?
- Inadequate internal controls due to the size of the entity.
- Lack of organizational integrity.
- Test the system. Start small and if nobody notices then expand operations.
- It can be ANYONE!

Signs of a Fraudster

- **RED** Flags
 - Living beyond their means.
 - Conflicting job responsibilities.
 - Organization cannot meet obligations (usually starts with payroll).
 - Excessive Gambling.
 - Avoidance of an audit.
 - Missing /Lost Records.
 - Refusal to take Sick/Annual Leave.
 - Overriding Internal Controls.
 - Cashing personal checks/can't reconcile cash drawer.
 - Large # of account write-offs.
 - Bank accounts not reconciled.
 - Charges without supporting documents.

Signs of a Fraudster

- **RED** Flags
 - Companies that are not normal routine vendors of the entity.
 - Payments (*outside of payroll*) to employees for reimbursements.
 - Large amounts of credit card transactions with a lack of adequate control.
 - Large time lapses from the time of collection to the ultimate deposit of revenue.
 - Purchases that bypass normal procedures such as approved purchase orders.
 - Unmonitored overtime.
 - Complaints about nonpayment notices from customers.
 - Unauthorized bank accounts.

Fraud Engagements

- Meet with Officials and ask **A LOT** of questions.
- Identify areas of concern.
- Meet with Prosecutor/Law Enforcement to coordinate activity and objectives.
- May look into allegations during the course of a regular audit.
- Statutory Authority:
 - WV Code §6-9-7 authorizes the Chief Inspector to examine into all of the fiscal affairs of any local government and issue subpoenas.

Fraud Engagements

- Perform procedures utilizing "forensic accounting" techniques.
- Forensic Accounting is defined as the application of specialized accounting, auditing, finance, economics and statistics (as well as skills in various aspects of law, research and investigative methods) in the collection, analyses and communication of evidential matters and related findings.
- Staff – Accredited Fraud Investigation Classes and Certification and Certified Fraud Examiners.
 - Understanding the rules of evidence.
 - Quantitative Tools such as data mining.
 - Computer examination techniques.

Fraud Engagements

- **Fraud Theory Approach** - scientific method of:
 1. Analyzing the data.
 2. Creating a hypothesis.
 3. Testing the hypothesis.
 4. Refining and amending the hypothesis.
 5. Accepting or rejecting the hypothesis.

Brainstorming.

Fraud Engagements

- Meetings:
 - Length of Service.
 - Insurance/Bonded.
- Computer.
- Define objectives/ongoing and dynamic process.
- Subpoenas/Search Warrants (photocopy of deposits).
- FEIN # to local banks.
- Gather Information.
- Prepare a Report.
- Assist Prosecutors/Provide Supporting Documentation(evidence)/Testify.
- Help question suspected perpetrators.

Anatomy of a Report

- Background and Methodology.
- Schedules – Vary by the type of work performed. Details the procedures and conclusions and provides support for the conclusions.
- Schedule of Comments – Provides internal control/compliance findings and recommendations related to the work performed.
- Frequently this report can be used as a basis for insurance reimbursement (*if available*).
- Considered confidential and issued only to the prosecutor.

Examples

Case #2 – What a Great Credit Union

- An employee in a small town was responsible for performing payroll functions which included calculating payroll, filling out tax forms and remittances and issuing checks to agencies. Another person in the office was suspicious of her but lacked the expertise to verify payroll transactions. It was determined that she was paying herself the proper rate of pay throughout the time period. The auditor increased the scope of testing in payroll since there was not adequate oversight and found that she was regularly depositing amounts to the employees credit union accounts...however...her credit union account was receiving much more than was withheld from her pay. Over time, it gradually increased to the point the town could not meet legitimate obligations. It was determined she deposited over \$10,000 extra into her credit union account and also paid over \$7,000 in AFLAC premiums to her account.

Examples

Case #4 – I need confetti

- A long time employee of a small town embezzled over \$30,000 over a 4 year period. The culprit collected and posted water/sewerage revenue. Cash payments posted to customers accounts agreed with deposit. However, the individual was "holding" stubs and checks from collections and substituting them for cash collections. She would then pocket the cash and "adjust" the check paying customer accounts and subsequently destroy the illegitimate posting journal. She started to get lazy and forgot to adjust peoples accounts. Customers were complaining that they had paid their bill and not been credited. A co-worker was suspicious and her suspicions were confirmed when she brought home the contents from the shredder at the office so her daughter could use it as confetti. They noticed bits of paper that looked like utility stubs and painstakingly "reconstructed" the stub. The auditor contacted the computer software vendor who assisted in reconstructing the adjustment journal. Confirmations were sent to customers and the adjustments were determined to be fraudulent.

Examples

Case #7 – No one is watching the store

- A Director at a SWA was the only employee that worked at the Authority. The SWA has an annual budget of approximately \$75,000 per year. The Director had complete control and the board did not even convene for regular scheduled board meetings. Over a period of 4 years, the Director had embezzled the following amounts:

Examples

Illegitimate Petty Cash	\$18,176
Excess Payroll	\$21,641
Fraudulent Expense Reimbursements	\$16,861
Cell Phone Bills	\$2,021
Credit Cards	\$19,750
Pay Pal Account	\$3,190
Total	\$81,639 (27% of Budget)

To make matters worse, the Director stopped paying the payroll withholdings...AND stopped paying the insurance company that they were bonded with so some cash could be freed up!

Examples

Case #8 - Two is company

- 2 Employees in a medium size city conspired to steal over \$210,000 from the Town over a 2 year period. The manager and clerk wrote checks to the Town's General Fund; took the checks to the bank; endorsed the back and pocketed the cash. They also received 38 paychecks in one of the fiscal years instead of the customary 26. They paid sick leave to themselves for time they had not accumulated. Travel expenses were paid from multiple sources including checks to the general fund, checks to themselves, and Purchasing Card transactions. The Purchasing Card was used for excessive meal and gasoline charges even though the employee was provided a city car and gas and all the meals were within the City limits.

Examples

Case #11 – The Business and Occupation Tax Festival

- A clerk for a small city opened an account for a festival that was held in the town. She collected "donations" for the festival. Then she decided she would begin depositing business and occupation tax revenue into the account as well. The disbursements from the account were mainly written to her and she made off with \$24,000 over a 14 month period.

STATUS

- Currently have 16 ongoing fraud investigations.
- Are considering the implementation of a local government fraud hotline.
- [County commission call](#)
- [Sample fraud reports](#)

THE END

Questions?
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- I Am Going...