



GELMAN, ROSENBERG & FREEDMAN
CERTIFIED PUBLIC ACCOUNTANTS

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**How to Protect
Your Organization
from Fraud**

May 12, 2011



Agenda

- ACFE 2010 Report
- Key Reasons for Fraud
- Fraud in Nonprofits
- Controlling Fraud
- Anti-Fraud
- When Fraud Is Discovered





Who is this high school graduate?





Answer: “Bernie” Madoff was sentenced to 150 years in prison on June 29, 2009

Chais Family Foundation

Elie Wiesel's Foundation For Humanity

Fair Food Foundation

JEHT Foundation

Jewish Federation of Greater Washington

Ramaz School

Lappin Foundation

Wunderkinder Foundation



Fraud

Intentional deceit and concealment often through:

- Falsified documentation
- Forgery
- Collusion among any combination of management, employees or third parties



2010 Report to the Nations

- Impact of Occupational Fraud
- Fraud Detection
- Perpetrators of Fraud
- Other Interesting Facts



Statistics from this report have been used throughout the presentation. Scan here with your smart phone to visit www.acfe.com and download the full report.



Impact of Occupational Fraud

- Organizations lose 5% of its annual revenue to fraud
 - Translates to a potential GLOBAL fraud loss of more than \$2.9 trillion
- The median loss caused by occupational fraud cases was \$160,000



Impact of Occupational Fraud

- One-quarter of frauds involved losses of at least \$1 million
- Small organizations are disproportionately victimized by occupational fraud



Fraud Detection

- The frauds lasted an average of 18 months before being detected
- Anti-fraud controls help reduce the cost and duration of occupational fraud schemes
- Occupational frauds are much more likely to be detected by tip than by any other means



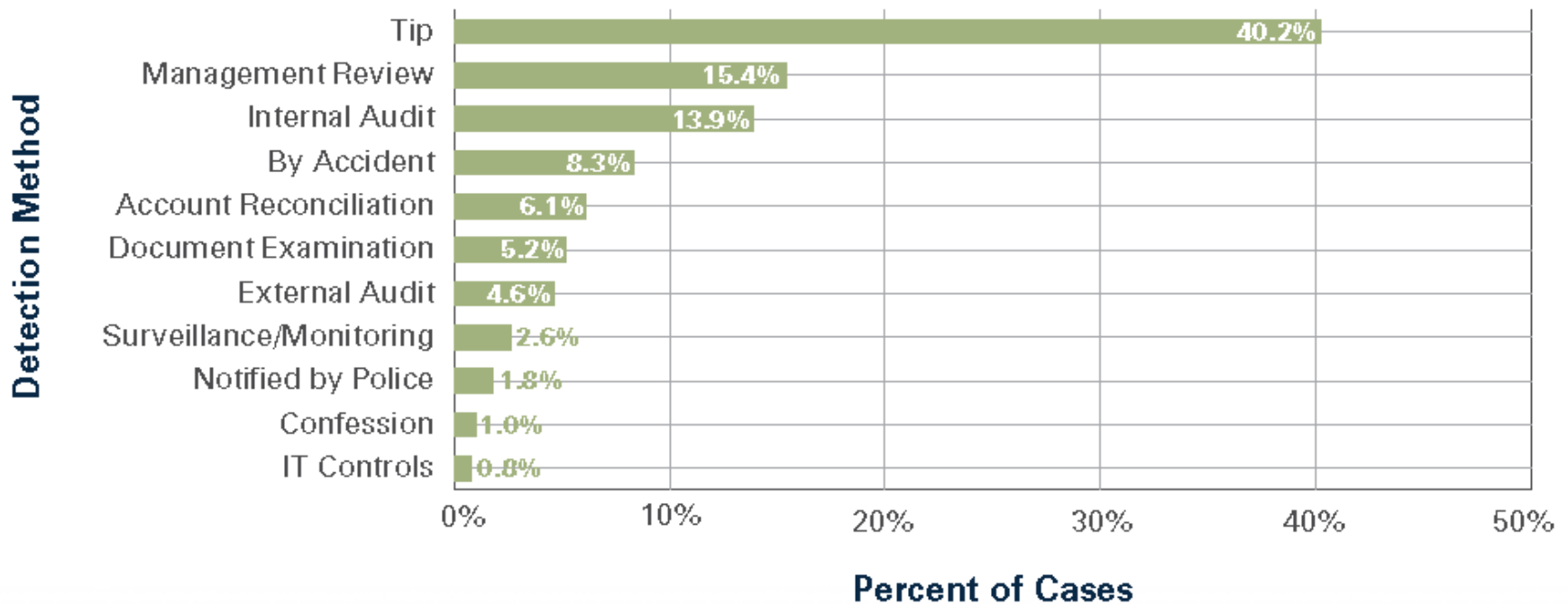
Question:

How do you think fraud is detected other than by tip?



Fraud Detection

Initial Detection of Occupational Frauds



Perpetrators of Fraud

High-level perpetrators cause the greatest damage to their organizations

- Frauds committed by owners/executives were three times as costly as frauds committed by managers
- Nine times as costly as employee frauds
- Executive-level frauds took much longer to detect



Perpetrators of Fraud

More than 80% of the frauds in the study were committed by individuals in one of six departments

- Accounting
- Operations
- Executive/upper management
- Customer service
- Purchasing
- Sales



Perpetrators of Fraud

- More than 85% of fraudsters in the study had never been charged or convicted for a fraud-related offense



Perpetrators of Fraud



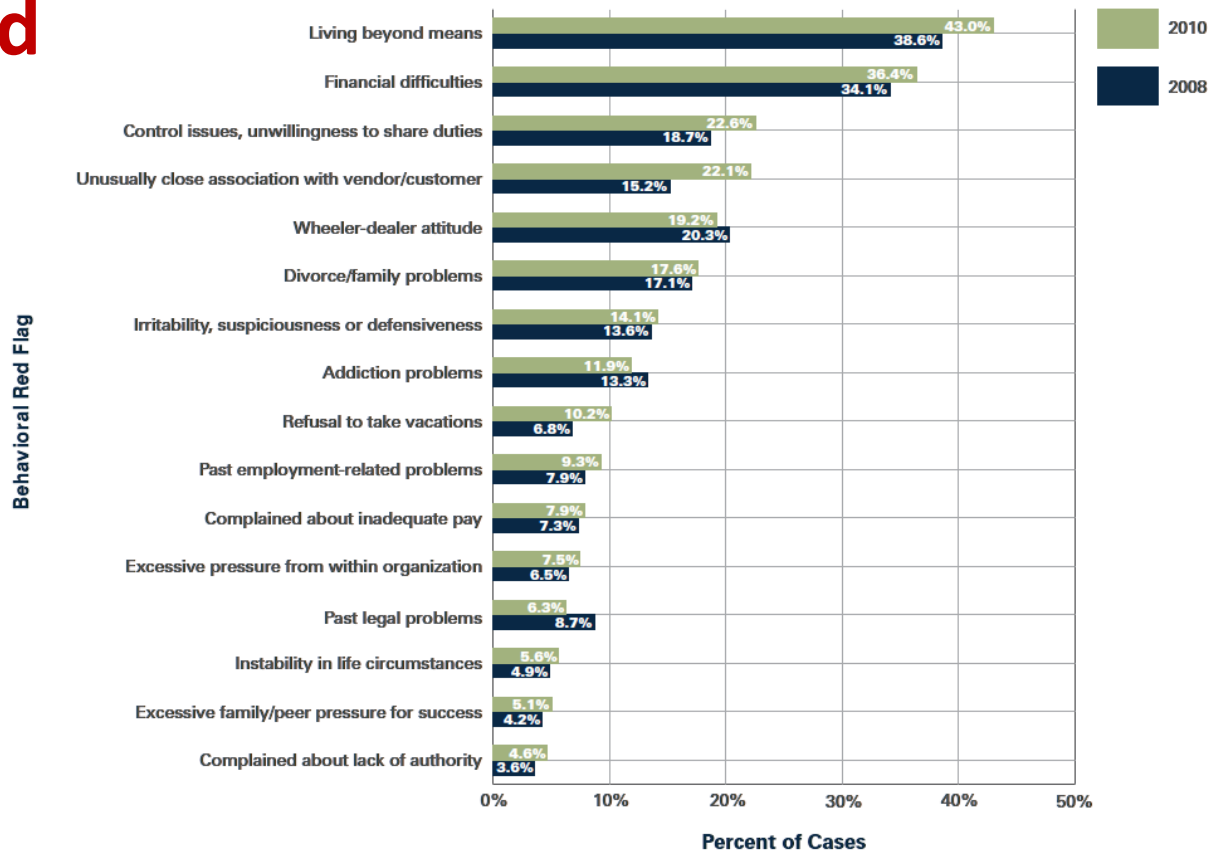
Red Flags:

- Living beyond their means (43% of cases)
- Experiencing financial difficulties (36% of cases)

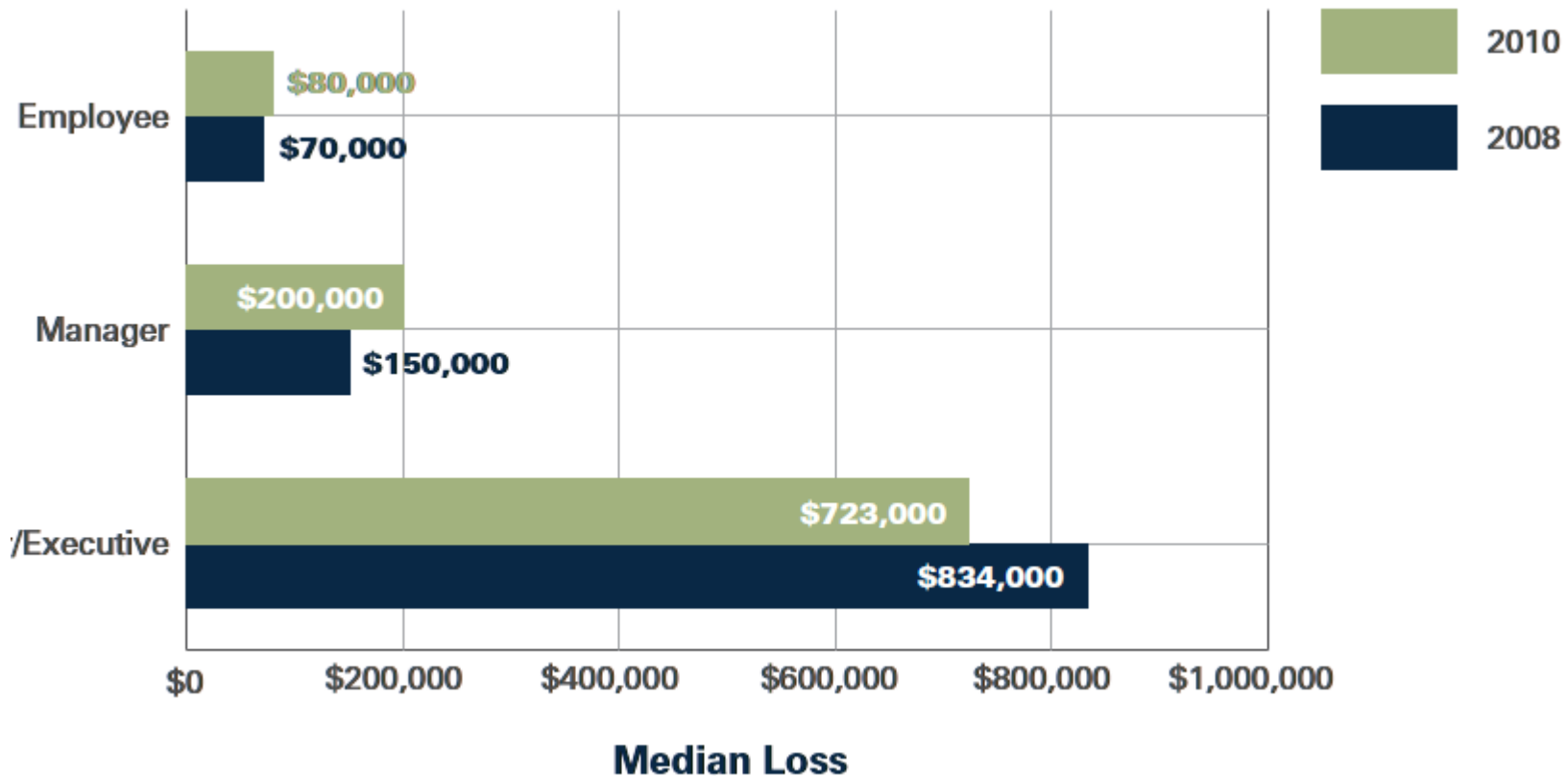


Perpetrators of Fraud

Behavioral Red Flags of Perpetrators²⁹



Perpetrators of Fraud



Fascinating Fraud Facts

- Fraud and abuse costs U.S. organizations more than \$400 billion annually
- The average organization loses more than \$9 per day per employee to fraud and abuse



Fascinating Fraud Facts

- Men commit nearly 75% of the offenses
- The typical perpetrator is a college-educated white male
- Most costly abuses occur in organizations with ≤ 100 employees

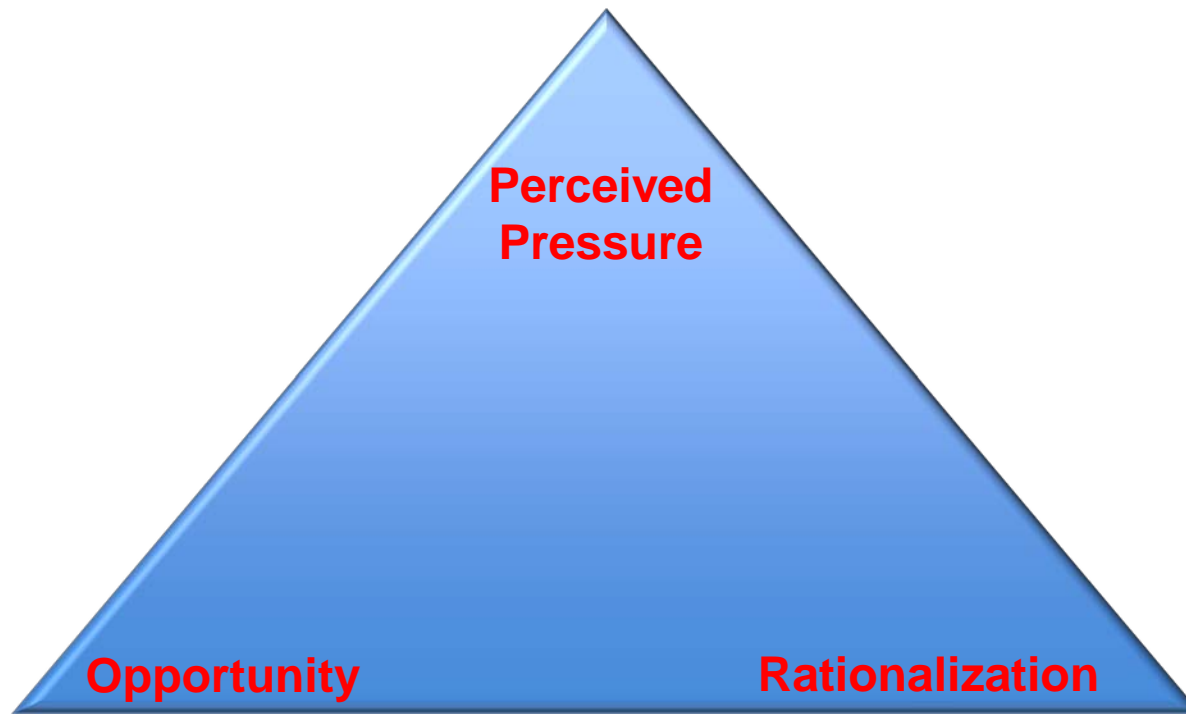


Fascinating Fraud Facts

- Approximately 14% of all frauds occur at nonprofits
- The median loss for nonprofits is \$109,000
- The median duration of all frauds at nonprofits is 24 months



Fraud Triangle



Key Reason for Fraud: Economic Hard Times



- High unemployment rate; more than 14% of homeowners are behind on mortgage payments



Key Reason for Fraud: Internal Threats

- Downsized workforce leaving disgruntled employees
- Increase in price of gas, costing more to get to work



Key Reason for Fraud: External Threats

- Dramatic increase in retail industry theft by customers
- Check fraud



Nonprofits Are Not Immune to Fraud

- Damage to organization's reputation
 - Negative publicity
 - Lower employee morale
 - Cost of litigation
 - Disruption to business operations
- In many cases, the perpetrator is “someone you know, like and trust”



Nonprofits Are Not Immune to Fraud

Why nonprofits face a disproportionate level of employee fraud:

- Lack of segregation of duties
- Employees are perceived to share values of the organization
- Board members are not involved in day-to-day activities and view their position as not involving supervision of areas where fraud can most easily occur



NONPROFITS MAKING HEADLINES



**Financial
Controller**

**Anderson Ranch
Arts Center**



Treasurer

Crime Stoppers



Treasurer

**Arizona High
School Hockey
Association**



**Assistant
Treasurer**

Treasurer

Way of the Cross Baptist Church

Pictures & Facts Taken
From Fraud Talk Blog

The Washington Post

Two Accused of Stealing \$1.5 Million from Opticians

By: Tom Jackson

Washington Post Staff Writer

December 10, 2010

The executive director and chief financial officer of a Fairfax County-based national association of opticians have been charged with embezzling more than \$1.5 million, in a scheme in which they allegedly covered for each other's thefts for more than six years...





By: Examiner Staff Writer & The Associated Press
April, 6, 2009

Nonprofit Head Steals Over \$400,000 from Needy Children in Philadelphia

- Forged payroll checks, bank statements and reimbursement forms sent to the state Dept. of Education to detail supposed legitimate expenses
- Invented ghost employees and inflated expenses and admin costs
- He used the money for jewelry, clothes, a Caribbean cruise, a Mercedes, and various high-end restaurants



PIONEER PRESS

By: Shannon Prather

June 3, 2006

Former Treasurer Gambles Away \$265,000 from Nonprofit

- Secretly opened 4 bank accounts in the name of the nonprofit
- Transferred money from the operating accounts
- Lost it all



THE CHRONICLE OF PHILANTHROPY

DC United Way Leader Pleads Guilty to Fraud

By: Ian Wilhelm and Brad Wolverton

March 18, 2004

- Bowling equipment
- Trips to Vegas
- \$333,000 for annual leave not taken
- \$94,000 extra in pension plan



Typical Examples of Fraud

1) Asset misappropriation

- Skimming
- Credit card abuse
- Payroll schemes
- Stealing of inventory and fixed assets
- Check tampering
- Purchasing/billing schemes



Typical Examples of Fraud

2) Bribery and corruption

- Fictitious vendor schemes
- Conflicts of interest
- Kickbacks
- Bid rigging
- Deceptive fundraising practices



Typical Examples of Fraud

3) Fraudulent statements

- Subrecipient fraud
- Fictitious revenue schemes
- Improper revenue and expense recognition
- Liability schemes
- Improper financial statement disclosures
- Improper asset valuation



Controlling Fraud

- 1) Setting the tone at the top
- 2) Assessing fraud risk and responses
- 3) Financial systems and controls
- 4) Non-financial systems and controls





Controlling Fraud

1) Setting the Tone

- Code of conduct
- Conflict of interest policy
- Equal treatment of employees



Controlling Fraud

2) Assessing Fraud Risks and Responses

- Identify and measure fraud risk
- Take steps to mitigate identified risk
- Monitor prevention and detection programs



Controlling Fraud

3) Financial systems and controls

- Reconcile accounts
- Perform ratio analysis
- Review general ledger adjustments
- Segregation of duties
- Institute job rotation and mandatory vacations
- Conduct surprise audits



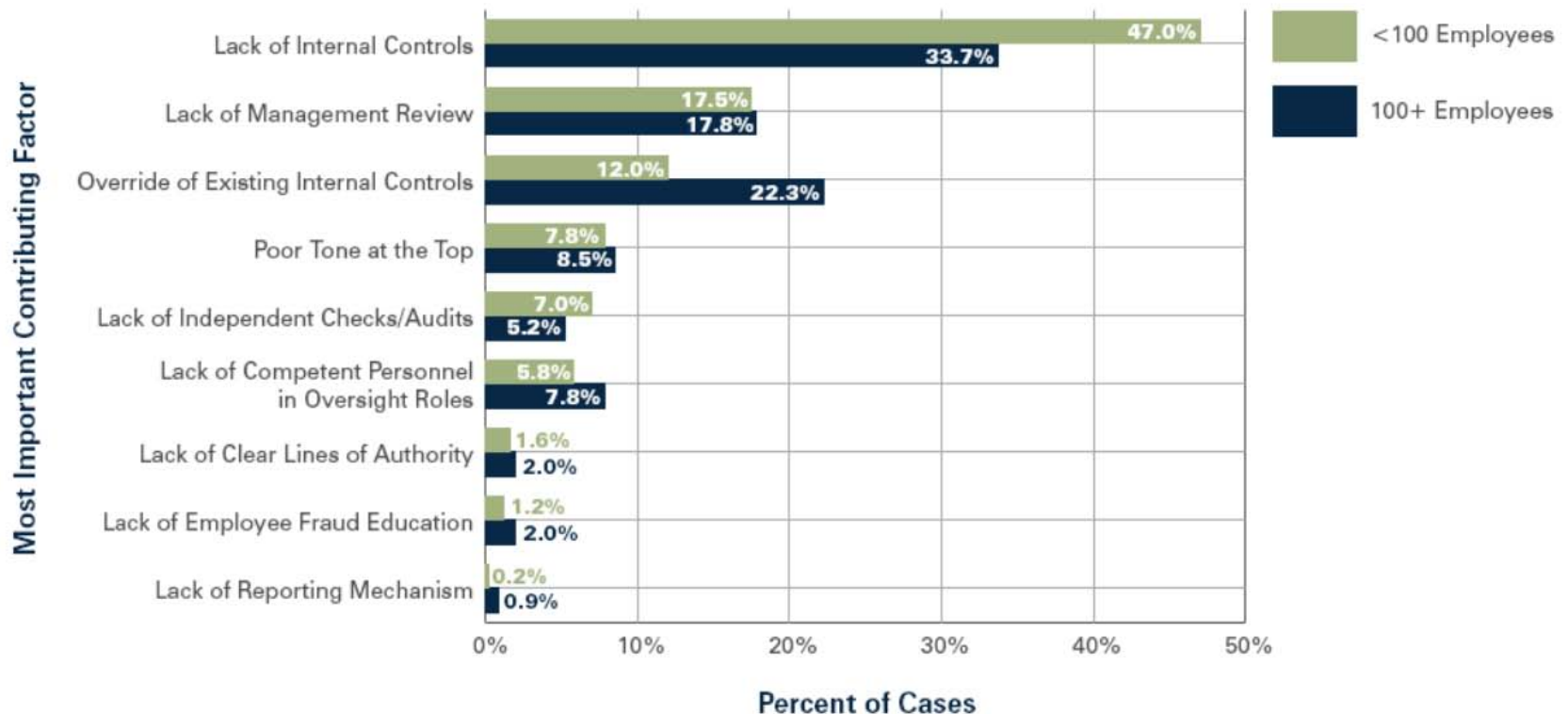
Question:

What are the top three primary internal control weaknesses?



Controlling Fraud

Primary Internal Control Weakness by Size of Victim Organization



Controlling Fraud

4) Non-financial systems and controls

- Background checks
- Communicate often with current employees to monitor when employees are feeling pressured
- Communicate consequences of fraud



Controlling Fraud

4) Non-financial systems and controls

- Set a good example by following rules
- Provide a hotline
- Conduct anti-fraud trainings
- Implement anti-fraud policy



Anti-Fraud Team

- 1) Audit Committee
- 2) External Auditors
- 3) Internal Auditors
- 4) Certified Fraud Examiners (CFE)
- 5) Other



Anti-Fraud Team

1) Audit Committee



- Challenge management
- Evaluate management identification of fraud risk and response
- “Zero tolerance”
- Communicate with external auditors



Anti-Fraud Team

2) External Auditors

- External auditors discover < 10% of frauds
- Audits are planned in accordance with generally accepted auditing standards



Anti-Fraud Team

2) External Auditors (cont)

- Auditors do assess fraud risk to plan and implement procedures to improve likelihood that auditor will detect material misappropriation of assets or material misstatements



Anti-Fraud Team

2) External Auditors (cont)

- SAS 99 fraud discussions
- Auditors must disclose:
 - **ANY FRAUD**, regardless of size
 - Illegal acts or instances of material noncompliance with laws or regulations



Anti-Fraud Team

2) External Auditors (cont)

- Auditors must disclose:
 - Material weakness and significant deficiencies in the design or operation of financial controls
 - Any disagreements with management



Anti-Fraud Team

2) External Auditors (cont)

- Auditors must disclose
 - Unusual accounting principles used or reporting practices
 - Basis for estimates
 - Significant audit adjustments
 - Unrecorded differences



Anti-Fraud Team

3) Internal Auditors

Increase probability of detecting fraud earlier resulting in smaller losses

- Report to the audit committee
- May examine 100% of activities
- Ongoing activities



Anti-Fraud Team

4) Certified Fraud Examiners

If fraud is detected....

- May assist audit committee
- Conduct examination to resolve allegations or suspicions of fraud
- Act as expert witness in legal proceedings



Anti-Fraud Team

5) Other

- Charity watchdogs
- Government agencies



When Fraud Is Detected

- Consult legal counsel
- Inform insurance carriers
- Preserve documents or evidence
- Repair breach in internal control policies and procedures



Solutions



When Fraud Is Detected



Common Reasons Fraud Is Not Reported/Prosecuted

- Fear of notoriety
- Fear of legal action (false arrest or wrongful termination)
- Concern about personal safety
- Compassion for the offender

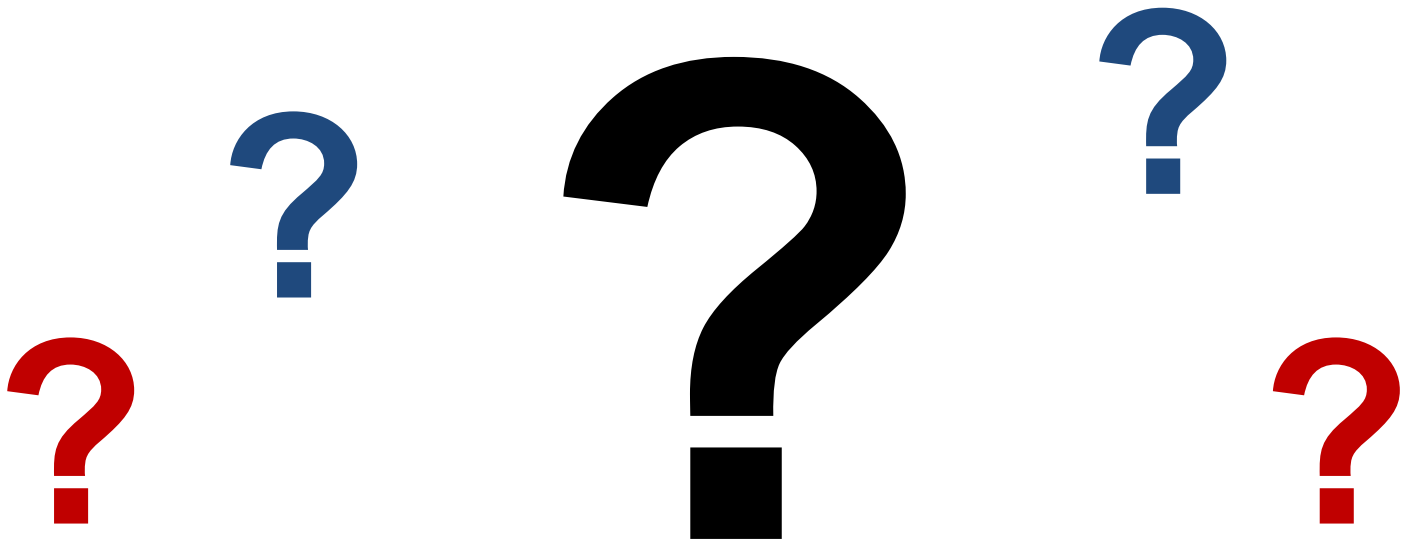


Downside to Not Reporting

- Creates environment that spurs rather than deters fraud
- Loss of credibility and respect among employees and others within the organization
- Some policies require insureds to prosecute employees or volunteers that steal



What Are You Doing?



Contact Information



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