

FORVIS

WEBINAR

Internal Controls for Fraud Prevention

March 21, 2023

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Meet the Presenters



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Advisory Services

Agenda

WEBINAR

- Introductions

- Key Takeaways

- Overview of Fraud & the Perpetrators of Fraud

- Enabling Factors & Red Flags

- Case Studies

- Fraud Deterrence & Prevention

- Q&A

Key Takeaways

- Good people commit fraud
- Outside factors contribute to someone committing fraud
- An organization cannot control pressure/outside incentives & rationalization
- Focus on perceived opportunities
 - Take the person out of the picture – TRUST IS NOT A CONTROL
 - Assess the ENVIRONMENT, not the person

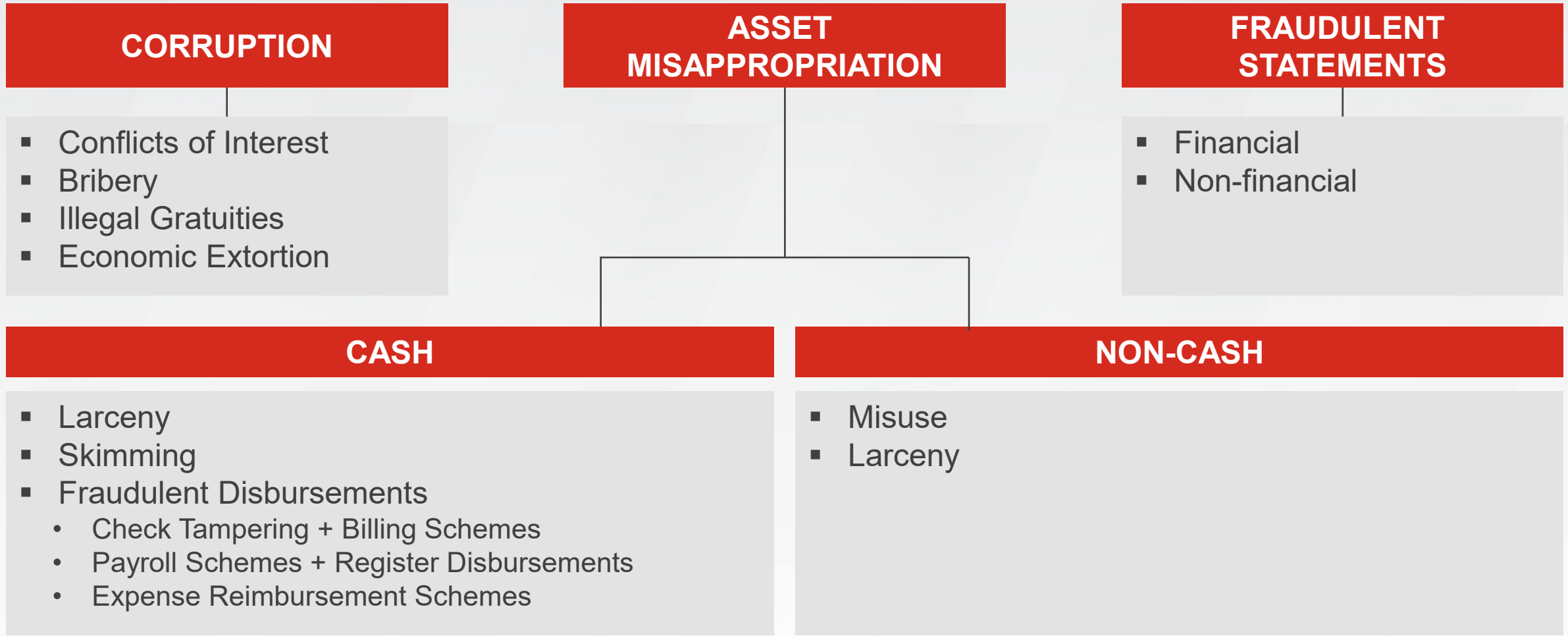
Key Takeaways (cont.)

- Fraud is most frequently detected by tips & proactive measures
- Create atmosphere of oversight with computer in the sky
- Controls protect the organization & employees

Overview of Fraud & the Perpetrators of Fraud

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ACFE Occupational Fraud & Abuse Classification System



Famous Fraud Cases



Jeff Skilling – Former
Pres. Enron



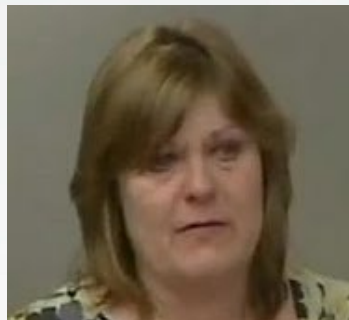
Charles Ponzi



Bernie Madoff



Linda Schrenko – \$600K
Former Superintendent
Georgia Schools



Deborah Newton –
\$750K from
Veterinary Hospital



Donald Guy Fuller
– \$562K over 13
yrs. NY School
Administrator;
Fictitious Vendor
Scheme



Diann Cattani –
\$500K over 4 yrs.
Prof. Services Com;
served 15 yrs.



Kenneth Kintsley –
\$300K over 3 yrs.;
Movie Theater
Manager; skimmed
daily receipts

Do Good People Commit Fraud?

YES!

Business Partner

Friend

Business Advisor

Trusted Employee

Family Member

Trustee

- Understanding this is key to establishing awareness & deterrence to protect an organization & its employees

Criminal & Employment Backgrounds

FIG. 42 DO PERPETRATORS TEND TO HAVE PRIOR FRAUD CONVICTIONS?

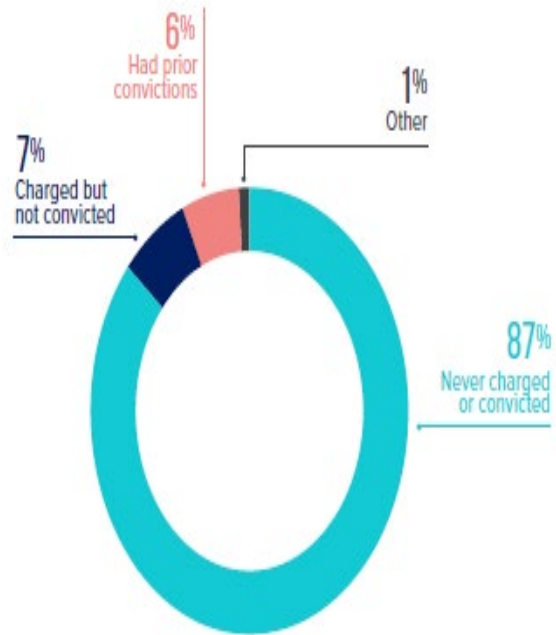
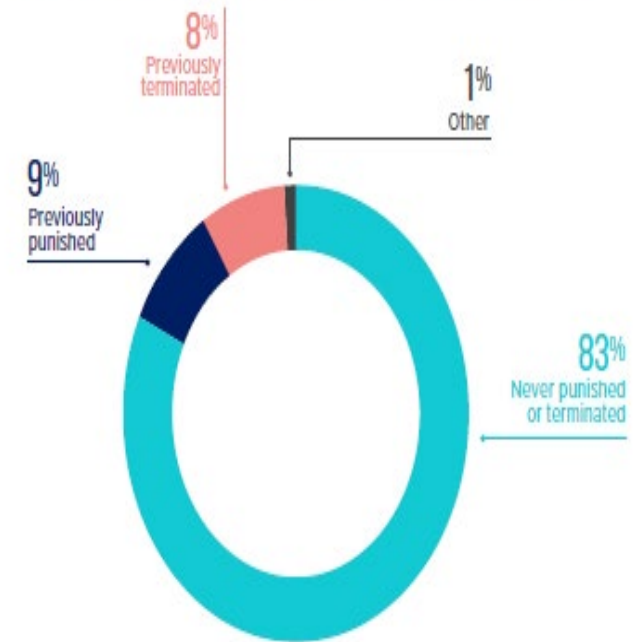
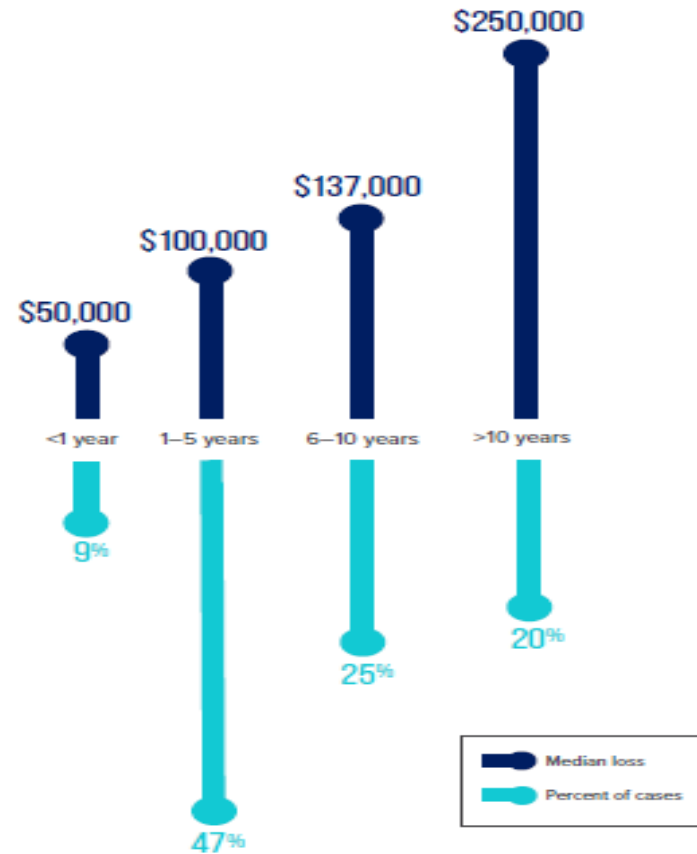


FIG. 43 DO PERPETRATORS TEND TO HAVE PRIOR EMPLOYMENT-RELATED DISCIPLINARY ACTIONS FOR FRAUD?



Tenure

FIG. 33 HOW DOES THE PERPETRATOR'S TENURE RELATE TO OCCUPATIONAL FRAUD?



Initial Detection of Occupational Frauds

FIG. 10 HOW IS OCCUPATIONAL FRAUD INITIALLY DETECTED?

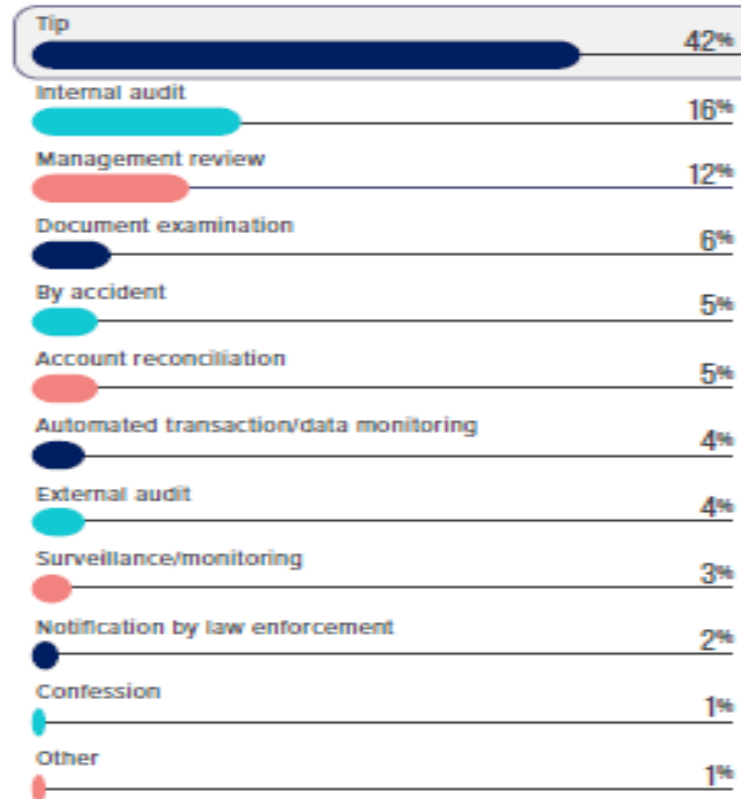
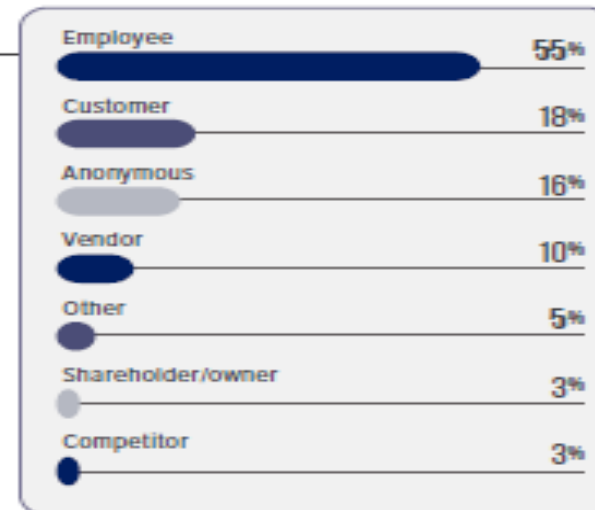


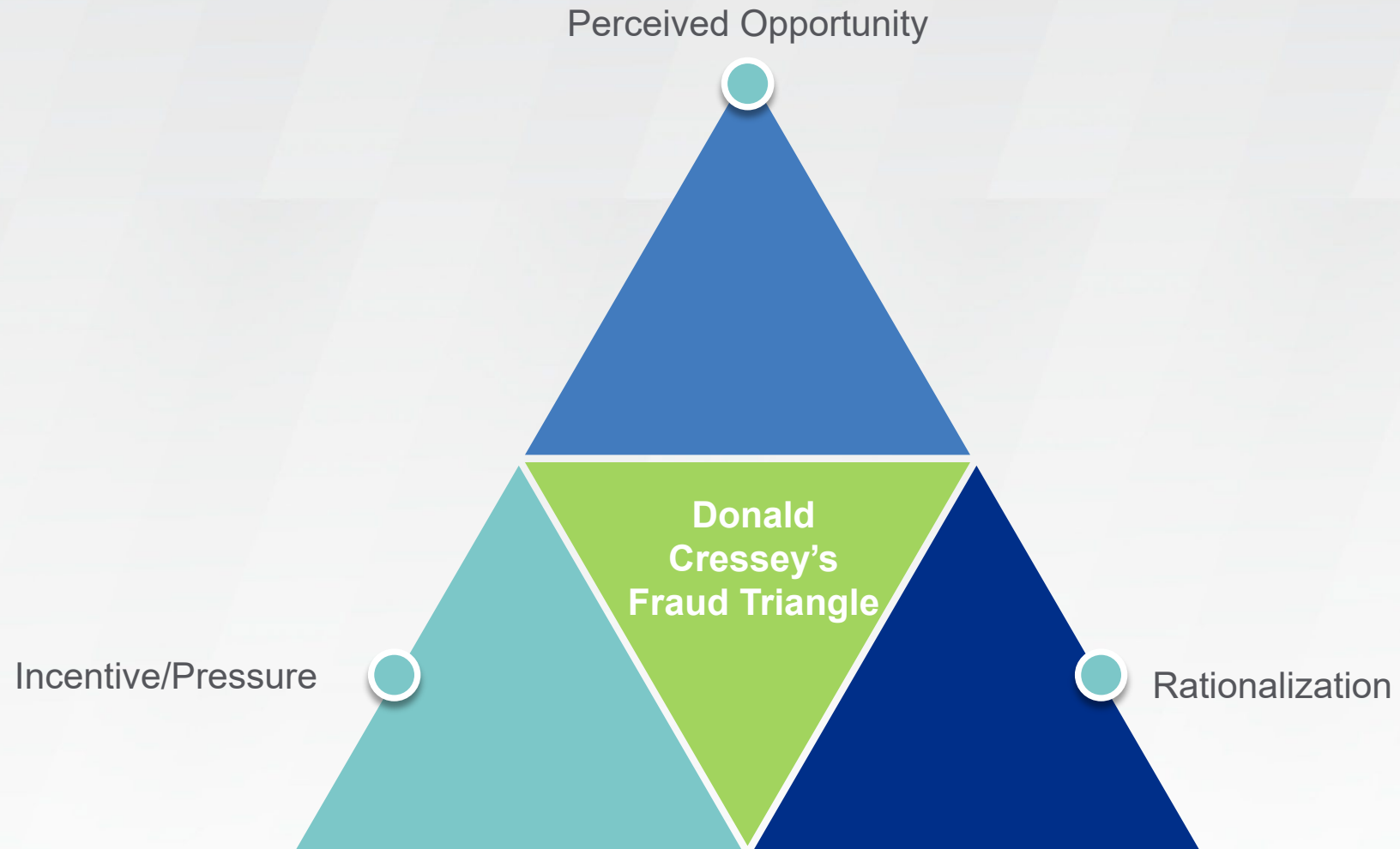
FIG. 11 WHO REPORTS OCCUPATIONAL FRAUD?



Enabling Factors & Red Flags

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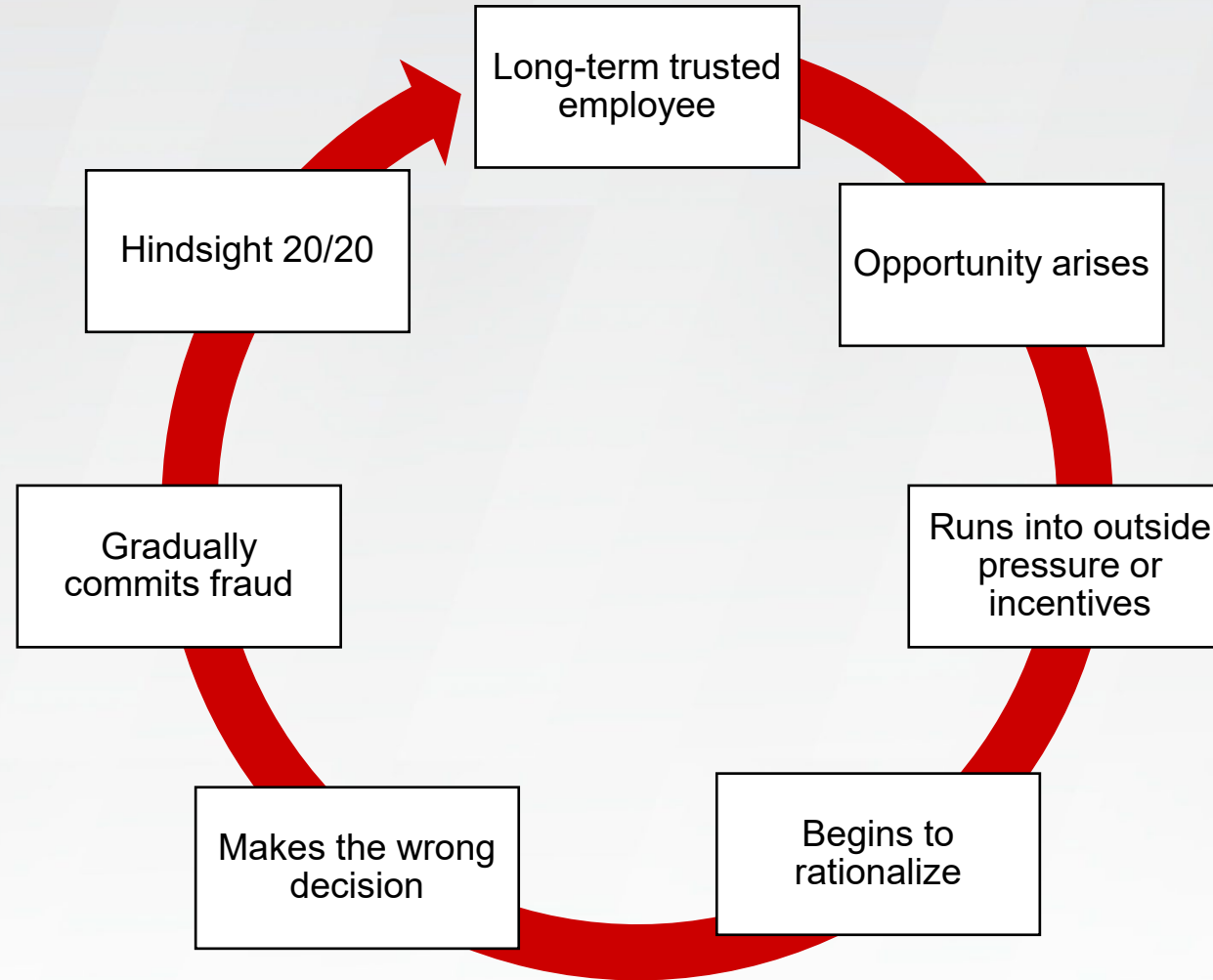
Enabling Factors



Pressures &/or Incentives

- Mid-life crisis
- Alcohol/drugs
- Gambling
- Financial difficulties
- Medical costs due to illness
- Work pressures
 - To meet budgets
 - To enhance bonuses

The Fraud Cycle



Case Studies

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Case Study #1 – Stealing Time

- **Timesheet Fraud**
 - Defrauded two employers
 - Found guilty on seven felony counts
 - Management was approving this employee's timesheet??

Case Study #2 – Pharmacy Theft

▪ Inventory Theft

- Over 300 pills stolen from the facility
- No one at the facility was being prescribed the drug
- This was a newly scheduled C2 narcotic
- Very potent & very inexpensive. The pills cost a total of \$25

Fraud Deterrence & Prevention

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Fraud Prevention Check-Up

- Oversight
 - Board, Audit Committee, or other governance roles

- Ownership
 - Responsible parties identified to manage fraud risks
 - Communication to business units

Fraud Prevention Check-Up (cont.)

- **Assessment**
 - Ongoing process to identify fraud risks in functional areas

- **Tolerance & Management**
 - What risk is acceptable? Has it been approved?
 - Avoidance, Acceptance, Sharing, Reduction

- **Process-Level Controls & Re-engineering**
 - Basic controls (authorization, custody, recording)
 - Controls can be costly, consider new processes

Fraud Prevention Check-Up (cont.)

- **Environmental-Level Controls**
 - Top-down ethical culture
 - Code of conduct
 - Training
 - Communication & reporting concerns
 - Formal investigative process by cross-functional team

- **Proactive Fraud Detection Methods**
 - Proactive & Preventive > Reactive & Detective
 - Leverage systems & exception reporting

Fraud Risk Assessment

- Overview/Benefits
 - Identify potential inherent fraud risks
 - Assess significance & likelihood of occurrence
 - Evaluates areas most susceptible to fraud
 - Maps existing controls to fraud risks
 - Determines if controls are operating properly
 - Identify ineffective or non-existent controls
 - Respond to residual fraud risks

Fraud Risk Assessment (cont.)

▪ Employee Assessment

- Does the company have written policies & procedures for accounting & purchasing?
- Does senior management exhibit & encourage ethical behavior?
- Does the organization provide an anonymous way to report suspected violations of fraud, waste, & abuse?
- Are pre-employment background checks performed?
- Are the duties related to authorization, custody of assets, & recording or reporting of transactions segregated?
- Do employees feel they are treated & compensated fairly?

Fraud Risk Assessment (cont.)

▪ **Employee Assessment**

- Do any employees appear to be spending far more than they are earning?
- Do any employees resent their superiors?
- Do any employees have outside business interests that might conflict with their duties at the company?
- Is the company experiencing high employee turnover?
- Are employees required to take annual vacations?
- Does the company have unrealistic productivity measurements & expectations?
- Does the organization educate employees about the importance of ethics & anti-fraud programs?

Fraud Risk Assessment (cont.)

- **Management Assessment**
 - Is the board of directors composed of mainly officers of the company or related individuals?
 - Is the organization under pressure to report favorable earnings?
 - Do any key employees have friends or relatives reporting directly to them?
 - Do any key employees have outside business interests that might conflict with their duties at the company?
 - Has the company recently experienced large operating or investment losses?

Fraud Risk Assessment (cont.)

- **Management Assessment**
 - Does the company change auditors often?
 - Does the company delay or avoid supplying auditors with the information necessary to complete the audits?
 - Does the company have poor accounting records?
 - Does the accounting department appear to be inadequately staffed?
 - Does the organization lack an internal control system, or does it fail to enforce the existing internal controls?

How Does a Control Environment Manage Risk?

An effective system of internal control

Provides accountability for achieving strategic objectives

Promotes operational efficiency & effectiveness

Improves the reliability of financial reporting to stakeholders

Strengthens compliance with applicable laws & regulations

Safeguards assets

COSO Components

COSO		▶ The COSO framework consists of 17 principles that support five components		
Control Environment	Risk Assessment	Control Activities	Information & Communication	Monitoring
<ul style="list-style-type: none"> ▶ Demonstrates commitment to integrity & ethical values ▶ Exercises oversight responsibility ▶ Establishes structure, authority, & responsibility ▶ Demonstrates commitment to competent talent ▶ Enforces accountability 	<ul style="list-style-type: none"> ▶ Specifies clear objectives ▶ Identifies & analyzes risk ▶ Assesses fraud risk ▶ Identifies & assesses significant changes 	<ul style="list-style-type: none"> ▶ Selects & develops control activities ▶ Selects & develops general controls over technology ▶ Deploys control activities through policies & procedures 	<ul style="list-style-type: none"> ▶ Uses quality information ▶ Communicates internally ▶ Communicates externally 	<ul style="list-style-type: none"> ▶ Conducts ongoing &/or separate evaluations ▶ Evaluates & communicates deficiencies timely

What Are Example of Control Activities?

- **Control activities occur at all levels & functions, in all organizations, & may include**
 - Segregation of duties
 - Authorization
 - Reconciliation
 - Review & approval
 - Education & training
 - Performance planning & evaluation

Examples of Entity-Level Controls

- Board of Directors meets quarterly; minutes are documented
- Employees sign off on The Code of Ethics during new-hire orientation & annually thereafter
- Employees undergo background checks before hiring into “sensitive” positions
- Management annually reviews policies & procedures to ensure they represent current business practices

Examples of Entity-Level Controls (cont.)

- The Continuity of Operations Plan (COOP) is tested annually
- Annual user access reviews are performed by management to confirm that the principle of least privilege & segregation of duties controls are maintained
- Security awareness training is taken by all employees annually

Examples of Transaction-Level Controls

- The Accountant prepares the deposit for the armored car pickup the evening before deposit date; deposit is locked in a safe & only appropriate personnel have access
- Travel & expense vouchers are approved by employees' supervisors before being processed for payment
- Procurements over \$X are approved by the Purchasing Director, Finance Director, & the Division Director requesting the purchase

Benefits of Implementing a Strong Internal Control Program

Weak Internal Controls	Strong Internal Control Program
<ul style="list-style-type: none">▪ Insufficient documentation to support a complete entity-level evaluation▪ An entity-wide risk assessment is not performed▪ Insufficient documentation of risk assessments for each significant fiscal process▪ Insufficient documentation of testing controls for each significant fiscal process	<ul style="list-style-type: none">▪ Implemented<ul style="list-style-type: none">• Entity-wide risk assessment▪ Identified, documented, & tested<ul style="list-style-type: none">• Entity-level controls• Transaction-level controls• IT controls▪ Benefits<ul style="list-style-type: none">• Effective/efficient operations• Reliable financial reporting• Compliant with laws/regulations• Safeguard assets

Best Practice – Complete Entity-Wide Risk Assessment Using SWOT

- Assess entity-wide risks using questionnaires &/or meetings
- Use SWOT analysis; leverage management surveys/meetings to develop common themes
- Do not treat as a task; take action to better your organization



Questions

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