



DANNIBLE & MCKEE, LLP

Certified Public Accountants and Consultants

Delivering **Confidence**

The background features a collage of newspaper clippings with headlines related to fraud and dishonesty. Visible headlines include "fraud and dishonesty", "Trusted employee", "Accountant", "steals millions", "years for massive fraud", "Retailer suffer heavy losses", "Pyramid scheme exposed", "Crooked staff eat into profits", and "Crime in business".

Don't Lose Control: Preventing Fraud in Your Organization During COVID-19

Presented by:

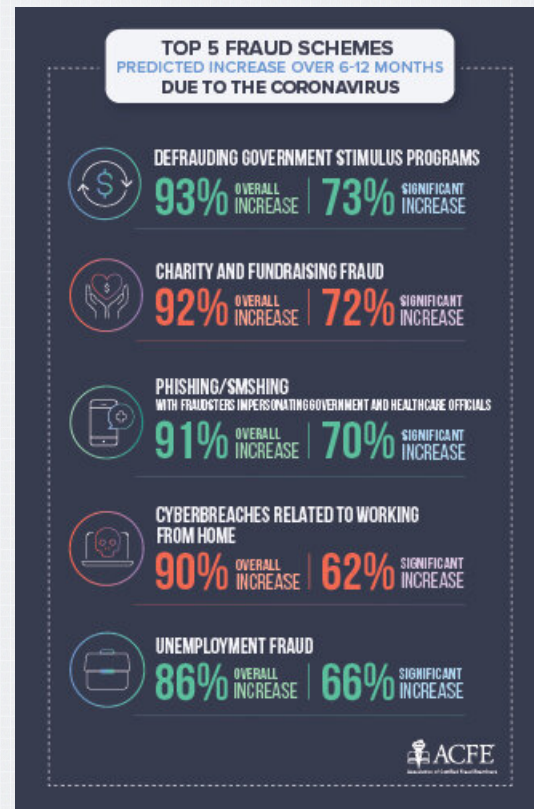
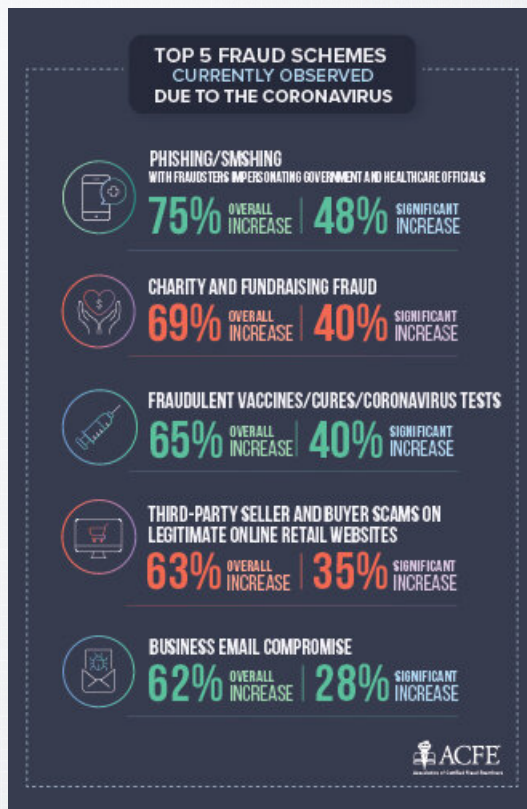
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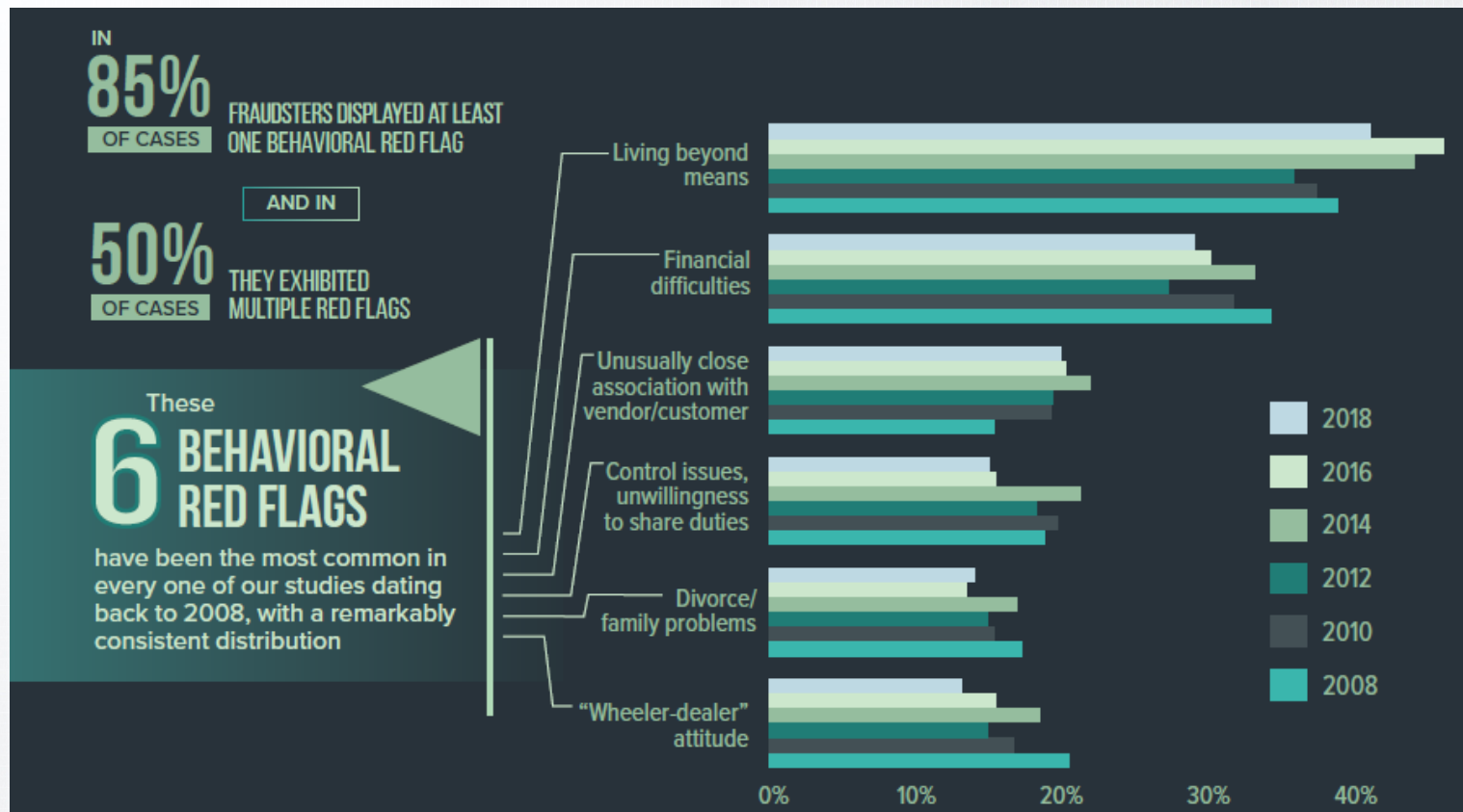
Dannible & McKee Fraud Prevention Conference

September 22, 2020

ACFE: “90% of Anti-Fraud Professionals Have Seen an Increase in Consumer Scams Due to COVID-19”



Behavioral Red Flags



Pre-COVID-19 Common Fraud Schemes



Pre-COVID-19 Fraud Triangle



Fraud Triangle in the Context of COVID-19

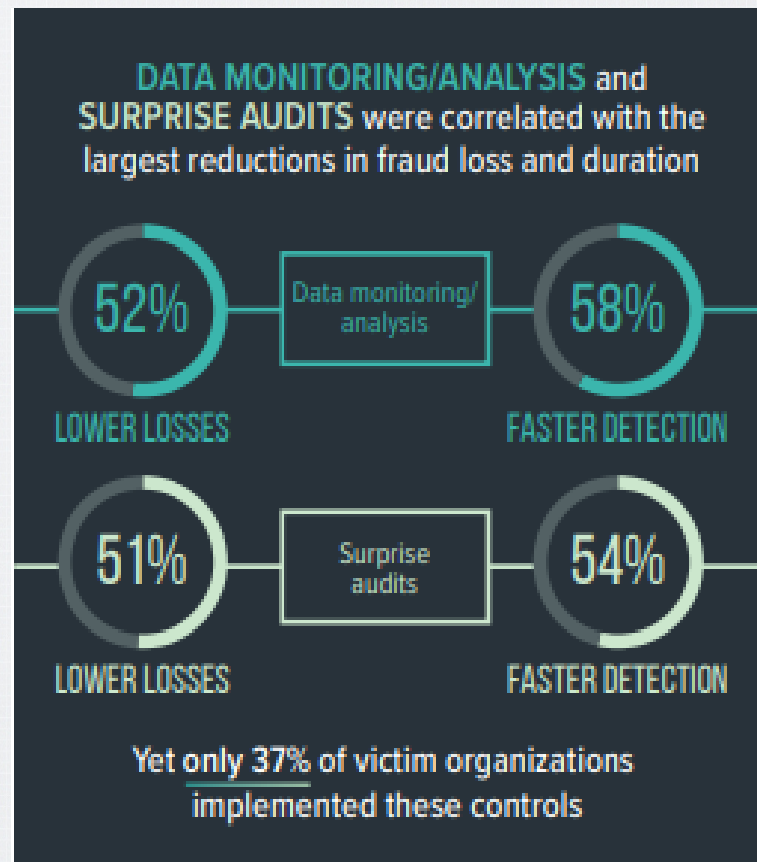




... Most Effective Internal Controls

Although you can never eliminate fraud, you can implement controls that help prevent and detect fraud when it occurs.

1. Data Monitoring/Analysis
2. Surprise Audits
3. External Audit of Internal Controls over Financial Reporting
4. Job Rotation/Mandatory Vacation
5. Management Review
6. Hot Line



... Anti-Fraud Controls In Place While Fraud Still Occurs

Control	Percent of cases	Control in place	Control not in place	Percent reduction
Code of conduct	80%	\$ 110,000	\$250,000	56%
Proactive data monitoring/analysis	37%	\$ 80,000	\$165,000	52%
Surprise audits	37%	\$ 75,000	\$152,000	51%
External audit of internal controls over financial reporting	67%	\$100,000	\$200,000	50%
Management review	66%	\$100,000	\$200,000	50%
Hotline	63%	\$100,000	\$200,000	50%

... Primary Internal Control Weaknesses that Contribute to Fraud

- Lack of Internal Controls – **30%**
- Overriding Existing Controls – **19%**
- Lack of Management Review – **18%**
- Poor Tone at the Top – **10%**
- Lack of Competent Personnel in Oversight Roles - **8%**



... Control Environment – Tone at the Top

- Demonstrates commitment to integrity and ethical value
- Board independence and exercises oversight responsibilities
- Establishes structure, authority and responsibilities
- Demonstrates commitment to competence
- Enforces Accountability



... Current Business Environment

- Extreme pressure on business operations
- Declining revenues for many organizations
- Cost-cutting measures implemented
- Downsizing, layoffs, furloughs
- Reduction of managerial oversight and control
- Increased pressure to perform
- Employee morale and organizational culture suffering from distancing
- Shifting strategy, resources and priorities
- Compromised internal controls

... Audit Environment Challenges (COVID-19)

- Working remotely
- Inability to visit locations and observe environment
- Reduction in management support and interest
- Reviewing records
- Understanding and testing internal controls
- Indirect benefits of physical interaction
 - Example: Communication

... Risk Assessment

- Specifies suitable objectives
- Identifies and analyzes risk
- Assesses fraud risk (considers potential fraud)
- Identifies and analyzes significant change

COVID-19 related:

- Identify any existing risks that are increased
- Identify any new risks



... New/Enhanced Risks (COVID-19)

- Cyber
 - Phishing
 - Intellectual property
 - Network vulnerabilities
- Physical Security
 - Asset misappropriation
 - Access controls
 - No oversight
 - Timecard fraud

... New/Enhanced Risks (COVID-19)

- Financial Statement Fraud
 - Meeting investor expectations
 - Complying with bank covenants
 - PPP loan compliance
- Organizational
 - Disengaged leadership
 - Short-term vision
 - Lack of physical interaction

... Control Activities

- Selects and develops control activities
 - Segregation of Duties
 - Physical Controls
 - Authorization of Transactions
 - Performance Review
 - Information Processing
 - Physical Control of Assets
 - Prenumbering of Documents
- Selects and develops general controls over technology
- Deploys through policies and procedures

... Information and Communication

- Uses relevant quality information
- Communicates internally
 - Internal Auditors
 - Audit Committee
 - Management
- Communicates externally
 - External Auditors
 - Consultants



Monitoring Activities

- Conducts ongoing and/or separate evaluations
- Evaluates and communicates deficiencies



... Cash Receipts Internal Controls

- Incoming mail opened by non-A/R employee.
 - i.e., not the A/R clerk
- Receipts should be documented separately
- Ideally, three copies (if company is large enough) should be sent to:
 - Cashier
 - A/R department
 - Accounting department
- A/R department should match bank deposits to remittance advices.
- Cash receipts to be restrictively endorsed when received and deposited daily.
 - Cash registers and lockboxes are good cash controls.

... COVID-19 Cash Receipts

- DO NOT have customers send checks to an employee's personal residence
- If the assigned employee, who usually opens mail is working from home, use another employee who is in the office and does not work for the A/R dept.
- If no one in the office can pick up this responsibility, consider:
 - Requiring customer payments to be electronic
 - Using a lockbox system with your bank

... Theft of Cash on Hand

- Theft of cash that has already been recorded on the company's books
 - Theft of cash from a register
 - Social distancing makes it hard to “look over someone's shoulders.”
 - Reversal of cash transactions
 - If people are working from home, employees coming into the office may get access to records they shouldn't.
 - Altering cash records
 - Look for proper approval for alterations if possible.



... Theft of Cash on Hand in the News (COVID-19)

Across the U.S.

- With the recent civil and social unrest sweeping the nation, there have been many documented incidents of looting across the country.
- Protests turning violent into riots which creates looting situations.
- Syracuse has been better than other cities, but that doesn't mean this can't change.
- Employees during the day know where the money is located; they may return at night during a riot to loot.

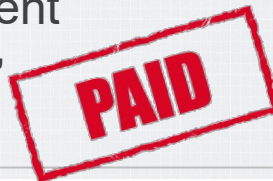
... Preventing Theft of Cash on Hand

Tips & safeguards to protect cash on hand:

- Segregation of duties
- Management approval for returns
- Cash reconciliation
- Accounts receivable reconciliation
- Daily cash deposits
- Employee screening
- One employee per register
 - Cameras over register and counting areas
- Tone at the top
 - Explicitly tell employees there's zero tolerance for stealing
- Go cashless/online ordering
 - Cash has a lot of germs, so it achieves two goals
- Insurance
- Don't leave excess cash in your business overnight.
- Limit employees that have access to financial records or passwords to those tasked with financial responsibilities.

... Cash Disbursement's Internal Controls

- Invoices that are paid by check:
 - Able to match canceled check
 - Look for proper approval and signatures (should be separate people)
- When invoice is received, accounting department. should match invoice to:
 - Purchase order
 - Receiving report
- Accounting department has the approved voucher packet and sends to treasurer who:
 - Prepares, signs, mails the check, and cancels all supporting docs. after payment
 - Marked as "Paid"



... COVID-19 Cash Disbursements

- DO NOT send checks to vendor's personal addresses
 - Alternative: use ACH or wire transfer
 - If vendor makes you send to alternative address; get request in writing from appropriate employee in the organization and follow up with a phone call.
- If switching to credit card from check disbursements:
 - Enforce organization's approval and spending policies
 - Get individual receipts from card administrator daily
 - Timely review card payments against invoices, receipts and approvals
- In general, you may want to consider moving to a more electronic system
 - Still maintain similar controls, just do it electronically

... Supply Scams

- Businesses are limited with supplies
 - Fraudsters have been able to mimic the look of well-known online retailers
 - Claim to have supplies you need; really fakes to grab credit card number
 - COVID supplies have been hot items to use (i.e., gloves, masks, cleaning supplies)



... Preventing Supply Scams



Tips & safeguards to prevent supply scams:

- Type out the URLs you know to be genuine
- Check them with trusted industry colleagues
- Do your own research; it takes a few seconds to Google something

... CEO Scam/ACH Transactions

- An employee gets a message that appears to come from a company higher-up directing the person to wire money, transfer funds, send gift card codes, etc.
 - It's just a spoofed boss email address or phone number
 - Know the signs: these methods of transferring money used because it is harder to trace
- COVID-19 has led to a significant increase in unusual financial transactions
 - Expedited orders, cancelled deals, refunds, etc.
 - Emergency requests that would have been questioned before COVID, now might not w/ COVID
 - Employees working from home can't walk over to whoever and investigate a questionable request.
- I.T. scam similar except it's an "I.T. employee" asking for a password

... CEO Scam in the News

Worldwide (\$2.3 billion)

- FBI tracked since October 2013
- Hacker will send someone within the organization a believable email requesting funds to be transferred.
 - They spoof the email address, so it genuinely looks like it came from a CEO, CFO or top executive.
 - They imitate specific language the employees use and incorporate that into their fake emails.
- Earlier this year, Mattel lost about \$3 million to this scam
 - Fake CEO email to CFO to pay one of their Chinese vendors

Local Business That Have Been Hacked

- Local Business:
 - Hackers were able to take over the email server of the Company
 - Email was sent from a “real” email address that the hackers were monitoring.
 - Email sent from the CFO to the AP Manager to ACH \$250,000 immediately for the owner’s personal insurance.
 - Wire was sent without any other verification.
 - The local bank sent the ACH to a bank in Washington that was to transfer it to another bank overseas.
 - Luckily for this Company the bank in Washington had flagged the wire and called to verify it.

Local Equipment Supplier

- Company's vendors email was hacked. This is happening so frequently it is now called "Vendor Email Compromise."
- Phony invoice was sent to Company's Accounts Payable from the "usual" email from its vendor.
- Invoice had new ACH instructions on it. The Company paid by ACH as instructed on the invoice for \$135,000, by ACH Wire.
- The Company had NO internal controls over approval of invoices.
- The Company had No other employee to approve ACH Wire Transactions.
- The Company also had No insurance to protect them from this, and the Company therefore lost \$135,000.

... Preventing CEO Scams



Tips & safeguards to prevent robocall scams:

- Warn employees about these scams and give them a contact where they can verify requests they received.
 - Never rush out a payment that seems suspicious
- Have multi-personnel approval process
- Email is not a secure way to send financial information.

... Expense Reimbursement Fraud

- Claiming reimbursement for fictitious or inflated expenses
 - Forged receipts
 - Double reporting expenses
 - Overstated expenses
 - Mischaracterized expense reimbursements
 - working from home home office expenses
 - Desks, laptops, monitors Internet
 - COVID expenses
 - Masks, gloves, cleaning supplies



... Preventing Expense Reimbursement Fraud

Tips & safeguards to prevent and detect expense reimbursement fraud:

- Expense reimbursement policy
- Tone at the top
- Require receipts
- Examine receipts to ensure authenticity
- Review process for employee expense reports
- Update expense policy for COVID
- Require supervisor review and approval
- Issue company credit cards as to not have employees use personal ones:
 - Easier to check records
 - Earn points
- Surprise audits
- Monitor spending over time

... Check and Payment Tampering

- Employee steals, alters or forges a check that is payable from the employer's business account
 - Altered Checks
 - Altered ACH
 - Forged Checks
 - Concealed Checks
 - Authorized Maker



... Preventing Check and Payment Tampering

Tips & safeguards to protect against tampering fraud:



- Maintain checks under lock and key
- Review of online checks clearing
- Review and reconciliation of accounts
- Limit access
- Investigate out-of-sequence checks
- Separation of duties
- Switch to an electronic payment method if possible, especially if your employees are working from home

Payroll Fraud

- Theft of cash from a business via the payroll system
 - False expense reports
 - Ghost employees
 - Advances not paid back
 - Unauthorized modification of records
 - Overriding or inadequate controls
 - Employees overstating hours and saying they worked the required amount when they didn't while working from home



... Payroll Fraud in the News

Staff coordinator (\$31,000)

- Theft occurred between April 2012 and October 2014
- Employee for ten years – described as “charismatic” and “outgoing”
- Submitted fraudulent timecards
- One of two employees responsible for matching time sheets to hours worked, including her own
- Perpetrator would double-check the figures and would slip in claims for extra shifts and inflated hours.
 - Falsified a total of 2,611.5 hours
- Upper management noticed money was missing

How could this have been prevented?

... Preventing Payroll Fraud



Tips & safeguards to prevent payroll fraud:

- Electronic timesheets
- Supervisor approval
- Separation of duties
- Review and analyze
- Reconciliation
- Owner review of payroll reports
- Outsource payroll function

... Paycheck Protection Program (PPP) Fraud

- Forging or falsifying loan application documents
 - Bank records, tax records, insurance, payroll, audited financial statements
 - Lender review of documents was very limited originally.
 - PPP fraud will be caught when companies apply for loan forgiveness since loans have already been distributed.
- Unclear guidance from the government
 - The GAO admits continuously updating guidelines created confusion
 - SBA did not release loan application until May 15, 2020, but waited to release regulations on loan forgiveness until May 22, 2020.
 - Four million loans were approved within that first week.

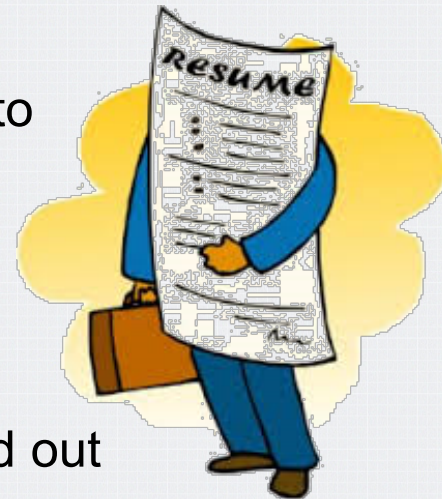
... Preventing PPP Fraud

Tips & safeguards to protect against PPP fraud:

- Know how to properly maintain your PPP loan
 - Summarize the economic distress or uncertainty that existed or was reasonably foreseeable at the time of your PPP loan submission
 - Document other forms of liquidity that you still have/had access to
 - Use PPP loan only for approved expenses
 - Document and save all records and receipts
 - Stay informed on current and upcoming loan forgiveness requirements
- U.S. government to perform full audits on companies receiving over \$2 million in PPP loans
- Ask your financial professional if you need more guidance

... Employee Screening Fraud

- COVID has/had closed several of the links in the background check for employers
 - Courts, public record repositories, drug testing labs
 - Previous employment and education verification is now harder to access with employees working from home and closures.
- Easy to forge academic records and may be hard to verify
 - Have employees submit transcripts directly from the college/university
- Millions are unemployed in U.S. currently
 - They all want to beef up their resumes to stand out (either truthfully or not)



... Employee Screening Fraud in the News

Upstate Medical University Hospital Boss (\$400,000)

- Fifteen months in 2017 to 2018
- Since it's a state taxpayer-funded hospital, two felonies were committed
 - Defrauding the government and lying on an official record
 - If this was just a regular private company, he would have been fired and nothing would have come of it.
- Had both real and falsified achievements and credentials on resume
 - Fabricated bachelor's and law degree
 - False former work titles
 - He even lied about surviving a 2013 bombing in Afghanistan.
- Investigation still on-going



... Preventing Employee Screening Fraud

Tips & safeguards to protect against employee screening fraud:

- Not all courts are closed, and many have reopened over the past couple months.
 - Public record searches are different from county to county.
 - Online resources may be available, but some info needs to be verified by the courts
 - Online information is only accurate if it's up to date, which can't happen if they are closed
 - National online databases are insufficient.
- Get official transcripts sent directly from the college/university
- Directly contact former employers
 - May take time to respond back depending on their current situation

... Preventing Employee Screening Fraud

Tips & safeguards to protect against employee screening fraud:

- Either delay screenings or stop screening until info becomes available
 - The background screening might just take longer if you want to verify all the information.
 - If you chose to forgo the background check and hire immediately, consider:
 - Flagging anything you find and follow up on it when resources become available
 - Changing the wording in the offer letter to have contingency for employment based on background check even after start date.
 - Deferring drug tests or potentially doing oral-fluid testing online via video chat w/ a trained observer.

... Boosting Numbers Due to COVID-19

- Improper timing of revenue recognition
- Fictitious revenue
- Channel stuffing
 - Selling excess inventory to suppliers
- Third-party transactions
 - Bill and holds, goods on consignment
- Fraudulent estimates
- Improper capitalization or deferral of expenses
- Misleading forecasts or projections



... Journal-Entry Internal Controls

- Standard JEs (usually covered by entity's internal controls)
 - Recurring basis to record transactions such as monthly sales, purchases and cash disbursements
 - Or to record recurring periodic accounting estimates
- Nonstandard entries (not always covered by same level of internal controls)
 - Nonrecurring transactions like business combinations
 - Or entries used to record a nonrecurring estimate, such as an asset impairment
- Other adjustments (Not formal JEs and might have no internal controls)
 - Consolidating adjustments
 - Report combinations
 - Reclassifications
- Thus, auditors consider placing additional emphasis on identifying and testing items processed outside of the normal course of business.

... Financial Statement Internal Controls

- Keep accurate and complete financial records with detail and supporting evidence
- Show proper management authorization
- Access to assets is restricted
 - Unannounced asset checks to compare book amount to actual

... COVID-19 JE & F/S Internal Controls

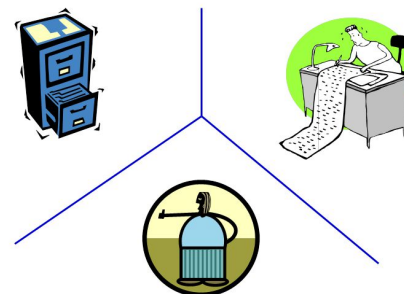
- Management should continue to review JEs and check reconciliations to ensure they are up to date and timely reviewed
- Estimates should be reviewed to ensure it is still reasonable with the COVID situation
 - Ex: Bad debt expense may increase due to customer having trouble paying
- Financial disclosures need to reflect any COVID material effects on F/S
- Document any changes to internal controls

Internal Controls

Ways to combat the lack of segregation within a Small Business' Accounting Function:

- Written Code of Ethics
- Educating and Training employees to prevent fraud
- Segregation of duties
- Maintaining reasonable expectations
- Performing regular bank reconciliations
- Set a good example from the top, finance committee
- Hire an outside financial professional to examine the books
- Institute a fraud hotline

Segregation of Duties



... What to do if you suspect fraud has occurred?

- Call your accountant, attorney or certified fraud examiner to assist you in this process
- Obtain as much information as possible before anyone is questioned
- Alert proper authorities of the findings and/or allegations
- Document all observations and actions
- Maintain confidentiality



Questions





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