Alba Advisors, LLC

Fraud Detection & Prevention

South Carolina Association of CPAs
Spring Accounting Conference
Charleston, SC
May 17, 2018

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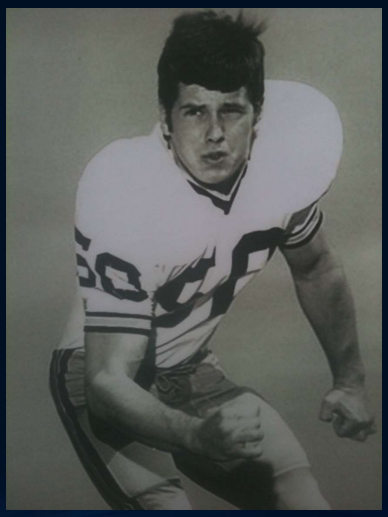
1

A future accountant?



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The Championship Watch?

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The Ring is the Thing!

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Deceit and Deception

Can be used for:

- Humor
- Magic tricks
- FRAUD

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What is Fraud?

Our perception of Fraud is formed by our own life/business experiences.

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Defining difficult topics…

"I shall not attempt to define the kinds of material I understand to be (pornographic)… but I know it when I see it."

Potter Stewart
US Supreme Court Justice
1964

"Personal doctrine of fairness."

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How big is Fraud?

- ACFE – Fraud in the US totals $1 trillion annually, 5% of all revenues. (*2018 Report to the Nations*)
- Fraud hits >85% of businesses each year. (*2017/18 Kroll Annual Global Fraud and Risk Report)*
- CAIF – Insurance Fraud costs each American household $1,000 a year.

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The "New Normal"?

"(Executives surveyed said) Fraud, cyber and security incidents are now the 'new normal' for companies across the world"

2016/17 Kroll Annual Global Fraud and Risk Report

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Why isn't Fraud prosecuted?

From a law enforcement perspective:

- **Lack of resources and failure to use them effectively.**
- **The good guys have rules, the bad guys don't.**

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Why isn't Fraud prosecuted?

From a business perspective, based on circumstance and interpretation Fraud might be:

- Tolerated.
- Condoned.
- Required.

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Why isn't Fraud prosecuted?

From a personal or moral perspective:

- Sympathy.
- Adverse publicity.
- Restitution.

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How is Fraud found?

- More than 53% of Fraud is found by accident.
- 4% is found by external audit.
- #1 anti-fraud measure (listed by 80% of companies) is external audit.

Association of Certified Fraud Examiners
2018 Report on Occupational Fraud & Abuse

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Why don't external audits find Fraud?

Three things are usually required to find Fraud:

- There has to be Fraud.
- You have to look for it.
- You have to stay until you find it.

Say what?

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There has to be Fraud

- Overwhelming % legitimate transactions.
- Judgment call.
- Not material.

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You have to look for it

- Audits are painful.
- Require a spirit of cooperation.
- Youth, inexperience and ego.

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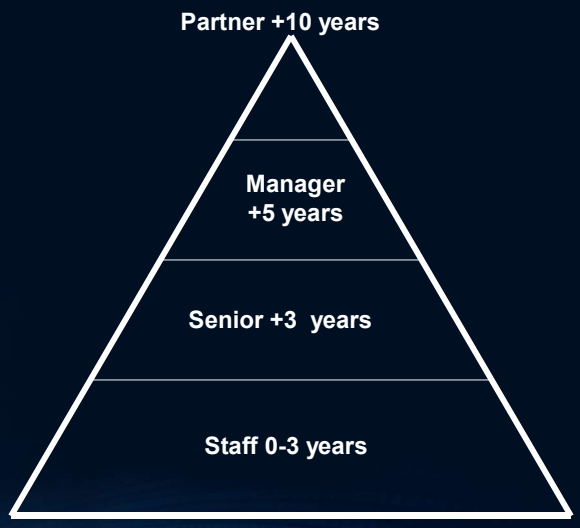
The structure of large accounting firms



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Stay until you find it

- Audits are expensive.
- Incentive to be timely and efficient.
- Disincentive to cause trouble.

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Addressing the challenges of finding Fraud

- Finding Fraud is easier if it's always there.
- Don't be too smart.

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Price Waterhouse?

20

20

A different perspective…

Complete the series:

?

A EF HI KLMN T VWXYZ
BCD G J OPQRS U

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Looking for *"IT"*

- Not always obvious where *"IT"* is.
- Don't always know what *"IT"* is.

No preconceived notions!

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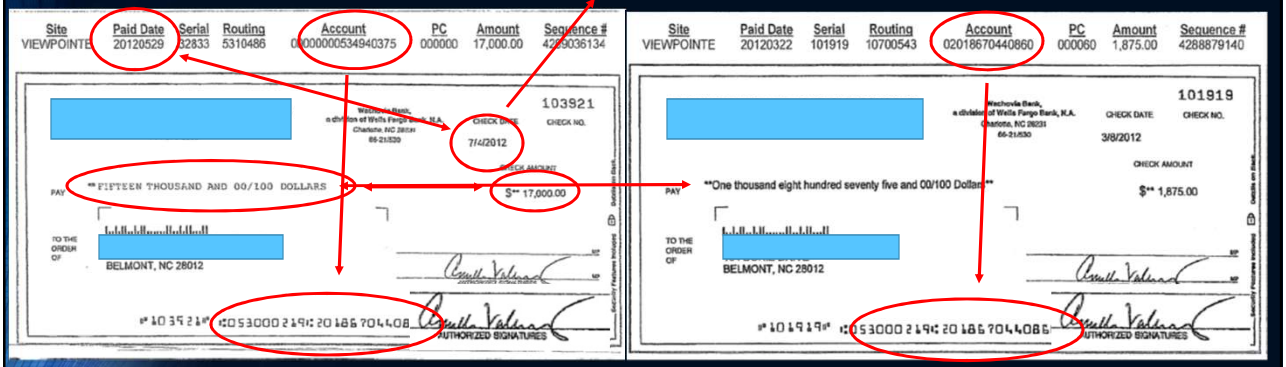
Fraud or Legit?

National Holiday?



Fraud

Legit

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Inferential Thinking

<u>Inferential thinking</u> is the reasoning involved in drawing conclusions based on evidence and prior knowledge rather than observation.

Uncommon use of common sense!

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Inferential Thinking in Practice

A = B
?
B = C

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If a computer gets wet…

…. all is lost.

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Which balance sheet do you prefer?

	Version # 1	Version # 2
Cash	$1,000,000	
A/R		$1,000,000
R/E	$1,000,000	$1,000,000

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Fraud is like a magic trick…

Incredibly baffling.

Until you know the secret.

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Addressing the challenges of finding Fraud

- Finding Fraud is easier if it's always there.
- Don't be too smart.
- Finding the story behind the numbers.

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Numbers

The language of business.

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The Analytical Game Plan

- Objective process to analyze information.
- Subjective process to adapt to the current situation.

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The Basic Playbook

The Mechanical Process of Analysis

Accumulate → Select → Relate → Evaluate

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Accumulate

- Establish universe of available information.
- Bank records, financial statements, tax returns.
- Bankruptcy?
- Google.
- People.
- Other ancillary information.

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Select

- What are we trying to prove or find?
- Recurring, large or unusual items.
- Things that don't fit.
- Focus on things that are <u>relevant</u> to the <u>circumstances</u>.

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What is relevant in the circumstance?

Audit Opinion

To the Board of Directors and Shareholders of XYZ Company, Inc.:

We have audited the accompanying balance sheet of XYZ Company, Inc. as of December 31, 19XX and the related statements of income, retained earnings and cash flows for the year then ended.

We conducted our audit an accordance with generally accepted auditing standards. Those standards …… overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of XYZ Company, Inc. as of December 31, 19XX and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

PriceWaterhouse & Co.
PriceWaterhouse & Co.

January 9, 19XX

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What does this # mean to you?

$1,000,000

Compared to what?

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Relate

- What does normal look like?
- Get a feel for trends or patterns.
- Identify things that don't fit.
- Look for contradictions.

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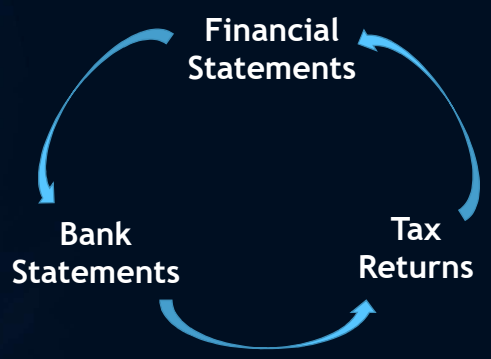
Logical Relationships



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Analyzing Relationships

Ask questions.

Continually.

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Evaluate

- What is the analysis saying?
- Is it logical?
- Does it demonstrate the issue?
- Is more work required?

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Evaluation – Is it logical?

How does it feel in your gut?

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Finding the story behind the numbers

Adapting the analytical process

- Capital – Money.
- Capacity – Range of performance.
- Conditions – Environmental issues.
- Character – Integrity.

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Capital - Money

- Rule #1 - Follow the money.
- Rule #2 - See rule #1.
- Determine the "value proposition."
- How much?
- Where is it going?
- Who has access?

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43

Capacity - Range of Performance

- Determine a reasonable range.
- Is something too good to be true?
- Is something too big or too small?

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Conditions – Environmental Issues

- Internal or external factors with extreme influence.
- Circumstances that cause people to act the way they do.
- Incentives. Who wins? Who loses?
- Out of the ordinary occurrences.

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Character - Integrity

- Reputation.
- Do you like them? Do they like you?
- Subtle clues.

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Can widespread Fraud be stopped?

Politicians

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Can widespread Fraud be stopped?

- Post Civil War.
- The 20's - Ponzi, stock market crash.
- The 80's - Ivan Bosky and Michael Milken.
- The 90's - the DOT-Comers.
- The early 2000's - World Com, Enron, Madoff.

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Today

Prominent Florida eye doctor convicted of Medicare fraud

Collected $105 million between 2008 and 2013. Frequently billed for tests and treatment of prosthetic eyes.

Associated Press
Apr 28, 2017

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Today

Wells Fargo Fined $185 Million for Fraudulently Opening Accounts

New York Times
Sept 8, 2016

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Today

CEO who gouged EpiPen Price is daughter of Democratic Senator

Associated Press
Aug 24, 2016

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51

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Where do we go from here?

CPA

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