Fraud and Its Effects

PRESENTED BY

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Professional Certifications

- Certified Public Accountant (CPA)
- Certified Fraud Examiner (CFE)
- Series 7 & 66 Licenses – Registered Representative (NASD)
- Group 1 License – Texas Department of Insurance
Professional Organizations

- American Institute of Certified Public Accountants (AICPA)
- Texas Society of Certified Public Accountants (including Litigation Services Section)
- Dallas Chapter of TSCPA
- Financial Consulting Group, L.C.
- Association of Certified Fraud Examiners
Professional Appointments

- Nexia International – Chairman, Audit Committee
- YMCA of Metro Dallas County – Chairman, Audit Committee & Board Member
- YMCA of Metro Tarrant County – Past Chairman of the Board, past Chairman of Finance Committee
- TCU Young Alumni Association – Past Board Member
- Hispanic Chamber of Commerce – Past Board Member
Today’s Topics

• Fraud
  – Definition/Theory
  – Statistics
  – Types of Fraud

• Dealing with Fraud
  – Prevention
  – Detection

• Examples
Fraud Trivia #1

Who is Jérôme Kerviel?
Bull Market Make Heroes

Scott Sullivan, WorldCom: 1998 CFO of the Year

Andrew Fastow, Enron: 1999 CFO of the Year

Mark Swartz, Tyco: 2000 CFO of the Year
Bear Markets Make Crooks
Former CFO’s of the Year

Scott Sullivan, 2002: Indicted and charged with fraud.

Andrew Fastow, 2002: Indicted and charged with conspiracy, fraud, money laundering, insider trading.

Mark Swartz, 2002: Indicted and charged with fraud.
Elements of a Fraud

- A representation
- About a material point
- Which is false
- Intentionally or recklessly so
- Relied upon by the victim
- To the victim’s damage
Theor y of Fraud Causation

Donald R. Cressey

- Known for his studies of organized crime
- Served as organized crime consultant to the President's Commission on Law Enforcement and Administration of Justice in 1966 and 1967
- Cressey’s hypothesis later became known as the “Fraud Triangle”
Why do People Steal?

PRESSTURE

Fraud Triangle

PERCEIVED OPPORTUNITY

RATIONALIZATION
Fighting Fraud
What Have We Done?

- Treadway Commission ’87
- COSO ’87
- SAS 53 ’88
- Certified Fraud Examiner ’88
- SAS 82 ’96
- Sarbanes Oxley ’02
- SAS 99 ’02
Fraud Trivia #2

Which of these is not a real SCAM?

A. Vishing
B. Romance
C. Texas Hold’em
D. Work at home
Organization Type of Victims

*Obtained from 2008 Certified Fraud Examiners report “2008 Report to the Nation on Occupational Fraud and Abuse”
Based on Size of Victim Organization

Size of Victim Organization — Median Loss

*Obtained from 2008 Certified Fraud Examiners report “2008 Report to the Nation on Occupational Fraud and Abuse”
Initial Detection of Occupational Fraud

Obtained from 2008 Certified Fraud Examiners report “2008 Report to the Nation on Occupational Fraud and Abuse”

Initial Detection of Frauds in Small Businesses

- Tip: 41.7% (Small Businesses), 46.2% (All Cases)
- By Accident: 29.6% (Small Businesses), 20.0% (All Cases)
- Internal Audit: 19.4% (Small Businesses), 10.7% (All Cases)
- Internal Controls: 23.3% (Small Businesses), 17.3% (All Cases)
- External Audit: 9.1% (Small Businesses), 14.3% (All Cases)
- Notified by Police: 3.3% (Small Businesses), 3.2% (All Cases)
Loss Based on Perpetrator's Income

*Obtained from 2008 Certified Fraud Examiners report “2008 Report to the Nation on Occupational Fraud and Abuse”*
Fraud Trivia #3

Who is this famous man, and what did he accomplish?
Tenure of Perpetrator

Tenure of Perpetrator — Frequency and Median Loss

*Obtained from 2008 Certified Fraud Examiners report “2008 Report to the Nation on Occupational Fraud and Abuse”
Age of Perpetrator

*Obtained from 2008 Certified Fraud Examiners report “2008 Report to the Nation on Occupational Fraud and Abuse”
Education of Perpetrator

*Obtained from 2008 Certified Fraud Examiners report “2008 Report to the Nation on Occupational Fraud and Abuse”
Position of Perpetrator – Median Loss

*Obtained from 2008 Certified Fraud Examiners report “2008 Report to the Nation on Occupational Fraud and Abuse”
Position of Perpetrator - Frequency

*Obtained from 2008 Certified Fraud Examiners report “2008 Report to the Nation on Occupational Fraud and Abuse”
Gender of Perpetrator

Gender of Perpetrator — Frequency

Gender of Perpetrator — Median Loss

*Obtained from 2008 Certified Fraud Examiners report “2008 Report to the Nation on Occupational Fraud and Abuse”
Fraud Trivia #4

Who is this man?

His name has recently become synonymous with fraud, as he has plead guilty to 11 counts including money laundering and perjury as well as securities, mail, and wire fraud. He will be facing up to 150 years in prison on these charges.
Number of Perpetrators

*Obtained from 2008 Certified Fraud Examiners report “2008 Report to the Nation on Occupational Fraud and Abuse”
Perpetrators’ Criminal Histories

Perpetrator’s Criminal History

- Never Charged or Convicted: 87.4%
- Charged but not Convicted: 6.8%
- Prior Convictions: 5.7%

*Obtained from 2008 Certified Fraud Examiners report “2008 Report to the Nation on Occupational Fraud and Abuse"
Distribution of Dollar Losses

Obtained from 2008 Certified Fraud Examiners report “2008 Report to the Nation on Occupational Fraud and Abuse”
Fraud Trivia #5

What 2002 movie was based on a young con artist who successfully impersonated an airline pilot, doctor, assistant attorney general and history professor, cashing more than $2.5 million in fraudulent checks in 26 countries?

a. The Magnificent Fraud
b. Catch Me if You Can
c. The Bourne Identity
d. Gangs of New York
### Behavioral Red Flags Present During Fraud Schemes

<table>
<thead>
<tr>
<th>Behavioral Red Flags</th>
<th>Percent of Cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>Living beyond means</td>
<td>39%</td>
</tr>
<tr>
<td>Financial difficulties</td>
<td>34%</td>
</tr>
<tr>
<td>Wheeler-dealer attitude</td>
<td>20%</td>
</tr>
<tr>
<td>Control issues, unwillingness to share duties</td>
<td>19%</td>
</tr>
<tr>
<td>Other</td>
<td>19%</td>
</tr>
<tr>
<td>Divorce/family problems</td>
<td>17%</td>
</tr>
<tr>
<td>Unusually close association with vendor/customer</td>
<td>15%</td>
</tr>
<tr>
<td>Irritability, suspiciousness, defensiveness</td>
<td>14%</td>
</tr>
<tr>
<td>Addiction problems</td>
<td>15%</td>
</tr>
<tr>
<td>Past legal problems</td>
<td>15%</td>
</tr>
<tr>
<td>Past employment related problems</td>
<td>14%</td>
</tr>
<tr>
<td>Complaining about inadequate pay</td>
<td>8%</td>
</tr>
<tr>
<td>Refusal to take vacation</td>
<td>7%</td>
</tr>
</tbody>
</table>

*The sum of percentages in this table exceeds 100% because in several cases the perpetrator exhibited more than one behavioral red flag.*

**Obtained from 2008 Certified Fraud Examiners report “2008 Report to the Nation on Occupational Fraud and Abuse”**
Fraud Schemes

- Asset Misappropriation
- Corruption
- Financial Statement Fraud

*Obtained from 2008 Certified Fraud Examiners report “2008 Report to the Nation on Occupational Fraud and Abuse”
Fraud Trivia #6

Approximately how much does the US lose due to fraud each year?

a. More than $50 billion
b. More than $200 billion
c. More than $500 billion
d. More than $900 billion
Misappropriation of Assets

- Cash fraud schemes
  - Skimming
  - Larceny
  - Fraudulent disbursements

- Accounts receivable schemes
  - Improper posting of credits
    - Discount
    - Return
    - Write-off

- Inventory and other asset schemes
  - Appropriating inventory and supplies for personal use
    - Stealing inventory
    - Theft of scrap proceeds
A/R Fraud - Lapping

Customer A
Owes
$100

Customer B
Owes
$100

Customer C
Owes
$100

Customer A pays $100 - A/R Clerk pockets the money

Customer B
Pays $100

Customer C
Owes $100 on the books

Customer A is credited $100 - Owes $0

Customer B is credited $100 - Owes $0
<table>
<thead>
<tr>
<th>Entry One</th>
<th>A/R</th>
<th>Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Entry Two</td>
<td>Fixed Assets</td>
<td>Cash</td>
</tr>
<tr>
<td>Entry Three</td>
<td>Cash</td>
<td>A/R</td>
</tr>
</tbody>
</table>
Healthsouth, Inc. Trick

Entry One

Entry Two

Entry Three
In 2008, the US Postal Service announced that only ___% of all identify theft acts were connected to the mail.

a. 2%
b. 5%
c. 10%
d. 15%
Financial Statement Fraud

- Fictitious revenues
  - Involves the sale or goods or services which never occurred
- Timing differences
  - Improper matching of revenues
  - Early revenue recognition
  - Recording expenses in the wrong period
- Concealed liabilities and expenses
  - Liability/expense omissions
  - Returns and allowances and warranties
- Improper disclosure
  - Liability omissions
  - Significant events
  - Management fraud
  - Accounting changes
- Improper asset valuation
  - Inventory
  - Fixed Assets
Corruption

- Bribery
- Illegal gratuities
- Economic extortion
- Conflicts of interest
Fraud Trivia #8

What firm has not been involved in legal problems in the past 10 years?

a. Arthur Andersen
b. KPMG
c. PWC
d. E&Y
e. Deloitte & Touche
f. None of the above
Fraud Trivia #9

What initiated the investigation into former governor Eliot Spitzer?

a. He bounced a check
b. Bank filed a SAR
c. He confessed to his wife
d. Internal audit investigation
Fraud Prevention

• What You Can Do
  – Tone at the Top
  – Code of Ethics/Conduct
  – Background Checks
  – Appropriate Compensation
  – Constant Training
  – System of Internal Controls
  – Consequences
Fraud Detection

• What You Can Do
  – Internal Audit
  – Separate Fraud Department
  – Software Tools
  – Monitoring
  – Whistleblower Policies
  – External Audit
  – Foster an Open Culture
Fraud Trivia #10

In 2008, the ACFE reported that most fraud is discovered by a tip. The second-most common way is by:

a. IRS audit
b. Nosy supervisors
c. Accident
d. Disgruntled employee
Firm Experiences with Fraud

- Financial Statement Fraud – 2007 Client
- Neurologist’s Office Case
- Fort Worth ISD Case
Financial Statement Fraud

• Compilation Client
• Inflating Accounts Receivable
• $123,000
• WP Accounting Services Identified
Neurologist’s Office Case

- Business Manager
- 25 years
- Refinance of Home Loan
- Credit Report
- HIPPA Audit
- $176,000
Fort Worth ISD Case

- Construction Fraud
- Collusion
  - Construction Superintendent
  - Concrete Vendor
- $7.6 Million Fraudulent Charges
- 14 Month Investigation
- FBI and DA’s Office
- Project Team
  - Construction Auditor
  - Engineer
  - CPA’s
- Jail Term – 96 Months for both Defendants
Questions?
Thank You!