


## Red Flags of Fraud What to look for and where!



Novotel Wollongong  
Friday 9<sup>th</sup> September 2011

**IMPACT**  
Forensics

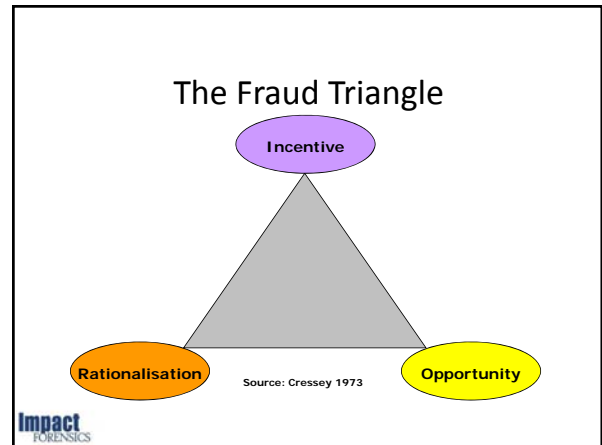
Level 1, 125-131 Crown Street, Wollongong NSW 2500  
PO Box 5336, Wollongong NSW 2520



### What is fraud?

- Fraud is a generic term
- An *intentional or reckless false representation* about a *material point* which is *believed* and *acted upon* by the victim to the victim's *damage*.
- *The use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organisation's resources or assets*

**Impact**  
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### Types of Fraud

- Excluding financial services industry related fraud, the five most common types of fraud against companies in Australia are:
  - False invoicing
  - Theft of inventory
  - Theft of cash receipts
  - Theft of plant and equipment
  - EFT fraud

**Impact**  
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### Who is Fraud Perpetrated Against?

- It is assumed that big business (and Financial Services industries) bear the brunt of the cost of fraud in Australia
- These businesses have better internal controls
- SMEs actually incur a greater median loss than large businesses
- Due to lower standards of internal control

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## SME Fraud Risk

- SME characteristics
  - Hands on approach to business
  - Fewer staff with greater responsibility
  - Fewer internal controls due to nature of business
  - Often a growing business
  - Personal and emotional investment



## SME – Fraud Risks

- Poor systems
- Growth
- Unregulated markets
- Lack of internal controls
- Reliance on external audit
- Belief that fraud risk is negligible
- Trust – (informal controls)



## Red Flags of Fraud

- An indicator that fraud may be present
- Don't guarantee its presence
- May be innocent, but may point toward something more sinister
- The AIC identifies 3 types
  - Behavioural
  - Organisational
  - Statistical



## Behavioral Red Flags

- The behavior of the individual may be an indicator.
  - Not taking leave
  - Lavish gifts
  - A “Wheeler and Dealer”
  - Lack of a strong code of personal ethics



## Organisational Red Flags

- Relates to traits of an organisation and can relate to the susceptibility of the business to fraud, or propensity to commit fraud.
  - Culture
  - High employee turnover





## Statistical Red Flags




- Often the way that fraud is discovered
- The result of analysing data collected by the organisation(s).
  - Excessive overtime paid
  - Reduction in revenue
  - Increase in expenditure







## How Many Red Flags is OK?


- One red flag on its own may be an anomaly
- But when the number of flags begins to mount, closer scrutiny is required








 <p><b>Bernard L. Madoff</b></p> <p><b>SENTENCE</b> 100 yrs</p> <p><b>COMPANY</b> Bernard L. Madoff Securities</p> <p><b>CRIME</b> Ran a Ponzi scheme for decades and defrauded investors out of billions of dollars.</p> <p><b>PLEADED GUILTY</b> March 2009</p> <p><b>WHERE HE IS NOW</b> Awaiting prison assignment.</p> <p><b>Red Flag</b> Returns too consistent Whistleblower for 7 years</p>	 <p><b>Lance K. Poulsen</b></p> <p><b>SENTENCE</b> 30 yrs</p> <p><b>COMPANY</b> National Century Financial Enterprises</p> <p><b>CRIME</b> Committed a \$3 billion fraud that led to the downfall of the company.</p> <p><b>CONNECTED</b> October 2008</p> <p><b>WHERE HE IS NOW</b> Has not been assigned a prison yet.</p> <p><b>Red Flag</b> Disclosures pointing to stress and questionable dealings, accusations</p>	 <p><b>Bernard J. Ebbers</b></p> <p><b>SENTENCE</b> 22 yrs</p> <p><b>COMPANY</b> WorldCom</p> <p><b>CRIME</b> Masterminded an \$11 billion accounting fraud.</p> <p><b>CONNECTED</b> March 2005</p> <p><b>WHERE HE IS NOW</b> Minimum security Federal prison in Oakdale, La</p> <p><b>Red Flags</b> Lack of transparency Dominant CEO</p>
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 <p><b>Jeffrey K. Skilling</b></p> <p><b>SENTENCE</b> 30 yrs</p> <p><b>COMPANY</b> Enron</p> <p><b>CRIME</b> Committed fraud and conspiracy to mislead shareholders and regulators.</p> <p><b>CONNECTED</b> May 2006</p> <p><b>WHERE HE IS NOW</b> Minimum security Federal prison in Dallas, Texas</p> <p><b>Red Flags</b> The old rules don't apply To good to be true Lack of transparency (SIVs)</p>	 <p><b>Samuel Israel III</b></p> <p><b>SENTENCE</b> 30 yrs</p> <p><b>COMPANY</b> Rayon Group, a hedge fund</p> <p><b>CRIME</b> Cheated investors out of more than \$400 million.</p> <p><b>PLEADED GUILTY</b> September 2005</p> <p><b>WHERE HE IS NOW</b> Awaiting transfer to a federal prison.</p> <p><b>Red Flags</b> Lack of due diligence despite promise to do so Audited?</p>	 <p><b>John J. Rigas</b></p> <p><b>SENTENCE</b> 10 yrs</p> <p><b>COMPANY</b> Adelphia Communications</p> <p><b>CRIME</b> Looted the company he founded and hid more than \$2 billion of its assets.</p> <p><b>CONNECTED</b> July 2004</p> <p><b>WHERE HE IS NOW</b> Minimum security Federal prison in Butler, N.C.</p> <p><b>Red Flags</b> Backdated contracts Middle management whistleblowers under pressure</p>
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 <p><b>Walter A. Forbes</b></p> <p><b>SENTENCE</b> 12 1/2 yrs</p> <p><b>COMPANY</b> Cendant</p> <p><b>CRIME</b> Committed fraud and conspiracy to mislead shareholders and regulators.</p> <p><b>CONNECTED</b> October 2008</p> <p><b>WHERE HE IS NOW</b> Minimum security Federal prison in White Deer, Pa.</p> <p><b>Red Flags</b> Accounting irregularities to overstate sales</p>	 <p><b>Sanjay Kumar</b></p> <p><b>SENTENCE</b> 10 yrs</p> <p><b>COMPANY</b> CA (Computer Associates)</p> <p><b>CRIME</b> Committed a \$4.2 billion accounting fraud that inflated sales for 2006 and 2007.</p> <p><b>PLEADED GUILTY</b> April 2008</p> <p><b>WHERE HE IS NOW</b> Medium security Federal prison in South Central New Jersey</p> <p><b>Red Flags</b> Backdated contracts 'the dating game'</p>	 <p><b>L. Dennis Kofrowski</b></p> <p><b>SENTENCE</b> 8-10 yrs</p> <p><b>COMPANY</b> Tyco</p> <p><b>CRIME</b> Looted the company and deceived investors.</p> <p><b>CONNECTED</b> June 2008</p> <p><b>WHERE HE IS NOW</b> Medium security state prison in Albany, N.Y.</p> <p><b>Red Flags</b> Personal use and looting of company assets</p>
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## Winner ! Sonya Causer




- **Sonya Causer** sits proudly in the Holden Sportwagon she successfully bid for in the Royal Children's Hospital Good Friday Appeal Online Auction last year.
- In total she bought **43 properties**, including five in suburban Brisbane and one in Tasmania
- The payroll manager of troubled whitegoods and electrical retailer Clive Peeters has admitted she **used \$20 million in company funds** on a spending spree over 18 months



## Current Market!!!

- Unfavourable(?) economic conditions
- Insufficient working capital
- High debt
- Profit squeeze

Conditions Are Perfect...



## Number 1 Red Flag

Tips, complaints or allegations about fraud



## Conclusion

- Fraud is pervasive, invasive and expensive
- Awareness of potential Red Flags for the business and vigilance in red flag monitoring can reduce the risk of occurrence and reduce the time for detection.
- Vigilance is key



## AML/CTF and Your Practice!

- What is it and how will it effect your practice?
  - If you provide a “designated service”, you must comply.
  - Compliance is not necessarily a tick and flick approach... it will take planning.
  - Everyone in this room needs to consider their need to comply.



## When?

- Beats me



## But it will happen...

- The Financial Action Task Force on Money Laundering (FATF) mutual evaluations = pressure.



## Be Ready

- Understand your designated services
- Understand your structure and reporting requirements
- Consider training and other compliance aspects
- Consider developing your Program A and B in readiness
- Each year your compliance needs to be *independently* audited.



Thank you

