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**KIRKLAND, RUSS,
MURPHY & TAPP**
CERTIFIED PUBLIC ACCOUNTANTS

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Identifying Fraud Risks & Proactive Tips and Techniques

Presented by:

*Laura Krueger Brock, CPA/CFF, CFE, CVA
Shareholder*



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Seminar Outline

- Fraud and Abuse
- Fraud Happens
- Characteristics of fraudsters
- Why employees steal
- Fraud Triangle
- Matching controls with risk
- What is a CFE?
- Cash disbursement fraud example
- Fraud detection techniques
- Interviewing techniques
- Related party fraud example
- Red flags (employee/management)
- Controls to mitigate fraud risk
- “Red Flags” (checks/invoices)
- 20 Danger Signs of Embezzlement
- Fraud Prevention



What is Fraud & Abuse?



Fraud & Abuse



- **Fraud**

“Any crime for gain, which uses deception as its principle mode of operation”

- **Occupational Fraud (abuse)**

“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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Other Definitions

- A deceitful act; a corrupt practice; an improper use or treatment; “misuse”
- Any intentional or deliberate act
 - To deprive another of property or money
 - By deception or other unfair means



What is Forensic Accounting?

- Forensic accounting is the integration of accounting, auditing and investigation skills
- “Forensic” according to ***Websters’ Dictionary*** means “Belonging to, used in or suitable to courts of judicature or to public discussion and debate”
- Not dead person

Types of People in the World



- Those Who Do Not Steal Anything
- Those Who Would Steal If The Circumstances Are Right
- Predators, Long History Of Stealing
- \$100



Fraud Happens

- Fraud happens as honest mistakes
- What happens when an employee makes a mistake and does not get caught?
- It does not take a genius to steal
- Many fraudulent situations are relatively easy to understand and easy to perpetrate schemes

Characteristics of Individuals Who Commit Fraud



- People who have experienced failure are more likely to cheat
- People who are impulsive, distractible and unable to postpone gratification are more likely to engage in deceitful crimes



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Characteristics of Individuals Who Commit Fraud



- The easier it is to cheat and steal, the more people will do so
- Lying, cheating and stealing increase when people have great pressures to achieve important objectives



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Common Employee Traits Found in Fraudulent Situations

- Employee gets along with co-workers
- Fosters sense of trust
- Works excessive hours
- Refuses assistance
- Manager or supervisor with controlling personalities
- Refuse to delegate work or take time off

Why Does an Employee Steal?



- The employee believes he or she desperately desires or needs the money
- Employee believes he or she can get away with it
- Employee feels frustrated or dissatisfied with some aspect of his or her job (underpaid or unappreciated



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Why Does an Employee Steal?

- Employee feels abused or exploited by employer and wants to “get even”
- Employee fails to consider the consequences of being caught
- Employees “never go to jail” or get harsh prison sentences
- Management is “living high” while employees are oppressed

How is Internal Theft Discovered?



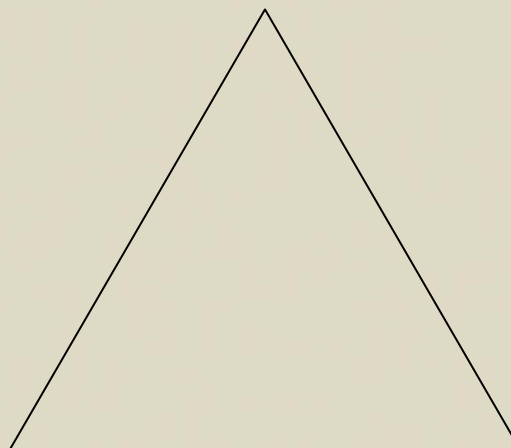
- 33% - Tips from co-worker or complaints
- 20% - Audits (internal 17%; external 3%)
- 47% - By accident



Fraud Triangle



Opportunity



Incentives/Pressures

Rationalization/Attitudes



Opportunity

- Poor controls/lack of segregation of duties
- Poor supervision
- Too much trust
- Poor communication within organization or Board
- Poor financial controls

Incentives / Pressures

Financial pressures

- Work related pressures

Personal pressures

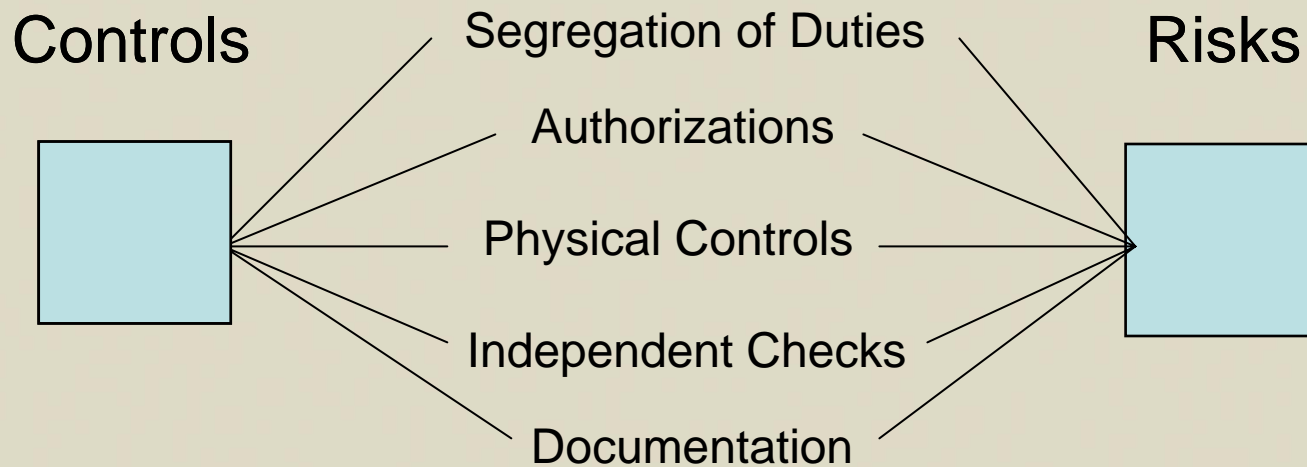
- Vice/Addictions



Rationalization / Attitudes

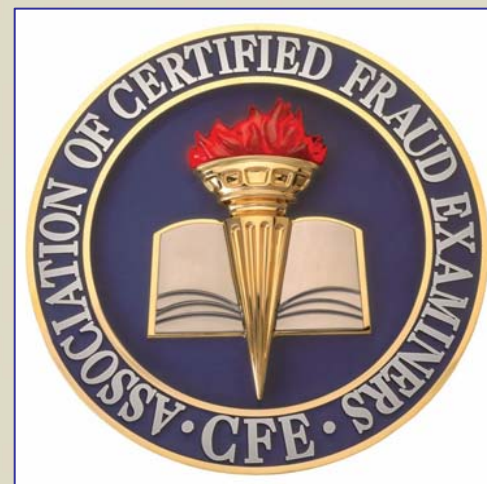
- I deserve it
- The government can turn it around if we can just comply with debt covenants one more time
- It's not hurting anyone (investors, lenders, general public)
- "I'm only borrowing it and I'll pay it back"
- "I need it more than my boss"
- "The "Government" can afford it"
- "It's for a good purpose"

Matching Controls With Risks



What is a CFE?

- Certified Fraud Examiner (CFE)
- Specialist in the detection and/or deterrence of a wide variety of fraudulent activity



ACFE Organization



“Association of Certified Fraud Examiners (ACFE) is a member-based global association dedicated to providing anti-fraud education and training. Together with its members, the ACFE is reducing business fraud worldwide and inspiring public confidence in the integrity and objectivity of our profession”

www.acfe.com



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ACFE Organization

Established in 1988 and headquartered in Austin, Texas
The ACFE has grown from:



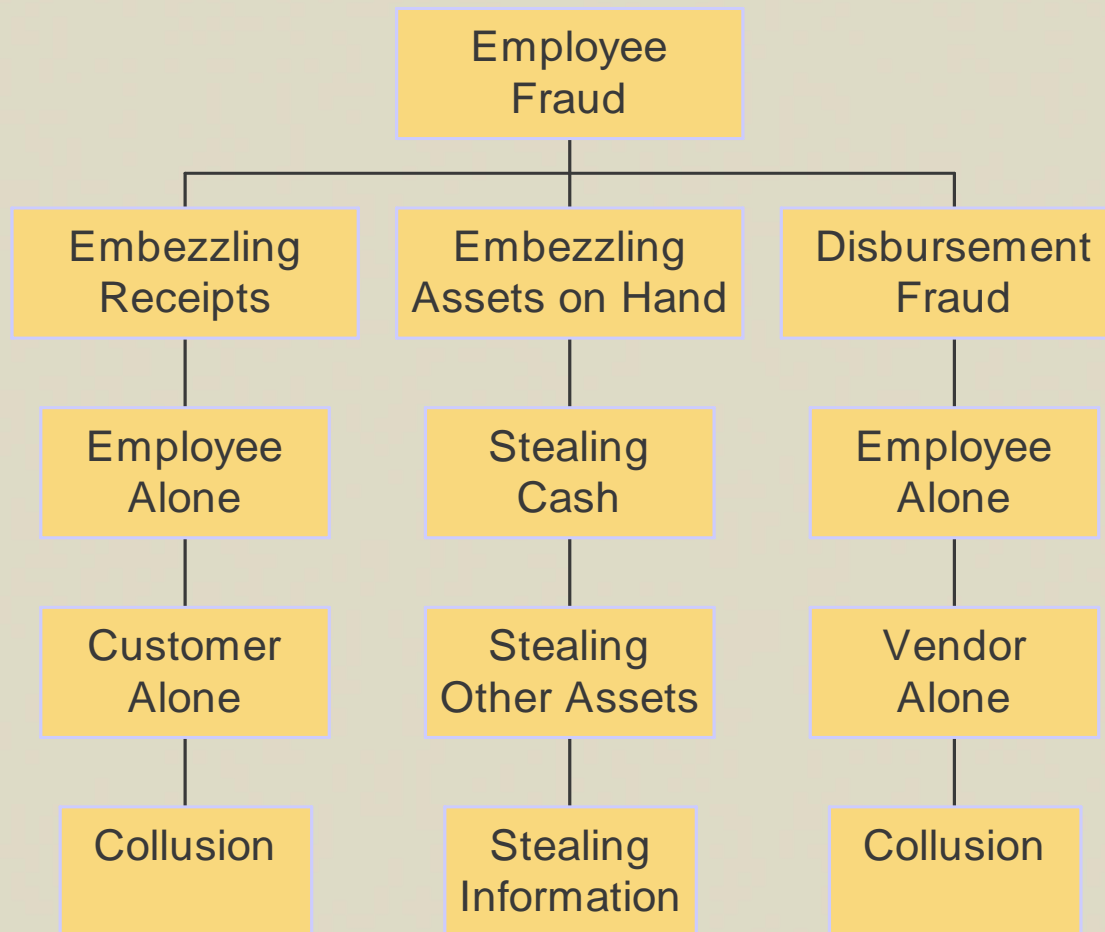
1992 - 5,500 members
2004 - 29,000 members
2007 - 40,000 members
2008 - 55,000 members

Membership represents 132 chapters in over 100 countries

Florida Chapters include: Ft. Myers, Jacksonville, Miami, Orlando, Pensacola, Tallahassee and Tampa

Membership requires CFE adhere to strict code of professional conduct and ethics

Ways to Commit Fraud



Major Methods of Perpetration

- Override of internal controls
- Contrived or non-substance transactions
- Fictitious and unrecorded transactions
- Collusion
- Forgery or fake documents

Example #1

- Entity has had “reviewed” financial statements for many years
- Hired by organization
- Not aware of fraud
- Received tip about gambling
- Came in under pretense to review internal controls
- Look at strengths and weaknesses
- Provide recommendations

Example #1

Disbursements by Vendor

- **Purpose**
 - To identify which vendors receive the most amount of cash disbursements from the Entity.
- **Procedure**
 - We obtained a cash disbursement detail from the IT Department for the period 1/1/06 through 6/12/07. This list included 17,351 checks totaling over \$404,000,000.
- **Conclusion**
 - We sorted the data by vendor name according to the cash disbursement information supplied by the IT Department. We prepared a schedule representing the top 20 vendors which had more than 50 transactions. The total of these 20 vendors made up 73% of the total cash disbursements.



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Example #1

Disbursements by Vendor

- Results
 - 5th Vendor with most checks written as payee was “Petty Cash”
 - 124 checks
 - Total over \$302,000
 - During 18 month period (\$16,000+ /month)

Petty Cash Checks



Petty Cash Checks

CHECK NUM	CHECK	CHECK DATE	AMOUNT	VENDOR NAME
72334	CHECK	1/3/2006	4,932.50	PETTY CASH
72438	CHECK	1/6/2006	1,257.81	PETTY CASH
72946	CHECK	1/18/2006	200.00	PETTY CASH
73064	CHECK	1/19/2006	555.25	PETTY CASH
73310	CHECK	1/30/2006	150.00	PETTY CASH
73311	CHECK	1/30/2006	150.00	PETTY CASH
73514	CHECK	2/3/2006	5,057.50	PETTY CASH
73568	CHECK	2/7/2006	600.00	PETTY CASH
73578	CHECK	2/7/2006	270.00	PETTY CASH
73946	CHECK	2/15/2006	155.85	PETTY CASH
74041	CHECK	2/17/2006	554.94	PETTY CASH
74098	CHECK	2/21/2006	3,000.00	PETTY CASH
74253	CHECK	2/28/2006	549.46	PETTY CASH
74407	CHECK	3/6/2006	4,690.00	PETTY CASH
74642	CHECK	3/10/2006	575.00	PETTY CASH
74948	CHECK	3/17/2006	4,500.00	PETTY CASH
75060	CHECK	3/20/2006	980.00	PETTY CASH
75175	CHECK	3/23/2006	441.71	PETTY CASH
75205	CHECK	3/27/2006	159.60	PETTY CASH
75287	CHECK	3/29/2006	0.01	PETTY CASH
75395	CHECK	3/31/2006	1,500.00	PETTY CASH
75486	CHECK	4/4/2006	5,637.50	PETTY CASH
75539	CHECK	4/6/2006	424.30	PETTY CASH
75569	CHECK	4/6/2006	196.49	PETTY CASH
75883	CHECK	4/12/2006	111.85	PETTY CASH
75986	CHECK	4/14/2006	900.00	PETTY CASH
76168	CHECK	4/20/2006	537.53	PETTY CASH
76212	CHECK	4/24/2006	7,700.00	PETTY CASH
76226	CHECK	4/25/2006	146.00	PETTY CASH
77072	CHECK	4/28/2006	442.85	PETTY CASH
77172	CHECK	5/2/2006	5,272.50	PETTY CASH
77195	CHECK	5/2/2006	147.01	PETTY CASH
77196	CHECK	5/2/2006	205.81	PETTY CASH
77504	CHECK	5/9/2006	442.47	PETTY CASH
77580	CHECK	5/10/2006	182.57	PETTY CASH
77691	CHECK	5/15/2006	96.45	PETTY CASH
77696	CHECK	5/15/2006	950.00	PETTY CASH
77808	CHECK	5/17/2006	534.74	PETTY CASH
77915	CHECK	5/22/2006	5,600.00	PETTY CASH
78081	CHECK	5/30/2006	700.78	PETTY CASH
78121	CHECK	5/31/2006	267.21	PETTY CASH
78241	CHECK	6/5/2006	5,637.50	PETTY CASH
78246	CHECK	6/5/2006	315.40	PETTY CASH
78635	CHECK	6/14/2006	941.04	PETTY CASH
78977	CHECK	6/27/2006	173.40	PETTY CASH
79036	CHECK	6/29/2006	922.86	PETTY CASH
79174	CHECK	7/5/2006	880.00	PETTY CASH

Petty Cash Checks (continued)



79221	CHECK	7/6/2006	128.76	PETTY CASH
79412	CHECK	7/10/2006	5,690.00	PETTY CASH
79472	CHECK	7/12/2006	142.81	PETTY CASH
79565	CHECK	7/13/2006	269.48	PETTY CASH
79578	CHECK	7/13/2006	954.52	PETTY CASH
79961	CHECK	7/31/2006	922.46	PETTY CASH
80108	CHECK	8/4/2006	4,192.50	PETTY CASH
80495	CHECK	8/15/2006	840.00	PETTY CASH
80496	CHECK	8/15/2006	809.63	PETTY CASH
80788	CHECK	8/22/2006	146.14	PETTY CASH
80951	CHECK	8/30/2006	1,000.00	PETTY CASH
81038	CHECK	9/1/2006	4,682.50	PETTY CASH
81063	CHECK	9/5/2006	345.89	PETTY CASH
81062	VOIDED	9/5/2006	345.89	PETTY CASH
81084	CHECK	9/6/2006	215.20	PETTY CASH
81404	CHECK	9/11/2006	893.86	PETTY CASH
81728	CHECK	9/20/2006	870.00	PETTY CASH
81729	CHECK	9/20/2006	817.92	PETTY CASH
81916	CHECK	9/22/2006	100.19	PETTY CASH
82156	CHECK	10/3/2006	4,895.00	PETTY CASH
82220	CHECK	10/6/2006	828.40	PETTY CASH
82772	CHECK	10/19/2006	225.95	PETTY CASH
82830	CHECK	10/20/2006	927.65	PETTY CASH
83041	CHECK	11/1/2006	7,000.00	PETTY CASH
83097	CHECK	11/3/2006	6,192.50	PETTY CASH
83360	CHECK	11/9/2006	881.62	PETTY CASH
83374	CHECK	11/9/2006	950.00	PETTY CASH
83753	CHECK	11/17/2006	313.49	PETTY CASH
83858	CHECK	11/22/2006	869.11	PETTY CASH
83984	CHECK	11/29/2006	7,500.00	PETTY CASH
84106	CHECK	12/4/2006	5,627.50	PETTY CASH
84167	CHECK	12/6/2006	952.69	PETTY CASH
84175	CHECK	12/6/2006	8,000.00	PETTY CASH
84461	CHECK	12/11/2006	175.52	PETTY CASH
84506	CHECK	12/12/2006	3,500.00	PETTY CASH
84510	CHECK	12/13/2006	63,825.00	PETTY CASH
84588	CHECK	12/15/2006	741.80	PETTY CASH
84598	CHECK	12/15/2006	915.00	PETTY CASH
84623	CHECK	12/15/2006	8,000.00	PETTY CASH
84694	CHECK	12/19/2006	1,175.00	PETTY CASH
84928	CHECK	12/30/2006	8,300.00	PETTY CASH
84970	CHECK	1/3/2007	6,692.50	PETTY CASH
84972	CHECK	1/3/2007	1,026.74	PETTY CASH
85007	CHECK	1/3/2007	177.50	PETTY CASH
85085	CHECK	1/5/2007	194.21	PETTY CASH
85155	CHECK	1/9/2007	965.00	PETTY CASH
85460	CHECK	1/16/2007	810.40	PETTY CASH
85710	CHECK	1/23/2007	1,210.00	PETTY CASH
86005	CHECK	2/2/2007	822.71	PETTY CASH
86004	VOIDED	2/2/2007	6,990.00	PETTY CASH
86308	CHECK	2/9/2007	500.00	PETTY CASH
86396	CHECK	2/12/2007	748.35	PETTY CASH



Petty Cash Checks (continued)

86440	CHECK	2/14/2007	745.00	PETTY CASH
86441	CHECK	2/14/2007	217.37	PETTY CASH
86004	CHECK	2/19/2007	6,990.00	PETTY CASH
86767	CHECK	2/26/2007	761.53	PETTY CASH
86926	CHECK	3/5/2007	5,865.00	PETTY CASH
87029	CHECK	3/7/2007	6,000.00	PETTY CASH
87294	CHECK	3/13/2007	902.64	PETTY CASH
87295	CHECK	3/13/2007	1,000.00	PETTY CASH
87705	CHECK	3/28/2007	733.42	PETTY CASH
87865	CHECK	4/3/2007	7,250.00	PETTY CASH
87927	CHECK	4/5/2007	500.00	PETTY CASH
88245	CHECK	4/12/2007	593.84	PETTY CASH
88247	CHECK	4/12/2007	980.00	PETTY CASH
88453	CHECK	4/18/2007	771.25	PETTY CASH
88686	CHECK	4/27/2007	910.00	PETTY CASH
88687	CHECK	4/27/2007	402.45	PETTY CASH
88807	CHECK	5/2/2007	8,367.00	PETTY CASH
88902	CHECK	5/8/2007	388.82	PETTY CASH
89323	CHECK	5/17/2007	850.00	PETTY CASH
89324	CHECK	5/17/2007	847.61	PETTY CASH
89595	CHECK	5/31/2007	915.00	PETTY CASH
89596	CHECK	5/31/2007	825.00	PETTY CASH
89597	CHECK	5/31/2007	968.92	PETTY CASH
89710	CHECK	6/5/2007	8,833.75	PETTY CASH
89824	CHECK	6/8/2007	615.00	PETTY CASH
			302,180.88	



Checks sorted by month



Petty Cash Disbursements by Date

Purpose: To analyze in further detail the petty cash disbursements during the period under investigation.

Procedures:

- KRMT obtained the detail for all petty cash disbursements for the period January 1, 2006 through June 12, 2007 and sorted by month.

	YEAR	MONTH	CHECKS	TOTAL AMOUNT
	2006	1	6	7,245.56
	2006	2	7	10,187.75
	2006	3	8	12,846.32
	2006	4	9	16,096.52
	2006	5	11	14,399.54
	2006	6	5	7,990.20
	2006	7	7	8,988.03
	2006	8	5	6,988.27
	2006	9	8	8,271.45
	2006	10	4	6,877.00
	2006	11	7	23,706.72
**	2006	12	11	101,212.51
	2007	1	7	11,076.35
	2007	2	8	17,774.96
	2007	3	5	14,501.06
	2007	4	7	11,407.54
	2007	5	7	13,162.35
	2007	6	2	9,448.75
				302,180.88



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Petty Cash Analysis 2001

<u>CHECK NUMBER</u>	<u>CHECK VOID</u>	<u>CHECK DATE</u>	<u>CHECK_A MOUNT2</u>	<u>CHECK AMOUNT</u>	<u>ROUNDED</u>	<u>ROUND CHECKS</u>	<u>POSSIBLE BONUS CHECK</u>	<u>DIFFERENCE</u>	<u>ENDOR NAME</u>	<u>YEAR</u>	<u>MONTH</u>
23314	CHECK	1/8/2001	575.53	\$ 575.53	580.00	\$ -	\$ -	\$ 575.53	PETTY CASH	2001	1
23527	CHECK	1/12/2001	544.57	544.57	540.00	-	-	544.57	PETTY CASH	2001	1
23695	CHECK	1/19/2001	416.34	416.34	420.00	-	-	416.34	PETTY CASH	2001	1
23752	CHECK	1/24/2001	432.59	432.59	430.00	-	-	432.59	PETTY CASH	2001	1
23863	CHECK	1/30/2001	446.12	446.12	450.00	-	-	446.12	PETTY CASH	2001	1
			2,415.15	2,415.15	2,420.00	-	-	2,415.15			1 Total
23944	CHECK	2/6/2001	490.01	490.01	490.00	-	-	490.01	PETTY CASH	2001	2
24021	CHECK	2/9/2001	353.18	353.18	350.00	-	-	353.18	PETTY CASH	2001	2
24312	CHECK	2/20/2001	412.42	412.42	410.00	-	-	412.42	PETTY CASH	2001	2
24542	CHECK	2/28/2001	311.67	311.67	310.00	-	-	311.67	PETTY CASH	2001	2
			1,567.28	1,567.28	1,560.00	-	-	1,567.28			2 Total
24638	CHECK		490.40	490.40	490.00	-	-	490.40	PETTY CASH	2001	3
24903	CHECK	3/13/2001	584.22	584.22	580.00	-	-	584.22	PETTY CASH	2001	3
25081	CHECK	3/20/2001	645.24	645.24	650.00	-	-	645.24	PETTY CASH	2001	3
25145	CHECK	3/23/2001	578.85	578.85	580.00	-	-	578.85	PETTY CASH	2001	3
25319	CHECK	3/30/2001	659.29	659.29	660.00	-	-	659.29	PETTY CASH	2001	3
			2,958.00	2,958.00	2,960.00	-	-	2,958.00			3 Total
25516	CHECK	4/5/2001	563.34	563.34	560.00	-	-	563.34	PETTY CASH	2001	4
25718	CHECK	4/12/2001	711.52	711.52	710.00	-	-	711.52	PETTY CASH	2001	4
25858	CHECK	4/17/2001	572.01	572.01	570.00	-	-	572.01	PETTY CASH	2001	4
25986	CHECK	4/20/2001	461.59	461.59	460.00	-	-	461.59	PETTY CASH	2001	4
26130	CHECK	4/26/2001	593.02	593.02	590.00	-	-	593.02	PETTY CASH	2001	4
			2,901.48	2,901.48	2,890.00	-	-	2,901.48			4 Total
26315	CHECK	5/8/2001	698.96	698.96	700.00	-	-	698.96	PETTY CASH	2001	5
26588	CHECK	5/15/2001	701.88	701.88	700.00	-	-	701.88	PETTY CASH	2001	5
			1,400.84	1,400.84	1,400.00	-	-	1,400.84			5 Total
27059	CHECK	6/7/2001	700.14	700.14	700.00	-	-	700.14	PETTY CASH	2001	6
	CHECK	6/14/2001	609.70	609.70	610.00	-	-	609.70	PETTY CASH	2001	6
27496	CHECK	6/25/2001	557.93	557.93	560.00	-	-	557.93	PETTY CASH	2001	6
			1,867.77	1,867.77	1,870.00	-	-	1,867.77			6 Total
27658	CHECK	7/6/2001	582.47	582.47	580.00	-	-	582.47	PETTY CASH	2001	7
28067	CHECK	7/19/2001	582.61	582.61	580.00	-	-	582.61	PETTY CASH	2001	7
			1,165.08	1,165.08	1,160.00	-	-	1,165.08			7 Total
28610	CHECK	8/13/2001	536.72	536.72	540.00	-	-	536.72	PETTY CASH	2001	8
28754	CHECK	8/17/2001	375.80	375.80	380.00	-	-	375.80	PETTY CASH	2001	8
28865	CHECK	8/28/2001	704.90	704.90	700.00	-	-	704.90	PETTY CASH	2001	8
29010	CHECK	8/31/2001	356.25	356.25	360.00	-	-	356.25	PETTY CASH	2001	8
			1,973.67	1,973.67	1,980.00	-	-	1,973.67			8 Total
29330	CHECK	9/12/2001	498.52	498.52	500.00	-	-	498.52	PETTY CASH	2001	9
29495	CHECK	9/20/2001	409.89	409.89	410.00	-	-	409.89	PETTY CASH	2001	9
29679	CHECK	9/27/2001	500.00	500.00	500.00	500.00	-	-	PETTY CASH	2001	9
29701	CHECK	9/28/2001	351.53	351.53	350.00	-	-	351.53	PETTY CASH	2001	9
			1,759.94	1,759.94	1,760.00	500.00	-	1,259.94			9 Total
29794	CHECK	10/3/2001	491.31	491.31	490.00	-	-	491.31	PETTY CASH	2001	10
30099	CHECK	10/16/2001	486.26	486.26	490.00	-	-	486.26	PETTY CASH	2001	10
30279	CHECK	10/23/2001	488.97	488.97	490.00	-	-	488.97	PETTY CASH	2001	10
			1,466.54	1,466.54	1,470.00	-	-	1,466.54			10 Total
30425	CHECK	11/1/2001	504.99	504.99	500.00	-	-	504.99	PETTY CASH	2001	11
30678	CHECK	11/12/2001	549.68	549.68	550.00	-	-	549.68	PETTY CASH	2001	11
30948	CHECK	11/21/2001	418.29	418.29	420.00	-	-	418.29	PETTY CASH	2001	11
31144	CHECK	11/30/2001	453.89	453.89	450.00	-	-	453.89	PETTY CASH	2001	11
			1,926.85	1,926.85	1,920.00	-	-	1,926.85			11 Total
31320	CHECK	12/7/2001	525.79	525.79	530.00	-	-	525.79	PETTY CASH	2001	12
31390	CHECK	12/11/2001	500.00	500.00	500.00	500.00	-	-	PETTY CASH	2001	12
31423	CHECK	12/13/2001	291.91	291.91	290.00	-	-	291.91	PETTY CASH	2001	12
31567	CHECK	12/17/2001	36,800.00	36,800.00	36,800.00	-	36,800.00	-	PETTY CASH	2001	12
31568	CHECK	12/17/2001	367.17	367.17	370.00	-	-	367.17	PETTY CASH	2001	12
31672	CHECK	12/24/2001	432.58	432.58	430.00	-	-	432.58	PETTY CASH	2001	12
31748	CHECK	12/28/2001	318.23	318.23	320.00	-	-	318.23	PETTY CASH	2001	12
			39,235.68	39,235.68	39,240.00	500.00	36,800.00	1,935.68			12 Total
				\$60,638.28	\$60,630.00	\$ 1,000.00	\$ 36,800.00	\$22,838.28			2001 Totals
							\$ 36,800.00				
							\$ -				

Christmas Bonus Amount Per

Difference

Petty Cash Analysis Summary 2001-2007

<u>YEAR</u>	<u>CHECK AMOUNT</u>	<u>ROUND CHECKS</u>	<u>POSSIBLE BONUS CHECK</u>	<u>DIFFERENCE</u>
2001 Totals	\$ 60,638.28	\$ 1,000.00	\$ 36,800.00	\$ 22,838.28
2002 Totals	91,263.46	44,400.00	-	46,863.46
2003 Totals	108,443.59	23,150.00	48,050.00	37,243.59
2004 Totals	314,919.30	228,220.00	45,350.00	41,349.30
2005 Totals	394,392.79	169,490.00	73,425.00	151,477.79
2006 Totals	224,463.98	73,340.00	63,825.00	87,298.98
2007 Totals	70,381.01	26,190.00	-	44,191.01
	<u>\$ 1,264,502.41</u>	<u>\$ 565,790.00</u>	<u>\$267,450.00</u>	<u>\$ 431,262.41</u>
Less 2006 receipts	(122,260.96)	(14,340.00)		
	<u>\$ 1,142,241.45</u>	<u>\$ 551,450.00</u>		

Factors Involved

- Excessive gambling
- Access to company checkbook
- Check signor
- Access to company books
- Received bank statements
- Prepared bank reconciliations
- Bank statements and bank reconciliations not reviewed by 2nd person

Proactive Detection Techniques

- Employee red flags
- Management red flags
- Other red flags
- Example related party/conflict of interest

Employee Red Flags

- Employees' lifestyle changes
- Expenses, cars, jewelry, homes, clothes
- Significant personal debt and credit problems
- Behavioral changes: drugs, gambling
- High employee turnover
- Refusal to take vacation or sick leave
- Lack of segregation of duties in a vulnerable area

Management Red Flags

- Reluctance to provide information
- Excessive number of checking accounts
- Frequent changes in auditors
- Excessive number of year-end transactions
- High employee turnover rate
- Unexpected overdrafts or declines in cash balance
- Financial transactions that do not make sense, common or business
- Photocopies or missing documents

Other Red Flags

- Poor segregation of duties
- Lack of management oversight
- Excess credit memos and other credit adjustments
- Customer complaints and discrepancies
- Missing or altered source documents
- Inadequate record-keeping
- Lack of independent review
- Lack of cash flow from operating activities
- Excess “no sales” or other non sale transactions
- Drop in gross profit margin

Forensic Investigations



- Entity/Department is concerned about possible fraud or theft
- Entity/Department has suffered a fraud or theft
- Entity has received a tip-off about a fraud/embezzlement or conflict of interest
- Entity has discovered significant accounting irregularities



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What is a Fraud Investigation?

- Interviewing those with relevant information
- Examining financial statements and supporting documentation
- Observing behavior, obvious displays of wealth
- Write a report about findings
- Present findings to client, board, attorney or jury

Interviewing Techniques



- Interviewing is an art
- Involves preparation
- Need to adjust interview for purpose:
 - Fact gathering
 - Confession



Initial Phase of Interview

- Who conducts the interview?
- Who is being interviewed?
- Purpose of the interview
- Interview methodology



Interviewer

- Internal auditor
- External auditor
- Law enforcement
- Fraud consultant



Challenge

- Getting the most information you can during the interview
- Getting to know what you don't already know
- Verifying what you already know
- Being able to get to the bottom line and determination of what the true situation is

Actual Interview

- Scheduled or surprise
- Preparation
- Rapport
- Professionalism
- Your body language
- Expressions and gestures
- Open-ended questions

Actual Interview - continued



- Taking notes
- Listening
- Being positive
- Gaining clarification and full understanding from the interviewees
- Documenting the interviews



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Interview Questions

- Introductory
- Informational
- Assessment
- Closing
- Admission seeking

Characteristics of a Fraud Examiner

- Patient
- Skeptic
- Investigative mind
- Organized
- Detail oriented
- Present data (charts and graphs)
- Tell the story with facts

Who Signs a Conflict of Interest Policy?

- Board members (90%)
- Executive management (43%)
- All employees (37%)
- Committee members (23%)
- Other management personnel (17%)
- Volunteers (10%)
- Employees below management level (8%)

2005 National Board Governance Survey for NFP
- Grant Thornton



Example #2 Related Parties

- Hired by NFP agency
- Not aware of fraud
- Received tip of impropriety of funds
- Came in to review expenses in accordance with grant agreement
- Were informed there were no related party transactions

Example #2 Related Party Transactions

- Entity had been audited for several years
- No general ledger or accounting records other than check book stubs provided
- Entered all checks into excel for 2007
- Sorted data by payee
- Checked corporate state website for all officers of entity and for other entities serving as registered agent or officer
- Reviewed all paid invoices provided

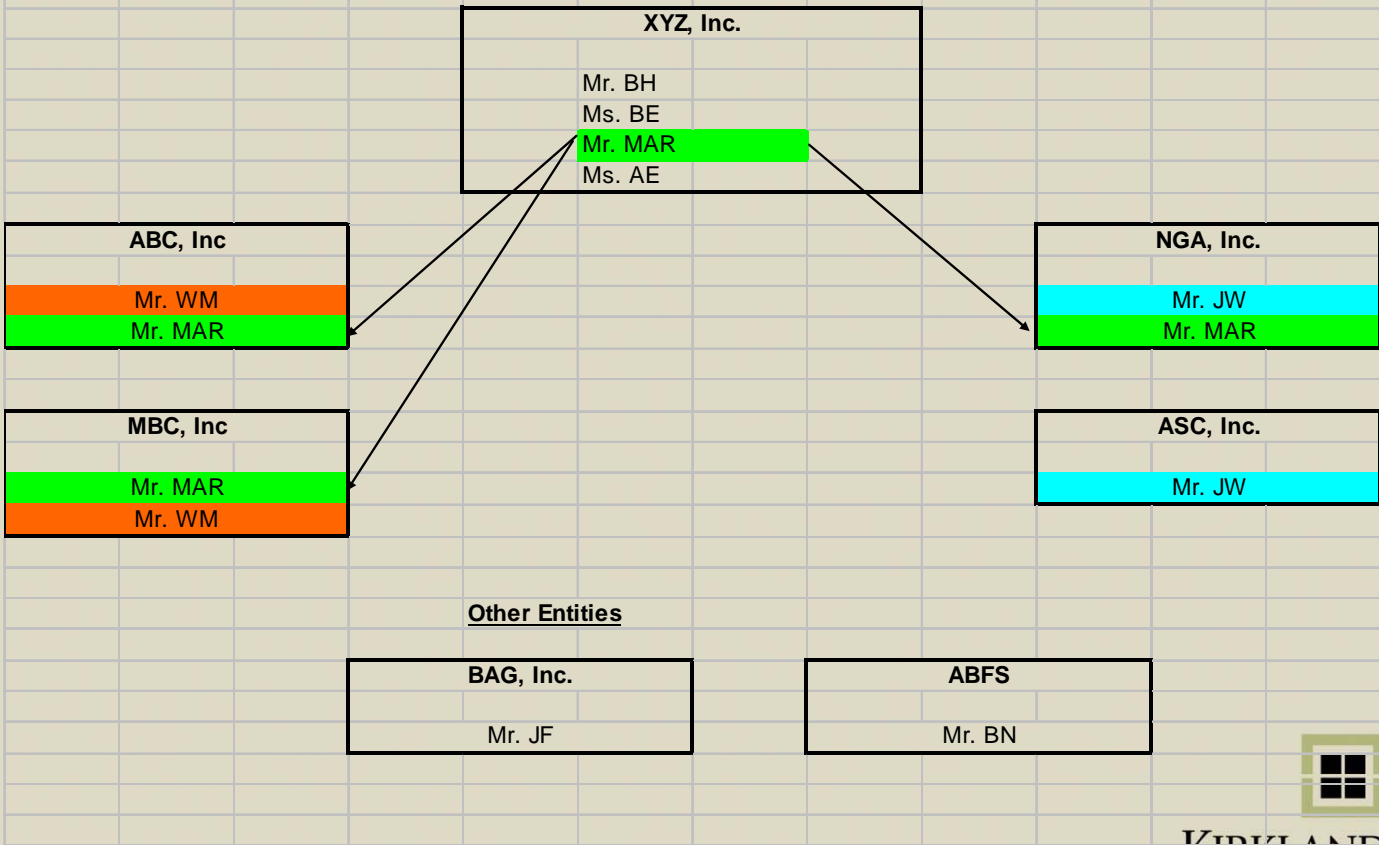


Example #2 Related Party Transactions

- Identified several related individuals
- Identified other entities with common ownership/board members
- Quantified amounts that had been paid to related parties

Example #2 Related Party Transactions

XYZ, Inc
Related Party Flowchart - 2007



Professional Skepticism



Controls to Mitigate Fraud Risk

- Examine bank reconciliations
- Review statements and canceled checks for missing items
- Look for large, unexplained reconciling items in the bank reconciliations
- Compare check endorsements to payee information
- Obtain cutoff statements
- Implement dual control over opening mail and cash receipts
- Perform surprise cash counts

Controls to Mitigate Fraud Risk

- Perform analytical procedures on expense accounts
- Search for and examine unusual expense account activity close to the end of the year
- Analyze sales discounts and returns
- Review vendor list and investigate any payments to unknown or unusual vendors
- Compare vendor addresses to employee addresses
- Use computer aids to identify a red flag as well as quantify it:
 - Compare check amounts from bank checks to cash disbursement journal
 - Review duplicate check numbers
 - Compare check payee from bank checks to cash disbursement journal

Controls to Mitigate Fraud Risk



- Rotate job schedules, looking for variances in revenues
- Direct observation:
 - Employee work areas
 - Employee lifestyles
 - Employee overtime activity



Controls to Mitigate Fraud Risk



- Create customer awareness asking for receipts
- Monitor and follow up on customer complaints
 - Whistle-Blower policy



Examples of Documentation “Red Flags”



Checks

- Payable to “cash” or “petty cash”
- Made out in even amounts for sums over \$500
- Unusual check endorsements
- Nonpayroll checks endorsed by hand



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Examples of Documentation “Red Flags”



Checks (continued)

- Missing checks or checks out of sequence
- Excessive number of voided checks
- Large, unexplained reconciling items in the bank reconciliation
- Bank account not reconciled on a timely basis
- Bank statements that do not include canceled checks
- Abnormal number of expense items or supplies reimbursements by employee



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Examples of Documentation “Red Flags”



Invoices

- Typed rather than printed
- Heading that is rubber-stamped rather than printed
- No telephone number
- Not vendor’s ordinary goods or services
- Disbursements are unsupported by invoices or other documentation



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Examples of Documentation “Red Flags”

Invoices (continued)

- Payments to vendors not on the approved list
- Vendor’s invoice without invoice numbers
- Vendor’s address that match employee address
- Purchases that by-pass the normal procedures.
- High volume of purchases from new vendors shortly after they obtain vendor status

20 Danger Signs of Embezzlement

1. Borrowing small amounts from fellow employees
2. Placing personal checks in change funds—undated, postdated – or requesting others to “hold” check
3. Personal checks cashed and returned for irregular reasons
4. Collectors or creditors appearing at the place of business, and excessive use of telephone to “stall off” creditors



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20 Danger Signs of Embezzlement

5. Placing unauthorized I.O.U.'s in change funds, or prevailing on others in authority to accept I.O.U.'s for small, short-term loan
6. Inclination toward covering up inefficiencies or "plugging" figures
7. Pronounced criticism of others, endeavoring to divert suspension
8. Replying to questions with unreasonable explanations



20 Danger Signs of Embezzlement



9. Gambling in any form beyond ability to stand the loss
10. Excessive drinking and nightclubbing or associating with questionable characters
11. Buying or otherwise acquiring through “business” channels expensive automobile and extravagant household
12. Explaining a higher standard of living as money left from an estate



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20 Danger Signs of Embezzlement



13. Getting annoyed at reasonable questioning
14. Refusing to leave custody of records during the day; working overtime regularly
15. Refusing to take vacations and shunning promotions for fear of detection
16. Constant association with, and entertainment by, a member of a supplier's staff



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20 Danger Signs of Embezzlement



17. Carrying an unusually large bank balance, or heavy buying of securities
18. Extended illness of self or family, usually without a plan of debt liquidation
19. Bragging about exploits and/or carrying unusual amounts of money
20. Rewriting records under the guise of neatness in presentation



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Fraud Prevention

- Adopt a fraud awareness policy
- Write a code of ethics and compliance standards
- Enforce existing controls
- Limit access to asset value

Fraud Awareness and Policies



- Promote an ethical environment
- Fraud dismissal policy
- Fraud risk analysis
- Computer security
- Adequate internal controls
- Internal audit function (co-sourcing)



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Questions?



Contact Information



Laura Krueger Brock, CPA/CFF, CFE, CVA
Shareholder

Kirkland, Russ, Murphy & Tapp, PA
13577 Feather Sound Drive, Suite 400
Clearwater, FL 33762

Tel – 727.572.1400

Fax – 727.571.1933

www.KRMTCPA.com

Lbrock@krmtcpa.com



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