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Recognizing the Red Flags of Fraud and How You Can Protect Your Business... with an Update on Current Fraud Trends

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Agenda

- Introduction
- Fraud Overview
- Red Flags of Fraud
- Selected Case Studies
- Questions & Answers

Question #1

How many of you have or know someone or company that has experienced a fraud?

- Discussion?



Question #2

How many of you are concerned that you may be susceptible to fraud?

- What causes you to be concerned?



Fraud Overview

- The term “Fraud” is often used loosely to describe certain actions.
- From a legal perspective, whether fraud has been committed is for a judge or jury to determine.
- Our discussion will focus on actions that may be indicative of fraudulent conduct.



What is Fraud?

- Intentional material false statement or willful omission of material fact, either orally or in writing.
- Knowledge by the perpetrator that the statements or omissions are false and misleading.
- Intent for the misrepresentation to be acted upon.
- Reliance by the victim on the statements made.
- Damage to the victim who relied upon the statements.

What is Fraud in a Commercial Setting?

- Organizational Crime: that which is committed by businesses, particularly corporations and government.
- Occupational Fraud: offenses against the law by individuals in the course of their occupation.

Characteristics of Occupational Fraud

- Is clandestine, or hidden;
- Violates the perpetrator's fiduciary duties to the victim organization;
- Is committed for the purpose of the direct or indirect financial benefit to the perpetrator;
- Costs the employee's organization assets, revenues or reserves; and
- Fraud is a global issue.



How Widespread is Occupational Fraud?

- Attempts to accurately measure the frequency or cost of occupational fraud will be, at best incomplete.
 - Fraud, by nature, is hidden.
 - There is no central repository for fraud data in the US.
 - A great deal of fraud cases go unreported.
 - It may not be possible or desirable for a company to find out exactly how much was stolen in a fraud.

ACFE Report to the Nations: 2016 Fraud Study

The Association of Certified Fraud Examiners (“ACFE”) conducted a study comprised of **2,410** cases of occupational fraud investigated across the globe between January 2014 and October 2015.

ACFE Report to the Nations 2016 Fraud Study

- Median loss in the US: **\$150,000**
- More than 23 percent of the cases caused at least **\$1 million in losses**
- Median duration – **18 months**.
- Estimated annual revenue loss to fraud - **5 percent**.
- On a \$5 million in revenue company, that is an annual fraud loss of **\$250,000**.

How Occupational Fraud Is Committed

Corruption

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

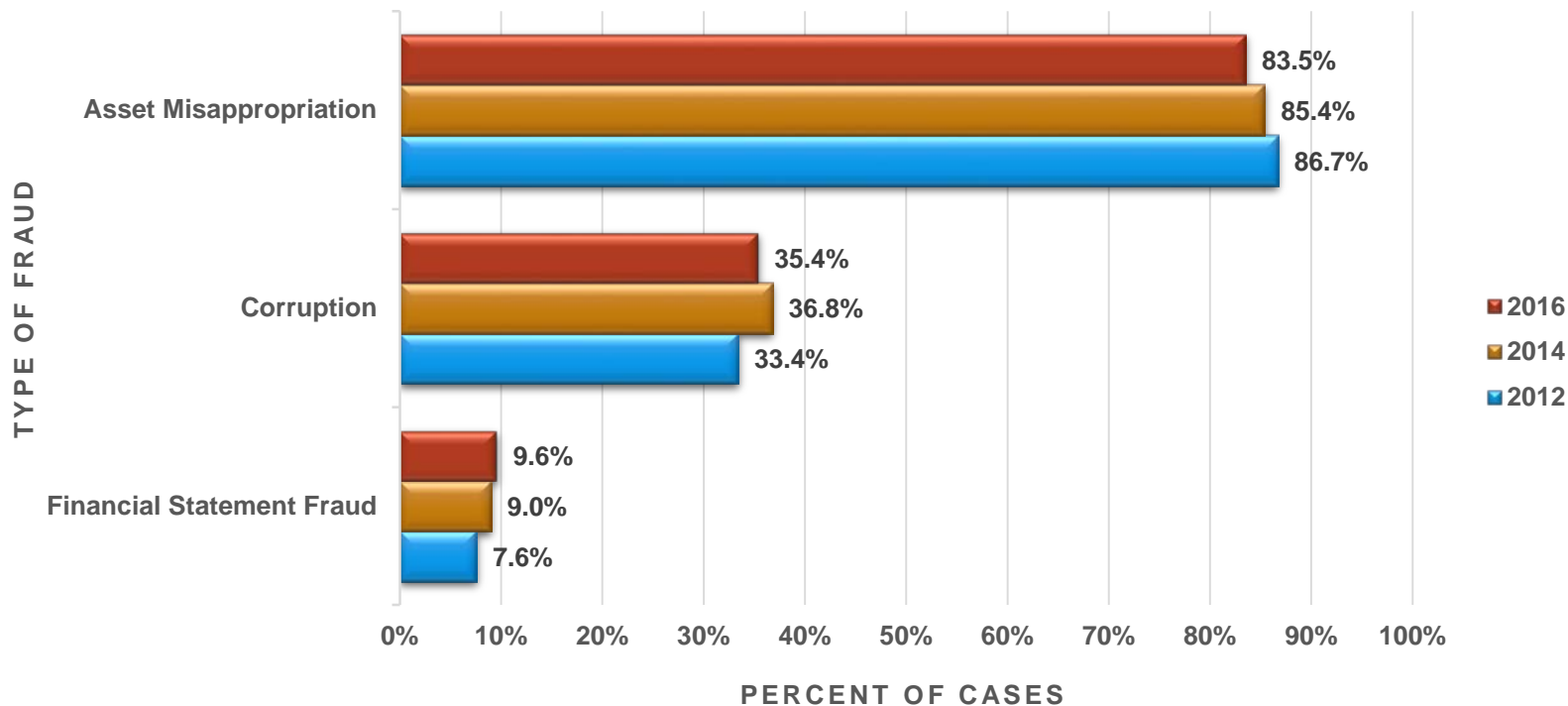
Asset Misappropriation

- Cash
- Inventory and All Other Assets

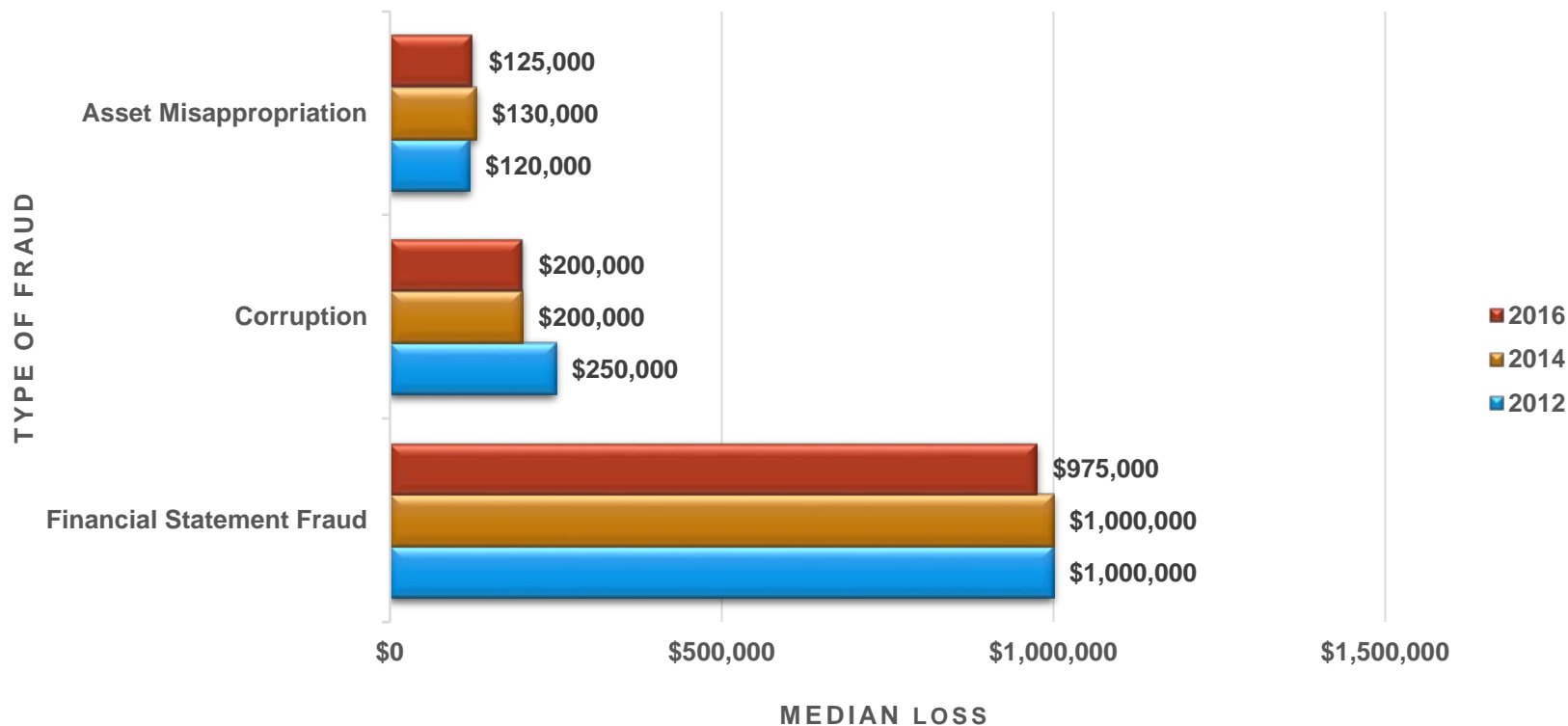
Financial Statement Fraud

- Net Worth/ Net Income Overstatements
- Net Worth/ Net Income Understatements

How Occupational Fraud Is Committed



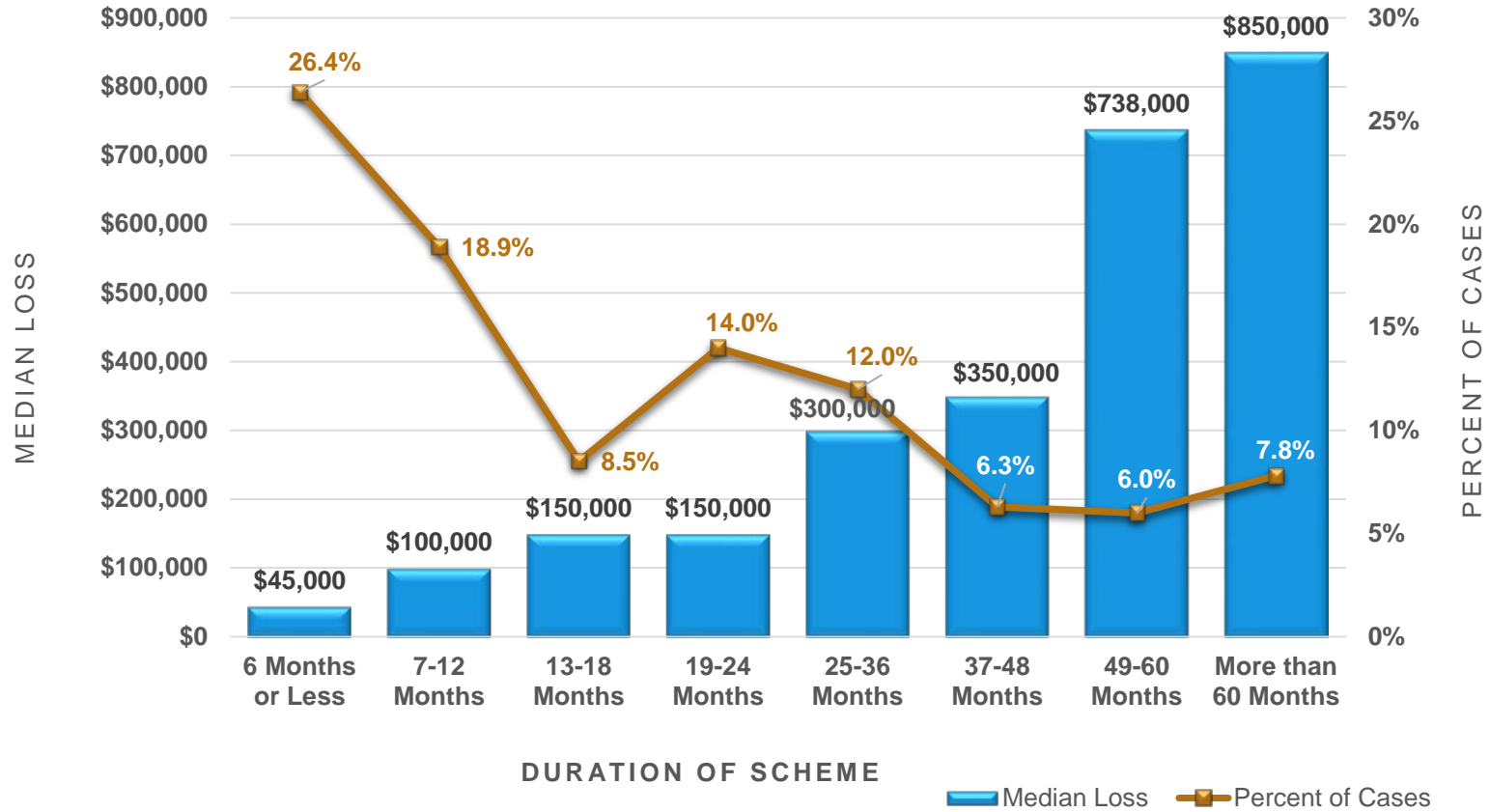
Median Loss by Type of Scheme



Types of Schemes - US

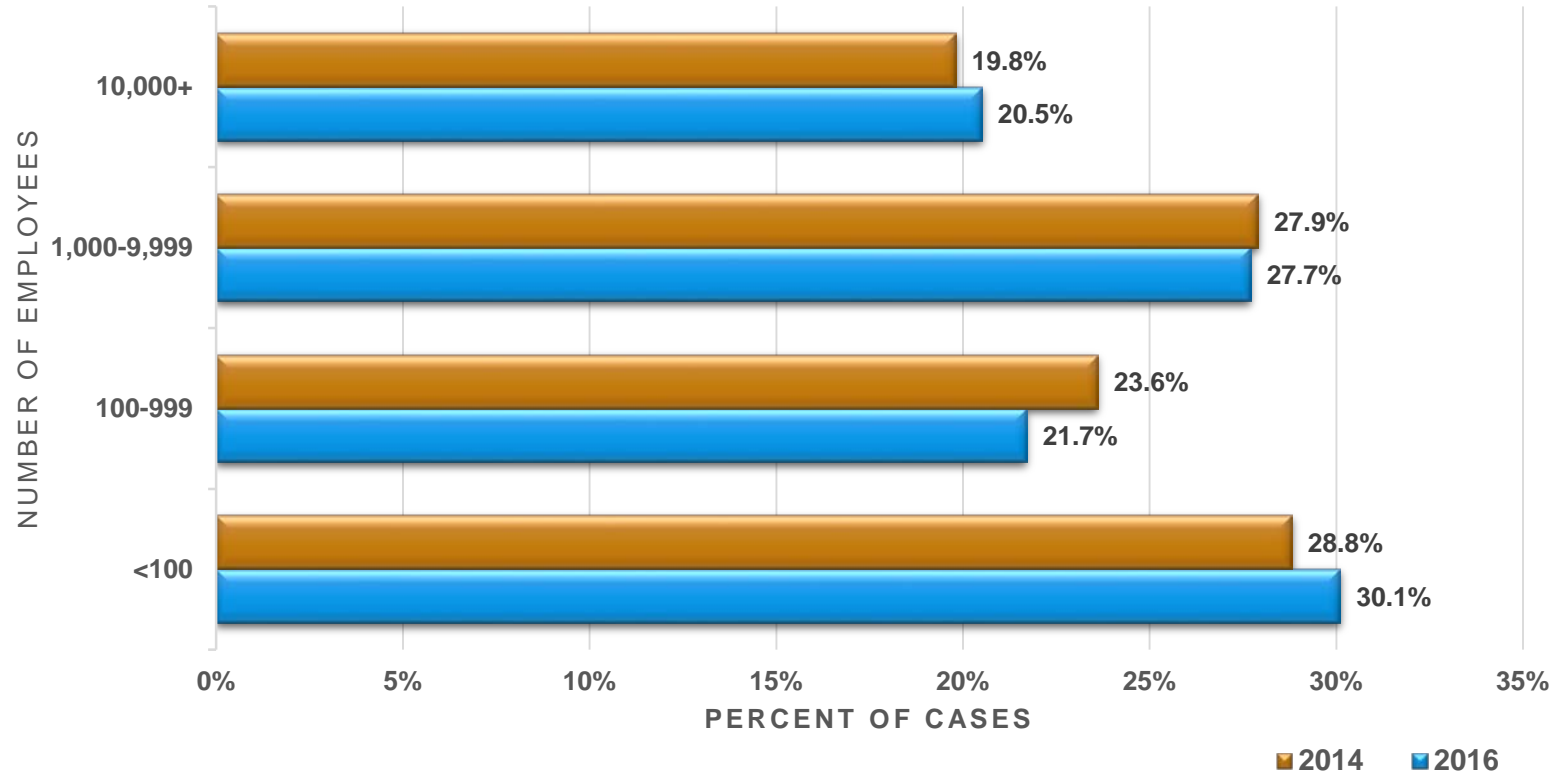
Scheme	Number of Cases	Percent of Cases
Billing	289	27.8%
Corruption	258	24.9%
Non-Cash	174	16.8%
Skimming	167	16.1%
Expense Reimbursements	164	15.8%
Check Tampering	154	14.8%
Payroll	131	12.6%
Cash on Hand	125	12.0%
Cash Larceny	102	9.8%
Financial Statement Fraud	93	9.0%
Register Disbursements	29	2.8%

Duration of Fraud – Frequency and Median Loss

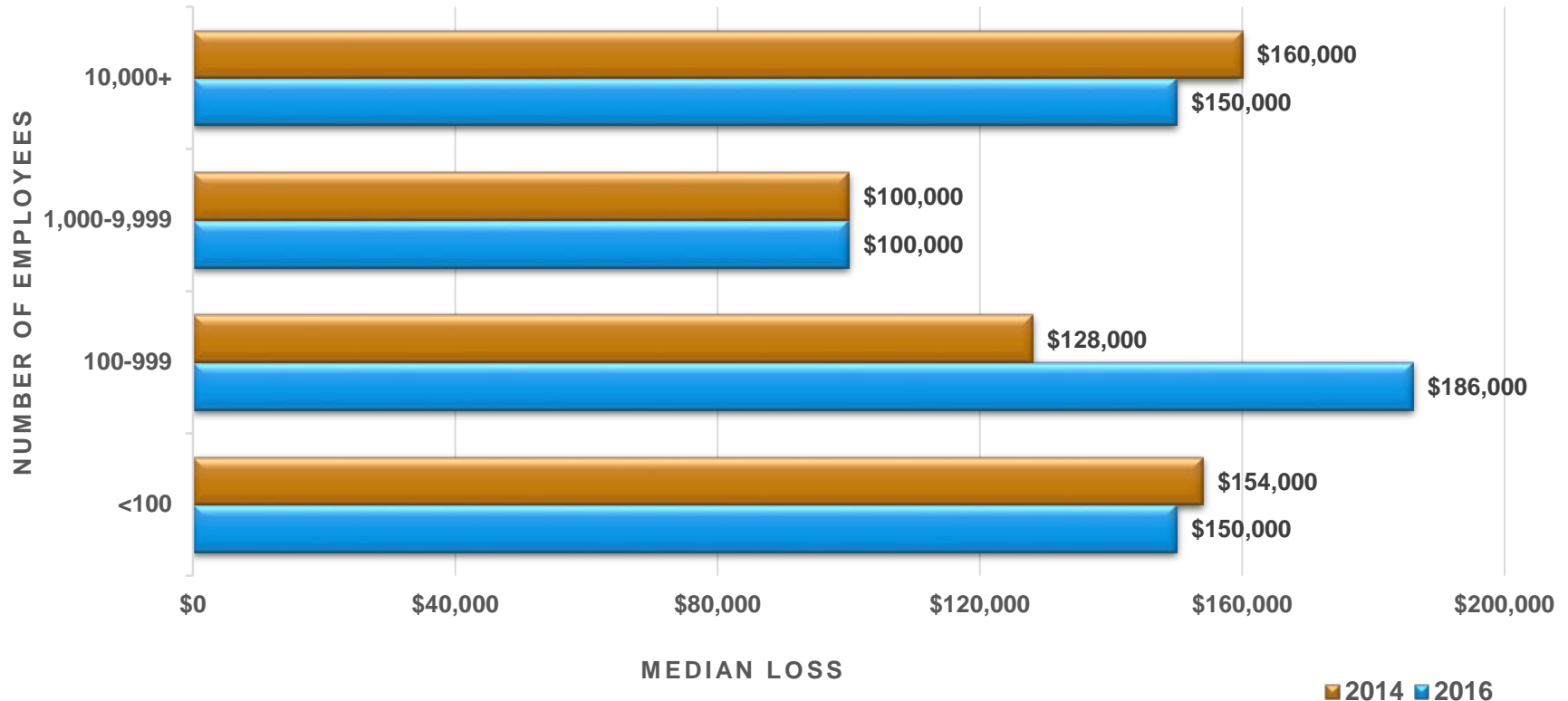


Who are the Victims?

Size of Victim Organization - Frequency



Size of Victim Organization – Median Loss

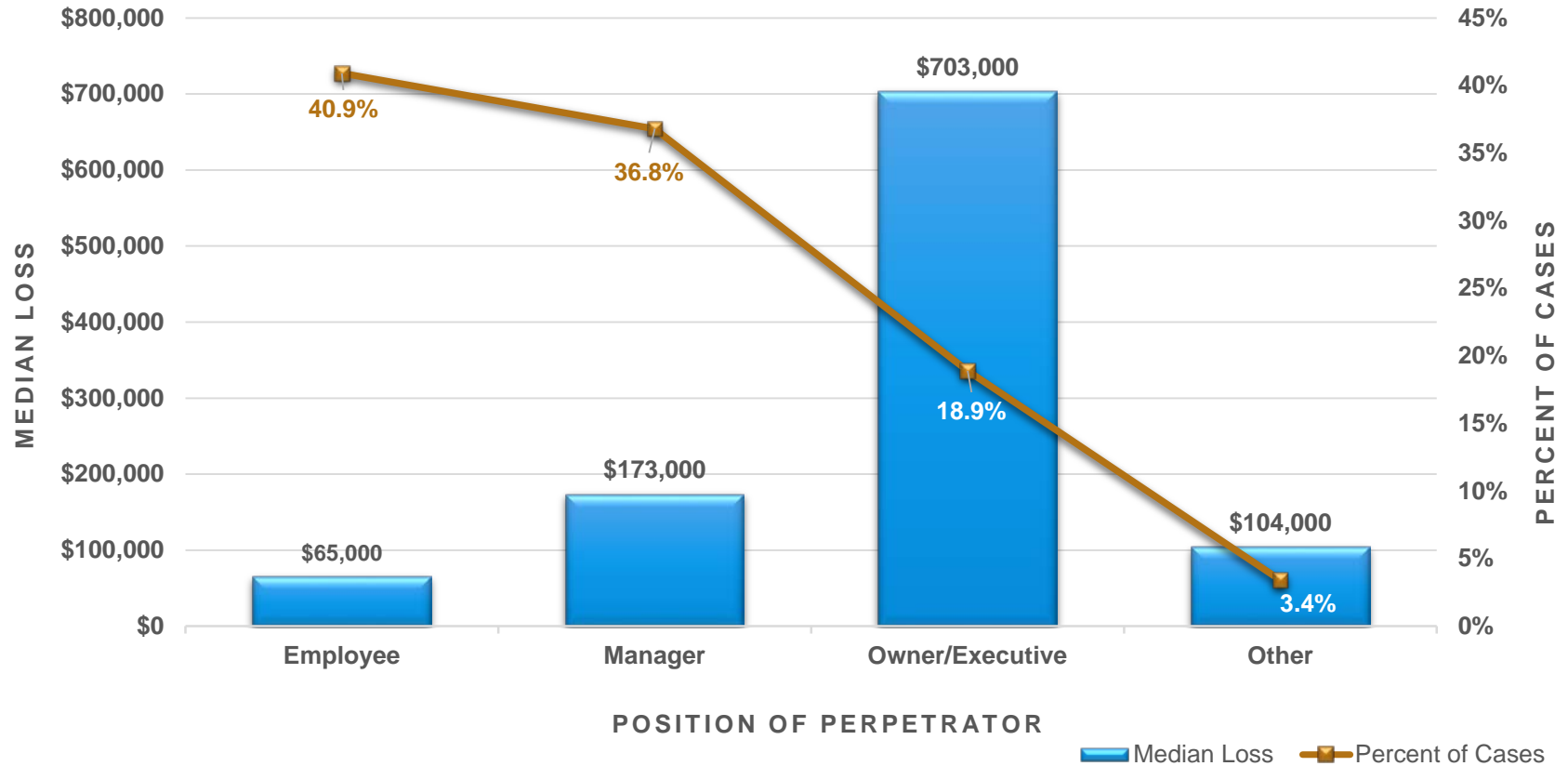


Type of Victim Organization

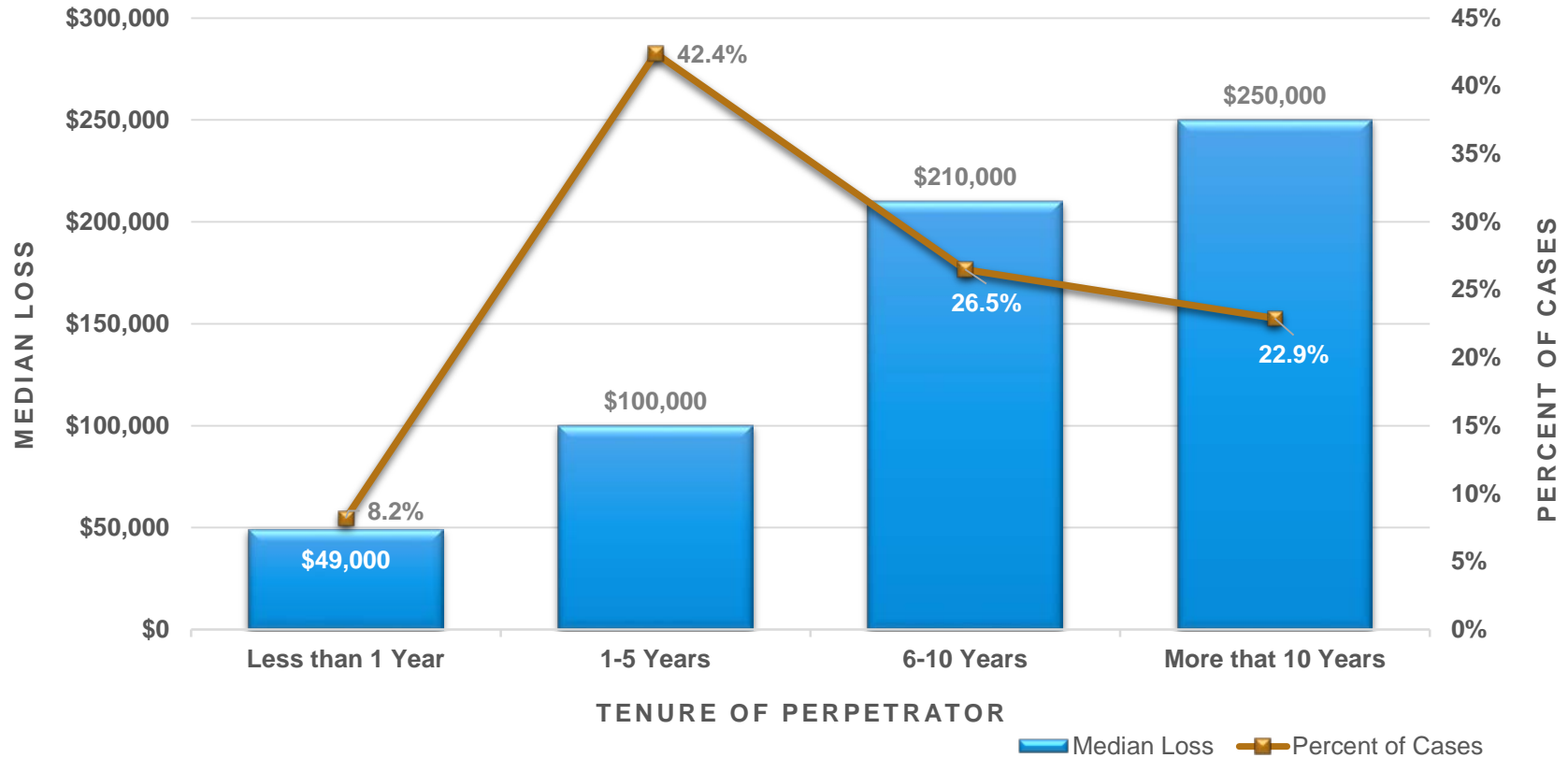


Face of the Perpetrator

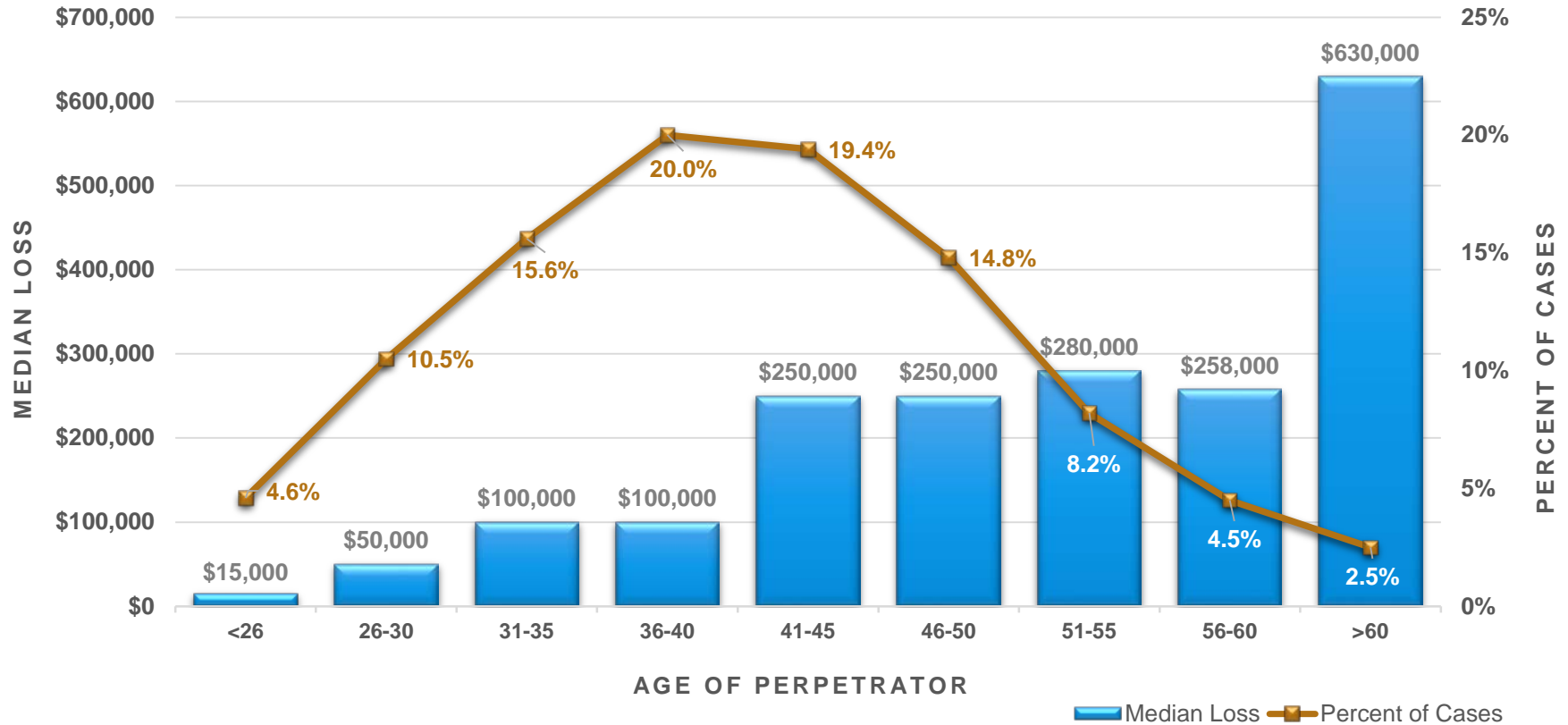
The Perpetrator – By Position



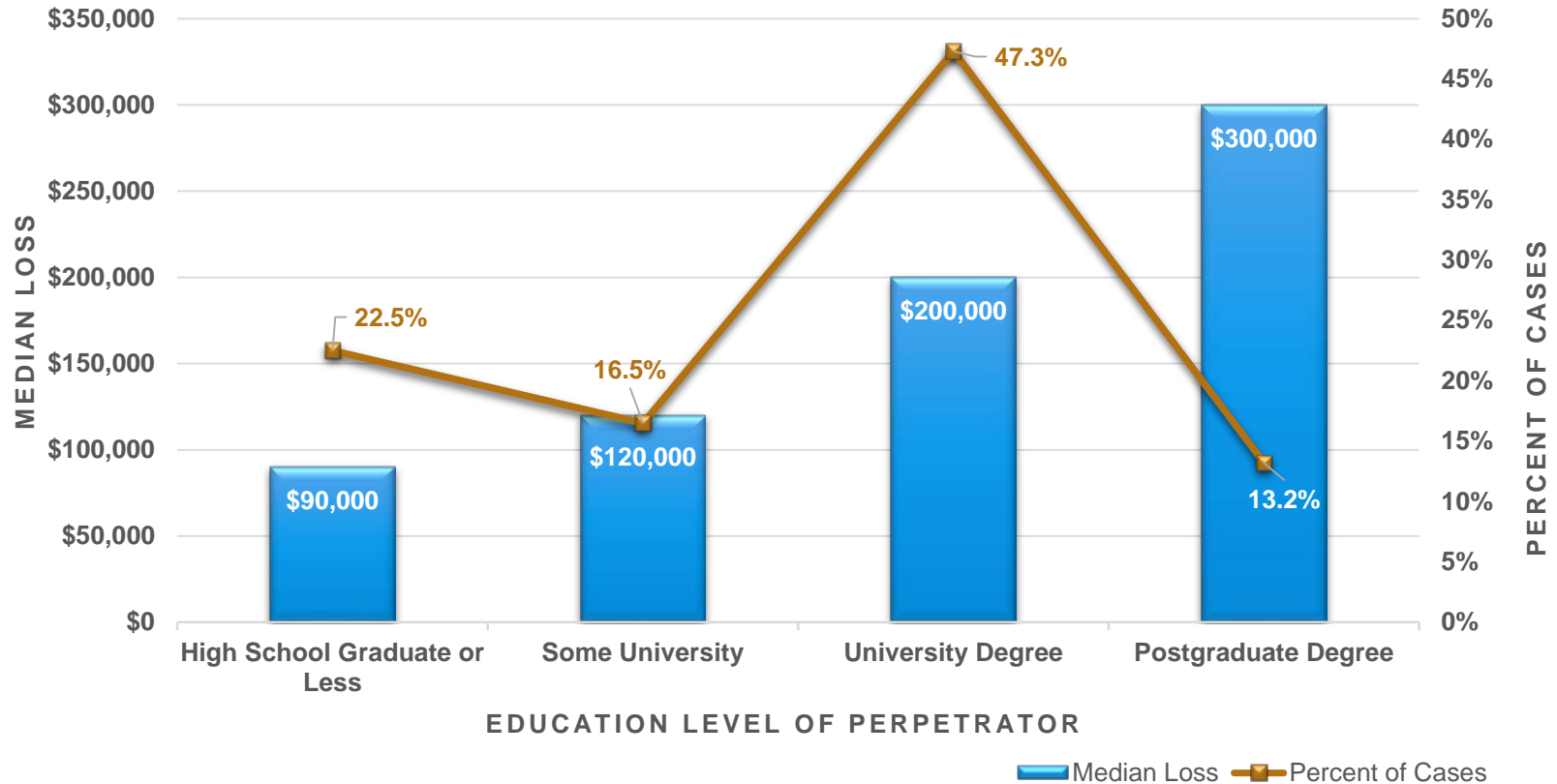
The Perpetrator – By Tenure



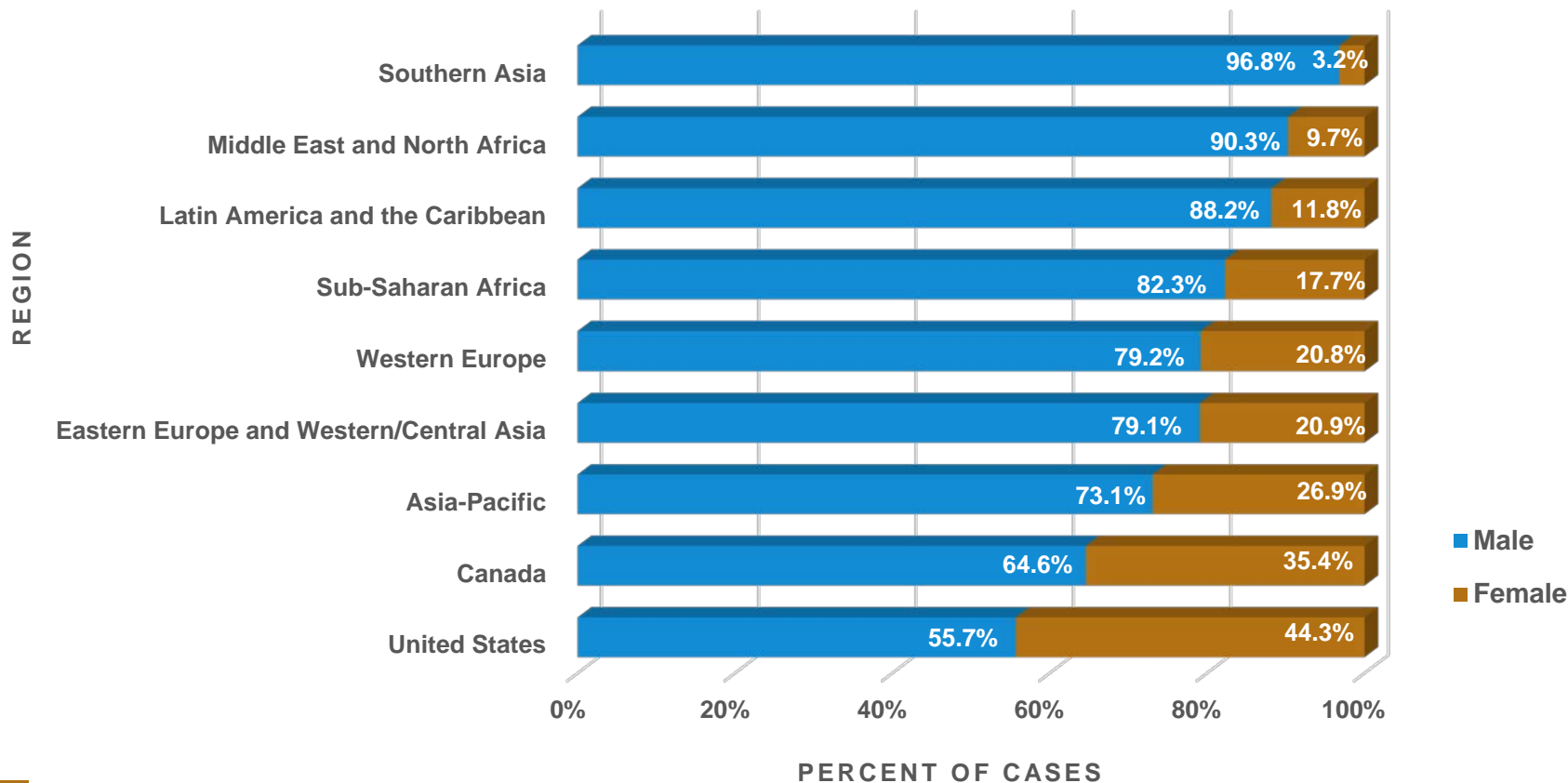
The Perpetrator – By Age



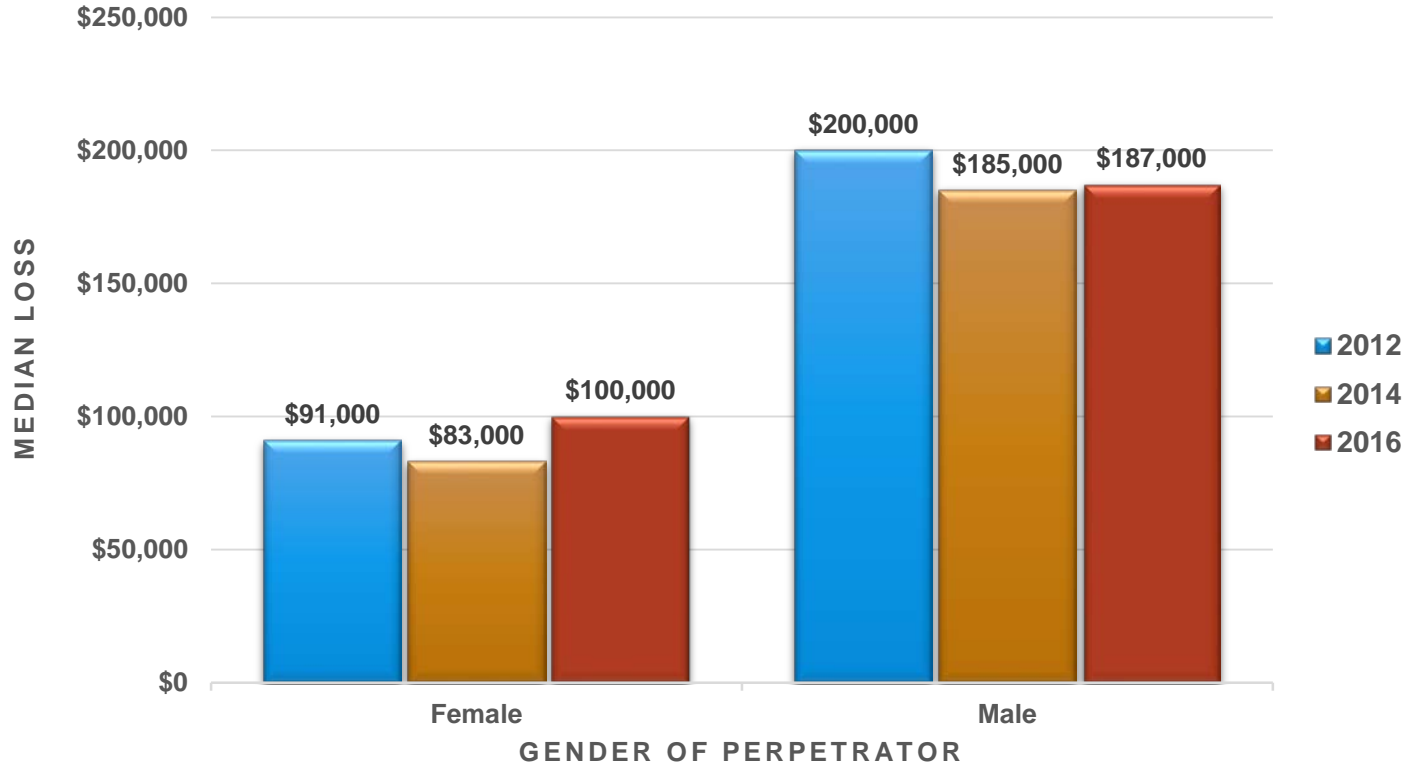
The Perpetrator – By Education



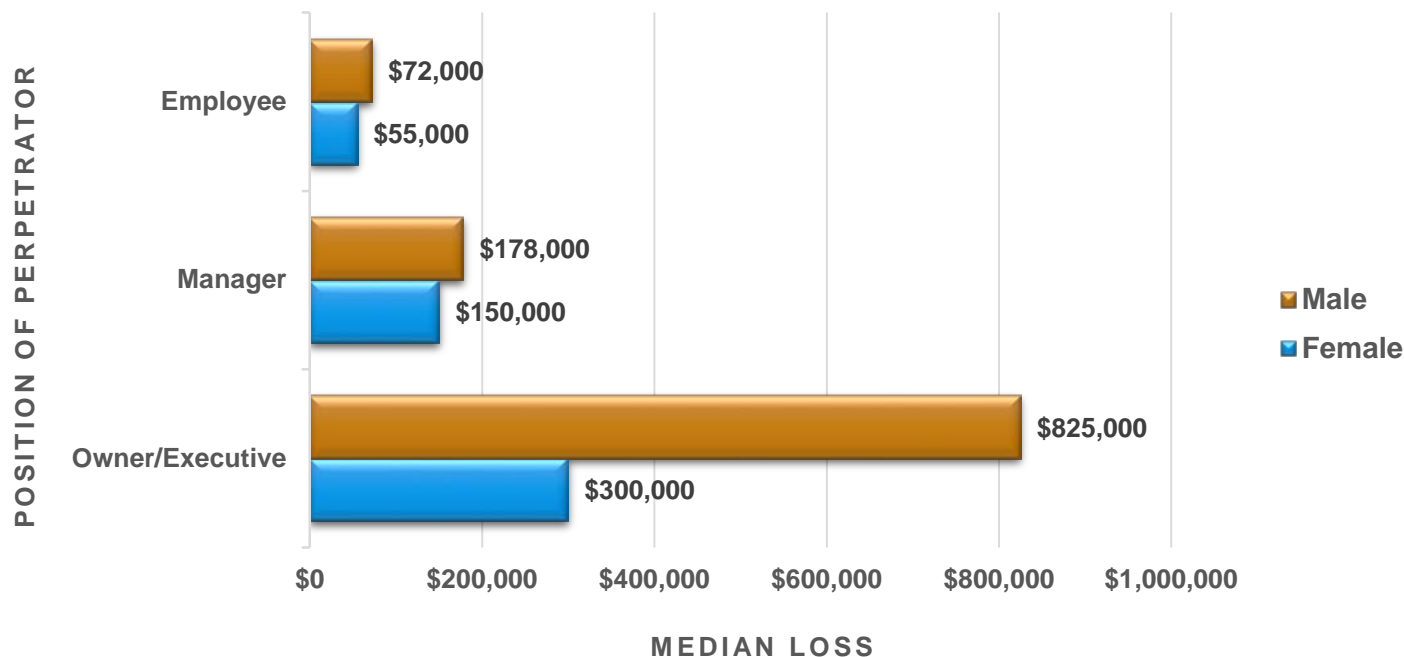
Perpetrator's Gender Based on Region



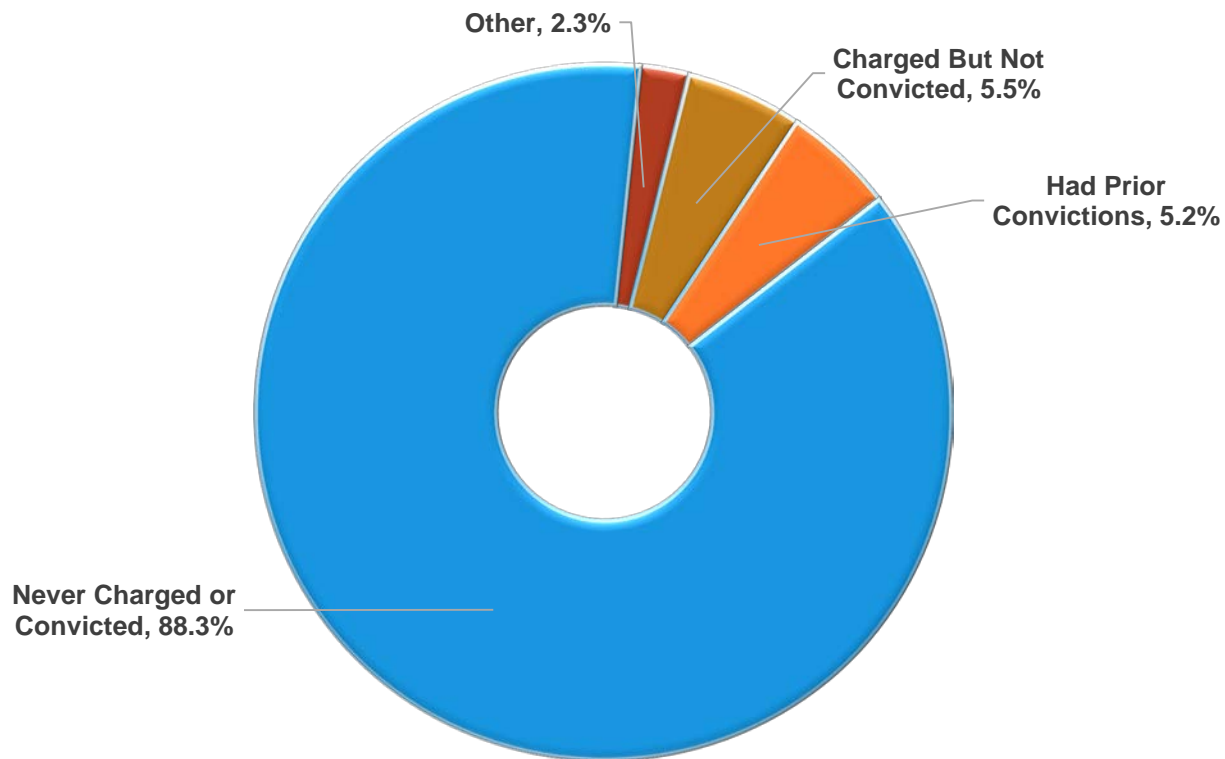
Gender of Perpetrator – Median Loss



Position of Perpetrator – Median Loss Based on Gender



Perpetrator's Criminal Background



How Fraud Schemes Are Detected

Top 3 Detection Methods:

1. Tips
2. Management Review
3. Internal Audit

Fraud

So, with that bad news, how do we increase the chances of detecting a fraud?

Red Flags of Fraud



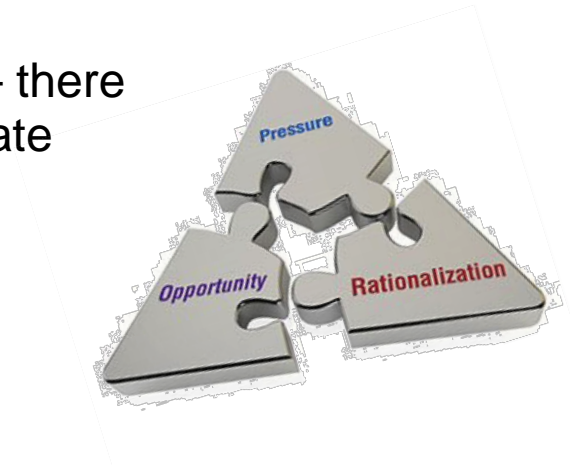
We increase our awareness of the red flags that may indicate that a fraud scheme is taking place!

Fraud Triangle



Red Flags of Fraud

- Fraud Triangle:
 - Significant academic and professional study on the issue that has allowed for the identification of key characteristics or red flags.
 - Fraud triangle is not limited to individuals – there is a linkage between individual and corporate behavior.



Behavioral Red Flags Associated with Fraud

1. Living Beyond Means
2. Financial Difficulties
3. Unusually Close Association with Vendor/Client
4. Control Issues, Unwillingness to Share Duties
5. Wheeler-Dealer Attitude
6. Divorce/Family Problems



Red Flags of Fraud – Individual

- Pressures
 - Individuals who show signs of living above their means.
 - Substance abuse.
 - Gambling issues.
 - Emotional instability.
 - Medical or family issues.



Red Flags of Fraud – Individual

- Opportunity
 - Weak to non-existent internal controls, including lack of segregation of duties.
 - Absentee ownership.
 - No/limited outside review of financial records.
 - Nature of the business
 - Heavy reliance on cash payments.
 - Portable inventory.
 - Significant number of vendors.



Red Flags of Fraud – Individual

- Rationalization
 - Tone at the top – I am only doing what ownership or other management personnel do.
 - This is my way of getting what is due to me.
 - I am only borrowing the money, once I get past this issue, I will pay it back and no one will know.



Red Flags of Fraud – Corporate

- Pressure
 - Excessive pressure is exerted on senior managers and employees to achieve unusually tough profit targets and business goals.
 - An industry that is under profit pressure.
 - Aggressive practices that push the limits of financial judgment or accounting treatment.
 - Financing needs.
 - Wall Street/Investor pressures.



Red Flags of Fraud – Corporate

- Opportunity
 - Limited to no corporate oversight of divisions or business units – hands-off management.
 - Limited to no internal control structure.
 - Limited to no external review of financial records.
 - Nature of the business:
 - Complexity of transactions.
 - Corporate structure.
 - Geographical dispersion.



Red Flags of Fraud – Corporate

- Rationalization
 - Tone at the top – I am only doing what ownership or other management personnel do.
 - This is my way of getting what is due to me.
 - I am doing what my competitors do.

Other Red Flags

- Operating results that don't mirror the industry or competitors – good or bad.
- Business that consistently has cash flow issues despite profitability.
- “Hoarding” of information and access to records.
- Answers to questions that don't make sense or which require significant time to answer.
- Complex relationships with vendors and financing sources that do not make sense or are not easily explained.

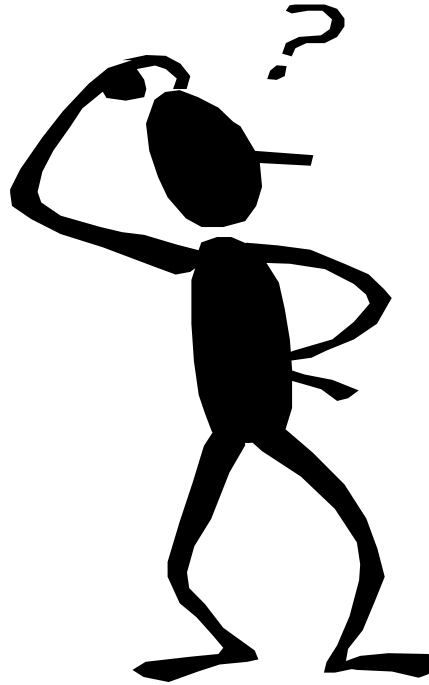
Other Red Flags

- The business may have multiple banking arrangements rather than one clear provider—a possible attempt to reduce transparency over its finances.
- Excessive secrecy about a function.
- Physical observations that don't match what is represented.

Take Aways

- Never going to eradicate fraud.
- What we can do though, is build the defenses against fraud:
 - Awareness of the red flags.
 - Build the control environment as best allowed by:
 - Financial resources.
 - Personnel resources.
- As professionals, we need to protect ourselves:
 - Professional liability claims.

Questions



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