# Fraud risk:

## What you don't know CAN hurt you

**Presenter:**

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CAOT Management Mondays Webinar
in collaboration with BDO CANADA LLP

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# The Presenter

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Robert is a Chartered Professional Accountant and the Ottawa Office Managing Partner with BDO.

He has over 30 years experience in Public Accounting. Robert specializes in assurance services to not-for-profit organizations and private companies. He has presented at various seminars for not-for-profit organizations on topics like fraud, governance, financial reporting and strategic planning.

He is the engagement partner for the Canadian Association of Occupational Therapists.

He is also very involved as a member of Board of Directors of various not-for-profit associations.

# Learning Objectives

After taking part in this webinar, participants will:

1. Have a better understanding of fraud risk.
2. Have knowledge of the type of frauds that exist.
3. Have an appreciation for methods they can use to prevent fraud.
4. Know what steps to take if fraud is discovered.



# Why is this Topic Relevant for Occupational Therapists?

The presentation will provide background information which is relevant to individuals that own corporations, manage corporations or are responsible for staff in health institutions.

Fraud is relevant at all levels and having better knowledge will strengthen all organizations and help minimize opportunities for fraud.

# Fraud Risk- Introduction

- Fraud is pervasive
- Impacts any business regardless of size or industry
- Schemes are very brash and often not very complicated
- Losses to organization are staggering and not just financial
- Recovery of losses is not often obtained

**What you don't know CAN hurt you**



# Fraud Risk- Outline

- Definition and theory (7 - 17)
- Preventative measures (18 – 21)
- Specific schemes and preventions (22 – 25)
- How to react to fraud (26)
- Anti-fraud programs (27 – 28)

# What is Fraud?

**Occupational Fraud**

*"the use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets."*

**Association of Certified Fraud Examiners**



# Who is the Fraudster?

**10 – 10 – 80 Rule**

**10%** of employees will never steal, no matter what

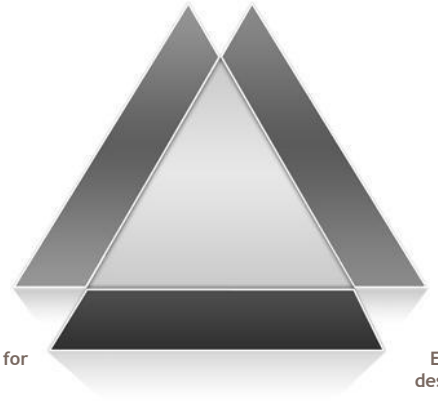
**10%** of employees will steal at any opportunity

**80%** of employees will go either way depending on how they rationalize a particular **opportunity**

Where do you fit in?

# The Fraud Triangle

**OPPORTUNITY**
Weak internal controls or ability to override controls



**NEED / PRESSURE**
Employee needs funds for lifestyle or habits

**RATIONALIZATION**
Employee feels funds are deserved for various reasons



# Environment of Fraud

- Lack of internal controls
- Override of existing internal controls
- Lack of management review
- Expected behaviour not clearly communicated
- Poor tone at the top

Lends itself to opportunity

# Environment of Fraud

- Lack of competent personnel in oversight roles
- Lack of independent checks
- Failure to believe it could occur
- Inappropriate amount of trust is placed in employees
- Lack of fraud awareness and training

Lends itself to opportunity



# Fraud Losses

- The typical organization loses an estimated 5% of its annual revenues to employee fraud
- Presence of anti-fraud controls is notably correlated with decreases in the losses and duration of fraud schemes

# Types of Fraud

*Asset misappropriation schemes*, in which an employee steals or misuses the organization's resources (e.g., theft of company cash, false billing schemes or inflated expense reports)

*Corruption schemes*, in which an employee misuses his or her influence in a business transaction in a way that violates his or her duty to the employer in order to gain a direct or indirect benefit (e.g., schemes involving bribery or conflicts of interest)

*Financial statement fraud schemes*, in which an employee intentionally causes a misstatement or omission of material information in the organization's financial reports (e.g., recording fictitious revenues, understating reported expenses or artificially inflating reported assets)



# Schemes and Duration

Most Frequent Schemes

- Corruption and billing schemes posed the greatest risk, representing more than 50% of the cases of fraud in Canada

Duration

- The average duration of employee fraud is 12 months, but for managers 24 months

# Victim Organizations

- Organizations with fewer than 100 employees and those with 100 to 999 employees have consistently experienced higher median losses than their larger counterparts, which reflects the reality that fraud can affect the smallest organizations



# Behaviour Red Flags

| | |
|---|---|
| Living beyond means | 35.6% |
| Financial difficulties | 27.1% |
| Unusually close relationship with vendor or customer | 19.2% |
| Control issues (unwillingness to share duties/take vacation) | 18.2% |
| Wheeler-dealer attitude | 14.8% |
| Divorce/family problems | 14.8% |
| Defensive behaviour | 12.6% |

# Detection Stats

| | |
|---|---|
| Tips | 43.3% |
| Management review | 14.6% |
| Internal audit | 14.4% |
| By accident | 7.0% |
| Account reconciliation | 4.8% |
| Document examination | 4.1% |
| External audit | 3.3% |



# General Preventative Measures

- Maintain proper internal controls
- Implement a good accounting system
- Effective management review of reports
- Surprise audits
- Reporting hotlines
- Be aware and ask questions
- Internal and external audit functions

# Preventative Measures – Employees

- Code of conduct
- Proper employee screening
- Proper supervision and review is critical
- Job rotation / mandatory vacations
- Employee support programs
- Video surveillance, perception of detection
- Fraud training
- Consider insuring against dishonesty
  - Fidelity insurance



# Preventative Measures – Internal Controls

- Separate functions – no employee should have control over an entire financial transaction
- Where segregation isn't possible, use compensating controls
- Look at bank statements and all cancelled cheques, wire transfers and debits for anything unusual
- More effective controls needed at senior managements levels as they can override controls
- Maintain control over cheques

# Preventative Measures – Hotlines

- Confidential reporting for employees and external sources
- Hotline or formal reporting system
- Should be encouraged to report suspicious behavior
- Implement a whistle blower policy



# Corruption

**Corruption**

- Employees use their influence in a way that violates their duty to employers in order to obtain a benefit
  - Receive or offer bribes
  - Accept or extort illegal payments
  - Engage in conflicts of interest
- Transactions may not be on the books, so internal controls not effective

**Prevention**

- Establish code of conduct with specific expectations, state consequences
- Annual sign off
- Supervisors should be aware of employees' relationships with customers and suppliers
- Occasional confirmation with customers / suppliers

# Asset Misappropriation

**Cheque Tampering**

- Forged maker
- Forged endorsements
- Altered payee or amounts after cheque is signed

**Cheque Tampering – Prevention**

- Proper security over unused cheques
- Proper security of mail procedures after cheques are signed
- Segregation of duties, handling cheques should not enter accounting entries
- Bank reconciliation procedure to scrutinize all cheques periodically



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# Asset Misappropriation

**Stealing Non-Cash Assets**

- Involves the employee stealing or misusing any company asset
- For example:
  - Employee steals inventory from a warehouse or storeroom
  - Employee misuses confidential information
  - Employee uses company assets for personal purposes

**Stealing Non-Cash Assets - Prevention**

- Use of video surveillance
- Proper physical security over warehouses
- Proper requisition procedures for inventory
- Monitoring of use of company assets



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# Asset Misappropriation

**Expense Account Abuse**

- Employee submits false expense claims:
  - Mischaracterized expenses
  - Overstated expenses
  - Fictitious expenses
  - Multiple reimbursements

**Expense Account Abuse - Prevention**

- Set up proper expense claim forms
- Only allow reimbursements, no corporate credit cards
- Only allow original receipts to be submitted
- Must be approved by someone else



# Reacting to Fraud

**Consider internal and external communications**

**Consider retaining counsel and informing Police**

**Secure assets**

- Employee's office
- Computer

**Dealing with suspected employee(s)**

- Consider suspending with pay pending an investigation
- Allows employee to clear name
- May be others involved

# Anti-Fraud Program

- Define acceptable conduct and dealings
- Define responsibilities for prevention and detection
- State consequences
- Establish and explain confidential reporting



# Anti-Fraud Policy

- Define hiring policies
- Clarify how an investigation should proceed
- Policies concerning gathering and preserving evidence
- Confidentiality and privacy
- Perform a formal fraud risk assessment including all levels of the organization

# Q & A – 15 min.



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