First Friday Fraud Facts

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Questions or Comments:

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Inside this issue:

The Oregon State Controller's Office created this newsletter. With their permission, the Idaho State Controller's Office edits and 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 cover potential warning signs of fraud and some potential ways the economic climate could contribute to additional fraud.

Behavioral Red Flags and Warning Signs

In most fraud cases the perpetrator exhibits warnings signs that can potentially lead to the discovery of the fraud scheme. According to a recent Association of Certified Fraud Examiners (ACFE) report, the most common warning sign was the perpetrator living beyond their financial means (43 percent of cases). This was followed very closely by signs of financial difficulties (over 36 percent of cases).

The warning sign attributable to the highest median loss, approximately $410,000, was an unusually close relationship or association with a vendor or customer. This could be because fraud schemes involving collusion, especially those with an outside party, can be very difficult to detect. Although found in more cases, the average median loss attributable to living beyond ones financial needs was significantly less at $250,000.

Another recent study indicated that some of the most common factors contributing to fraud are pressures to do 'whatever it takes' to meet goals (81 percent), to seek personal gain (72 percent), and the perpetrator did not consider their actions to be fraudulent (40 percent).

In addition, some behaviors are more common in certain fraud schemes. For example, in fraud cases examined as part of an ACFE study, an unusually close relationship with a vendor or customer is most commonly attributable to a corruption scheme; whereas

excessive pressure within the organization is more commonly an indicator of financial statement fraud.

However, living beyond one's means was relatively equally distributed amongst each of the three major fraud scheme classifications, (financial statement fraud, corruption, and asset misappropriation). Although these behavioral indicators have the potential to alert you to fraud, waste, or abuse within your organization, it's important to note, the presence of behavioral red flags does not necessarily mean fraud has occurred. These signs are merely a POTENTIAL indicator of POTENTIAL fraud.

The Fraud Triangle in an Economic Downturn

Previous issues of F^4 have mentioned the fraud triangle; essentially, the three components contribute to the perpetration of fraud. These three components are opportunity, pressure, and rationalization:

- Opportunity: with an increased focus on increasing revenues, efficiencies, and effectiveness the potential may exist to decrease the focus on internal controls.
- Pressure: facing potential layoffs and cutbacks while the cost of living stays flat or increases could cause an increased incentive or motivation to commit fraud. In addition, the potential for increased pressures to perform and demonstrate value within your organization may lead some to perpetrate fraud.
- Rationalization: as workforces and salaries are cut back many employees are forced to do more work for less money, which can lead to a feeling of entitlement — "I deserve it" or "they owe it to me."

What You Can Do

Good controls to assist in the prevention and detection of fraud are the responsibility of everyone within the organization. Some basic elements of fraud prevention and detection all levels of staff should be aware of include:

- Ensuring a basic understanding of red flags and staying aware should the warning signs occur.
- Understanding how your duties play a role in the internal control structure within the organization. Knowing why processes and procedures are established the way they are can help provide an

understanding of how each step works to mitigate risks and protects against fraud, waste, and abuse.

- Read and understand policies and procedures within your organization and stay aware of changes or deviations.
- Report suspicions and inconsistencies that could be the result of fraud, waste, or abuse.

Fraud Case Overview

This case outlines an embezzlement of funds involving a school district business manager.

A school district superintendent noticed some discrepancies in the district's financial records and began looking closer at the records. Realizing a potential fraud, the superintendent began working with the government auditors as well as the local police department. The initial investigation indicated an alleged embezzlement of over $292,000 in an 11-month time period.

The auditors involved expanded the investigation to encompass a seven-year time frame. They concluded the school district's business manager had forged at least 538 checks. The forged checks were made payable to either the perpetrator or other parties. The perpetrator allegedly created fraudulent balance statements to help conceal the fraudulent actions. The school district did not have adequate internal controls in place; several red flags were overlooked, including a lack of segregation of duties within the fiscal processes.

Ultimately, the majority of checks were deposited into the perpetrator's personal bank accounts. In just over seven years the perpetrator was allegedly able to embezzle $3,378,701 from several school district bank accounts.

As a result of this information the state government suspended the school district's Board of Finance and took over these duties in an attempt to restore financial accountability. The perpetrator was fired from their position as business manager after the initial discovery of the missing $292,000.