

Internal Fraud

Maine Association of Community Banks

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Discussion Goals and Objectives

- Basic overview of internal fraud and importance of proper event management.
- Discussion of prevention, detection, mitigation points
- Case preparation and presentation.
- Discourse and exchange of ideas!

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 2006 Report to the Nation

2006 ACFE: Report to the Nation

- 1,134 cases surveyed – 01/2004 – 01/2006
- Banking – 14.3% - \$258K median loss
- Survey identified 5% avg. of organization's revenue lost to fraud and theft losses
- If applied to 2003 US GDP - \$652 Billion in losses!
- Asset Misappropriation (cash or property)
 - 91.5% / \$150K median loss
 - Cash: 87.7 / \$150 K
- Banking Statistics
 - 148 total cases from survey
 - Cash larceny – 19.6%
 - Non-cash larceny – 15.5%
 - Skimming - 14.2%
 - Billing schemes – 12.2%
 - Check tampering – 12.2%
 - Wire Transfer – 10.8

Who commits Occupational Fraud?

*ACFE 2006 RTN

- Position
 - Employee – 39.5% (\$78K)
 - Manager – 41.2% (\$218K)
 - Owner / Executive – 19.3% (\$1MM)
- Criminal History
 - No prior criminal history – 87.9%
 - Arrested, not convicted – 4.4%
 - Prior convictions – 7.7%
- Tenure
 - < 1 yr. – 10.2 (\$45K)
 - 1-5 yrs. – 25.7% (\$100K)
 - 5 - 10 yrs. – 26.3% (98K)
 - 6-10 yrs. – 22.8% (\$205K)
 - >10 yrs. – 37.7% (\$263K)

How were cases found?

*ACFE 2006 RTN

- Tip – 34.2%
- By Accident – 25.4%
- Internal Audit – 20.2%
- Internal Controls – 19.2%
- External Audit – 12%
- Police – 3.8%
- Tips by Source
 - Employee – 64.1%
 - Anonymous – 18.1%
 - Customer – 10.7%
 - Vendor – 7.1%
- In \$1MM+ cases...
 - Tip – 44%
 - By Accident – 24.4%
 - Internal Audit – 17.7%

Prevention

- Common Anti-Fraud Measures
 - External Audit
 - Internal Audit
 - Fraud Training
 - Hotline
 - Surprise Audits
 - Control Environment
- Take away opportunity!
 - Opportunity, motive, rationalization

- Losses Minimized
 - Internal Audit: No - \$218K, Yes - \$120K
 - Surprise Audits: No - \$200K, Yes - \$100
 - Hotline: No - \$200K, Yes - \$100K

Prevention

- Background Checks
 - Criminal, fingerprint, credit, resume and background vetting
- Adequate security controls
- Adherence to Policy and Procedures
- Effective field management
- Adequate cash management, other asset controls
- ‘Post mortem’ loss analysis is a good place to start...

Detection

- Loss analysis
 - Review fraud cases for patterns
- Fraud Auditing
 - Horizontal and Vertical financial analysis
 - SAS 99
 - AICPA material
- Reporting mechanism
 - Hotline, other means for internal and external reporting
- Behavioral Red Flags
 - Changes in personality
 - Spending issues
 - Poor attitude / Revenge
 - Interaction with HR
- Surprise Audits
- Fraud Awareness training
- Your own detection methods
 - Reports
 - Systems
 - Systematic authorities, etc.



Uh-Oh...

“Poo-poo Happens” – Reagan Corbett’s bib

The Investigative Process...

- Begin Documentation trail
 - Case management system
 - Narratives / Memos
 - Database – your diary
- Treat all matters equally
 - Proceed as if case ends in civil litigation
 - Adhering with Policies
- Objective search for the truth, acting as fact finder
- Ensure you can remain objective
- Let facts guide you, not supposition
- Re-think hypothesis as necessary

The Investigative Process...

- Corporate / Agency / Legislative Policies
 - Buy in from the top
 - Authority and autonomy to take necessary actions
 - SOGs vs. SOPs
 - Action plan in place
- Consistency in Actions
 - Consistency, Consistency, Consistency...
- Within Boundaries
 - Legal issues
 - Ethical issues
 - Employment
 - Other parameters
- Legal Arena
 - Criminal (70.6% RTN)
 - Civil (23.5% RTN)
 - Regulatory (DOL, MHRC)

Evidence

- Real

- Physical thing that is involved in the act or case in question
- Relevant and material to the facts at hand in the issue
- Can be authenticated
- Ex: murder weapon, the forged check, the burned down house, the wrecked auto...
- Contraband...

- Demonstrative

- Illustrates testimony of witnesses
- Authenticated by the person utilizing the testimonial evidence
- Maps, drawings, diagrams, link analysis charts, etc.

Evidence

- Documentary

- Documents used to prove assertions material to the issue
- Can be real evidence too
- Must be authenticated
- Best Evidence rule
- Hearsay concerns

- Testimonial

- Testimony offered in a legal proceeding, ex: trial, deposition, hearings, etc.
- Witnesses must be competent
- Other rules (hearsay, etc.) must be observed also

Evidence Examples

- Forged instruments
- Account records
- Witness statements
- Interview / interrogation records
- Written statements
- Audit trails
- Diagrams or other link analysis illustrations
- Attendance / HR records
- G/L or other accounting records
- Digital evidence

Evidence

- General Requirements
 - Relevant
 - Material
 - Competent
- Authentication
 - Chain of Custody
 - Best Evidence
- Interviews/Interrogations
- Can be excluded
 - Prejudicial
 - Irrelevant / Immaterial
 - De Minimis
 - Needless presentation of cumulative evidence

Documentation

- Your findings
 - Narratives
 - Database information
 - Chronological listing of events
- Interviews
 - Witnesses
 - Complainants
 - Subjects
- Records
 - Account records
 - Audit logs / trails
 - Telephone records
 - Other business records
- Descriptions of materials
- Document your Evidence...

Documentation

- Should clearly and concisely describe the relevant facts and outline evidence
- Narrative that is jargon free, easy to read, and clearly understood
- Who, what, where, when, how, and why...
- Keep case narrative updates concurrent with investigation steps
- Reference evidence via Attachment Addendum or other descriptor
- Secure originals!
- Outsiders will read this...

Case Preparation

- Discussion with management, legal counsel, other decision makers outlining relevant factors and findings
- Adherence to policies / procedures
- Prosecution vs. civil recovery
- Regulatory Requirements
 - S-OX
 - SARs
 - Other regulatory requirements...
- Employment Decisions
- Realistic expectations

Case Presentation

- Professional presentation
 - “Business” presentation
 - Legally and ethically sound
 - Objective and factual presentation
- Consultation with law enforcement on case
 - You are responsible for driving your case
- Continued Involvement
 - From initiation through adjudication
 - Court testimony, etc.
- Additional Actions
 - Restitution orders
 - Civil recourse
 - Civil prohibitions