


MIS 5208 – Lecture 05 – Recognizing the Symptoms of Fraud

Ed Ferrara, MSIA, CISSP
eferrara@temple.edu

Learning Objectives

- Fraud symptoms (as we have discussed) help you recognize fraud.
 - If fraud symptoms are recognized, frauds can be detected early.
 - The text shares many examples of various real-life frauds and how they could have been detected if the fraud symptoms had led someone to investigate.
 - We will review some of these cases here.
- 
- Understand how symptoms help in the detection of fraud.
 - Identify and understand accounting symptoms of fraud.
 - Describe internal controls that help deter and detect fraud.
 - Identify and understand analytical symptoms of fraud.
 - Explain how lifestyle changes help detect fraud.
 - Discuss how behavioral symptoms help detect fraud.
 - Recognize the importance of tips and complaints as fraud symptoms.

Elgin Aircraft

- Claims processing and claims payment – adjudicate healthcare claims
- Self-insured company
- Claims processing verifies claim documentation, then forwards document to claims payment.
- Claims payment approves and signs the payment.
- Management has strong faith in their internal controls
 - Various audits – government, defense, internal and outside auditors
- **Medical Plans**
 - HMO – network of approved doctors – treating employees for a set fee
 - PPO – employees can see the doctor of their choice – compensating the employee for 80% of doctor fees
- **Medical Forms and Payments**
 - Forms completed by attending doctor and a verification statement of the charges
 - Doctors paid directly – no payments to employee

Claims Department Manager

- Auditor observed Claims Manager arriving at work by Chauffeured Limousine
- One of the company's "best employees"
- Never missed a day of work for 10 years



Fraud Investigation

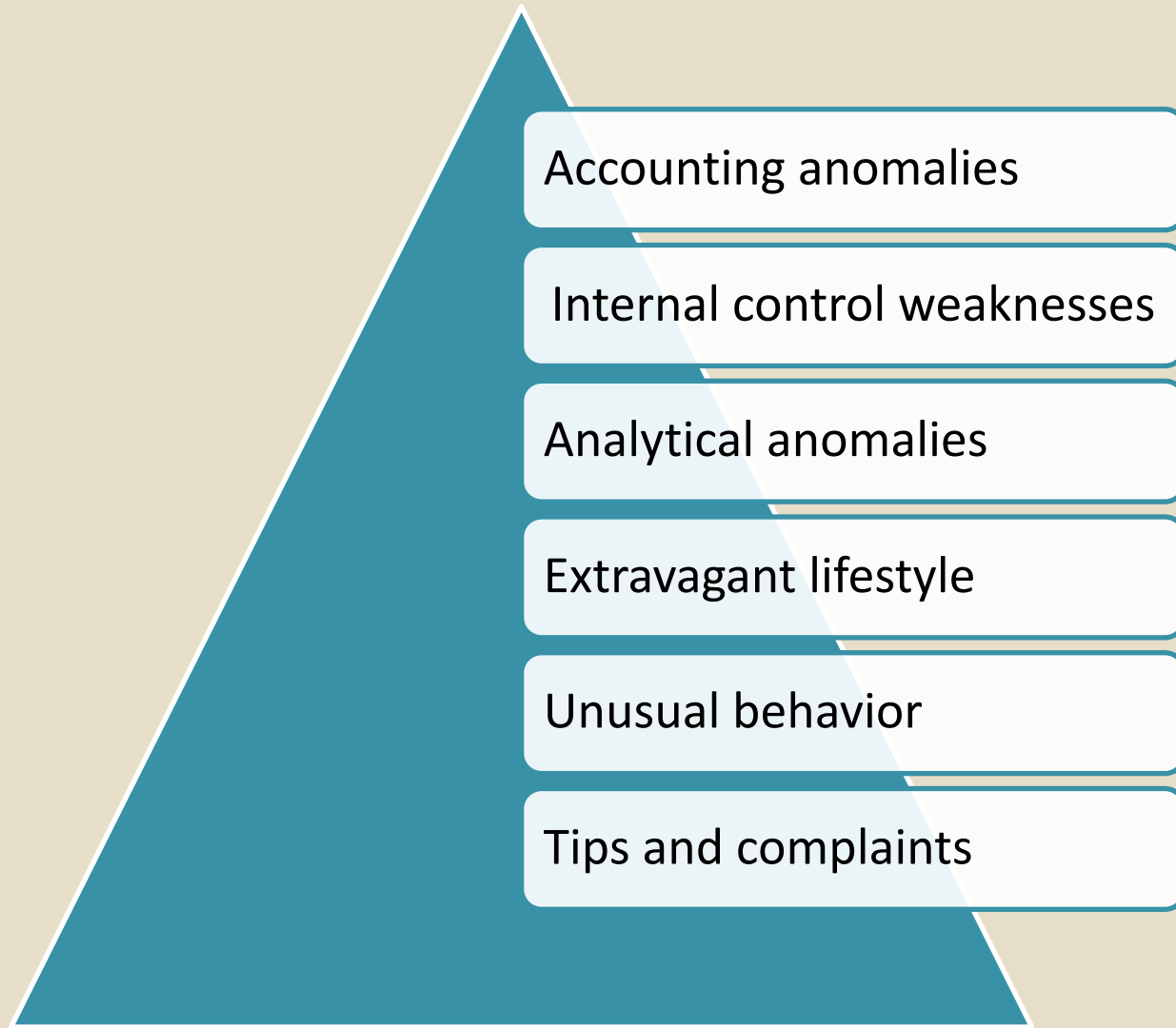
- Outcome

- Claims Department Manager
 - Embezzled \$12M
 - 22 "dummy" doctors submit claims for employees with little or no medical expenses



Image Source: <https://www.private-investigators-uk.com/wp-content/uploads/2015/03/Fraud-Investigation-Service1-e1442901961444.jpg>

Symptoms of Fraud



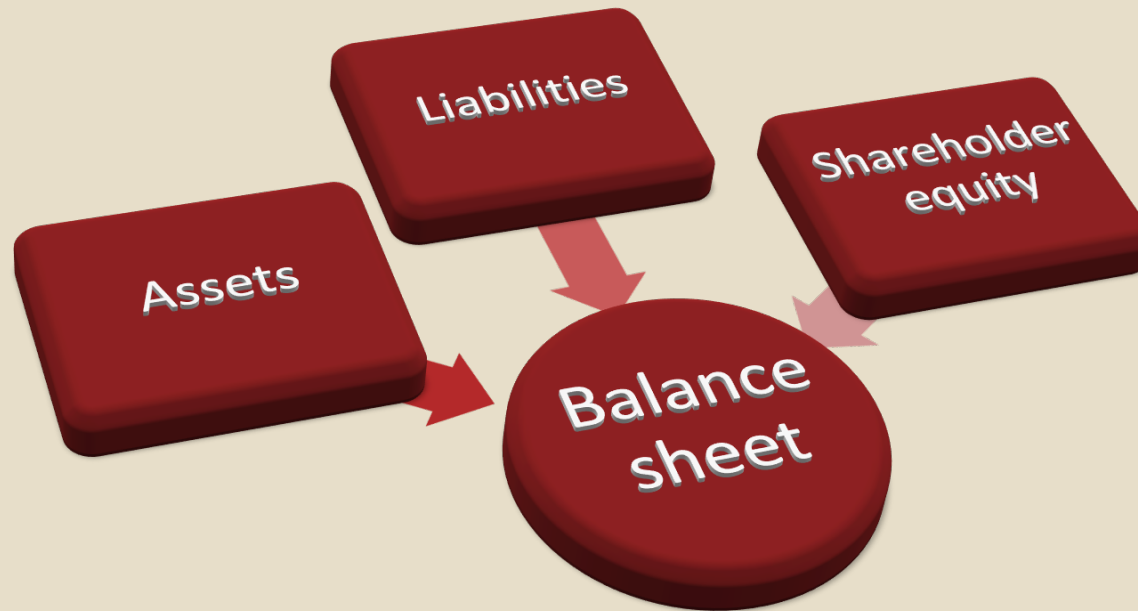
Accounting Anomalies

- Accounting anomalies result from:
 - Unusual processes or procedures
- Questions to Ask:
 - Are the payments reasonable?
 - Do the endorsements make sense?
 - Why are bills and payments going to the same address?
- Common anomaly frauds involve:
 - Irregularities in source documents
 - Faulty journal entries
 - Inaccuracies in ledgers
- Document Anomalies
 - Missing documents
 - Stale items on bank reconciliation
 - Excessive voids or credits
 - Common names or addresses – payees and customers
 - Increased past due accounts
 - Increased reconciling items
 - Alterations of documents
 - Duplicate payments
 - Second endorsements on checks
 - Non-sensical document sequences
 - Questionable handwriting on documents
 - Photocopied documents

Faulty Journal Entries

- Accounting is a language with rules and grammar
 - Debits = Credits
 - Owner's Equity = Assets - Liabilities

The Balance Sheet



Shareholder equity (value) = Assets - Liabilities

The “Balance Sheet”

Question: Do balance sheets balance? For example, this balance sheet does not balance:

SCIENTIFIC ENERGY, INC. CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2011 AND 2010		
	2011	2010
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,215,561	\$ 1,780,317
Accounts receivable, net	-	2,874,628
Accounts receivable, interest	-	51,952
Prepaid expense	2,396	17,056
Total current assets	1,217,957	4,723,954
Property, plant and equipment, net of accumulated depreciation of \$181,354 and \$93,477 as of December 31, 2011 and 2010, respectively	169,593	257,103
Other assets:		
Long-term investments	2,258,393	1,806,243
Total assets	\$ 3,645,943	\$ 6,787,300
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	\$ 3,445	\$ 2,821,862
Total current liabilities	3,445	2,821,862
Commitments and contingencies		
Stockholders' equity:		
Preferred stock: par value \$0.01 per share; 25,000,000 shares authorized, none issued and outstanding	-	-
Common stock: par value \$0.01 per share, 500,000,000 shares authorized, 94,915,855 shares issued and outstanding as of December 31, 2011 and 2010	949,159	949,155
Additional paid in capital	5,734,030	5,734,030
Accumulated deficit	(2,728,508)	(2,723,706)
Accumulated other comprehensive (loss) income	(312,183)	5,954
Total stockholders' equity	3,642,498	3,965,438
Total liabilities and stockholders' equity	\$ 3,945,943	\$ 6,787,300

<http://www.sec.gov/Archives/edgar/data/1276531/000127653112000003/0001276531-12-000003-index.htm>

Source: <http://www.xbrlsite.com/2013/Samples/DetectingAccountingAnomalies.pdf>

The “Balance Sheet”

ADVANCED VENTURES CORP.
(A DEVELOPMENT STAGE COMPANY)
BALANCE SHEET
AS OF DECEMBER 31, 2011 AND 2010

	As of December 31, 2011	As of December 31, 2010
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 9,991	\$ 300
Deferred offering costs	-	20,000
Total current assets	9,991	20,300
Total Assets	\$ 9,991	\$ 20,300
LIABILITIES AND STOCKHOLDERS' (DEFICIT)		
Current Liabilities:		
Accounts payable and accrued liabilities	\$ 16,410	\$ 27,253
Loans from related parties - Directors and stockholders	28,205	22,950
Total current liabilities	44,615	50,203
Total liabilities	44,615	50,203
Commitments and Contingencies		
Stockholders' Equity (Deficit):		
Common stock, par value \$.0001 per share, 200,000,000 shares authorized; 5,500,000 and 3,000,000 shares issued and outstanding, respectively	550	300
Additional paid-in capital	54,750	-
(Deficit) accumulated during the development stage	(89,923)	(30,203)
Total stockholders' Equity (deficit)	(34,623)	(29,903)
Total Liabilities and Stockholders' Equity (Deficit)	\$ 9,992	\$ 20,300

<http://www.sec.gov/Archives/edgar/data/1500122/000114420412017437/0001144204-12-017437-index.htm>

Source: <http://www.xbrlsite.com/2013/Samples/DetectingAccountingAnomalies.pdf>

Internal Control Weaknesses

- Internal controls
 - Control environment
 - Accounting System
 - Control Activities
- Weaknesses or Lack of:
 - Segregation and separation of duties (SOD)
 - Physical safeguards
 - Independent checks
 - Proper authorization
 - Proper documents and records
 - Override of existing controls
 - Inadequate accounting system

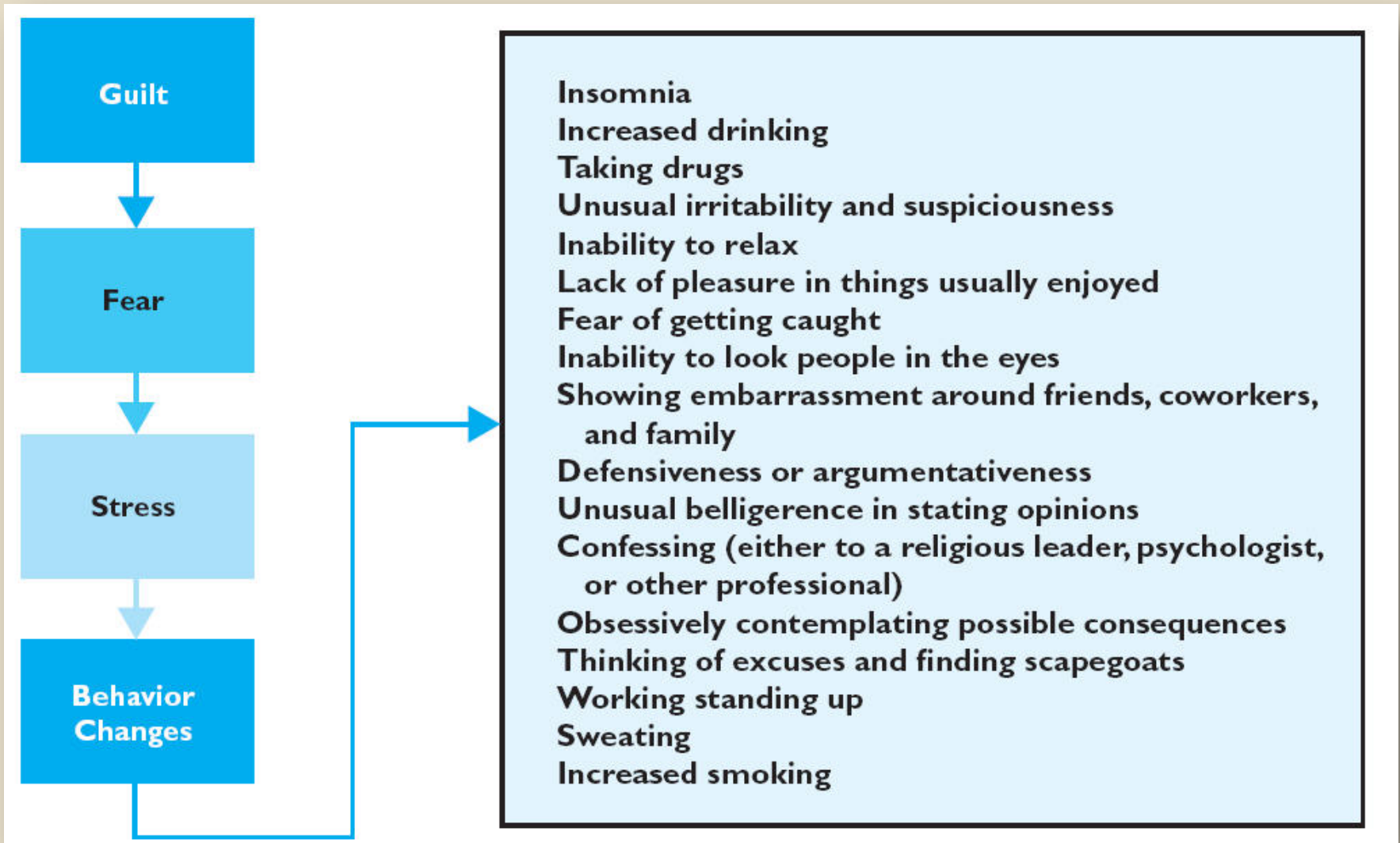
Analytical Fraud Symptoms

- Analytical Fraud symptoms include:
 - Unexplained inventory shortages or adjustments
 - Deviations from specifications
 - Increased scrap
 - Excess purchases
 - Too many debit or credit memos
 - Significant increases or decreases in account balances, ratios, or relationships
 - Physical Abnormalities
 - Cash shortages and overages
 - Excessive late charges
- Unreasonable financial statement relationships:
 - Increased revenues with decreased inventory
 - Increased revenues with decreased receivables
 - Increased revenues with decreased cash flows
 - Increased revenue with decreased payables
 - Increased volume with increased cost per unit
 - Increased volume with decreased scrap
 - Increased inventory with decreased warehousing costs

Internal Control Weaknesses

- Internal control fraud symptoms include:
 - Lack of segregation of duties
 - Lack of physical safeguards
 - Lack of independent checks
 - Lack of proper authorization
 - Lack of proper documents and records
 - Overriding of existing controls
 - Inadequate accounting system
- Other indicators
 - Forfeited vacation time
- Controls
 - Employee transfers
 - Audits
 - Employee notification of services performed

Unusual Behaviors



•

Thank you