

MITIGATING FRAUD RISKS WITHIN LOCAL GOVERNMENTS



By
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Objectives

At the end of this session, you will be able to:

- Understand the latest fraud risks affecting your local government
- Identify actual instances of fraud, namely theft of cash, that have recently occurred within cities, counties, and other local governments
- Learn about what internal control activities could have been in place to prevent the fraud from occurring or at least detect the malfeasance earlier

How 'big' is Fraud? Typical organization loses 5% of revenues per year due to fraud.

** Source – 2016 Report to the Nation on Occupational Fraud and Abuse*



Research Tools

- To research your organization's likely risks given industry and size look to **The 2016 ACFE Report to the Nation**
 - Best source to research organizational exposure by industry and firm size; 2016 version available online free at <http://www.acfe.com/rtt2016/docs/2016-report-to-the-nations.pdf>



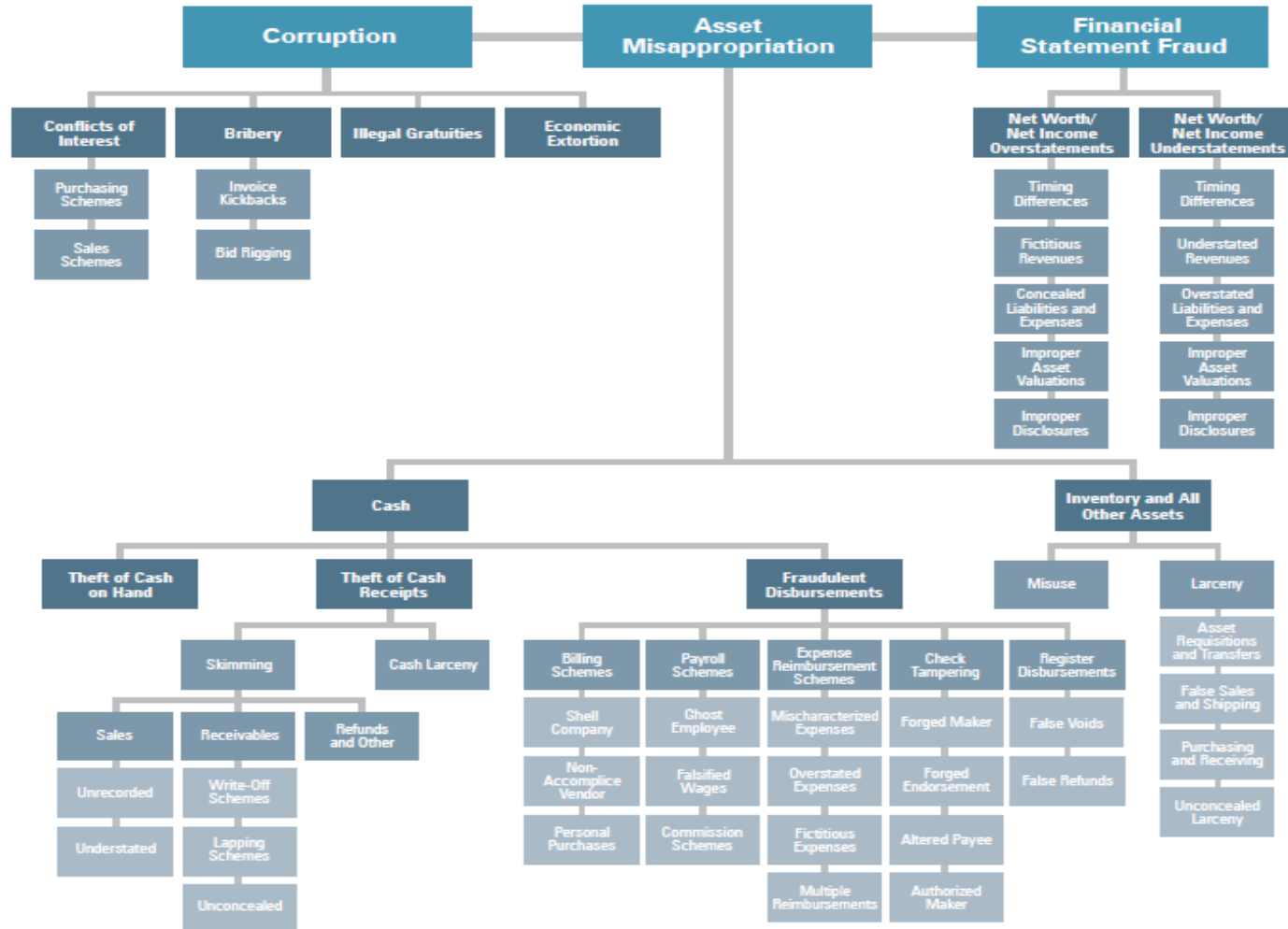
Types of Occupational Fraud - Definitions

- Occupational Fraud can be broken down into three main categories:
 - *Corruption* schemes, in which an employee misuses his or her influence in a business transaction in a way that violates his or her duty to the employer in order to gain a direct or indirect benefit (e.g., schemes involving bribery or conflicts of interest)
 - *Financial statement fraud* schemes, in which an employee intentionally causes a misstatement or omission of material information in the organization's financial reports (e.g., recording fictitious revenues, understating reported expenses or artificially inflating reported assets)
 - *Asset misappropriation* schemes, in which an employee steals or misuses the organization's resources (e.g., theft of company cash, false billing schemes or inflated expense reports)



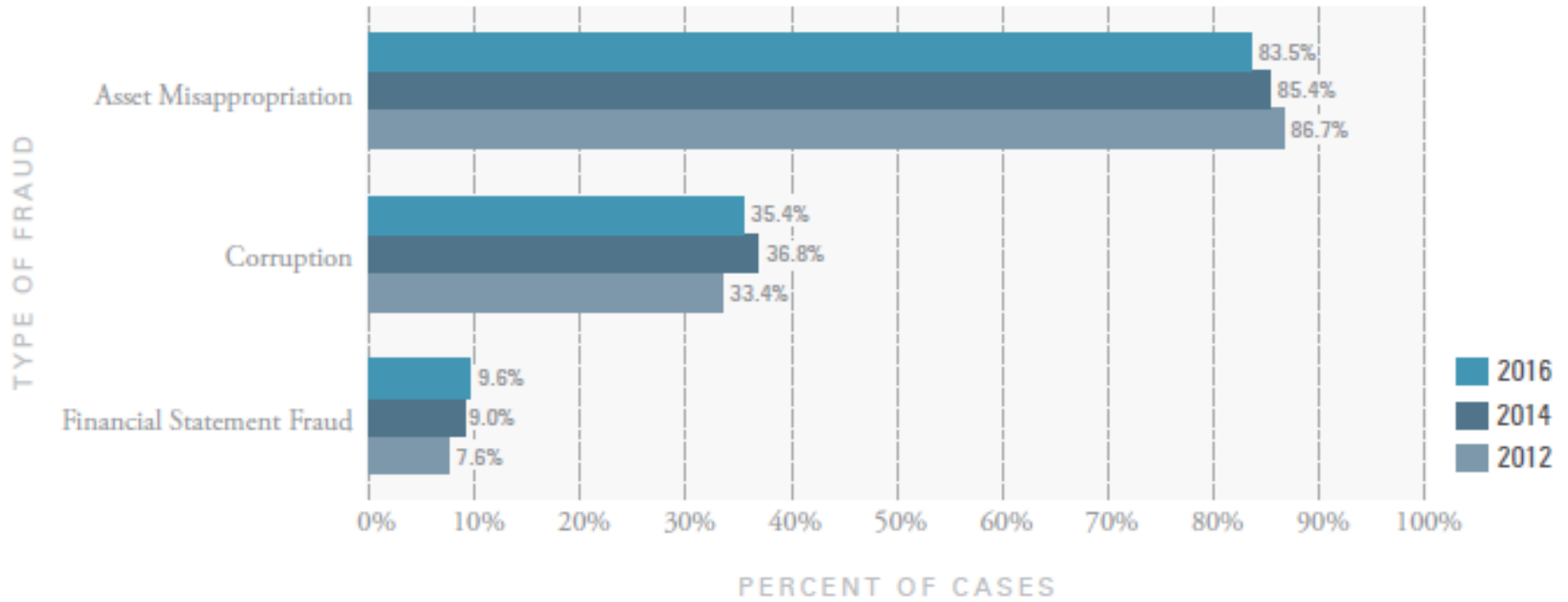
Occupational Fraud Tree

Figure 3: Occupational Fraud and Abuse Classification System (Fraud Tree)



Occupational Fraud by Category - Frequency

Figure 4: Occupational Frauds by Category—Frequency



GROUP DISCUSSION



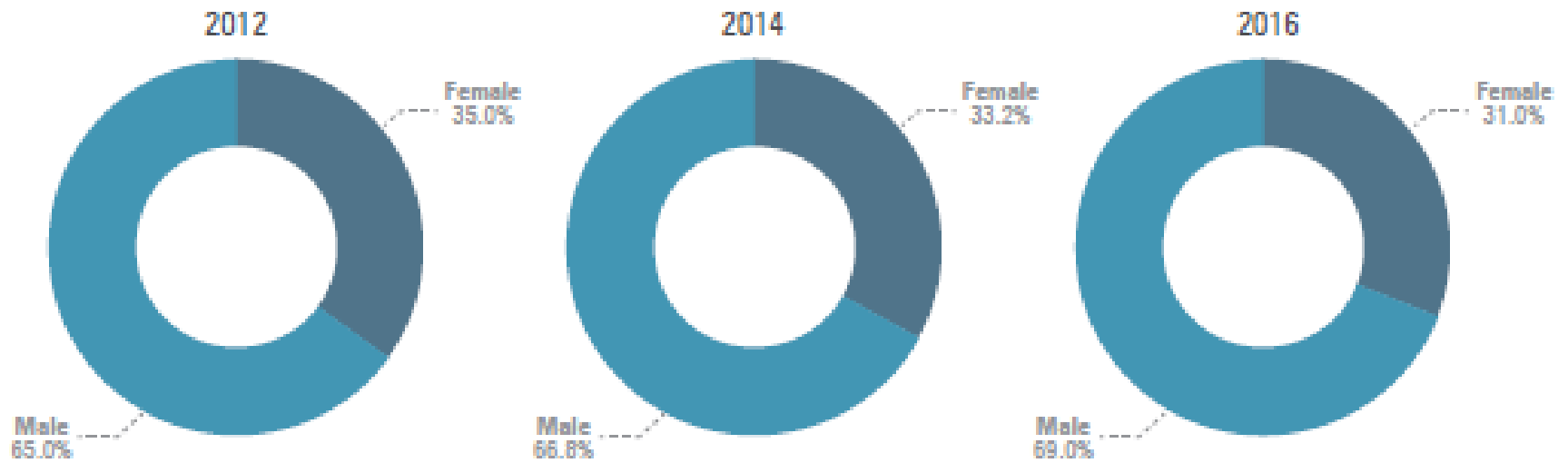
Who Commits Fraud (All Industries)?

- Male or female?
- Over 40 or under 40?
- Employees, managers, or executives?
- What was the most common position held by the fraudster?
- High school graduate and some college, bachelor's degree, or post-graduate degree?



Perpetrator's Gender

Figure 79: Gender of Perpetrator—Frequency



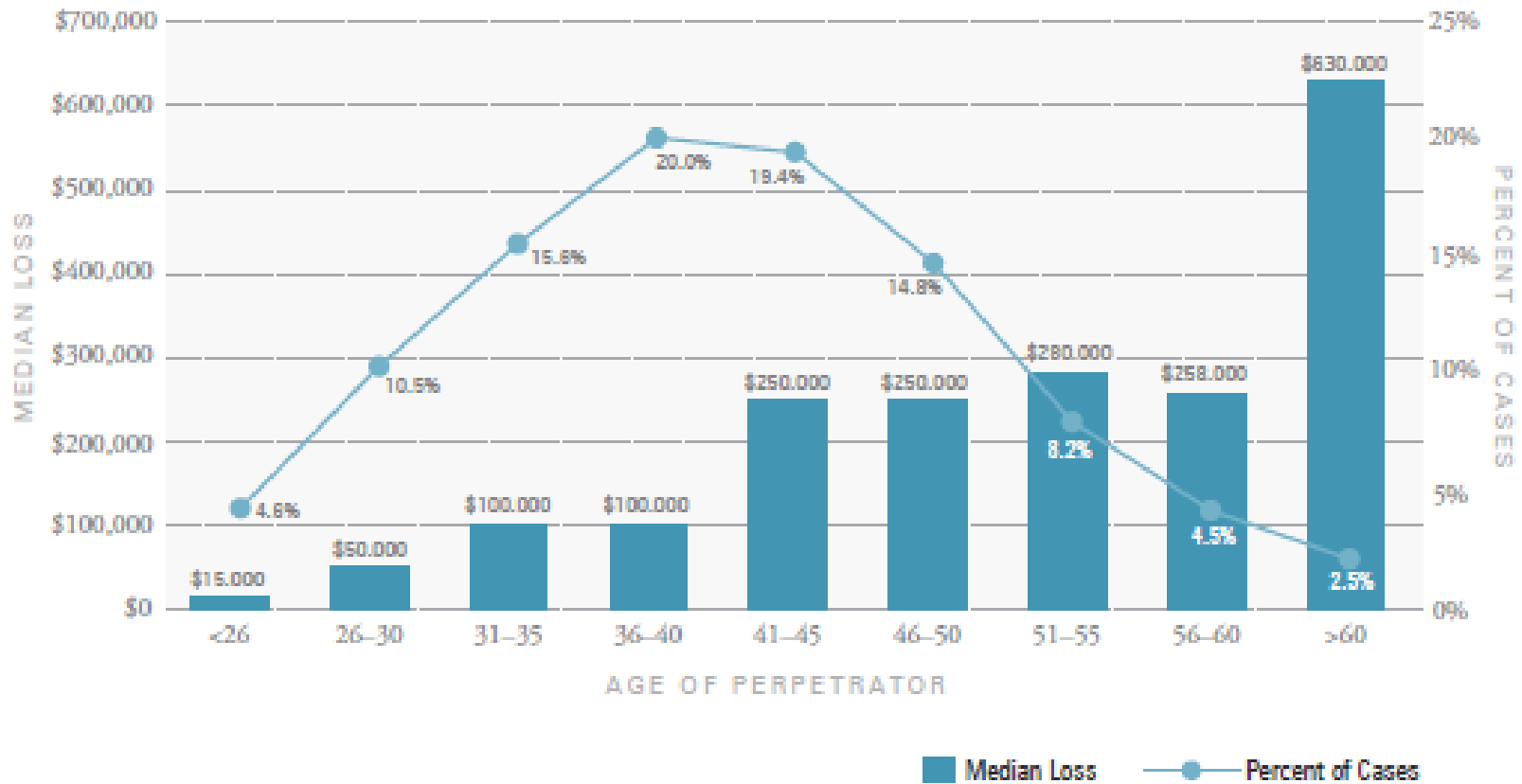
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Perpetrator's Age – Frequency & Median Loss

Figure 85: Age of Perpetrator—Frequency and Median Loss



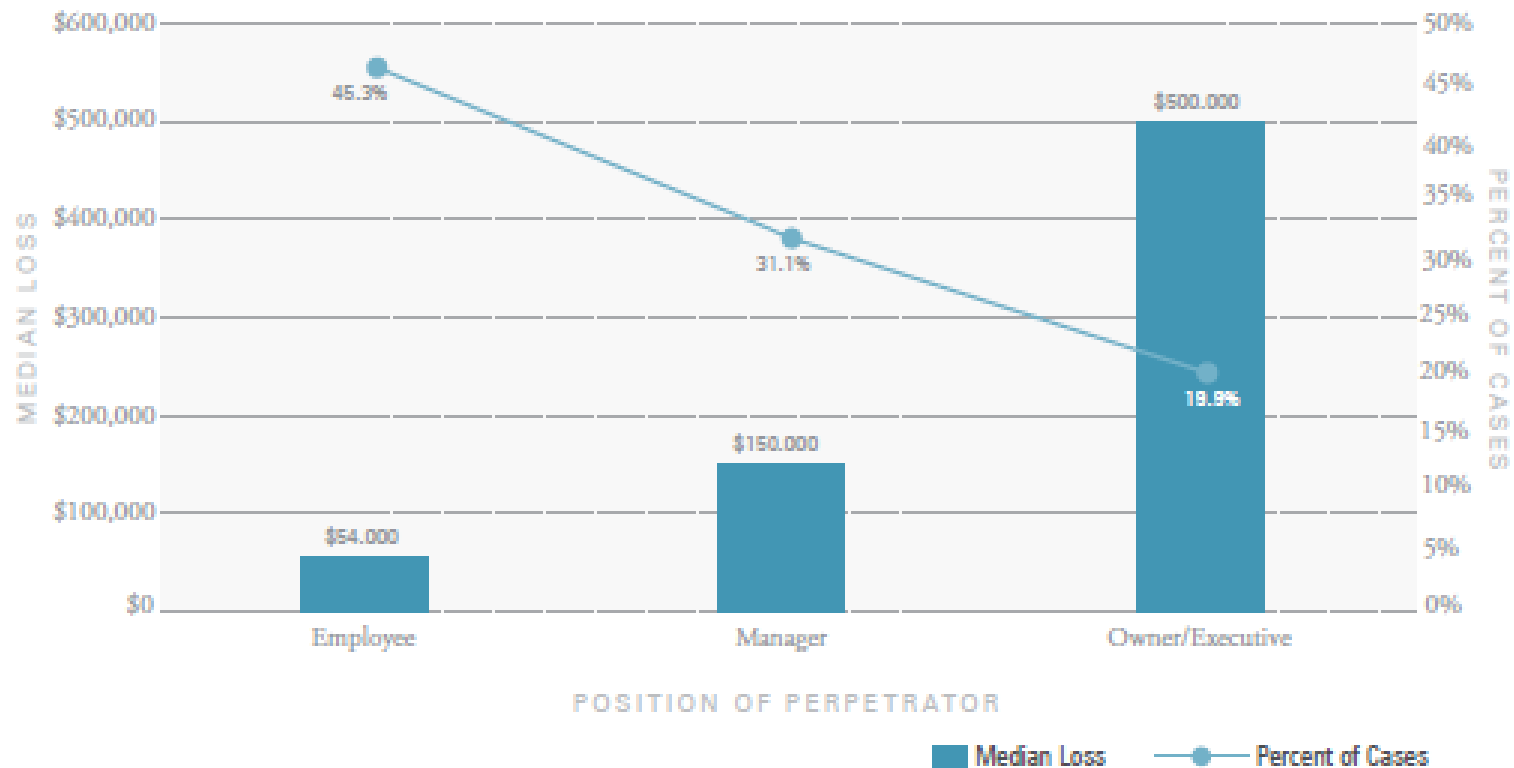
Who Commits Fraud (All Industries)?

- ~~Male or female?~~
- ~~Over 40 or under 40?~~
- Employees, managers, or executives?
- What was the most common position held by the fraudster?



Perpetrator's Position – Frequency & Median Loss

Figure 67: Frequency and Median Loss Based on Position of Perpetrator—United States



Who Commits Fraud (All Industries)?

- ~~Male or female?~~
- ~~Over 40 or under 40?~~
- ~~Employees, managers, or executives?~~
- What was the most common position held by the fraudster?



Perpetrator's Department – Frequency

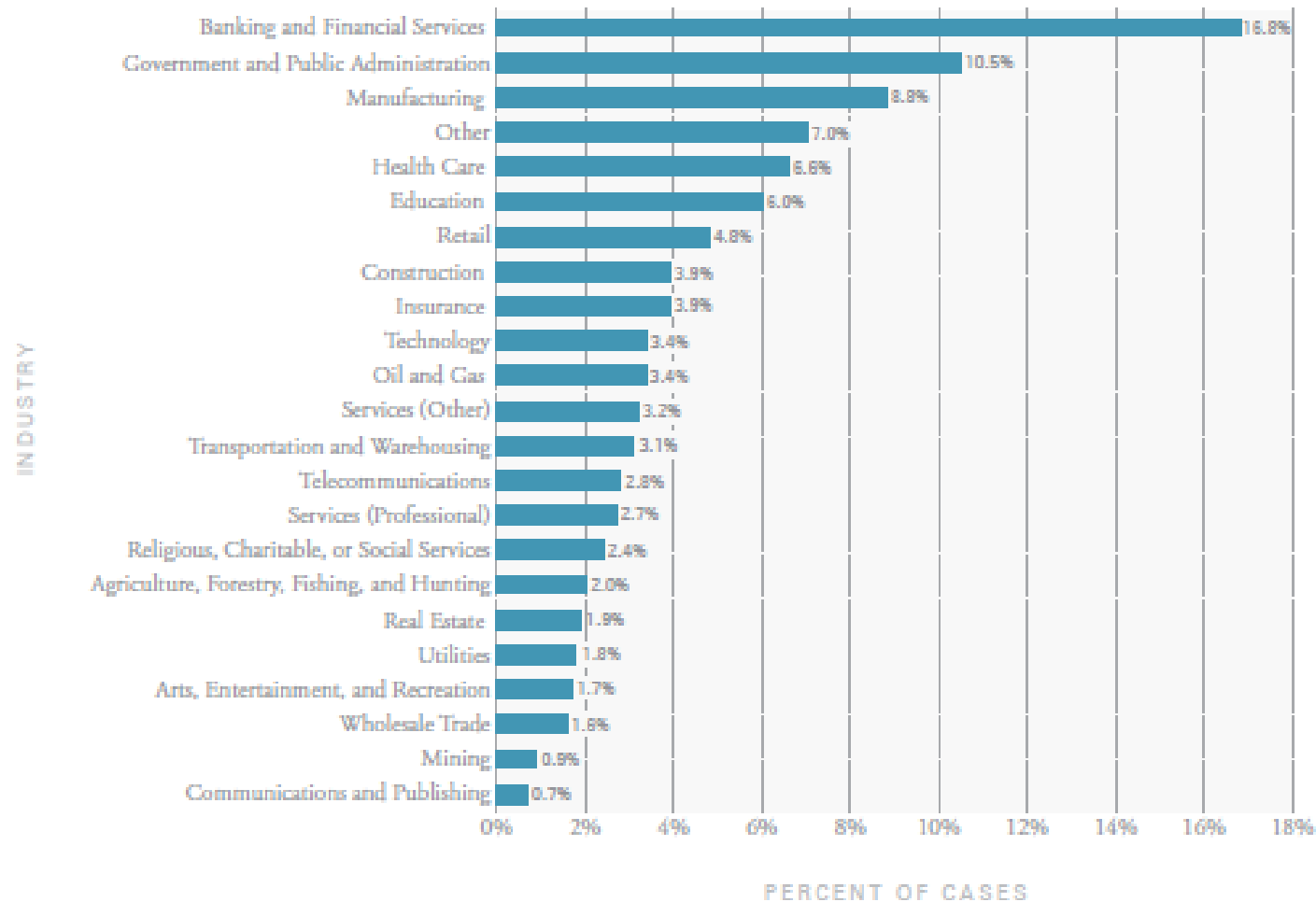
Figure 78: Frequency of Schemes Based on Perpetrator's Department

Department/ Scheme	Accounting	Operations	Sales	Executive/Upper Management	Customer Service	Purchasing	Finance	Warehousing/ Inventory
Cases	348	312	260	228	189	161	94	86
Billing	27.0%	21.5%	14.2%	36.8%	9.5%	25.5%	24.5%	9.3%
Cash Larceny	14.9%	7.7%	8.1%	10.1%	14.3%	3.7%	18.1%	0.0%
Cash on Hand	15.5%	13.8%	6.5%	12.3%	18.5%	13.0%	22.3%	5.8%
Check Tampering	30.5%	9.3%	2.7%	13.6%	7.4%	6.2%	24.5%	1.2%
Corruption	21.6%	34.9%	34.6%	50.9%	25.4%	68.9%	37.2%	32.6%
Expense Reimbursements	15.8%	12.2%	14.2%	23.7%	5.8%	14.9%	14.9%	3.5%
Financial Statement Fraud	12.9%	5.4%	7.3%	30.3%	3.7%	3.1%	23.4%	9.3%
Non-Cash	7.2%	19.6%	20.4%	24.6%	16.4%	18.6%	13.8%	57.0%
Payroll	21.6%	6.4%	1.5%	10.1%	3.7%	5.0%	7.4%	2.3%
Register Disbursements	3.2%	4.2%	5.0%	1.8%	3.2%	4.3%	3.2%	0.0%
Skimming	17.5%	12.8%	11.9%	11.8%	16.9%	7.5%	12.8%	5.8%



Types of Frauds and Frequency by Industry

Figure 43: Industry of Victim Organizations



Types of Frauds and Frequency – Local Governments

Figure 45: Frequency of Schemes Based on Industry

Industry/Scheme	Banking and Financial Services	Government and Public Administration	Manufacturing	Health Care	Education	Real	Construction	Insurance	Oil and Gas	Technology	Services (Other)	Transportation and Warehousing	Telecommunications	Services (Professional)	Religious, Charitable, or Social Services
Cases	368	229	192	144	132	104	86	85	74	74	70	68	62	60	52
Billing	9.5%	25.3%	32.8%	31.3%	34.1%	15.4%	27.9%	17.6%	20.3%	29.7%	22.9%	22.1%	12.9%	26.7%	25.0%
Cash Larceny	11.1%	7.9%	5.2%	9.7%	13.6%	12.5%	8.1%	4.7%	4.1%	5.4%	15.7%	4.4%	1.6%	13.3%	9.6%
Cash on Hand	17.9%	10.5%	8.3%	11.1%	17.4%	11.5%	7.0%	4.7%	9.5%	8.1%	22.9%	5.9%	4.8%	20.0%	13.5%
Check Tampering	9.5%	9.2%	13.5%	14.6%	7.6%	9.6%	10.5%	17.6%	4.1%	5.4%	18.6%	10.3%	6.5%	31.7%	25.0%
Corruption	37.5%	38.4%	48.4%	30.6%	31.8%	32.7%	36.0%	28.2%	48.6%	44.6%	28.6%	51.5%	41.9%	16.7%	28.8%
Expense Reimbursements	5.4%	15.7%	22.9%	20.1%	15.9%	8.7%	20.9%	9.4%	10.8%	27.0%	12.9%	8.8%	19.4%	16.7%	25.0%
Financial Statement Fraud	12.0%	7.9%	10.9%	13.2%	5.3%	5.8%	17.4%	7.1%	6.6%	12.2%	17.1%	5.9%	9.7%	11.7%	3.8%
Non-Cash	10.6%	14.8%	30.2%	13.2%	17.4%	32.7%	22.1%	5.9%	17.6%	18.9%	22.9%	29.4%	38.7%	10.0%	13.5%
Payroll	3.8%	13.5%	11.5%	9.7%	7.6%	3.8%	16.3%	5.9%	8.1%	2.7%	11.4%	7.4%	3.2%	11.7%	13.5%
Register Disbursements	2.7%	1.7%	5.7%	2.1%	1.5%	8.7%	1.2%	0.0%	0.0%	1.4%	5.7%	2.9%	3.2%	1.7%	1.9%
Skimming	6.8%	14.0%	8.3%	12.5%	25.0%	17.3%	15.1%	10.6%	8.1%	5.4%	21.4%	11.8%	6.5%	18.3%	19.2%



Fraud Detection

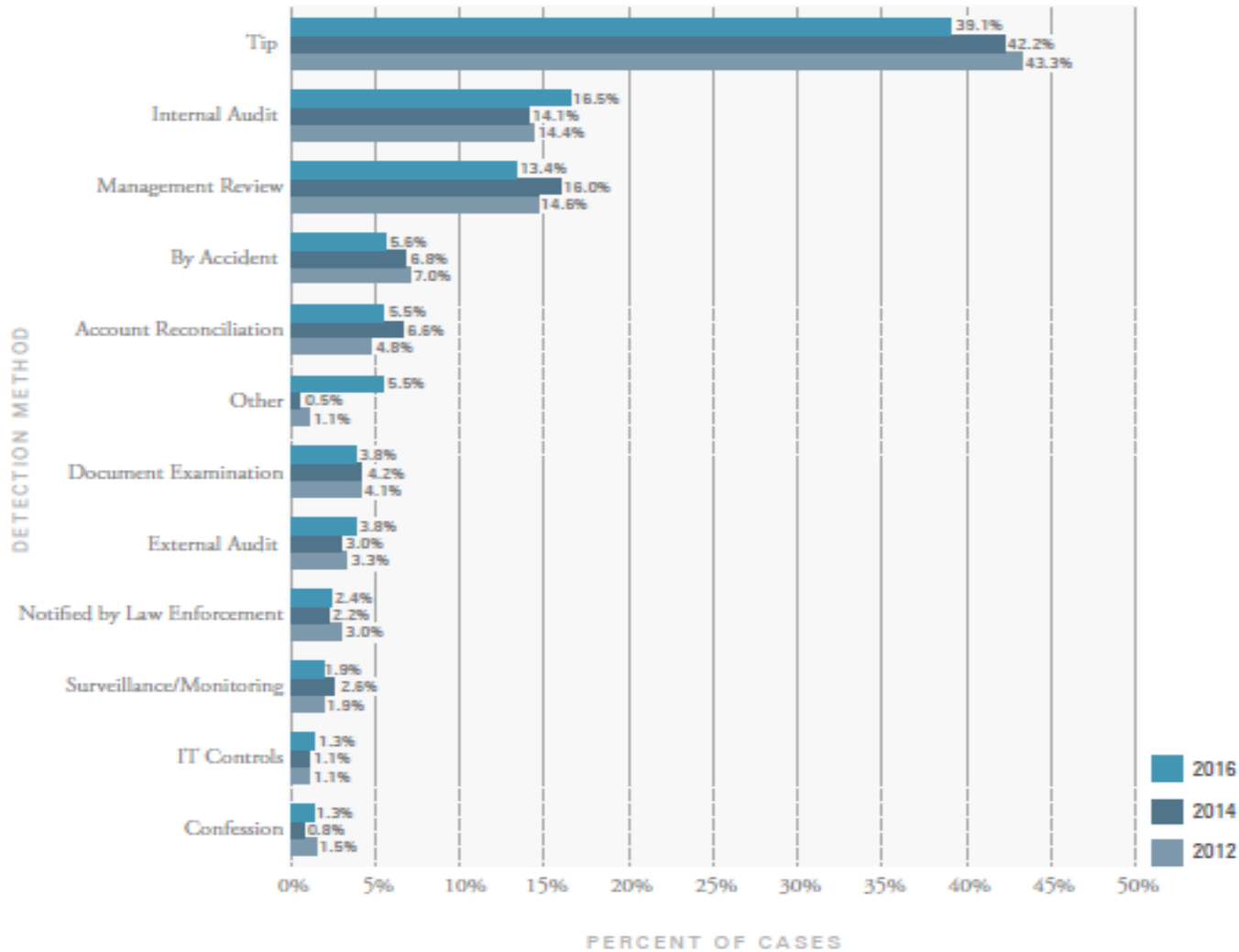
Figure 23: Detection Method by Region—
United States

Detection Method	Percent of Cases
Tip	37.0%
Management Review	14.3%
Internal Audit	14.1%
By Accident	7.2%
Account Reconciliation	6.1%
Other	5.5%
Document Examination	4.8%
External Audit	4.0%
Notified by Law Enforcement	2.5%
Surveillance/Monitoring	1.9%
IT Controls	1.5%
Confession	1.2%



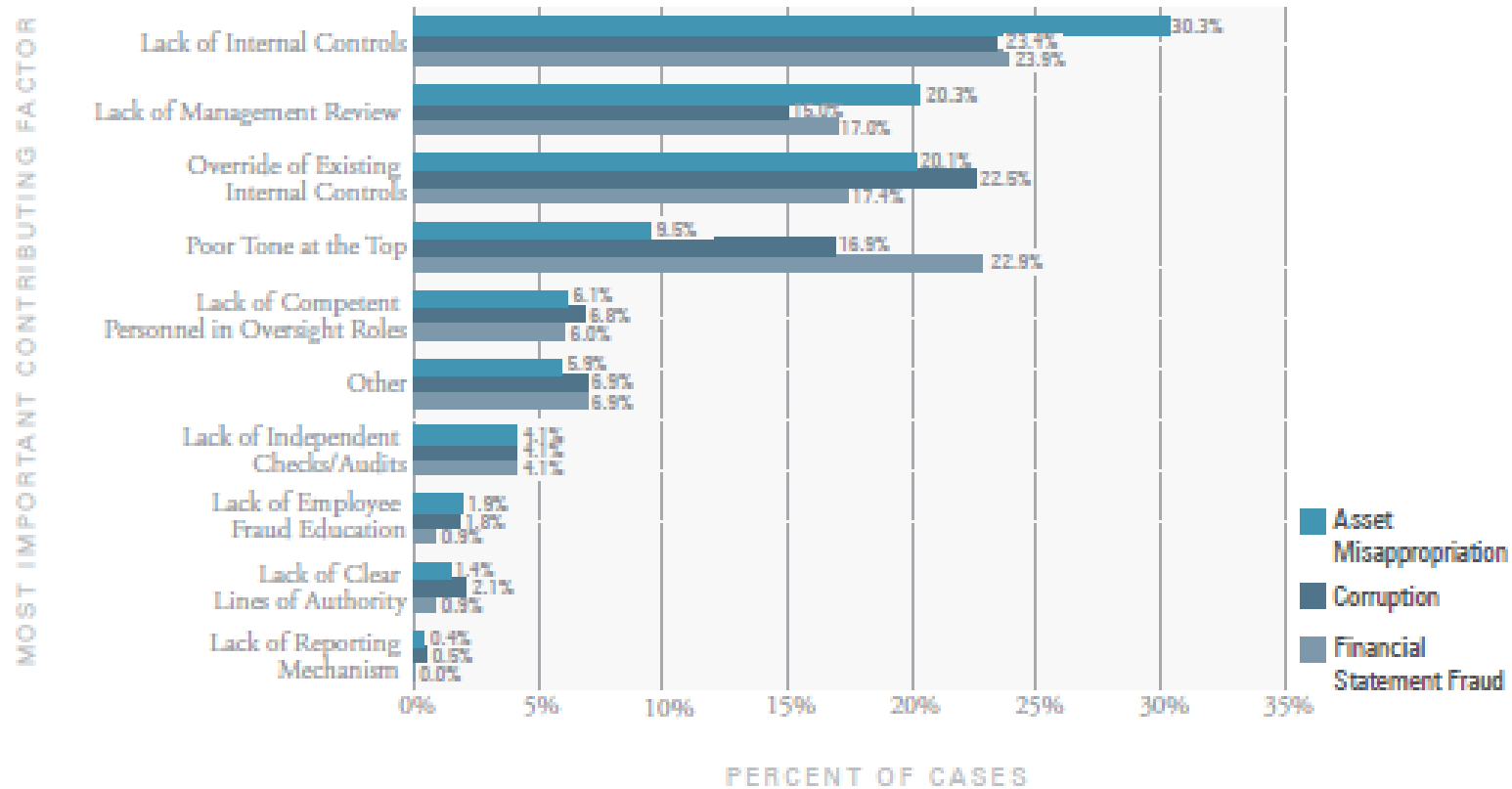
Fraud Detection – 3 Year Comparison

Figure 21: Initial Detection of Occupational Frauds



Factors that Contribute to/Allow Fraud

Figure 64: Primary Internal Control Weakness by Scheme Type



GROUP DISCUSSION



Why Should We Care?

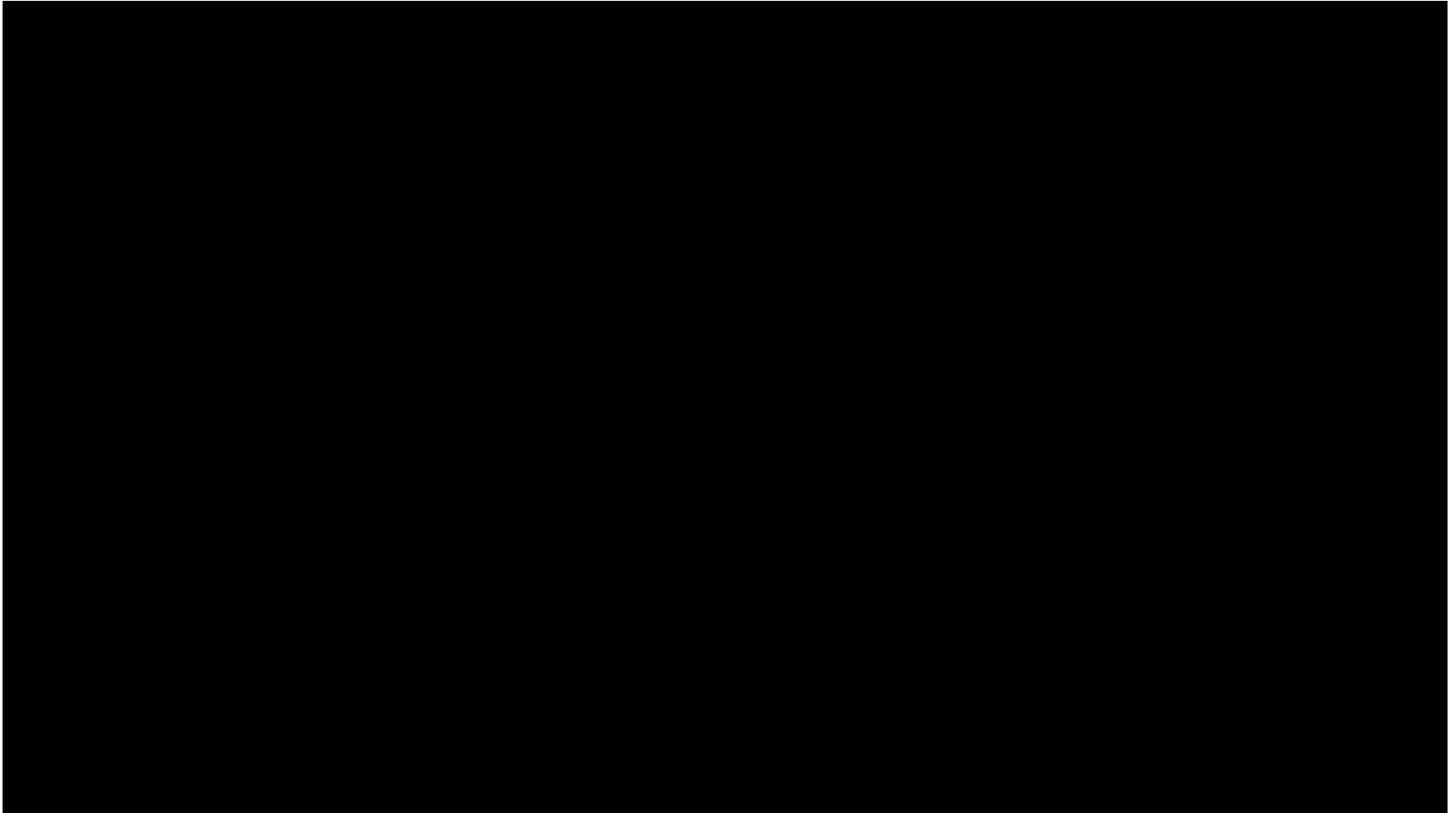
Why Should Local Governments Be Concerned About Fraud?



#1a – Pocket Change Theft of Epic Proportions



#1b – Another Hand in the Tip Jar



GROUP DISCUSSION

- Could this scenario occur at your local government?
- If not, why not?
- If yes, what internal controls could be implemented at your local government to minimize this risk?



#1 – What Did we Learn

- Better tone at the top!
- Anonymous tip line
- Periodic analytical reviews of revenues received from various sources and investigate anomalies
- Minimize cash collections with no means of reconciliation
- Employee background checks



#2a – Wanna Buy a Sprinkler Head?



#2b – Chainsaw Massacre



#2b – Chainsaw Massacre – The Culprit

- The identity of the perpetrator was not revealed in the video
- Mug shot was later provided in a separate news article



#2b – Chainsaw Massacre – The Culprit



#2c – Grand Theft Auto VII



#2c – Steal Government Vehicle - Result



#2c – Steal Government Vehicle - Result



GROUP DISCUSSION

- Could this scenario occur at your local government?
- If not, why not?
- If yes, what internal controls could be implemented at your local government to minimize this risk?



#2 – What Did we Learn

- Employee background checks
- Periodic inventory procedures; better inventory management
- Monitor purchasing activity
- Segregation of duties required; involve more individuals in the review and approval process relating to repair, maintenance, and improvement projects



#3a – The Dirty Plumber



#3b – More Corruption



#3c – Massive Billing Scheme



#3c – Massive Billing Scheme – The Facts

- How it unfolded:

<http://www.pasadenastarnews.com/general-news/20150416/pasadena-embezzlement-case-everything-you-need-to-know>



#3c – Massive Billing Scheme - Detection

Council Committee Audio Excerpts - May 13, 2014



GROUP DISCUSSION

- Could this scenario occur at your local government?
- If not, why not?
- If yes, what internal controls could be implemented at your local government to minimize this risk?



#3 – What We Learned

- Review internal controls over procurement process
 - Is there adequate segregation of duties over the evaluation and approval process
 - Is there a written set of policies and procedures surrounding the procurement process? Is it monitored to ensure policies are followed?
 - Are thresholds for approval process appropriately set?
 - Evaluate invoice review and payment approval process



#4a – Flushing \$\$\$ Down the Drain



#4b – Flushing \$\$\$ Down the Drain



#4c – Lower Your Friend’s Property Taxes



GROUP DISCUSSION

- Could this scenario occur at your local government?
- If not, why not?
- If yes, what internal controls could be implemented at your local government to minimize this risk?



#4 – What We Learned

- Written policy and adequate employee training surrounding utility billing adjustments
- Periodic review/audit of adjustments
- Ability to post credits to customer accounts should require approval (even for those with admin rights)
- Financial analytical review analysis (periodic budget to actual and prior period to current period comparisons)
- Data analytics



#5 – Watch those Pcard Charges!!



GROUP DISCUSSION

- Could this scenario occur at your local government?
- If not, why not?
- If yes, what internal controls could be implemented at your local government to minimize this risk?

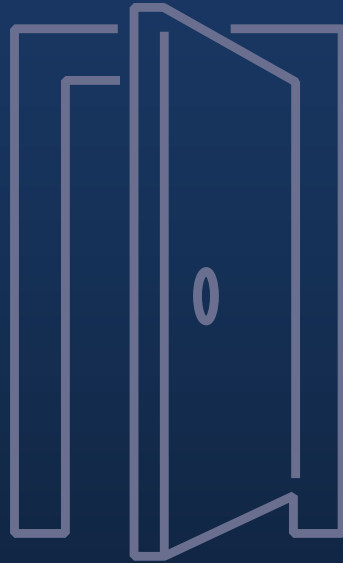


#5 – What We Learned

- Written policy and adequate employee training surrounding use of local government entity's credit cards and purchasing cards
- Robust review process of monthly card statements
- Periodic use of data analytics to evaluate Pcard activity compared to user listing



Questions and Comments



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