

# First Friday Fraud Facts+

March 2, 2012

*The Idaho State Controller's Office distributes this newsletter as a cost-effective method of increasing awareness about ways to detect and prevent fraud, waste, and abuse in government.*



## QUESTIONS OR COMMENTS:

Matt McBride, CGFM  
Financial Specialist  
P.O. Box 83720  
Boise, ID 83720-0011

Phone: (208) 332-8805

Fax: (208) 334-3415

E-mail: [mmcbride@sco.idaho.gov](mailto:mmcbride@sco.idaho.gov)

## Inside this issue:

Welcome	1
Lapping	1
Red Flags	1
Best Practices	2
Fraud Case	2
Fiscal Focus	3
Announcements	3

Welcome to First Friday Fraud Facts+ (F<sup>4+</sup>). This edition will cover a common type of accounts receivable fraud referred to as lapping and workplace fraud.

## LAPPING

Lapping, which is fairly common, occurs when money received in payment of an account is taken by an employee rather than being appropriately deposited. This shortage is covered by misapplying the next remittance to the deficiency, and so on. Like other fraud, lapping usually starts small, with the perpetrator intending to make up for the deficiency. Failure to detect the theft emboldens the perpetrator and, instead of making up the deficiency, the perpetrator expands it. Lapping schemes tend to unravel when they become too large for the perpetrator to manage.

## RED FLAGS

Several potential red flags may exist when lapping is taking place. Some of these include:

- Frequent errors/corrections of errors on invoices and other documents
- Excessive number of voided transactions
- Unauthorized bank accounts
- Sudden activity in a dormant banking account
- Taxpayer complaints that they are receiving non-payment notices
- Discrepancies between bank deposits and postings
- Abnormal number of expense items, supplies, or reimbursements to an employee
- Presence of employee checks in petty cash



- Excessive or unjustified cash transactions
- Bank accounts that are not reconciled on a timely basis

#### **BEST PRACTICES**

- Segregate duties between posting to the accounts receivable ledger and cash receipts
- Review of non-payment complaints by someone not involved in the receipting function
- Periodic review of receivable accounts by supervisory personnel for a pattern of late payments
- Proper authorization of bank accounts and petty cash disbursements
- Timely reconciliation of bank accounts by supervisory personnel

#### **FRAUD CASE**

This case involves a hospital secretary caught in a complicated check lapping scheme, which resulted in more than \$230,000 stolen over 5 years. The secretary had been employed for 14 years at the hospital and was in charge of gathering cash and checks for a daily bank deposit to the hospital's food services vendor.

The scheme came to light when the hospital decided to change food service vendors, and the hospital and vendor began settling their accounts. Vendor records showed hundreds of thousands of dollars' worth of unpaid invoices for cafeteria and catering services at the hospital; while hospital records showed those invoices as having been paid. Once this discrepancy was discovered an investigation uncovered the fraud.

Investigators soon discovered the hospital secretary had initially taken cash from the hospital cafeteria. The secretary took checks from the hospital, which had been intended to pay for catering, and used them to make a deposit to the cafeteria account. Sometimes the secretary would make up the difference with her own personal checks.

The secretary also used her access to the vendor's cafeteria records to change the entry for the day's cash intake to an amount that equaled the catering invoice. The scheme went undetected because hospital records would show that the checks for catering cleared, leading the hospital to believe those bills had been paid. Meanwhile, the vendor didn't notice the missing cafeteria money because it was receiving checks that it thought were cafeteria revenue.

When the investigation turned up the discrepancies the hospital and vendor contacted the state's attorney general. The secretary admitted to the crime when interviewed by state police and was charged with larceny over \$250 by scheme and one count of false entry in corporate books. She was sentenced to 31 months in prison, (with the last 24 months of her sentence being suspended), and was ordered to pay full restitution.

### **FISCAL FOCUS—WORKPLACE FRAUD**

#### **Do you suspect your coworker of fraud?**

- 1) Alert management. Resist the temptation to question the suspect directly or to try to catch them in the act. You could put yourself in danger or ruin the case. Decisions about fraud should be left to management.
- 2) Extreme care should be taken until proof exists.
- 3) If you are a manager, resist the urge to fire the individual immediately based upon your suspicions. It may turn out the original suspect is not the culprit, and proof of the crime will vanish with the guilty party.
- 4) Management should confer with professionals skilled in questioning, such as a private investigator or attorney.
- 5) Every detail of the story presented by the suspect should be verified and documented.

#### **Dealing with the aftermath of fraud**

- 1) The magnitude and proof of the crime, extenuating circumstances, and exposure to public embarrassment may influence management's decision to seek restitution, prosecution, or both.
- 2) Consult with an attorney on the terms of restitution and your ability to enforce a restitution agreement.
- 3) Put controls in place to prevent any future fraud and follow your internal controls.
- 4) Report any fraud on the attestation letter your director signs for the State Controller's Office. Depending on the circumstances and the magnitude of the offense, fraud could have a material effect on the financial statements. The reporting and audit personnel are trained to handle your information discretely.

### **ANNOUNCEMENTS**

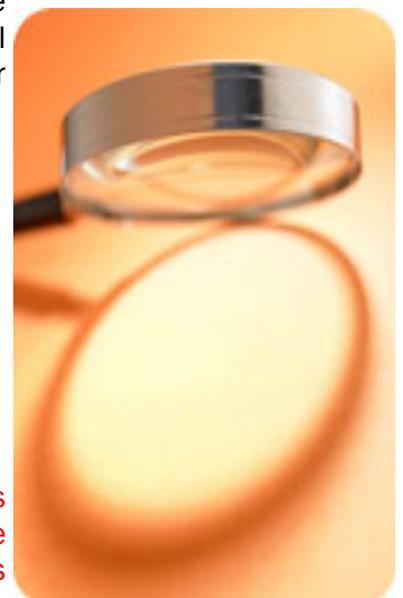
Annual Internal Control Training held at the State Controller's Office:

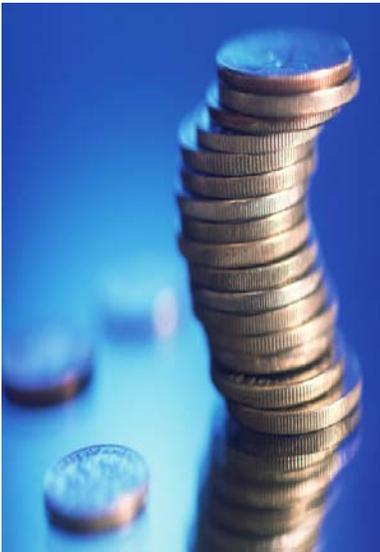
When: a) Tuesday, April 3, 2012, from 8:15 a.m. — 10:15 a.m.

OR

b) Thursday, April 5, 2012, from 8:15 a.m. — 10:15 a.m.

Learn why internal controls are important to your organization and who is responsible for ensuring they are practiced. The training will cover the objectives of internal controls, including the COSO's 17 points of focus





and a round table style discussion, which will provide participants an opportunity to share their internal control concerns and receive feedback.

CPE: 2 Free

To register, please have your supervisor submit an email to Jennifer Bonilla at [jbonilla@sco.idaho.gov](mailto:jbonilla@sco.idaho.gov). Supervisor authorization is required for all SCO training.