Fraud - Not In Our Organization, No Way!

American Coalition For Ethanol
Omaha, NE
August 16, 2017
About Eide Bailly

• A top 25 CPA firm in the nation
• Founded in 1917
• 1,700 professionals on staff
Background

Eric Hansen, CFE, CFI
• Forensic Accounting Manager
• CFE, CFI and Former Law Enforcement Officer
• Over 10 Years Financial Investigations Experience

Forensic Accounting
• Fraud Prevention
• Fraud Detection/Investigation
• Computer/Internet Forensics
• E-Discovery Services
Why Is Forensic Accounting Important?

• Fraud Occurs Everywhere and **NO** Organization is Immune

• Fraudsters are Usually Insiders

• Understanding Your Companies Vulnerabilities Can Help the Organization

• Preventing is Cheaper than Investigating
What’s In It For You?

• Introduction to Fraud

• Fraud Schemes

• Internal Controls

• External Fraud Risks/Cyber Schemes
Introduction To Fraud
What is Fraud?

Fraud – an intentional deception made for personal gain or to damage another individual

• Violates the perpetrator’s fiduciary duties, it is intentional
• Committed for the purpose of direct or indirect financial benefit
• Costs the employing organization
• Is hidden (concealed)
Fraud Triangle - General

- Will Employees Steal?

Source: Association of Certified Fraud Examiners
Fraud Triangle

• Why Does Fraud Occur?

Source: Association of Certified Fraud Examiners
Ethanol Industry Fraud Stats – Victim Industry

Source: ACFE 2016 Report to the Nations
## Ethanol Industry Fraud Stats – Median Loss

![Image](https://www.eidebailly.com)

<table>
<thead>
<tr>
<th>Industry</th>
<th>Number of Cases</th>
<th>Percent of Cases</th>
<th>Median Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mining</td>
<td>20</td>
<td>0.9%</td>
<td>$500,000</td>
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<tr>
<td>Wholesale Trade</td>
<td>36</td>
<td>1.6%</td>
<td>$450,000</td>
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<tr>
<td>Services (Professional)</td>
<td>60</td>
<td>2.7%</td>
<td>$310,000</td>
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<tr>
<td>Agriculture, Forestry, Fishing, and Hunting</td>
<td>44</td>
<td>2.0%</td>
<td>$300,000</td>
</tr>
<tr>
<td>Oil and Gas</td>
<td>74</td>
<td>3.4%</td>
<td>$275,000</td>
</tr>
<tr>
<td>Construction</td>
<td>86</td>
<td>3.9%</td>
<td>$259,000</td>
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<tr>
<td>Technology</td>
<td>74</td>
<td>3.4%</td>
<td>$235,000</td>
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<tr>
<td>Communications and Publishing</td>
<td>15</td>
<td>0.7%</td>
<td>$225,000</td>
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<tr>
<td>Real Estate</td>
<td>41</td>
<td>1.9%</td>
<td>$200,000</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>192</td>
<td>8.8%</td>
<td>$194,000</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>62</td>
<td>2.8%</td>
<td>$194,000</td>
</tr>
<tr>
<td>Banking and Financial Services</td>
<td>368</td>
<td>16.8%</td>
<td>$192,000</td>
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<tr>
<td>Transportation and Warehousing</td>
<td>68</td>
<td>3.1%</td>
<td>$143,000</td>
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<tr>
<td>Government and Public Administration</td>
<td>229</td>
<td>10.5%</td>
<td>$133,000</td>
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<tr>
<td>Health Care</td>
<td>144</td>
<td>6.6%</td>
<td>$120,000</td>
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<tr>
<td>Insurance</td>
<td>85</td>
<td>3.9%</td>
<td>$107,000</td>
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<tr>
<td>Utilities</td>
<td>40</td>
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<td>$102,000</td>
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<tr>
<td>Other</td>
<td>153</td>
<td>7.0%</td>
<td>$100,000</td>
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<tr>
<td>Services (Other)</td>
<td>70</td>
<td>3.2%</td>
<td>$100,000</td>
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<tr>
<td>Retail</td>
<td>104</td>
<td>4.8%</td>
<td>$85,000</td>
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<tr>
<td>Religious, Charitable, or Social Services</td>
<td>52</td>
<td>2.4%</td>
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<td>Arts, Entertainment, and Recreation</td>
<td>37</td>
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<tr>
<td>Education</td>
<td>132</td>
<td>6.0%</td>
<td>$62,000</td>
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</table>

Source: ACFE 2016 Report to the Nations
### Ethanol Industry Fraud Stats – Industry Schemes

<table>
<thead>
<tr>
<th>Industry/Scheme</th>
<th>Cases</th>
<th>Banking and Financial Services</th>
<th>Government and Public Administration</th>
<th>Manufacturing</th>
<th>Health Care</th>
<th>Education</th>
<th>Retail</th>
<th>Construction</th>
<th>Insurance</th>
<th>Oil and Gas</th>
<th>Technology</th>
<th>Services (Other)</th>
<th>Transportation and e-Commerce</th>
<th>Telecommunications</th>
<th>Services (Professional)</th>
<th>Religious, Charitable, or Social Services</th>
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<tr>
<td>Billing</td>
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<td>32.0%</td>
<td>31.3%</td>
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<td>15.4%</td>
<td>27.9%</td>
<td>17.6%</td>
<td>20.3%</td>
<td>29.7%</td>
<td>22.9%</td>
<td>22.1%</td>
<td>12.9%</td>
<td>25.7%</td>
<td>25.0%</td>
<td></td>
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<tr>
<td>Cash Larceny</td>
<td>111</td>
<td>7.9%</td>
<td>9.2%</td>
<td>9.7%</td>
<td>13.6%</td>
<td>12.5%</td>
<td>8.1%</td>
<td>4.7%</td>
<td>4.1%</td>
<td>5.3%</td>
<td>15.7%</td>
<td>4.4%</td>
<td>1.6%</td>
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<td>Cash on Hand</td>
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<td>7.0%</td>
<td>4.7%</td>
<td>5.5%</td>
<td>8.1%</td>
<td>22.9%</td>
<td>5.9%</td>
<td>4.8%</td>
<td>20.0%</td>
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<td>Check Tampering</td>
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<td>14.6%</td>
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<td>9.6%</td>
<td>10.5%</td>
<td>17.6%</td>
<td>4.1%</td>
<td>5.4%</td>
<td>18.6%</td>
<td>10.3%</td>
<td>6.5%</td>
<td>21.7%</td>
<td>25.0%</td>
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<tr>
<td>Corruption</td>
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<td>38.4%</td>
<td>30.5%</td>
<td>30.6%</td>
<td>31.8%</td>
<td>32.7%</td>
<td>36.0%</td>
<td>28.2%</td>
<td>16.0%</td>
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<td>20.5%</td>
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<td>21.5%</td>
<td>16.5%</td>
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<tr>
<td>Expense Reimbursements</td>
<td>5.4%</td>
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<td>22.8%</td>
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<td>15.9%</td>
<td>8.7%</td>
<td>20.9%</td>
<td>9.4%</td>
<td>10.8%</td>
<td>27.0%</td>
<td>12.8%</td>
<td>8.9%</td>
<td>19.4%</td>
<td>16.7%</td>
<td>25.0%</td>
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<tr>
<td>Financial Statement Fraud</td>
<td>12.0%</td>
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<td>17.4%</td>
<td>7.1%</td>
<td>6.3%</td>
<td>12.2%</td>
<td>17.1%</td>
<td>5.9%</td>
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<td>11.7%</td>
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<td>Non-Cash</td>
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<td>13.2%</td>
<td>17.4%</td>
<td>32.7%</td>
<td>22.1%</td>
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<td>18.0%</td>
<td>22.9%</td>
<td>29.4%</td>
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<td>Payroll</td>
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<td>7.6%</td>
<td>3.8%</td>
<td>15.3%</td>
<td>5.9%</td>
<td>8.1%</td>
<td>2.7%</td>
<td>11.4%</td>
<td>7.4%</td>
<td>3.2%</td>
<td>11.7%</td>
<td>13.5%</td>
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<td>Register Disbursements</td>
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<td>5.7%</td>
<td>2.1%</td>
<td>1.5%</td>
<td>8.7%</td>
<td>1.2%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>1.4%</td>
<td>5.7%</td>
<td>2.9%</td>
<td>3.2%</td>
<td>1.7%</td>
<td>1.9%</td>
<td></td>
</tr>
<tr>
<td>Skimming</td>
<td>6.8%</td>
<td>14.0%</td>
<td>8.3%</td>
<td>12.5%</td>
<td>26.0%</td>
<td>17.3%</td>
<td>15.1%</td>
<td>10.6%</td>
<td>8.1%</td>
<td>5.4%</td>
<td>21.4%</td>
<td>11.8%</td>
<td>6.5%</td>
<td>18.3%</td>
<td>19.2%</td>
<td></td>
</tr>
</tbody>
</table>

Source: ACFE 2016 Report to the Nations
Ethanol Industry Fraud Schemes

Figure 3: Occupational Fraud and Abuse Classification System (Fraud Tree)

Source: ACFE 2016 Report to the Nations
Corruption / Kickback Scheme Example
CONTROL WEAKNESSES IN ORGANIZATIONS OFTEN DIRECTLY CONTRIBUTE TO FRAUD.

**TOP 3 CONTROL WEAKNESSES THAT CONTRIBUTED TO FRAUD**

- **29%** Lack of internal controls
- **20%** Override of existing internal controls
- **19%** Lack of management review

Source: ACFE 2016 Report to the Nations
Fraud’s Impact - Monetary

Figure 105: Recovery of Victim Organization’s Losses

Source: ACFE 2016 Report to the Nations
Fraud’s Impact – Company

**Honest** Employees Pay For **Dishonest** Employees Stealing From A Company

- Increased Layoffs
- Fewer Pay Increases
- Reduced Morale
- Decreased Benefits
- Increased Audits
- Loss of External Confidence
Preventative/Detective Tools
Red Flags – Business Trends

- Cash flow problems
- Unexplained lack of profitability/rapid growth
- Problems with financial statements
- Questionable transactions
- Missing inventory
- Records not produced upon demand
- Missing source documents
Red Flags – Watch Out For

- Invoice Template (Excel)
- Sequentially numbered invoices from vendors
- Fold or non-fold vendor invoices/statements
- Purchases under authorized threshold level
- Missing authorizations
  - Lack of required signatures on PO’s, invoices, checks, etc.
- Increase in the number of disbursements to a vendor/dollar amounts paid to a vendor
- Even dollar transactions
Red Flags – Employee Behaviors

- Employees with the following
  - Unusually high personal debts
  - Living beyond one’s means
  - Excessive gambling habits
  - Alcohol/drug problems
  - Dissatisfied with pay/salary
  - Feeling of insufficient recognition
  - Never taking a day off
  - Poor credit rating
Red Flags – Employee Behaviors

Source: ACFE 2016 Report to the Nations
Extravagant Lifestyle

Something’s fishy, I mean, look at this place. How much do drug sniffers earn?

Police Dog
Fraud Prevention & Detection

• Probability of Fraudulent Activity is typically based on the following factors:
  • How easy is it to commit fraud
  • Company’s fraud history
  • Motivational factors
Fraud Prevention & Detection

• Basic Principle - People Rarely Commit Fraud if They Think They will be Caught

• Perception of Detection is the Most Effective Deterrent to Fraud

• “An Ounce of Prevention is Worth a Pound of Cure”
  Benjamin Franklin
Internal Controls – Best Practices

• “Tone at the Top”

• Employee Education

• Proactive Policies

• Vigorously Pursue Dishonest Acts

• Anonymous Reporting Program (Hotline)

• Background Checks (Criminal History/Financial Pressure)
Internal Controls – Best Practices Cont.

• Segregation of Duties (Authorization, Recording and Custody)

• Proper Procedures for Authorization

• Adequate Documents and Records – require and retain all invoices/source documents to support transactions

• Physical Control over Assets and Records

• Independent Checks on Performance

• Employee Dishonesty Insurance Coverage
Fraud Schemes Detection Methods

Source: ACFE 2016 Report to the Nations
Fraud Prevention & Detection - Recap

- Top Five Fraud Prevention/Detection Measures
  - Effective Internal Controls
  - Fraud Awareness Education/Policy
  - Anonymous Fraud Hotline
  - Pre-Employment Background Checks
  - Employee Dishonesty Insurance
Cyber Schemes
Cyberthreats refer to the possibility of or attempt of gaining unauthorized access to a device or system or network using a data communication pathway. – U.S. Department of Homeland Security
Cyberthreat Stats

• According to a recent CSI/FBI Computer Crime & Security Survey
  • 68% of organizations spend 2% or less of their IT budget on IT security.
  • Organizations that participated in the survey (5,000 IT practitioners) lost $52.5 million due to computer incidents.
  • 52% of organizations had identified some form of unauthorized computer usage (10% did not know).
  • Only 29% of companies have insurance for compensating them after a successful breach.
  • Most attack types have decreased in frequency; however, there were increases in misuse of Web application, sabotage and system penetration.
## Data Value

<table>
<thead>
<tr>
<th>Item</th>
<th>Advertised Price (in US Dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States-based credit card with card verification value</td>
<td>$1–$6</td>
</tr>
<tr>
<td>United Kingdom-based credit card with card verification value</td>
<td>$2–$12</td>
</tr>
<tr>
<td>An identity (including US bank account, credit card, date of birth, and government issued identification number)</td>
<td>$14–$18</td>
</tr>
<tr>
<td>List of 29,000 emails</td>
<td>$5</td>
</tr>
<tr>
<td>Online banking account with a $9,900 balance</td>
<td>$300</td>
</tr>
<tr>
<td>Yahoo Mail cookie exploit—advertised to facilitate full access when successful</td>
<td>$3</td>
</tr>
<tr>
<td>Valid Yahoo and Hotmail email cookies</td>
<td>$3</td>
</tr>
<tr>
<td>Compromised computer</td>
<td>$6–$20</td>
</tr>
<tr>
<td>Phishing Web site hosting—per site</td>
<td>$3–5</td>
</tr>
<tr>
<td>Verified PayPal account with balance (balance varies)</td>
<td>$50–$500</td>
</tr>
<tr>
<td>Unverified PayPal account with balance (balance varies)</td>
<td>$10–$50</td>
</tr>
<tr>
<td>Skype account</td>
<td>$12</td>
</tr>
<tr>
<td>World of Warcraft account—one month duration</td>
<td>$10</td>
</tr>
</tbody>
</table>

Advertised prices of items traded on underground economy servers  
*Source: Symantec Corporation*
Cyber Fraud Schemes

• Most Common Schemes:
  
  • Phishing

  • Social Engineering
    • Phishing emails, pretexting, baiting, Quid Pro Quo and tailgating are examples
Phishing

• Common Elements of Phishing to look out for:
  • Unauthenticated Email Address
  • Typos and Grammatical Mistakes
  • Awkward Greeting
  • Sense of Urgency
  • Randomly Generated Numbers
  • Links
  • Company Logos
Fraudulent Email Example 3  
*(subject lines vary)*

Subject: ACH Transfer Review

Dear Client,

ACH Transfer (ID:03847439) is going to be reviewed because of the incorrectly input data when sending the payment.

Important: Please fill in the application form attached attentively and send it to us. After that your transfer will be processed.

If you have any questions or comments contact us at info@nacha.org. Thank you for using www.nacha.org.

Employee Name

Risk Management Services
### Phishing Example #2

**Fraudulent Email Example 2**

*subject lines vary, at random-reputable company name and payment amount inserted*

<table>
<thead>
<tr>
<th>Subject: Pending Payment request from “reputable company name inserted here”</th>
</tr>
</thead>
<tbody>
<tr>
<td>We recorded a payment request from “reputable company name inserted here” to enable the charge of $170.10 on your account.</td>
</tr>
<tr>
<td>Receipt number: 45287954</td>
</tr>
<tr>
<td>The payment is pending for the moment.</td>
</tr>
<tr>
<td>If you made this transaction or if you just authorize this payment, please ignore or remove email message.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>The transaction will be shown on your monthly statement as “reputable company name inserted here”</th>
</tr>
</thead>
<tbody>
<tr>
<td>If you didn’t make this payment and would like to decline it, please click on the link below: Decline transaction #40683343 from “reputable company name inserted here”: $170.10</td>
</tr>
<tr>
<td>Best regards, “reputable company name inserted here”</td>
</tr>
</tbody>
</table>
Cyber Schemes – Best Practices

- Keep browser and security software updated
- Safeguard online activity
- Stronger form of authentication/additional layers of security for access to bank services
- Use encrypted e-mail for confidential, nonpublic information
- Mask account numbers and Tax ID numbers in correspondence
Conclusion
Takeaways

• Fraud is an Act of Convenience and Desperation
• Do Not Overlook Obvious Signs of Fraud
• Be Skeptical About Questionable Activity
• Understand the Types of Fraud Common in the Industry
• Ask Questions and Report Irregularities
Questions???

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