

# FRAUD – A CASE DISCUSSION

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# AGENDA

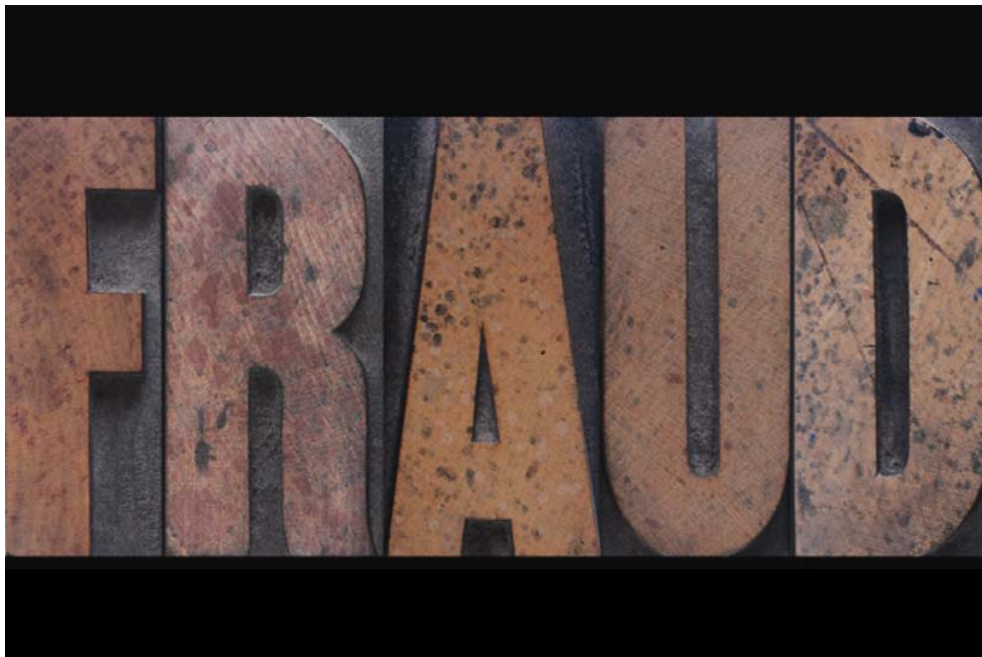
- Fraud in the Headlines
- Fraud Detection – Background Information
- Fraud Prevention and Response Actions - Case Study Illustrations



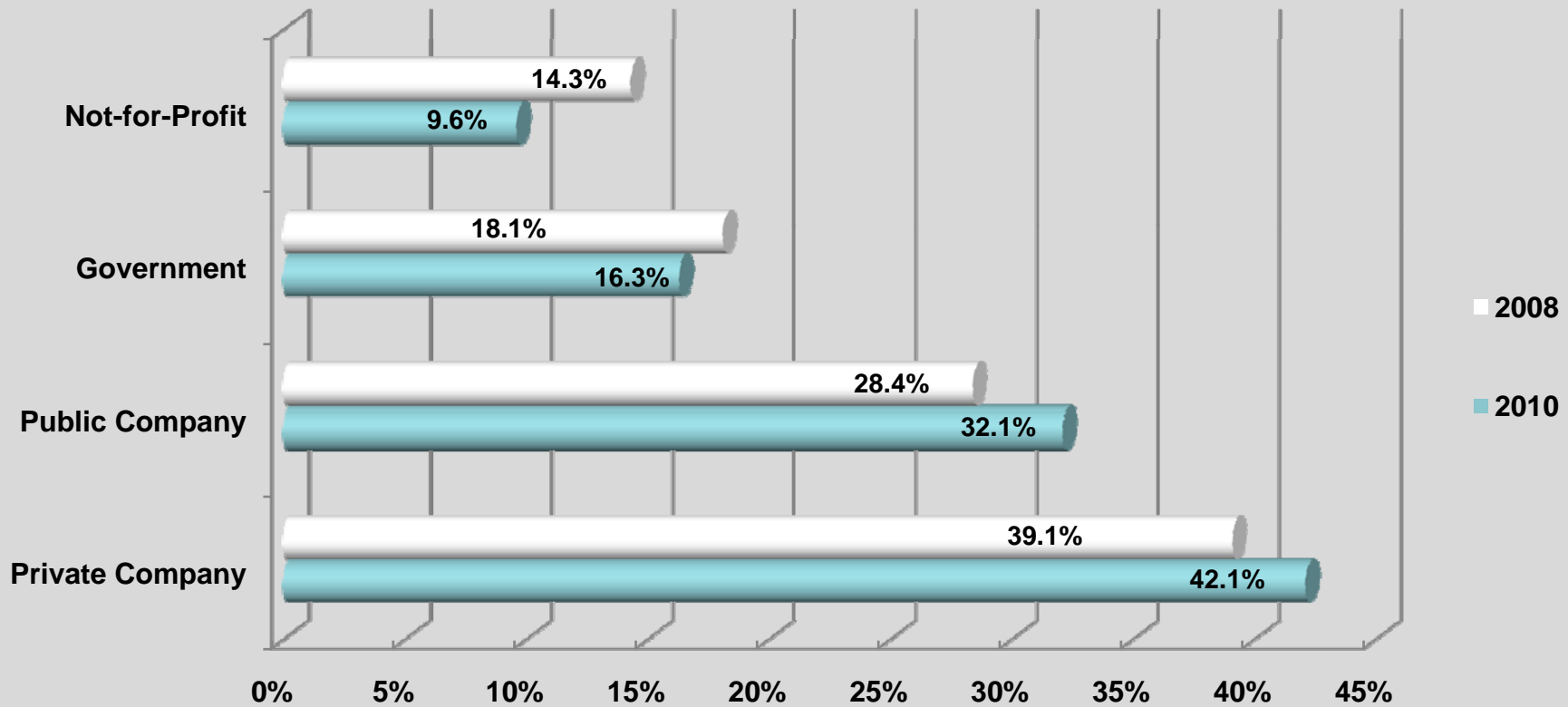
# FRAUD IN THE HEADLINES

- **“How to Steal \$50 Million” – Milwaukee Magazine**
- **“Three plead guilty in SCJ fraud case” – Racine Journal Times**
- **“Lawyer convicted in Bielinski Builders fraud reinstated to bar after serving two-year prison term” – Milwaukee Journal Sentinel**
- **“Fraud Suspect Denies Bilking Christian School” – Milwaukee Journal Sentinel**
- **“Former UWM student leader gets probation in embezzlement case” – Milwaukee Journal Sentinel**
- **“Former pastor charged with theft of church funds” – Milwaukee Journal Sentinel**

# FRAUD DETECTION – BACKGROUND INFORMATION

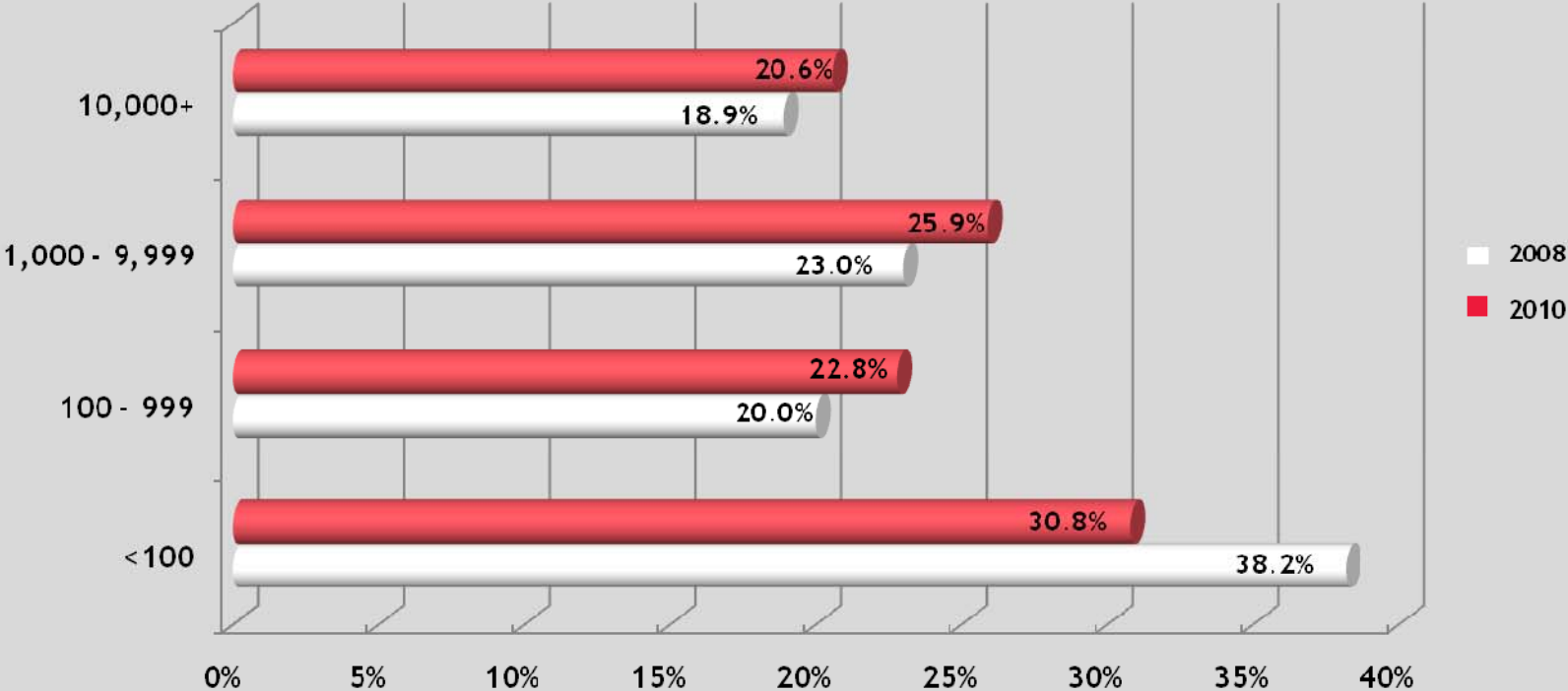


## Type of Organizations Victimized by Fraud



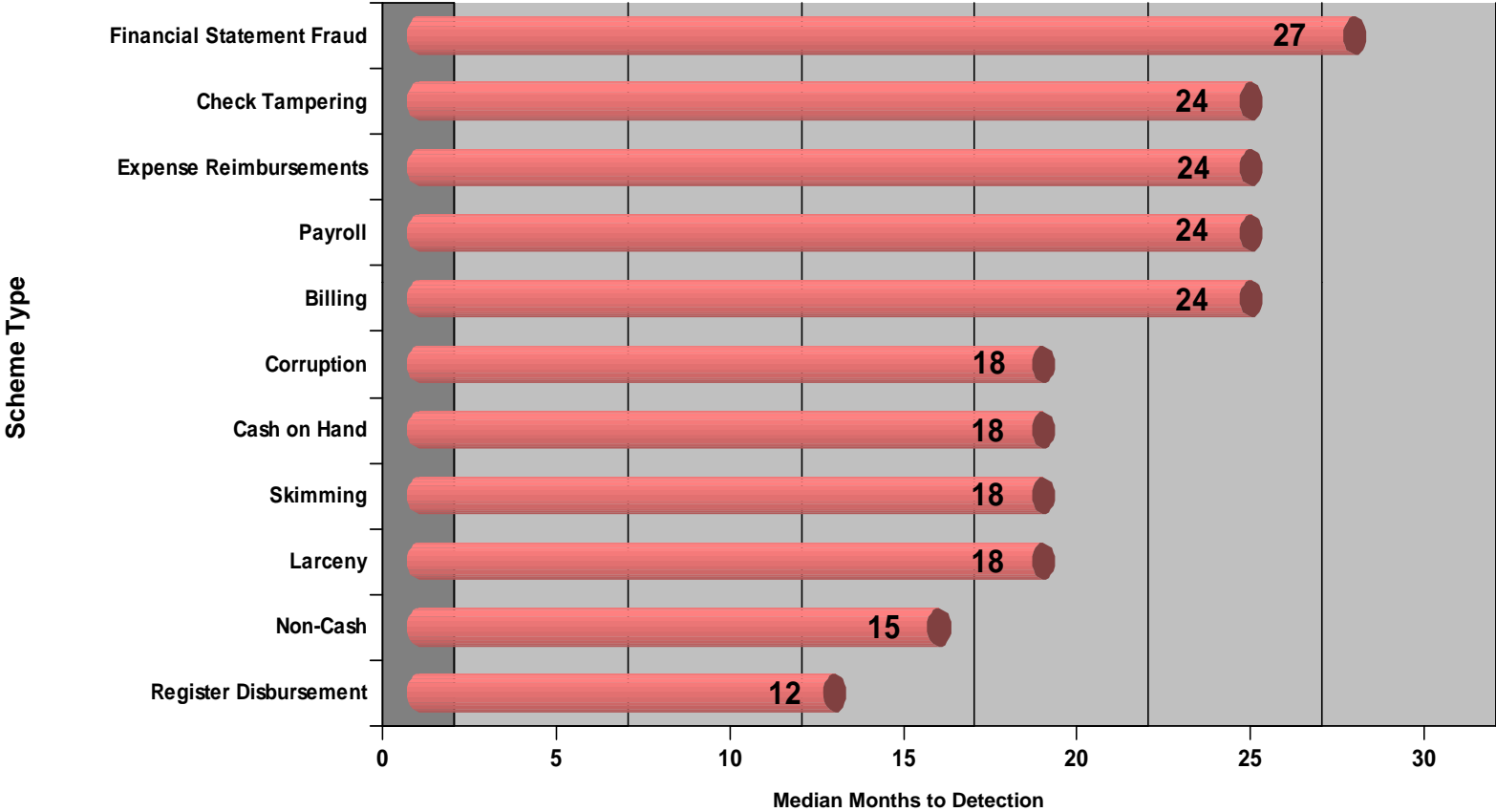
Source: Association of Certified Fraud Examiners - 2010 Report to the Nations

### Size of Organization Victimized by Fraud



Source: Association of Certified Fraud Examiners - 2010 Report to the Nations

# Median Duration of Fraud Based on Scheme Type



Source: Association of Certified Fraud Examiners - 2010 Report to the Nations

## Number of Cases Based on Perpetrator's Department

Department	Number of Cases	Percentage	Median Loss
Accounting	367	22.0%	\$ 180,000
Operations	299	18.0%	\$ 105,000
Sales	225	13.5%	\$96,000
Executive/Upper Management	224	13.5%	\$829,000
Customer Service	120	7.2%	\$46,000
Purchasing	103	6.2%	\$500,000
Warehousing/Inventory	78	4.7%	\$ 239,000
Finance	70	4.2%	\$450,000
Information Technology	47	2.8%	\$ 71,400
Marketing/Public Relations	34	2.0%	\$ 248,000
Manufacturing and Production	28	1.7%	\$ 150,000
Board of Directors	24	1.4%	\$800,000
Human Resources	22	1.3%	\$ 200,000
Research and Development	13	0.8%	\$ 100,000
Legal	8	0.5%	\$566,000
Internal Audit	3	0.2%	\$ 13,000

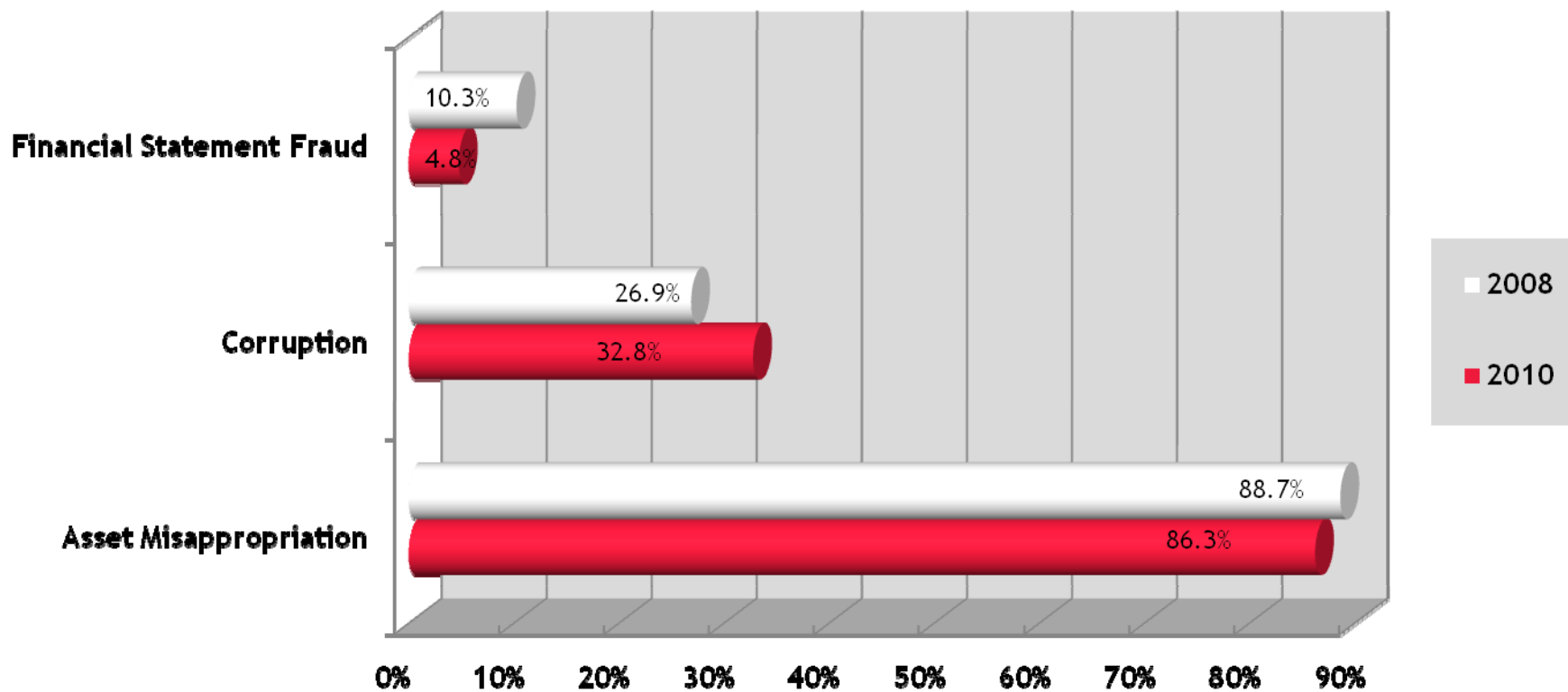
*Source: Association of Certified Fraud Examiners - 2010 Report to the Nations*

# Occupational Fraud Categories

- **Asset Misappropriation** – schemes in which the perpetrator steals or misuses an organization's resources
- **Corruption** – schemes involve employee's use of his or her influence in business transactions in a way that violates their duty to the employer and obtains benefit for themselves or a partner
- **Financial Statement Fraud** – schemes involve the intentional misstatement or omission of material information in the organization's financial reports

*Source: Association of Certified Fraud Examiners - 2010 Report to the Nation*

## Occupational Frauds by Category - Frequency



Source: Association of Certified Fraud Examiners - 2010 Report to the Nations

Asset Misappropriation Sub-Categories					
Category	Description	Examples	Cases Reported	Percent of all cases <sup>5</sup>	Median Loss
<b>Schemes Involving Theft of Cash Receipts</b>					
Skimming	Any scheme in which cash is stolen from an organization <i>before</i> it is recorded on the organization's books and records	<ul style="list-style-type: none"> <li>Employee accepts payment from a customer, but does not record the sale, and instead pockets the money</li> </ul>	267	14.5%	\$60,000
Cash Larceny	Any scheme in which cash is stolen from an organization <i>after</i> it has been recorded on the organization's books and records	<ul style="list-style-type: none"> <li>Employee steals cash and checks from daily receipts before they can be deposited in the bank</li> </ul>	181	9.8%	\$100,000
<b>Schemes Involving Fraudulent Disbursements of Cash</b>					
Billing	Any scheme in which a person causes his employer to issue a payment by submitting invoices for fictitious goods or services, inflated invoices or invoices for personal purchases	<ul style="list-style-type: none"> <li>Employee creates a shell company and bills employer for services not actually rendered</li> <li>Employee purchases personal items and submits invoice to employer for payment</li> </ul>	479	26.0%	\$128,000
Expense Reimbursements	Any scheme in which an employee makes a claim for reimbursement of fictitious or inflated business expenses	<ul style="list-style-type: none"> <li>Employee files fraudulent expense report, claiming personal travel, nonexistent meals, etc.</li> </ul>	278	15.1%	\$33,000
Check Tampering	Any scheme in which a person steals his employer's funds by intercepting, forging or altering a check drawn on one of the organization's bank accounts	<ul style="list-style-type: none"> <li>Employee steals blank company checks, makes them out to himself or an accomplice</li> <li>Employee steals outgoing check to a vendor, deposits it into his own bank account</li> </ul>	274	13.4%	\$131,000
Payroll	Any scheme in which an employee causes his employer to issue a payment by making false claims for compensation	<ul style="list-style-type: none"> <li>Employee claims overtime for hours not worked</li> <li>Employee adds ghost employees to the payroll</li> </ul>	157	8.5%	\$72,000
Cash Register Disbursements	Any scheme in which an employee makes false entries on a cash register to conceal the fraudulent removal of cash	<ul style="list-style-type: none"> <li>Employee fraudulently voids a sale on his cash register and steals the cash</li> </ul>	55	3.0%	\$23,000
<b>Other Asset Misappropriation Schemes</b>					
Cash on Hand Misappropriations	Any scheme in which the perpetrator misappropriates cash kept on hand at the victim organization's premises	<ul style="list-style-type: none"> <li>Employee steals cash from a company vault</li> </ul>	121	12.6%	\$23,000
Non-Cash Misappropriations	Any scheme in which an employee steals or misuses non-cash assets of the victim organization	<ul style="list-style-type: none"> <li>Employee steals inventory from a warehouse or storeroom</li> <li>Employee steals or misuses confidential customer financial information</li> </ul>	156	16.3%	\$90,000

<sup>5</sup>The sum of percentages in this table exceeds 100% because several cases involved asset misappropriation schemes from more than one category.

Source: Association of Certified Fraud Examiners - 2010 Report to the Nations

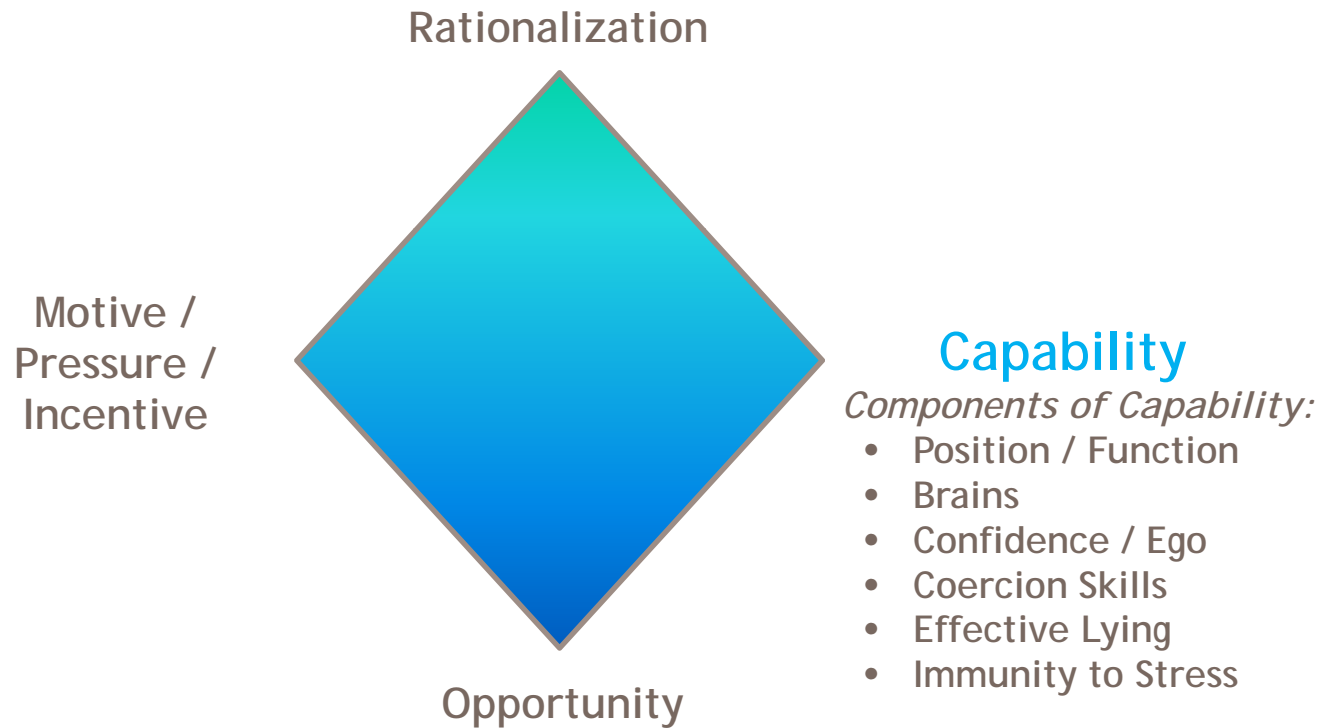
# BREAKDOWN OF ALL OCCUPATIONAL FRAUD SCHEMES - FREQUENCY

United States — 1,021 Cases		
Scheme	Number of Cases	Percent of Cases
Billing	282	27.6%
Corruption	224	21.9%
Check Tampering	173	16.9%
Skimming	165	16.2%
Non-Cash	160	15.7%
Expense Reimbursements	154	15.1%
Cash on Hand	117	11.5%
Payroll	108	10.6%
Cash Larceny	98	9.6%
Financial Statement Fraud	44	4.3%
Register Disbursements	25	2.4%

*Source: Association of Certified Fraud Examiners - 2010 Report to the Nations*

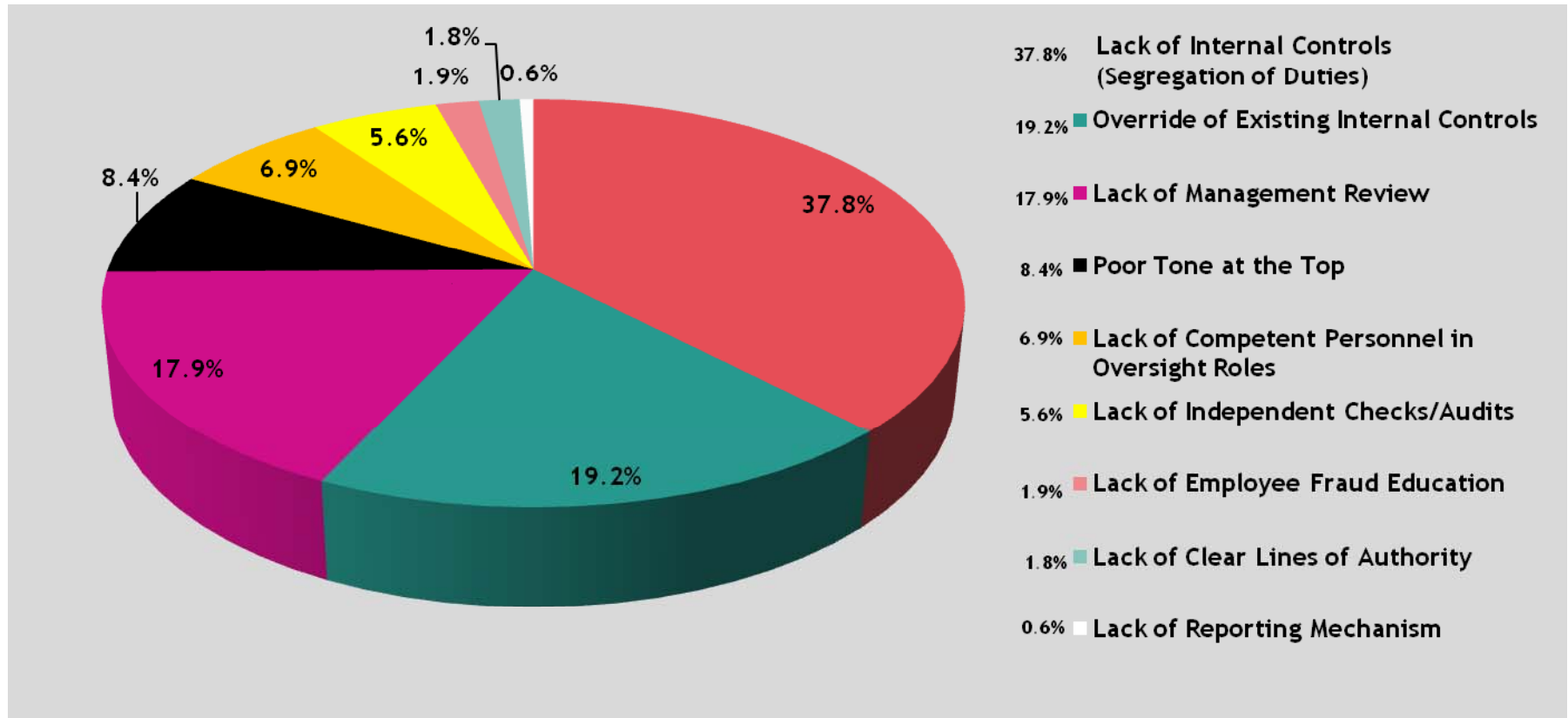


# The Fraud Diamond: Considering the Four Elements of Fraud



*Source: Beyond the Fraud Triangle, The CPA Journal, July 1, 2010*

# Factors That Contribute to Fraud



Source: Association of Certified Fraud Examiners - 2010 Report to the Nations

United States — 876 Cases		
Behavioral Red Flag	Number of Cases	Percent of Cases
Financial difficulties	392	44.7%
Living beyond means	391	44.6%
Control issues, unwillingness to share duties	205	23.4%
Divorce/family problems	201	22.9%
Wheeler-dealer attitude	173	19.7%
Unusually close association with vendor	141	16.1%
Irritability, suspiciousness or defensiveness	127	14.5%
Addiction problems	124	14.2%
Past employment-related problems	85	9.7%
Past legal problems	75	8.6%
Refusal to take vacations	74	8.4%
Complaining about inadequate pay	64	7.3%
Instability in life circumstances	54	6.2%
Excessive pressure from within organization	51	5.8%
Excessive family/peer pressure	39	4.5%
Complaining about lack of authority	37	4.2%

\*\*The sum of percentages in these tables exceeds 100% because in many cases perpetrators displayed more than one behavioral red flag.

Source: Association of Certified Fraud Examiners - 2010 Report to the Nations

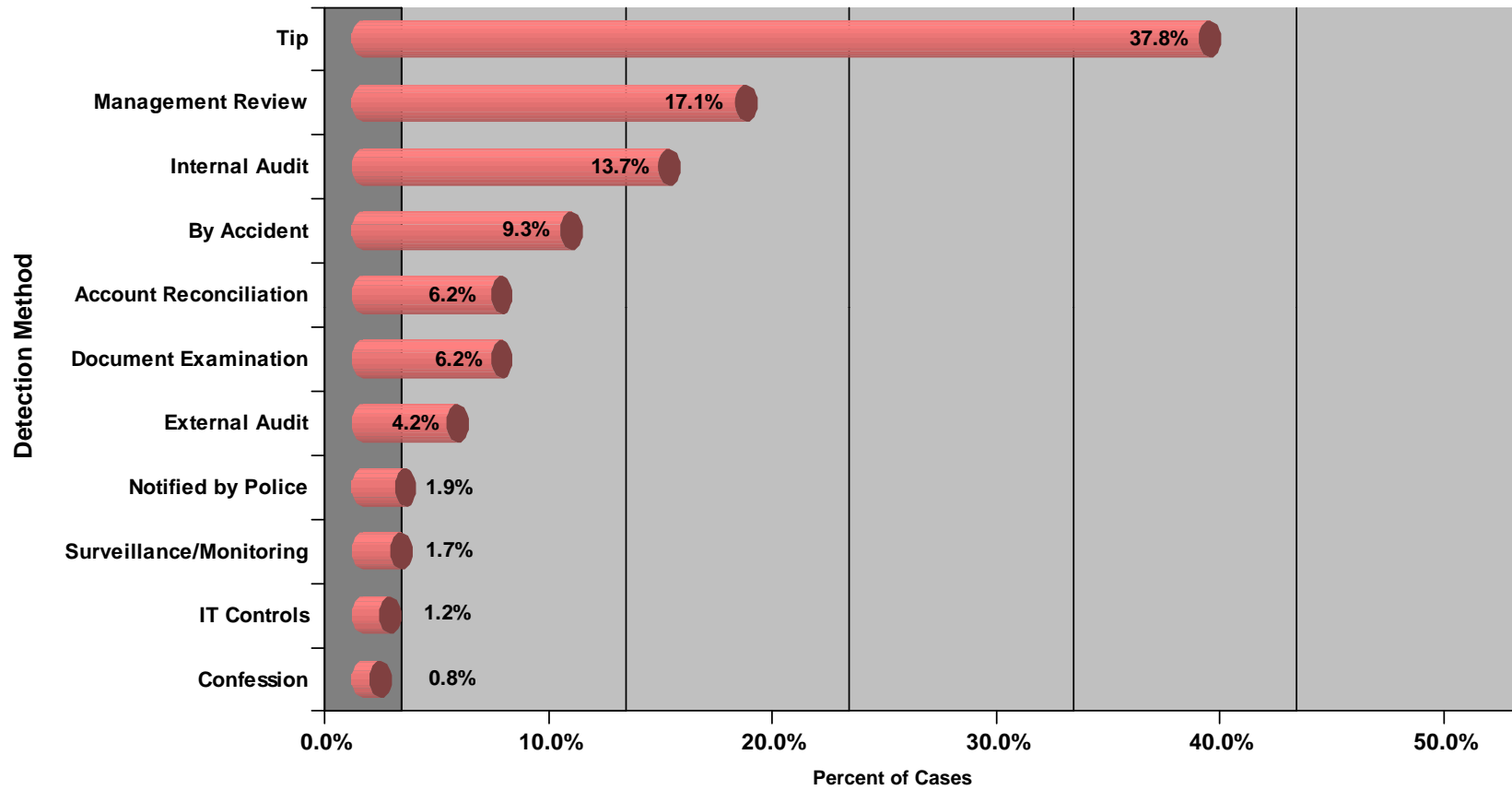
<b>Behavioral Red Flags Present During Fraud Scheme — Sorted by Median Loss</b>			
<b>Behavioral Red Flag</b>	<b># of Cases</b>	<b>Pct. of Cases<sup>24</sup></b>	<b>Median Loss</b>
Unusually close association with vendor / customer	146	15.2%	\$410,000
Wheeler-dealer attitude	195	20.3%	\$405,000
Excessive pressure from within organization	62	6.5%	\$388,000
Living beyond means	370	38.6%	\$250,000
Control issues, unwillingness to share duties	179	18.7%	\$250,000
Refusal to take vacations	65	6.8%	\$250,000
Addiction problems	128	13.3%	\$225,000
Past legal problems	83	8.7%	\$184,000
Irritability, suspiciousness, or defensiveness	130	13.6%	\$180,000
Past employment-related problems	76	7.9%	\$163,000
Complaining about inadequate pay	70	7.3%	\$132,000
Complaining about lack of authority	35	3.6%	\$120,000
Divorce / family problems	164	17.1%	\$118,000
Financial difficulties	327	34.1%	\$111,000
Excessive family / peer pressure for success	40	4.2%	\$90,000
Instability in life circumstances	47	4.9%	\$58,000

<sup>24</sup>The sum of percentages in this table exceeds 100 percent because in several cases the perpetrator exhibited more than one behavioral red flag.

*Source: Association of Certified Fraud Examiners - 2010 Report to the Nations*

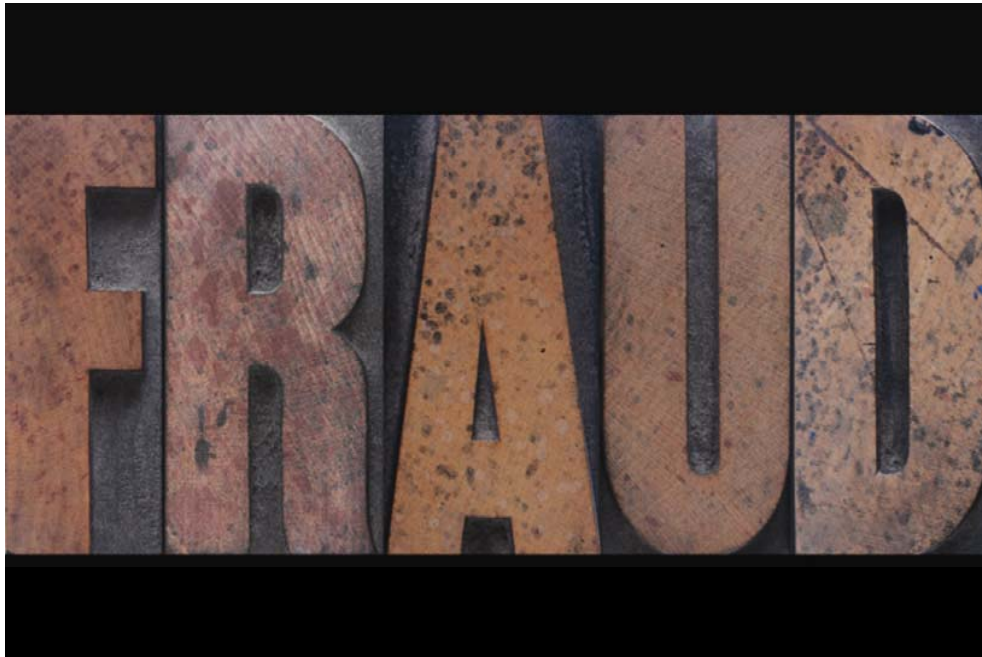
# Detection Method

Detection in the United States – 1,001 Cases



Source: Association of Certified Fraud Examiners - 2010 Report to the Nations

# FRAUD PREVENTION AND RESPONSE ACTIONS – CASE STUDY ILLUSTRATIONS



# **Case Study 1 – Creative Accounting Techniques**

**“Summerfest Officials ask for probe of bookkeeping theft alleged; festival firm’s comptroller quits.”**

Milwaukee Sentinel

**This investigation was launched after City Comptroller James A. McCann found apparent discrepancies in Milwaukee World Festival audits provided to his office.**

Milwaukee Sentinel

**“McCann said elaborate measures were taken to falsify the records, which, when delivered to his office, were permanently bound in a way that closely resembled the official audits.”**

Milwaukee Sentinel

**“Former Summerfest comptroller Mark Klusman left a note in his desk saying he was solely to blame for providing falsified audits to the city, officials said Friday.”**

Milwaukee Sentinel

**“Enclosed you will find the actual and correct financial statements of Milwaukee World Festival for the years 1988, 1989 and 1990. The other statements were falsified by me without the knowledge of anyone in Milwaukee World Festival or Reilly Penner & Benton. This is why the problems showed up. If you will review them you will not find any problems (other) than the disclosure points you made previously.”**

Milwaukee Sentinel

**“Investigations by Seidman and McCann’s office have revealed that three falsified audits were given to the city. Each time, the audit was changed in a way that inflated World Festival’s net income, in a possible attempt to hide a \$10,000 overpayment of the organization’s 1988 rent to the city.”**

Milwaukee Sentinel

**The report issued by Ernst & Young suggested Klusman “may have been overstating operating results rather than covering up a significant misappropriation of MWF funds.”**

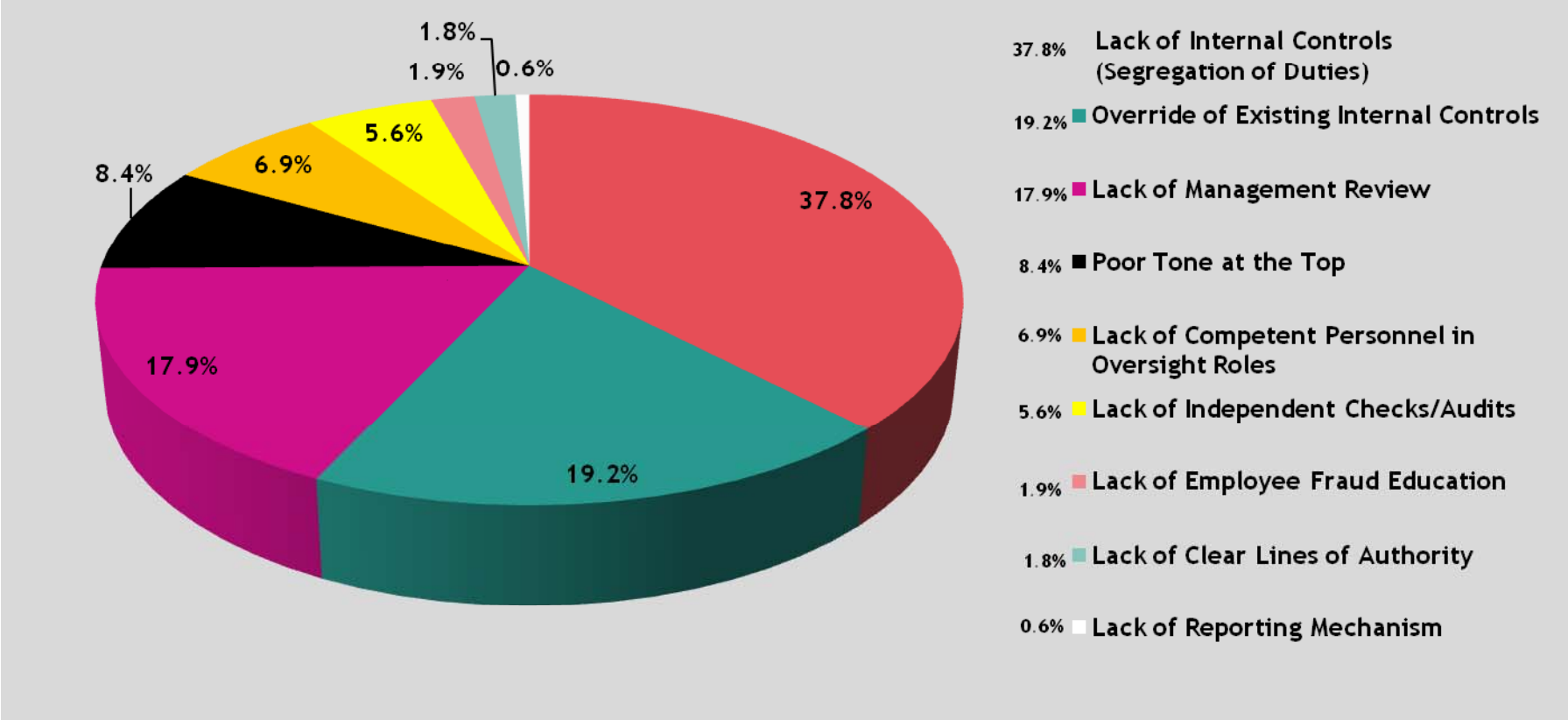
Milwaukee Sentinel

# What Happened???

## Partial List of Fraudulent Transactions

- M&I Bank and First Bank
  - \$450,000 transferred to First Bank
  - Books and records continue to reflect cash in BOTH banks
- Deposits in Transit
  - By \$342,000
  - Overstatements involved 3 bank accounts
  - DIT covered subsequent to year end by transferring cash from investment account
- MWF Retirement Plan
  - Two transfers totaling \$377,000 were moved to the operating account
- Result: Fund Balance of MWF overstated \$1,169,000

# FACTORS THAT CONTRIBUTE TO FRAUD

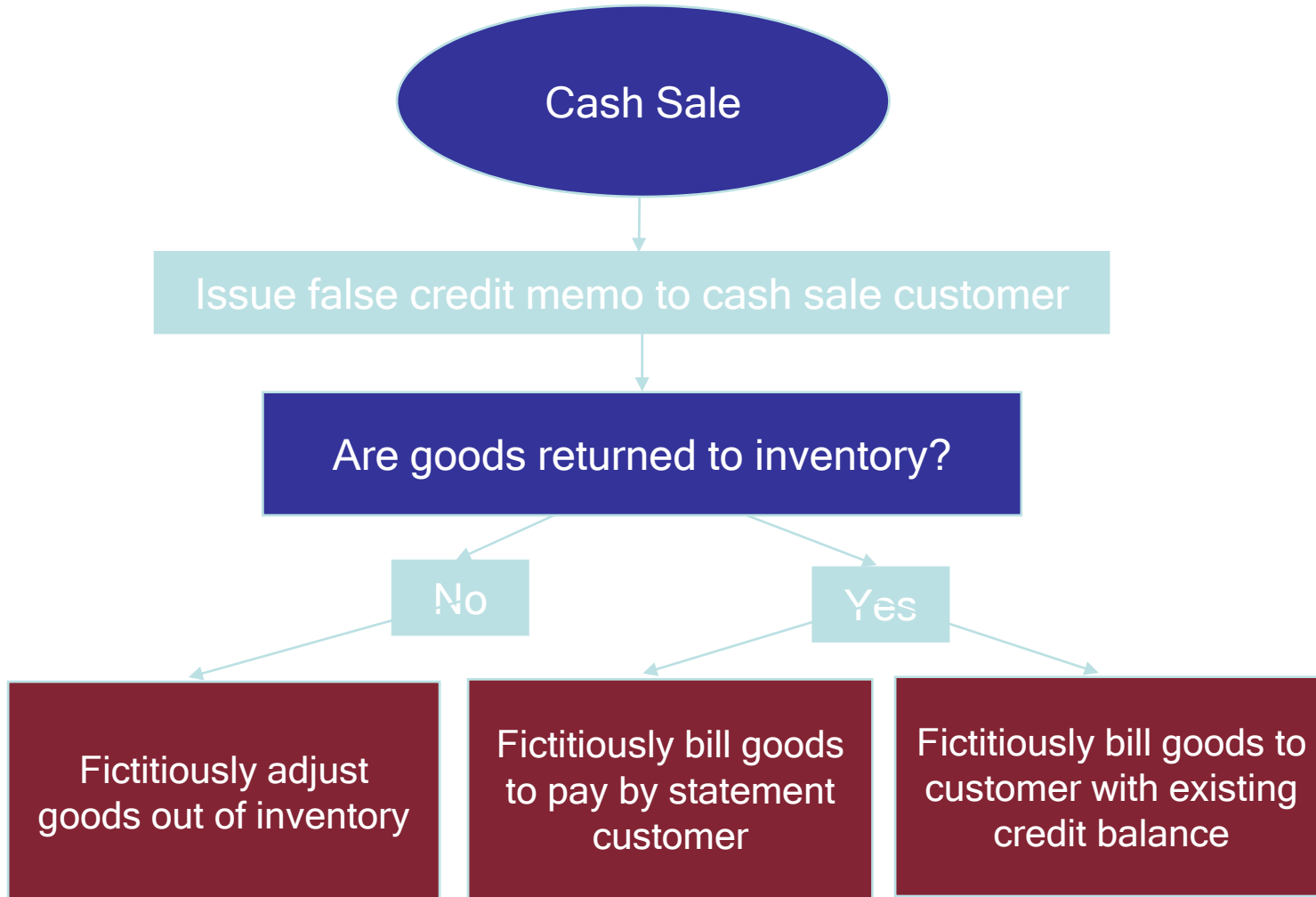


Source: Association of Certified Fraud Examiners - 2010 Report to the Nations

## **Case Study 2 – Whistleblower Hotline**

- **A whistleblower complaint was received from an employee alleging that his manager was diverting customer payments for personal gain.**
- **Aon’s investigators conducted interviews, performed a forensic review of the manager’s computer, and analyzed relevant customer records, invoices, and internal accounting entries.**
- **Aon’s investigation revealed that the manager had engaged in an elaborate scheme to defraud the company by manipulating inventory counts and making credit adjustments against customer accounts, creating the illusion that the customer never received or paid for the product.**
- **Aon’s investigators questioned the manager and secured an admission of guilt. The manager was terminated by the client and appropriate law enforcement was brought in to pursue a criminal case against the manager.**

# The Scheme



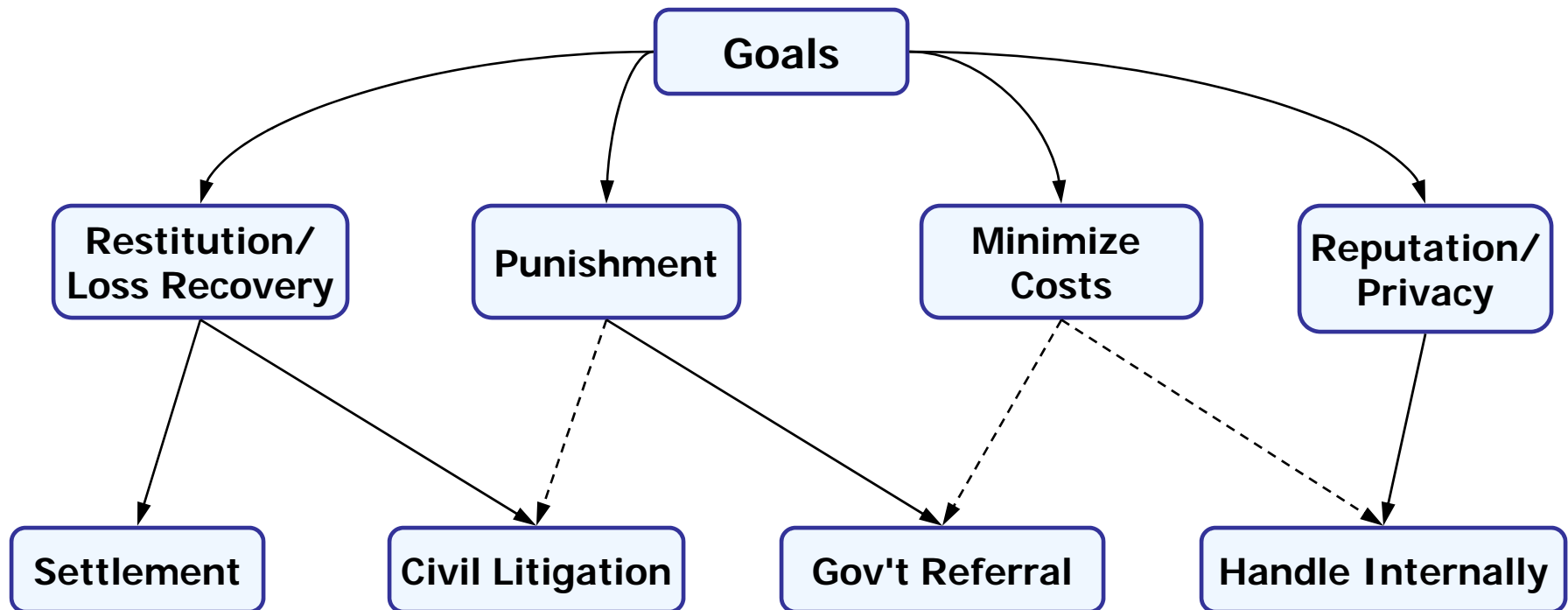
# Case Study 3 – Buyer-Vendor Relationships

- **Buyer-vendor relationships are vulnerable points for fraud**
  - Kickback relationships
  - False invoicing
  - Self-dealing
- **Case study**
  - ABC Company hires third-party transportation services to deliver its goods for distribution
  - Unbeknownst to ABC, its employee responsible for hiring such services engages transportation companies without competitive bidding and receives money and other things of value from the transportation companies awarded business

# FIRST THINGS FIRST - WHAT TO DO IF VICTIMIZED BY FRAUD?

- Assemble the response team with counsel
- Determine organizational goals, which drive the action plan
- Take steps to preserve evidence in a privileged setting
- Initiate insurance claim notification process

# ORGANIZATION'S GOALS DRIVE THE ACTION PLAN



# Thank you

