


Auditing For Fraud

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Things Everyone Should Know About Fraud

- The Association of Certified Fraud Examiners has published their biannual *Report to the Nations on Occupational Fraud and Abuse* since 1996
- As in the past reports, the 2016 edition provided some alarming statistics that everyone should be aware of and concerned about

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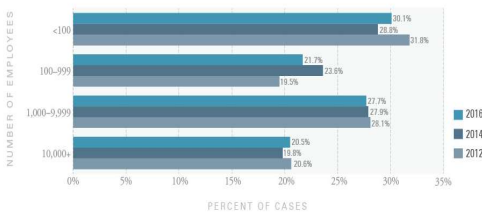
REPORT TO THE NATIONS ON OCCUPATIONAL FRAUD AND ABUSE

2016 GLOBAL FRAUD STUDY



Size of Organization

Figure 40: Size of Victim Organization—Frequency



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Size of Organization

Figure 41: Size of Victim Organization—Median Loss

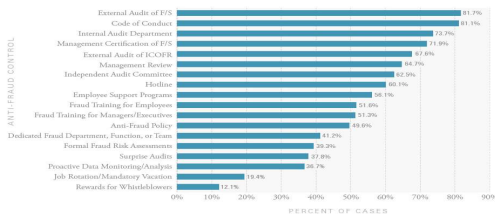


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Anti-Fraud Controls at Victim Organizations

Figure 47: Frequency of Anti-Fraud Controls



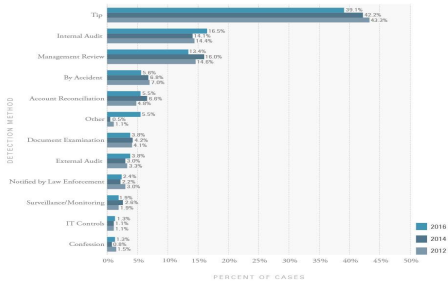
Key:
 External Audit of F/S = Independent External Audits of the Organization's Financial Statements
 Management Certification of F/S = Management Certification of the Organization's Financial Statements
 External Audit of ICOPFR = Independent Audits of the Organization's Internal Controls Over Financial Reporting

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Initial Detection of Occupational Frauds

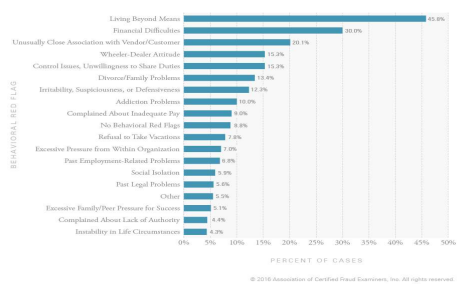
Figure 21: Initial Detection of Occupational Frauds



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Behavioral Red Flags Displayed by Perpetrators

Figure 94: Behavioral Red Flags Displayed by Perpetrators



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Auditing For Fraud Attributes of a Fraud Auditor (Frauditor)

- Ability to deal effectively with people
- Attitude
- Show Interest In Others
- Ability to establish rapport with strangers
- Adapting to different personalities and circumstances

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Fraud: The intentional, wrongful obtaining of either money or some other advantage or benefit from government programs. Fraud includes theft, embezzlement, false statements, illegal commission, kickbacks, conspiracies, obtaining contracts through collusive arrangements, and similar devices.

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Abuse: Administrative violations of departmental, agency or program regulations which impair the effective and efficient execution of programs. These violations may result in losses, or they may result in denial or reduction in lawfully authorized benefits to participants.

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Waste: Incurring unnecessary cost as a result of inefficient or ineffective practices, systems or controls.

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Six Common Myths About Fraud

1. Most people will not commit fraud
2. Fraud is not material
3. Most fraud goes undetected
4. Fraud is usually well concealed

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In order for fraud to exist, we have to take it and make people think it's something else. We often look right at it and not see it because we think it's something else.

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5. The auditor can't do a better job in detecting fraud
6. Prosecuting fraud perpetrators deters others

General Comments About Fraud

- A fraud specialist needs to be on site
- Its impossible for the auditor to satisfy everyone

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- Interviews are the most critical step of a fraud examination
- Early audit involvement is needed
- Trials are (almost) a no-win situation
- Data processing frauds are no different from manual frauds except
- Management doesn't think fraud will happen to them

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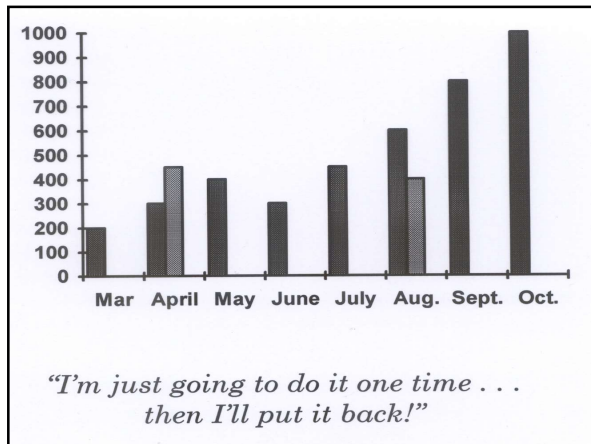
- The person committing fraud tends to be progressive
- Fraud is almost always first defended as an "accounting problem." (It's the computer's fault.)
- The perpetrator may admit to what the auditor knows if
- The position and background of the guilty person are unpredictable

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- The No. 1 Internal Control Weakness
- ### Blind Trust
- Most frauds are passive
 - Fraud perpetrators are often repeat offenders
(Bet you can't do it just once!)

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- The real cost of fraud goes beyond the monetary loss
- Employees may not comply with internal controls
- Fidelity bonds can't protect you from fraud

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Why do auditors fail to detect fraud?

Chances are, if you go in with your eyes wide shut you won't find anything!

If you keep on doing what you've always done, chances are you will find what you always found.

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Reasons Auditors Fail To Detect Fraud

- We mechanically “tick and turn.” (And we’re darn good at it!)
- We don’t perform the basis, traditional audit tests and procedures
- Lack of “substantive” testing
- We avoid those “High Risk” areas, especially if they are immaterial in amount

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Auditing For Fraud

- Lack of adequate training to recognize fraud indicators But we sure can follow the audit work program!
- We tend to accept any “Reasonable” auditee explanation for an audit exception. (Sounds Good To Me!)
 - But does it make sense?

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- We don’t have adequate training in order to recognize basic internal control weaknesses and what can happen as a result of such
- Inadequate audit time budgets
- We just don’t want to find fraud because it causes problems in our predictable lives
- We *ASSUME*

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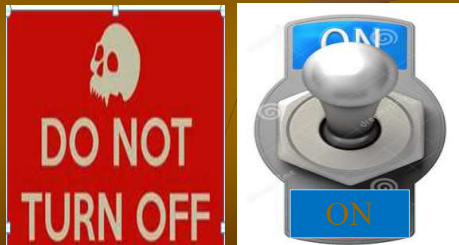
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Never ever, ever anticipate what you will or will not find

- Just because you have never found fraud at a certain client's operations, don't anticipate that you won't find fraud this year
- Just because you found fraud last year, don't anticipate that you will probably find fraud this year
- Go in neutral – I don't know but I'll look

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Professional Skepticism Has No On or Off Switch



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Society Encourages Fraud By:

1. Failing to prosecute
2. Generally accepting the lack of integrity
3. Inefficiencies in the judicial system
4. Inflation
5. Ostracism of the whistle blower

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What's In It For You



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How does management (appear to) participate in fraud?

By Failing To:

- Establish and document responsibility
- Separate job responsibilities
- Establish goals and objectives and develop a system to enable one to measure success



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By Failing To:

- Hire qualified and honest personnel



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Auditing For Fraud

By Failing To:

- Hire qualified and honest personnel
- Develop consistent personnel policies
- Have written policies and procedures
- Have adequate controls over internal documents used to account for cash

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By Failing To:

- Ensure adequate physical security for assets and records
- Have an independent inventory of assets
- Assign a high priority to internal control
- Have an adequate on-the-job training program
- Use information provided by employees related to fraud, waste and abuse

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SAS 122, AU 315 – *Understanding the Entity and Its Environment and Assessing the Risk of Material Misstatement*

Components of Internal Control

1. The Control Environment i.e.: The Tone At the Top

It's Everything

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The Control Environment

It's Everything

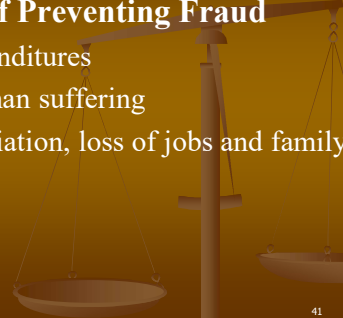


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Benefits of Preventing Fraud

1. It reduces expenditures
2. It prevents human suffering
3. Prevents humiliation, loss of jobs and family and friends.



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Reactions by Our Profession

- Revised and issued new Yellow Book in January 2011
 - Draft of new 2017 Yellow Book is now out for review and comment

AICPA:

- Issued SAS No. 82, *Consideration of Fraud In a Financial Statement Audit* (SAS No. 122, AU 240)



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- Now the auditor is required to *ask questions about fraud*
- Brainstorming with staff
- Auditor must now determine if there is an increased risk for fraud
- If so, he must then design tests to determine if a material fraud has occurred

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- Must be able to distinguish between a fraud and an error

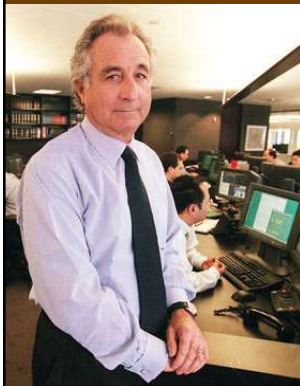
Remember

Fraud and Stupid
Often Look Exactly the Same

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Fraud

Stupid



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There are three types of fraud:

- Misappropriation of assets – 85.4%
- Corruption – 36.8%
- Fraudulent Financial Statements – 9%

Who steals

- The basically honest person

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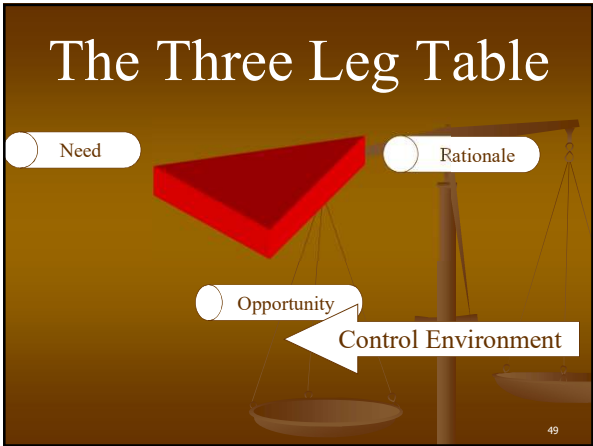
- Three things must be present for a basically honest individual to commit fraud:

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FRAUD TRIANGLE



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Question

Have You Ever
Thought About Stealing

Next Question

Would You Steal

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- Falsified documents are often involved, including forgery
- In my opinion, contrary to SAS No. 122, AU 240, fraud is usually NOT well concealed if

You know what to look for

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There are three basis categories of risk factors re: fraudulent financial reporting:

- Management Characteristics
- Industry Conditions
- Operating characteristics and financial stability

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Characteristics of misappropriation of assets:

- Susceptibility (Opportunity/Inherent Risks)
- Employee relationships or pressures
- The presence or absence of controls that prevent or detect misappropriation of assets
- Size of organizations should be taken into consideration
- Complexity of operations

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Assessment of risk is an ongoing activity, from planning to conclusion of the audit

- Don't be a creature of habit
- Don't do the same ol' same ol' audit procedures
- Talk to people
- By definition, revenue recognition is defined as a high-risk area

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Primary Goals In Fraud Development

- YOU control the scope of an audit
- Be 100% accurate
 - 99% won't get it!
- Don't go to court
 - Obtain a confession



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Examination Methodology

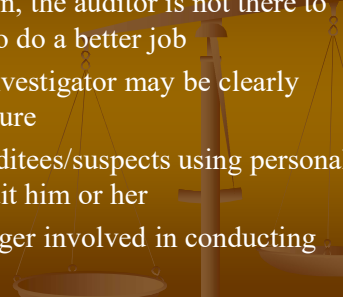
- Document Examination
- Interviewing
- Interrogation



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- In an investigation, the auditor is not there to help everybody to do a better job
- The role of the investigator may be clearly adversarial in nature
- You may find auditees/suspects using personal attacks to discredit him or her
- There can be danger involved in conducting investigations



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- You may find adversaries where allies were expected or were previously
- Be quiet about your work

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Characteristics of a well written report

1. Accuracy
2. Clarity
3. Impartiality
4. Relevance
5. Timeliness
6. Opinions
7. Brevity

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How Not Two Write

St. Augustine: “The area at the rear of the human body which lies between two imaginary lines running parallel to the ground when a person is standing, the first or top of such line drawn at the top of the cleavage of the nates (i.e., the prominence formed by the muscles running from the back of the hip to the back of the leg) and the second or bottom line drawn at the lowest visible point of this cleavage or the lowest point of the curvature of the fleshy

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... protuberance, whichever is lower, and between lines are perpendicular to the ground and to the horizontal lines described above, and which perpendicular lines are drawn through the point at which each nate meets the outer side of each leg.”

In an effort to come up with an ordinance that would ban some skimpy swimsuits from beaches, St. Johns County Commissioners are mulling a 136-word definition of the word *buttocks*.

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To Catch A Thief

Think Like One!

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First, You Have To Look

Second

You Have To Listen

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Three Major Causes of Fraud (The Fraud Triangle)

1. Situational Pressures

- Alcohol
- Drugs
- Gambling
- Sex

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1. Opportunities

- Always provided by management

2. Rationalization

When you have an unsharable need, combined with opportunity and rationalization, you will have fraud

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Common Types of Fraud Encountered In Our Investigations

- Carrying fictitious names on the payroll
- Falsifying inventories to cover thefts
- Manipulating time cards
- Paying false invoices, either self-prepared or obtained through collusion with suppliers

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- Overloading expense accounts
- Unauthorized long distance phone charges
- Carrying employees on the payroll beyond their actual severance date
- Charging personal purchases to the government on credit cards or split purchase orders

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- Claiming overtime that was not earned
- Overstatement of claims for reimbursement
- Advances not accounted for
- Fraudulent penalty payments
 - Failure to assess/collect liquidated damage claim

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Danger Signs That May Indicate Fraud

- Regular borrowing small amounts of cash from fellow employees
- Asking an individual or business to “hold” the maker’s check
- Understaffing resulting in overtime and no vacation

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- Difficulty in obtaining audit evidence
- Low or inadequate salary
- Resentment – not treated fairly – being taken advantage of
- Severe disciplinary actions
- Lack of respect or appreciation by superiors
- Highly domineering senior management

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- Living and spending beyond their means
- Conflict of interest
- Car license number on invoices
- Open-ended contracts

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Indicators of Possible Fraud Receipts and Disbursements

- Unusual checks
- Any check for an even amount in excess of \$50
- Any transaction converted to cash
- Any deposit or currency in a large amount

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- Any non-payroll checks made payable to employees
- Missing or destroyed books or records
- Frequent use of no-check withdrawals
- Altered entries or documents
- Loans to employees or others
- Excessive use of holding or clearing accounts
- Large increases in monthly/quarterly expenditures

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Indicators of Fraud Contract Fraud

- Excessive purchasing of small tools/supplies
- Split purchases
- Bids – High/Low – Same ones time and again
- Unsuccessful bidder who becomes a subcontractor after the contract is awarded
- Large and frequent change orders

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- Minority “fronts”
- Slippages or other contract modifications
- High level approval of a low level transaction
- Presence of a thief’s adding machine
- Payroll checks with second endorsements
- Failure to meet specifications
- Odd purchases

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- Copies of invoices rather than originals
- Unusual sequence of numbers on vendor invoices
- Unauthorized or unusual long distance telephone calls (Amounts and time)

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The Ten Commandments To Improve Your Chances of Detecting Fraud

1. Assume anyone can commit fraud
2. Use your knowledge of internal controls to *think dirty* and then check it out
3. Good documentation does not mean that something happened. It simply means that somebody said that it happened

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4. Pay attention to documents, numbers, dates, support, amount, tax, different pens, etc.
5. Reasonableness of accounting entries
6. Pay attention to hints or rumors of wrongdoing
7. Check out hunches - Learn to trust your instincts

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8. Be noseey – don't easily accept explanations, especially if they don't make sense or you don't understand them
9. Use statistical sampling to force you to look at items you would not generally otherwise examine
10. Look for patterns of unusual transactions

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Finding fraud is a lot like hunting in the woods.

The woods are full of animals.

You just have to know what they look like and where they like to hide!

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Good Luck Hunting

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