How to Detect and Prevent Internal Fraud, Theft and Abuse
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The Pros & The Cons
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Using 35 years of experience in auditing, corporate finance, and investment banking, Gary D. Zeune, CPA, provides CPAs, attorneys and executives with hands-on experience in fraud and corporate strategy performance improvement. Mr. Zeune instructs courses for:

- FBI National Training Academy
- Office of the U.S. Attorney
- The SEC Institute
- National Association of Securities Dealers
- North American Securities Administrators Association
- American Society for Industrial Security
- Over 35 state CPA societies and bar associations
- American Institute of CPAs
- American Management Association
- Institute of Management Accountants
- Entrepreneurship Institute
- Treasury Management Association
- Private classes for numerous companies and accounting firms.

Mr. Zeune has instructed Strategy Formulation and Implementation in the Executive MBA Program and Accounting and Honors Finance at The Ohio State University. He is also a member of the Education Executive Council and is past chairman of the Education Marketing and Public Relations Committees of The Ohio Society of CPAs. His other memberships include: the American Institute of CPAs, and the Regulation of Public Offerings Committee of the Ohio Division of Securities.

Prior to forming his consulting practice in 1986, Mr. Zeune was an Assistant Vice President of Corporate Finance at The Ohio Company, a Columbus, Ohio investment banking firm. He also spent more than five years in Treasury and Finance at Wendy's International, where he was responsible for mergers and acquisitions, financial and SEC reporting, and corporate finance. He was on the audit staff of Ernst & Ernst from 1973 to 1977; and taught accounting at Ohio University from 1970 to 1973, where he received his bachelors in mathematics and masters in accounting, with honors.

Articles and Books

Mr. Zeune is also widely published. He has published more than 40 professional articles and is the author of The CEO’s Complete Guide to Committing Fraud and Outside the Box Performance. He has been a member of the Editorial Advisory Boards of the Journal of Working Capital Management and The Ohio CPA Journal.

For Deloitte & Touche, he authored Financing Business Growth and has completed the first draft of The Complete Guide to Buying or Selling a Closely Held Business, two books in the firm’s Entrepreneurial Series. He has authored chapters for two books published by Warren Gorham Lamont, the world’s largest financial publisher: Accessing the Capital Markets and Options for Raising Capital.

White Collar Criminals

Mr. Zeune has the ONLY speaker's bureau in the country specializing in white-collar criminals — The Pros & The Cons. Mr. Zeune's speakers tell their stories of how and they committed their crimes. Their frauds range from $18,000 to $350 million. Speakers include CPAs, attorneys, and business people. The frauds include:

- Mark Morze created 10,000 phony documents to steal $100 million in the infamous ZZZZ Best Carpet Cleaning fraud (86% of the revenue was fake and no one found it)
- Fred Shapiro defrauded nearly every major financial institution in the City of Philadelphia to the tune of $8.6M. He is a former attorney, accountant, educator and inmate. Fred worked undercover with the U.S. attorney’s office and the FBI in a drug and money laundering operation in an effort to minimize his sentence.
- Nick Wallace committed a $350 million fraud as the President of ESM Government Securities resulting in the collapse of the Ohio Saving & Loan Guarantee Fund, and the bankruptcy of 69 Ohio S&Ls
- Dunlap Cannon was the largest real estate closing attorney in Memphis. He went to prison for 32 months for stealing $5 million from his clients.
- Suffering from medical expenses and family deaths, bookkeeper Teri Lynn Norwood stole $18,000, promising to pay it back. She ran out of time.

100% No-Risk Guarantee

Mr. Zeune’s executive education training is consistently rated at least a 4.7 on a 5-point scale. If you are not satisfied for any reason, if you don’t learn at least 10 new things you can use the following day, there are no fees or expenses. PERIOD.
### ACTION STEPS FROM GARY’S CLASS

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<th>Action Item</th>
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*Thanks for attending. Don’t hesitate to call or email if you have questions. . . gdz*
Outside the Box Performance: How to Beat Your Competitors' Brains Out is packed with the techniques small and mid-size world-class companies use to become and stay competitive, and make a ton of money. Learn the secrets to unlock the multitude of new techniques which "drive" your profitability. This book compliments the class and provides new ideas to incorporate in your business. For example, do you know what the basis of competition will be in the next 10 years? It’s around you ALL the time. You expect it everyday as a customer. Or, how to beat your competitors by asking your customers two simple questions? If not, sit back and learn how to 'beat your competitors' brains out!'

Don't you want to know how Barry Minkow and Mark Morze stole $100 million from investors in the ZZZZ Best Carpet Cleaning fraud, right under the noses of auditors, underwriters and lawyers? The first chapter of 100 pages in The CEO's Complete Guide to Committing Fraud tells you. It also has 8 chapters on other frauds: computer, real estate, fake financial statements, public company frauds, and a chapter by an auditor who became the target of a fraud investigation, just 4 weeks after becoming the engagement partner.

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_______ The CEO's Complete Guide to Committing Fraud (300 pages)
_______ Outside the Box Performance (200 pages)
_______ Number of books ordered

1 @ $19.95 _________
2 - 5 @ $15.95 each _________
6+ @ $12.95 each _________
Postage/Shipping _________ $5.00
Total _________

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Ex-con: Cunningham Faces Rough Road In Prison - By William Finn Bennett

Walt Pavlo USA TODAY Ethics training -

Gary Zeune on Fraudsters Speaking Out on Fraud The Corporate Counsel - Podcast

OU alumnus examines corporate crime, criminals - By Ashley Ferguson

Ex-cons tout ethics through corporate speakers bureau - By Sarah Anderson

Man's Lifestyle Sold Investors - By Jim Woods

"The Pros of Cons" - By Michael Goldstein


Does your compensation system encourage illegal activity? - By Gary D. Zeune, CPA, Published in White Color Crime Fighter in November 2004


How to Foster Fraud : Forget Ethics - By Gary D. Zeune in White Color Crime Fighter in August 2004

Your Auditors Can Stop Fraud , If they know what to look for - By Stephen Pedneault published in White Color Crime Fighter in August 2004


Local CPA, ex-cons attempt to spread word that crime doesn't pay - by SEAN CASEY [ Daily Reporter Staff Writer ] in Central Ohio Source " The Daily Reporter"

The costs of not securing personally identifiable Data - By Benjamin Wright "The Information Systems Audit and Control Assn." Site : www.isaca.org
Ex-Cons find peace and paycheck on the Burgeoning lecture circuit - By Joshua Harris Prager published in Wall Street Journal May 25th, 2004

Felons become educators for Business - By Mitch Moxley [ Financial Post ] Published in National Post July 17, 2004

A new regard for ethics on the job - By MEREDITH COHN [ SUN STAFF ] Originally Published JULY 9, 2004

The pros of preventing cons - White-collar criminals help companies avoid fraud in their midst By Chiree McCain, For Business First - June 25, 2004

Are You Teaching Your Employees to Steal? - By Founder Gary D. Zeune, CPA in Strategic Finance

When it's one of your own a first-person account of Fraud Inside A Bank - by ex-con Dave London in RMA Journal

FRAUD HAPPENS : How an honest employee crossed the line - by Teri lyn Norwood Published in White - Collar Crime Fighter Magazine , November 2003

Internal theft can destroy years of small business owner's work - by Jane Applegate

Fraud and Theft Start Small - by Founder Gary Zeune in NJ CPA Society Journal

How to Predict When People Will Embezzle - by Founder Gary Zeune in White Collar Crime Fighter

Hubbell details life of fraud - September, 2000 in San Antonio Express

Speaking with Conviction - from Report on Fraud

Corporate crooks hit lecture circuit - from Denver Post

Ex-Con Tells How Auditors Failed to Help Clients Guard Against Fraud - by Mark Morze in White Collar Crime Fighter

Preventing Your Firm's "Enron" - by Founder Gary Zeune in Ohio CPA Journal

SAS 99 17 Ways to Protect Yourself From Malpractice - by Founder Gary Zeune in 7 CPA journals

Regulation SAS 99 Aimed at Curbing Company Fraud - from Bizjournals , March 2004

Business First Auditors’ Alert: How NOT to Get Sued Under Fraud Auditing Standards - by Founder Gary Zeune in White Collar Crime Fighter

SAS 99 Friend or Foe - by Founder Gary Zeune in two publications


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See the back of Gary's business card.

There is no cost and you can unsubscribe at any time.

"Just wanted to let you know that I appreciate being on your distribution list. I have found that there are many items that you refer to me that are helpful."

. . .Mike McGlynn
The Future

1. I want to grow up and steal from and cheat my employer
2. Who should be concerned about fraud, theft, abuse
   - Auditors
   - Controllers
   - Loss prevention specialists
   - Owners and managers at all levels
   - HR personnel
   - Academics
How Much Fraud is There

1. Association of Certified Fraud Examiners
   1. $660 Billion
   2. 6% of revenue
   3. $9 per day per employee
   4. $4,500 per employee

2. E&Y
   1. 20% of employees know of fraud and abuse
   2. 48% of employees think employers can do more

Cost of Fraud

![Bar chart showing total occupational fraud losses from 1996 to 2004.](chart.png)
3 Types of Frauds

- Fraud Statements (7.9%) - $1,000,000
- Corruption (30.1%) - $250,000
- Asset Misappropriations (92.7%) - $93,000

Who the Victims Are

- Private Company ($123,000) - 41.8%
- Public Company ($100,000) - 30.3%
- Government ($37,500) - 15.8%
- Not-for-Profit Organization ($100,000) - 12.2%
Most Fraud at Small Organization

Percent of Cases Based on Size of Victim Organization

<table>
<thead>
<tr>
<th>Number of Employees</th>
<th>2004</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;100</td>
<td>45.6%</td>
<td>39.0%</td>
</tr>
<tr>
<td>100-999</td>
<td>21.1%</td>
<td>20.1%</td>
</tr>
<tr>
<td>1,000-9,999</td>
<td>19.6%</td>
<td>23.4%</td>
</tr>
<tr>
<td>10,000+</td>
<td>13.3%</td>
<td>17.5%</td>
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Small Organizations Suffer More

Median Loss Based on Size of Victim Organization

<table>
<thead>
<tr>
<th>Number of Employees</th>
<th>2004</th>
<th>2002</th>
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<tbody>
<tr>
<td>&lt;100</td>
<td>$98,000</td>
<td>$127,500</td>
</tr>
<tr>
<td>100-999</td>
<td>$78,500</td>
<td>$135,000</td>
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<tr>
<td>1,000-9,999</td>
<td>$53,000</td>
<td>$87,500</td>
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<tr>
<td>10,000+</td>
<td>$105,500</td>
<td>$97,000</td>
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Ethics: Students Who Cheat

1. 9 business students at U of Maryland were text messaging during an ____________________
2. Texas teen charged with selling test answers stolen with keystroke recording software
3. 7 Kansas State students plagiarized papers off internet
Ethics: Students Who Cheat

1. ___% of students admit cheating at least once last year and ___% admit serious cheating......Rutgers survey of 60 colleges
2. ___% of high school students admit to at least one instance cheating and ___% to plagiarism
3. ___% of private school students admit cheating
4. Gallup survey of 13 - 17 year olds ___% cheat 'a great deal' or a 'fair amount'
5. Josephson Institute of Ethics 2004 surveyed 24,763 high school students ___% cheat on exams

Ethics: Students Who Cheat

1. Cheating isn’t new
2. What’s new is how widespread and accepted
3. Old.......  
   1. People who cheated were in the minority
   2. Kept it to themselves
4. Now.......  
   1. Majority
   2. Bold
Ethics: Success at Any Cost

1. Technology + Bad Behavior = Acceptable in Society
2. Who........
   1. Athletes + drugs + outrageous behavior
   2. Executives cooking the books
   3. Journalists faking stories
   4. Teachers faking student test scores
3. Normalization of cheating....Everybody is doing it....
   If you don’t, you’re a chump
4. Message........nothing is out of bounds for ______

Ethics: Technology Makes Cheating Easy

1. Camera phone to ______________________
2. MP3 players with digitized notes
3. Internet and IM are both anonymous
4. Fast and quick and deniable
5. ‘Grab-and-go’ culture
6. Technology masks the guilt factor
Ethics: Why Students Cheat

1. Education is a means to __________
2. Message…..financial well-being more important than being a moral person
3. “If you think what went on with Enron or WorldCom is bad, just wait,” Michael Josephson (Founder Josephson Institute of Ethics)

Fraud Tip: What are you doing ________________

Which is more costly for banks

Source: Occupational Fraud and Abuse
Red Flag Work Habits

1. Come to work early or leave late
2. Works nights and weekends
3. Seldom absent from work
4. Reports to office during brief absences
5. Ask others to hold work while gone

What Fraud Perpetrators Do

- They don’t play by the rules
  (1) Ignore internal controls
  (2) Compromise internal controls
Internal Controls: Concept vs. Reality

Internal Controls and Fraud, Joseph R. Dervaes, CFE, ACFE Fellow, CIA

Fraud Tip: If you REALLY want to know how controls work, ask the people who do the work ________________________________.

Fighting Fraud Proactively

1. Tone at the top
2. Walking the talk
3. Fraud is not “if”, but “when”
4. Protect your employees
5. Communicate why controls are important
6. Trust but verify = _______________________

Fraud Tip: ________________________________
Four Elements of Fraud

- All four must be present under common law
  1. A material false statement
  2. Knowledge that the statement was false when it was made
  3. Reliance on the false statement by the victim
  4. Damages as a result

Frauds Facts

1. Employees have a fiduciary relationship to their employers
2. Embezzlement is a special kind of fraud
   - To willfully take someone’s money or property by virtue of position of trust or employment
3. Larceny is legal name for stealing
   - Larceny by fraud or deception
Abuse: A Few Examples

1. Buying stuff for others using employee __________
2. Taking company inventory
3. Not working for hours submitted
4. Fake T&E expenses
5. Unauthorized loooooong lunch hour
6. Arrive late/leave early
7. ‘Mental’ health days
8. Not working to potential
9. Working under the influence

Fraud vs. Abuse

Fraud: Stealing $100

Abuse: Calling in sick

What would likely happen if employee gets caught stealing $100 _________ vs. what’s likely for taking ‘sick” ________________

The difference __________
History of Fraud

1. Crime had been genetically based
2. Coined “white collar crime”
3. Theory of differential association
   - Dishonest employee will infect honest employees

Edwin H. Sutherland
The Triangle of Fraud
Donald R. Cressey

"Trusted persons become trust violators when they conceive of themselves as having a financial problem [NEED] which is non-sharable, are aware this problem can be secretly resolved by violation of the position of financial trust [OPPORTUNITY], and are able to apply to their own conduct in that situation verbalizations [RATIONALIZATIONS] which enable them to adjust their conceptions of themselves as trusted persons," Other People's Money: A Study in the Social Psychology of Embezzlement, based on interviews with 200 embezzlers.

Cressey’s Non-sharable Problems

1. Violations of ascribed obligations
2. Personal failures
3. Business reversals
4. Physical isolation
5. Status gaining
6. Employer-employee relations
Cressey’s Rationalizations

1. Non-criminal or
2. Justified or
3. Offender doesn’t control the situation

“In cases of trust violation encountered, significant rationalizations were always present before the act took place, or at least at the time it took place, and, in fact, after the act had taken place the rationalization was often abandoned.”

Fraud Tip: Once the line is crossed, it becomes easier to __________

Cressey’s 3 Offenders Types

1. Independent businessmen
   - I was just borrowing the money
   - The funds were really theirs (everyone’s _______)
2. Long-term violators
   - Prevent family shame, disgrace or poverty
   - Necessity (employers were cheating them)
   - Employers cheated others
3. Absconders
   - Take the money and run - isolated

Fraud Tip: Many experts think 4th type: ___________
Cressey’s 9 Reason People Perpetrate

1. Living beyond their means
2. Overwhelming desire for personal gain
3. High personal debt
4. Close association with customers
5. Feeling pay not commensurate with responsibility
6. Wheeler-dealer attitude
7. Strong challenge to beat the system
8. Excessive gambling habits
9. Undue family pressure

Deterring Fraud: The Internal Auditor’s Perspective

Cressey’s Fraud Scale

Deterring Fraud: The Internal Auditor’s Perspective
Theft by Employees
Hollinger-Clark Study

1. Richard Hollinger, Purdue, and John Clark, U of Minn
2. 10,000 American workers
3. Employees steal because of workplace conditions
4. Experts have 5 related hypothesis of employee theft
   1. External financial pressures
   2. Young employees not as hard working + honest
   3. Every employee can be tempted to steal
   4. Job dissatisfaction
   5. Broadly shared formal and informal org structure

Deviance Factors:
Hollinger-Clark Study

1. No relationship between income and theft, but was between “concern” over income and theft
2. Larger % of younger employees steal more since less __________
   ■ Inferior benefits to younger workers signals that they aren’t important and ______________
   ■ BUT, same benefits to all usually not practical
3. Low job satisfaction for all age groups especially younger workers
4. Controls generate mixed employee reactions: preventive vs.. mistrust
Theft by Employees
Hollinger-Clark Study

5. Perceived certainty of detection much more of a deterrent than actual detection

6. Informal social controls the best deterrent....“loss of respect among one’s acquaintances was the single most effective variable”

7. “....theft and work place deviance are in large part a reflection of how management at all levels...is perceived by the employee.”

Fraud Tip: ________________________________

Comprehensive Control System

- Financial Controls
- Nonfinancial Systems
- Management Oversight and Behavior
Internal vs. Financial Controls

Internal controls

Financial controls

Policies
Procedures
Behaviors
Practices

1. Preventive controls
   - Filing cabinets
   - Passwords
   - Approvals

2. Detective controls
   - Bank recs
   - Variance analysis
   - Vacations
   - Surveillance

WHICH IS NECESSARY?????
Nonfinancial Controls

1. HR and IT systems
2. Physical security
3. Communications systems
4. Insurance

Management Oversight + Behavior

1. Tone at the top
2. Financial analysis and budgeting
3. Communications
4. Board oversight
5. Integrity and ethics
6. Comply with organization policies
Segregate These Duties

1. Billing
2. Recording revenue
3. Receipt and recording payments
4. Deposits
5. Posting receipts
6. Reconciling bank statement
7. Reconciling A/R subledger

Cash vs. Non-cash Thefts

Breakdown of Asset Misappropriations

- Cash ($98,000) - 93.4%
- Non-Cash ($100,000) - 22.1%
Cash Thefts

Breakdown of Cash Misappropriations

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<th>Category (Median Loss)</th>
<th>Percent of Cases</th>
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<td>Fraud Disbursements ($125,000)</td>
<td>74.1%</td>
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<tr>
<td>Skimming ($85,000)</td>
<td>28.2%</td>
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<tr>
<td>Cash Larceny ($80,000)</td>
<td>25.9%</td>
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Revenue and Cash Receipts

1. Skimming
2. Lapping
3. Write-offs
4. Unauthorized credits
5. Unrecorded sales
Skimming Committed By.....

1. Anyone collecting or opening mail
2. Anyone logging receipts, preparing or making deposits
3. Anyone involved in sales

Checks can be easily converted/stolen

The Skimming Surgeon

1. 42-year old plastic surgeon
2. Large physician-owned office
3. Top money earner making up to $800,000
4. Each doc operated own office
5. Purely elective surgeries not covered by insurance
6. All charges required to be paid upfront turned into front office cashier

Adapted from Shy Doc Gave Good Face
The Skimming Surgeon

1. Patients entered through his private door
2. Rita Mae’s nose job
3. She noted her policy covered some nose jobs
4. To file a claim she needed a _______________
5. She calls ________ that she had written a _______
6. Made out to _________
7. Which was deposited in _________
8. Dr. Snard kept meticulous medical records

Adapted from Shy Doc Gave Good Face

The Skimming Surgeon

1. Making money was his family’s sport
2. WHY ____________
3. Imposed new controls
   ■ Central billing system
   ■ Post signs educating patients
   ■ Segregate duties
4. 4 years and $200,000
5. Practice allowed Dr. Snard to stay with _________

Adapted from Shy Doc Gave Good Face
Understated Sales
1. Recorded but at too little
2. Cashier prepares written receipts but instead of carbon paper between the slips inserts __________
3. False discounts give customer receipt for full price but record sale at discount

Other Skimming Opportunities
1. Late fees and similar charges
2. Write-off of receivables
3. Unauthorized credits
4. Unrecorded sales
   1. Ring _______
      1. Detection: _____________________
   2. Remove the printer ribbon, track sales, steal cash, roll _________________
      1. Detect by ____________________
Preventing (?) Skimming

1. Can’t prevent
2. Occurs at any point funds enters
3. Dual control at first receipt
   - Don’t have to hire a second employee
   - Each person count half in presence of other
4. Segregate recording payments and post payments
5. Lockbox, but NOT foolproof
   - Some customers won’t use it
   - Print invoices with or insert BRE’s with ________

Detecting Skimming

1. Rotate duties and require vacations
2. Reconcile BREs received and Post Office charges
Purchasing and Disbursement Schemes

1. Billing schemes
2. Personal expenses
3. Refund schemes
4. Check tampering and EFT schemes

Fraud in Tooth College

1. Married college business office supervisor takes girlfriend on business trip
2. Cover additional expense with phony expense report listing as his travel mate a college senior
3. Expense report reviewed at random by
4. Dir. of IA interviews the supervisor, who is fired
5. Dir. of IA attempts to interview supervisor’s office mate and asst, who didn’t saying her Calif. uncle had been

Adapted from Medical School Treats Fraud and Abuse
Fraud in Tooth College

1. Search the supervisor’s and asst's office finding bags of expensive dental tools and prostheses
2. Supervisor’s office process A/P invoices so IA suspects ________________
3. Master file contained every vendor ever __________
4. Selected 50 without ______________________
5. Matched with A/P info
6. XYZ Supply billed several times a month, all under $4500, no vendor application or bid form

Adapted from Medical School Treats Fraud and Abuse

Fraud in Tooth College

1. XYZ invoices on plain paper, prepared on a ______
   1. Some even had invoice numbers
   2. 4 digit Box number but PO used __________
   3. Found blank invoices in asst's ______
2. Vendors and employees could pick up the _______
3. Thank you in mail from vendor for purchasing 8 toner cartridges of $1,500 each but cost max $____
4. Supervisor was stunned his asst had stolen $63,000 working next to him and he ________________

Adapted from Medical School Treats Fraud and Abuse
Fraud in Tooth College

Fraud Tip: ______________

_______________________

Adapted from Medical School Treats Fraud and Abuse

Controls “Drive” Behavior

<table>
<thead>
<tr>
<th>CAUGHT ON TAPE</th>
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<tbody>
<tr>
<td>Percent of vehicles going more than 10 mph above the speed limit before and after speed cameras were installed in various locations in Washington, D.C.</td>
</tr>
<tr>
<td>Before cameras</td>
</tr>
<tr>
<td>Ridge Rd. SE</td>
</tr>
<tr>
<td>Southern Ave. SE</td>
</tr>
<tr>
<td>Brentwood Ave. NE</td>
</tr>
<tr>
<td>Florida Ave. NE</td>
</tr>
<tr>
<td>Reno Rd. NW</td>
</tr>
<tr>
<td>16th St. NW</td>
</tr>
<tr>
<td>Riggs Rd. NE</td>
</tr>
</tbody>
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Source: Insurance Institute for Highway Safety
Controls Over Purchasing and Disbursements

1. Purchase request and authorization
2. Receiving and recording payable
3. Approval of vendor invoices and check writing
4. Mailing of checks
5. Reconcile A/P subledger and bank account

Personal Purchases

1. Use legit vendors
2. Usually not material
3. Purchasing or receiving employees
4. Supplies, food, books, clothing, computers, office furniture, and equipment
5. Typical control weaknesses
   - Failure to reconcile purchases with receivers
   - Failure to segregate duties
Credit Card Abuses

1. Anyone can have one
2. No credit checks on employees
3. Credit limits based on reasonable need
4. Locked up until needed
5. Card holders acknowledge rules and responsibility
6. Prompt review of statements
7. Submit supporting charge slips or pay personally
8. Quickly suspend or revoke if abused
9. Use purchasing cards instead of credit cards

Credit Card Best Practices

1. Criteria for issuance
2. Initial and annual credit checks
3. Position of trust
4. Used for business (with examples)
5. Never used for personal expenses or cash
6. Maintain physical control
7. Procedures for lost cards
Credit Card Best Practices

8. Spending limit by card
9. Types / amounts needing prior approval
10. Submit charge slips within ____ days
11. Report disputed charges within ___ days
12. Procedures to request increase in limit
13. Acknowledge violations of card policy violates code of conduct and is grounds for revocation, firing or prosecution

Duplicate Payment Schemes

1. What: Multiple payments to legit vendors
2. Who: Purchasing employees, AP or accounting clerks
3. Poor controls make it easy
4. Services are easier since _____________
5. Simple: Copied/faxed/original invoice not cancelled
Sophisticated Duplicate Payment Schemes

1. Create the duplicate payment
   1. Cut check for legit invoice but hold
   2. Wait for new statement with ‘paid’ amounts
   3. Pay same amount again
   4. Take the first check
2. Convert the check to cash
   1. Endorse over to their own name
   2. Open account in vendor name at different bank
   3. Use a check-cashing establishment

Minimizing Duplicate Payments

1. Preventive controls
   - Pay from ONLY original invoices
   - Match invoices with receivers or POs
   - Match quantities or services against authorized
   - Capture vendor invoice numbers
   - Immediately cancel vendor invoices
   - Don’t allow requestor to mail check
2. Detective controls
   - Review vendor histories, endorsements
   - Confirmations
Fictitious Vendor Invoices

1. Most for services
2. Don’t divert check
3. DON’T mail to __________’ __________’ __________
4. Use former legit vendor
   - Must intercept the check or change the address

Minimizing Fraudulent Vendors

1. Preventive controls
   - Verify existence
   - Segregate duties
   - Delete old vendors
2. Detective controls
   - Review vendor master file
   - Compare budget vs. actual and prior year
   - Review vendor payment details
     - Consecutive invoice numbers
     - Different sequence
The Triangle of Fraud

Two kinds of need:
1. Direct
2. Indirect

Pressure/Incentive

Trigger

Need

Opportunity
Low probability of getting caught

Rationalization
Action fits inside code of conduct

Situational Fraud and Embezzlement

5-10%
Always

80-90%
Situational Fraud and Embezzlement

5-10%
Never
Rationalizing Reasons to Steal

**Seeking Relief**
Personal bankruptcy filings

- Chapter 7
- Chapter 13

**Borrowing Trouble**
A surge in subprime lending has increased the number of people facing the risk of foreclosure. Originations of subprime mortgages in billions of dollars.

<table>
<thead>
<tr>
<th>Year</th>
<th>Originations</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>570</td>
</tr>
<tr>
<td>2006</td>
<td>680</td>
</tr>
<tr>
<td>2007</td>
<td>780</td>
</tr>
<tr>
<td>2008</td>
<td>870</td>
</tr>
<tr>
<td>2009</td>
<td>950</td>
</tr>
</tbody>
</table>

Little Rationalizations

- **Item Stolen**
  - Pens: 60%
  - Post-It: 40%
  - Envelopes: 32%
  - Paper: 28%
  - Paper clips: 26%

Fraud Tip: What month is stealing office supplies the greatest __________________
Ethics: Resumes

1. Society for Human Resource Management survey......
96% of 2,500 members ALWAYS check references, credentials or both
2. ResumeDoctor.com checked 1,133 resumes for employment dates, job titles or roles, and education
   1. ____% had at least one ‘inaccuracy’
   2. ____% had at least two ‘inaccuracies’

Ethics: Why Lie

1. Conceal periods of ________________
2. Enhance education and/or cover a shortfall
3. “the dog-eat-dog mentality of American society can drive people to exaggerate credentials. People are more anxious about the economy these days than they were in the ‘90s,” David Callahan, The Cheating Culture
4. “When you embellish it speaks to your integrity,” Deidra Adams, HR Dir., Constellation Energy
Ethics: Does Training Work

1. KPMG found 75% of 4,000 employees saw misconduct in prior year, same as before _________
2. Almost everyone has ethics training by __________ so if you don’t have ethics when you start work why would you suddenly _________________
3. Employees whose companies had rigorous ethics programs reported less misconduct, less pressure to bend the rules, more likely to report misconduct BUT ½ said they felt pressure to “do whatever it takes to meet targets”

Fraud Tip: ________________________________

Ethics: Snakes in Suits

1. 1 to 2% of population fit definition of psychopath
2. In-depth surveys of 200 executives
3. Who do these describe: charismatic, great storyteller, highly competitive, skillful influencing others ________________
4. “I found 3.5% had enough traits to suggest they might have __________________,” Dr. Paul Baiak
5. Universities are testing MBA students for ethics BEFORE __________________________
Ethics: Executive Recruiters

1. In depth background investigations of executives
2. References
3. Talk to former bosses, peers, subordinates, auditors, bankers not on the resume
4. Check for credit or legal problems
5. Does candidate come from company know for ‘doing whatever it takes’, ‘stretching the truth’, or ‘getting away with everything they can’

Ethics: Driving Unethical Behavior

1. Evaluate performance w/ only quantitative measures
2. Premier Inc. judges employees not just on ‘making the numbers’ but ‘how they make the numbers’
   - Complying with company’s code of conduct is used for annual pay calculation
3. Keep track of ‘star’ performers’ activities so you don’t have an ______________

Fraud Tip: ________________________________
Ethics: What’s the Best Way to Prevent Someone From Stealing

BY APPLYING FOR A JOB WITH __________________
YOU AGREE TO THE FOLLOWING BACKGROUND CHECKS
1. Criminal
2. Civil
3. Credit
4. Driving

__________________________  ___________
Signature                       Date

BY APPLYING FOR A JOB WITH ______________
YOU AGREE TO THE FOLLOWING BACKGROUND CHECKS
1. Criminal
2. Civil
3. Credit
4. Driving

__________________________  ___________
Signature                       Date

Wished They’d Checked

Dave Edmondson
RadioShack CEO

James Joseph Minder
resigned as chairman of
Gun maker Smith & Wesson
when it was discovered he
had spent ______________
for ______________. Asked why
he had not disclosed his past.
His reply? ______________
Integrity

“Integrity must be accompanied by ethical values, and must start with the chief executive and senior management and permeate the organization. Control systems cannot rise above the integrity and ethical values of the people who create, administer and monitor them,” COSO report.

Why Managers Bend the Rules

1. CEO/Owner/Founder larger than life
2. Most are locals
3. Status to work there
4. Compensation structure
5. Cook-the-books
   1. Hit the numbers
   2. Make the numbers
   3. Help the numbers
Why Managers Bend the Rules

1. Starts as one-time, temporary, fix
2. Snowballs and becomes _________

3. Franklin C. Brown
   Vice Chairman/General Counsel
   Counsel to Rite Aid CEO for 40+ years
   76 years old
   Backdating contracts + $25,000 to secretary
   Sentenced to 10 years
   WHY ______________________

---

Why Managers Bend the Rules

No legislation or code of conduct can guarantee honesty.
Earnings Management Defined......

- Did you hear about the company that needed a CFO? Five finalists were given financial information and told to compute net earnings. The first 4 got the right answer, but not the job.

- The last candidate got the job when he asked, __________________________

When Does Juggling the Numbers Become Fraud???

1. Do you manipulate the numbers ________
2. Not all GAAP is high quality
Earnings management

- Selecting and applying GAAP to report desired results instead of reality
  - Inventory
  - Depreciation
- Performance timing
  - Maintenance
  - Inventory obsolescence
  - Sales period
- GAAP sometimes doesn’t reflect economic reality
  - R&D

Shedding Light on Fraud

![Bar chart showing the percentage of companies in which fraud occurred in different industries.](chart.png)
Shedding Light on Fraud

Outsiders—auditors and customers, for example—tailed CEOs and CFOs in committing the most fraud.

NAMED IN PERCENTAGE OF CASES

- Chief executive officer
- Chief financial officer
- Outsiders (for example, auditors and customers)
- Controller
- Vice president or equivalent
- Board member (nonmanagement)
- Lower level employee
- Chief operating officer

PERCENTAGE OF FRAUD CASES

- California 10%
- New York 11%
- Texas 8%
- Florida 8%
- All other states 58%

Companies with headquarters in California and New York accounted for more than a quarter of the fraud occurrences.
Revenue and Financial Reporting Fraud

The Hockey Stick

Lumber Yard
3-year average sales
$22 million

Sales at 12/15
$18 million

Jan Dec
Sagent Technology

1. Software to collect information from databases
2. IPO in 1999 and reached a high of $43+
3. Company was desperately trying to reinvent itself
4. April 2000 auditors refused to approve $3.5 million contract
5. Salesman Gary Williams Jones hired in hot dot com bubble as East Coast Federal Sales Director
6. Church, ferrying the elderly to doctors and inviting kids into his home at Christmas
7. East Coast recruiter was supposed check his background

Blond, blue-eyed and blessed with a gift of gab, instinctive feel for people. played football with the San Diego Chargers. began cheating modestly, starting with forging a purchase order of $172,500 in software to the National Gallery of Art
2. Sent purchase orders with either forged signatures of agency or fictitious employees
3. Submitted $5million in sales to federal agencies
4. $428,383 in commissions
## Sagent Technology

1. Convicted of bank fraud, forgery, Medicaid fraud and larceny in SC and VA
2. Fired from Global Knowledge in Mass. for fabricating $11 million contract
3. Phony sales for nearly a year
4. Unraveled when an official with the U.S. Navy Medical Systems called to say the authorizing signature of a real-life official was phony
5. Company collapsed in mid-November 2001

## Sagent Technology

1. Market value dropped by 70% in one day
2. Traded low of 25 cents
3. CEO+CFO fired and restated its financial statements
4. Laid off 20 percent of its employees -- 60 people
5. Shareholder lawsuits
6. Williams gets 46 months in prison

Fraud Tip: _________________________________
1. “There was absolutely nothing sophisticated about this,” said Jones’ attorney, federal public defender Barry Portman.
2. Never asked to see an original document
3. Never met a real person at the agencies
4. Sagent execs wouldn’t confront Jones
5. Delays blamed on federal secrecy or ineptitude
6. Told CFO he would handle the collections himself
7. Senator will help him

---

Controls “Drive” Behavior

<table>
<thead>
<tr>
<th>Percent of vehicles going more than 10 mph above the speed limit before and after speed cameras were installed in various locations in Washington, D.C.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Before cameras</strong></td>
</tr>
<tr>
<td>Ridge Rd. SE</td>
</tr>
<tr>
<td>Southern Ave. SE</td>
</tr>
<tr>
<td>Brentwood Ave. NE</td>
</tr>
<tr>
<td>Florida Ave. NE</td>
</tr>
<tr>
<td>Reno Rd. NW</td>
</tr>
<tr>
<td>16th St. NW</td>
</tr>
<tr>
<td>Riggs Rd. NE</td>
</tr>
</tbody>
</table>

Source: Insurance Institute for Highway Safety
Cultural Audit

1. “A corporation’s culture is what determines how people behave when they’re not being watched,” Tom Morris
2. “You’re trying to help the broad middle strengthen its ethical backbone to resist going along with the evil few,” Kirk O. Hanson Exec. Dir. Karkkula Center for Applied Ethics, Santa Clara University
3. Ethics is doing the right thing even when no one’s looking.....gdz

Is Ethical Behavior Enough?

1. Profitability is not optimized by only ethical compliance and codes of conduct
2. Cannot force people to behave ethically and for benefit of stakeholders
3. Some people have to have a reason to behave ethically and many ‘systems’ drive unethical behavior
Teaching Employees to Embezzle

1. Away from home
2. Working LOTS of hours
3. Accidentally watches a pay per view movie
4. A/P does what with the $5
5. Why
6. Employee thinks
7. Employee does what next expense report
8. What did you teach the employee

Hiring Ethical Employees

- Your hands aren’t tied ________________
- Best predictor of future behavior is __________
- Background and reference checks
- People will voluntarily talk about ethics
- Everyone who interviews should share, crosscheck and evaluate
- People with low integrity tend to think everyone does it and will brag
- Key: multiple examples
- Show understanding, not __________
11 Questions to Hire Ethical Employees

1. We often have to choose between what is right and what is best for the company. Tell me about when that’s happened to you.

2. Tell me about the ethics of your company. What are you comfortable and uncomfortable with?

3. Tell about an ethical decision you had to make. How did you make a decision?

4. Why would someone at your company stretch the rules? What did you think?

5. Have you ever had to bend the rules or exaggerate a little to get a sale?

6. Have you ever had to make something seem a little better than it really was?

7. Tell me about a situation where you had to go around company rules to get something done?
11 Questions to Hire Ethical Employees

8. We’ve all done things we later regret. Tell me about one and what you’d do differently today.

9. Have you ever had someone mislead the company or a client significant? How’d you handle it?

10. People think regulations, rules, and policies are either to be followed to the letter or to be broken. You?

11. Have you ever gotten credit for work someone else did? How’d you handle it?

What Are You Doing to Hire and Reward Ethical Employees???
Goal Discongruence

When the ‘system’ puts the decision-maker in a position of conflict.

Goal Congruence

When the ‘system’ puts the decision-maker in win-win position.
Goal Discongruence

Management has set the target. They expect me to achieve it. My future, my job could be on the line. I want to succeed, and I want to please my boss, management, and the company. I want to look good when compared to my peers.

Goal Discongruence Sales Force

1. Managers accountable for regions’ sales goals
2. Established by ..............
3. Company policy was ‘team work’
4. Primary motivators were individual quotas and rewards
5. Result: ‘team members’ were in competition with .......  
6. Example: who should get credit for a sale
Goal Discongruence Revenue

1. Software company management set very aggressive sales targets
2. Sales recorded when product shipped
3. End of month ➔ call customers to _______
4. Shipments to customers who hadn’t ______
   1. What do customers then do _________
5. Not enough? Ship to _____________
6. Company went bankrupt because management didn’t understand the ____________________

Defective Compensation Systems

“30 Minutes or It’s FREE”

Long-haul trucking

See Does your compensation system encourage illegal activity? on web site
Melt Down Over Pay System

1. FirstEnergy Corp caused BIG power ‘blackout
2. Recently fined $28 million for near melt down
3. Cooperate in prosecuting 3 former employees
4. Engineers Siemaszko and Geisen were each indicted on five counts and contractor-consultant Cook was indicted on four
5. Each could get 5 years + fine of $250,000
6. Company avoided criminal prosecution because it changed its culture

Melt Down Over Pay System

1. Workers covered up the most extensive corrosion ever seen in a plant
2. “Company and NRC concluded that the rust hole had been growing for __ years and that Davis-Bessie managers had ignored the evidence because they were focused on ______ rather than safety.”
Melt Down Over Pay System

1. Davis-Besse case changed the way the NRC regulates the nuclear industry
2. NRC increased inspection routines and instilled a more "questioning attitude"
3. NRC beefed up training and required more detailed records of discussions with plant operators

Fraud Tip: These changes sound like ________________

Fraud Tip

1. People behave the way you ________________

2. To align company and employee goals so employees will do what's in the best interest of the company

______________________________
Payroll and Expense Schemes

Fraud Tip: Payroll and expense reimbursement are so routine that owners, management, supervisors usually don’t _____________________

Ghost Employees

1. Fake employee on payroll
2. Least common but most costly
3. Most common in large organizations because employees ______________________________
4. What’s required:
   ■ Add a new employee or keep a former employee
   ■ Hourly - prepare and insert timesheet
Minimizing Ghost employees

1. Different employees add/maintain employee records vs. check prep and distribution
2. ID
3. Match payroll with employee list
4. Check employee number sequence
5. Do payroll deductions make sense
6. Does net payroll = funds transferred
7. Do all employees have personnel files
8. Check for former employees on payroll
9. Duplicate addresses/SSNs/deposit account #s
10. Reconcile account by someone not in payroll system
11. Review endorsements for multiple paychecks to same person
12. Reconcile payroll accounts to control accounts
Overstatement of Hours Worked

1. Most common
2. Individually small but can be BIG if __________
   - Becomes part of company culture
3. 16% of employees report witnessing E&Y 2002 survey

Overstatement of Hours Worked

Manual Systems

1. Manipulating
   - Forge supervisor's signature
   - Change timesheets after approval
   - Supervisor ________________
2. Controls
   - Review by someone who knows _____________
   - Control timesheets after ____________
   - Send timesheets directly and timely to payroll
   - Formal process for corrections
Overstatement of Hours Worked

Computerized Systems

1. Most common
   - Employees clock others in/out
   - Front-line workers

2. Controls
   - Supervisor monitor or video camera
   - Passwords or fingerprints
     - Periodically change

Overstatement of Pay Rates

1. Usually office workers or someone who can change master file

2. Preventive controls
   - Segregate authorization of pay rates from entry
   - Password protect access
   - Signed forms by supervisor and/or employee

3. Detective controls
   - Review and approve prior to check distribution
   - Hours X Rate (___________) = Payroll register
Payroll Withholding Schemes

1. Payroll clerk withholds too little of own pay but remits too much
   - Match remittance to _______________

2. Payroll clerk withholds too little of own pay but over withholds from other employees
   - TOTAL withholdings are _____
   - Can be used on any _______________
   - Outside payroll service

Reverse The Withholdings

1. Supervisor got payroll software tech to “open” the field codes so she could _______________
   2. So Federal, state, local taxes, Social Security and other withholding were _______________
   3. She then put the payroll service CDs in deck drawer
   4. Using her own desktop software she generated fake reports so the totals matched amount disbursed
   5. How did she cover $$ paid to herself _______________
   6. Cost to company $____________
Expense Schemes

1. Best protection
   - Segregation of duties
   - Comprehensive review and approval
2. *but difficult to CONTROL* if top management
   - Review by board, internal or external auditor
even if has to be after the fact

Fictitious/Duplicate Expenses

1. Easy to create/duplicate receipts with __________
2. Fill in blank copies of receipts __________
3. Submit same receipt on ________________
4. Submit different receipts for same expense _______
5. Submit receipt paid by another organization
   - Employee on industry association board/comm
6. Submit receipt for items paid directly
7. Two employees submit receipts for same _______
Fictitious/Duplicate Expenses
Prevention and Detection

1. Cross-check between employees
2. Compare employee’s sequential expense reports
3. Submit within specified time to ________________
4. Compare expense reports with AP for direct pays

Airfare and Travel - 3 Schemes

1. Travel never taken but turns in ________________
2. Tickets for companions buy one at full fare get second _____________
3. Switching tickets
   - Buy 2 tickets for legit trip
   - 1st is advance low price ticket
   - 2nd is last minute high priced refundable ticket
   - Cancel second ticket
   - Keeps _____________
Controlling Travel Schemes

1. Preventive controls
   - Pre-approval
   - Proof of trip (get _________________________)
2. Detective controls
   - Cross-check ticket numbers
   - Employee's name on supporting docs
   - Match dates on tickets to hotel/meals/timesheets

Personal Purchase Schemes

1. Hard to say no if top management ______________
2. Preventive control
   - Pre-approval best but not practical for travel exp
   - Does AP have a reason to pay attention
3. Detective controls
   - __________ invoices or receipts
   - Check name and address on invoice/receipt
   - Name/org of everyone on meal receipt
   - Examine receipts for non-business items
Wal-Mart Fake Expenses

1. Vice Chairman and No. 2 executive
2. Submitted fraudulent expenses + illegal gift card use for $500,000
3. Guilty of wire-fraud and tax-evasion
4. Nearly all for personal expenses
5. “I’m reimbursing myself for funding secret anti-union spying campaign, so I don’t have any __________.”
6. 51 $100 gift cards for company All-Stars

Wal-Mart Fake Expenses

1. Bought 3-12 gauge shotguns, puppy chow Celine Dion CD, vodka, wine, fishing license, $3.54 Polish sausage
2. Caught when he presented a gift card to buy contact lenses and clerk couldn’t understand why he was an All-Star
3. Sentence: 27 months home detention + 5 years probation, no jail (8/10/06) $50,000 fine + $400,000 restitution

Fraud Tip: WHY ______________________________
Wal-Mart Fake Expenses

1. VP Robert Hey, Jr., 42
2. 3 counts of wire fraud=30 years + $1 million _____ for aiding and abetting but plead guilty for probation
3. Between 1997 and 2004 “used his position to....illegally manipulate the employee travel reimbursement and vendor invoice accounting system at WalMart to embezzle monies, gift card and products, which were provided to a senior WalMart executive for the executive’s personal benefit and use.”

WARNING: ______________________________

Dear Abby: I have owned a business for 13 years. Recently, one of my employees forged a customer’s check in the amount of $1,000. I have tried to talk to him and ask why, and I have threatened to go to the police. We have more than just a working relationship. We did a lot of things together outside work but never had a sexual relationship.

This man worked for me for more than two years and, other than this crime, was a perfect employee. He insists that he didn’t forge the check that he had cashed at the customer's bank and tries to justify it by saying he deserved the extra money. I always paid him on time and gave him many perks. Please help me....Lost Big-Time

Dear Lost: Wake up! Your “perfect employee” is a thief, a forger and a sociopath. He might be a charmer — aren’t they all — but that’s what has enabled him to reach the point he has.

For your emotional wellbeing and for the sake of your business, please tell the police what you have learned. If you don’t, the next person to be burned will be you. Bank on it.
How to Deter Employee Fraud

1. Know the risks in your business
2. Make your views on fraud known
3. Create a culture that frustrates fraud
4. Ensure that your internal controls are effective
5. Make certain that personnel policies are effective
6. Review disciplinary policies

How to Deter Employee Fraud

1. Perform thorough background and reference checks on all new employees
2. Review and improve internal controls
3. Written code of conduct
4. Establish an employee hotline
5. Never drop your guard. Never ignore “red flags”
6. Fraud response plan
7. Internal audit to detect fraud
8. Train senior management in fraud detection and prevention
9. Expand Board of Directors oversight
10. Create a positive work environment
Ben Wright, Esq.

- The Law of Fraud
- Document Destruction and Retention
- Private Securities Litigation Reform Act
- Altering or destroying workpapers is a ____________
- If workpapers are incomplete can’t issue an ________

Dunlap Cannon

- Real estate attorney
- $1 million income
- Father
- Life style issues
- Bank accounts
- Fraud lesson __________________________
Jesse Oddi
- Clerk of Courts
- Financial stress
- $450,000 embezzlement
- 5+ years
- NM Municipal League
- Fraud lesson ________________________

SAS 99
Mark Morze
- Pepperdine University
- Toastmaster Speaking Champion
- Fraud: Ex-Con Tells All Part II
- CFO, ZZZZ Best Carpet Cleaning
- 10,000 phony documents
- $50 million of revenue, 86% was __________
- “If you were my auditor, ________________________
Embezzlement
Walt Pavlo

- Mid-level manager at MCI
- $6 million embezzlement
- KPMG
- Association of Certified Fraud Examiners
- CNBC
- Fraud lesson ____________________________

Corporate Identity Theft
John Kammin

- Professional identity thief
- Assists law enforcement
- Trains banks how to protect themselves
- Fraud lesson ________________
Financial Reporting Fraud
Nick Wallace

- President ESM Government Securities
- $350 million fraud
- Bankrupted 69 S&Ls
- 2 suicides
- Wallace serves 6½ years
- Gomez goes to prison
- Fraud lesson_____________________

Embezzlement
TeriLyn Norwood

- Accounts payable supervisor
- $18,000 embezzlement
- Financial stress
- Profiled in WSJ
- Montel Williams Show
- Fraud lesson______________________
Bank Fraud
Dave London

- Bank president
- Gambling
- Embezzlement
- CFO figured it out
- 33 months
- Fraud lesson: If you’re doing something wrong and someone figures it out you don’t _______________

Barry Minkow

- CEO ZZZZ Best
- Senior Pastor
- Fraud Discovery Institute
- Fee ____________
Profiled in.....

- WSJ
- NYT
- CFO
- Sunday Herald (Canada)
- Miami Herald
- National Post (Canada)
- Business First
- San Antonio Express
- Washington Post
- Report on Fraud (Kroll Int’l)
- Risk Management Journal
- Spirit
- Houston Chronicle
- Baltimore Sun
- Forbes
- Denver Post

In-House Training

- SEC
- Dept of Justice
- FBI
- Federal Reserve Bank
- National Association of Securities Dealers
- Old Republic Title Company
- NationalLease
- Southern Gas Association
- Retail Industry Leaders Assn
- Young Presidents Organization
- National City Bank
- National Rural Electric Coop
- SAS Institute Inc.
- American Corporate Counsel
- Am Society of Industrial Security
In-House Training CPA Firms

- Mellott & Mellott
- Yeo & Yeo, P.C.
- Scott + McElveen
- Bowman & Company
- Grant Thornton
- KPMG Peat Marwick
- Berry Dunn McNeil & Parker
- Olsen, Thielen & Co.
- Packer, Thomas & Co.
- Hahn Loeser & Parks
- Cindrich, Mahalak & Co.
- The Morehouse Firm
- Boulay, Heutmaker, Zibell
- Suby VonHaden & Associates
- Blackman & Sloop, CPAs
- Deloitte & Touche
- Rea + Associates
- Summers Spencer & Callison, CPAs