

# First Friday Fraud Facts+

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## QUESTIONS OR COMMENTS:

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*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.*

Welcome to First Friday Fraud Facts+ (F4+). This edition will discuss occupational fraud.

The Association of Certified Fraud Examiners (ACFE) defines occupational fraud as "the use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets."<sup>1</sup>

## OCCUPATIONAL FRAUD SCHEMES

According to an ACFE study, a majority of occupational fraud occurs within the departments of accounting, operations, sales, executive/upper management, customer service, and purchasing.

The eleven most common occupational fraud schemes, including examples, are:

- Corruption – Schemes involving bribery
- Billing schemes – Employee purchases personal items and submits an invoice to their employer for payment
- Financial statement fraud – Overstating assets, overstating revenues, underreporting liabilities and expenses
- Skimming – Employee accepts payment from a customer without recording the transaction, and pockets the money
- Cash on hand misappropriations – Employee steals cash from the vault
- Non-cash misappropriations – Employee steals inventory or equipment
- Expense reimbursement – Employee files an expense report for personal travel or for expenses from a nonbusiness event
- Payroll fraud – Employee claims overtime for hours not worked
- Cash larceny – Employee steals cash and checks received from customers before the deposit can be made into the organization's bank account
- Cash register disbursement – Employee voids a sale on the cash register and steals the cash
- Check tampering – Employee steals a check issued to a vendor for payment and deposits it into employee's own bank account<sup>1</sup>



### COST OF OCCUPATIONAL FRAUD

Based on the ACFE study, it's estimated that organizations lose about 5 percent of their annual revenue due to fraud. Estimated global total annual fraud loss is more than \$3.5 trillion.<sup>1</sup>

### RED FLAGS

- Employee living beyond their means
- Employee exhibiting excessive control
- Behavior changes in an employee
- Employee never taking vacation
- Employee showing unusual close association with vendors or customers<sup>1</sup>

### DETECTING OCCUPATIONAL FRAUD

In the ACFE study, organizations used the following methods to detect occupational fraud.

<u>Detection Method</u>	<u>Percent of Cases</u>
Tip	43.3%
Management Review	14.6%
Internal Audit	14.4%
By Accident	7.0%
Account Reconciliation	4.8%
Document Examination	4.1%
External Audit	3.3%
Notified By Police	3.0%
Surveillance/Monitoring	1.9%
Confession	1.5%
IT Control	1.1%
Other <sup>1</sup>	1.0%

### FRAUD CASE

In this case, a CPA took advantage of her employer's weak internal controls, in order to supplement her lifestyle and pay off her and her husband's large debts. Cecile worked in the accounting department of a large motor company in California. Her job included processing and approving U.S. Customs Service invoices for import taxes on cars that the company shipped from another country. After an invoice was approved, the company's accounts payable department would send a check or wire transfer to the bank account of Customs Service as stated on the invoice.

The motor company's sales were growing rapidly, leading to increased business expansion. Due to this growth, the accounting department would review only a portion of the Customs Service invoices before paying them.

Cecile observed this weakness in the company's internal controls and informed her husband. They subsequently decided to devise a billing scheme. Cecile asked her brother to open a bank account under a fictitious business name. Cecile then made a photocopy of a valid Customs Services invoice which she had previously approved and the company had paid. She altered the date and bank information on the document copy to show the current date and the bank account number of the fictitious business. She then made a copy of the false invoice to make it look genuine. Cecile approved the bogus bill, sent it to accounts payable, and requested that they wire the money to the bank.

The false invoice was paid without any questions asked. Once the money arrived in the fictitious business' bank account, Cecile withdrew the cash, and used it to pay off debts. Before anyone at the motor company discovered the fraud, a total of \$889,000 was paid out by the company.

The scheme was unraveled after the company's internal auditors noticed that two of the fictitious invoices were paid for similar amounts within a short period of time. Due to variances in car import volumes, it was unusual for two separate invoices to show the same amount within such a short time frame. The auditors also discovered that the wire transfers for the fraudulent invoices were for import taxes on vehicles delivered to the Tacoma port of entry. The company had always paid those import taxes by check.

Eventually, all three individuals involved in the fraud were found guilty and convicted. Cecile was sentenced to six years and four months in state prison. Her husband was sentenced to four years, and her brother was sentenced to two years and four months.<sup>2</sup>

### **ANTI-FRAUD TRAINING**

Organizations should conduct anti-fraud training to educate employees on how to recognize and report illegal conduct, and to promote a strong ethical environment.<sup>3</sup> The ACFE provides valuable ideas on how to prevent and detect fraud. Free resources can be found on the ACFE website: <http://www.acfe.com/free-resources.aspx>.

<sup>1</sup>Association of Certified Fraud Examiners. *2012 Report to the Nations on Occupational Fraud and Abuse*. [http://www.acfe.com/uploadedFiles/ACFE\\_Website/Content/rtnn/2012-report-to-nations.pdf](http://www.acfe.com/uploadedFiles/ACFE_Website/Content/rtnn/2012-report-to-nations.pdf). Accessed January 23, 2014.

<sup>2</sup>Tie, Robert (2013). *'Customized' embezzlement: a near-\$1 million billing scheme*. <http://www.fraud-magazine.com/article.aspx?id=4294976900>. Accessed January 23, 2014.

<sup>3</sup>Association of Certified Fraud Examiners. *Detecting Occupational Fraud*. 2007 Fraud Examiners Manual. p. 4.537



**ANNOUNCEMENTS**

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

a) Tuesday, April 15, 2014, from 10:00 a.m. – 12:00 p.m.

OR

b) Wednesday, April 16, 2014, from 8:00 a.m. – 10:00 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 principles, and a round table style discussion, which will provide participants an opportunity to share their internal control concerns, insights, and receive feedback.

CPE: 2 Free

Registration details coming soon.