First Friday Fraud Facts

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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 issue will cover some of the statistics regarding occupational fraud according to a recent study conducted by the Association of Certified Fraud Examiners (ACFE). In addition, this issue will review one of the most common types of fraud in the government sector—corruption.

The Fraud Perpetrator

Approximately 40 percent of the occupational frauds in the United States are perpetrated by individuals in either the accounting or operations department of an organization. The majority (over 60 percent) of frauds perpetrated by someone in the accounting department are the result of a check tampering (over 33 percent) or billing scheme (over 30 percent); while the frauds perpetrated by individuals in the operations department are predominately the result of corruption (over 30 percent) or billing schemes (over 22 percent).

In general, only 7 percent of occupational frauds are perpetrated by employees that have been previously convicted of a fraud-related offense. In addition, 86 percent of employees who have perpetrated fraud have never been convicted of any prior offense. Although they may not have been convicted, approximately 8 percent of perpetrators had been previously punished by an employer and 10 percent had been terminated for fraud-related activities.

Fraud in Government & Public Administration

Billing schemes are the most common type of occupational fraud in the United States, followed by corruption and check tampering. In the government and public administration sector corruption is the most common fraud scheme, followed by billing schemes, and

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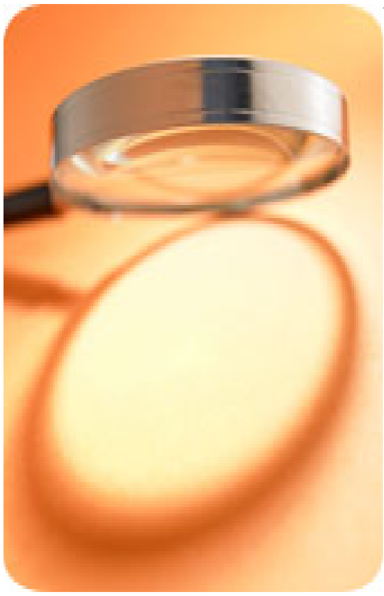


expense reimbursement schemes; while check tampering is far less common (ranking 6th in frequency).

Across all industries and sectors, the average loss per occurrence as a result of occupational fraud in the United States is approximately $105,000; while the government and public administration sector has a slightly lower average of $100,000. In general, government and public administration has one of the highest rates of occupational fraud occurrence; however, it also has one of the lowest median loss rates.

Corruption

Corruption occurs when an employee uses their influence in a way that violates their duty to their employer for the purpose of obtaining a benefit for themselves or someone else. Common forms of corruption are kickbacks, bid rigging, conflicts of interest, bribery, and price fixing.

Corruption cases have an average duration of 18 months and an average loss of approximately $175,000, which is higher than the government sector average. As noted above, corruption is the most commonly reported type of occupational fraud in the government sector. Over 32 percent of the government sector fraud cases evaluated in the recent ACFE study were the result of corruption.

Red Flags

Several potential red flags are often found in cases involving kickback schemes. Some of these include:

- A middleman in the contract who has no obvious value to the performance of the contract
- Contracts not awarded as the result of a competitive bidding process
- Concurrent or repetitive contracts awarded to poor performing contractors
- Former officials becoming suppliers to a contractor
- Officials and suppliers are related, either through family or friendship

Prevention & Detection

Due to the nature of kickbacks, the actual payment occurs outside or off the books of the organization. This makes it very difficult to uncover such schemes, even for highly skilled auditors and/or forensic specialists. The best defense against kickbacks is a good prevention program. Many controls can be put in place to help prevent kickback schemes, for example:

- Solicit sealed bids and open them before a group
- While good working relationships with vendors are important, avoid developing personal relationships
- Ensure proper review of all expenditures
- Ensure employees are aware of the red flags and detection methods

FRAUD CASE OVERVIEW

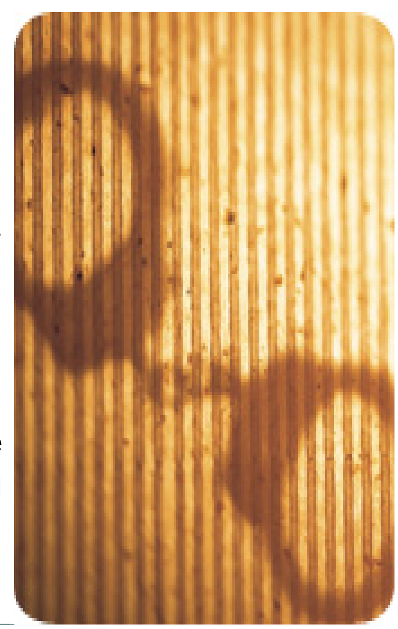
This case involves a contractor and several sub-contractors working with a federal agency. One of the project managers for the prime contractor was able to use his position to influence the award of various sub-contracts involving several different companies in exchange for kickbacks from the sub-contractors.

The project manager operated a shell company in order to hide the kickbacks. The shell company issued false invoices to the sub-contractors. Each sub-contractor would cause a payment to be issued from the sub-contractor to the shell company operated by the project manager. Each sub-contractor would inflate the costs of the sub-contract to include the kickbacks. The kickbacks would be included in the inflated costs invoiced to the prime contractor and then passed on to the federal agency. On several occasions the project manager provided portions of the kickbacks to the sub-contractors.

The project manager was involved in kickback schemes with various sub-contractors over a six-year period.

Several sub-contractors involved pled guilty and were sentenced, as follows:

- One individual was sentenced to 20 months in jail and ordered to pay $154,597 in criminal fines and restitution
- One individual was sentenced to five months in jail and five months of home confinement, and ordered to pay $35,000 in restitution
- One company operating as a sub-contractor was sentenced to pay criminal fines and restitution of more than $2.6 million



Several additional parties, including the project manager for the prime contractor, are awaiting trial and/or sentencing. The project manager could face as much as 70 years in jail in addition to substantial criminal fines and restitution.