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Fraud Red Flags & Proactive Prevention Activities

Fraud's Impact on Local Government

- Village School District: \$661,766
- Urban School District: \$4.2 million
- County: \$3 million
- Community School: \$1.2 million
- Single Treasurer, Multiple Schools: 19 audits, 67 FFRs, \$1.1 million



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Fraud's Impact on Local Government

- All but one convicted in federal or state court for:
 - Racketeering (R.C. 2923.32);
 - Theft in Office (R.C. 2921.42);
 - Tampering with Records (R.C. 2913.42)
- Sentenced to Combined 33 Years



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Fraud's Impact on Local Government

- But, all occurred over a minimum of 3 years.
- If a fraud occurs over a 3-year period, we can prevent it.

How?



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Session Objectives

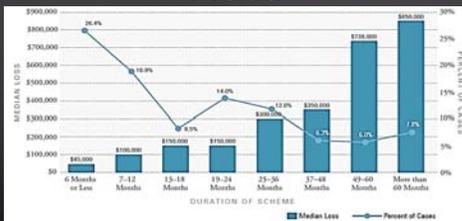
- Discuss Fraud Indicators
- Learn Common Fraud Schemes
- Learn strategies to be proactive in preventing fraud



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Frequency & Duration of Fraud



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Financial Crimes

Who Commits Fraud?



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Cressey's Fraud Triangle



Need

Opportunity

Rationalize

Fraud Triangle



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Warning Signs

- What warning signs should we all be on the lookout for?
- What are some red flags we should be aware of?



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Warning Signs, cont.

- Lifestyle - changes or beyond means





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Warning Signs, cont.

- Weak Internal Controls!
- Unsupported transactions / journal entries / adjustments
- Unexpected overdrafts / declines in cash balances
- Photocopied or missing documents
- Make sense?
- Business & common sense



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Fraud Schemes

- Introduce Basic Fraud Schemes, then move into
- Strategies to Combat Those Schemes



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Expense Reimbursement Schemes

- Travel and expense budgets = common target for fraud.
- Generally, fall into four categories:
 1. Mischaracterized expense reimbursements;
 2. Overstated expense reimbursements;
 3. Fictitious expense reimbursements;
 4. Multiple reimbursements.



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Expense Reimbursement Schemes



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Register Disbursement Schemes

- Common at Schools
- In practice, employee removes cash from register, then
- Enters refund or voids sale to cover up theft.



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Billing Schemes

- **Most common and costly disbursement fraud.**
 - Attack purchasing function;
 - Cause organization to buy goods or services that are:
 1. Nonexistent;
 2. Overpriced;
 3. Not needed by the organization.



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Billing Schemes, cont.

- **Fraudster provides false support;**
 - Invoices, purchase orders, purchase requisitions, receiving reports, etc.
- Organization issues check based on false information
- Purpose for most billing schemes is to generate cash or goods for sale



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Fraud Prevention Techniques

- **First, a Shameless Plug:**
 - Talk to your attorney
 - Use your internal auditor (if you have one)



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Fraud Prevention: Fraud Prevention Program

- Appropriate Ethical Training
- On-going Risk Assessment Program
- Written policies & procedures
- Internal controls
- Segregation of Duties and Reconciliation
- Fair & balanced discipline
- Audit committees



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Fraud Prevention: Fraud Prevention Program, cont.

- Quick, but Important Point:
 - We need to be realistic in our assessing our fraud prevention program
 - If you have an audit committee, but it rarely meets and passes on tips, what good is it?
 - If internal controls are not enforced, what good are they?
 - If an ethics policy is not communicated, why have one?



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Fraud Prevention: Attitude

- Attitude: The Importance of Exercising Professional **SKEPTICISM**
 - Trust, but Verify



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Fraud Prevention: Techniques

- Segregation of Duties
- Reconciliation
- Oversight



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Segregation of Duties

- Disperse critical functions of a process to more than one person or department.
- In general, the approval function, the accounting/reconciling function, and the asset custody function should be separated among employees.
- When not feasible, a detailed supervisory review of related activities is required



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Segregation of Duties

- Consider separating these functions:
 - Cash Receipts
 - Cash Counts
 - Bank Deposits
 - Reconciliations
 - Posting of deposits



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Reconciliation

- Checks & Balances
- For example, month-end reconciliations comparing ledgers to bank statements
- At home, comparing bank statements with our own checkbooks



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Oversight

- Asking the right questions of employees and fiscal officers
- If you don't know, ask
- If nothing else, we gain a better understanding of functions of our public offices



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Median Loss Based on Presence of Anti-Fraud Controls

Control	Percent of Controls	Control in Place	Control Not in Place	Percent Reduction
Proactive Data Monitoring/Analysis	26.7%	\$92,000	\$200,000	54.0%
Management Review	64.7%	\$100,000	\$200,000	50.0%
Hotline	60.1%	\$100,000	\$200,000	50.0%
Management Certification of Financial Statements	71.9%	\$104,000	\$205,000	49.3%
Surprise Audits	37.8%	\$100,000	\$195,000	48.7%
Dedicated Fraud Department, Function, or Team	41.2%	\$100,000	\$192,000	47.9%
Job Rotation/Mandatory Vacation	19.4%	\$98,000	\$170,000	47.6%
External Audit of Internal Controls over Financial Reporting	67.6%	\$105,000	\$200,000	47.5%
Fraud Training for Managers/Executives	51.3%	\$100,000	\$190,000	47.4%
Fraud Training for Employees	51.6%	\$100,000	\$188,000	46.8%
Formal Fraud Risk Assessments	39.3%	\$100,000	\$187,000	46.5%
Employee Support Programs	56.1%	\$100,000	\$183,000	45.4%
Anti-Fraud Policy	49.6%	\$100,000	\$175,000	42.9%
Internal Audit Department	73.7%	\$123,000	\$215,000	42.8%
Code of Conduct	81.1%	\$120,000	\$200,000	40.0%
Rewards for Whistleblowers	12.1%	\$100,000	\$163,000	38.7%
Independent Audit Committee	62.5%	\$114,000	\$180,000	36.7%
External Audit of Financial Statements	81.7%	\$150,000	\$175,000	14.3%



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Reporting Fraud

- Auditor of State's Fraud Hotline
 - R.C. 117.103
 - H.B. 66 (2012)
- Call Local Law Enforcement
- Special Audit (*State ex rel. Oriana House v. Montgomery*, 108 Ohio St.3d 419 (2006))



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Reporting Fraud, cont.

- Records Retention:
 - Suspects may try to destroy or steal records, so it's up to us to protect evidence.
- Retirement System:
 - If charged with Theft in Office under R.C. 2921.41, pension may be frozen and included as restitution if convicted



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