



Insights into Occupational Fraud

SIAAB 2019 Fall Government Auditing Conference

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October 22, 2019

Abridged version

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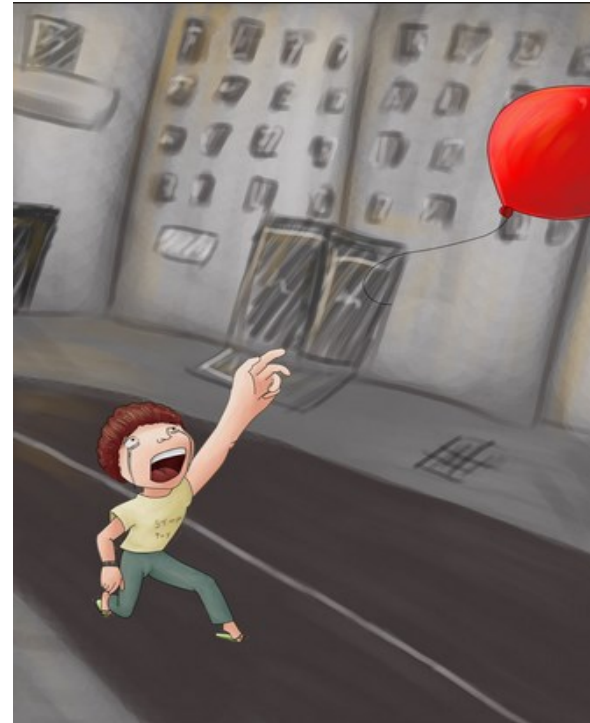


Overview of Occupational Fraud

- . What it is, how much, & how perpetrated
 - . Use ACFE data to understand
- . Include some data for government only
- . Frameworks used to understand fraud
 - . Actors and actions
- . Anti-fraud measures – preventive & detective
- . Illinois cases and examples



Association of Certified Fraud Examiners





2018 Report to the Nations (RTTN) on Occupational Fraud and Abuse

Examined almost 2,700 cases
in 125 countries

Cumulative losses for those
cases were more than
\$7 billion

Anecdotal evidence

55% of cases reported
less than the 200,000 loss,
with median loss of
\$130,000

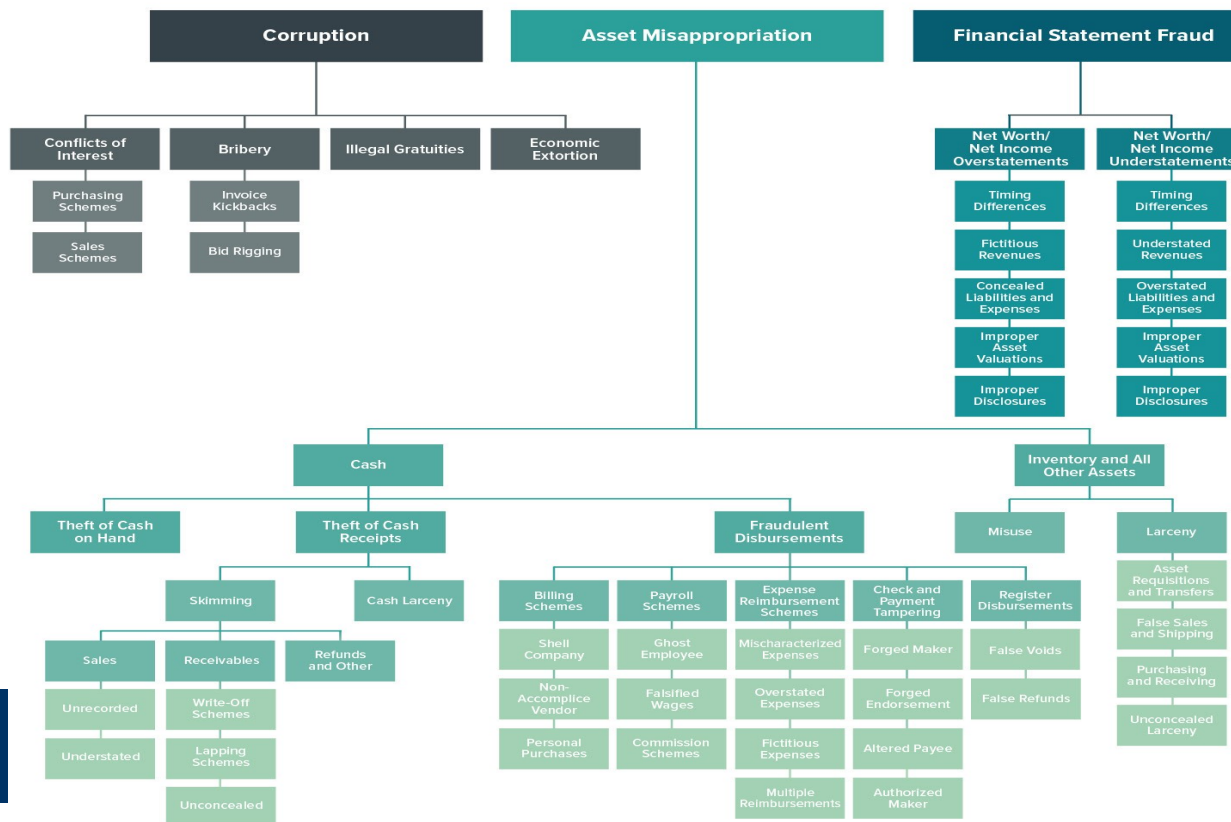
22% losses =

\$1 million or more



Occupational Fraud: What it is and How

FIG. 4 Occupational Fraud and Abuse Classification System (the Fraud Tree)



30% of the reported cases involve 2 or more schemes





Financial Statement Fraud

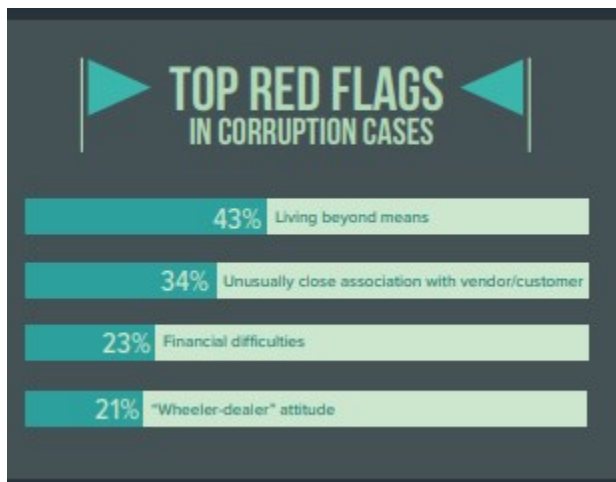
- 10% of the cases
- \$800,000 median loss





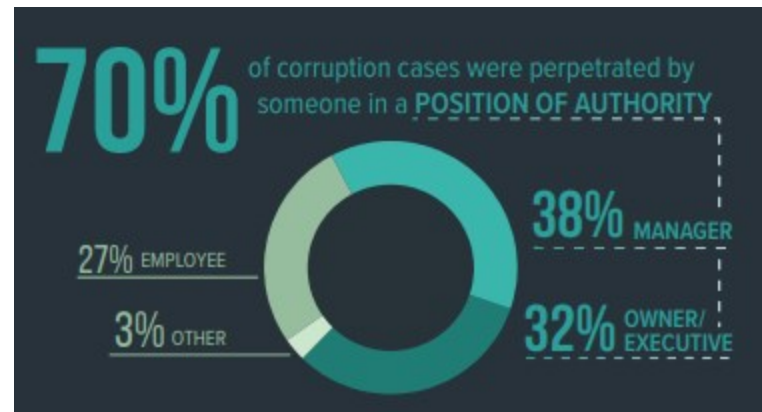
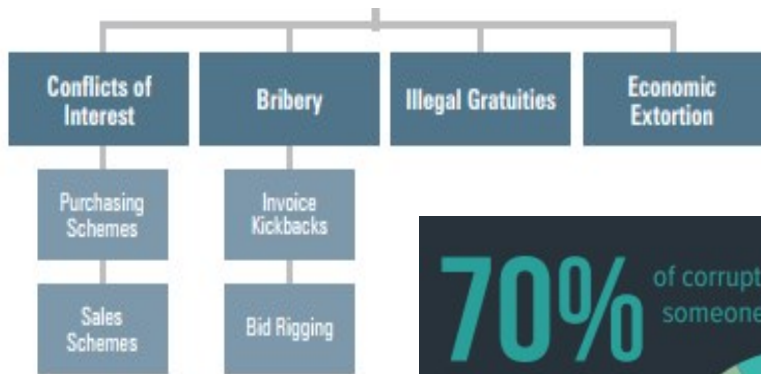
Corruption: 38% of the cases

Median loss = \$250,000



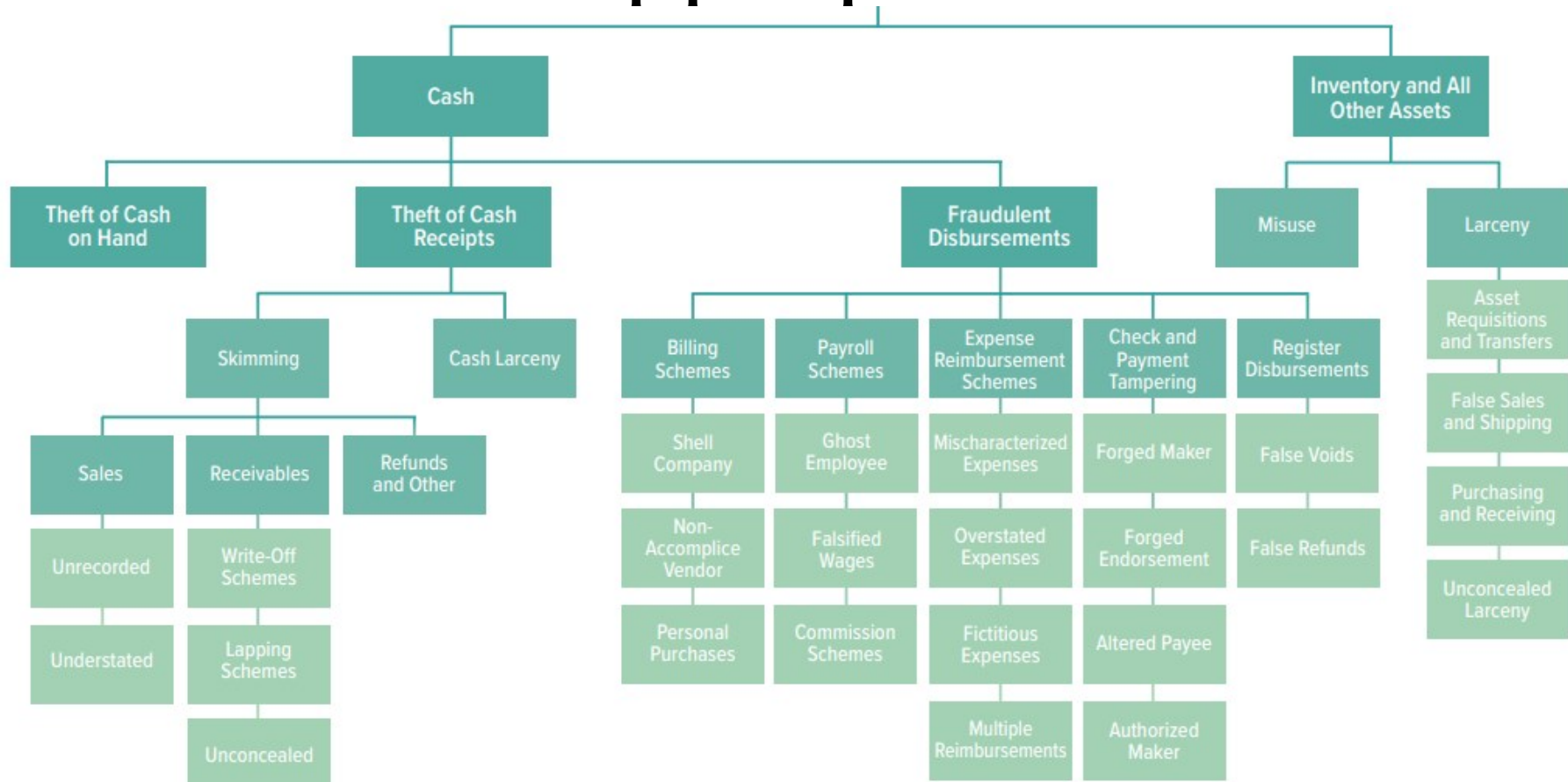


Corruption





Asset Misappropriation





Asset Misappropriation





Risk – that 4 letter word



FIG. 6 What asset misappropriation schemes present the greatest risk?

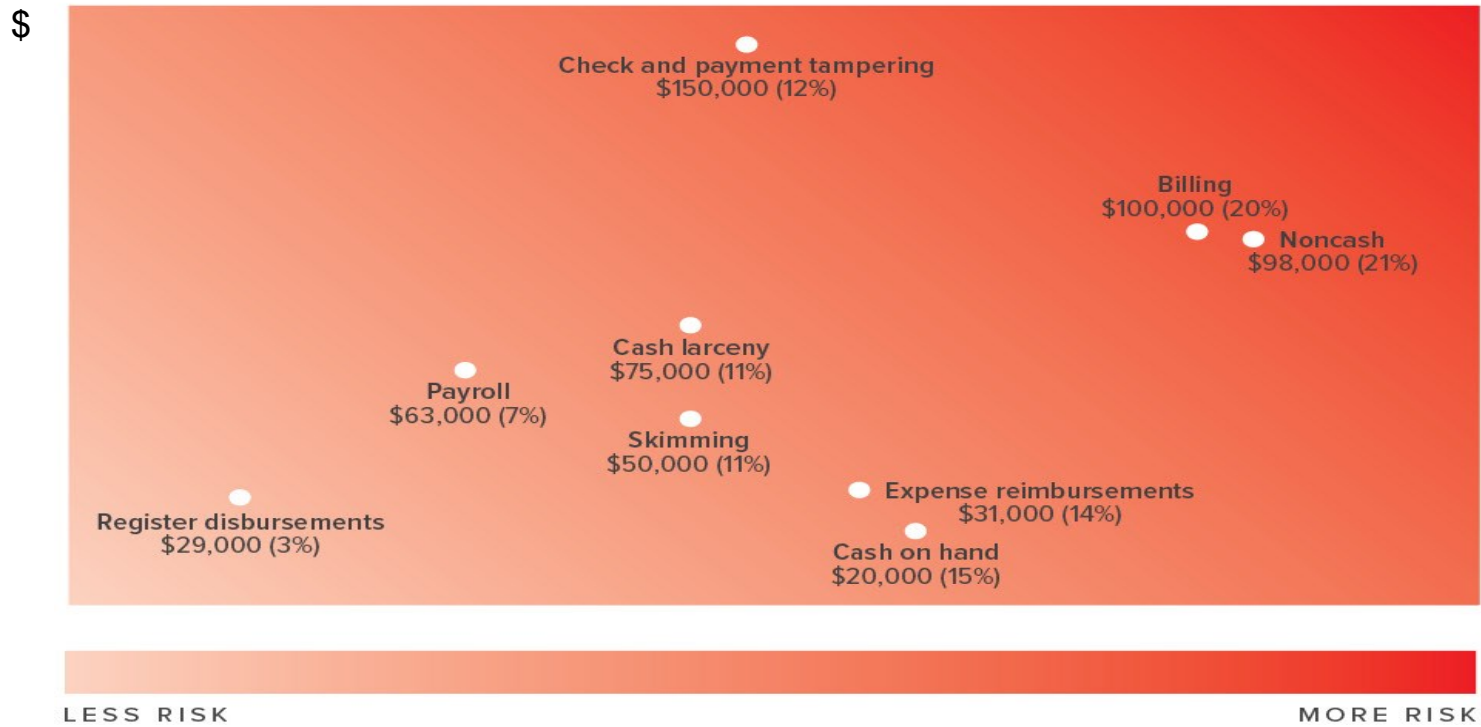




FIG. 29 What are the most common occupational fraud schemes in high-risk departments?

Department	Cases	Billing	Cash larceny	Cash on hand	Check and payment tampering	Corruption	Expense reimbursements	Financial statement fraud	Noncash	Payroll	Register disbursements	Skimming
Accounting	290	29%	14%	17%	30%	23%	12%	13%	7%	14%	2%	19%
Operations	266	15%	8%	15%	8%	36%	11%	4%	20%	5%	2%	11%
Executive/upper management	223	35%	14%	16%	15%	62%	29%	30%	20%	12%	3%	9%
Sales	216	10%	12%	12%	6%	34%	13%	6%	25%	2%	5%	14%
Customer service	155	5%	16%	31%	8%	19%	4%	1%	15%	3%	5%	14%
Administrative support	147	33%	7%	21%	14%	26%	22%	8%	19%	13%	3%	14%
Finance	110	17%	15%	21%	16%	37%	13%	16%	15%	6%	2%	10%
Purchasing	94	18%	5%	6%	5%	77%	10%	3%	31%	3%	2%	4%



LESS RISK

MORE RISK



FIG. 28 What departments pose the greatest risk for occupational fraud?

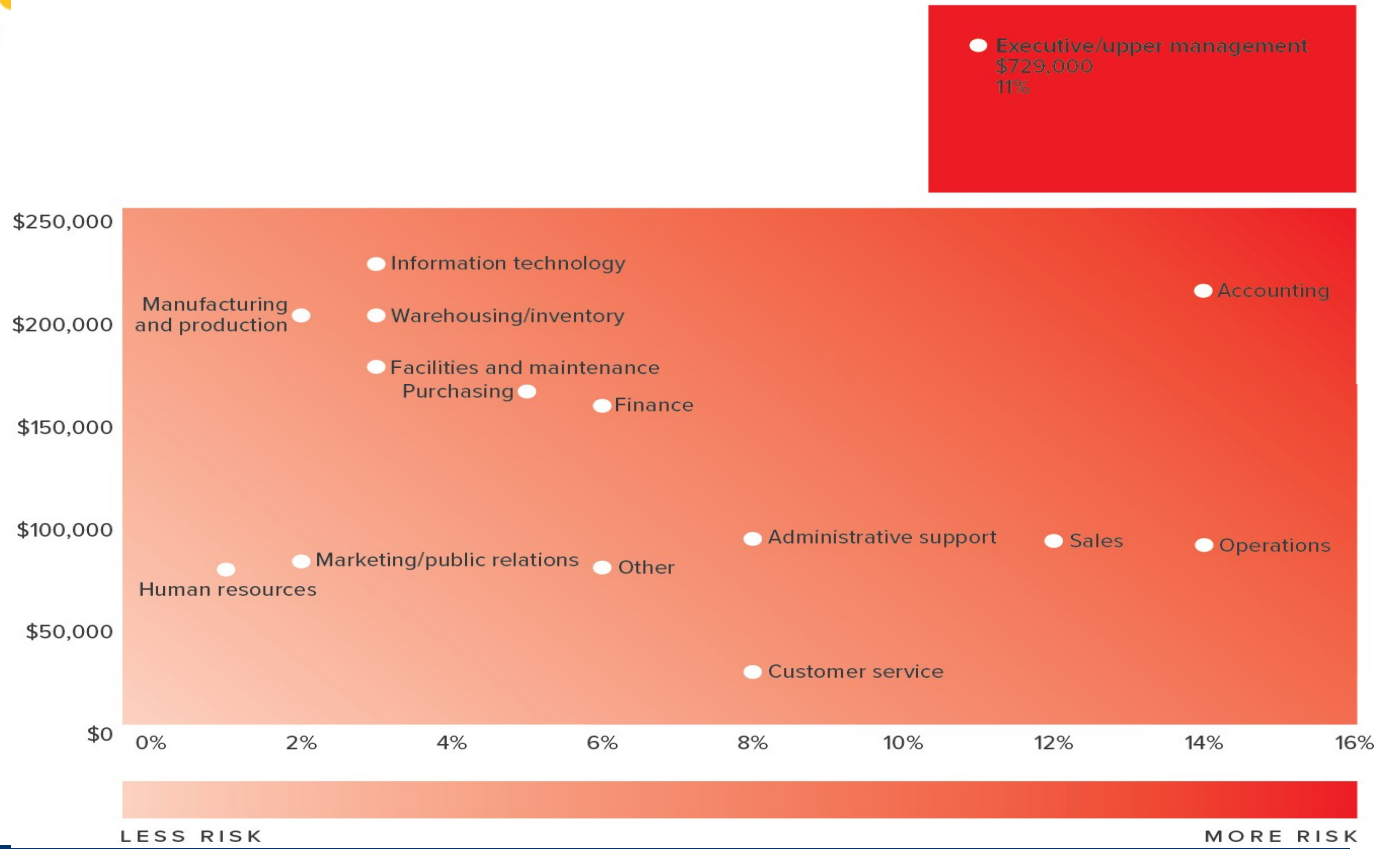
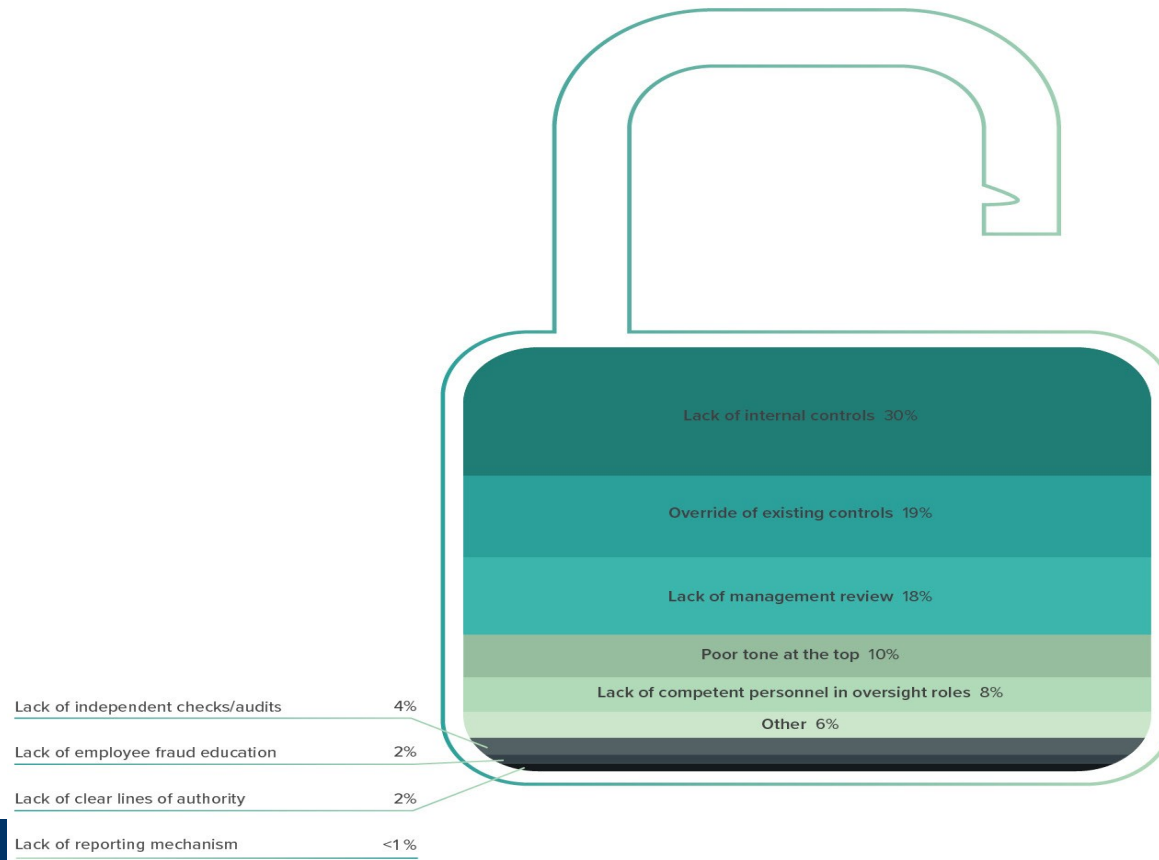


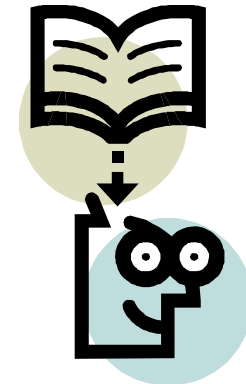
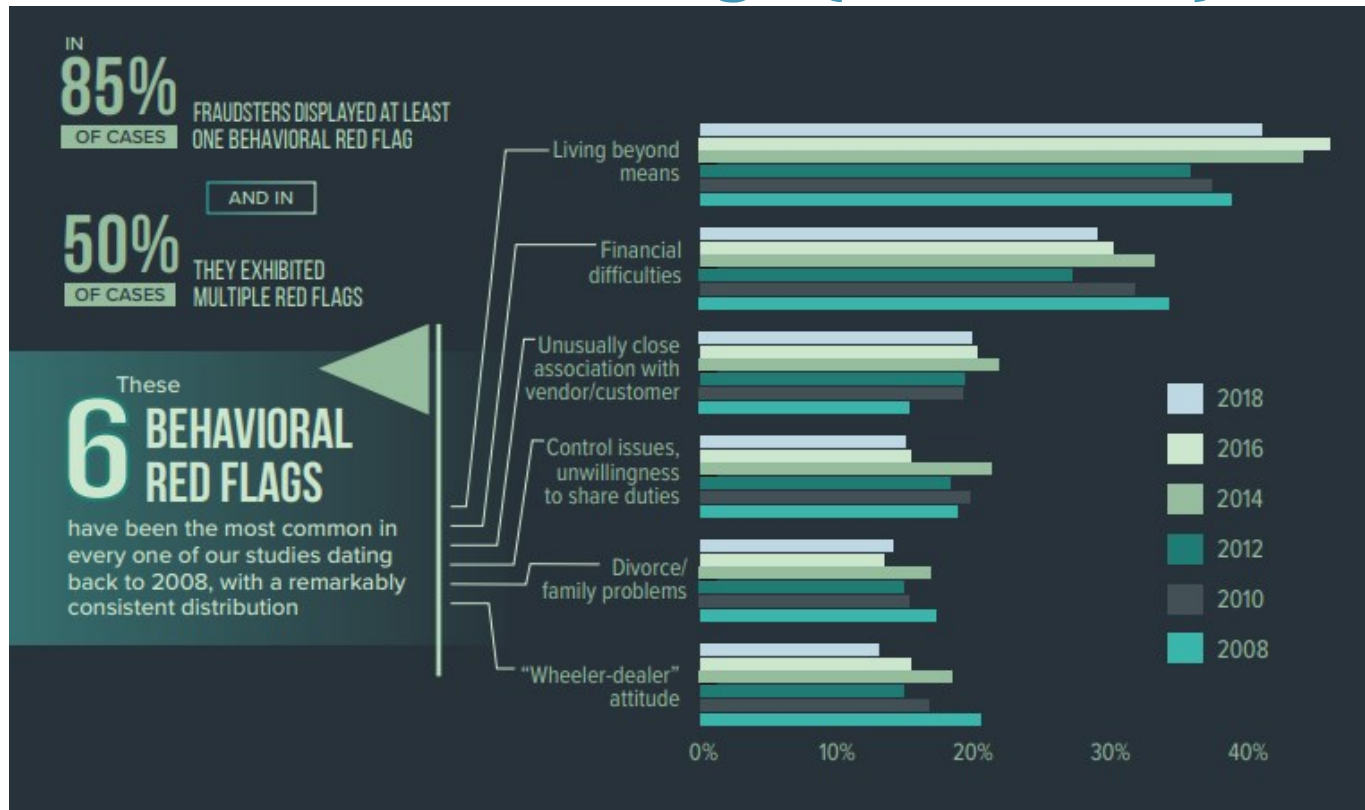


FIG. 22 What are the primary internal control weaknesses that contribute to occupational fraud?





Behavioral Red Flags (over time)





Fraud within government

All data taken from 2018 RTTN – Government edition

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Compare ACFE Data of the U.S. with Government Agencies

FIG. 85 What are the most common occupational fraud schemes in the United States?

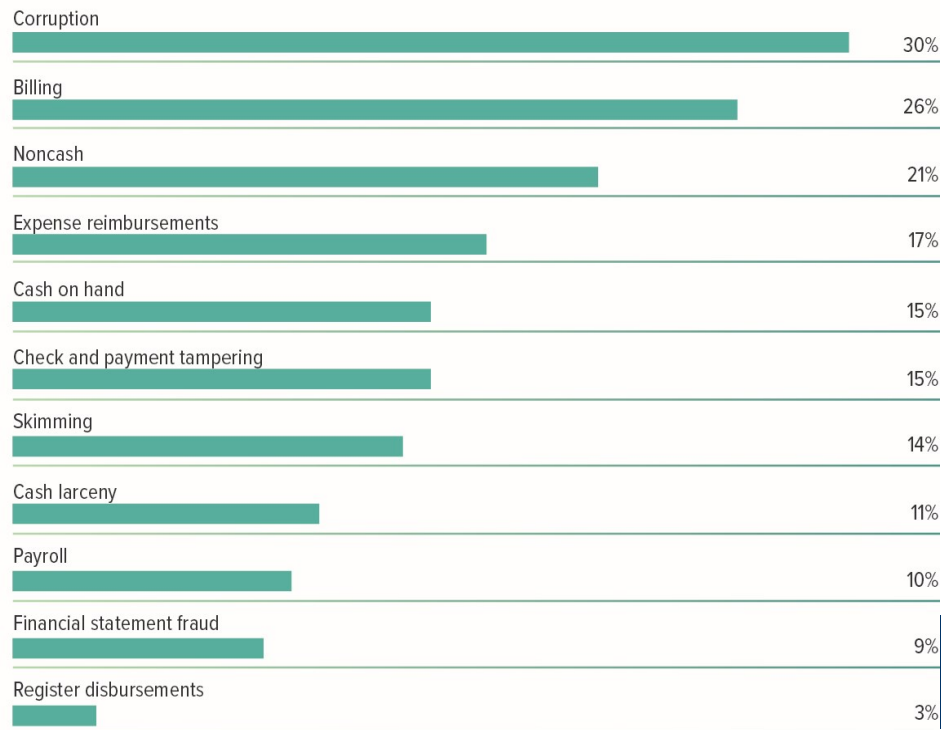


FIG. 2 What are the most common occupational fraud schemes in government agencies?

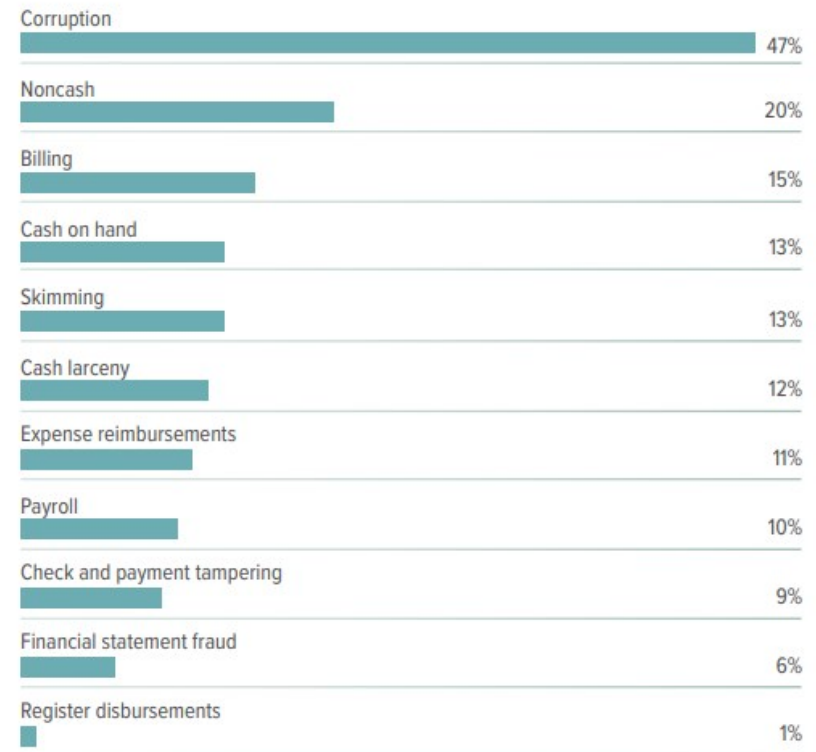


FIG. 9 How is occupational fraud initially detected?

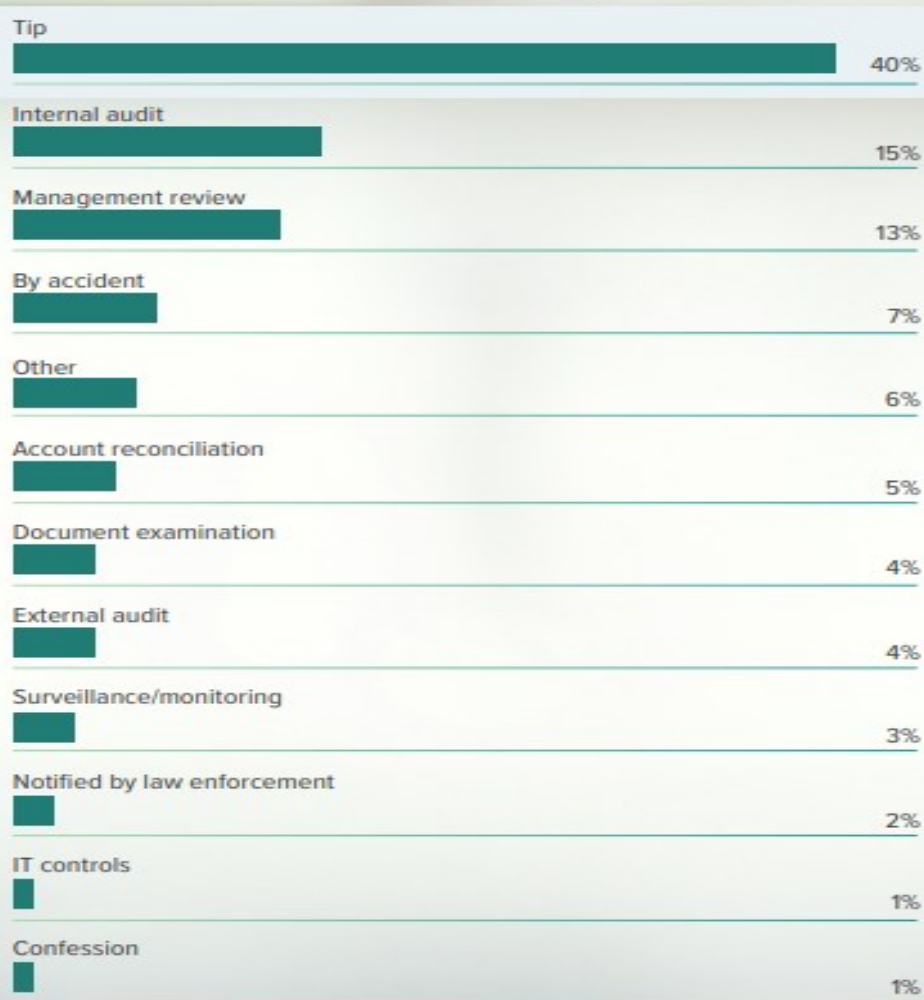
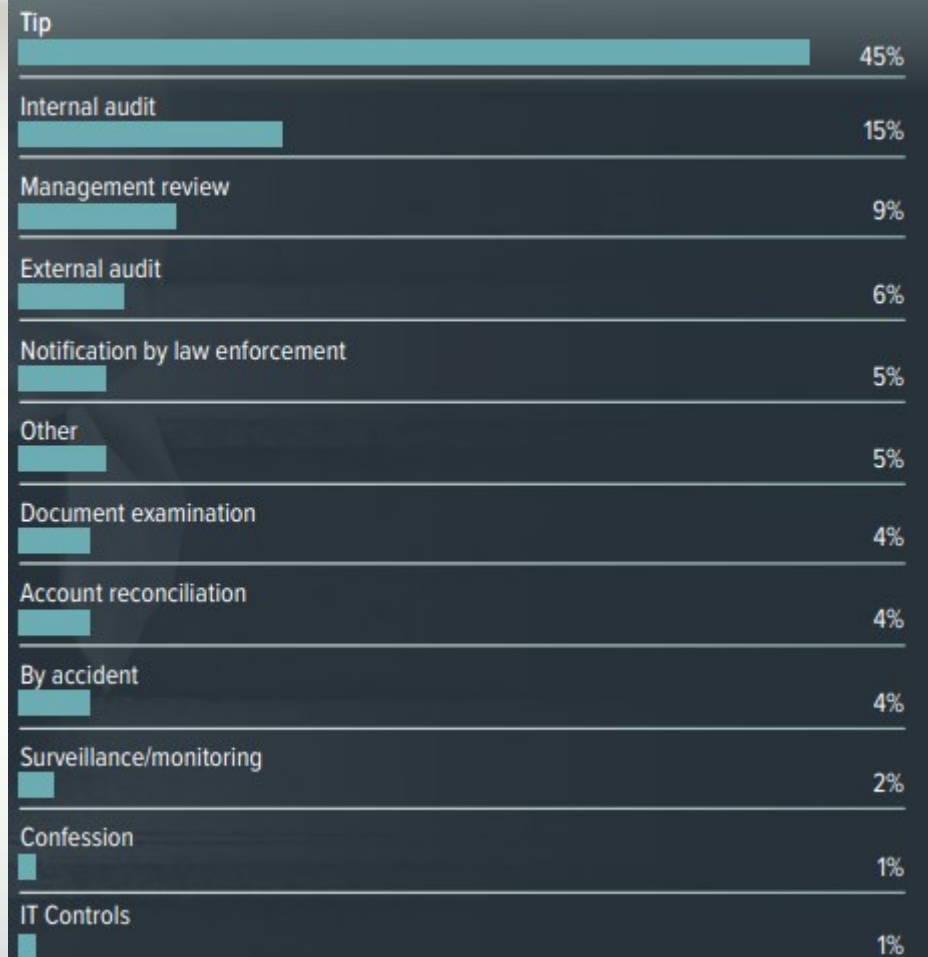


FIG. 3 How is occupational fraud initially detected in government agencies?





66%

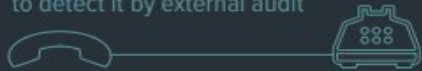
of government agencies had hotlines

TIPS

are by far the most common initial detection method.

Employees provide over half of tips, while a substantial amount also came from anonymous parties and customers.

Government agencies **without hotlines** were **three times as likely** to detect fraud by accident and **four times as likely** to detect it by external audit



of tips come from **EMPLOYEES**



of tips are **ANONYMOUS**



of tips come from **CUSTOMERS**

Telephone hotlines are most popular, but whistleblowers use various reporting mechanisms

Telephone hotline



40%

Web-based/online form



27%

Mailed letter/form



24%

Email



18%

Other



10%

NOT ALL TIPS COME THROUGH HOTLINES

When a reporting mechanism is not used, the top three parties whistleblowers report to are:

DIRECT SUPERVISOR 39%

LAW ENFORCEMENT OR REGULATOR 21%

INTERNAL AUDIT 13%

Government



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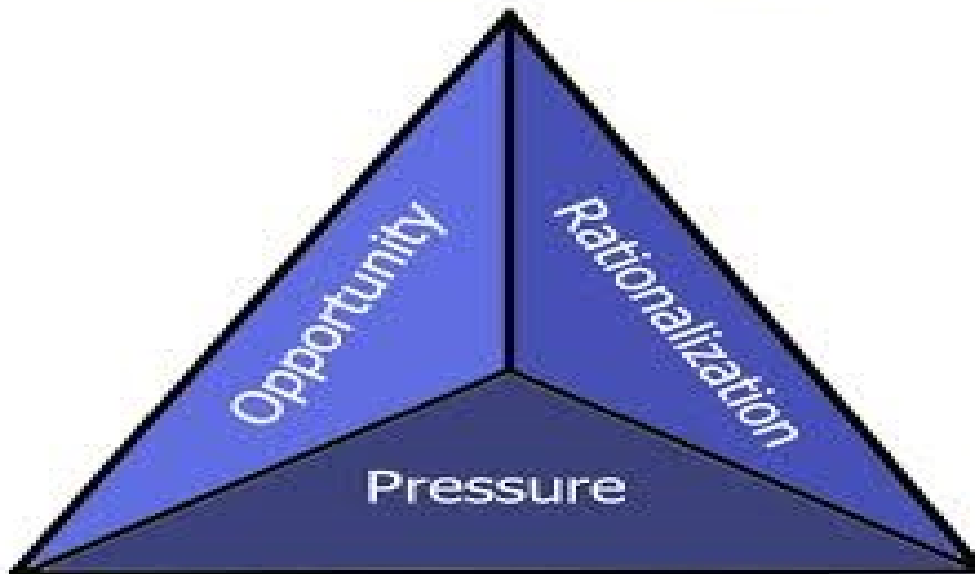
What frameworks help make sense of this?





Donald Cressey in the 1950s

The Fraud Triangle



The explanation embraced by the external audit literature (AU-C 240, ISA 240)



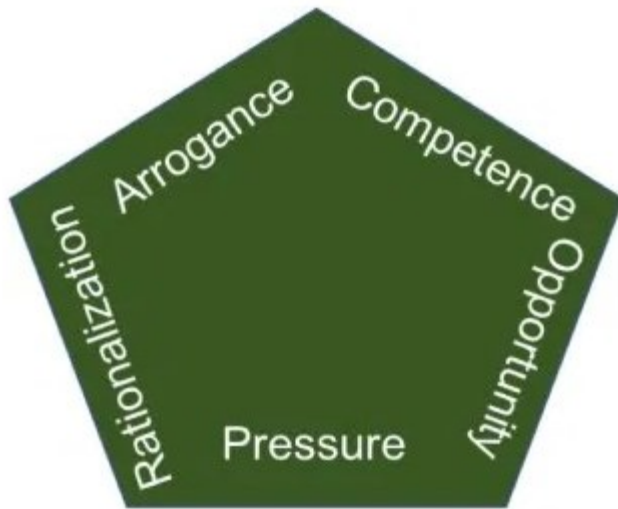
In 2004, David T. Wolfe & Dana R. Hermanson published



- Position/function
- Brains
- Confidence/ego
- Coercion skills
- Effective lying
- Immunity to stress

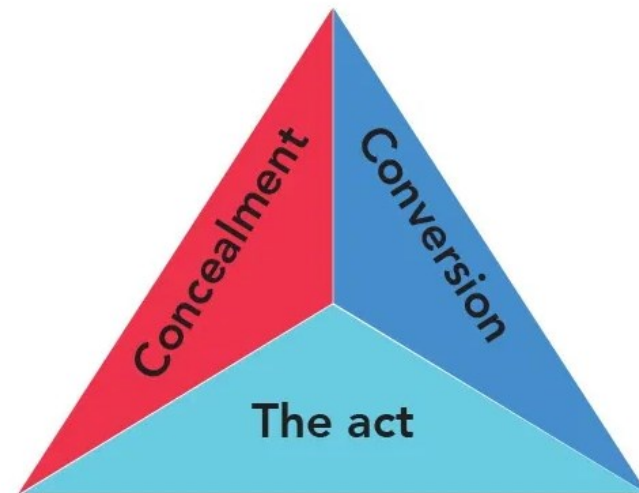


Distinguish the “actor” from the “action”



Crowe
Horwath
Fraud
Pentagon

Copyright 2019 Jonathan T. Marks



Triangle of Fraud Action
Albrecht, et.al. *Fraud Examination* 2006, 2012

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ABC Model

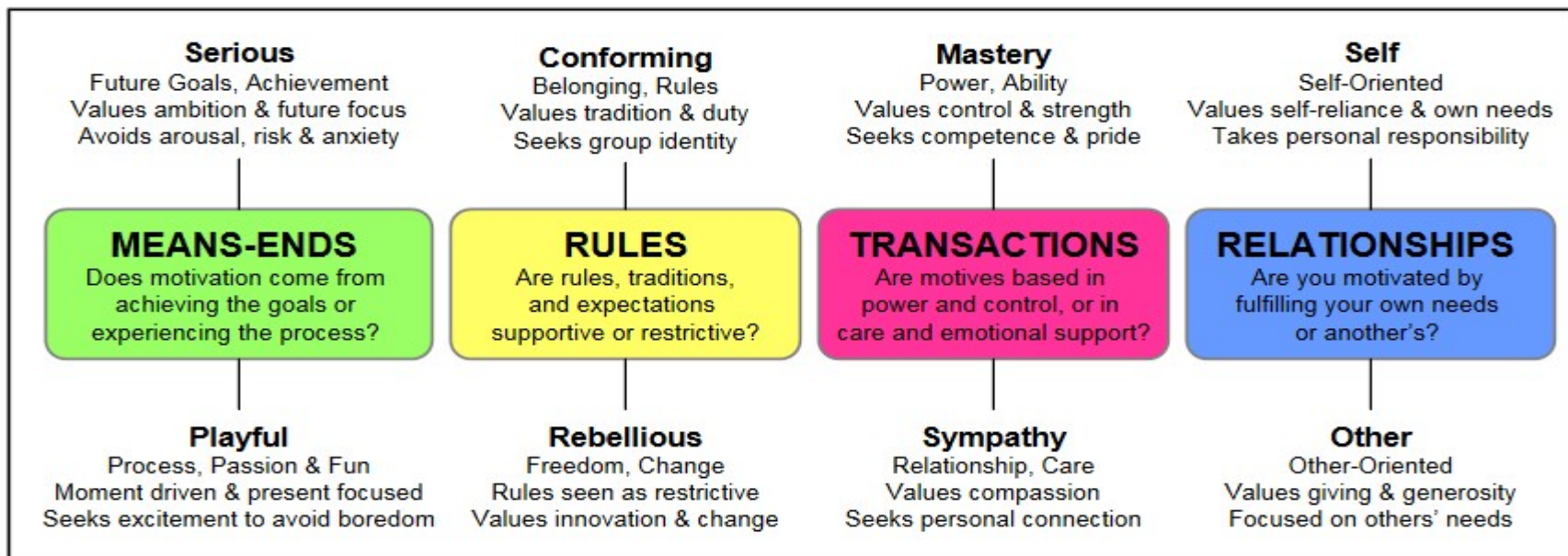
- Bad **A**pple
 - Personality characteristics
- Bad **B**ushel
 - Group dynamics of collusive behavior
- Bad **C**rop
 - Cultural or societal factors

Ramamoorti, Morrison, Koletar, 2009





Reversal Theory of Motivation



Psychologists Ken. Smith and Michael Apter – 1970s



Reversal Theory of Motivation

Values of the Eight Motivational States Impact on Fraud Motivation

Source: © Apter International. Used with permission.

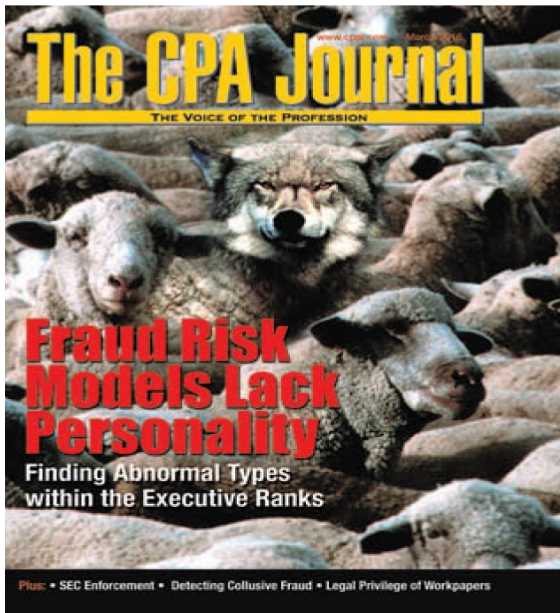


1. Serious – need for money due to dire financial circumstances
2. Playful – thrill of the chase
3. Conforming – everyone is doing it
4. Rebellious – pleasure of being bad
5. Mastery – beating the system
6. Sympathy – form of self-indulgence
7. Self – personal gain
8. Other – using gains for one's family

Rand Gambrell (May 3, 2017). BKD Forensics Institute Webinar – Psychology of Fraud



Sparking a debate



- 2 articles that year
- When Reckless Executives Become Dangerous Fraudsters: Reward Structures and Auditing Procedures Need to Be Reformed to Deter ‘Dark Triad’ Personalities

2016 Max Block Award Winner: Outstanding Article in the Area of News & Views/Opinion



Beg to disagree



- There Is No Financial Fraud Personality Type by Jeffrey Borenstein, MD, Psychiatrist, and Arthur J. Radin, CPA
- *“Until the brain is better understood, we believe that trying to define dark triad individuals is another step in the failed attempt to define criminals based on non-experiential information.”*
- *May 2017*

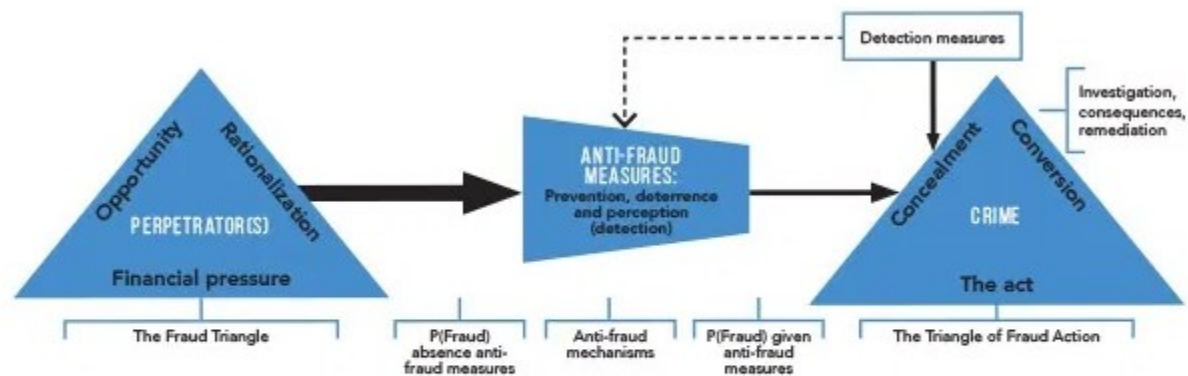


Figure 2: A meta-model of fraud and white-collar crime (adapted from *The Evolution of Fraud Theory*, by Jack Dominey, A. Scott Fleming, Mary-Jo Kranacher and Richard A. Riley Jr., "Issues in Accounting Education," Volume 27, Issue 2, May 2012.



Internal Controls



- Widely used model from COSO
 - Contains 5 components
- C-R-I-M-E

▪ Committee of Sponsoring Organizations 1985, 1992, 2013



Fraud Risk Management Process

Figure 1. Ongoing, Comprehensive Fraud Risk Management Process



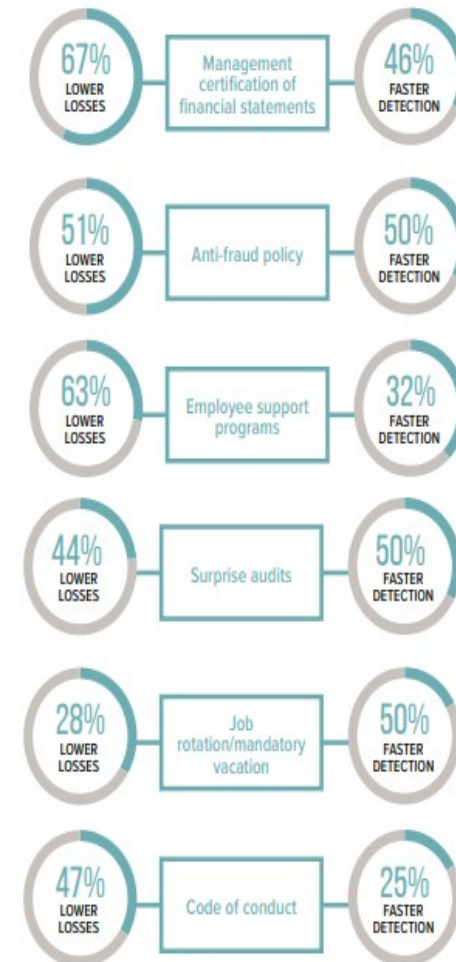
COSO/ACFE, September 2016



FIG. 7 What anti-fraud controls are the most common in government agencies?

Control	Percent of cases
Code of conduct	86%
External audit of financial statements	84%
Internal audit department	79%
External audit of internal controls over financial reporting	71%
Employee support programs	68%
Management certification of financial statements	68%
Hotline	66%
Management review	58%
Anti-fraud policy	50%
Independent audit committee	49%
Fraud training for employees	48%
Fraud training for managers/executives	47%
Formal fraud risk assessments	35%
Dedicated fraud department, function, or team	34%
Surprise audits	28%
Proactive data monitoring/analysis	27%
Job rotation/mandatory vacation	16%
Rewards for whistleblowers	12%

FIG. 8 How does the presence of an anti-fraud control relate to the median loss and duration of fraud in government agencies?



✓ Corruption

✓ Conflicts of Interest

✗ Purchasing Schemes

Purchasing Schemes Data Analytics Tests

Compare purchasing rates for similar products by vendor to identify if products were purchased at higher rates.

Compare purchases by ordering clerk for each vendor and product to identify vendor preference patterns.

Compare the total number of contracts by vendor to identify the presence of any bid-rotation activity.

Determine the average value of contracts awarded per vendor to identify if high-dollar contracts are awarded systematically.

Analyze whether any significant charitable and social contributions are linked to contract awards.

Look for one-time vendors or vendors with expedited payments.

Compare employee names, addresses, and account information to vendor master information to identify potential conflicts of interests or hidden relationships.

+ Sales Schemes

Fraud Risk Management Guide

A joint publication of COSO and the ACFE

Anti-Fraud Data Analytics Tests



More Data Analytic Tools

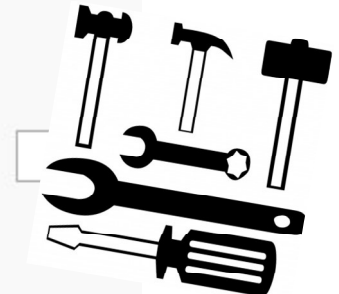
- Moving beyond the Corruption example for Purchasing....
- Kickbacks: Analyze the free-text payment descriptions for high-risk keywords such as "expedite fee," "facilitation payment," or government liaison names.
- Asset Misappropriation - Billing scheme: Extract vendors with incomplete profiles, especially those with missing telephone numbers or tax ID numbers.
- Financial statement fraud- Revenue Identify revenue recognized at period-end and subsequently reversed or partially reversed.

<http://www.acfe.com/fraudrisktools-tests.aspx>



Fraud Risk Assessment Scorecard

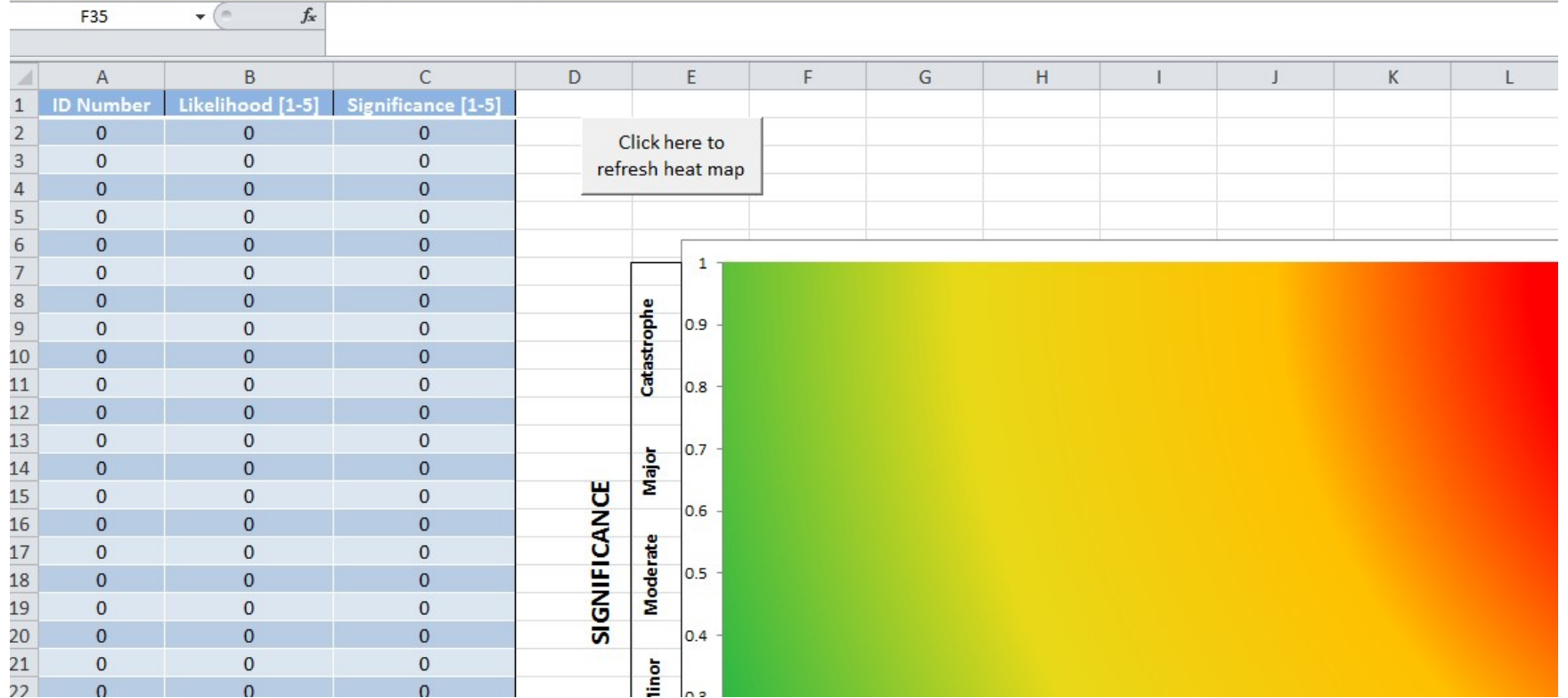
Fraud Risk Governance Area, Factor, or Consideration	Score	Notes
INVOLVING APPROPRIATE LEVELS OF MANAGEMENT		
Our fraud risk assessment team includes all appropriate levels of management and internal and external sources to assess fraud throughout the organization.		<input type="text"/>
Our risk assessment team includes resources such as: <ul style="list-style-type: none">• Accounting/finance personnel• Non-financial business unit and operations personnel• Information technology personnel• Risk management personnel• Legal and compliance personnel• Internal audit personnel• External consultants, if expertise is not available internally		<input type="text"/>
Management, senior management, business unit leaders, and significant process owners participate in the risk assessment seeing as they are ultimately accountable for the effectiveness of our organization's fraud risk management efforts.		<input type="text"/>





Risk Assessment Templates with Follow-up tools

Security Warning Macros have been disabled. Enable Content





<http://www.ephemeraha.com/rita>
if interested in self-study of Dixon fraud



STUDY THE LARGEST U.S. MUNICIPAL FRAUD EVER



The U.S. Marshals Service held a live auction in Dixon, Illinois on September 23-24, 2012, to sell more than 300 quarter horses and horse-related equipment belonging to Rita Crundwell. Rita was charged with embezzling \$53 million from the city of Dixon, eventually pleaded guilty, and is currently serving a nearly 20-year sentence. The auctions raised millions of dollars to be returned to the citizens of Dixon Illinois.

Home page photo used under Creative Commons License as provided by Shane T. McCoy/U.S. Marshals

This website accumulates and highlights information: photographs, legal documents, financial documents, videos, press releases, and news reports. All of these materials are available free of charge to be used to stimulate discussion in fraud-related classroom studies.

An examination of this case will show that \$53 million can get you 20!

Financial Resources	History and Background	Legal Documents	Citizens of Dixon
Resources Related to Rita's Empire	What People Were Saying	The 4-legged Beauties	Observations

Click on the Course of Interest

- [Auditing](#)
- [Governmental and Not-for-Profit Accounting](#)
- [Introductory Accounting Classes](#)
- [Fraud and Forensic Accounting](#)
- [Ethical Dilemmas](#)

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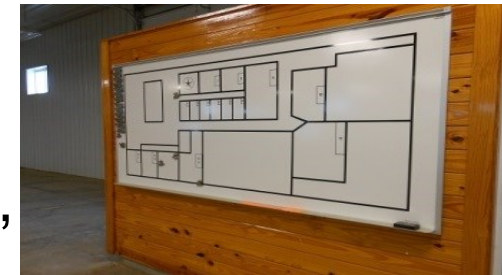
Disposition of Seized Horses In U.S.A. vs. Rita A. Crundwell



The Trophy Room
“Before”



Trophy Room “After”



“Good I Will Be”



An example of
misappropriated assets
– fictitious vendor
scheme



References

- ACFE (Association of Certified Fraud Examiners) Report to the Nations: 2018 Global Study on Occupational Fraud and Abuse. www.acfe.com
- ACFE (Association of Certified Fraud Examiners) Report to the Nations: 2018 Global Study on Occupational Fraud and Abuse – Government Edition. www.acfe.com
- W. Steve Albrecht, Chad O. Albrecht, Conan C. Albrecht, and Mark F. Zimbelman, (Summary of Triangle of Fraud Action) *Fraud Examination* (2012) Cengage Learning.
- Jonathon T. Marks (2019) Crowe Horwath Fraud Pentagon
<https://boardandfraud.com/2018/09/21/the-fraud-pentagon-an-enhancement-to-the-fraud-triangle/>
- Jonathan T. Marks (June 27, 2018) Meta-Model of Fraud – Two Triangles combine for better fraud case comprehension <https://boardandfraud.com/2018/06/27/meta-model-of-fraud-two-triangles-combine-for-better-fraud-case-comprehension/>



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- Rand Gambrell (May 3, 2017) Psychology of Fraud. BKD Forensics Institute Webinar. https://www.bkd.com/sites/default/files/2018-07/the_psychology_of_fraud.pdf
- Barry J. Epstein and Sridhar Ramamoorti (2019) When a triangle becomes a singularity: assessing and responding to “dark triad” fraud risk. 2019 Williamburg Advanced Fraud Academy https://www.eiseverywhere.com/file_uploads/7185785e8dc7d7b6d4c70632a0f6c29a_FINAL%20Epstein%20and%20Ramamoorti%20material%20for%20Adv%20Fraud%20Conf.pdf
- David T. Wolfe and Dana R. Hermanson (2004) The Fraud Diamond: Considering the Four Elements of Fraud <https://pdfs.semanticscholar.org/c9c8/32fa299f648464cbd0172ff293f5c35684b6.pdf>
- Jack Dominey, A. Scott Fleming, Mary-Jo Kranacher and Richard A. Riley Jr. (May 2012) “Issues in Accounting Education,” Volume 27, Issue 2.
- Ramamoorti, Morrison, Koletar (2009) Bringing Freud to Fraud: Understanding the State of Mind of the C-Level Suite/White Collar Offender through “A-B-C” Analysis https://ecommons.udayton.edu/acc_fac_pub/71