

“Frauditing” Preventing and Detecting Fraud in Your Exempt Organization

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Agenda

- Fraud and Your Organization
- The Perpetrator
- Internal Controls and Detection
- Discussion of Fraud at NFP
- Taking Action
- Association of Certified Fraud Examiners (ACFE) - Fraud Prevention Check-UP

Consumer Fraud

- **Consumers lost \$5.8 billion to fraud last year — up 70% over the prior year**
- Almost 2.8 million people filed a fraud complaint, an annual record.
- Those figures also don't include reports of identity theft. More than 1.4 million Americans also reported being a victim of Identity theft in 2021
- Younger Americans tended to be fraud targets most frequently, but those over age 70 reported losing more money. The typical person over age 80 lost triple that of those in their 20s

Fraud

- **Pandemic Fraud – More than \$163 billion in pandemic unemployment benefits was likely issued in error with a big chunk due to fraud - US Dept of Labor**
- Feds arrest a New York Couple and seize \$3.6 billion in stolen cryptocurrency
- 3 individuals used stolen and fictitious identities to submit 150 fraudulent applications to obtain more than \$20 million in COVID-relief funds based on phony payroll records and tax documents to the SBA.
- May 2021 – Colonial Pipeline shut down 5 days – paid nearly \$5 million in bitcoin. CEO later testified that hackers were able to get in system **by logging into its VPN with a former employee's password.**

NFP Fraud

- An arts center lost \$1.48 million over five years in a scheme by a low-level accounts receivable employee. The employee **created fake companies**, assigned vendor numbers to them, and then submitted invoices for work never performed.
- A nonprofit lost \$500,000 when it was discovered that its former **chief financial officer wrote fraudulent checks** to herself and forged her supervisor's signature on them. Her crime was uncovered when she resigned from her position, and the new CFO discovered the missing checks.

NFP Fraud

- An employee **embezzled \$1.4 million** from a nonprofit. The woman made over 350 unauthorized wire transfers and issued over 250 checks to herself, her husband, and several of her creditors. She was arrested and placed on a pretrial release with the condition that she refrain from illegal activities. However, that didn't deter her. She used a different name to secure employment with a different nonprofit and failed to disclose her prior indictment. She stole \$57,000 from the second nonprofit during her pretrial release period.
- An administrative assistant working at this nonprofit admitted to embezzling over \$5.1 million in a scheme that went unnoticed for eight years. The employee had access to critical financial systems and **she created**

NFP Fraud

- 74% of nonprofit fraud was perpetrated by individuals at the officer and management levels
- top three causes of nonprofit fraud were:
 - lack of internal controls
 - lack of management review of existing internal controls
 - override of existing internal controls
- nonprofit organizations utilized recommended fraud controls at far lower rates than did other organizations

NFP Fraud

- 21% of nonprofits conducted surprise audits, whereas 40% of other organizations did
- 24% of nonprofits conducted formal fraud risk assessments, whereas 43% of other organizations did
- 44% of nonprofits instituted management review of internal controls, whereas 68% of other organizations did
- 57% of nonprofits utilized an internal audit department, whereas 76% of other organizations did

NFP Fraud

- Question:

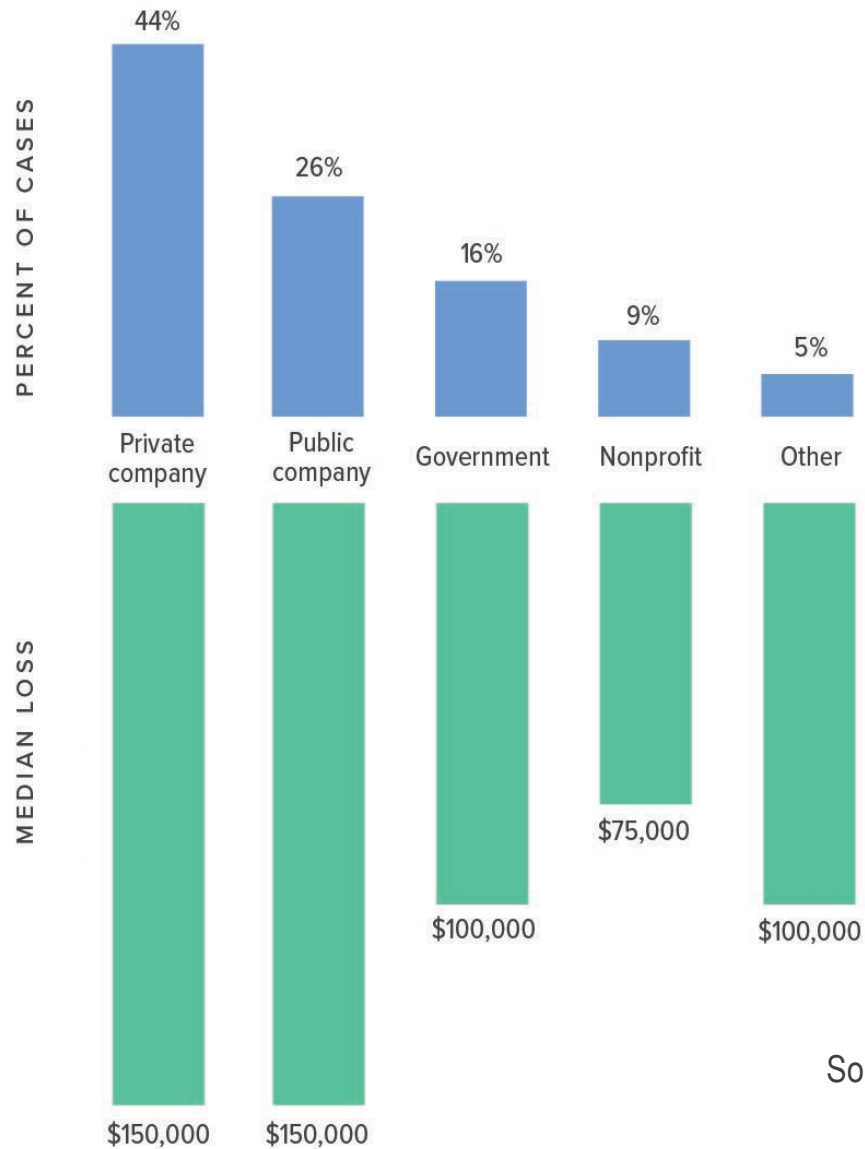
Have you been with an Organization when fraud had occurred?

A) Yes

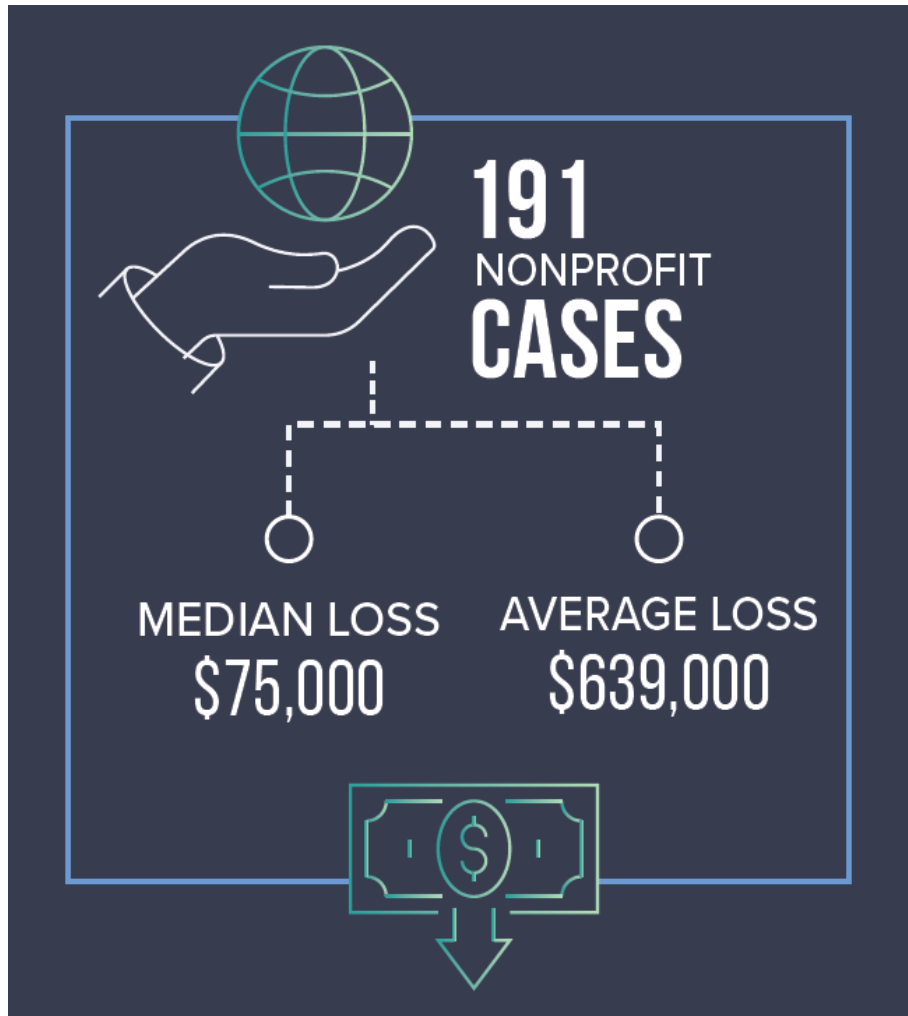
B) No

Fraud and Your Organization

FIG. 14 What types of organizations are victimized by occupational fraud?









Source: ACFE Report to the Nations



Source: ACFE Report to the Nations

Nonprofit schemes

Percent of cases

Corruption		41%
Billing		30%
Expense reimbursements		23%
Cash on hand		17%
Noncash		16%
Skimming		15%
Check and payment tampering		14%
Cash larceny		12%
Payroll		12%
Financial statement fraud		11%
Register disbursements		3%

Source: ACFE Report to the Nations

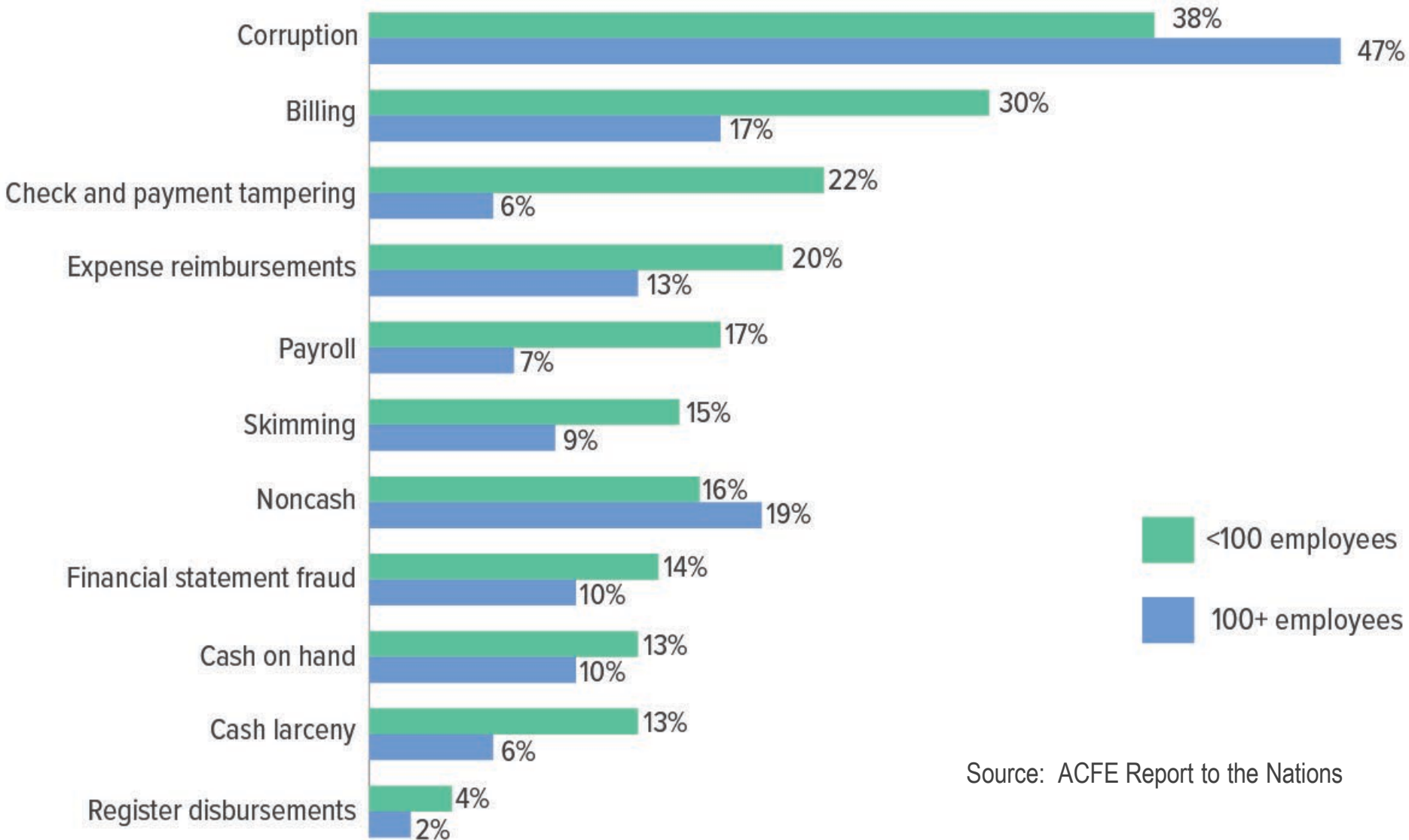
Schemes

- **Billing schemes** include: false vendors or shell companies; resubmitting valid invoices for duplicate payment; and including personal expenses as company charges.
- **Corruption** includes: conflict of interest, bribes, kickbacks, bid rigging, and sales schemes.
- **Skimming** includes: theft of incoming payments before they are entered into the system hidden by lapping receivables or unrecorded sales.

Schemes (Cont.)

- **Expense reimbursement schemes** include: mischaracterized expenses, overstated expenses, fictitious expenses, and duplicate reimbursements.
- **Check tampering** includes: forged maker, forged endorsement, and altered payee.
- **Payroll schemes** include: ghost employee, retaining an employee on payroll after termination, falsified wages, and commission schemes.

FIG. 18 How do fraud schemes vary by organization size?



Source: ACFE Report to the Nations

The Perpetrator

Attributes of an Embezzler

Sense of
Entitlement

Superiority
Complex

Greed

Pressure
from
Above

Well-Educated

Rule-Breaker Mentality

Thrill
Seeker

Position
of Trust

Financial
Stress

Addiction

FIG. 36 How does the perpetrator's age relate to occupational fraud?

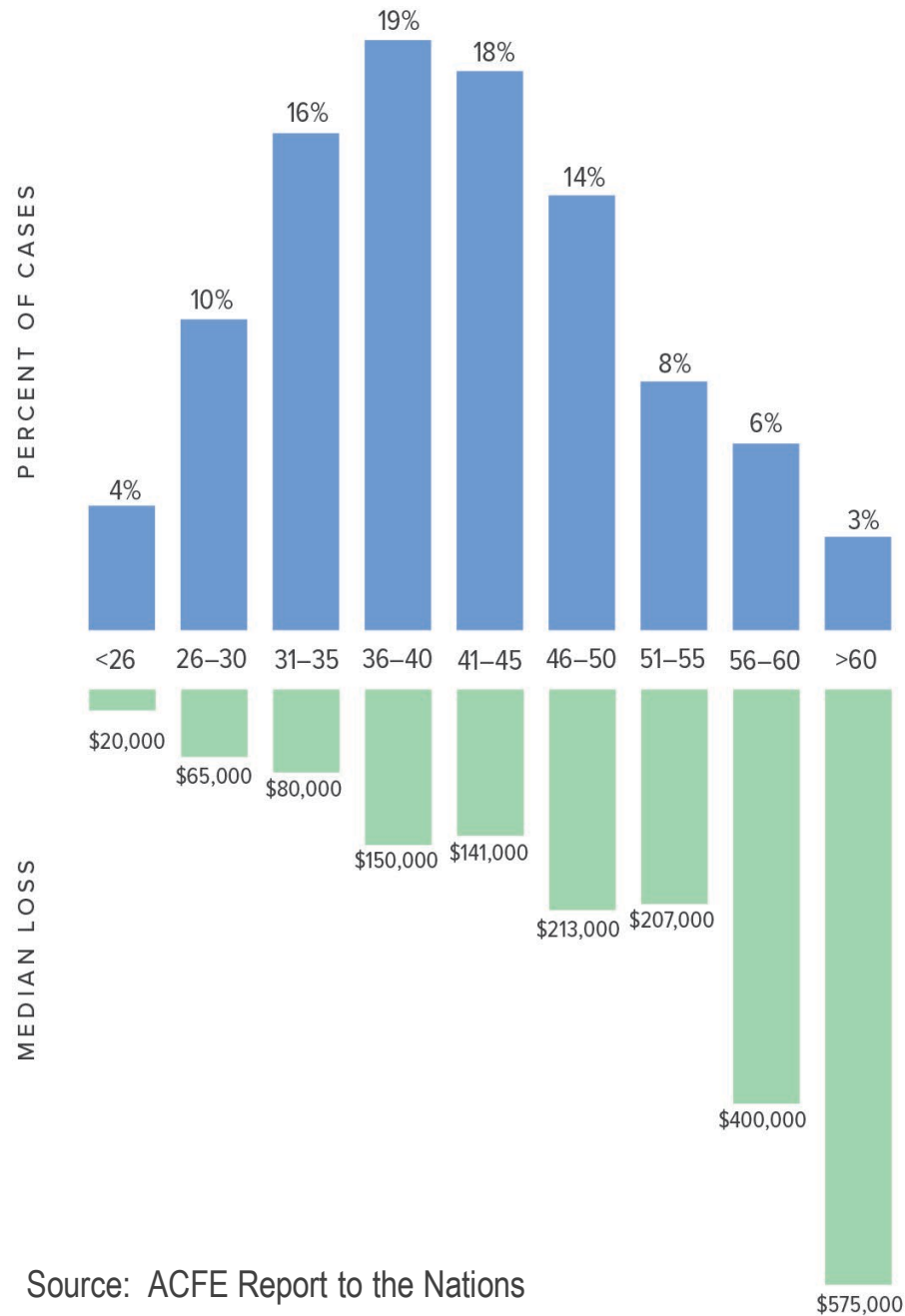
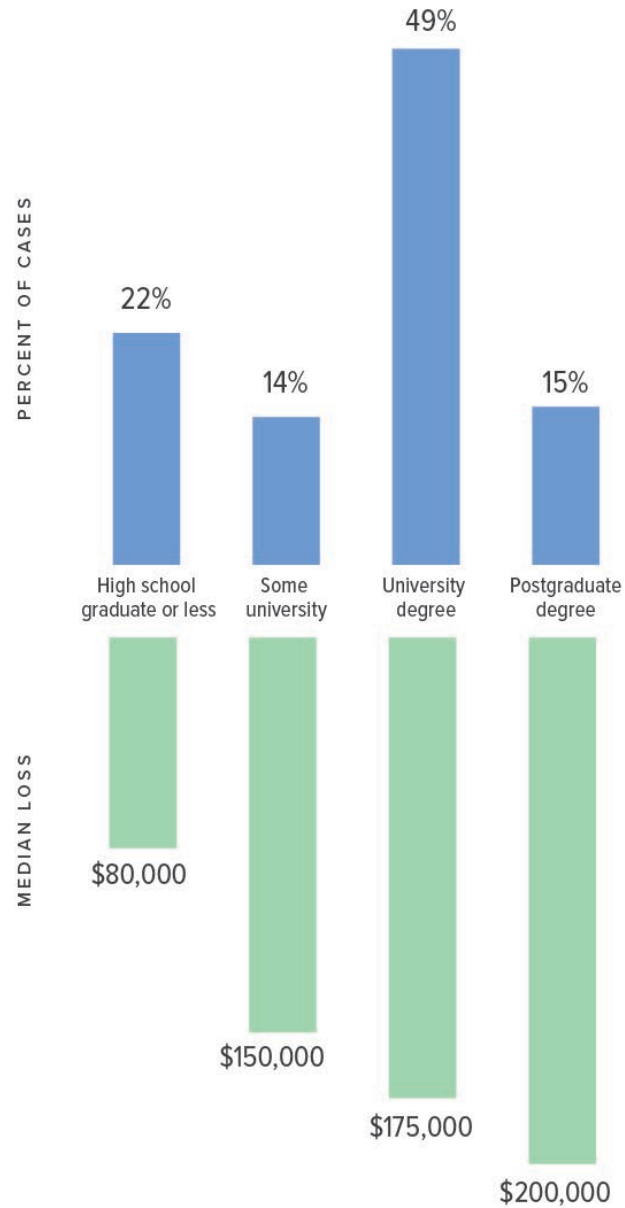
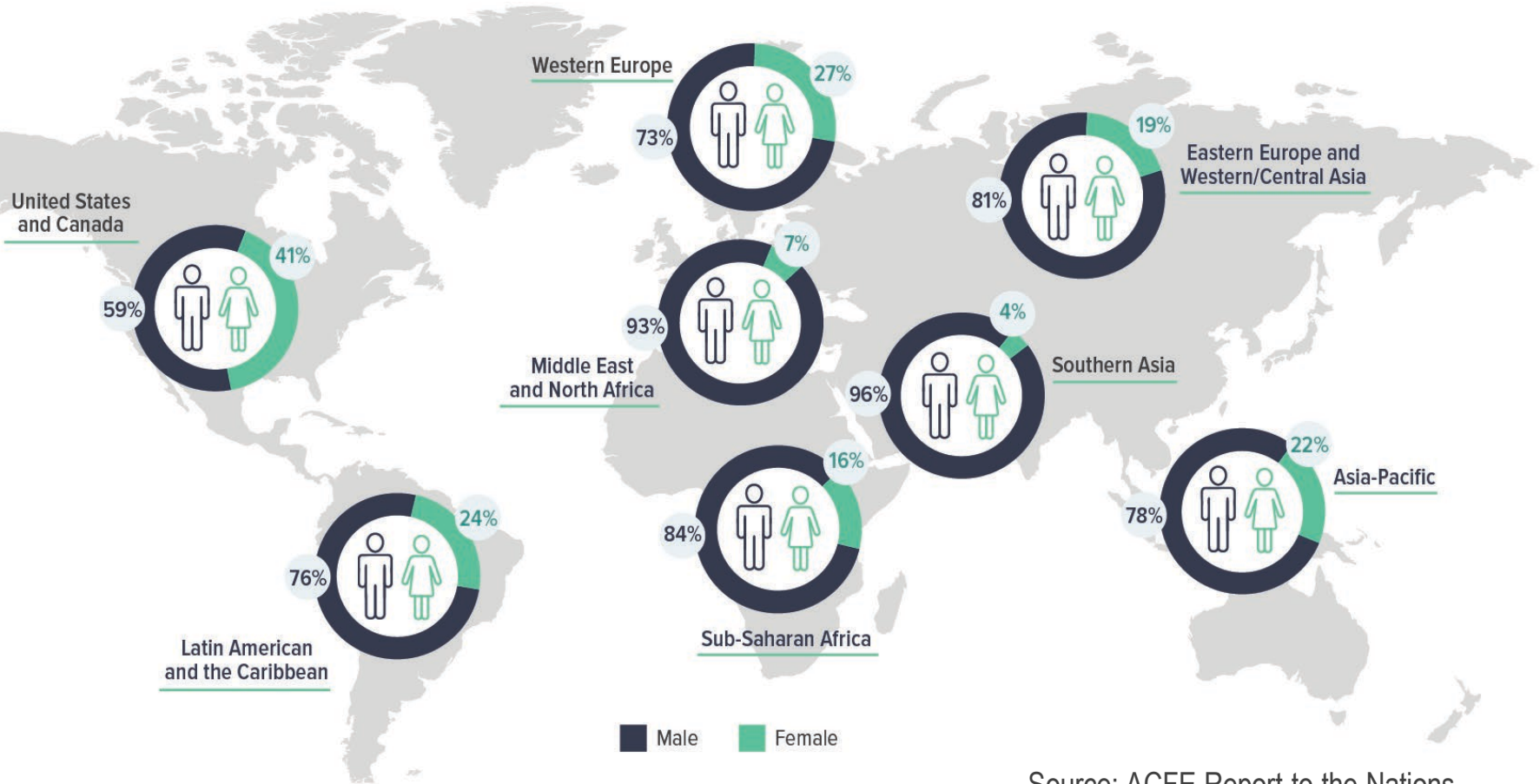


FIG. 37 How does the perpetrator's education level relate to occupational fraud?



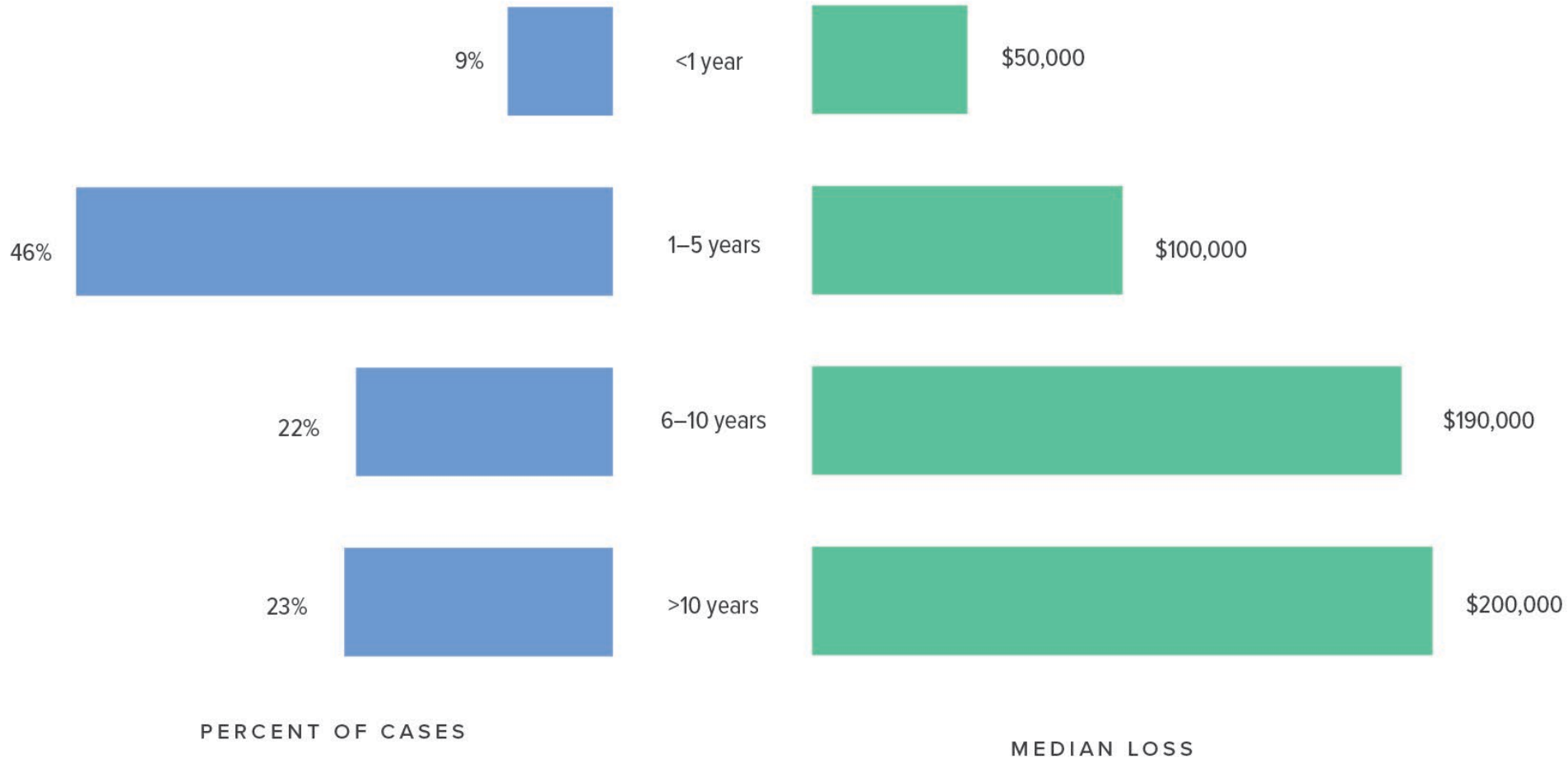
Source: ACFE Report to the Nations

FIG. 34 How does the gender distribution of perpetrators vary by region?



Source: ACFE Report to the Nations

FIG. 29 How does the perpetrator's tenure relate to occupational fraud?



Source: ACFE Report to the Nations

Perpetrators AT NONPROFITS



39%
of cases

Owner/executive
MEDIAN
LOSS \$250,000

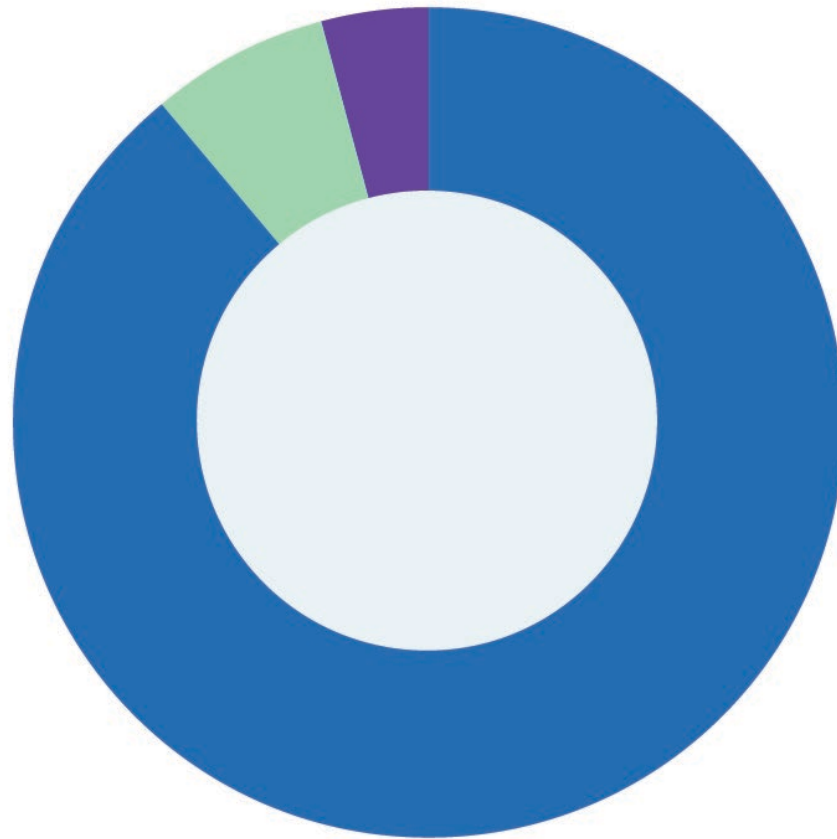
35%
of cases

Manager/supervisor
MEDIAN
LOSS \$95,000

23%
of cases

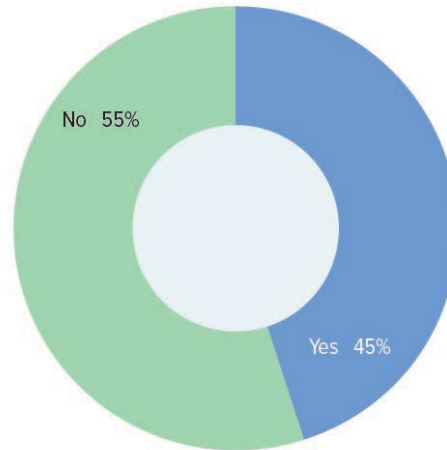
Employee
MEDIAN
LOSS \$21,000

FIG. 39 Do perpetrators tend to have prior fraud convictions?

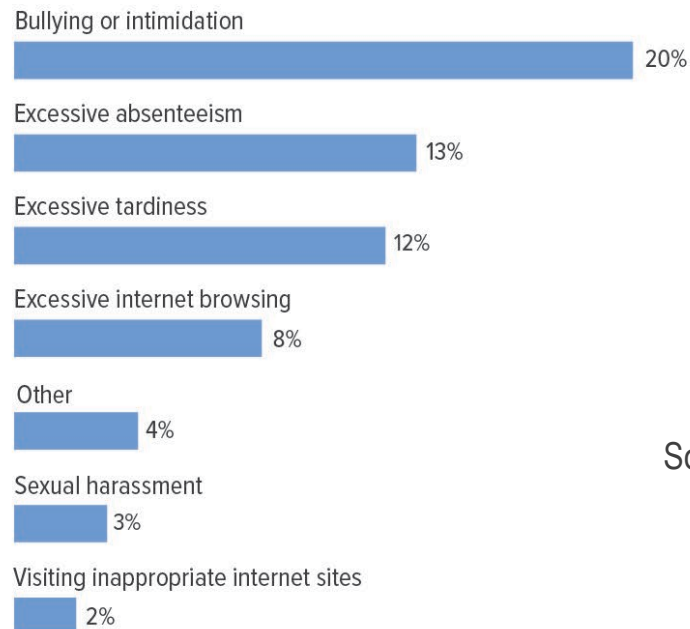


- Never charged or convicted (89%)
- Charged, but not convicted (7%)
- Had prior convictions (4%)

FIG. 42 Do fraud perpetrators also engage in non-fraud-related misconduct?

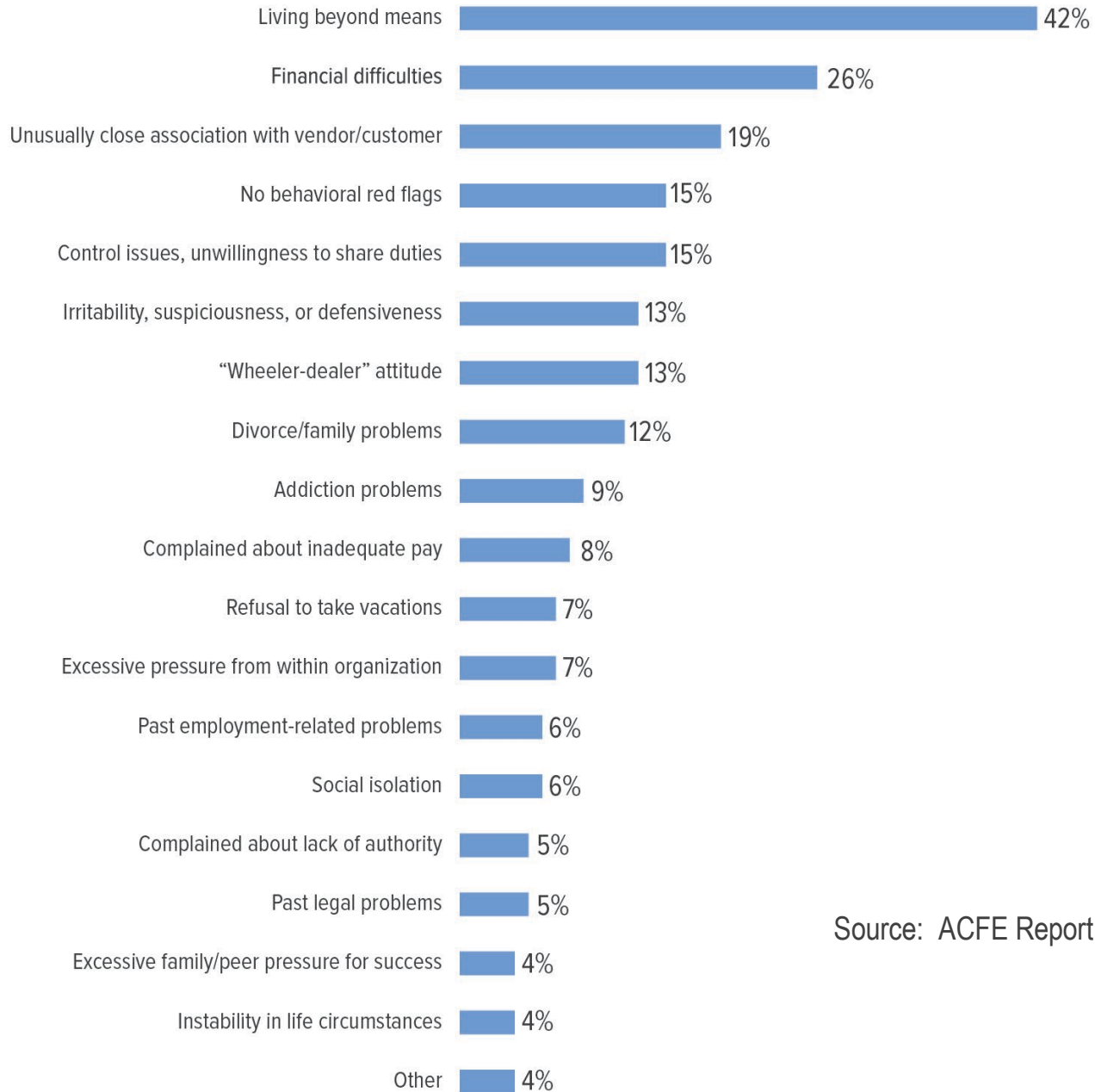


Which forms of non-fraud misconduct are most common among fraud perpetrators?



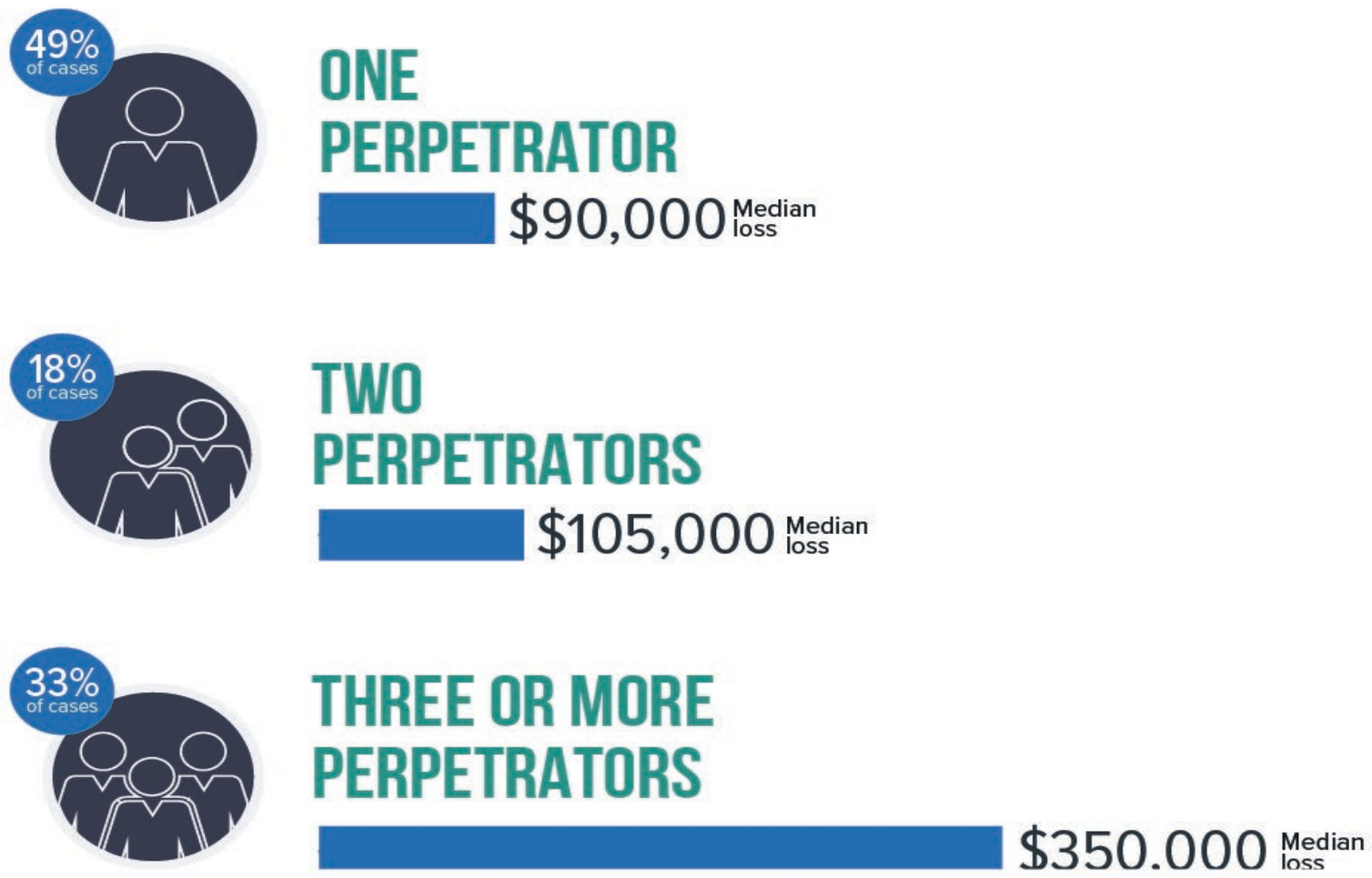
Source: ACFE Report to the Nations

FIG. 41 How often do perpetrators exhibit behavioral red flags?



Source: ACFE Report to the Nations

FIG. 38 How does the number of perpetrators in a scheme relate to occupational fraud?

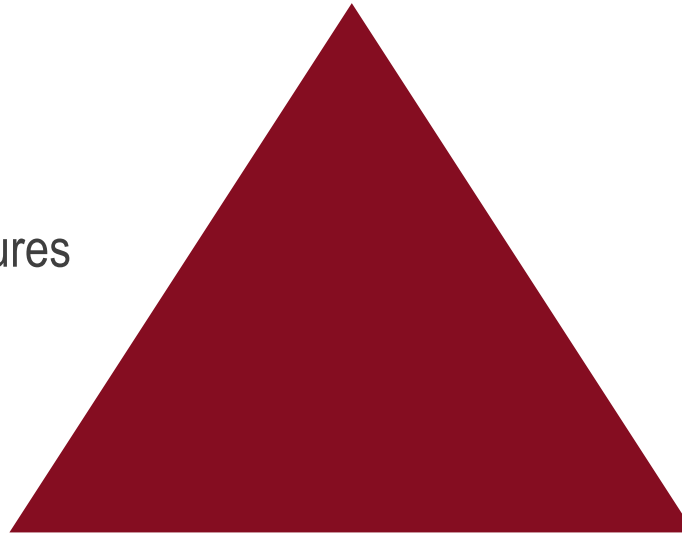


Source: ACFE Report to the Nations

The Fraud Triangle

Pressure

- Personal debt
- High medical bills
- Supporting a habit
- Work-related pressures



Opportunity

- Inadequate segregation of duties
- Rapid turnover/ lack of oversight
- Absence of mandatory vacations
- Constant “crisis” mode
- Controls not followed

Rationalization

- “I’m not hurting anybody”
- “This company owes me”
- “I’ll pay it back”

Internal Controls and Detection

Weaknesses at Nonprofits



NFP Fraud

- Question:

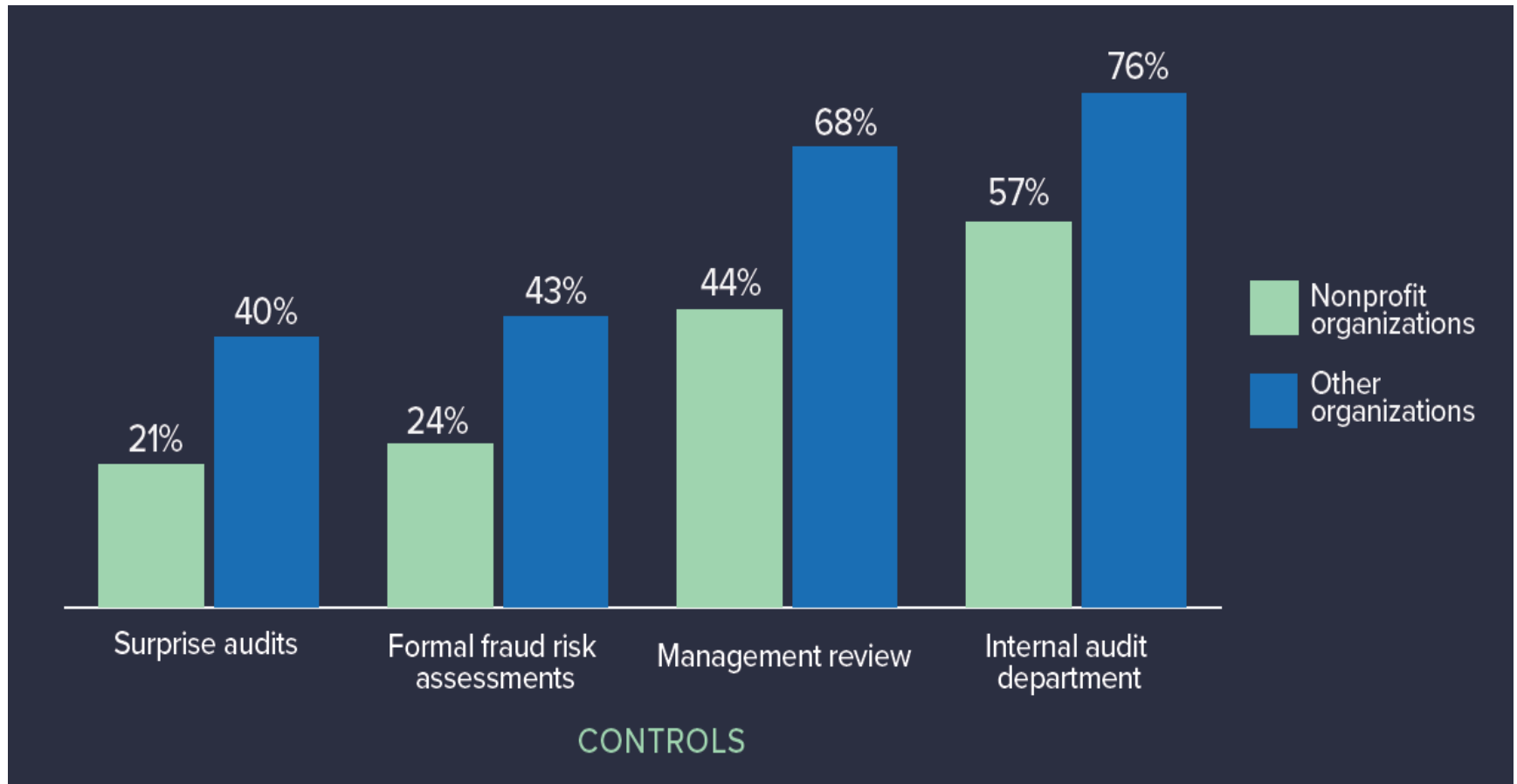
Does your Organization have the following:

A) Surprise Audits

B) Formal fraud assessments

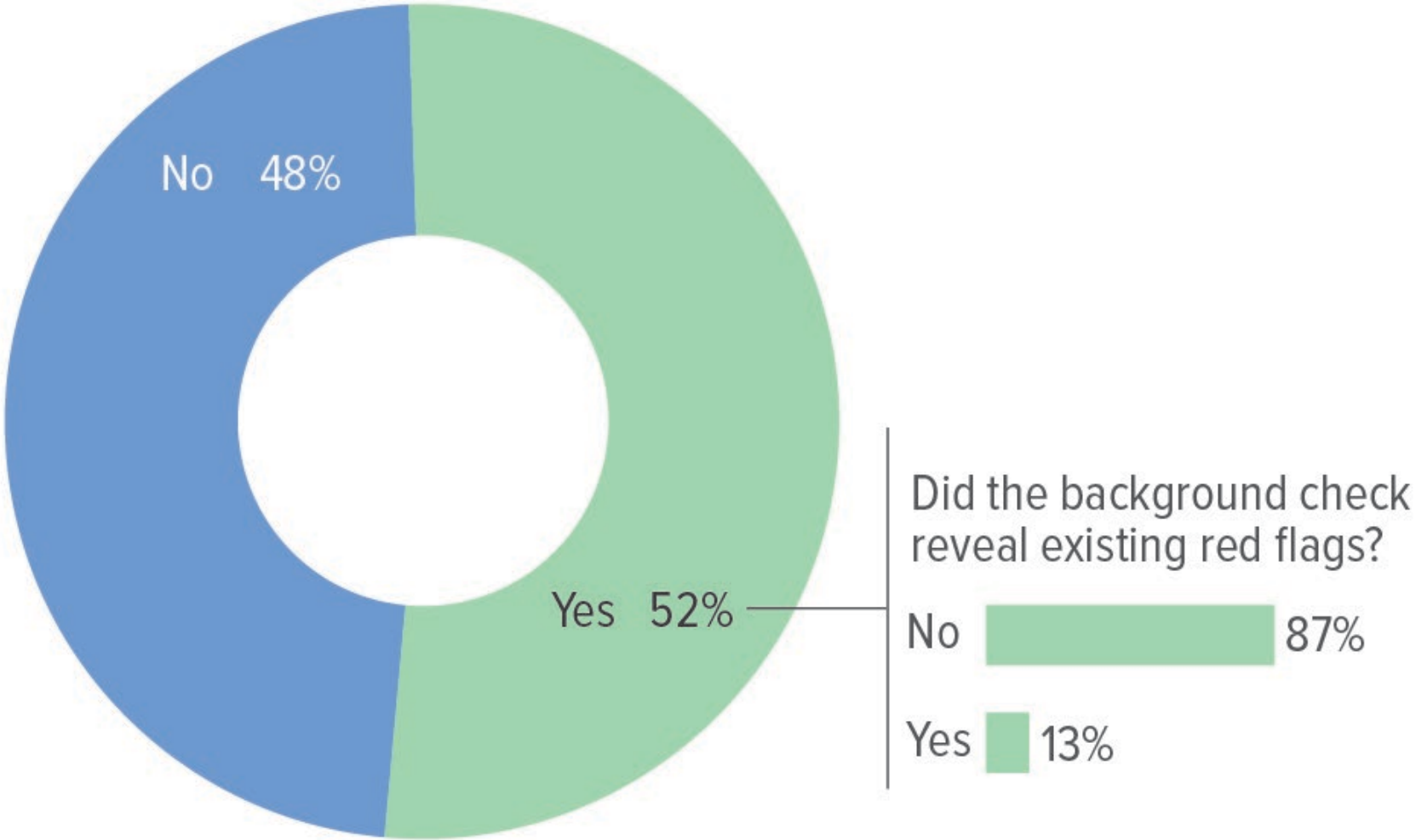
C) Internal Audit Department

Controls at Nonprofits Compared to Others



Source: ACFE Report to the Nations

FIG. 25 Was a background check run on the perpetrator prior to hiring?



Source: ACFE Report to the Nations

FIG. 22 How does the presence of anti-fraud controls relate to median loss?

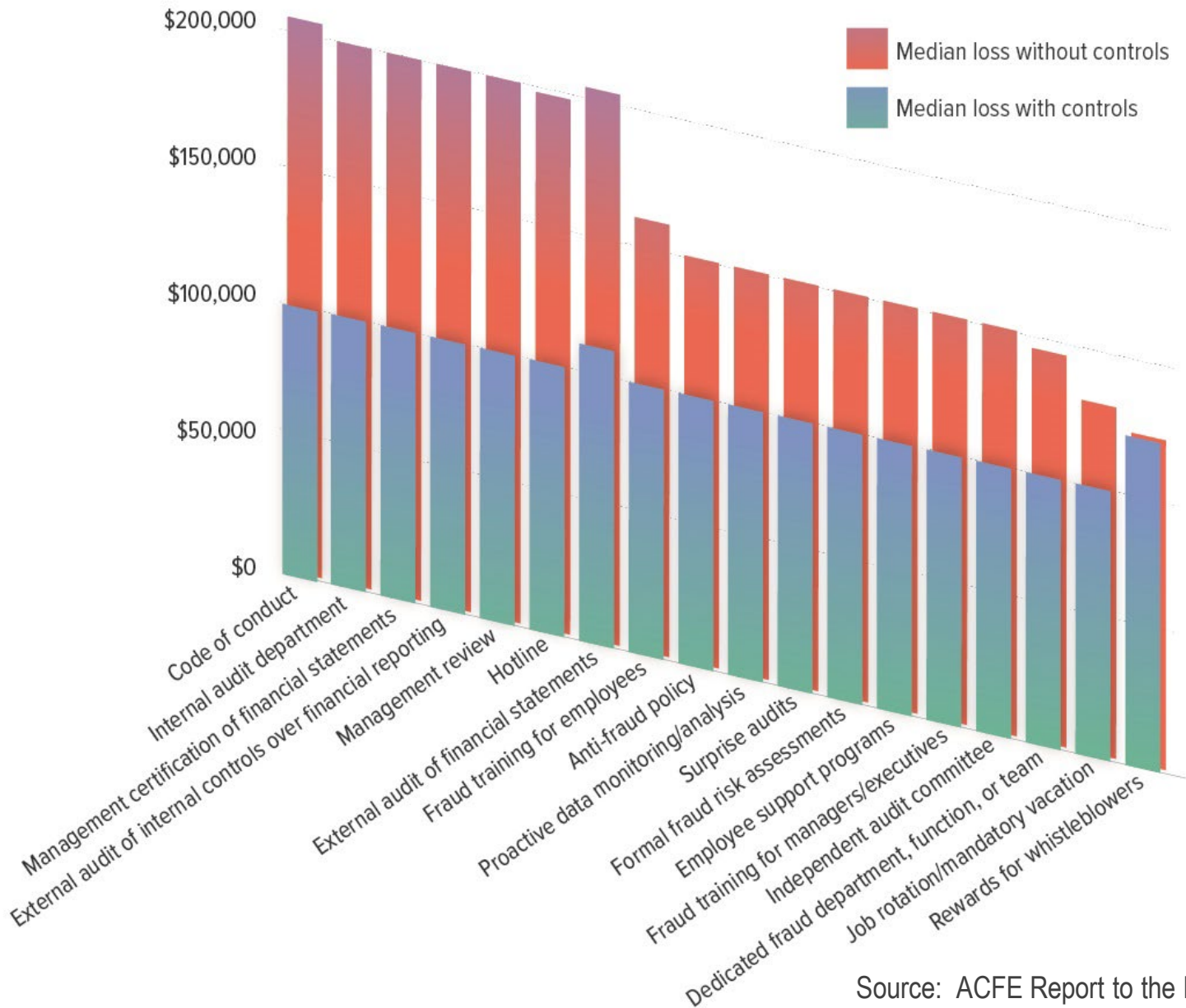
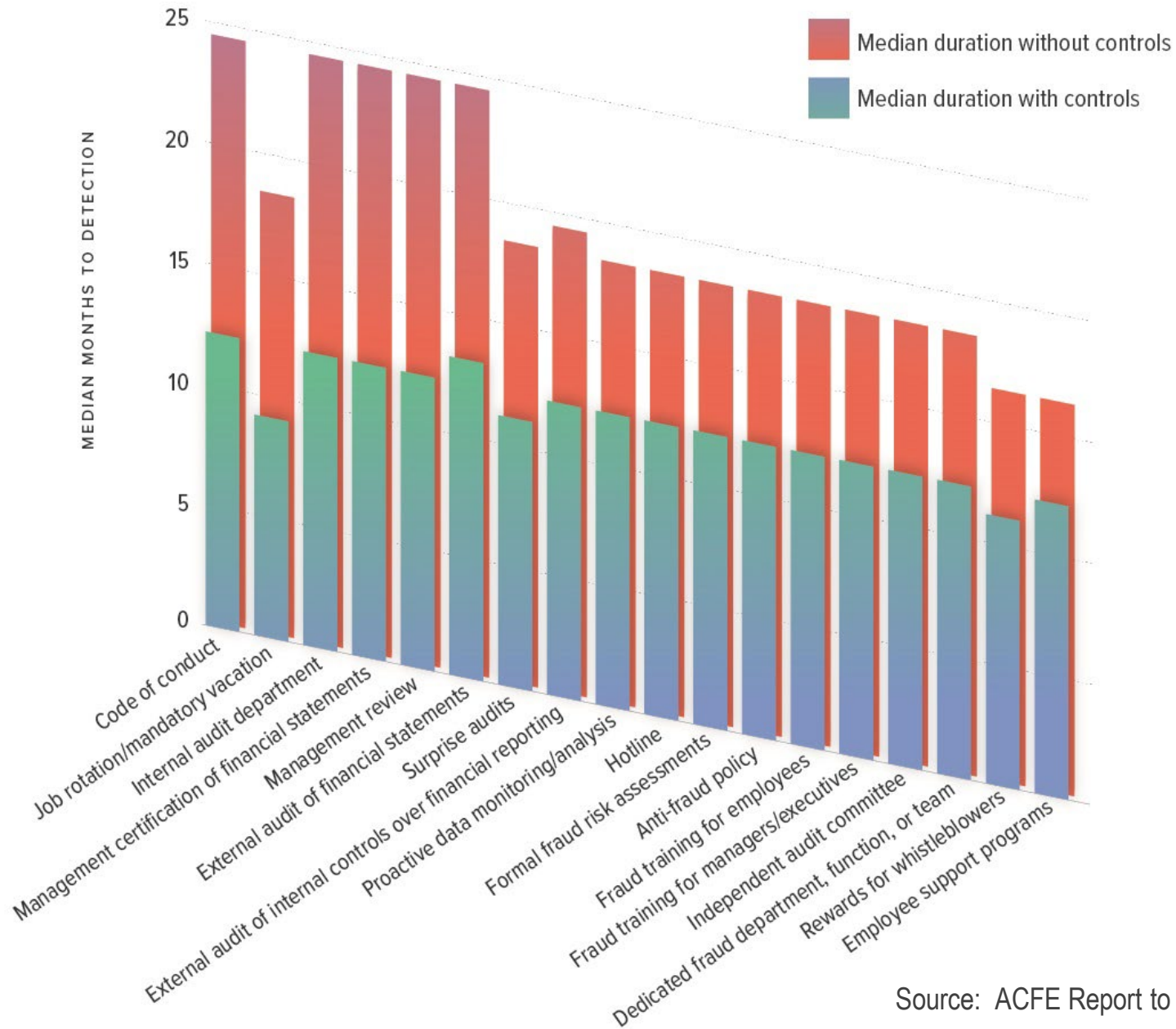
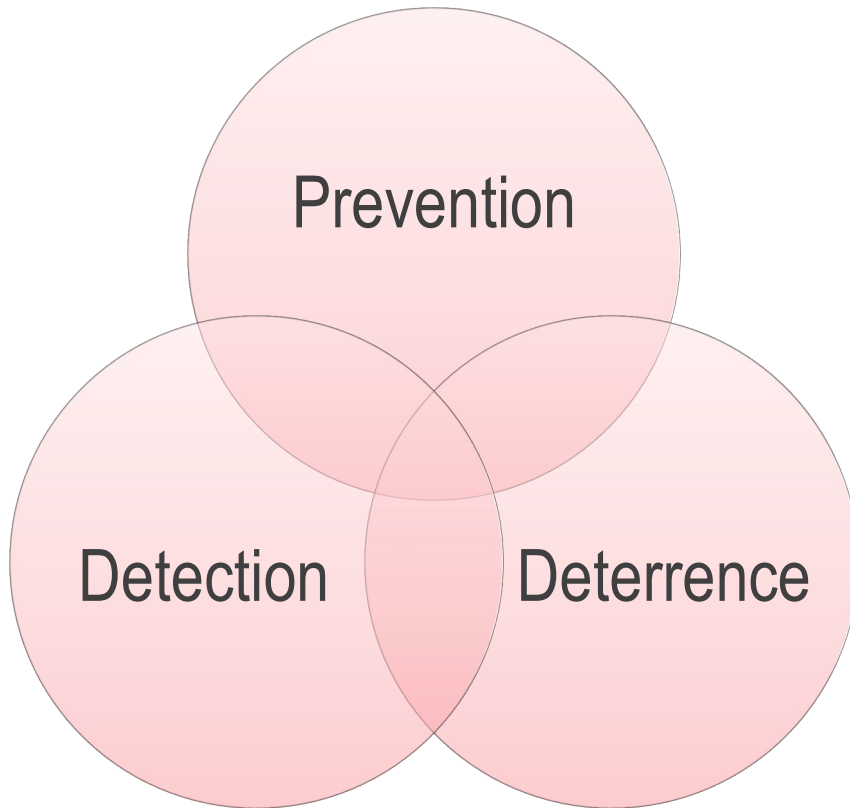


FIG. 23 How does the presence of anti-fraud controls relate to the duration of fraud?



Effective Controls



Prevention

- Code of conduct
- Employee counseling services
- Fraud training
- Employee background checks
- Mandatory vacations, job rotation
- Segregation of duties

Detection

- Fraud hotline
- Financial statement trend analysis
- **Monthly** financial statement preparation and review
- **Monthly** reconciling of accounts
- Surprise (internal) audits
- External audit
- Employee exit interviews

Deterrence

- Prosecuting fraud perpetrators

Code of Conduct

- Conflicts of interest
- Confidentiality
- Relationships with customers and suppliers
- Gifts and entertainment
- Unethical behavior
- Use of corporate assets
- How to report fraud or unethical behavior

It is important to monitor the compliance with the code of conduct which may include requiring at least annual confirmation of compliance and understanding the code.

Tips on Analytical Reviews

- Establish a baseline and then look for outliers or values that exceed averages.
- Look at both high and low values that are unexpected.
- Small anomalies may add up over time.
- Group your data into meaningful classifications and compare between periods and, if applicable, locations.
- Data analytics should be repeated and ongoing in order to establish patterns and deviations from regular expectations.
- Communicate that monitoring activities are being conducted regularly so that employees are aware that close attention is being paid.

Detection AT NONPROFITS

TIP OR
COMPLAINT

40%



INTERNAL
AUDIT

17%



MANAGEMENT
REVIEW

13%



BY
ACCIDENT

7%



EXAMINATION
OF DOCUMENTS

6%



Source: ACFE Report to the Nations

NFP Fraud

- Question:

Would you be a whistleblower of fraud in your organization?

A) Yes

B) No

Taking Action

Fraud Prevention Check-Up

- ACFE has a **Fraud Prevention Check-Up** tool available here:
<http://www.acfe.com/fraud-prevention-checkup.aspx>
- Questions include:
 - **Risk Assessment**
 - To what extent has the organization established a process for oversight of fraud risks by the board of directors or others charged with governance?
 - To what extent has the organization created “ownership” of fraud risks by identifying a member of senior management as having responsibility for managing all fraud risks?
 - **Anti-fraud controls**
 - To what extent has the organization implemented measures to eliminate or reduce each of the significant fraud risks identified in its risk assessment?

Fraud Prevention Check-Up (cont.)

The check-up tool includes examples and suggestions such as:

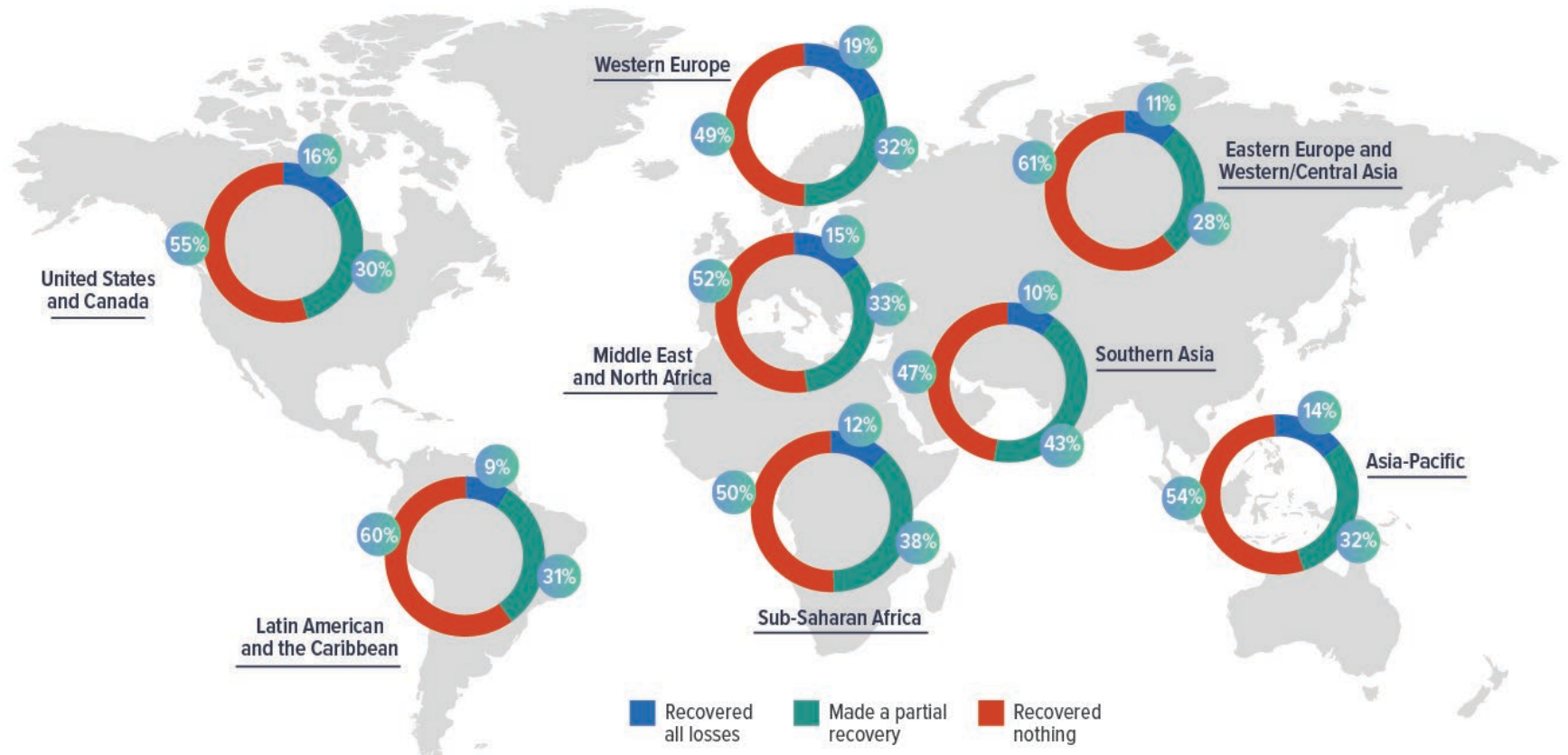
1. Fraud risks relating to receipt of funds can be eliminated or greatly reduced by centralizing that function or outsourcing it to a bank's lockbox processing facility.
2. The risk of sales representatives falsifying sales to earn sales commissions can be reduced through effective monitoring by their sales manager, with approval required for sales above a certain threshold.
3. Although "soft" controls to promote appropriate workplace behavior are more difficult to implement and evaluate than traditional "hard" controls, they appear to be the best defense against fraud involving senior management.

Fraud Risk Assessment

- Understand the controls that are in place
 - Are they being followed?
- What controls should be added?
 - Prioritize based on level of risk
 - Costs vs. benefits
- Are there ineffective controls in place that should be removed?
- Risk assessment should consider:
 - fraud **prevention** controls
 - fraud **detection** controls
- Trying to prevent **all** fraud generally is **not** cost-effective
 - No guarantee you can prevent **all** fraud, no matter what controls you have

FIG. 46 How did the recovery of fraud losses vary by region?

Source: ACFE Report to the Nations



Fraud Investigation





ACFE FRAUD PREVENTION **CHECK-UP**

ACFE Check-Up

One of the ACFE's *most valuable* fraud prevention resources, the **ACFE Fraud Prevention Check-Up** is a simple yet powerful test of your company's fraud health. Test fraud prevention processes designed to help you identify major gaps and fix them before it is too late.

- proactively identify and manage your fraud risks
- pinpoint opportunities to save you money
- organization that fails to protect itself appropriately faces increased vulnerability to fraud
- Most organizations score very poorly in initial fraud prevention check-ups
- fraud prevention processes help increase the confidence of Audit Committee and public

ACFE Check-Up

- **Fraud risk oversight – Audit Committee**
- **Fraud risk ownership**
- **Fraud risk assessment**
- **Fraud risk tolerance and risk management policy**
- **Process-level anti-fraud controls / reengineering**
- **Environment-level anti-fraud controls**
- **Proactive fraud detection - compliance**

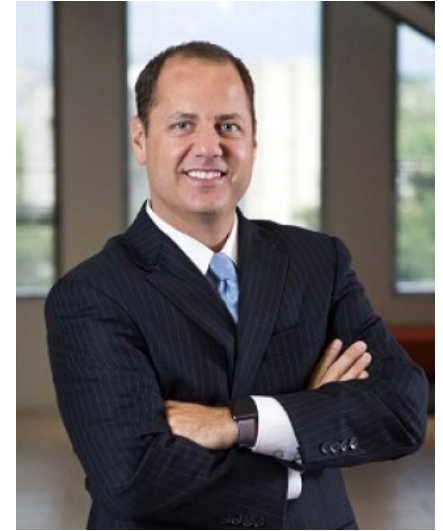
A hand with dark nail polish is holding a yellow sticky note in the bottom right corner. The background consists of a grid of nine yellow sticky notes on a light blue wall. The text "Any Questions?" is overlaid in the center in a dark blue font.

Any
Questions?

Thank you for your time.

Greg Plotts, CPA

- Greg Plotts, CPA, serves as a partner in Aronson's Nonprofit & Association Services Group. He is a proactive and collaborative leader with over 20 years of industry experience.
- Greg specializes in financial statement assurance and consulting matters for associations, healthcare entities, and other exempt organizations. He has a wide range of experience with complex issues, including internal controls, revenue recognition, fraud investigations, international audit matters, foreign currency transactions, valuation of intangible assets, joint ventures, mergers and acquisitions, and more.
- Greg's passion lies in building strong, productive relationships with both his clients and team. He invests the time to listen and learn about his clients' organizations, objectives, and challenges. He then partners with them to implement the right strategic initiatives to achieve their short- and long-term objectives. As an enthusiastic mentor, he is committed to cultivating a positive and healthy team culture, where all members thrive and grow.
- Prior to joining Aronson, Greg held steadily increasing leadership roles at both a "Big 4" accounting firm and a regional accounting firm. Active in the community and profession, his involvement builds on his knowledge and understanding of the nonprofit industry and increases the value he brings to his clients.



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