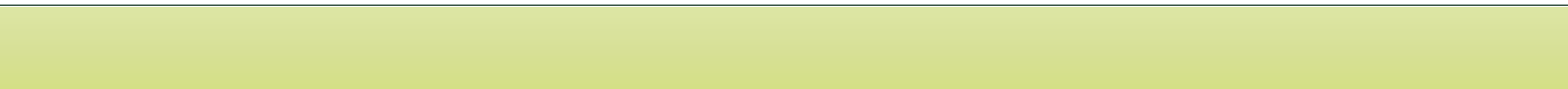




Fraud Risk Assessment

Eric Kinsherf, CPA
MMAAAA Conference
June 12, 2018



Agenda

- Overview
- What is Fraud?
- How does Fraud happen?
- How to Detect and Prevent Fraud
- Summarize

Objectives

- Gain better Understanding of Fraud Risk
- Illustrate examples
- Understand process of Conducting a Fraud Risk Assessment



WHAT IS FRAUD?

MUNICIPAL Fraud Cases

MASSACHUSETTS ALLEGED MUNICIPAL THEFT

BIGGEST MUNICIPAL EMBEZZLER IN UNITED STATES HISTORY

Recent alleged municipal thefts

Amount allegedly stolen, period of theft, named perpetrator and position by town

Hubbardston

Tax collector Cynthia Washburn-Doane

2004 to 2014 \$500,000+

Barre

Tax collector Marcia Langelier

2005 to 2011	\$307,353
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Brimfield

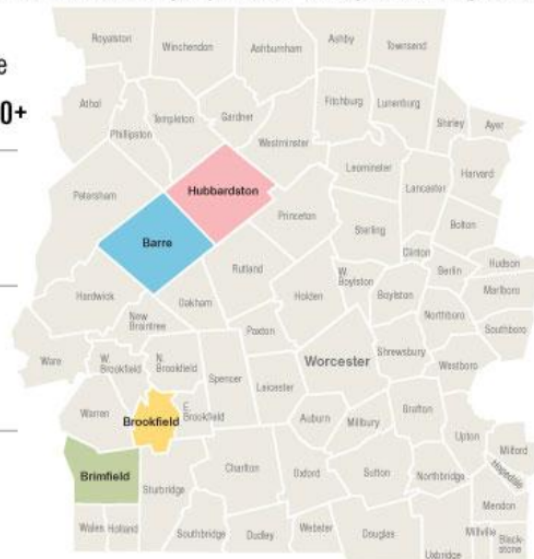
Treasurer Kirsten Weldon

2006 to 2013	\$80,868
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Brookfield

Municipal Clerk Beth Conant

2013 to 2014 **\$43,947**



Source: Court records

T&G Staff/DON LANDGREN JR.

Rita Crundwell and the Dixon Embezzlement

THE \$53 MILLION BAMBOOZLE: How the trusted comptroller of a small Illinois town became the biggest municipal embezzler in U.S. history, according to the feds—and no one noticed

BY BRYAN SMITH

PUBLISHED SEPT. 24, 2012



Rita Crundwell leaves a Rockford, Illinois, courthouse after a hearing on her embezzlement case in August 2012. PHOTO: RAY WHITEHOUSE

UPDATE (11.14.12): Rita Crundwell pleaded guilty to fraud on November 14 in federal court in Rockford.

MARKETPLACE

Source: <http://www.telegram.com/article/20160102/NEWS/160109825>

Source: www.chicagomag.com/Chicago-Magazine/December-2012/Rita-Crundwell-and-the-Dixon-Embezzlement/

What is Fraud?

- Association of Certified Fraud Examiners definition of Occupational Fraud:

“The use of one’s occupation for personal enrichment through the **deliberate** misuse or misapplication of employing organization’s resources or assets.”

3 MAIN FRAUD CATEGORIES

Asset Misappropriation

- Theft of Cash
- Skimming
- Theft of Inventory or Assets
- Fraudulent Disbursements thru Invoices, Payroll, Expense Reports, Voids, Refunds, Check Tampering

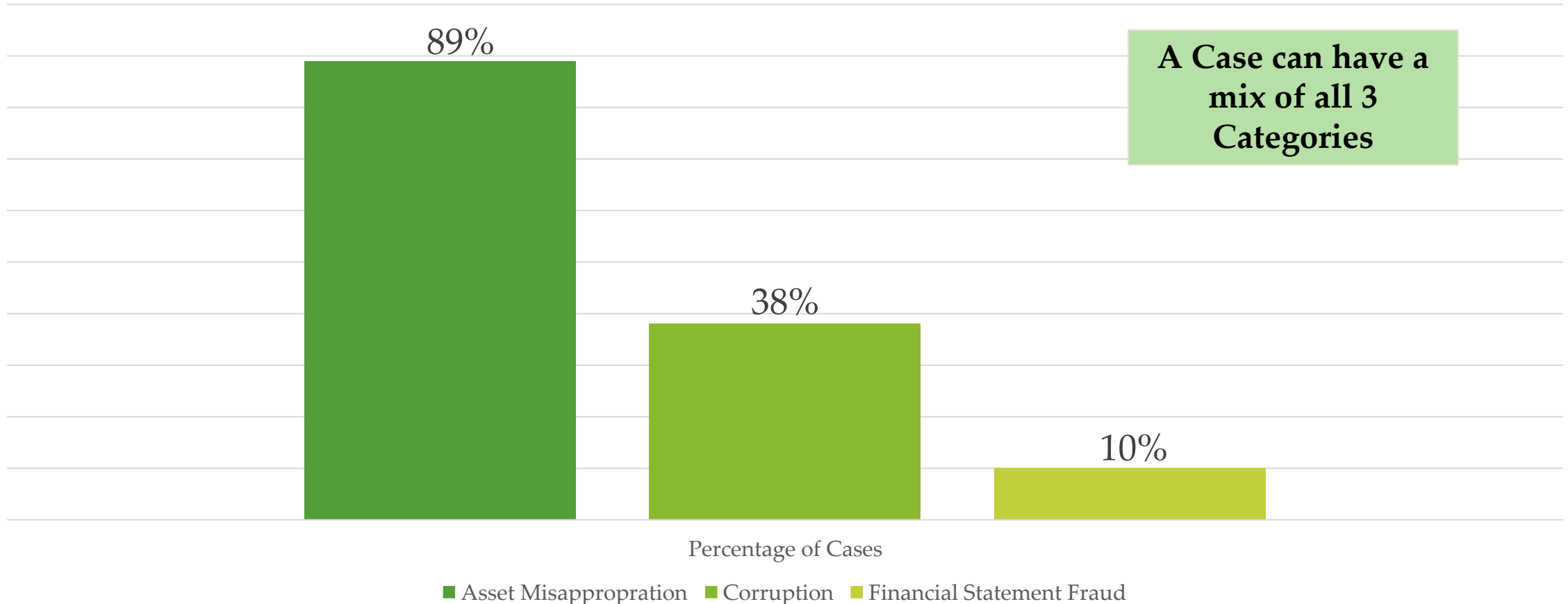
Corruption

- Bribes
- Conflicts of Interest
- Illegal Gratuities
- Economic Extortion

Financial Statement Fraud

- Intentionally misrepresenting the values such as:
 - Revenue
 - Expenditures
 - Assets
 - Liabilities
 - Equity
 - Improper Disclosures

89% of ACFE Cases involved Asset Misappropriation.



Source: 2018 ACFE Report

EXAMPLES OF FRAUD



opportunity,
bided his time.

Bid rigging noun is a form of **FRAUD** in which a commercial contract is promised to one party even though for the sake of appearance several other parties also present a bid.

This form of collusion is illegal in most countries. It is a form of price fixing and market allocation often practiced where contracts are determined by a call for bids, for example in the case of construction contracts.

Larceny Schemes

- Theft from other registers
 - Using another cashier's register or access code
- Death by a thousand cuts
 - Stealing small amounts over an extended period of time
- Reversing transactions
 - Using false voids or refunds
 - Causes the cash register tape to balance to the cash drawer
- Altering cash counts or cash register tapes
- Destroying register tapes

51

Monday - Thursday 8:00AM - 6:00PM PST
Friday 8:00AM - 4:00PM PST
(866) 273-7934 websitebackup.com
info@websitebackup.com

ACCOUNT SUMMARY

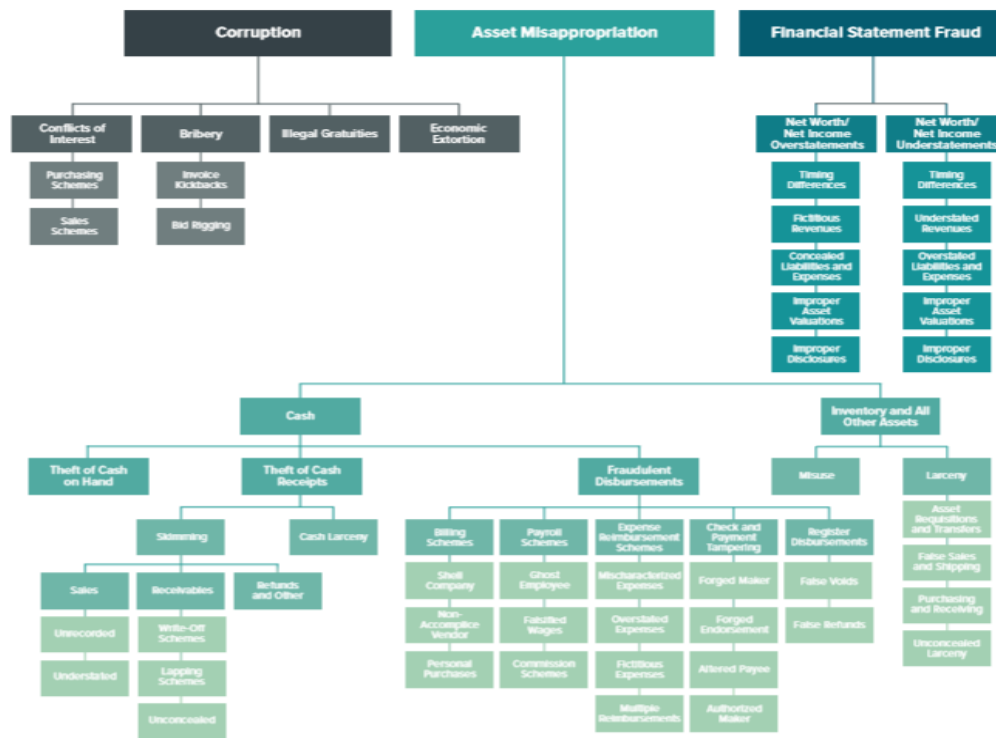
ITEM	PRODUCT DESCRIPTION	AMOUNT
001	Website Backup Service Plan - WebsiteBackup Pro	Annual Charge \$70.00
	- Incremental Backup (monthly)	Included \$0.00
	- Domain Name(s)	
	- Host (Web Server) (active)	
	- WWW Forwarding (active)	
	- Domain Masking (n/a)	
002	Max No. Web Pages (100)	Included \$0.00
003	Data Storage (2 GB)	Included \$0.00
	TOTAL	\$70.00

THANK YOU, WE APPRECIATE YOUR BUSINESS

PLEASE DETACH THE BOTTOM PORTION AND RETURN USING ENCLOSED ENVELOPE

3 Fraud Category with Examples of Fraud

FIG. 4 Occupational Fraud and Abuse Classification System (the Fraud Tree)⁶

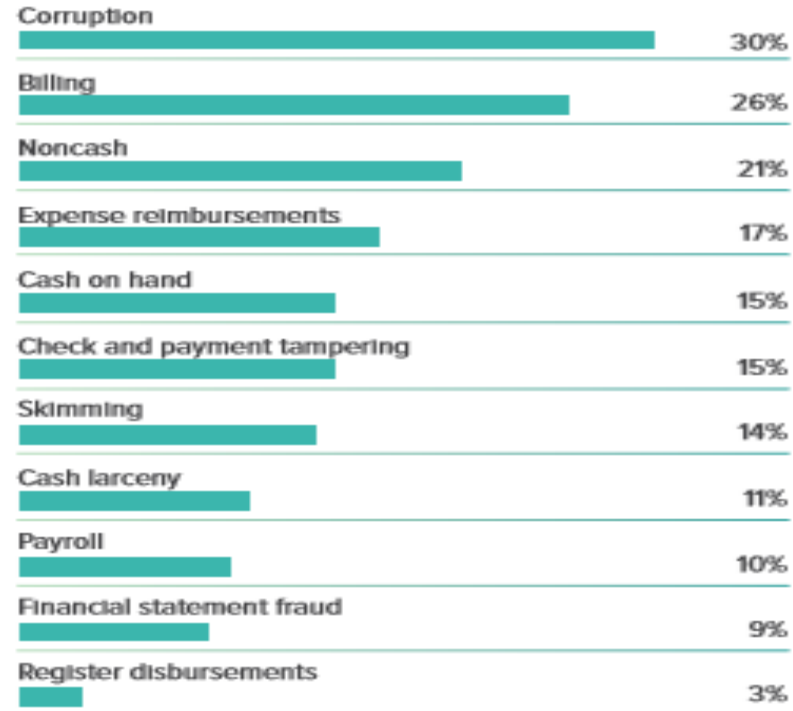


⁶ The definitions for many of the categories of fraud schemes in the *Fraud Tree* are found in the Glossary of Terminology on pg. 78. In previous reports, the category check and payment tampering was referred to simply as check tampering. However, to better reflect the increasing shift toward electronic payment methods, we have changed the category title.

ACFE United States Fraud Scheme Statistics

Asset
Misappropriation
Is the Largest
Category!

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



Common Fraud Themes

- **Smaller Organization** typically have fewer anti-fraud controls which increase the risk of fraud.
- Median **duration** of a fraud scheme is **16 months**.
- **Internal Control weaknesses** were responsible for over 50% of Fraud!
- Only 4% of fraudsters had a prior conviction.
- Majority of Victim organizations **recovered nothing**.



HOW DOES IT HAPPEN?

FRAUD TRIANGLE

RATIONALIZATION

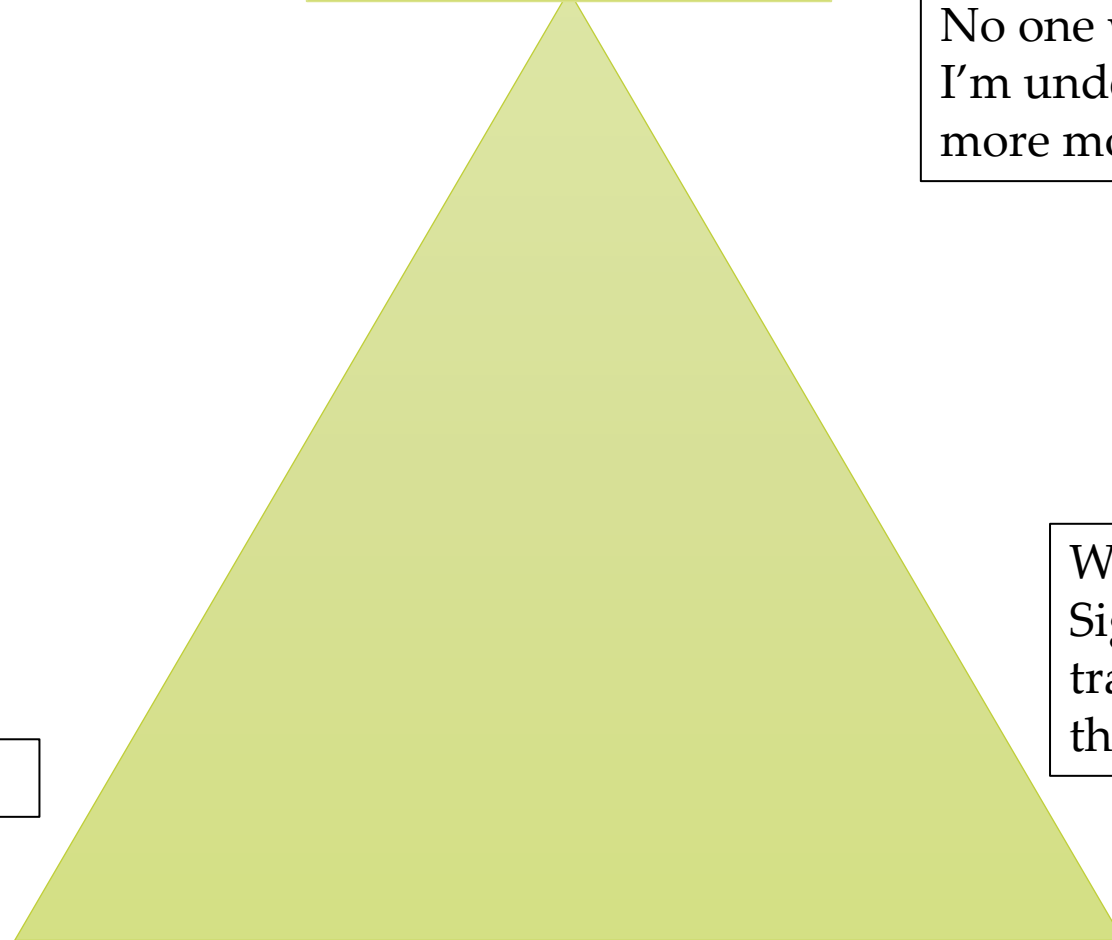
I will pay it back and no one will notice.
No one will get hurt.
I'm underpaid and deserve more money.

Unable to Pay Personal Bills

INCENTIVE

Weak Internal Controls -
Signs checks, records all transactions, and reconciles the bank statements.

OPPORTUNITY





HOW DID IT HAPPEN?

City of Dixon Case

Worked at the City of Dixon for 21 years before setting up a secret bank account.

Took Money for 20 years before discovered.

Exhibit 1. Timeline of Events in Rita Crundwell's Life

Date	Event
January 10, 1953	Rita Humphrey's birthday.
1970	Employed as intern in the City of Dixon municipal government while in high school.
1974-1986	Married to and divorced from Jerry L. Crundwell (retained married name). No children.
1971-1983	Secretary for the City of Dixon Mayor.
1983-2012	Served as the City of Dixon's Comptroller and Treasurer on full-time basis.
December 18, 1990	Opened RSCDA account at Fifth Third Bank.
January 1991	Transferred funds out of RSCDA for the first time for personal use.
October 2011	Kathe Swanson discovers RSCDA account and informs Mayor Burke. FBI is contacted.
April 17, 2012	Arrested at work in the City of Dixon on a one-count indictment of wire fraud.
November 14, 2012	Pleads guilty to wire fraud and admits to money laundering. Her assets, including over 400 horses, were seized.
February 13, 2013	Sentenced to 19 years, 7 months (maximum possible was 20 years).
February 18, 2013	Receives full suspension from the American Quarter Horse Association. ⁶
October 16, 2013	City of Dixon settled a lawsuit against Fifth Third Bank and the auditors.
March 5, 2030	Expected release date from prison. She is incarcerated at the Federal Correctional Institution at Waseca, MN.

FRAUD TRIANGLE

RATIONALIZATION

RITA'S
RATIONALIZATION? WE
CAN ONLY SPECULATE

PASSION FOR RAISING
AND SHOWING QUARTER
HORSES WHICH IS VERY
EXPENSIVE!

INCENTIVE

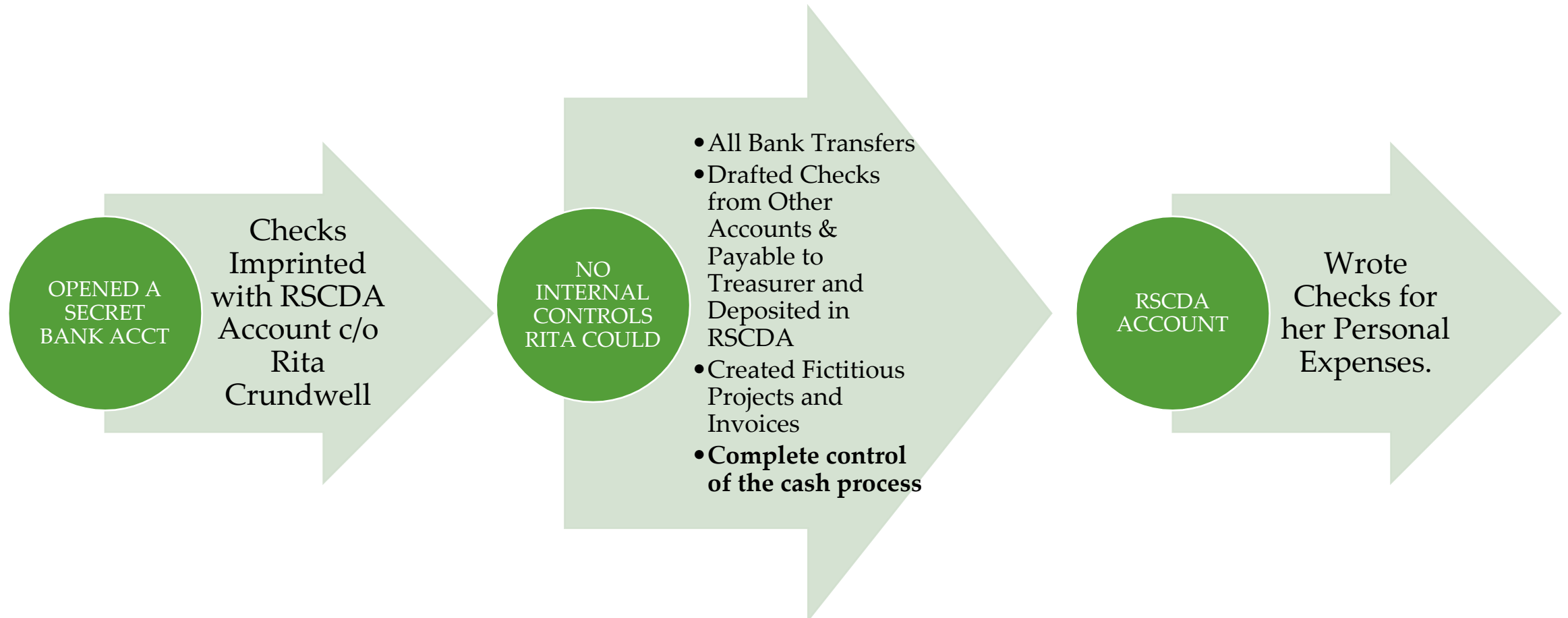
RITA CONTROLLED the
WHOLE CASH PROCESS
FROM PICKING UP THE
MAIL TO BANK
RECONCILIATIONS

OPPORTUNITY

Fraud Risk at the City of Dixon

- No Segregation of Duties. One person controlled the process.
- Rita picked up the mail, made all deposits, updated the journals and ledgers, prepared and signed checks, moved investment monies, and did the bank reconciliations.
- Rita had no supervisor and earned complete trust from the Mayor, Council, and Colleagues.
- Unqualified Audit opinions were given each year.

WHAT DID RITA DO?



Issues with the Auditors

- Lack of Independence
- Noted Material Weaknesses but no enhanced audit procedures done and no audit report on Internal Controls over Financial Reporting
- Other Issues

Exhibit 4. Auditors Associated with City of Dixon

Dates	Event
1993-2005	CliftonLarsonAllen ¹¹ (Clifton) audits City of Dixon and provides unqualified opinions each year
2006-2011	Samuel S. Card, CPA participates in arrangement with Clifton to audit City of Dixon ¹² and renders unqualified opinions each year
2011-2012	FBI initiated investigation leading to April 17, 2012 arrest of Rita Crundwell
2012 to present	Wipfli LLP retained to audit Dixon after the fraud

Source: JOURNAL OF FORENSIC AND INVESTIGATIVE ACCOUNTING VOL 7, ISSUE 1 JAN – JUNE 2015



HOW WAS IT DISCOVERED?

VACATION

- RITA TOOK A 12 WEEK VACATION
- CITY CLERK ASSUMED RESPONSIBILITY AND CONTACTED BANK FOR A ROUTINE REQUEST OF ALL BANK STATEMENTS



HOW TO PREVENT FRAUD



UNDERSTANDING FRAUDSTERS

Understand what Fraudster Do

Ranking of Top 8 Concealment methods used by Fraudster

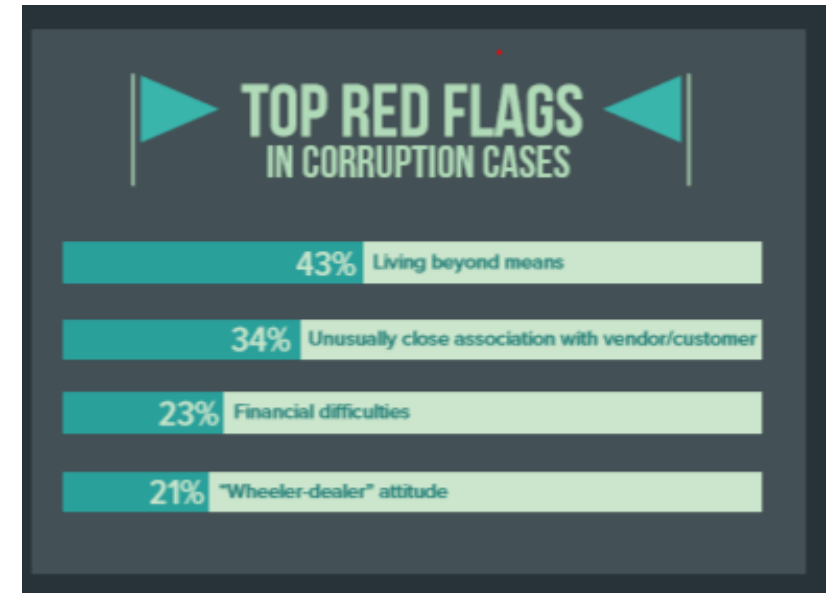
1. Created Fraudulent Physical Documents
2. Altered Physical Documents
3. Created Fraudulent Transactions in the Accounting System
4. Altered Transactions in the Accounting System
5. Altered Electronic Documents and Files
6. Destroyed Physical Documents
7. Created Fraudulent Electronic Documents or Files
8. Created Fraudulent Journal Entries

What Internal Controls do you have in place to prevent these concealment methods from happening?

Who is reviewing the documents or transactions to ensure that they are legitimate?

Employee Red Flags of Fraud

- Unexplained increases in wealth
- Living beyond their means
- Close employee association with vendor etc..
- Personal Issues such as legal, financial, substance abuse
- Never takes a vacation
- Unwilling to share duties
- Lack of transparency
- Financial decisions made by one person



Source: 2018 ACFE Report



UNDERSTANDING INTERNAL CONTROLS

INTERNAL CONTROLS

Accounting term, is a process for assuring achievement of an organization's objectives in operational effectiveness and efficiency, reliable financial reporting, and compliance with laws, regulations and policies.

Why Important?

- **Reduce Risk of Asset Loss**
- **Ensure Accurate and Complete Information**
- **Reliable Financial Reporting**
- **Compliance with Laws, Regulations and Policies**



EVALUATE INTERNAL CONTROLS AND UNDERSTAND RED FLAGS

City of Dixon do Afterwards?

INTERNAL CONTROL CHANGES

- REDUCED BANK ACCOUNTS TO **ONE** BANK ACCOUNT
- NO PAPER CHECKS ALLOWED
- SEGREGATION OF DUTIES
- INDEPENDENT PANEL TO OVERSEE FINANICAL REPORTING (CPA, BANKER, ATTORNEY)
- ANNUAL AUDITED FINANICAL STATEMENT PRESENTED TO CITY COUNCIL AND POSTED ON WEBSITE



EXAMPLE: DISBURSEMENTS

Disbursement Red Flags

- Altered or Incomplete Supporting Documentation
- Invoices from same vendor look different
- Unexplained increases in expenses
- Vendors with no physical addresses or no W9
- Employees picking up vendor checks
- No Segregation of Duty – one person sets up vendor, entering invoices, approving the warrant, printing and mailing checks.

Example: Disbursement Internal Controls

- Follow Chapter 30B Procurement Laws.
- Purchase Order Approval Process.
- W9 to ensure valid vendor. Also Google, Research, Call the Vendor.
- Invoices are signed off by the department head.
- Review Invoices to ensure not fraudulent, excessive or unlawful.
- Segregation of Duties: Review the process who has too much control.
- Train staff on the importance of Internal Controls and Fraud Prevention.
- Keep check stock in a locked and secured area.
- Do not allow hand written checks.
- Signed vendor checks should not be returned to those who authorized the payment.
- Restrict Check signer access to accounting records, cash receipts, bank reconciliations.
- Restrict access to the vendor master file.
- Department Heads review Expenditure Reports
- Accounting, Town Manager review Expenditure Reports.
- Review the Vendors annually. Inactivate Old Vendors.
- Compare Employee Addresses to Vendor Addresses.
- If something doesn't feel right, investigate further.



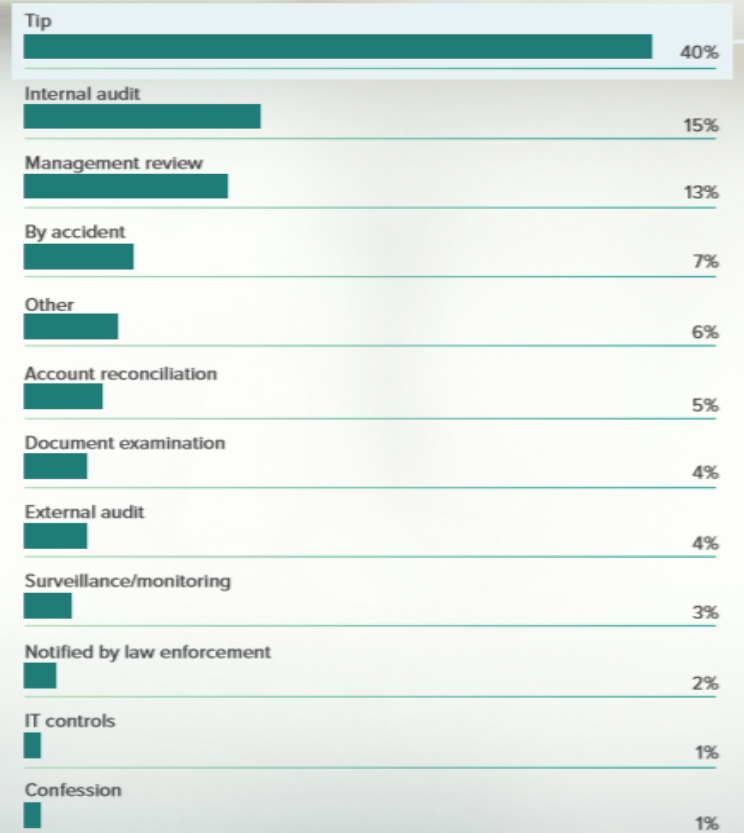
Understand the Detection Methods

Detection Methods

TOP 3 are 68% of how Frauds were Detected!

1. TIPS	40%
2. INTERNAL AUDIT	15%
3. MANAGEMENT REVIEW	13%

FIG. 9 How is occupational fraud initially detected?



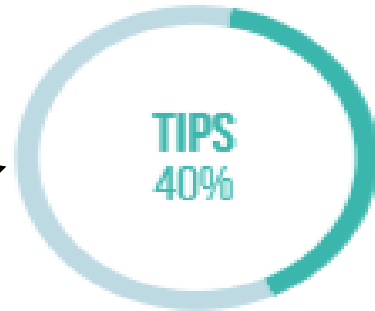


DETECTION - # 1 TIPS

MOST COMMON INITIAL DETECTION METHODS

TIPS ARE THE MOST COMMON METHOD OF DETECTION

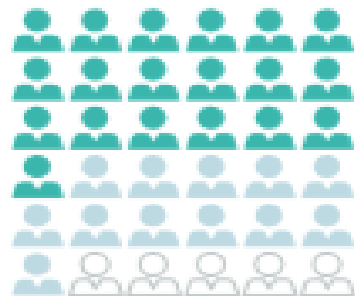
TIPS CAN COME FROM CUSTOMERS, VENDORS, ANONYMOUS, ETC..



INTERNAL
AUDIT
15%

MANAGEMENT
REVIEW
13%

EMPLOYEES
provide over half
of tips, and nearly
1/3 come from
OUTSIDE PARTIES



ORGANIZATIONS WITH HOTLINES
detect fraud by tips more often




HOTLINES



NO HOTLINES

WHAT DO YOU HAVE IN PLACE SO PEOPLE CAN REPORT SUSPICIOUS OR FRAUDULENT BEHAVIOR?

Examples of Fraud Hotline Websites

 **Mass.gov**


Search Mass.g

[LIVING ▼](#) [WORKING ▼](#) [LEARNING ▼](#) [VISITING & EXPL](#)

MORE ABOUT: [Protect Public Money](#) [Confidential Fraud, Waste and Abuse Hotline](#) [Government Accountability](#)

OIG Fraud Hotline

Contact the Office of the Inspector General's 24-hour Fraud Hotline to confidentially report corruption, fraud, waste or abuse related to government funds or property.

 *Report fraud, waste and abuse of government funds or property 24 hours a day. Complaints are confidential and can be made anonymously.*

Springfield, Massachusetts

 One Call to City Hall

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About the Fraud Hotline

Financial Accountability is a top priority for the City of Springfield, Massachusetts. With this goal in mind, the [Office of Internal Audit](#) has created a fraud hotline that can be used to report information about fraud, waste or abuse of resources related to or involving City personnel, resources, or operations.

If you have information regarding known or suspected misuses of municipal funds or resources, we encourage you to report what you know to the City's Office of Internal Audit. You may submit your concerns or findings in one of three ways:

1. Complete a [Fraud Information Report](#) online *or*
2. Leave a recorded voicemail message on the **fraud hotline** at **(413) 886-5125**. This hotline is available 24-hours a day, 7-days a week *or*
3. Send a [written report](#) via **U.S. mail** to the following address:

Office of Internal Audit
36 Court Street - Room 411
Springfield, MA 01103

We strongly encourage you to provide as much detail as possible in your correspondence so we are better able to investigate your concerns. If you elect to leave a voicemail message on the hotline or to mail in your tip, please provide a detailed description of the activity you wish to report, the names of the individuals and departments involved, dates and times of the incident, and the location the incident occurred. In addition, if you are aware of any supporting documentation that may be helpful such as invoice numbers, purchase order numbers, check numbers, etc., please include this information as well. Finally, if you wish to allow the Office of Internal Audit to contact you, please provide your name, telephone number and e-mail address, along with your preferred method and time for contact.

If you wish to remain anonymous, you may do so by omitting all personal information from your correspondence. To the extent permitted by law, the Office of Internal Audit will treat all information as confidential including the identity of persons coming forward to file reports.



Fraud Hotline
[Report Fraud](#)
[Types of Fraud](#)
[Fraud FAQ](#)

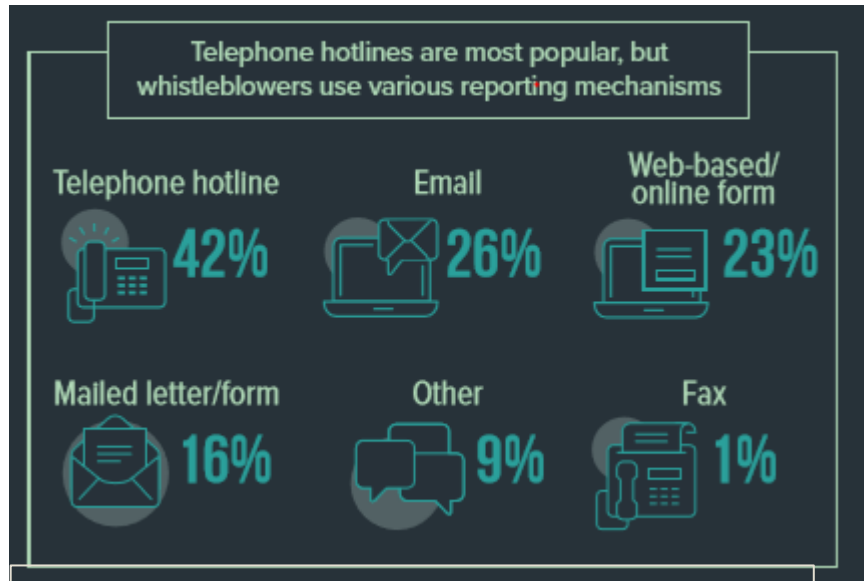
Office of Internal Audit
Yong Ju No, CPA
36 Court Street, Room 411
Springfield, MA 01103 ([map](#))
413.784.4844
yno@springfieldcityhall.com
Fraud Hotline 413.886.5125
Fax 413.750.2363

Online Services: ▼
Help and Answers: ▼
City Departments: ▼
Select Language ▼

Do you have:

1. Fraud Policy

2. Whistleblower Policy



Source: 2018 ACFE Report

Do Employees know what to do if they suspect Fraud?

Do Employees feel safe reporting Fraud? Biggest fear is retaliation.

Don't assume Employees know what to do.

Don't let Policies just sit in the book.

Make sure the Policies are communicated and reviewed with staff on an ongoing basis.



DETECTION – #2 INTERNAL AUDITS

INTERNAL AUDITS

- Routinely check and test the internal controls of a process.
- Hire an outside firm to do Internal Audits.



DETECTION – #3 MANAGEMENT REVIEW

MANAGEMENT REVIEW

- **VERY IMPORTANT FOR MANAGEMENT TO BE ENGAGED IN THE FINANCIAL MANAGEMENT OF THE CITY OR TOWN.**
- Are they really reviewing the invoices, revenue and expenditure reports?
- Or are they trusting someone else to do it?



SUMMARY

Summarize

Importance of Understanding, Preventing and Detecting Fraud:

1. Fraud Categories and Fraud Statistics – Where is your Town, City or School at Risk?
2. How does it Happen? Fraud Triangle – Incentive, Rationalization, Opportunity (50% due to WEAK INTERNAL CONTROLS).
3. Understanding the Fraudsters, Red Flags, Concealment Methods.
4. Detection and Prevention – Tips, Internal Controls, Management Review. What do you have in place? Where are you at Risk?

Conducting A Fraud Risk Assessment

- Assess perceived fraud risks in a "brainstorming" session with Management
- Develop questions and a matrix for each department in Town or City
- Identify Fraud Risks, Controls in Place to mitigate risks, and recommendation for improvement for each department
- This should be an ongoing process after the initial assessment