STATE BOARD OF ACCOUNTS

FRAUD PREVENTION

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WHAT IS FRAUD?

- Any activity that relies on deception in order to achieve a gain

- Criminal Fraud – "knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her determinant" (Black Law Dictionary)

WHY DO PEOPLE COMMIT FRAUD?

THE FRAUD TRIANGLE

Via Association of Certified Fraud Examiners (ACFE)

Perceived Financial Need (Pressure)

Perceived Opportunity

Rationalization

TYPES OF FRAUD

3 Main Categories

Category #1
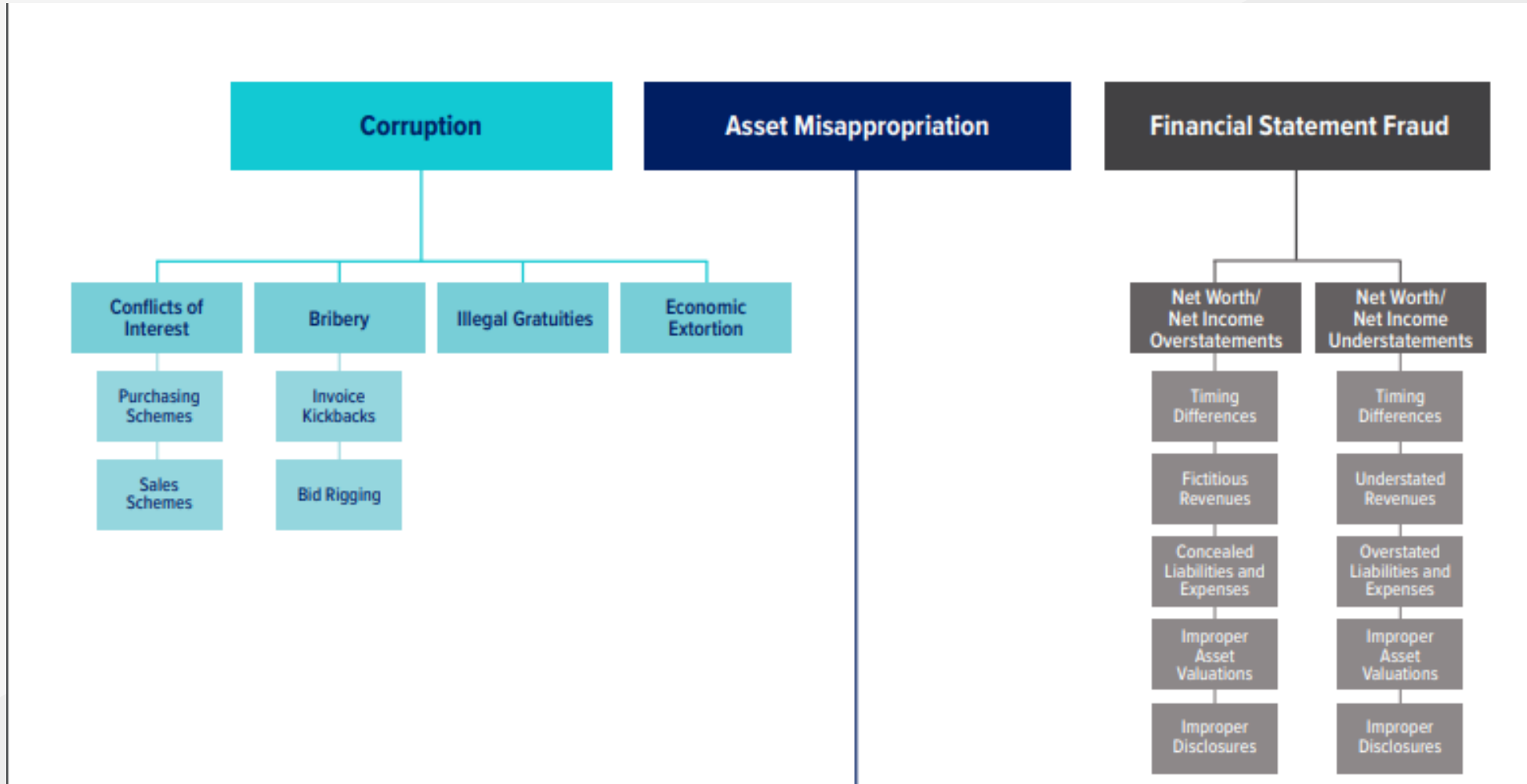
Asset Misappropriation

Category #2

Corruption

Category #3
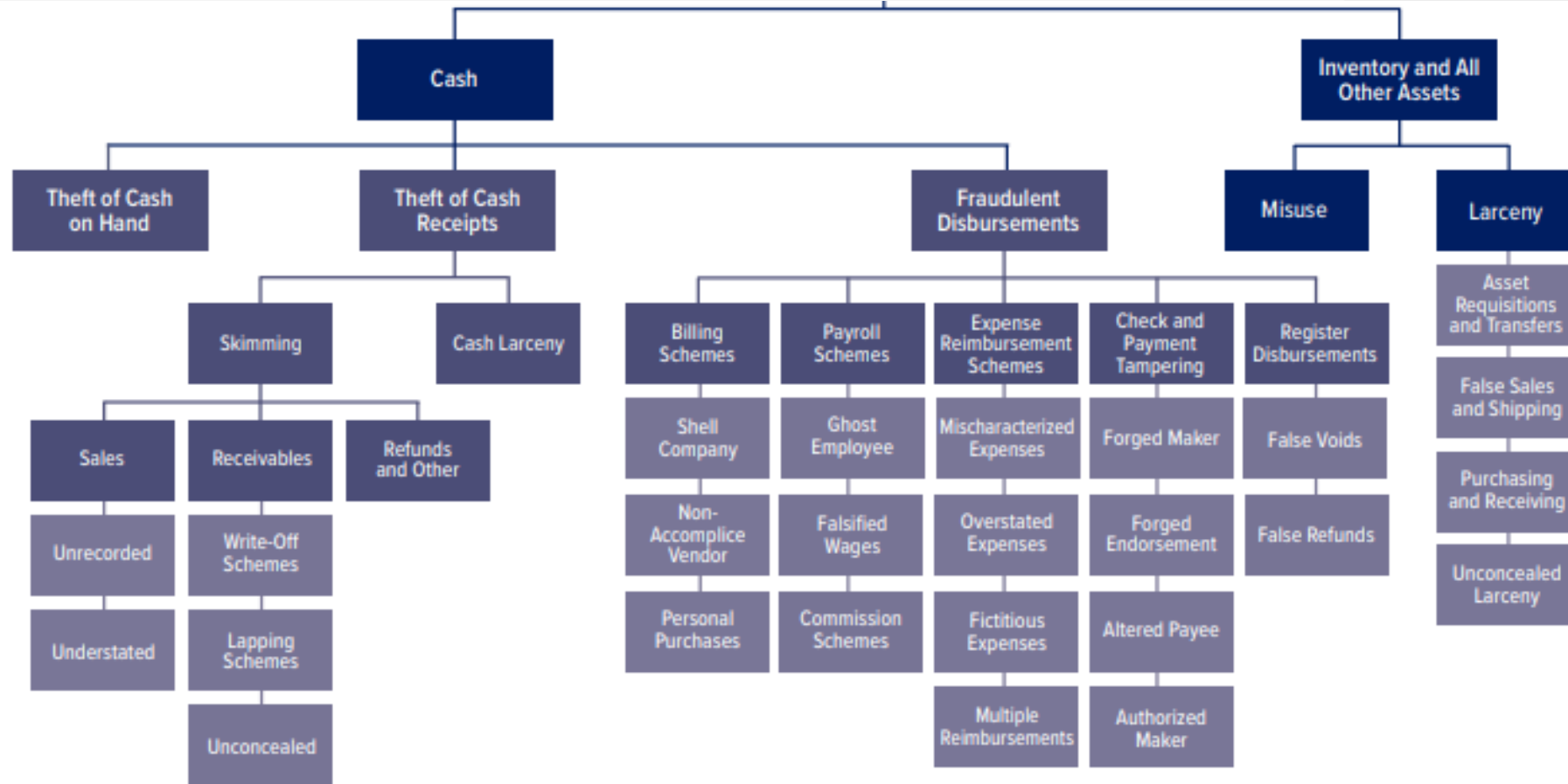
Financial Statement Fraud

THE FRAUD TREE

Via Association of Certified Fraud Examiners (ACFE)

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FRAUD SCHEMES

- Cash Receipt Schemes
  - Skimming – Removing cash BEFORE entry
  - Larceny – Removing cash AFTER entry

- Concealing Receivables
  - Lapping – Taking Customer A's money to use on Customer B's, etc…

FRAUD SCHEMES (CONTINUED)

- Fraudulent Disbursements
    - Forging checks
    - Creating fake invoices
    - Altering timecards
    - Cash Register – could falsely provide a refund or falsely void transactions

- Expense Reimbursement Schemes
    - Mischaracterized, overstated, fictitious, or multiple expenses

FRAUD SCHEMES (CONTINUED)

- Billing Scheme
  - False invoicing via shell companies via non-existent vendors (personal purchases)

- Payroll Schemes
  - Ghost employment
  - Falsified hours
  - Salary/Commission combinations

FRAUD SCHEMES (CONTINUED)

- Bribery Schemes
  - Official (Public) or Commercial (Private)
  - Solicit corrupt payments to influence acts
  - Illegal Gratuities – Items given to reward a decision

- Financial Statement Fraud Schemes
  - False/unauthorized entries
    - Transfers
    - Withdrawals
    - Disbursements
    - Disclosures

CRYPTOCURRENCY SCHEMES

Via 2024 ACFE "Occupational Fraud 2024:
A Report to the Nations"

Other
6%

Manipulation of reported cryptocurrency assets on the financial statements

Conversion of misappropriated assets to cryptocurrency

47%

33%

Proceeds of fraud laundered using cryptocurrency

22%

29%

29%

Bribery or kickback payments made in cryptocurrency

Misappropriation of organizational cryptocurrency assets
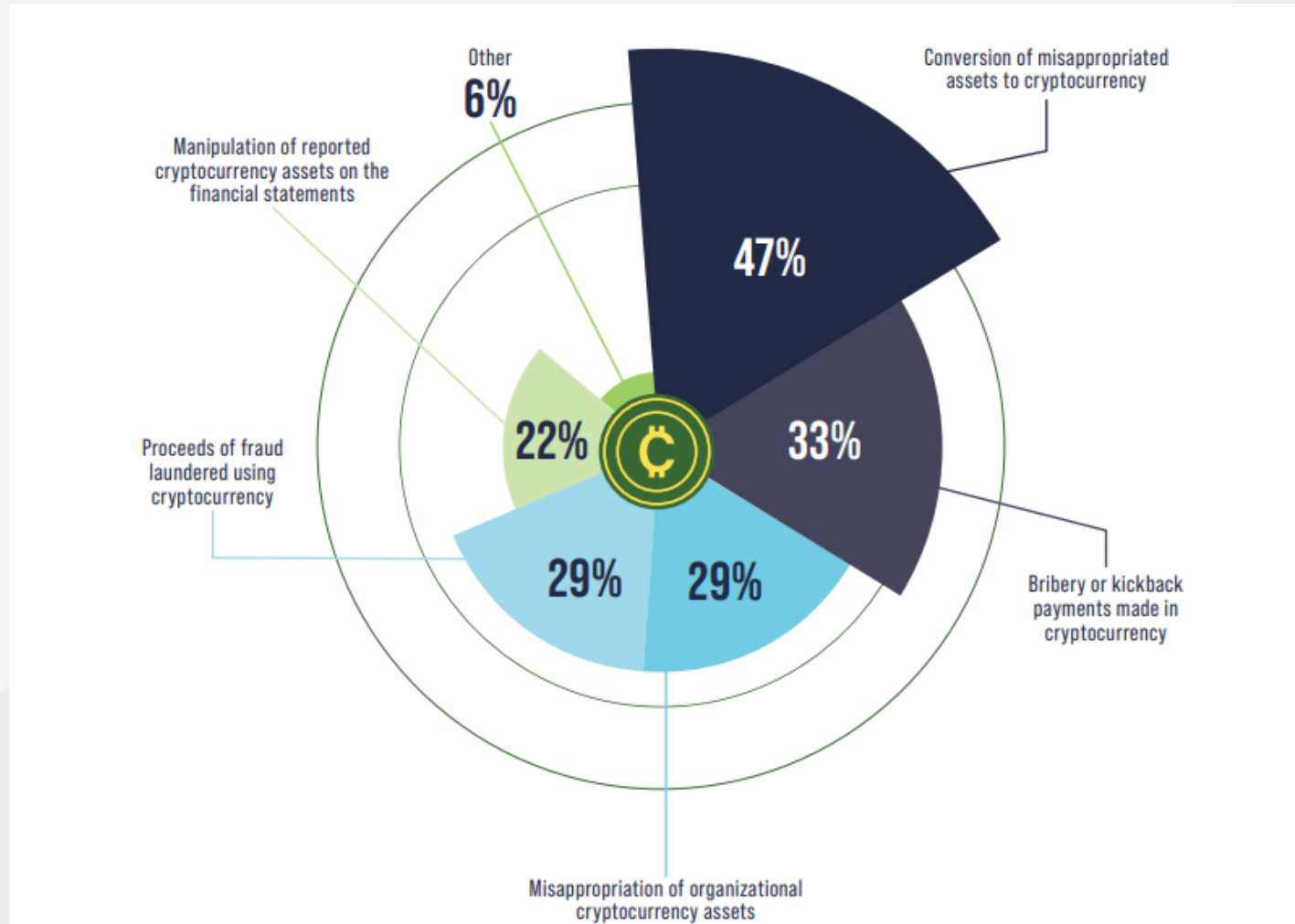
INTERNET AND COMPUTER FRAUD

- Fraud is growing EXPONENTIALLY in virtual spaces

- SBOA IT Manual:
  - *Accounting and Uniform Compliance Guidelines Manual for Indiana Political Subdivisions – Information Technology*
  - Scope: "This Manual addresses requirements to all financial accounting systems. In the event these requirements are not met by the computer environment of the accounting system, compensating manual controls must be implemented."

FRAUD STATISTICS

SOURCE

- *"Occupational Fraud 2024: A Report to the Nations"*

- Published by the Association of Certified Fraud Examiners

- [Link to the Report](#)

STUDY COVERAGE

Losses

Cases covered caused total losses of over $3.1 billion

Median Loss per Case

$145,000

Cases

1,921 cases from 138 countries and territories

Revenue Loss

CFEs estimate organizations lose 5% to fraud each year

Average Loss per Case

$1.7 million

KEY FINDINGS - SCHEMES

- Asset Misappropriation Schemes
  - Most common but least costly
  - 89% of cases fell under this scheme resulting in a $120,000 median loss
  - Most Common – Billing Schemes and Theft of Noncash Assets – 22% each
  - Most Costly – Check and Payment Tampering ($155,000 median loss) and Billing Schemes ($100,000 median loss)

- Financial Statement Frauds
  - Least common but most costly
  - 5% of cases fell under this scheme resulting in a $766,000 median loss

KEY FINDINGS - DETECTION

- A typical fraud case lasts 12 months before detection

- 43% of frauds were detected by tips – 3x as many cases as the next most common method
  - 52% tips from vendors, 21% from customers, and 11% from vendors

- 48% of reported cases included corruption

- Most common mechanisms to report fraud
  - Email and web-based reports have now surpassed telephone hotlines

KEY FINDINGS – ANTI-FRAUD CONTROLS

- Presence of anti-fraud controls are associated with lower fraud losses and quicker fraud detection

- 82% of victim organizations modified their anti-fraud controls following the fraud
  - 27% of these modifications are expected to be "extremely effective" in preventing future similar frauds

- Median for frauds by owners and executives were over 7x greater than those carried out by employees

- Over half of all cases came from five departments:
  - Operations (14%), Accounting (12%), Sales (12%), Customer Service (9%), Executive/Upper Management (9%)

KEY FINDINGS - PERPETRATORS

- Frauds carried out by 3+ perpetrators caused median losses over 4x frauds carried out by a single perpetrator

- 84% of perpetrators displayed at least one behavioral red flag

- Increased Longevity → More Costly

- Case Results – 68% of perpetrators were terminated by their employers
  - 57% of cases referred to law enforcement, 72% of referrals resulted in a conviction
  - Of those not referred to law enforcement, 49% cited internal discipline and 34% cited fear of bad publicity

KEY FINDINGS - OTHER

- Top 5 Median Losses by Industry
    - 5. (tie) Real Estate and Government and Public Administration ($200,000)
    - 4. Construction ($250,000)
    - 3. Manufacturing ($267,000)
    - 2. Wholesale Trade ($361,000)
    - 1. Mining ($550,000)

- Non-profit organizations experience losses half the size of those at other types of organizations

HOW DID COVID IMPACT OCCUPATIONAL FRAUD?

- 53% of cases in the 2024 report had at least one pandemic-related factor contribute to fraud occurrence
- Top 3 Fraud Factors:
    - Organizational Staffing Changes
    - Shift to Remote Work
    - Operational Process Changes

- Median Losses up 24% from 2022-2024
    - Financial Statement Fraud Median – 29% increase
    - Corruption Median – 33% increase
    - Asset Misappropriation – 20% increase

HOW IS FRAUD CONCEALED?

- Top 5 Concealment Methods:
    - 1. Created Fraudulent Physical Documents (41%)
    - 2. Altered Physical Documents (37%)
    - 3. Created Fraudulent Electronic Documents or Files (31%)
    - 4. Altered Electronic Documents or Files (28%)
    - 5. Destroyed or Withheld Physical Documents (23%)

- 11% of cases did not involve any attempt to conceal the fraud

INTERNAL CONTROL WEAKNESSES CONTRIBUTING TO OCCUPATIONAL FRAUD

- Lack of internal controls (32%)
- Override of existing internal controls (19%)
- Lack of management review (18%)
- Lack of competent personnel in oversight roles (9%)
- Poor tone at the top (8%)
- Lack of independent checks/audits (5%)
- Other (4%)
- Lack of employee fraud education (3%)
- Lack of clear lines of authority (1%)
- Lack of reporting mechanism (1%)

COMPONENTS OF INTERNAL CONTROL – C.R.I.M.E

- **C**ontrol Activities – Actual procedures performed

- **R**isk Assessment – Where could things go wrong?

- **I**nformation and Communication – If things go wrong, do you know?

- **M**onitoring – A continuous process

- Control **E**nvironment – "Tone at the Top"

RISKY AREAS TO ASSESS - SCHOOLS

Corporation Level

Receipt/Payment Transactions

Financial Reporting

Federal Grants

Security of Assets

Payroll

ECA Level

Vendor Payments

Athletic Events

Concessions

Fundraisers

School Lunch (Cash Collections)

WHERE DOES TRUST COME INTO PLAY?

- Trust is NOT an internal control!!

- Situation: Someone at your school is very knowledgeable about processes, and no one else knows how certain programs or procedures work

- What's Missing: Someone else should understand and review this person's work!

TYPES OF CONTROLS

- Preventive Controls – controls established with the objective of preventing errors or fraud that could result in a misstatement of the financial statements
    - Ex. Dual signatures on checks, password-protected files, controls limiting access to and protecting assets

- Detective Controls – controls put in place to detect and correct errors or fraud that have already occurred and that could result in a misstatement of the financial statements
    - Ex. Bank reconcilements, inventory counts, other periodic controls

DETECTION

- If you identify errors or fraud early, then the damage can be mitigated!

- Learning from these findings allows for improvements to detect and deter fraud in the future

DETECTIVE CONTROLS

- Reporting Avenues – hotlines, email, online form, etc.
- Internal "Audits" or "Surprise Audits"
- Management Review of Periodic Processes
  - Bank reconcilements
  - Physical inventory checks
  - Cash change and sales reports (ECAs – ticket sales)
- Proactive Data Monitoring – analytical reviews, reasonableness testing, etc.
- Review equipment usage

INITIAL DETECTION

- How is occupational fraud originally detected?
    - Tip (43%)
    - Internal Audit (14%)
    - Management Review (13%)
    - **External Audit (3%)**

- Who reports occupational fraud?
    - Employee (52%)
    - Customer (21%)
    - Anonymous (15%)
    - Vendor (11%)

PREVENTIVE CONTROLS

- Fraud Prevention training
- Anti-Fraud policy (Code of Conduct)
- Job rotation/mandatory vacation
- Safeguarding assets
- Verify vendor legitimacy

- Monitor if policies and procedures are being followed
  - Determine if sufficient to address risk
  - Determine if changes in environment (or individuals) require changes

PREVENTION RECOMMENDATIONS

- Ensure no one person has control over all parts of a transaction

- Restrict use of agency credit cards and verify all charges made

- Protect checks against fraudulent use

- Protect cash and check collections

PREVENTION RECOMMENDATIONS (CONTINUED)

- Review the use of position to waive fees or to not charge for services

- Review the use of unit's credit card and policy

- Review overpayments of salaries

- Be aware of possible kickbacks, bribery, pay-to-play schemes

SEGREGATION OF DUTIES

- Duties that **SHOULD** be separated:

- Receipt Roles – Collecting, Depositing, Recording and Reconciling Functions

- Purchasing Roles – Ordering, Receiving, Claim Creation/Approval, Payment, and Reconciling Functions

- Inventory Roles – Requisition, Receipt, Disbursement, Conversion to Scrap, and Receipt of Scrap Proceeds Functions

	Duties	Employee Number							
		1	2	3	4	5	6	7	8
Cash Receipts									
1.	Open mail and write receipt								
2.	Receive money, issue official receipts								
3.	Take off cash register totals								
4.	Balance cash drawer or cash register								
5.	Make up bank deposits								
6.	Take deposits to bank or remit to receiving officer								
7.	Post receipts								
8.	Access to computer system to make adjustments								
9.	Approves adjustments								
10.	Post credits to accounts receivable								
11.	Prepare customer billings								
12.	Mail billings or statements								
13.	Approve bad debt write offs								
14.	Approve accounts receivable adjustments								
15.	Issue permits, licenses, etc.								
16.	Issues receipts for electronic deposits								

Cash Disbursements

1. Authorize purchases							
2. Prepare purchase orders							
3. Certify receipt of goods or services							
4. Audit claims							
5. Approve claims - Disbursing Officer							
6. Approve electronic transfers							
7. Write checks							
8. Initiate electronic transfers							
9. Post checks							
10. Sign checks - Control of signature stamp							
11. Mail or distribute checks							
12. Custodian of petty cash							
13. Custodian of investments							
14. Access to check stock							
15. Access to computer system to make adjustments							
16. Approves adjustments							

Payrolls

1. Post vacation and sick leave records							
2. Check and extend time cards							
3. Prepare payroll claims							
4. Approve payroll claims for department							
5. Approve payroll claims for disbursing officer							
6. Calculate deductions and net pay							
7. Write payroll checks							
8. Sign payroll checks							
9. Distribute payroll checks							
10. Prepare earnings and deductions reports							
11. Prepare W-2s and compare to earnings records							
12. Access to computer system to make adjustments							
13. Approves adjustments							

Cash

1. Receives bank statement in mail and opens it
2. Compares checks cleared to disbursements posted
3. Compares deposits to receipts posted
4. Prepares bank reconcilement
5. Approves bank reconcilement

Statement of Expenditures of Federal Assistance

1. Enters grant information into Gateway
2. Approves grant information entered in Gateway
3. Approves the prepared SEFA

Financial Close and Reporting

1. Closes the financial records
2. Enters financial statement information into Gateway
3. Approves the Gateway annual report
4. Approves the prepared financial statements

Notes to the Financial Statements

1. Enters the required information into Gateway
2. Approves the notes to the prepared financial statements

RED FLAGS

- **Living beyond means**
- **Financial difficulties**
- **Close vendor/customer relationship**
- **Control issues/unwillingness to share duties**
- **Irritable/defensive/suspiciousness**
- **Wheeler-dealer attitude**
- **Bullying or intimidation**
- **Divorce/family problems**
- Complained about inadequate pay
- Addiction problems

- Excessive pressure from within organization
- Refusal to take vacations
- Past legal problems
- Complained about lack of authority
- Pressure for success – family/peers
- Excessive tardiness/absenteeism
- Social isolation
- Instability in life circumstances
- Excessive internet browsing

RED FLAG TRENDS

- Highest Median Losses
  - Excessive pressure from within the organization ($617,000)
  - Past legal problems ($500,000)
  - "Wheeler-dealer" attitude ($350,000)
  - Bullying or intimidation ($300,000)

- Longest Median Durations
  - Bullying or intimidation (24 months)
  - Divorce or family problems (22 months)
  - Control issues/unwillingness to share duties (20 months)
  - Refusal to take vacations (19 months)

STATE EXAMINER DIRECTIVE 2015-6

- [Link to Directive](#)

- Materiality threshold for reporting irregular variances, losses, shortages, and thefts

- Must notify SBOA and County Prosecutor

- ***NO MATERIALITY THRESHOLD*** for fraud

CHARGE REPORT – B54446

- FY2011 through FY2019

- Overpayment of tuition support, Complexity Grant, Special Education Grant, and Curricular Materials Cost Reimbursement → $68,763,676.13

- Special Investigation Cost → $218,174.62

- Disbursement Deficiencies → $85,687,698.60

- What happened??...LACK OF INTERNAL CONTROLS

FRAUD PREVENTION CHECKLIST - #1

- Is ongoing anti-fraud training provided to all employees of the organization?

  - Do employees understand what does and does not constitute fraud?
  - Have the costs of fraud to the company and everyone in it been made clear to all employees?
  - Do employees know where to seek advice when faced with uncertain ethical decisions?
  - Do employees believe they can speak freely?
  - Has a policy of zero tolerance for fraud been communicated to employees through words and actions?

FRAUD PREVENTION CHECKLIST - #2

- Is an effective fraud reporting mechanism in place?

    - Have employees been taught how to communicate concerns about known or potential wrongdoing?
    - Are one or more reporting channels available to employees?
    - Are whistleblower resources maintained and accessible to all employees?
    - Do employees trust that they can report suspicious activity anonymously and/or confidentially (where legally permissible) and without fear of reprisal?
    - Has it been made clear to employees that reports of suspicious activity will be promptly and thoroughly evaluated?
    - Do reporting policies and mechanisms extend to vendors, customers, and other outside parties?
    - Do reporting mechanisms include multilingual capacities and 24/7 access to a trained interviewer?

FRAUD PREVENTION CHECKLIST - #3

- To increase employees' perception of detection, are the following proactive measures taken and publicized to employees?

  - Is possible fraudulent conduct aggressively and proactively sought out vs. passively or reactively?
  - Are surprise fraud audits performed in addition to regularly scheduled audits
  - Are data analytics techniques used to proactively search for fraud?
    - If so, has the use of such techniques been communicated throughout the organization?
  - Do managers actively review the controls, processes, accounts, or transactions under their purview for adherence to company policies and expectations?

FRAUD PREVENTION CHECKLIST - #4

- Is the management climate/tone at the top one of honesty and integrity?

  - Are employees periodically surveyed to determine the extent to which they believe management acts with honestly and integrity?
  - Are performance goals realistic and clearly communicated?
  - Have fraud prevention goals been incorporated into the performance measures that are used to evaluate managers and to determine performance-related compensation?
  - Has the organization established, implemented, and tested a process for oversight of fraud risks by the board of directors or others charged with governance (e.g. the audit committee)?

FRAUD PREVENTION CHECKLIST - #5

- Are fraud risk assessments performed to proactively identify and mitigate the company's vulnerabilities to internal and external fraud?

  - Are fraud risk assessments updated regularly (e.g. annually), as well as following times of notable organizational or environmental changes?
  - Are the results of the fraud risk assessment shared with appropriate levels of management and used to update the organization's anti-fraud program and controls?

FRAUD PREVENTION CHECKLIST - #6

- Are strong anti-fraud controls in place and operating effectively, including the following?

  - Proper separation of duties
  - Use of authorizations
  - Physical safeguards
  - Job rotations
  - Mandatory vacations

FRAUD PREVENTION CHECKLIST - #7

- Does the internal audit department, if one exists, have adequate resources and authority to operate effectively and without undue influence from senior management?

FRAUD PREVENTION CHECKLIST - #8

- Does the hiring policy include the following (where permitted by law)?

    - Past employment verification
    - Criminal and civil background checks
    - Credit checks
    - Drug screening
    - Education verification
    - References check

FRAUD PREVENTION CHECKLIST - #9

- Are employee support programs in place to assist employees struggling with addiction, mental/emotional health, family, or financial problems?

FRAUD PREVENTION CHECKLIST - #10

- Is an open-door policy in place that allows employees to speak freely about pressures, providing management the opportunity to alleviate such pressures before they become acute?

FRAUD PREVENTION CHECKLIST - #11

- Are regular, anonymous surveys conducted to assess employee morale?

THANK YOU

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