

FRAUD AND THE TRUSTED EMPLOYEE

FRAUD PREVENTION

Presented by

Brad Kanter, CPA, CGMA, CFF, CFE, CVA, EA, MAC, MAFF



CERTIFIED PUBLIC ACCOUNTANTS

FORENSIC ACCOUNTANTS



ABOUT THE PRESENTER

BRAD KANTER, CPA, CGMA, CFF, CFE, CVA, EA, MAC, MAFF

**FOUNDER AND PRINCIPAL,
KANTER & ASSOCIATES, PA, CPAS**

- Prior to starting the practice in 2004, Mr. Kanter worked in private accounting, serving as Accounting Manager, Controller, then Legal Administrator for Multi-Million-dollar law firms. After leaving the Legal Industry he served as Controller and Business Manager of a publicly traded, national PEO.
- This background provided him the unique experience to understand the interrelationships between operations and accounting.
- Over the last 15 years, Mr. Kanter has successfully grown the practice to 8 staff, servicing hundreds of clients both individual and businesses. Out of 41,600 public accounting practices nationwide, our firm is in the top 1000 based on billings.
- The firm performs, Forensic Accounting, IRS Controversy Services, Compilations, Reviews, Fully Outsourced Turn Key Accounting Services ,Outsourced Controller and CFO Solutions as well and Tax Preparation
- In addition, Mr. Kanter has provided Forensic Examination and Fraud Examination on matters including Misappropriation of Asset Claims, Hidden Assets, Non-Compliant Tax and Accounting Recordkeeping and Irregular Cash Management.
- Mr. Kanter has also provided Litigation Support Services to include Depositions, Interviews, Court Hearings and Expert Testimony.



Fraud and the Trusted Employee

A discussion about occupational Fraud

Brought to you by:



Brad Kanter, CPA, CGMA, CFF, CFE, CVA, EA, M.AC., MAFF

Founder / CEO

411 St. Petersburg Dr. Oldsmar, FL 34677

Office 813.855.5433

Eric Benke

Principal / Business Advisor

411 St. Petersburg Dr. Oldsmar, FL 34677

Office 813.855.5433 Cell: 813.503.0043

ARE YOU AT RISK OF FRAUD?

- Fraud Facts
- The Fraud Triangle
- Case studies
- How YOU can prevent Fraud

* Actual case studies were published by the Association of Certified Fraud Examiners, of which Mr. Kanter is a Certified member.



FRAUD FACTS

The Association of Certified Fraud Examiners conducts an annual survey to approximately 42,000 Certified Fraud Examiners (CFE's).

Following are some facts and figures from occupational fraud from the study.

- The median loss for all cases in the study was \$150,000, with 23.2% of cases causing losses of \$1 million or more.
- Asset misappropriation was by far the most common form of occupational fraud, occurring in more than 83% of cases.
- Among the various forms of asset misappropriation, billing schemes and check tampering schemes posed the greatest risk based on their relative frequency and median loss.

FRAUD FACTS

- Check tampering, skimming, payroll and cash larceny schemes were twice as common in small organizations as in larger organizations.
- Small organizations had a significantly lower implementation rate of anti-fraud controls than large organizations.
- The perpetrator's level of authority was strongly correlated with the size of the fraud.
- More occupational frauds originated in the accounting department than in any other business unit.
- Fraud perpetrators tended to display behavioral warning signs such as:
 - Living beyond means
 - Financial difficulties,
 - Unusually close association with a vendor or customer
 - Excessive control issues
 - General "wheeler-dealer" attitude involving unscrupulous behavior and
 - Recent divorce or family problems.



Financial Forensics is the Art & Science of Investigating People and Money.

THE FRAUD TRIANGLE



Opportunity — the situation allows the fraud to occur.

Motivation — someone feels the need to commit fraud, such as the need for money.

Rationalization — justification for the deceptive act by the one committing the fraud.

CASE STUDY

THE VETERAN BOOKKEEPER

An accountant with 20 years' tenure bleeds a nonprofit dry

- Susan was a trusted employee at a small 501(c)(3) that operated under a larger national organization.
 - Susan was the longest tenured employee, having worked there for 20 years.
 - She served as a historical resource for other employees
 - Marilyn, the Executive Director relied on her for a variety of tasks
 - Susan rarely took vacations
 - Marilyn noticed Susan often had new handbags and drove a nicer car than anyone else but didn't think too much about it.
- One day, the banking officer of the larger organization was surprised to see a low cash balanced and mentioned it to Marilyn. She also commented how surprised she was at how many checks were written to Susan... which prompted an investigation



CASE STUDY

THE VETERAN BOOKKEEPER

An accountant with 20 years' tenure bleeds a nonprofit dry

- It was soon discovered false checks have been written... a lot of them
- A pattern of behavior emerged that Susan exhibited for over a decade
 - She would write herself checks and either use a signature stamp or forge the signature
 - She coded these checks to an obscure GL account
 - Later, she re-coded the expenditures to a more befitting account.



Prior to their bank introducing item imaging, Susan would simply remove the canceled checks she wrote to herself and destroy them.

When the bank began using check imaging, she covered her tracks in a rudimentary way. During an interview, the hired CFE asked Susan what software program she used to alter the check images in the bank statements. She said, ‘I didn’t use software. I cut-and-pasted.’”

She literally cut vendor names from previous images with an Exacto knife and paste them on the images, then photocopied them all, and filed them.

Brought to you by Kanter & Associates, PA, CPAs | www.kanterpa.com | 813-855-5433

CASE STUDY

THE VETERAN BOOKKEEPER

An accountant with 20 years' tenure bleeds a nonprofit dry



In the end, Susan stole an estimated \$2.8 Million Dollars over a period of 10 years!

Why was she able to get away with it for so long?

System Based Processes (In this case there were none)

- a. The financials and general ledger were never reviewed by anyone other than Susan
- b. No segregation of duties existed for check writing (Accounts Payable)

CASE STUDY

THE VETERAN BOOKKEEPER

An accountant with 20 years' tenure bleeds a nonprofit dry



How could have been this be avoided?

Internal Controls

1. Create a control environment
 - a. Lead your staff by example. Don't model behavior to your clients or staff that accepts fraud or "gray" behavior
2. Create segregation of duties
 - a. One person should not be responsible for "all things accounting"
 - b. If a small administrative staff inherently creates separation of duty issues, workarounds or mitigation MUST be considered

CASE STUDY

SONNY AND HIS GHOST EMPLOYEES

A man swindles his family's business out of \$500,000

Background

- Sonny was the youngest son of a family whose parents owned and operated a small manufacturer of electrical equipment of which all of the adult worked.
- Sonny was part owner and officer and was responsible for all of HR and Payroll functions including approving timesheets which were submitted to a payroll company who generated physical paychecks for the employees based on Sonny's reports.
- Over the course of 9 years, Sonny embezzled \$500,000 by creating scores of ghost employees



CASE STUDY

SONNY AND HIS GHOST EMPLOYEES

A man swindles his family's business out of \$500,000

The Scheme

- Besides the office staff, the company employed numerous low-income workers, mostly migrants who worked the factory floor.
- Sonny fraudulently issued payroll checks to actual employees who had either been absent that payroll period or who had left the company thereby creating ghost employees. He filled this ghost pool with low-income workers who weren't familiar with or were suspicious of direct deposit and whose command of English was limited.
- Since he was the only one looking at the records, he had no problem falsifying them. He would fish out the fraudulent checks, forge endorsement on the back then deposit them into his personal account.



CASE STUDY

SONNY AND HIS GHOST EMPLOYEES

A man swindles his family's business out of \$500,000

The Whistleblower

- Sonny's sister, Maisie was the CFO.
- After almost 9 years of Sonny's scheme, just by happenstance, Maisie decided to review the fronts AND back of cancelled checks for the previous quarter.
- She saw several checks endorsed over to her brother. Curious and concerned, she performed a 10 year spot-check which uncovered many of these fraudulent checks.
- Maisie hired an outside accounting firm to conduct an audit which revealed hundreds of these ghost employee checks



CASE STUDY

SONNY AND HIS GHOST EMPLOYEES

A man swindles his family's business out of \$500,000

The Findings

- The audit discovered the company was reporting income to the state and federal government as these ghosts were actually very real people, causing huge tax problems for these low-income people.
- Besides the emotional trauma Sonny created for his family, any of these ghost employees could sue the company leaving it in a vulnerable position.
- Although the rest of the family was willing to keep the matter “in the family”, Maisie called the police and pressed charges, causing further trauma in the family.
- In the end, Sonny was convicted on 4 counts of fraud and sentenced to 23 months in prison and a \$508,000 restitution order.



HOW TO “BULLETPROOF” YOUR BUSINESS AGAINST FRAUD

- **Create a Control Environment** : Lead your staff by example. Don't model behavior to your clients or staff that accepts fraud or “gray” behavior
- **Background Checks:** Perform background checks on ANY employees that are involved in HR, Accounting and management.
- **Separation of duties:** Activities such as authorizing transactions, recording transactions, and maintaining control of the related assets should be separated among employees.
- **Physical controls:** Assets and accounting records must be kept safe and accessible only to authorized personnel.
- **Proper authorization:** Only personnel with authorization should be allowed to collect money, process transactions, or make purchases.
- **Employee management:** Employees should be trained to carry out their job and must be made aware of any internal control procedures, ethical responsibilities, and channels for reporting irregular activities.

HOW TO “BULLETPROOF” YOUR BUSINESS AGAINST FRAUD

- **E-commerce / Technology controls:**

- Only authorized personnel should have passwords to conduct electronic business transactions
- Two Factor Authentication
- Firewalls are maintained to prevent unauthorized access
- The system’s antivirus software should be regularly updated.

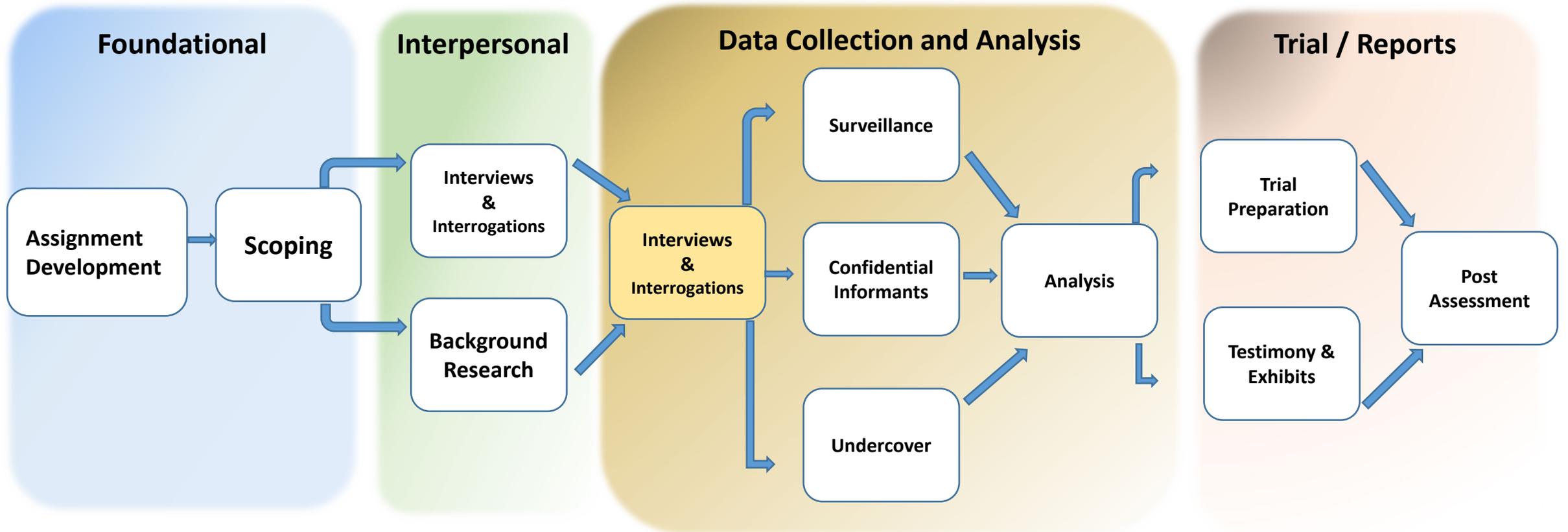
- **Insurance:** Take out an Employee Dishonesty policy for your company. Should fraud occur, you will have some recourse.

It is important to note, in order to successfully file a claim, you must have some reasonable controls in place.

- External / Outside review of processes & procedures and internal controls
- Annual review of processes
- Outside accounting by impartial party (CPA Firm)

WHY A FORENSIC EXAMINATION IS COSTLY

Forensic Accounting Investigation Methodology



QUESTIONS?



Brought to you by Kanter & Associates, PA, CPAs | www.kanterpa.com | 813-855-5433