

Thieves Within Part 2: Powerful Prevention Tools for the Small Business

Thu., April 28
The webinar will
start at 11 a.m. CT



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Administration



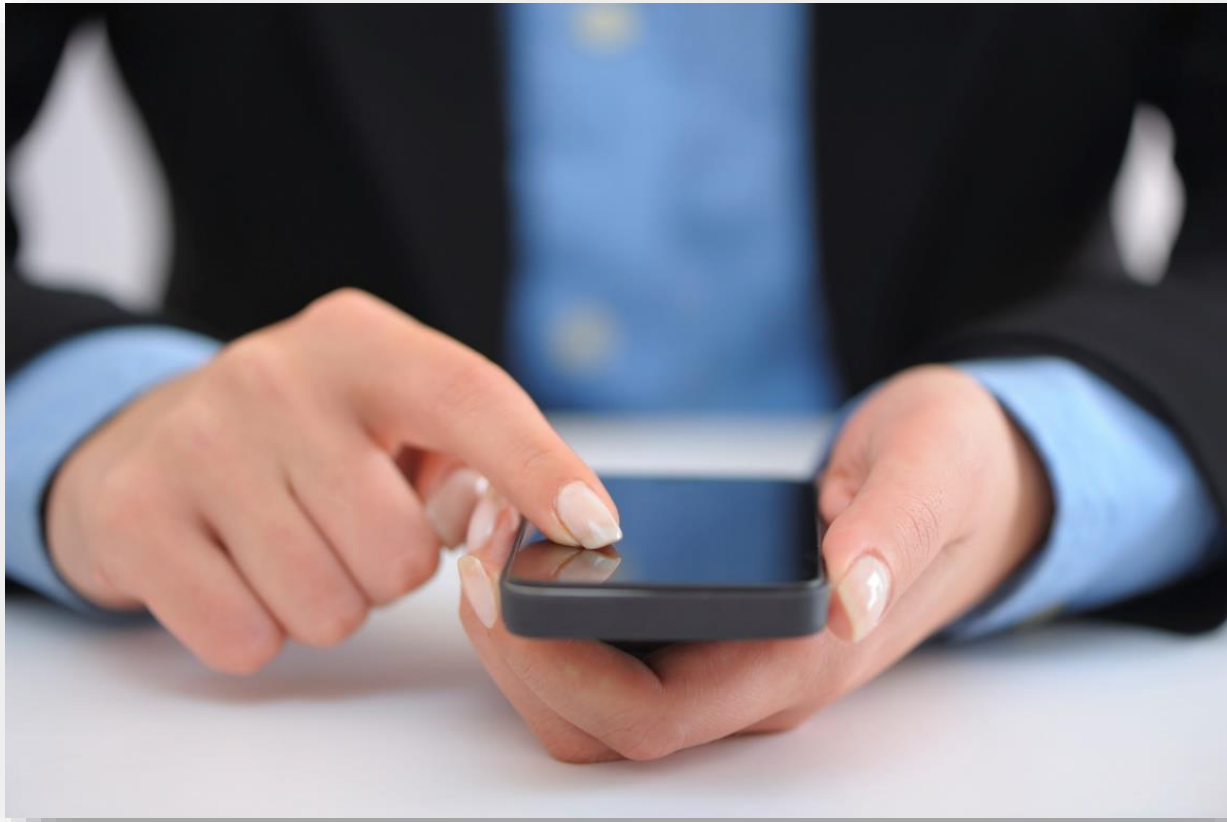
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About the Speaker



Cindy McSwain
Senior Vice President
Outsourcing Services

Leads AGH's outsourcing services

Plus 10+ yrs. audit experience

Member of AICPA, KSCPA, and
numerous civic organizations

About the Speaker



Jandrea Blumanhourst

Manager, Controller Services

Audit and private sector financial leadership positions

Experience with large commercial companies, governmental entities and not-for-profits

Outsourced CFO, monthly close-out, audit support, fraud investigation, accounting systems

Objectives

Review why occupational fraud occurs and its impact on your business

Identify the most commonly occurring fraud schemes

Understand why management's approach is the most important prevention tool

Learn how to segregate duties as an internal control





Polling Question #1

What is Fraud?

Occupational Fraud as defined by



“The use of one’s occupation for personal enrichment through the **deliberate misuse or misapplication** of the employing organization’s resources or assets.”

Fraud Statistics

\$

5% of annual revenue lost to fraud

5% of annual revenue lost to fraud

Median fraud loss in US dollars

Fraud Statistics

\$\$\$
\$

5% of annual revenue lost to fraud

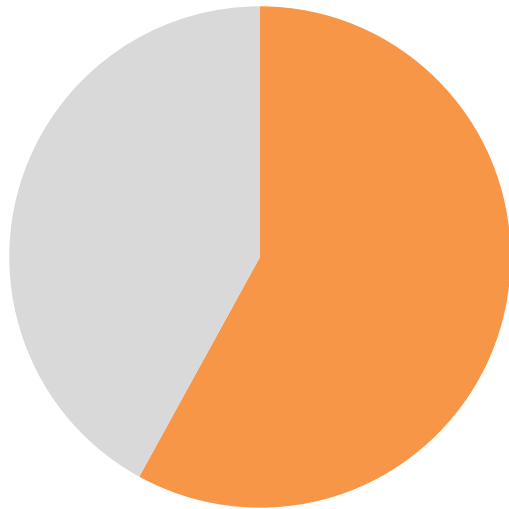
145_k

Median fraud loss
in US dollars



Frauds lasted a median of
18 months before detection

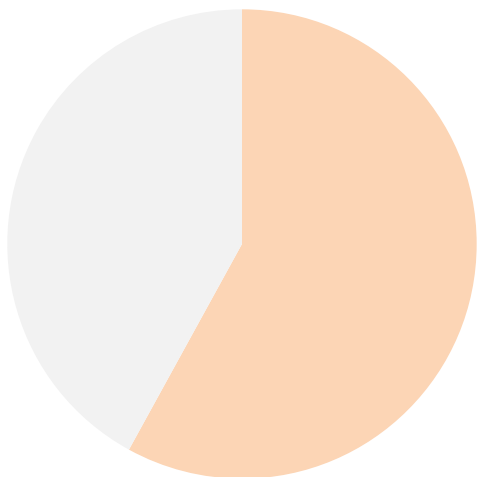
Fraud Statistics



58%

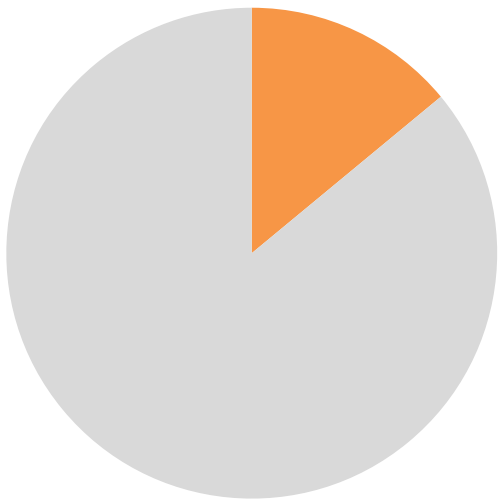
recovered **none**
of their losses

Fraud Statistics



58%

recovered **none**
of their losses



14%

made a **full** recovery



Polling Question #2

Common Fraud Schemes

Cash

**Accounts
Receivable**

**Property &
Equipment**

**Accounts
Payable**

Payroll

Common Fraud Schemes

Cash

Items sold for cash but sale is not recorded and cash is misappropriated;

Checks received are deposited but not recorded; checks are written to employees for the same amount and also are not recorded;

Customer remittances are misappropriated and collectible accounts are written off or otherwise credited; and

Duplicate payments of invoices are made.

Common Fraud Schemes

Cash

Vendor invoices are altered and photocopied to conceal alteration and the related payment benefits third parties;

Check signature or endorsement is forged;

Checks are issued for benefit of employees or third parties, and payees are changed in the cash disbursements journal;

Cash disbursements journal is overstated, the overstated amount is recorded, and the difference is misappropriated; and

Kiting exploits the time required for checks to clear the bank.

Common Fraud Schemes

Accounts Receivable

Goods shipped or services rendered but not billed, and the accounts receivable are not recorded;

Billings recorded, but goods not shipped or services not rendered at all or not rendered until the following period;

Customers billed at incorrect amounts; and

Revenues recorded in wrong period to achieve desired earning trends, commissions, bonuses, or profit-sharing goals.

Common Fraud Schemes

Accounts Receivable

Revenues understated to reduce taxes, royalties, or rentals based on sales volume;

Revenues recognized while the customer's obligation to pay is contingent on future events;

Orders from customers with poor credit are accepted and normal or favorable credit terms are granted; and

Orders are accepted at terms other than those established by management.

Common Fraud Schemes

Accounts Receivable

Unwarranted credits or discounts granted under a kickback arrangement;

Accounts receivable aged incorrectly, and potentially uncollectible amounts not recognized;

Accounts receivable improperly written off to conceal misappropriation of cash receipts;

Credits issued for returns or allowances are not earned or are not in accordance with company policy; and

Lapping occurs when an employee steals cash received and diverts customer payments to cover it up.

Unauthorized purchases are incurred;

Purchases are recorded but goods or services are not received;

Liability is incurred but not recorded; and

Purchase amount is recorded incorrectly.

Common Fraud Schemes

Accounts Payable

Purchase is charged to wrong account or is recorded in wrong period;

Purchases at other than favorable terms are made to facilitate side deals for the personal benefit of employees;

Purchases are misclassified to conceal lack of authorization; and

Improper deferrals of income are recorded in order to shift income to future periods.

Common Fraud Schemes

Accounts Payable

Purchase discounts are taken but not recorded and amounts of discounts are misappropriated;

Employees conceal unauthorized purchases for their own benefit;

Contingent liability is understated or not recorded; and

Kickbacks are paid by vendors to the company's purchasing agent.

Common Fraud Schemes

Property & Equipment

Capitalization policies

- Depreciable lives and methods
- Estimated residual values
- Costs properly included or excluded
- Financial statement vs. tax benefits

Failure to review asset listing

- Failure to recognize impairment losses
- Property remains on books after disposal
- Sales of property are not recorded, and proceeds are misappropriated

Property is used for personal benefit rather than company business

Common Fraud Schemes

Payroll

Time cards or reports are padded;

Unauthorized work or work not performed is accrued;

Accrual of employee benefits (e.g., vacation pay or sick leave) is recorded but not earned; and

Employees' earnings are over accrued or under accrued because of the use of improper rates or computation errors.

Fictitious employees (“ghost employees”) are on the payroll;

Authorization and write-off of **employee advances**;

Payroll costs, expenses, or related liabilities are misclassified;

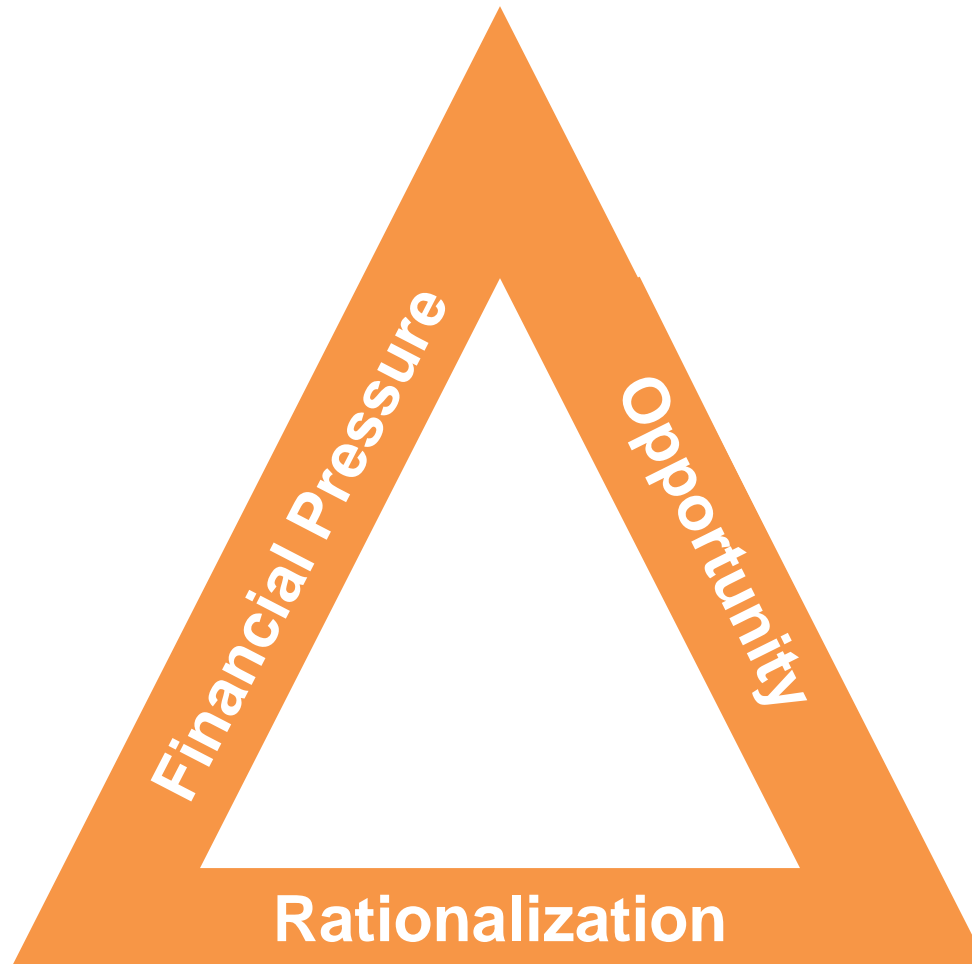
Payroll is recorded in period paid rather than in period earned; and

Terminated employees remain on the payroll.



Polling Question #3

The Fraud Triangle



The Fraud Triangle

“ I need it!”

*“ I can do it
without anyone
knowing!”*

Financial Pressure

Opportunity

Rationalization

“ I deserve it!”

FRAUD

Mitigating / Preventing Internal Fraud

Management's role

Internal controls





Management's Role

Culture

Implement Code of Conduct

Incorporate ethics into performance evaluations

Two-way communication

Management: Discussion of ethics by leaders

Employees: Employee hotline
(www.ourworkplace.com)

Periodic review of internal controls

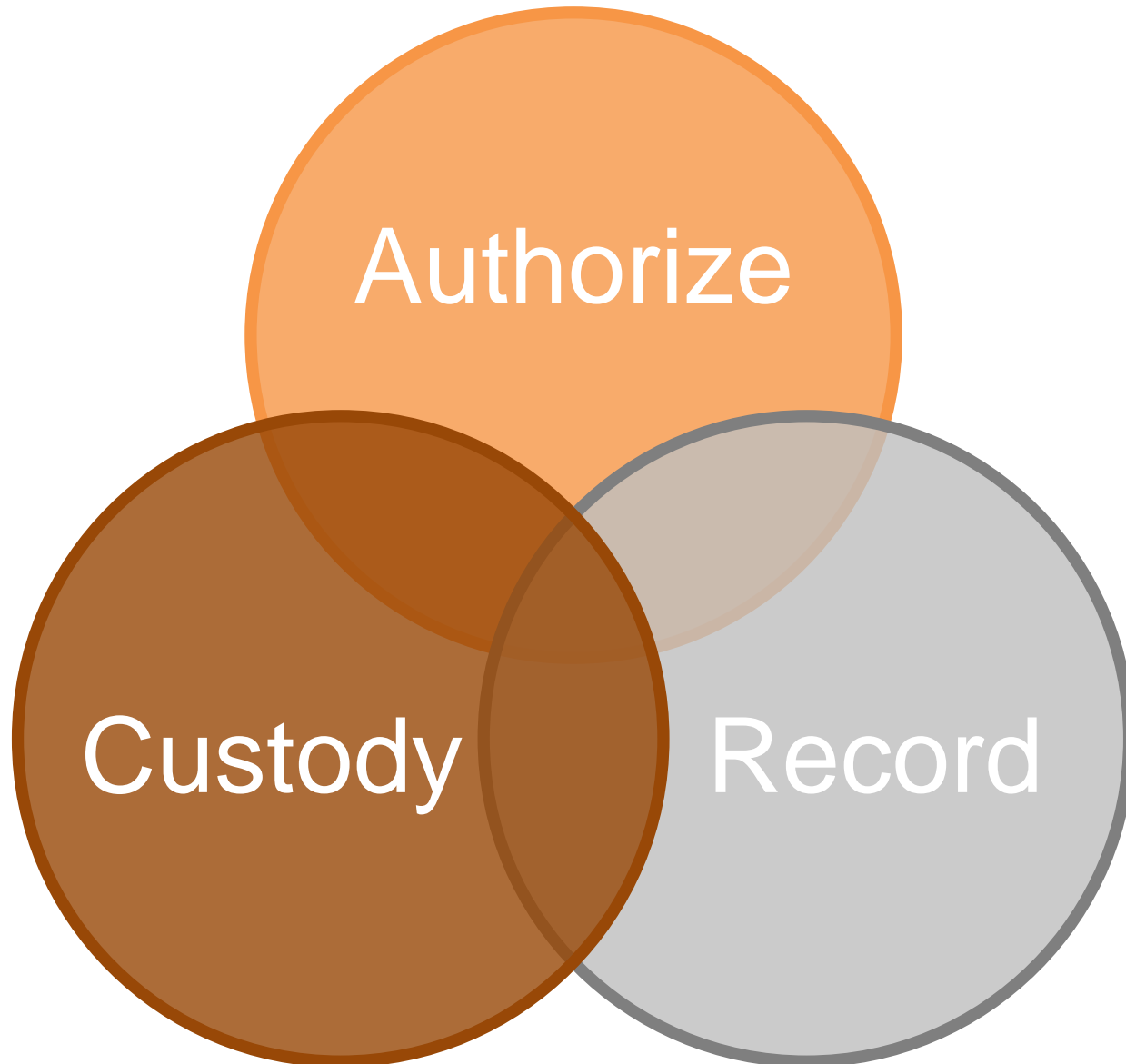


Internal Controls

Internal controls defined:

Actions designed to **minimize the potential** of material misstatement, fraud or other financial misconduct or error.

Internal Controls: Financial Policies and Processes



Internal Controls: Financial Policies and Processes

Authorize



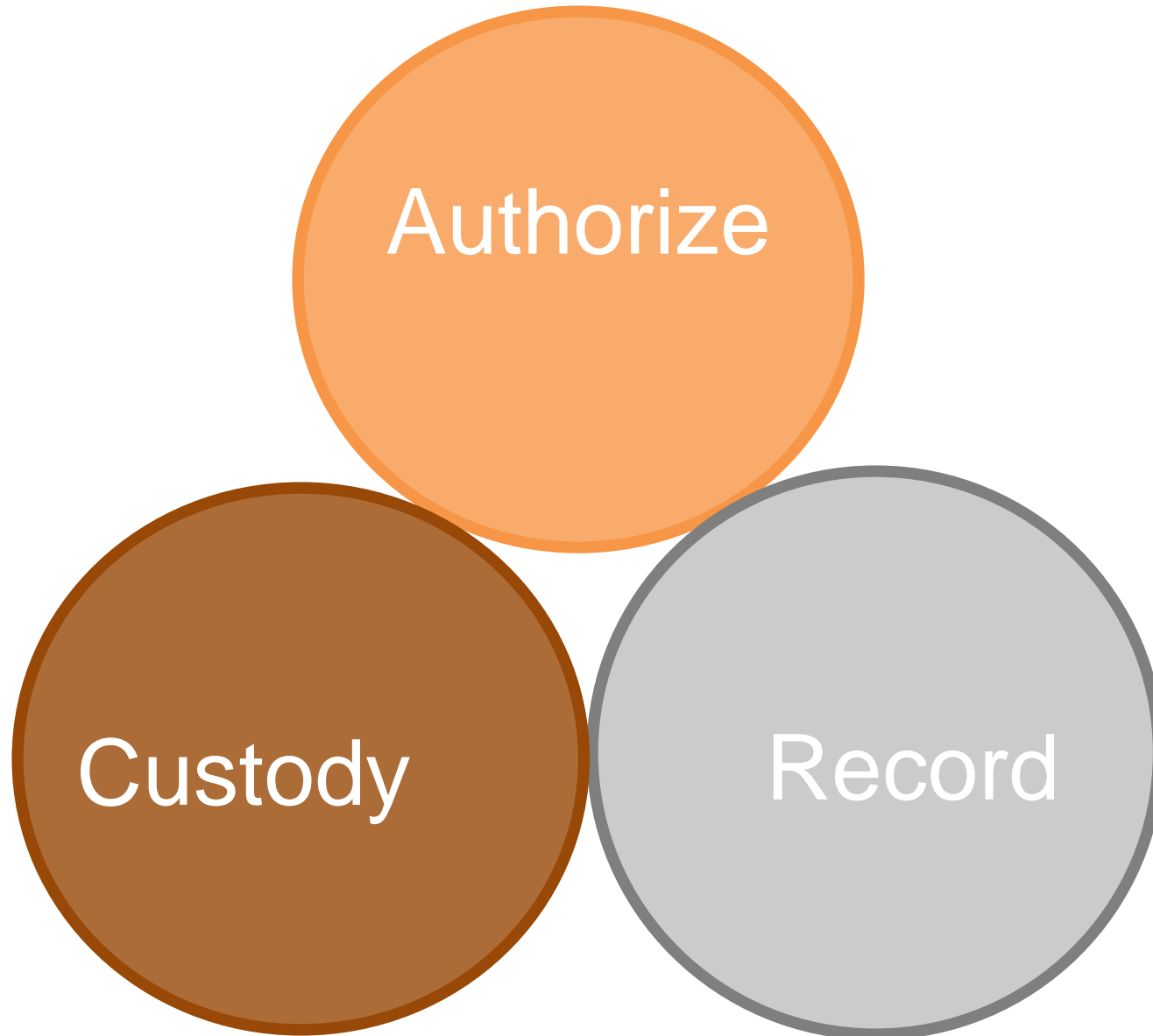
Record

Custody

Internal Controls: Financial Policies and Processes



Internal Controls: Financial Policies and Processes



Cash is King

90% of all fraud involved asset misappropriation.

85% of asset misappropriation involved theft or misuse of cash.



Cash is King

Positive pay

Blank check stock

Check stock security features

Bank account **reconciliations**

Direct deposit

Talk to your bank



Segregation of Duties: Cash

Mail opened by employee not responsible for accounting records

Prepare list of all cash receipts and copy to:

Accounting department

Controller

Preparer



Segregation of Duties: Cash

Restrictive endorsements on checks

Make deposits daily

Bank statements opened AND reviewed by someone other than employee(s)
maintaining cash records

Signed checks should NOT be returned to accounts payable employee

Review of adjusting journal entries

What About the *Really* Small Business?

Owner should review

unopened bank statements
and credit card statements

Reconcile bank statements
immediately

Review bank reconciliations
carefully

Open your own **mail**



What About the *Really* Small Business?

Check signing

Sign **ALL** checks

Review supporting documentation for all disbursements in excess of predetermined amounts

Don't rely on **rubber signature** stamps

Don't leave **pre-signed checks** lying around

What About the *Really* Small Business?

Review **monthly aging** of accounts receivable and accounts payable

Review and approve all **write-offs** of accounts receivable and **credit memorandums**

Don't run **personal expenses** through your business

What About the *Really* Small Business?

Approve and monitor changes to payroll

Review monthly financial statements and question variances

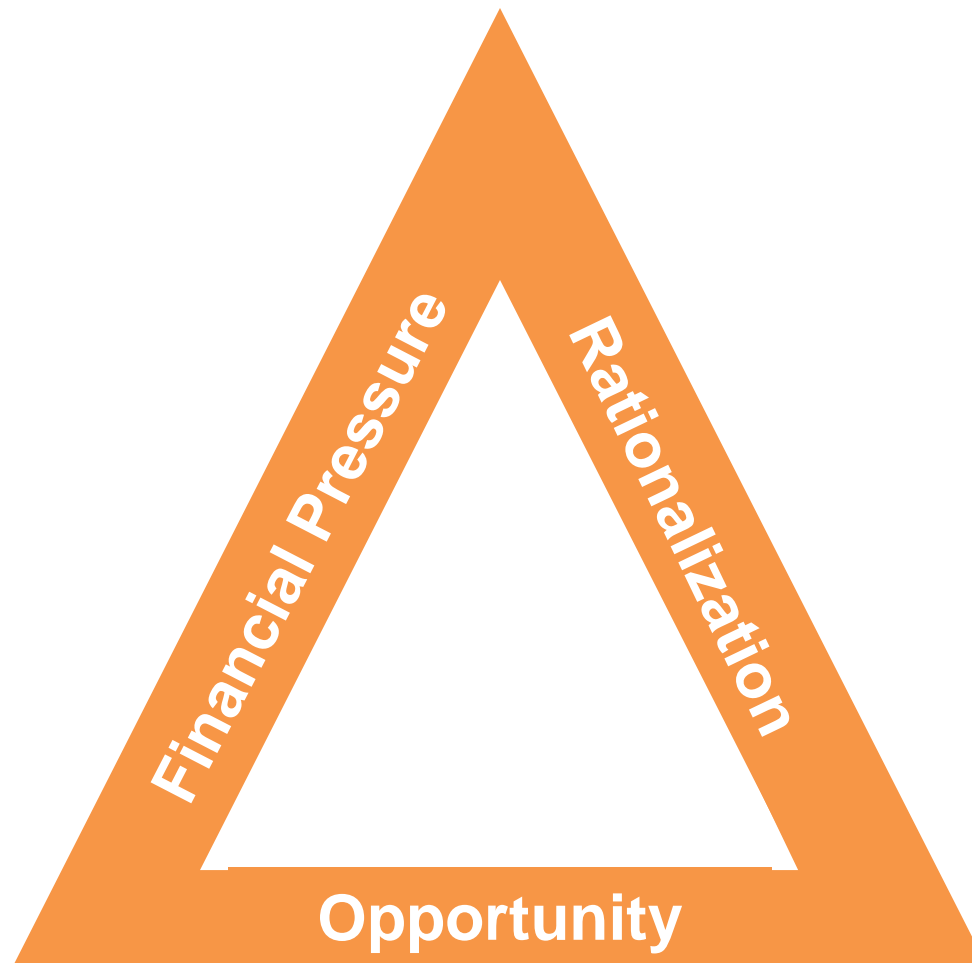
Have a questioning attitude – don't accept answers that don't make sense; investigate or question further



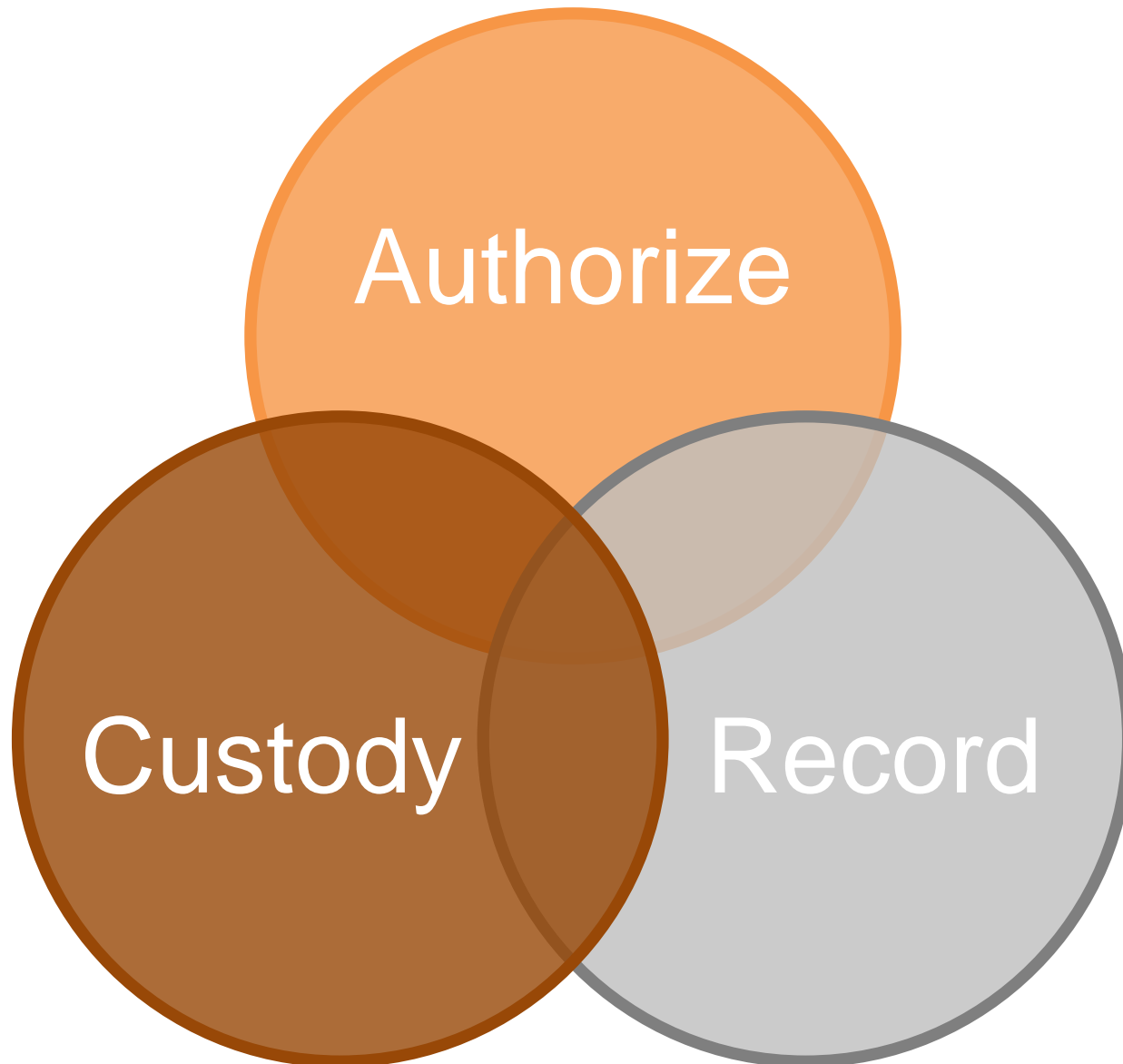
Polling Question #4

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The Fraud Triangle



Internal Controls: Financial Policies and Processes



Recap

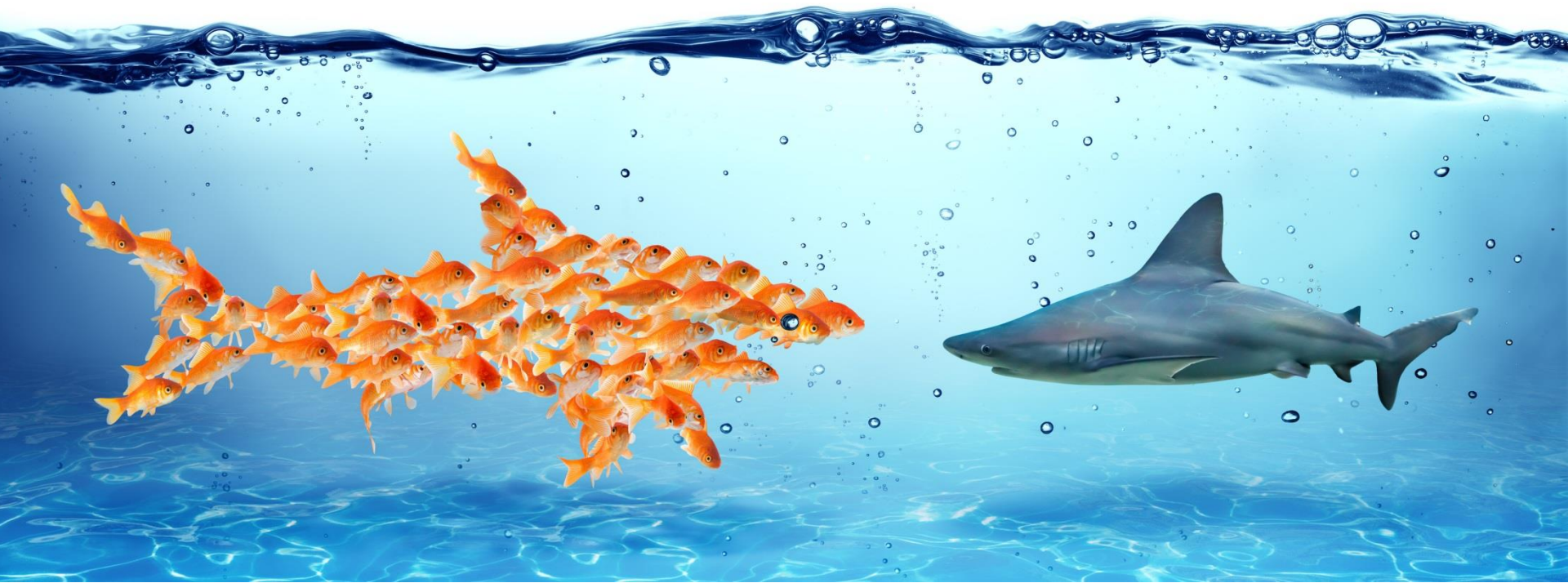
Fraud Overview

Common Fraud Schemes

Internal Controls to Use



Everyone Plays a Part.....



Thank You!



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