First Friday Fraud Facts

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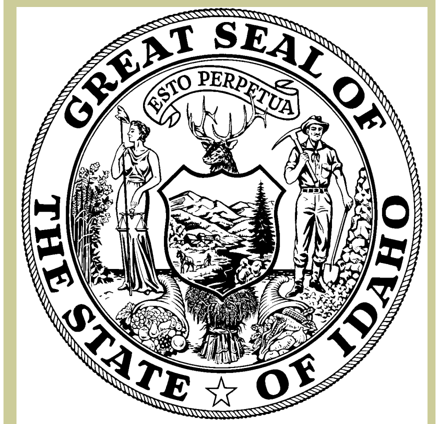

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Inside this issue:

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Welcome to First Friday Fraud Facts (F^4). Past issues have addressed, to some degree, billing schemes. This edition will take a closer look at billing schemes, including reviewing some of the preventative and detective controls that can be employed to address the risks of fraud involving billing schemes within an organization.

BILLING SCHEME OVERVIEW

As has been covered in previous issues of F^4, billing schemes occur when an individual causes their employer to issue a payment for an illegitimate or overstated charge. This typically takes the form of invoices for fictitious goods or services, inflated invoices, or invoices for personal expenses. In general, most billing schemes involve charges for services, rather than goods, as it is easier to conceal services that are not performed than goods that are not received.

Billing schemes are one of the most common methods of perpetrating fraud; ranking number two in frequency, second only to corruption. There are several factors that contribute to this:

- There is no risk of removing assets from the organization because a payment is "willingly" issued.
- Expending funds is a common occurrence within an organization, so it is often easier to conceal billing schemes.
- Frequently there are weaknesses in controls that can be exploited by an employee. In general, billing schemes go undetected for an average of approximately two years and have a median loss of about $100,000.
- Technological advances allow for easy fabrication or alteration of supporting documentation.

In addition to being one of the most widely perpetrated frauds, billing schemes on average have a duration of approximately two years and

a median loss of about $100,000. This ranks them the fourth highest in average loss according to the 2008 Association of Certified Fraud Examiners *2008 Report to the Nation on Occupational Fraud & Abuse*.

Red Flags

There are several potential red flags that are often found in cases involving billing schemes. Some of these include:

- Unexplained increases in services performed
- Payments to unapproved vendors
- Missing or incomplete supporting documents
- Inflated prices

Prevention

There are many controls that can be put in place to help prevent billing schemes. Some of the most common include:

- Segregation of duties between purchase requests, purchasing goods and services, purchase authorization, merchandise receipt, payment authorization, and vendor payment processing
- Requiring appropriate documentation for ALL transactions
- Appropriate supervisory approval for payments
- Promptly logging in goods received
- Marking invoices and supporting documentation as "paid" so they cannot be re-submitted for duplicate payment
- Ensuring employees are aware of the red flags and detection methods

Detection

In addition to controls that can be utilized to prevent billing schemes, there are controls that can be used to detect these instances of fraud. One area that organizations can address is to ensure a careful examination of vendor invoices. This can include:

- Invoices containing items not typically used or purchased by the organization, unusually high prices, quantities that are inconsistent with organizational needs, or invoices payable to individuals
- Invoices not prepared or printed professionally. This can be increasingly difficult to spot. Be aware of missing information, such as phone or fax number, invoice number, or tax ID number

- Checking for sequentially numbered invoices from the same vendor
- Be aware of invoices that do not appear to have come in the mail, i.e. no creases or folds
- Invoices that do not appear on the same paper or format as typically used by the vendor
- Comparing invoice prices to purchase order prices
- Looking for signs of erasure or alteration of a purchase order
- Reviewing accounts payable records for duplicate payments and invoice numbers

Fraud Case Overview

This case involves a government finance director who embezzled over $1.4 million through a billing scheme. The perpetrator was able to exploit internal control weaknesses, high turnover in key positions, and inadequate independent audits to their advantage.

Over the course of several years the individual was able to perpetrate the fraud by manipulating and forging over 50 checks ranging in amounts from $4,000 to over $30,000. The checks were directed to a shell company the employee had established to aid the perpetration of the fraud. This was primarily accomplished through two methods: theft of blank checks that the individual then stamped with the appropriate official's signature, and then later typed in the name of the shell company; and converting checks that should have been voided to instead be payable to the shell company.

The fraud occurred over a period of approximately six years. During this time the perpetrator was also promoted.

The fraud was discovered when an employee hired by the organization to prepare paperwork for a required annual audit noticed the discrepancies while reviewing the financial records.

The perpetrator pleaded guilty to 57 counts of theft and first-degree aggravated theft and was sentenced to 8 1/2 years in prison and ordered to pay restitution of over $1.8 million as well as legal fees.