

# Accounting Fraud

## Identification, Prevention, and Detection

Jodi Gissel, PhD, CPA, CFE  
Marquette University  
jodi.gissel@marquette.edu  
414.288.8041

---

---

---

---

---

---

---

---

## What is Fraud?

**fraud** \frôd\ *noun*

All multifarious means which human ingenuity can devise, and which are resorted to by one individual to get an advantage over another by false suggestions or suppression of truth, and includes all surprise, trick, cunning or dissembling, and any unfair way which another is cheated (Black's Law Dictionary)

Always involves deception, deceit ⇒ INTENT

- ▶ No such thing as an "accidental fraud" (Wells 2003)

▶ Slide 2

---

---

---

---

---

---

---

---

## ACFE Categorizations of Occupational Fraud

Fraudulent Financial Reporting	Corruption	Asset Misappropriation
Timing differences	Bribery <ul style="list-style-type: none"><li>• Vendor kickbacks</li><li>• Bid-rigging</li></ul>	Cash receipts
Fictitious revenues	Illegal gratuities	Cash on hand
Concealed or overstated liabilities and expenses	Economic extortion	Fraudulent disbursements <ul style="list-style-type: none"><li>• Billing</li><li>• Payroll</li><li>• Reimbursements</li><li>• Check or payment tampering</li></ul>
Improper asset valuations	Conflicts of interest <ul style="list-style-type: none"><li>• Sales</li><li>• Purchasing</li></ul>	Inventory, other assets
Improper disclosures		

▶ Slide 3

---

---

---

---

---

---

---

---

## Fraud Risk Factors ("Red Flags")

### Conditions that increase risk of fraud

- ▶ Fraud triangle is one method to categorize factors

### Caveats

- ▶ No proven "formula" to identify fraudsters
- ▶ Just because factors present, does not absolutely mean there is fraud – just increased risk
- ▶ Different people in same situation react differently
  - ▶ Some never commit fraud

▶ Slide 4

---

---

---

---

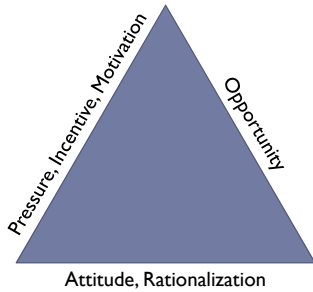
---

---

---

---

## Fraud Triangle



▶ Slide 5

---

---

---

---

---

---

---

---

## Fraud Triangle:

### **Examples** of Pressures, Incentives, Motivations

- ▶ Financial or legal difficulties
- ▶ Personal challenges
- ▶ Addictions (gambling, drugs, alcohol)
  
- ▶ Organizational stability or profitability
- ▶ Recurring negative cash flows
- ▶ Debt covenants
- ▶ Bonus or compensation structure

▶ Slide 6

---

---

---

---

---

---

---

---

Fraud Triangle:  
**Examples of Opportunities**

---

- ▶ Large amount of cash on hand or processed
- ▶ No mandatory vacation policy
- ▶ High level of trust
- ▶ High turnover
- ▶ Unusually close relationship with vendor or customer

▶ Slide 7

---

---

---

---

---

---

---

---

Fraud Triangle:  
**Examples of Opportunities**

---

**Lack of or inadequate internal controls, such as:**

- ▶ Background checks
- ▶ Staffing and/or competent personnel
- ▶ Segregation of duties\*
- ▶ Clarity in lines of authority and responsibility
- ▶ Authorizations, oversight, reviews
- ▶ Documents and records
- ▶ Physical controls

▶ Slide 8

---

---

---

---

---

---

---

---

**Segregation of Duties**

---

Minimizes opportunity to perpetrate and conceal fraudulent activity

Disperse key responsibilities within process

- ▶ Maintain custody of assets
- ▶ Authorize or approve transactions
- ▶ Record transactions
- ▶ Independent review/oversight also critical

▶ Slide 9

---

---

---

---

---

---

---

---

Fraud Triangle:  
**Examples of Attitudes**

- ▶ Belief actions not criminal or improper
- ▶ Disregard of need for rules or internal controls
- ▶ History of violations of laws or regulations
- ▶ Enjoys challenge
- ▶ Control issues, unwilling to share duties
- ▶ Unethical behaviors

▶ Slide 10

---

---

---

---

---

---

---

---

Fraud Triangle:  
**Examples of Rationalizations**

- ▶ "Everyone does it"
- ▶ "The organization owes me"
- ▶ "It isn't hurting anyone"
- ▶ "The organization has plenty of money"
- ▶ "I'm doing it for my family"
- ▶ "I had no other choice"

▶ Slide 11

---

---

---

---

---

---

---

---

ACFE Categorizations of Occupational Fraud

Fraudulent Financial Reporting	Corruption	Asset Misappropriation
Timing differences	Bribery <ul style="list-style-type: none"> <li>• Vendor kickbacks</li> <li>• Bid-rigging</li> </ul>	Cash receipts
Fictitious revenues	Illegal gratuities	Cash on hand
Concealed or overstated liabilities and expenses	Economic extortion	Fraudulent disbursements <ul style="list-style-type: none"> <li>• Billing</li> <li>• Payroll</li> <li>• Reimbursements</li> <li>• Check or payment tampering</li> </ul>
Improper asset valuations	Conflicts of interest <ul style="list-style-type: none"> <li>• Sales</li> <li>• Purchasing</li> </ul>	Inventory, other assets
Improper disclosures		

Improper use of influence to gain unfair advantage

▶ Slide 12

---

---

---

---

---

---

---

---

## Bribery

Offering, giving, receiving, or soliciting anything of value to influence official act (decision of government agent) or business decision (decision of employee in commercial organization)

- ▶ Does not need to be *accepted* to constitute bribery!
- ▶ Thing of value can be tangible or intangible, for example:
  - ▶ Cash
  - ▶ Property
  - ▶ Meals, travel, entertainment
  - ▶ Information
  - ▶ Future employment (for self or other)

▶ Slide 13

---

---

---

---

---

---

---

---

## Kickbacks

Vendor pays organization's employee for

- ▶ Facilitating payment of false or overpriced invoices
- ▶ Diverting business to the vendor
  - ▶ Often leads to overbilling in future

Red flags

- ▶ Price inflation
- ▶ Excessive purchase levels
- ▶ Inventory shortages
- ▶ Inferior quality

▶ Slide 14

---

---

---

---

---

---

---

---

## Bid-Rigging

Competitive bidding process



Organization's employee manipulates process to favor vendor

▶ Slide 15

---

---

---

---

---

---

---

---

## Bid-Rigging

Tailor project to match particular vendor's capabilities

Prequalifications to reduce competitors (if motivated by bribery)

- ▶ Red flags
  - ▶ Inability to generate list of suitable vendors
  - ▶ Significantly fewer bids than expected

Deliberately vague specifications, with future amendments

- ▶ Red flag
  - ▶ Low-bid awards followed by amendments significantly increasing amount

Bid-splitting to avoid competitive bidding requirement

- ▶ Red flag
  - ▶ Contracts frequently just below competitive bidding requirements

▶ Slide 16

---

---

---

---

---

---

---

---

## Bid-Rigging

Severely restrict bidding deadline

Obscure publication of bid request (location, timing)

- ▶ Red flag
  - ▶ Significantly fewer bids than expected

Provide insight on bid preparation and/or provide specifications early

Disclose "sealed" bids

Extend bid deadline or accept late bids

- ▶ Red flag
  - ▶ Last contractor to submit bid consistently wins contracts and/or consistently wins by narrow margin (over time, multiple jobs)

▶ Slide 17

---

---

---

---

---

---

---

---

## Bid-Rigging

"Need recognition" scheme

- ▶ Red flags
  - ▶ Unusually high contractual requirements for materials stock
  - ▶ High write-offs of surplus as scrap during completion of work

Fictitious suppliers

- ▶ Red flags
  - ▶ Same address as another vendor
  - ▶ Same errors or calculations on multiple bids

▶ Slide 18

---

---

---

---

---

---

---

---

## Other Corruption

### Illegal gratuities

- ▶ Something given to **reward** rather than to influence

### Extortion

- ▶ Employee **demand**s payment to influence decision in vendor's favor
  - ▶ Refusal results loss of business

### Conflicts of interest

- ▶ **Undisclosed** economic or personal interest in transaction that adversely affects organization
  - ▶ Breach of fiduciary/agent responsibility
  - ▶ If organization **aware** of, no conflict of interest – no matter how favorable outcome is for employee

▶ Slide 19

---

---

---

---

---

---

---

---

## ACFE Categorizations of Occupational Fraud

Fraudulent Financial Reporting	Corruption	Asset Misappropriation
Timing differences Fictitious revenues Concealed or overstated liabilities and expenses Improper asset valuations Improper disclosures	Bribery <ul style="list-style-type: none"><li>• Vendor kickbacks</li><li>• Bid-rigging</li></ul> Illegal gratuities Economic extortion Conflicts of interest <ul style="list-style-type: none"><li>• Sales</li><li>• Purchasing</li></ul>	Cash receipts Cash on hand Fraudulent disbursements <ul style="list-style-type: none"><li>• Billing</li><li>• Payroll</li><li>• Reimbursements</li><li>• Check or payment tampering</li></ul> Inventory, other assets

▶ Slide 20

---

---

---

---

---

---

---

---

## Cash Receipts and Cash on Hand

### Skimming of receipts – theft prior to record of receipt

- ▶ Original sale unrecorded or understated
- ▶ Receivable unrecorded or understated

### Cash larceny of receipts – theft after record of receipt

- ▶ Original sale
- ▶ Receivable
- ▶ Bank deposit or cash on hand

▶ Slide 21

---

---

---

---

---

---

---

---

### Cash Receipts and Cash on Hand

**Prevention and detection**

- ▶ Segregation of duties
  - ▶ Custody – taking in receipts
  - ▶ Authorization – approve write-offs, voids
  - ▶ Recording – post entries to system
  - ▶ Review – monthly bank reconciliation
- ▶ Active management oversight and review
- ▶ Surprise audits
- ▶ Video cameras
- ▶ Use customers as resource
  - ▶ e.g., \$5 if no receipt given (skimming)
  - ▶ Follow up on customer complaints, inquiries

▶ Slide 22

---

---

---

---

---

---

---

---

### Cash Receipts and Cash on Hand

**Detection**

- ▶ Declining gross sales (skimming)
- ▶ Unusually old balances on accounts receivable aging report (skimming)
- ▶ Missing or manipulated records or documentation (cash larceny)
- ▶ Unsupported journal entries (“force balancing”)
- ▶ Reversing journal entries (e.g., apply “courtesy” discounts)
- ▶ High level of write-offs

▶ Slide 23

---

---

---

---

---

---

---

---

### Cash Receipts and Cash on Hand

**If register is used**

- ▶ **Prevention**
  - ▶ Require supervisor authorization and supporting documentation for voids, “no sale” transactions
- ▶ **Detection – review X or Z report**
  - ▶ Low sales
  - ▶ Excessive voids or ‘no sale’ transactions
  - ▶ Cash per report does not match cash in drawer (cash larceny)
  - ▶ Frequently does not balance, even small amounts – ‘death by a thousand cuts’ (cash larceny)
  - ▶ Unusual blank space gaps or skipped transaction numbers on register tape (cash larceny)

▶ Slide 24

---

---

---

---

---

---

---

---



### Cash Receipts and Cash on Hand

**Detection**

- ▶ Cash larceny from bank deposit
  - ▶ Compare bank deposits with records of receipts
  - ▶ Compare office and bank copies of deposit slips
  - ▶ Bank reconciliation reflects increasing amounts of deposits in transit

▶ Slide 25

---

---

---

---

---

---

---

---

### ACFE Categorizations of Occupational Fraud

Fraudulent Financial Reporting	Corruption	Asset Misappropriation
Timing differences Fictitious revenues Concealed or overstated liabilities and expenses Improper asset valuations Improper disclosures	Bribery <ul style="list-style-type: none"> <li>• Vendor kickbacks</li> <li>• Bid-rigging</li> </ul> Illegal gratuities Economic extortion Conflicts of interest <ul style="list-style-type: none"> <li>• Sales</li> <li>• Purchasing</li> </ul>	Cash receipts Cash on hand Fraudulent disbursements <ul style="list-style-type: none"> <li>• Billing</li> <li>• Payroll</li> <li>• Reimbursements</li> <li>• Check or payment tampering</li> </ul> Inventory, other assets

▶ Slide 26

---

---

---

---

---

---

---

---

### Billing Schemes

- ▶ **Shell company**
  - ▶ Employee forms fraudulent shell company
- ▶ **Non-accomplice vendor**
  - ▶ Employee uses legitimate vendor information
- ▶ **Personal purchases**
  - ▶ Employee uses organization's funds for personal items
  
- ▶ **Fraudster submits false documentation**
- ▶ **Organization processes payment as if legitimate**
  - ▶ Key: Get organization to accept documentation as legitimate

▶ Slide 27

---

---

---

---

---

---

---

---



## Shell Company

### Detection

- ▶ Surveillance of post office box
- ▶ Public records searches
  - ▶ Articles of incorporation (state level)
  - ▶ DBA registration (local level)
- ▶ Address nonexistent or residential (e.g., Google maps)
- ▶ Compare vendor address and employees' addresses

▶ Slide 31

---

---

---

---

---

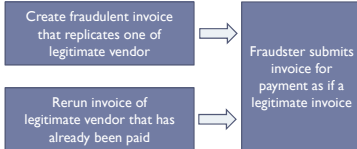
---

---

---

## Non-Accomplice Vendor Schemes: Overbilling

Fraudster uses legitimate vendor invoices (or a replication of one) to generate fraudulent payments



Note: If fraudster cannot gain control of check before it is mailed to vendor, may use different vendor mailing address (or bank account information, if direct funds transfer)

Note: If accounting software flags duplicate invoice numbers, may add a letter to invoice number (e.g., original is 40004, rerun invoice is 40004A)

▶ Slide 32

---

---

---

---

---

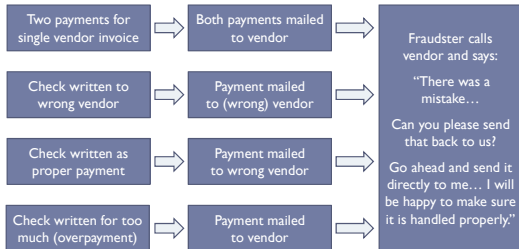
---

---

---

## Non-Accomplice Vendor Schemes: Pay-and-Return

Fraudster circumvents control requiring that separate people approve payment, generate payment, and mail payment



▶ Slide 33

---

---

---

---

---

---

---

---

## Non-Accomplish Vendor Schemes

### Prevention and detection

- ▶ Active management oversight and review
- ▶ Segregation of duties
  - ▶ Custody – receipt of invoices
  - ▶ Authorization – approval of invoices for payment
  - ▶ Recording – entry of invoices into system
  - ▶ Recording – check preparation
  - ▶ Review – check-signing authority
  - ▶ Custody – mail payments

▶ Slide 34

---

---

---

---

---

---

---

---

## Non-Accomplish Vendor Schemes

### Detection

- ▶ Increasing expenses
- ▶ Sort payments by vendor and:
  - ▶ Invoice number – Duplicates or similar?
  - ▶ Amount – Duplicates?
- ▶ Inspect and compare checks converted
  - ▶ Endorsement
  - ▶ Bank information
- ▶ Compare mailing address or electronic payment info in system with invoice

▶ Slide 35

---

---

---

---

---

---

---

---

## ACFE Categorizations of Occupational Fraud

Fraudulent Financial Reporting	Corruption	Asset Misappropriation
Timing differences	Bribery <ul style="list-style-type: none"><li>• Vendor kickbacks</li><li>• Bid-rigging</li></ul>	Cash receipts
Fictitious revenues	Illegal gratuities	Cash on hand
Concealed or overstated liabilities and expenses	Economic extortion	Fraudulent disbursements <ul style="list-style-type: none"><li>• Billing</li><li>• Payroll</li><li>• Reimbursements</li><li>• Check or payment tampering</li></ul>
Improper asset valuations	Conflicts of interest <ul style="list-style-type: none"><li>• Sales</li><li>• Purchasing</li></ul>	Inventory, other assets
Improper disclosures		

▶ Slide 36

---

---

---

---

---

---

---

---

## Payroll Schemes

### Falsified wages

- ▶ Inflate hours worked and/or pay rates
- ▶ Time off at regular pay
- ▶ Overtime when took paid time off

### ▶ Ghost (nonexistent) employee

- ▶ Former employee
- ▶ Fictitious person
- ▶ Accomplice

▶ Slide 37

---

---

---

---

---

---

---

---

## Payroll Schemes

### Prevention and detection

- ▶ Active management oversight and review
- ▶ Segregation of duties
  - ▶ Custody – document time worked
  - ▶ Authorization – supervisor verification and approval
  - ▶ Recording – maintain personnel and pay data
  - ▶ Recording – entry of time information into system
  - ▶ Recording – check preparation
  - ▶ Review – check-signing authority
  - ▶ Custody – distribute payments

▶ Slide 38

---

---

---

---

---

---

---

---

## Payroll Schemes

### Detection

- ▶ Detailed scrutiny of records
- ▶ Investigate unauthorized changes to payroll records
- ▶ Falsified wages
  - ▶ High overtime pay as percentage of base
- ▶ Ghost employee
  - ▶ Social security number missing
  - ▶ Tax withholdings low or zero
  - ▶ Address: missing, fictitious, PO box, same as another employee
  - ▶ Direct deposit account same as another employee
  - ▶ Dual endorsement of checks

▶ Slide 39

---

---

---

---

---

---

---

---

## ACFE Categorizations of Occupational Fraud

Fraudulent Financial Reporting	Corruption	Asset Misappropriation
Timing differences Fictitious revenues Concealed or overstated liabilities and expenses Improper asset valuations Improper disclosures	Bribery <ul style="list-style-type: none"><li>• Vendor kickbacks</li><li>• Bid-rigging</li></ul> Illegal gratuities Economic extortion Conflicts of interest <ul style="list-style-type: none"><li>• Sales</li><li>• Purchasing</li></ul>	Cash receipts Cash on hand Fraudulent disbursements <ul style="list-style-type: none"><li>• Billing</li><li>• Payroll</li><li>• Reimbursements</li><li>• Check or payment tampering</li></ul> Inventory, other assets

▶ Slide 40

---

---

---

---

---

---

---

---

## Reimbursement Schemes

- ▶ **Mischaracterized reimbursements**
  - ▶ Submit personal expenses as if legitimate organization expenses
    - ▶ Example: Take friend to dinner and charge as business meeting
- ▶ **Overstated reimbursements**
  - ▶ Submit legitimate business expenses but inflate amount
    - ▶ Example: Alter receipt to reflect \$40 instead of \$10
- ▶ **Fictitious reimbursements**
  - ▶ Fabricate expenses
    - ▶ Example: Get blank receipts from taxi or restaurant and create fictitious receipts, or create and print receipts from computer
- ▶ **Multiple reimbursements**
  - ▶ Submit same organization expenses more than once
    - ▶ Example: Submit copy of same receipt in subsequent request, or submit item charged to company credit card as a separate request

▶ Slide 41

---

---

---

---

---

---

---

---

## Reimbursement Schemes

### Detection

- ▶ **Examine detailed documentation**
  - ▶ Prevention: Only accept original receipts
- ▶ **Investigate unprofessional-looking receipts**
- ▶ **Compare expense reports to work schedule**
  - ▶ Travel coincide with vacation/time off?
  - ▶ Consider weekends or unusual times
- ▶ **Check illogical combinations (e.g., car rental and mileage)**

▶ Slide 42

---

---

---

---

---

---

---

---

## Reimbursement Schemes

### Detection

- ▶ Verify amounts charged to organization credit card not submitted separately as reimbursement request
  - ▶ Prevention: Strict deadline (e.g., within 7 days)
- ▶ Investigate approval by anyone other than direct supervisor
- ▶ Confirmation with customers/business associates
- ▶ Increasing expenses
- ▶ Duplicate amounts
- ▶ Requests just below threshold for requiring approval

▶ Slide 43

---

---

---

---

---

---

---

---

## ACFE Categorizations of Occupational Fraud

Fraudulent Financial Reporting	Corruption	Asset Misappropriation
Timing differences Fictitious revenues Concealed or overstated liabilities and expenses Improper asset valuations Improper disclosures	Bribery <ul style="list-style-type: none"><li>• Vendor kickbacks</li><li>• Bid-rigging</li></ul> Illegal gratuities Economic extortion Conflicts of interest <ul style="list-style-type: none"><li>• Sales</li><li>• Purchasing</li></ul>	Cash receipts Cash on hand Fraudulent disbursements <ul style="list-style-type: none"><li>• Billing</li><li>• Payroll</li><li>• Reimbursement</li><li>• Check or payment tampering</li></ul> Inventory, other assets

▶ Slide 44

---

---

---

---

---

---

---

---

## Check Tampering

- ▶ Employee either:
  - ▶ (1) Fraudulently prepares check drawn on organization's account
  - ▶ (2) Intercepts check drawn on organization's account that is intended for 3<sup>rd</sup> party

▶ Slide 45

---

---

---

---

---

---

---

---

### Anatomy and "Life Cycle" of a Check

The diagram shows a check from VICK & SONS PLUMBING, INC. dated March 1, 2013, for \$3,000.00 payable to Matthew Supply Co. The check is signed by Anastasopoulos. Red circles and arrows highlight the following elements:

- Account owner:** VICK & SONS PLUMBING, INC.
- Payee:** Matthew Supply Co.
- Maker of the check:** Anastasopoulos (signature)
- Bank the check is "drawn" on:** The bank name and address at the bottom of the check.

Slide 46

---

---

---

---

---

---

---

---

---

---

---

---

### Anatomy and "Life Cycle" of a Check

The flowchart illustrates the process from writing a check to cashing it. Red circles and arrows highlight:

- Check endorser:** Matthew Supply Co. (the payee's name on the check)
- Bank that cashes or deposits check:** The bank where the check is cashed or deposited.

Slide 47

---

---

---

---

---

---

---

---

---

---

---

---

### Anatomy and "Life Cycle" of a Check

This flowchart includes a scenario for insufficient funds (NSF). The process is as follows:

- Check is written
- Check is given or mailed to payee
- Payee converts check (cashes or deposits it)
- Bank where cashed or deposited submits it to bank that check is "drawn" on
- If sufficient funds in owner's account, amount paid and deducted from account
- If NOT sufficient funds in owner's account, returned "NSF"

Slide 48

---

---

---

---

---

---

---

---

---

---

---

---



### Check Tampering

Matthew Supply Co.  
 2346789234

**Forged endorsement scheme**

**Altered payee scheme**

VICK & SONS PLEMBING, INC.  
 700 N. HIGHWAY 101  
 WAYNE, N. CAROLINA  
 28389-3200

**Forged maker scheme**

**Authorized maker scheme**

▶ Slide 49

---

---

---

---

---

---

---

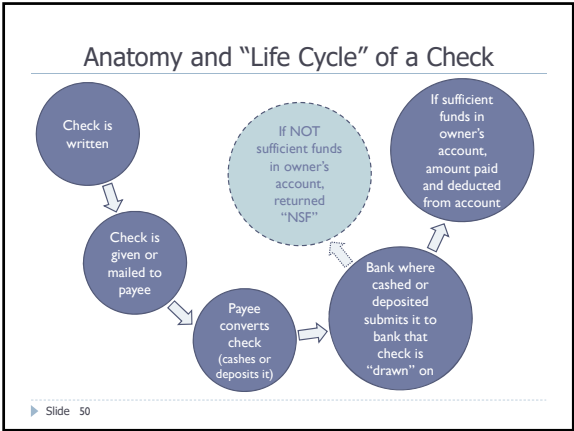
---

---

---

---

---




---

---

---

---

---

---

---

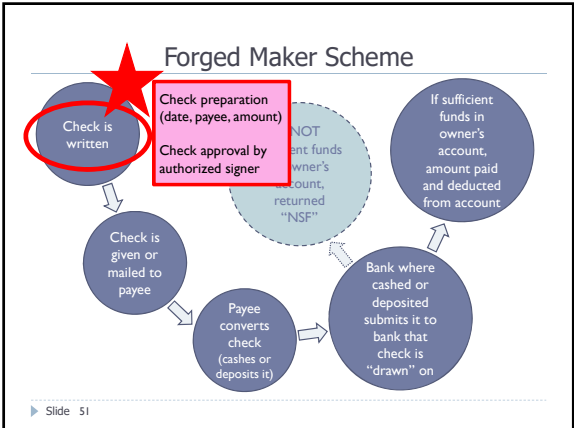
---

---

---

---

---




---

---

---

---

---

---

---

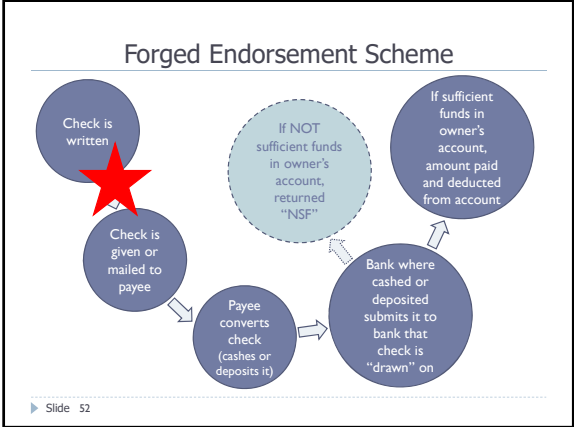
---

---

---

---

---




---

---

---

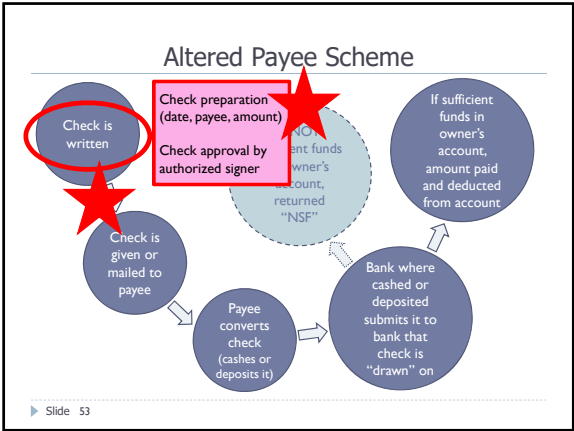
---

---

---

---

---




---

---

---

---

---

---

---

---

- ### Check Tampering
- #### Prevention and detection
- ▶ Active management oversight and review
  - ▶ Physical controls over blank checks, signature stamps or files
  - ▶ Segregation of duties
    - ▶ Custody – blank checks
    - ▶ Custody – signature stamp or file
    - ▶ Authorization – approval of checks to be written
    - ▶ Recording – check preparation
    - ▶ Review – check-signing authority
    - ▶ Custody – mail checks
    - ▶ Review – monthly bank reconciliation
- ▶ Slide 54

---

---

---

---

---

---

---

---

## What Can We Do?

- ▶ **Management**

- ▶ Educate management and employees regarding red flags
- ▶ Tone at the top, hiring practices, internal controls

- ▶ **Internal auditors**

- ▶ Watch for accounting irregularities, internal control weaknesses, other red flags

- ▶ **Employees**

- ▶ Understand red flags
- ▶ Promptly report any concerns

▶ Slide 55

---

---

---

---

---

---

---

---