

Fraud Awareness and Prevention

June 15, 2017

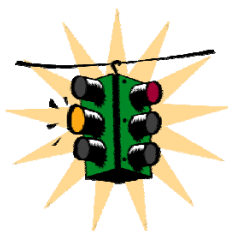
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OFFICE OF COUNTY INVESTIGATIONS
DEPARTMENT OF AUDITOR-CONTROLLER
COUNTY OF LOS ANGELES



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OBJECTIVES OF CLASS



- **Raise awareness** of occupational fraud
- **Detect** the symptoms of occupational fraud
- **Prevent** occupational fraud



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WHO WE ARE (Authority)

- Office of County Investigations (OCI)
Division of Department of Auditor-Controller
County of Los Angeles
- Operate the Los Angeles County Fraud, Waste, and Abuse Hotline pursuant to California Government Code Section 53087.6, and conduct criminal and administrative investigations into allegations received via the Hotline.
- Law enforcement authority of OCI investigators, including the ability to serve search warrants, is described in California Penal Code Section 830.13.



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WHO WE ARE (Staff)

- Investigators with a diverse background in:
 - Auditing
 - Forensic accounting
 - Computer forensics
 - Human Resources
- CPA, CIA, CISA, CFE, graduate degrees, etc.



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WHO WE ARE (Training)

- Complete PC 832 Arrest training as required by the Commission on California Peace Officer's Standards and Training (POST)
- Reid Interview and Interrogations Techniques
- Other DOJ, local law enforcement, and Public Agency Training



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Office of County Investigations Responsibilities

- Investigate waste, fraud and abuse allegations received via the Fraud Hotline.
- Investigate and coordinate criminal cases with appropriate law enforcement.
- Maintain the Hotline and a confidential database of fraud complaints and outcomes
- Safeguard the integrity and independence of the investigative function



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Our Mission

Promote public trust in County government by:

- Providing a mechanism for reporting and investigating waste, fraud and abuse
- Making impactful recommendations to improve business processes and strengthen internal controls
- Working with prosecutors and management to ensure that appropriate criminal and administrative actions are considered



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WHO WE INVESTIGATE

- County employees
 - Permanent, temporary, seasonal
- County contractors and vendors
- Customers and clients
 - Involved with a County employee to defraud the County
- ...and cases referred by the Board of Supervisors.



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COUNTY FRAUD HOTLINE

Calendar Year 2016 Stats

1,079 New Cases Opened
 1,087 Cases Closed
 245 (22%) Substantiated
 477 (44%) Not substantiated
 365 (34%) Not Investigated



Visit fraud.lacounty.gov to review our Semi-Annual Reports of Fraud Hotline Activity



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WHY HAS FRAUD INCREASED?

- We have seen an increase in reported and substantiated cases (e.g., 492 cases closed in 2005)
- Many possible reasons for this.
- Some may say due to a decline in personal ethics



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HIGH SCHOOL SENIORS WERE ASKED - DID YOU:

- ✓ Cheat on a Test?
- ✓ Copy Someone's Work?
- ✓ Plagiarize?

ANSWERED YES

- 1983 - 5% (Department of Education Survey)
- 2000 - 80% (Department of Education Survey)
- 2008 - 95% (Rutgers University Survey)



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CAN YOU IMAGINE WORKING AT THE FOLLOWING COMPANY? IT HAS A LITTLE OVER 500 EMPLOYEES WITH THE FOLLOWING STATISTICS:

- 29 ACCUSED OF SPOUSAL ABUSE
- 7 ARRESTED FOR FRAUD
- 19 ACCUSED OF WRITING BAD CHECKS
- 117 BANKRUPTED AT LEAST 2 BUSINESSES
- 3 ARRESTED FOR ASSAULT
- 71 CANNOT GET A CREDIT CARD DUE TO BAD CREDIT
- 14 ARRESTED ON DRUG-RELATED CHARGES
- 8 ARRESTED FOR SHOPLIFTING
- 21 ARE CURRENT DEFENDANTS IN LAWSUITS
- IN 1998 ALONE, 84 WERE STOPPED FOR DRUNK DRIVING




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CAN YOU GUESS WHICH ORGANIZATION THIS IS?

GIVE UP?




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105th United States Congress
January 1997 to December 1998
During Clinton Administration


Fraud can be anywhere, whether in the private or public sector. It is not unique to the County, and occurs even with those individuals whom we hold to a higher standard.

*Source: Capitol Hill Blue, 1999
(As of 2016, no recent studies published)*



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AWARENESS



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What is Fraud?

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

Source: "Managing the Business Risk of Fraud: A Practical Guide" sponsored by IIA, AICPA and ACFE.



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OCCUPATIONAL FRAUD DEFINED

THE USE OF ONE'S OCCUPATION FOR PERSONAL ENRICHMENT THROUGH THE DELIBERATE MISUSE OR MISAPPLICATION OF THE EMPLOYING ORGANIZATION'S RESOURCES OR ASSETS.



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FRAUD TYPES

- Theft (Cash, Supplies, Donations, etc.)
- Procurement Fraud
- Misuse of Agency Resources / Equipment
- Bribery
- "Time" Fraud (Work hour abuse, overtime)



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OCCUPATIONAL FRAUD KEY ELEMENTS

- IS CLANDESTINE
- VIOLATES THE PERPETRATOR'S FIDUCIARY DUTIES TO THE ORGANIZATION
- FOR THE PURPOSE OF FINANCIAL BENEFIT TO THE PERPETRATOR
- COSTS THE ORGANIZATION ASSETS OR REVENUE



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Fraud Awareness and Prevention Training

- What Should I Be Looking For?
 - As managers, you should be aware (paranoid?) of the signs of potential fraud.
 - These signs are called **Red Flags**, which we will cover in detail in this class.
 - 39% of frauds in organizations are discovered by tip



Statistics obtained from ACFE Global Fraud Study, 2016)

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Noteworthy Cases Nationwide



Merrill Lynch agrees to pay \$100 million in penalties and revamp stock analyst compensation in a settlement agreement with the New York Attorney General.



A federal grand jury convicts Arthur Andersen LLP of a felony count of obstructing justice.



Enron Corp. discloses that it made \$754 million of payments and stock awards to senior executives in the year prior to the company's \$40 Billion bankruptcy filing.



WorldCom Inc. unveils massive accounting fraud, with \$3.8 billion in expenses that were improperly booked as capital expenditures.



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Noteworthy Cases Nationwide



Bristol-Myers Squibb announces that the SEC is investigating whether the company improperly inflated revenues by as much as \$1 billion through the use of sales incentives.



PricewaterhouseCoopers agrees to pay \$5 million in a settlement with the SEC, stemming from charges concerning a lack of auditor independence with their clients.



AOL TimeWarner discloses that the SEC is investigating its accounting practices and how it generated revenue through a series of unconventional deals.



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Noteworthy cases nationwide

- Bernie Madoff
\$170 Billion
- ZZZZ Best Carpet
\$100 Million
- City of Bell
\$5.5 Million



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HEADLINES

Six indicted in Coliseum scandal, including two top rave producers

Written by: 2017-11-28 am



Six people have been indicted in the Los Angeles Memorial Coliseum scandal, including those who were arrested Thursday.



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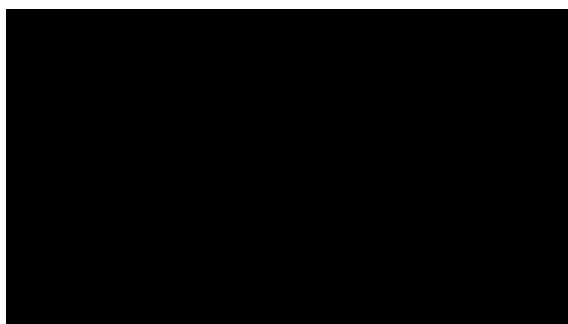
Noteworthy cases nationwide

- From 1983-2012, Rita Crundwell stole \$53 Million from the small town of Dixon, IL., while the city had to make painful cuts to their budget.
- The biggest municipal fraud in US history.
- Convicted on November 14, 2012 (pleaded guilty)
- Imprisoned at Federal Correctional Institution, Waseca; projected release date of March 5, 2030



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<https://www.youtube.com/watch?v=LvFRt2fP5uc>
<https://www.youtube.com/watch?v=NCeavVGIAs>

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MANAGEMENT'S MISCONCEPTIONS



- OUR PEOPLE ARE HONEST, SO WE HAVE NO FRAUD
- CONTROLS WILL PREVENT FRAUD
- AUDITS WILL DETECT FRAUD



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MANAGEMENT'S RESPONSE TO FRAUD

- DENIAL
- ANGER
- COOPERATION
- EAGERNESS



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WHY PEOPLE COMMIT FRAUD

- 40% of people say they would steal, 30% say they might, 30% say they wouldn't
- If you, as a manager, believe your staff would never commit fraud, you may miss the red flags.
- "Paranoia" – you should think about the worst thing that could happen in your operation.
- Be proactive.



Statistics obtained from ACFE Global Fraud Study, 2016)

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Fraud Reality

- Smallest organizations tend to suffer larger losses.
- Most often victimized (in order):
 - Financial Services / Banking
 - **Government / Non-Profit**
 - Manufacturing



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Fraud Awareness and Prevention Training

Learning Activity:

- What does “Fraud” mean to you?



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2016 Revenue Loss Survey



REPORT TO THE NATIONS
ON OCCUPATIONAL FRAUD AND ABUSE

2016 GLOBAL FRAUD STUDY



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2016 Revenue Loss Survey

5% of Revenue is Lost Annually to Occupational Fraud



Statistics obtained from ACFE Global Fraud Study, 2016)

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Fraud Data

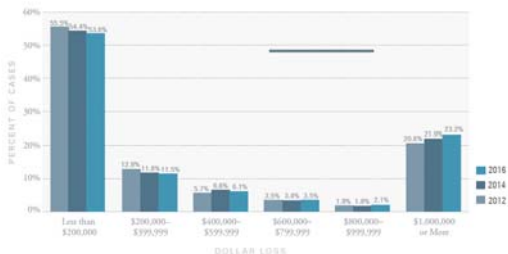
- Translates to \$3.5 trillion based on gross world product.
- Median loss \$150,000, and 23% of cases exceed \$1 million.
- 58% of victims do not recover any of the losses



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Statistics obtained from ACFE Global Fraud Study, 2016)

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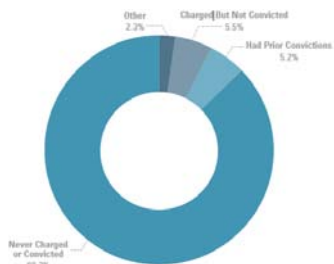
Fraud Data



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Statistics obtained from ACFE Global Fraud Study, 2016)

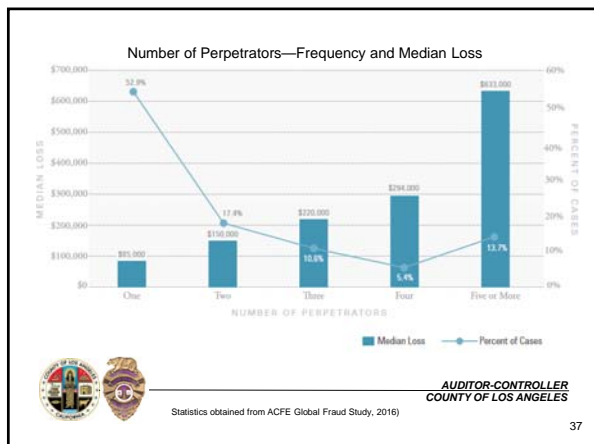
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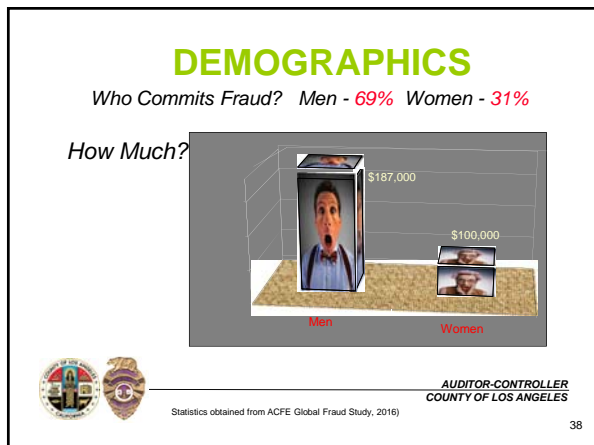
Perpetrator's Criminal Background

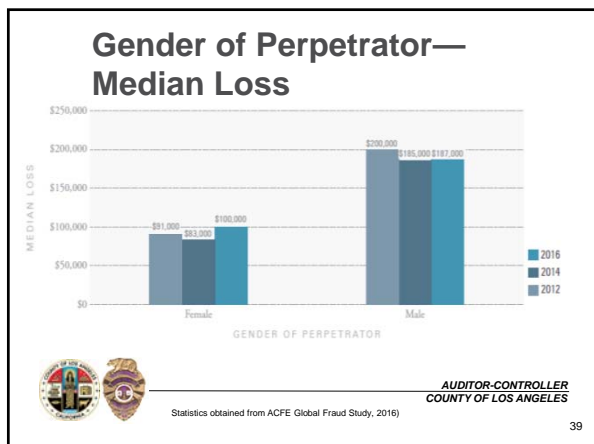


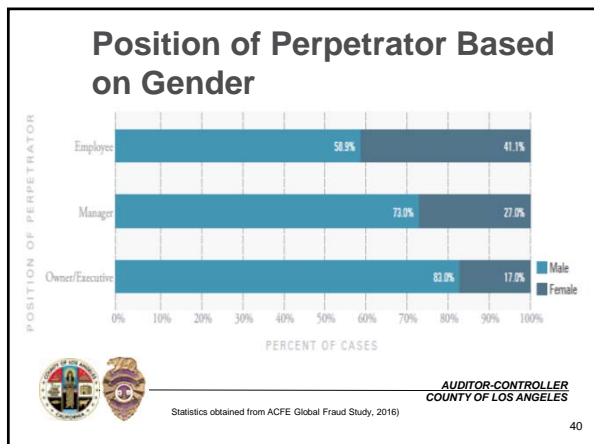
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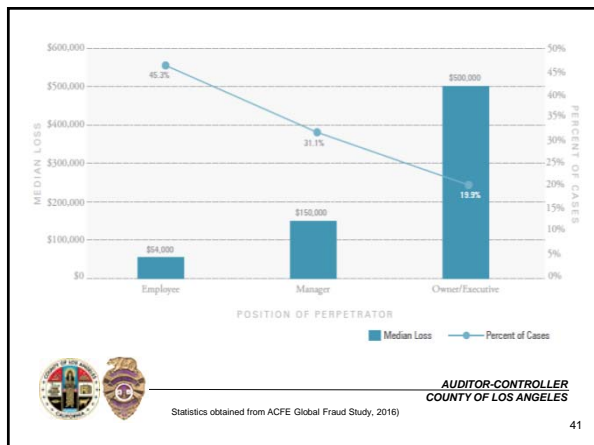
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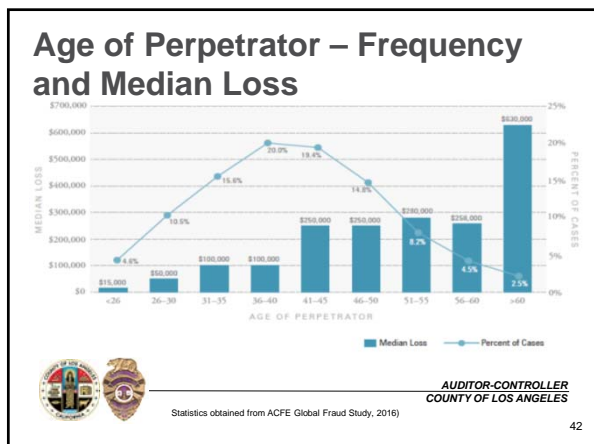












FRAUD REALITY

- We are only catching fraud after it happens – and that’s expensive
- Median fraud lasts 18-months before detection.



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Statistics obtained from ACFE Global Fraud Study, 2016)

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Fraud Data

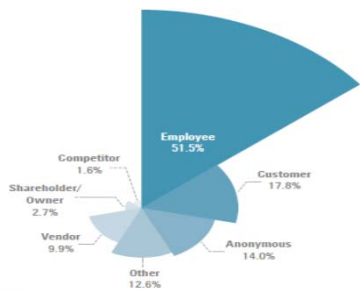
- Occupational fraud more likely detected by:
 - **39% tip**
 - 17% internal audit
 - 13% management review
 - 6% by accident
 - 6% account reconciliation



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Statistics obtained from ACFE Global Fraud Study, 2016)

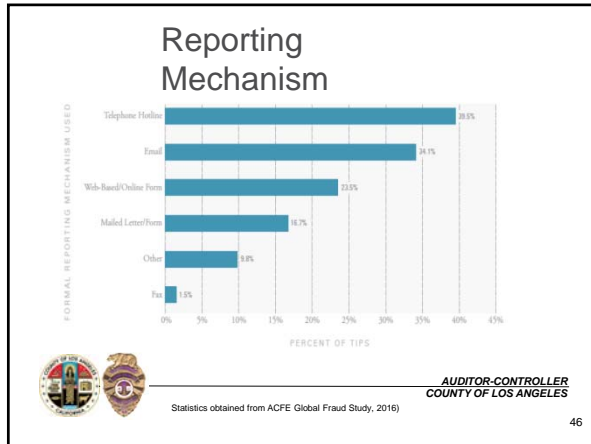
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Source of Tips



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Statistics obtained from ACFE Global Fraud Study, 2016)

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CHARACTERISTICS OF THE WHITE COLLAR CRIMINAL

- Tend to repeat and escalate their crime.
- Stealing is continuous once it starts. It usually is not a one time event.
- Exploit weaknesses in internal controls to cover up their crimes.
- Rationalize their thefts by thinking they are merely borrowing and will pay it back
- Usually work their crimes alone.

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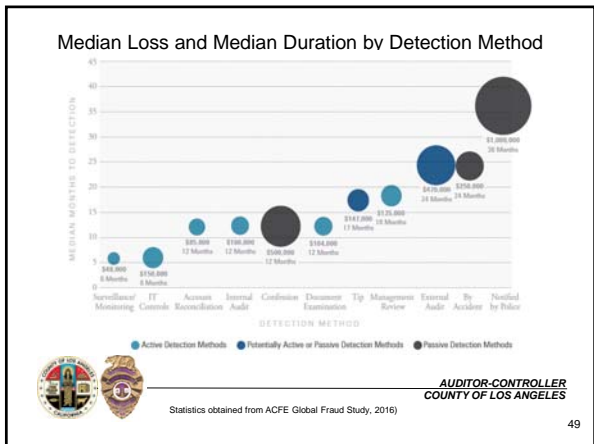
CHARACTERISTICS OF THE WHITE COLLAR CRIMINAL

- Tend to be compulsive (gambling, abusing alcohol/drugs).
- Spend money freely (their own and/or the County's).
- The schemes used to complete the fraud are usually simple. They are seldom complex, but many are creative.
- Embezzlers almost always spend the money they take. They seldom stockpile it.
- In 83% of fraud cases, the fraudsters are first-time offenders with clean employment history or no criminal history.

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Statistics obtained from ACFE Global Fraud Study, 2016)

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FRAUD RISKS . . .

AND DETECTION

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- ### Risk Areas
- Fraud most often in accounting, sales, executive management
 - Some operations/areas may be more susceptible to fraud, and more difficult to safeguard with traditional detective and preventive controls
 - Areas with a reliance on the integrity or diligence of a single employee, or where decision making resides with third-parties
-
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Types of Cash Fraud Schemes

- **Skimming** – Cash stolen before it is recorded on the books.
 - Sales, Refunds, Receivables
- **Disbursements** – Perpetrator causes his organization to disburse funds through some trick or convinces them that money is owed.
 - Fictitious invoices, Mileage, Travel, Expense Reimbursement, Gift Cards, Tokens, Check Tampering, Payroll
- **Larceny** – Cash / Cash equivalent stolen without force after it has been recorded on the books.
 - Cash on Hand, Blank Check Stock, Inventory



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Larceny Examples

- Credit Card numbers (ID Theft)
- Check Information (ID Theft)
- Gift Cards
- Tokens/Stamps
- Cash / Revolving Funds (Reconciliation)

Fraudster's Goal: Concealment - Identifying and taking items from areas with little control over them



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Examples of Skimming Schemes

- Failure to receipt / under receipting
- Substitution (Counterfeit/Check & Money Order)
- Money Transfer / Reconciliation shortages
- Voided transactions
- Fictitious Refunds
- Fake receipts

Fraudster's Goal: Concealment – Taking funds before they are recorded, substituting funds or removing the funds from “the books”




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DATA SECURITY

- Inappropriate access to databases
- Information used for identity theft
- Modification to sensitive data
- Personal use of server/equipment

Other data security areas not covered in this class:

- Data breach by from outside
- Phishing Scams and Malware



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FIELD STAFF



**HIGH RISK FOR
OCCUPATIONAL FRAUD AND
OFFICIAL MISCONDUCT!**




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FIELD STAFF

OCCUPATIONAL RISK FACTORS:

- AUTONOMY
- REGULAR INTERACTION WITH THE PUBLIC
- DISCRETIONARY AUTHORITY
- PUBLIC PERCEPTION
- DECISIONS CAN HAVE SIGNIFICANT FINANCIAL IMPLICATIONS



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Bid Rigging & Collusion

Risk Factors and Red Flags

- Identical or nearly identical bids from different companies
- Bids far exceed the agency's estimates of the value of the contract for the market and services offered
- A winning bidder subcontracts part of the award to one or more losing bidders



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WHY PEOPLE COMMIT FRAUD



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WHAT MAKES GOOD EMPLOYEES GO BAD?

- OPPORTUNITY
 - Temptation is too great
 - Personal Gain/Greed
- FINANCIAL PRESSURES
 - Living beyond means
 - Debt
 - Vice (e.g., gambling shopping, etc.)
- WORK-RELATED PRESSURES
 - Unrecognized performance
 - Feeling of dissatisfaction
 - Fear of losing ones job
 - Being overlooked for a promotion
 - Feeling underpaid





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RED FLAGS

In 91% of cases, the fraudster displayed one or more behavioral red flags that are often associated with fraudulent conduct and 57% displayed two or more behavioral red flags





Statistics obtained from ACFE Global Fraud Study, 2016)

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Organizational Red Flags




- No Communication of Expectations
- Too Much Trust in Key Employees
- Lack of Proper Authorization Procedures
- Lack of Attention to Detail
- Changes in Organizational Structure
- Lax Management Style
- Tendency Toward Crisis Management




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ACCOUNTABILITY AND CONTROL RED FLAGS



- Lack of Separation of Duties
- Lack of Physical Security and/or Key Control
- Not rotating assignments among employees
- Weak Links in Chain of Controls and Accountability
- Missing Independent Checks on Performance
- Poor System Design
- Inadequate Training



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FINANCIAL DOCUMENT RED FLAGS



- Missing Documents
- Alteration of Documents
- Excessive Number of Voided Documents
- Documents Not Numerically Controlled
- Questionable Handwriting or Authorization
- Duplicate Payments
- Unusual Billing Addresses or Arrangements
- Address of Employee Same as Vendor
- Duplicate or "Home Made" Photocopied Invoices



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Lavish lifestyle

- CEO drove luxury cars
- Dined at high-end restaurants
- Rented a luxury apartment in addition to owning a home
- Owned a yacht



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RED FLAGS




- ☐ TOO LARGE/SMALL
- ☐ ODD PRACTICE
- ☐ TOO OFTEN/RARE
- ☐ ODD TIMES/PLACES
- ☐ TOO HIGH/LOW
- ☐ SHORTAGES
- ☐ TOO MUCH/LITTLE
- ☐ COMPLAINTS





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RED FLAGS




- WEAK INTERNAL CONTROLS
 - Almost always present
 - Or controls are in place but not being followed
 - If your section has weak internal controls, it is RIFE for fraud



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PREVENTION



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Prevention & Deterrence

OCI Axiom:
Detection is grand, but prevention is divine!



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CRIMINALS DO NOT LOOK FOR CHALLENGES

**THEY LOOK FOR OPPORTUNITIES
TAKE AWAY THOSE OPPORTUNITIES**



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TONE FROM THE TOP

Management must:

- Set the tone that reflects the desired culture
- Personally demonstrate the tone in everyday communications and functionality
- Drive tone down through all levels of the organization
- Communicate with specific message of ethics and integrity at least annually
- Consistently enforce the organization's Code of Conduct



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DOES YOUR AGENCY HAVE THESE POLICIES?

- PROHIBITING EMPLOYEES FROM ACCEPTING GIFTS
- ACCEPTANCE AND SAFEGUARDING OF DONATIONS
- REPORTING SUSPECTED FRAUD



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INTERNAL CONTROLS

Internal Control is an organizational plan which defines separation of duties and how an operation can ensure that assets are safeguarded, accounting records are accurate and timely, and transactions that get processed and recorded are only those transactions that management wants processed and recorded.



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Internal Controls . . .

A few basic Internal Controls:

- Duties should be separated so that no one employee controls all key aspects of a transaction (initiating, approving, processing, recording)
- Passwords, safe combination, etc, should be restricted to key personnel, secured in a safe place, and changed regularly
- Access to funds, records, blank check stock, confidential information, databases, etc., should be limited to authorized personnel



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<https://www.youtube.com/watch?v=gSmh6yOmwhI>

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Controls - Collections Received by Mail

- Double Custody – Both responsible
- Cash: Manager Notification
- Restrictive Endorsement
- Mail Log – Cross Referencing
- Log Adjustments
- Separation of Duties: Receipting / Balancing



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Internal Controls over Revolving Funds



Revolving & Cash Aid Funds: Funds established for the purpose of carrying out specific activities (i.e. petty cash, cashiering, transportation, clothing, etc)



Revolving Funds are to be:

- Assigned to a Fund custodian with no other cash handling responsibilities
- Balanced on a daily basis
- Only used for the purpose for which it was established
- Secured at all times



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Protection Against Check Fraud

- Maintain tight security over blank check stock and cancelled checks.
- Destroy unused checks from closed accounts.
- Use check stock with security features.



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Credit Card Acceptance

- Identification
 - CDL Name Match Card
 - Signature (Reverse)
- Validation
 - Expiration Date
- Refunds made to the credit card not the card holder
- No Cash Back



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Procurement/Contracts

Monitoring & Compliance Challenges

- Intangible and Difficult to Quantify Services and Deliverables
- Payments Triggered by Client Participation or Attendance
- Subjective Outcome Measures
- Divergence Between Programmatic (qualitative) and Fiscal (quantitative) Performance
- Reconciling Services Billed vs. Provided



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HELPFUL MEASURES TO PREVENT FRAUD

1. STRONG INTERNAL CONTROLS
2. BACKGROUND CHECKS ON NEW EMPLOYEES
3. REGULAR FRAUD AUDITS
4. ESTABLISHED FRAUD POLICIES
5. WILLINGNESS TO PROSECUTE
6. ETHICS TRAINING FOR STAFF
7. ANONYMOUS FRAUD REPORTING MECHANISMS
8. WORKPLACE SURVEILLANCE



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DATA SECURITY

- Identify Sensitive Data
- Limiting Access
- Password changes and requirements
- Portable Device Encryption
- Incident Reporting and Notification



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AUTOMATED DETECTION

- Continuous Systems Monitoring
- Suspicious Activity and Transaction Flagging
 - Address and Account # Comparisons
 - Payment Analysis



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WHICH MEASURES ARE MOST HELPFUL IN PREVENTING FRAUD?



1. STRONG INTERNAL CONTROLS
2. BACKGROUND CHECKS ON NEW EMPLOYEES
3. REGULAR FRAUD AUDITS
4. ESTABLISHED FRAUD POLICIES
5. WILLINGNESS TO PROSECUTE
6. ETHICS TRAINING FOR STAFF
7. ANONYMOUS FRAUD REPORTING MECHANISMS
8. WORKPLACE SURVEILLANCE



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Preventing and Fighting Fraud

Prevent Plan:

- What fraud **could** employees in your organization do?
- How would you **prevent** it?

Fighting:

- **Hotline**, including mechanism for both internal and external anonymous reporting
- **Training** and awareness
- Adherence to **policies** and internal controls
- **"Tone at the top"**, and accountability



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Combating Fraud

“There’s nothing better for deterrence than seeing other people go to jail.”

-Laurie Levenson, Loyola Law School Professor



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WHERE TO REPORT SUSPECTED FRAUD

- Applicable Fraud Hotline
- Supervisor
- Executive Management
- Audit Committee
- Board of Directors
- Government Agency Providing Funding
- Local Law Enforcement
- Office of State Attorney General responsible for approving Non-Profit status
- Taxing Authorities



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QUOTES



- **THERE ARE NO SMALL FRAUDS, JUST THOSE THAT HAVE NOT HAD THE OPPORTUNITY TO GROW.**
- **FRAUD IS CONTINUOUS**
- **GREED KNOWS NO LIMITS**



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AN OUNCE OF PREVENTION.....

- It is better to prevent fraud before it occurs, than to detect it after it has already happened.
- Be aware of situations that might be conducive to fraud.
- Be "paranoid". Be proactive.



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QUESTIONS



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