

Fraud & Importance of Internal Controls

Rehmann

EMPOWER YOUR PURPOSE®

Questions:

- How many of you have committed fraud?

**IN FACT ... don't answer that question!*

- Actually...how many of you/or your school/or your districts have been a victim of fraud?
 - > or you think you have been...
 - > or you don't have any idea...
 - > or you have concerns right now...



What is fraud?

- A simple definition is an act of intentional deception designed to exploit a victim. (Investopedia)
- I prefer to:
Keep it SUPER SIMPLE!
- Fraud exists as a result of a or many lie(s)...purposeful lies....
...the purpose of those lies is generally for personal gain by the liar(s)



Meet the Speaker



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Forensic Accounting

"Forensic Accounting"

> A term used to refer to the specialty practice area of accounting which includes fraud investigation and conducting financial analysis as part of litigation support

- It combines accounting, auditing, and investigative skills and may include serving as an expert witness
- A subspeciality of forensic accounting is "Fraud auditing"
- "Art" not a "science"...a MINDSET...an
.....Investigative Mindset.....

Association of Certified Fraud Examiners (ACFE)

- International professional anti-fraud organization of fraud examiners
- Mission to reduce the incidence of fraud and white-collar crime and to assist the membership in fraud detection and deterrence
- Certified Fraud Examiners Designation earned for combination of experience and passing examinations



Fraud Won't Happen to Us Insights

About **75%** of U.S. organizations are affected by employee theft, with three out of every four employees admitting to stealing from their employer at least once

Source: Zippia



Small and Midsize Organizations-those with 150 or fewer employees-**80%** of embezzlements impact these organizations, nearly 1/3 with losses exceeding **\$500,000**

Source: Hiscox



12 Months – Typical length fraud is perpetrated before detection

Source: ACFE Occupational Fraud 2022)



It is estimated that organizations worldwide lose **5%** of their annual revenues to fraud

Source: Report to the Nations on Occupational Fraud and Abuse

So...is there a Keep It Super Simple method of combating fraud...

Internal controls are the first line of defense in combating fraud..

But I hire trusted employees...what about trust?

"Trusting your employee is not an internal control"

– Frank Suponic, Partner in the Advisory Services group at Marcum Accountants and Advisors

Internal Controls

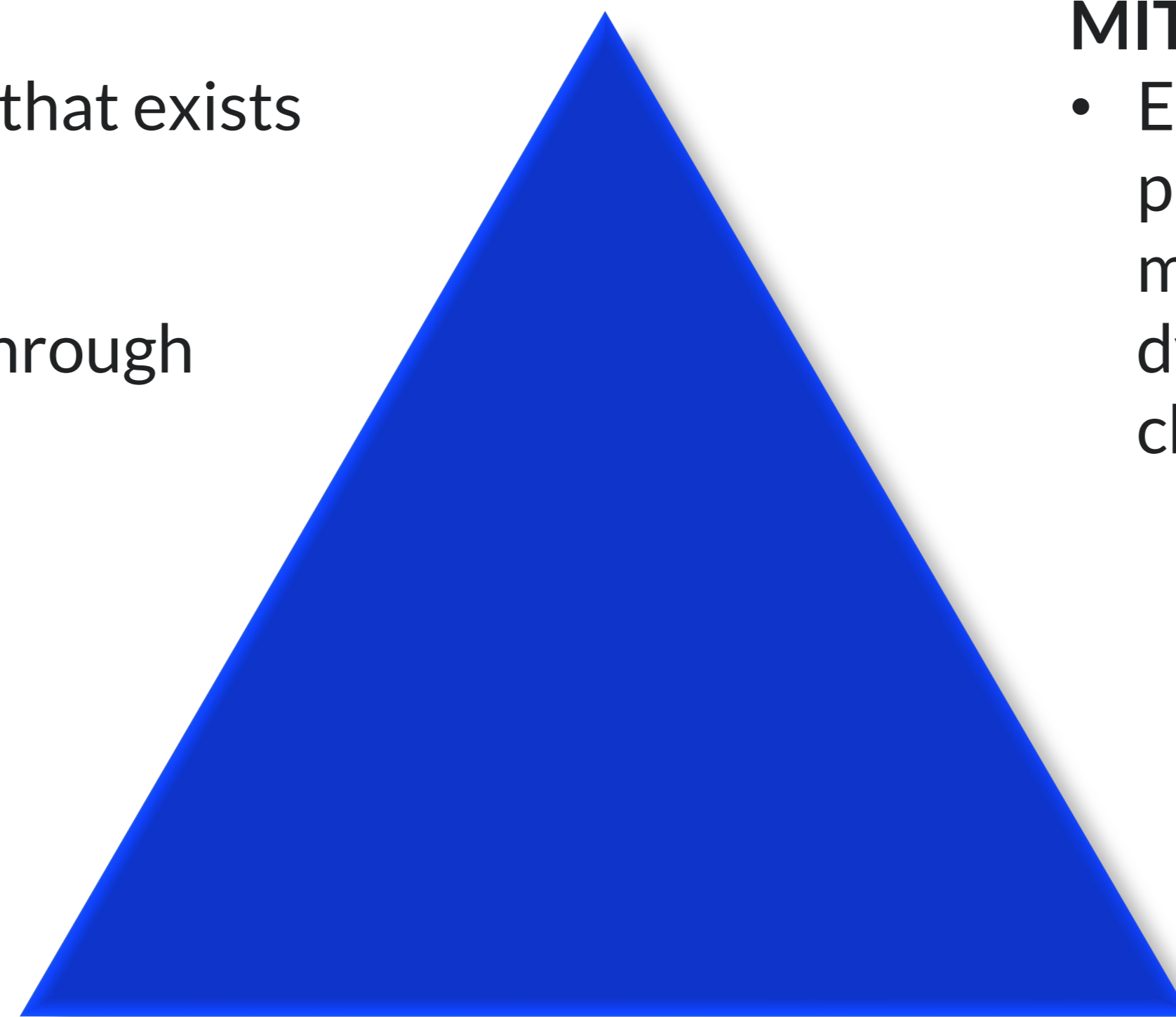
- Properly planned...designed...implemented and monitored internal controls are absolutely critical and necessary for any organization
- Internal controls should mitigate or eliminate the OPPORTUNITY for the occurrence of MOST fraud
- Dynamic perspective of internal controls – constantly assessing and evolving I/C

Now who has heard the word/descriptor OPPORTUNITY in the context of fraud...

Fraud Triangle*

OPPORTUNITY:

- Foundational understanding that exists for prevention....
- Eliminate the opportunity through effective internal controls



Opportunity

MITIGATION:

- Ensure internal controls are well planned, effectively implemented and more importantly monitored and dynamically adapted to an ever-changing organization environment

*Developed by Donald Cressey

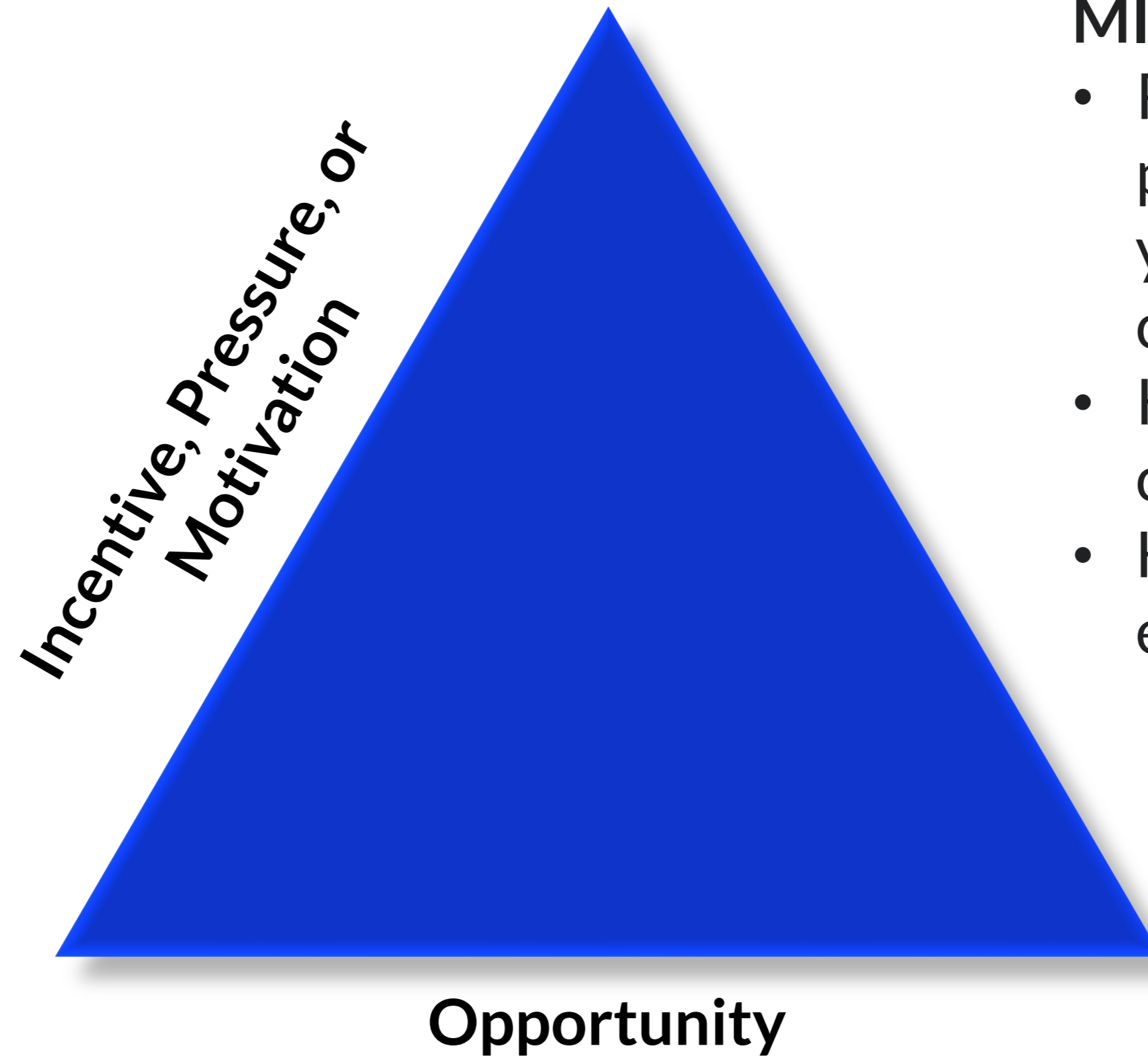
The Opportunity to Commit Fraud Typically Results From Weak or Ineffective Internal Controls...such as:

- 1 Lack of segregation of duties
- 2 Lack of physical safeguards
- 3 Proper authorization process ignored or not established
- 4 The ability to override controls
- 5 Inadequate accounting system

Fraud Triangle

INCENTIVE, PRESSURE, or MOTIVATION:

- Need and greed
- Pressures
 - Performance pressures
 - Vices
 - Secret habits/life
 - Living beyond one's means



MITIGATION:

- Realistic/moderate performance pressures re: performance...what are you incentivizing...performance at all cost?
- Know your employees.. invest where it counts...personally
- Health and well-being programs for employees...EAP etc.

Incentives, Pressures or Motivations

Vices

Unexpected
Financial Needs

Living Beyond
One's Means

Secret
Life

Personal
Debt

Financial
Losses

Fraud Triangle

RATIONALIZATION:

- Fabrication of a "moral" excuse to justify the fraud committed
- Develop reasons as to why it is ok for the person to commit the fraud and why doing so won't be an issue
 - I deserve/victim
 - District won't miss the \$



MITIGATION:

- Ensure a "buy-in" culture within your org
 - Open door policies...not just words
 - Listen
 - Invest
- Employees invest when they:
- Feel impactful
 - Are "seen"
 - Receive comm/feedback

Rationalization to Commit Fraud:

- 1 Feeling exploited by employer
- 2 Believes the company has victimized them
- 3 Believes if they do not commit the fraud, they may lose their job (performance pressure)
- 4 The organization will never miss the money/asset(s)
- 5 Will do whatever the organization needs to succeed (greater good for everyone's sake)

That's great and all, but...

So...you now know key "buckets" or topics that fundamentally enable and promote fraud activities:

- Opportunity
- Incentive, Pressure or Motivation
- Rationalization

...but what should I be aware of and on the look-out for when it comes to fraudulent accounting transactions and technical topics...

Well...since you asked...



Know Your Organization!

Accounting Irregularities:

- Excessive or unusual voids or credits
- Document or check sequence irregularities
- Unbalanced ledgers or illogical journal entries
- Excessive or unusual journal entries at or near period end
- Journal entries lacking supporting documentation
- Unexplained adjustments to \$ on hand, A/P, or expenses
- Expense reimbursement requests without supporting documentation or receipts



Know Your Organization!

Analytical Irregularities:

- Skewed payroll compared to staff
- Unexpected supply or inventory expenses
- Unusual capital account fluctuations
- Outliers to years past w/o justification

If balances or fluctuations seem strange, they probably are...employ basic comparative analytics to assess.

Conclusion: Prevention and Awareness

- 1 Within your power...fraud fortification
- 2 Within your power...personnel fortification
- 3 Communication and training...it is on leadership's radar...
- 4 Be aware and vigilant...





Q & A



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Thank you for joining this session!

Our team of public sector experts is here to support you as you navigate the unique challenges that impact this industry.

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Stop by our booth (414/416) to connect with our team and get a craft coffee from our espresso bar!