

The background features a large, faint watermark of the Seal of the State Board of Accountancy, Indiana. The seal is circular and contains the text "STATE BOARD OF ACCOUNTANTS" around the perimeter and "INDIANA" in the center. It also depicts a central figure holding a scale and a sword, surrounded by stars.

# Fraud Prevention

**Chase Lenon, CPA, CGFM**  
**Director of Audit Services**

## What is Fraud?



- Fraud is a deliberate act (**or failure to act**) with the intention of obtaining an unauthorized benefit, either for oneself or for the institution, by using deception or false suggestions or suppression of truth or other unethical means, which are believed and relied upon by others.

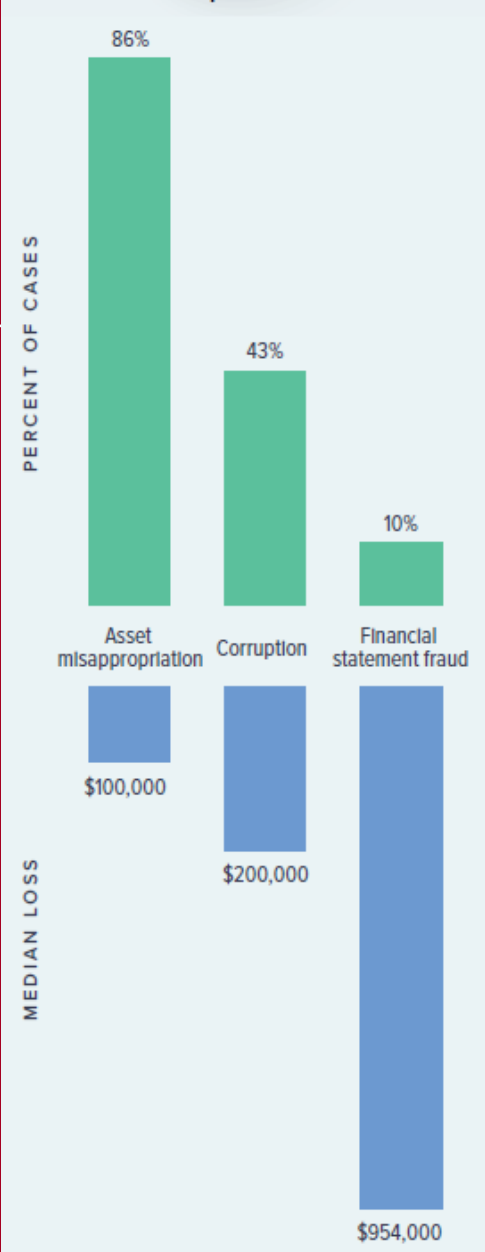
## Why Commit Fraud?



- Perceived Financial Need
- Perceived Opportunity
- Rationalization



FIG. 2 How is occupational fraud committed?

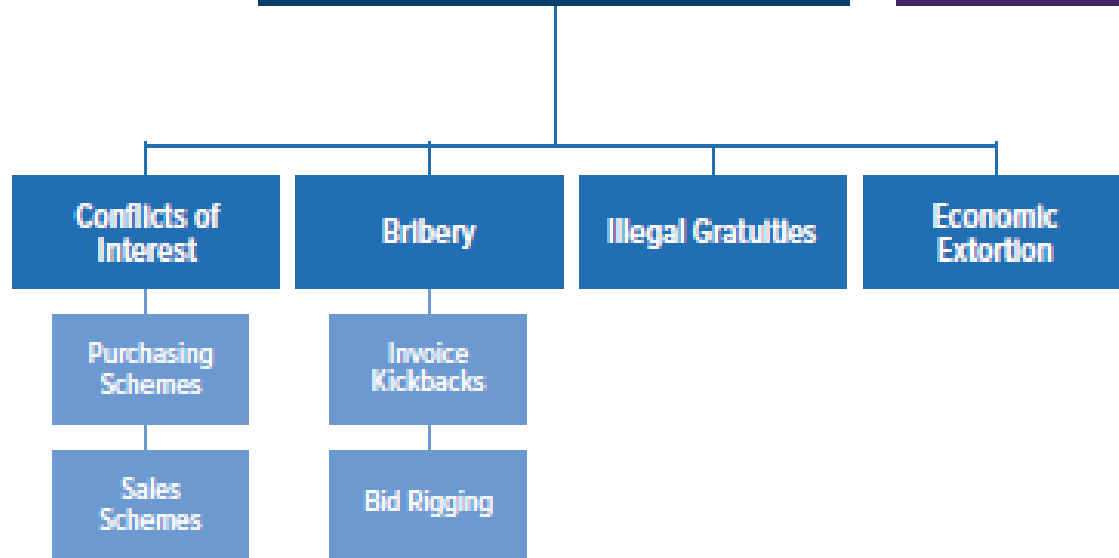


## 3 Main Categories of Fraud



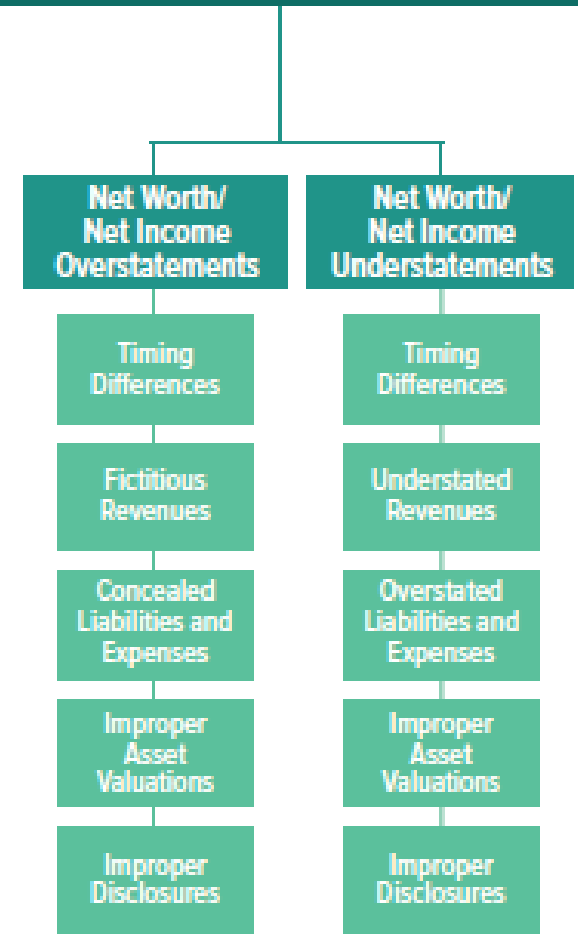
1. Asset Misappropriation
2. Corruption
3. Financial Statement Fraud

## Corruption

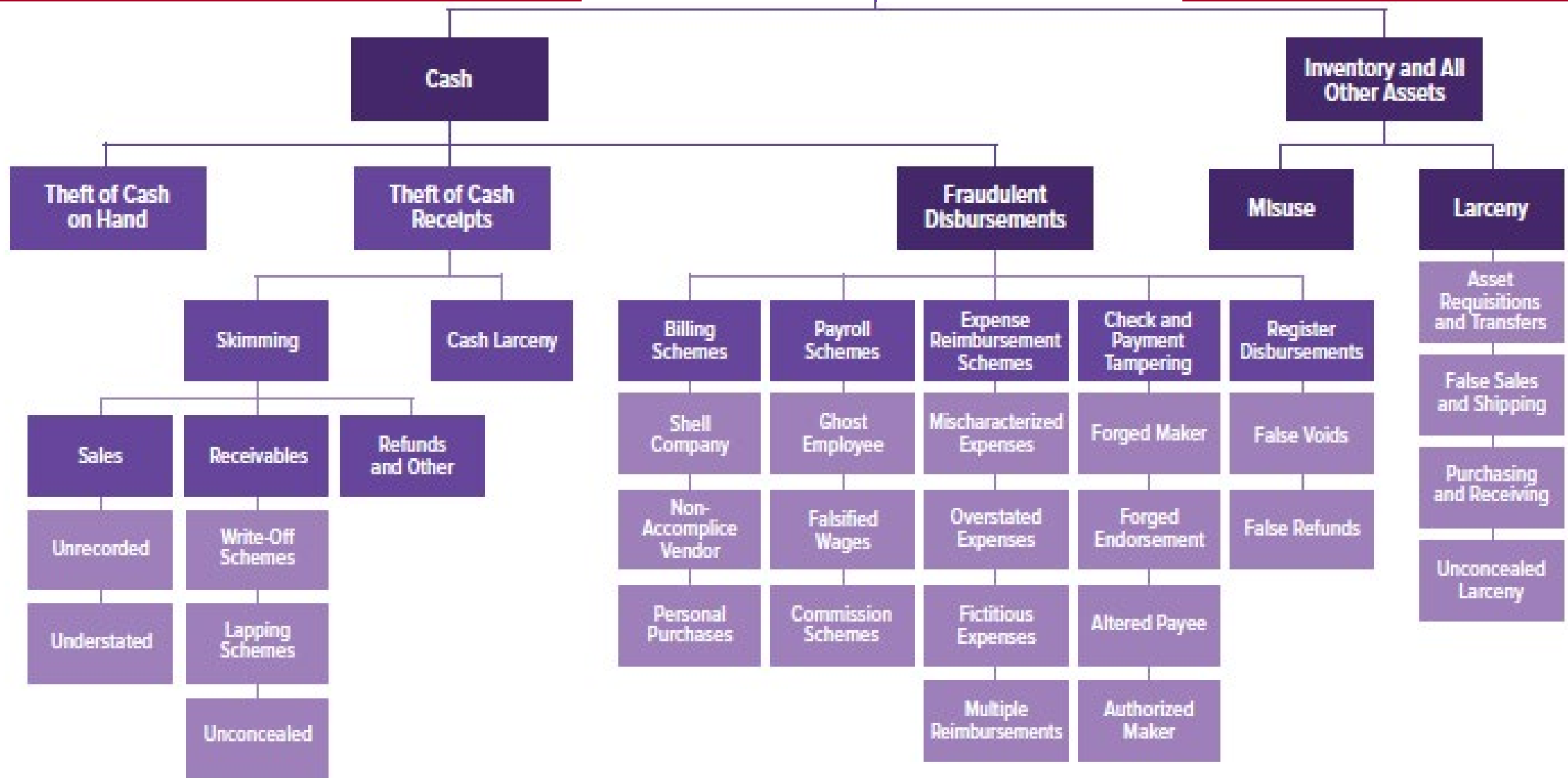


## Asset Misappropriation

## Financial Statement Fraud



# Asset Misappropriation





- Cash Receipt Schemes:

- Skimming – removing cash BEFORE entry
- Larceny – removing cash AFTER entry

- Concealing Receivables:

- Lapping – taking customer A's money to use on customer B's account etc...

## Fraud Schemes



- Fraudulent Disbursements

- Forging checks, creating fake invoices, altering timecards.
- Cash Register? Could falsely provide a refund or falsely void transactions.

- Expense Reimbursement Schemes

- Mischaracterized, overstated, fictitious, or multiple expenses.





- Billing Scheme

- False invoicing via shell companies via non-existent vendors (personal purchases).

- Payroll Schemes

- Ghost employment, falsified hours, salary/commission combinations.

# Fraud Schemes



- Bribery Schemes

- Official (public) or Commercial (private).
- Solicit corrupt payments to influence acts.
- Illegal Gratuities - Items given to reward a decision (different than bribery – after the fact).

- Financial Statement Fraud Schemes

- False entries.
- False/unauthorized:
  - Transfers
  - Withdrawals
  - Disbursements
  - Disclosures



- Fraud is growing exponentially in virtual spaces.

- SBOA IT Manual:

- <https://www.in.gov/sboa/files/Information-Technology-Manual-2017-Amended.pdf>



# Fraud Statistics

Source



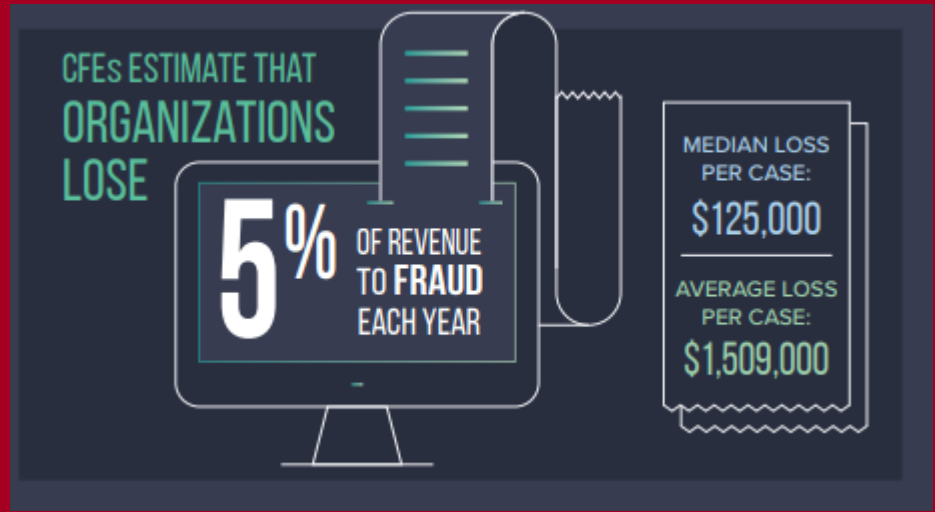
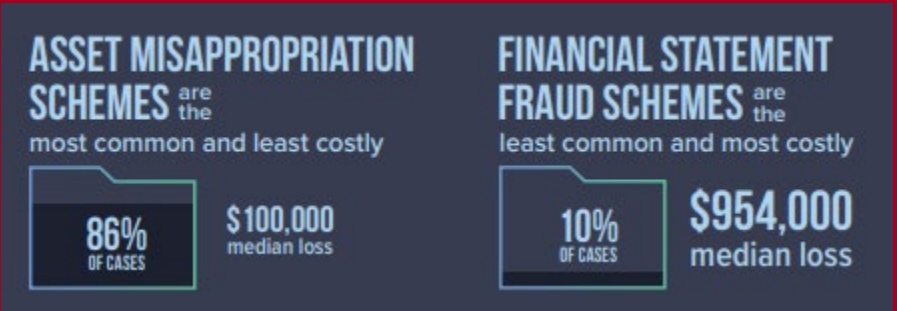
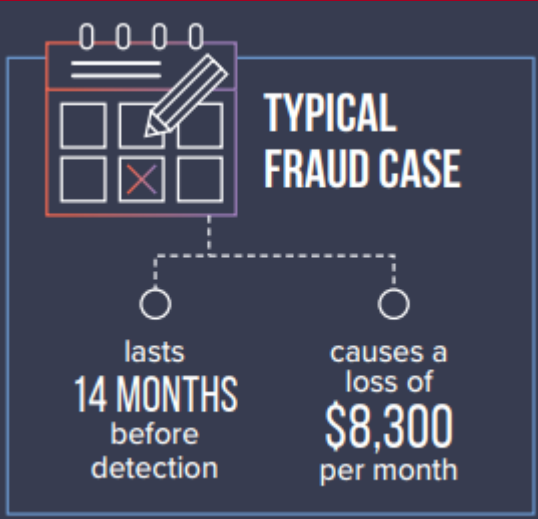
- *Report to the Nations*

- *2020 Global Study on Occupational Fraud and Abuse*

- *Published by: The Association of Certified Fraud Examiners*

- *Report: <https://acfe-public.s3-us-west-2.amazonaws.com/2020-Report-to-the-Nations.pdf>*

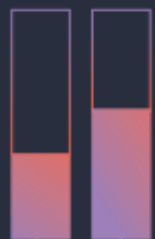
# Key Findings



# Key Findings Continued



Organizations with **FRAUD AWARENESS TRAINING** for employees were **more likely** to gather tips through




**FORMAL REPORTING MECHANISMS**

**56%** of tips with training

**37%** of tips without training



**43%** OF SCHEMES WERE DETECTED BY TIP, and half of those tips came from employees 



**TELEPHONE HOTLINE** and **EMAIL** were each used by whistleblowers in

**33%** OF CASES

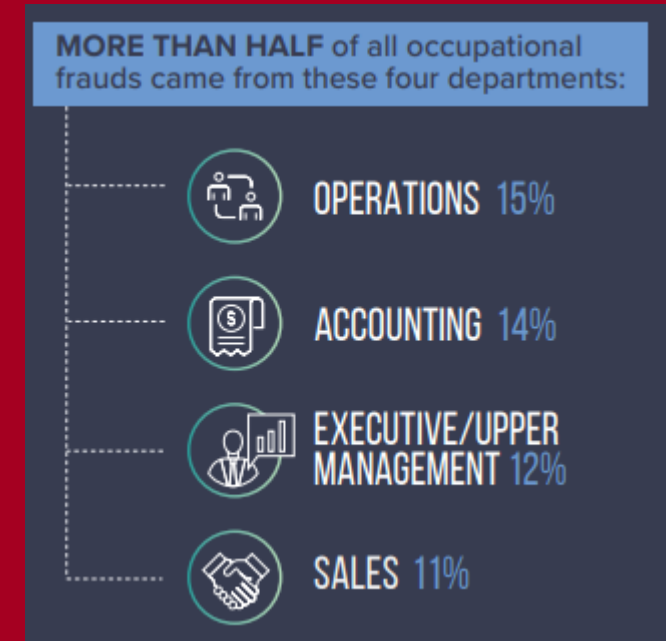
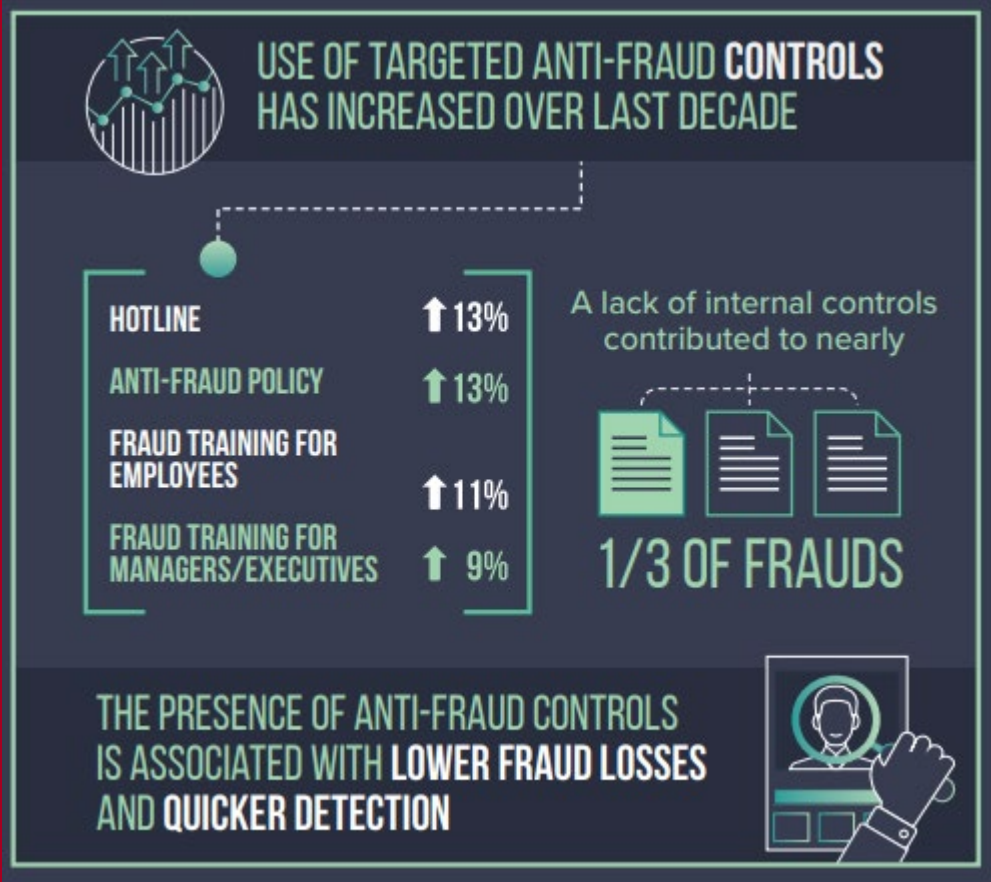


**CORRUPTION**

WAS THE MOST COMMON SCHEME IN EVERY GLOBAL REGION



## Key Findings Continued





# Key Findings Continued



# How is Fraud Concealed?



## TOP 4 CONCEALMENT METHODS USED BY FRAUDSTERS



40%

Created fraudulent physical documents



36%

Altered physical documents



27%

Altered electronic documents or files



26%

Created fraudulent electronic documents or files



12% did not involve any attempts to conceal the fraud

## INTERNAL PUNISHMENT

80% OF PERPETRATORS



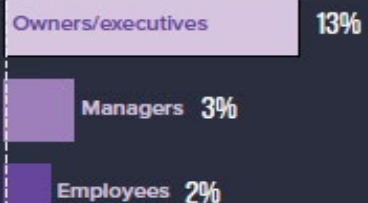
RECEIVED SOME PUNISHMENT

Owners/executives are less likely to receive punishment

### TERMINATION for FRAUD



### Received NO PUNISHMENT



## CIVIL LITIGATION

MEDIAN LOSS resulting in CIVIL LITIGATION



\$400,000



28% of cases resulted in civil litigation.

Of these cases:

41% resulted in judgment for the victim

36% settled

21% resulted in judgment for the perpetrator

## CRIMINAL PROSECUTION

MEDIAN LOSS in cases referred to LAW ENFORCEMENT



\$200,000



59% of cases were referred to law enforcement

Of these cases:

56% pleaded guilty/no contest

23% were convicted at trial

12% were declined prosecution

2% were acquitted

• Responses to Fraud



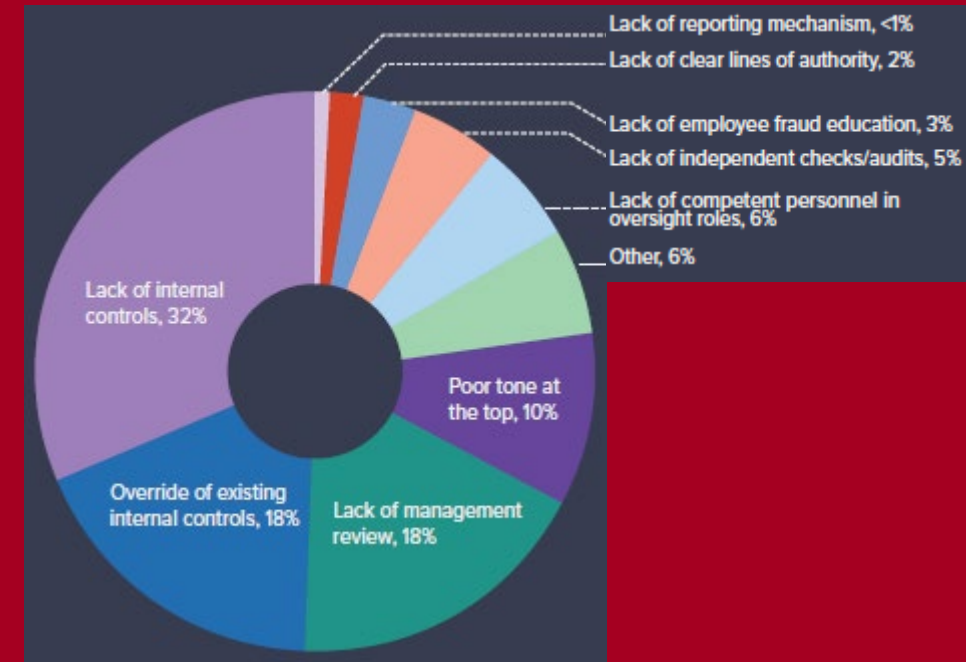
# Fraud Prevention

## Internal Controls



- Primary weakness contributing to fraud?

- Lack of controls!!!



# Components of Internal Control



- **Control Activities**
  - Actual procedures performed
- **Risk Assessment**
  - Where could things go wrong?
- **Information and Communication**
  - If things go wrong, do you know?
- **Monitoring**
  - It needs to be continuous process
- **Control Environment**
  - 'Tone at the top'

**C.R.I.M.E!**

## Risky Areas to Assess - Schools



- Corporation Level:
  - Receipt/Payment Transactions
  - Financial Reporting
  - Federal Grants
  - Security of Assets
  - Payroll
- Extracurricular Accounts
  - Vendor Payments
  - Athletic Events
  - Concessions
  - Fundraisers
  - School Lunch/Textbook Rental

Trust is not a control!



- Do you have someone at your school who is very knowledgeable about processes and no one else knows how certain things work?
- Someone else should understand and review!



## Types of Controls



- **Preventative controls** are those such as requiring dual signatures on checks or having password-protected files. This type of control protects and limits access to assets.
- **Detective controls** include reconciling the bank or inventory counts. Typically, these internal controls are performed periodically to see if any need to be corrected. They will often turn up internal errors or problems, as well as any external errors (such as bank errors).

## Detection



- If you identify errors (or fraud) early, then you can **mitigate the damage!!**
- Allows for improvements to detect and deter fraud.

# Detective Controls



- Avenue to report:
  - Hotlines, email, online form etc....
- Internal “Audits”
- Management Review of periodic processes
  - Bank reconcilements
  - Physical inventory checks
  - Cash change and sales reports (such as ticket sales on the SA-4)
- Proactive Data Monitoring
  - Analytical reviews, Reasonableness testing etc...
- Review equipment usage

FIG. 9 How is occupational fraud initially detected?

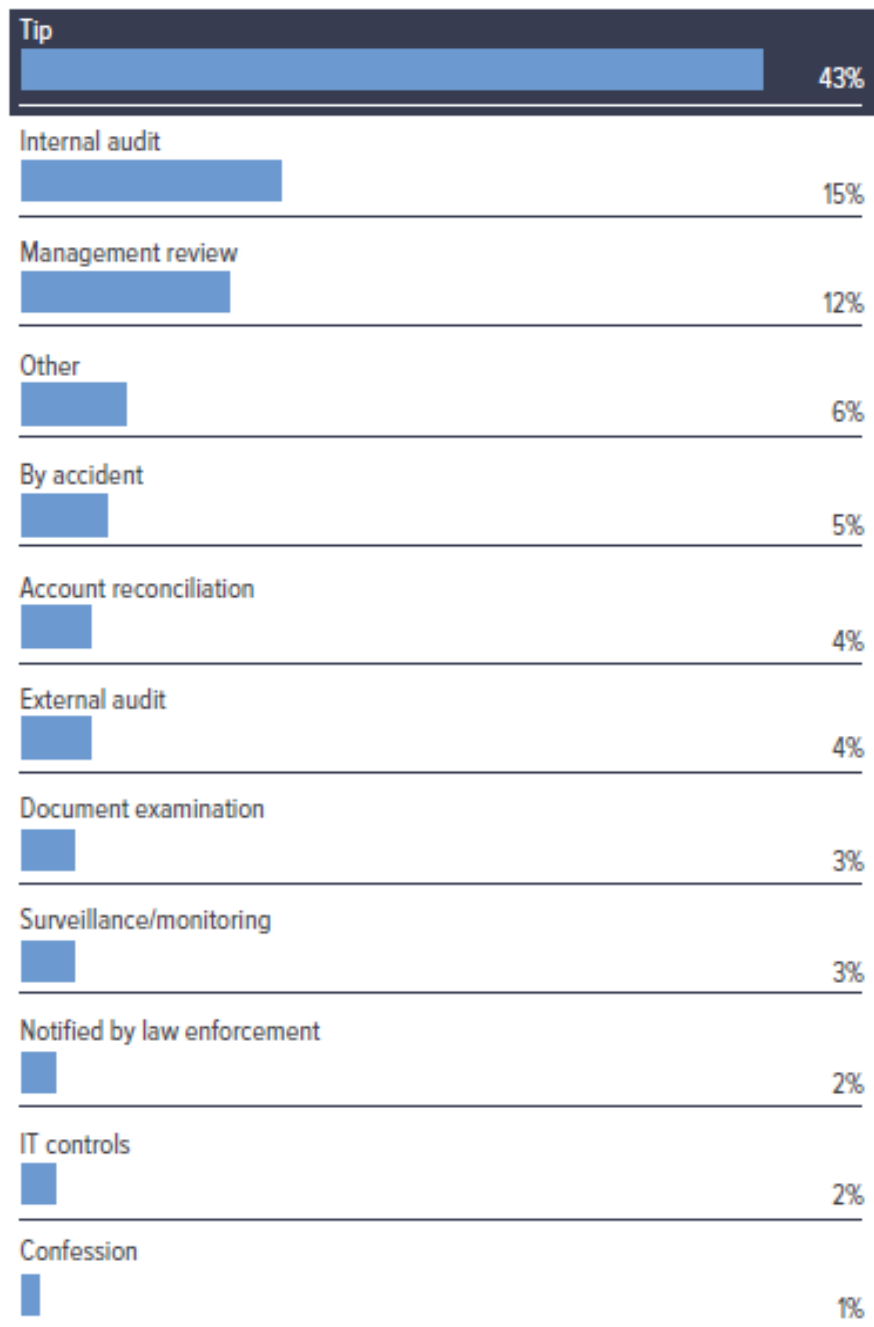
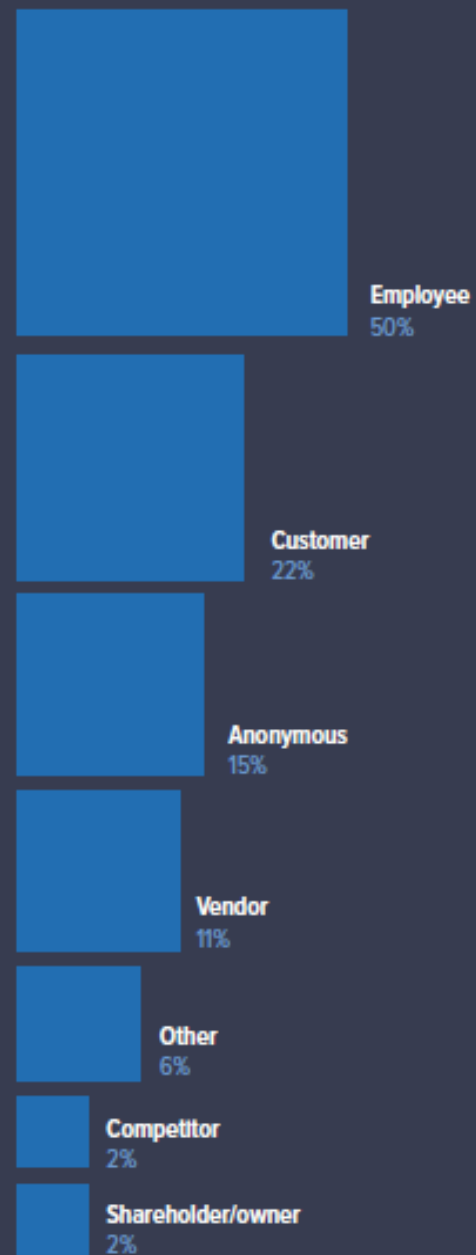


FIG. 10 Who reports occupational fraud?



## Preventive Controls



- Fraud Prevention Training
  - Anti-Fraud Policy (code of conduct)
  - Job Rotation/Mandatory vacation
  - Safeguarding Assets
  - Verify Vendor Legitimacy
- 
- Monitor if policies and procedures are being followed
    - Determine if sufficient to address risk
    - Determine if changes in environment (or individuals) require changes

## Prevention Recommendations



- Ensure no one person has control over all parts of a transaction.
- Restrict use of agency credit cards and verify all charges made.
- Protect checks against fraudulent use.
- Protect cash and check collections.

## Prevention Recommendations



- Review the use of position to waive fees or to not charge for services.
- Review the use of unit's credit card and policy.
- Review overpayments of salaries.
- Be aware of possible kickbacks, bribery, pay-to-play schemes.

## Segregation of Duties



- Duties that “should” be separated:
- Receipt roles - Collecting, Depositing, Recording and Reconciling functions.
- Purchasing roles – Ordering, Receiving, Claim Creation/Approval, Payment, and Reconciling functions.
- Inventory roles - Requisition, Receipt, Disbursement, Conversion to scrap and Receipt of scrap proceeds functions.



		Employee Number							
Duties		1	2	3	4	5	6	7	8
<u>Cash Receipts</u>									
1.	Open mail and write receipt								
2.	Receive money, issue official receipts								
3.	Take off cash register totals								
4.	Balance cash drawer or cash register								
5.	Make up bank deposits								
6.	Take deposits to bank or remit to receiving officer								
7.	Post receipts								
8.	Access to computer system to make adjustments								
9.	Approves adjustments								
10.	Post credits to accounts receivable								
11.	Prepare customer billings								
12.	Mail billings or statements								
13.	Approve bad debt write offs								
14.	Approve accounts receivable adjustments								
15.	Issue permits, licenses, etc.								
16.	Issues receipts for electronic deposits								

<u>Cash Disbursements</u>									
1.	Authorize purchases								
2.	Prepare purchase orders								
3.	Certify receipt of goods or services								
4.	Audit claims								
5.	Approve claims - Disbursing Officer								
6.	Approve electronic transfers								
7.	Write checks								
8.	Initiate electronic transfers								
9.	Post checks								
10.	Sign checks - Control of signature stamp								
11.	Mail or distribute checks								
12.	Custodian of petty cash								
13.	Custodian of investments								
14.	Access to check stock								
15.	Access to computer system to make adjustments								
16.	Approves adjustments								

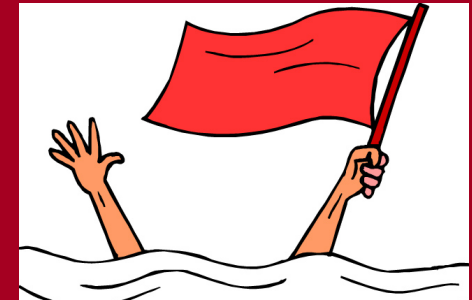
<u>Payrolls</u>								
1. Post vacation and sick leave records								
2. Check and extend time cards								
3. Prepare payroll claims								
4. Approve payroll claims for department								
5. Approve payroll claims for disbursing officer								
6. Calculate deductions and net pay								
7. Write payroll checks								
8. Sign payroll checks								
9. Distribute payroll checks								
10. Prepare earnings and deductions reports								
11. Prepare W-2s and compare to earnings records								
12. Access to computer system to make adjustments								
13. Approves adjustments								

<u>Cash</u>								
1. Receives bank statement in mail and opens it								
2. Compares checks cleared to disbursements posted								
3. Compares deposits to receipts posted								
4. Prepares bank reconciliation								
5. Approves bank reconciliation								
<u>Statement of Expenditures of Federal Assistance</u>								
1. Enters grant information into Gateway								
2. Approves grant information entered in Gateway								
3. Approves the prepared SEFA								
<u>Financial Close and Reporting</u>								
1. Closes the financial records								
2. Enters financial statement information into Gateway								
3. Approves the Gateway annual report								
4. Approves the prepared financial statements								
<u>Notes to the Financial Statements</u>								
1. Enters the required information into Gateway								
2. Approves the notes to the prepared financial statements								

## Red Flags



- Living beyond means
- Financial difficulties
- Close vendor relationship
- Unwilling to share duties
- Irritable/defensiveness
- Problems at home
- Complained about pay
- Refusal to take vacations
- Excessive pressure within
- Past employment issues
- Legal problems
- Wanting more authority
- Excessive peer pressure
- Instability in life
- Bullying/Intimidation
- Poor evaluation
- Wheeler-dealer attitude
- Social Isolation



In **52%** of cases, the fraudster exhibited red flags connected to their **work duties**.

Unusually close association with vendor/customer



Control issues, unwillingness to share duties



Irritability, suspiciousness, or defensiveness



"Wheeler-dealer" attitude



Complained about inadequate pay



Refusal to take vacations



Excessive pressure from within organization



Past employment-related problems



Complained about lack of authority



In **63%** of cases, the fraudster exhibited red flag behavior associated with his or her **personal life**.

Living beyond means



Financial difficulties



Divorce/family problems



Addiction problems



Social isolation



Past legal problems



Instability in life circumstances



Excessive family/peer pressure for success



# SBOA Special Investigations Perspective



## SBOA Special Investigations



### • Role:

- Assess situations where there is an indication of fraud or other criminal activity involved (Situations may be complaints into the SBOA, issues that come up in routine audits, self referrals, law enforcement referrals).
- Where appropriate, conduct a focused audit/investigation on the activities related to the potential criminal activity.
- Coordinate with law enforcement, prosecutors, and the Indiana Attorney General to resolve the matter through the judicial system.
- Prevent the misuse of public resources through education and outreach.



## What to Expect during a Special Investigation



- Assessment Phase

- Notate: Who, what, when, where, how much.
- Initial review – determine what engagement.

- Audit/Investigation Phase

- Analyze data and identify facts of the situation.
- Determine Accountability and intent.

## What to Expect during a Special Investigation



- Coordination with Law Enforcement
  - Prosecutors, IRS, IDOR, IAG, ISP, FBI etc...
  - Subpoena issuance, documentation to support criminal cases.
- Reporting/Prevention/Outreach Phase
  - SI Report, Special Compliance Report, IC letter.
  - Discussion with SBOA directors, recommend solutions to officials.

## SI Considerations



- Most matters take time to resolve.
- Emotions can run high.
- Investigations are conducted with the highest level of professionalism.
- Mismanagement, sloppiness, political differences and ethical lapses are not criminal.

## State Examiner Directive 2015-6



- Materiality threshold for reporting irregular variances, losses, shortages, and thefts.
  - [https://www.in.gov/sboa/files/Directive\\_2015-6.pdf](https://www.in.gov/sboa/files/Directive_2015-6.pdf)
- Must notify SBOA and County Prosecutor.
- No materiality threshold for Fraud.

## Recent Charges



- Charter school broadly overstates its ‘brick and mortar’ offerings, must pay \$300K
  - <https://www.indystar.com/story/news/education/2021/01/29/state-investigation-indiana-charter-school-lied-virtual-online-status/4315865001/>
- Money Missing From Long Beach Water Department
  - [https://www.nwitimes.com/news/local/govt-and-politics/money-missing-at-long-beach-water-department-state-audit-finds/article\\_237a3840-1b8a-5b5c-9817-dbff24f4c98b.html](https://www.nwitimes.com/news/local/govt-and-politics/money-missing-at-long-beach-water-department-state-audit-finds/article_237a3840-1b8a-5b5c-9817-dbff24f4c98b.html)
- State Board of Accounts asks South Newton for repayment of \$751,907 in state support
  - [https://www.newsbug.info/newton\\_county\\_enterprise/news/local/state-board-of-accounts-asks-south-newton-for-repayment-of-751-907-in-state-support/article\\_15486669-7408-5f41-8a9a-2b4f880b16c0.html](https://www.newsbug.info/newton_county_enterprise/news/local/state-board-of-accounts-asks-south-newton-for-repayment-of-751-907-in-state-support/article_15486669-7408-5f41-8a9a-2b4f880b16c0.html)
- State board asks former treasurer to repay more than \$20,000
  - <https://www.wthitv.com/content/news/State-board-asks-former-treasurer-to-repay-more-than-20000--573015061.html>

## Recent Charges



- SBoA releases Vincennes Police Department investigation findings
  - <https://www.wthitv.com/content/news/State-Board-of-Accounts-releases-Vincennes-Police-Department-investigation-findings-573588001.html>
- Center Township Trustee Using Township Funds For Personal Use
  - [https://www.nwitimes.com/news/local/govt-and-politics/money-missing-at-long-beach-water-department-state-audit-finds/article\\_237a3840-1b8a-5b5c-9817-dbff24f4c98b.html](https://www.nwitimes.com/news/local/govt-and-politics/money-missing-at-long-beach-water-department-state-audit-finds/article_237a3840-1b8a-5b5c-9817-dbff24f4c98b.html)
- State Board of Accounts asks ex-MSD administrator to repay \$60,000 paid while on unpaid leave
  - <https://www.thestarpress.com/story/news/local/2020/09/14/former-sanitary-administrator-asked-pay-back-60-000-sboa/5756732002/>
- Woman charged with theft of police beneficiary funds
  - <https://www.abc57.com/news/woman-charged-with-theft-of-police-beneficiary-funds>

## Fraud Prevention Checklist



### 1. Is ongoing anti-fraud training provided to all employees?

- Do employees understand what fraud is?
- Have the consequences of fraud been made clear?
- Do employees know where to seek advice on potential unethical situations?
- Has a zero-tolerance policy been communicated through words/actions?



## 2. Is an effective fraud reporting mechanism in place?

- Do employees know how to use?
- Is there more than one reporting channel?
- Do employees trust reports are confidential?
- Has it been made clear that reports will be acted upon promptly?
- Do reporting policies extend to external parties?





### 3. To increase employees' perception of detection, are these measures being taken?

- Is fraud sought out rather than dealt with passively?
- Are internal surprise audits performed?
- Are data analytics used to identify variances?
- Are controls reviewed and monitored?

## Fraud Prevention Checklist



### 4. Is management's tone at the top one of honest and integrity?

- Are employees surveyed to determine if management acts with integrity?
- Are performance goals realistic?
- Have fraud prevention goals been identified?
- Has there been internal control policies implemented and tested?

## Fraud Prevention Checklist



5. Are fraud risk assessments performed to proactively identify and mitigate the company's vulnerabilities to fraud?



## Fraud Prevention Checklist



### 6. Are strong anti-fraud controls in place and operating effectively?

- Proper Segregation of Duties
- Use of Authorizations
- Physical Safeguards
- Job Rotations
- Mandatory Vacations

## Fraud Prevention Checklist



7. Does the internal audit department, if one exists, have adequate resources and authority?

- Important to operate without undue influence from management

## Fraud Prevention Checklist



### 8. Does the hiring policy include:

- Past employment verifications
- Criminal and civil background checks
- Credit checks
- Drug screening
- Education Verification
- Reference checks

## Fraud Prevention Checklist



9. Are employee support programs in place to assist with employees struggling with:

- Addiction
- Mental/Emotional Health
- Family problems
- Financial Problems

## Fraud Prevention Checklist



10. Is an open-door policy in place that allows employees to speak freely about pressures?





## Fraud Prevention Checklist



11. Are regular, anonymous surveys conducted to assess employee morale?



Contact Information



**Chase Lenon, CPA**

**Jonathan Wineinger**

Directors of Audit Services



**Schools.townships@sboa.in.gov**



**317-232-2512**

Questions?

