



Fraud Schemes: How and Why They Work

Dennis Dycus

Course # 1123346, Version 2004, 2 CPE Credits

your self-study.
your way.

Course CPE Information

Course Expiration Date

Per AICPA and NASBA Standards (S9-06), QAS Self-Study courses must include an expiration date that is *no longer than one year from the date of purchase or enrollment*.

Field of Study

Auditing. Some state boards may count credits under different categories—check with your state board for more information.

Course Level

Basic

Prerequisites

There are no prerequisites.

Advance Preparation

None.

Course Description

This fascinating course examines a number of real-life fraud schemes and explains in detail how and why they worked. We'll delve into many different types of fraud—including money laundering, forgery, and misappropriation of assets—in several different types of business and organizations. For each case study, the instructor provides valuable insight into how the fraud was eventually detected, why it occurred, and how it could have been prevented. You'll come away with a better understanding of what you can do to prevent fraud in your organization.

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Publication/Revision Date

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Instructional Design

This Self-Study course is designed to lead you through a learning process using instructional methods that will help you achieve the stated learning objectives. You will be provided with course objectives and presented with comprehensive information and facts demonstrated in exhibits and/or case studies. Review questions will allow you to check your understanding of the material, and a qualified assessment will test your mastery of the course.

Please familiarize yourself with the following instructional features to ensure your success in achieving the learning objectives.

Course CPE Information

The preceding section, “Course CPE Information,” details important information regarding CPE. If you skipped over that section, please go back and review the information now to ensure you are prepared to complete this course successfully.

Table of Contents

The table of contents allows you to quickly navigate to specific sections of the course.

Learning Objectives and Content

Learning objectives clearly define the knowledge, skills, or abilities you will gain by completing the course. Throughout the course content, you will find various instructional methods to help you achieve the learning objectives, such as examples, case studies, charts, diagrams, and explanations. Please pay special attention to these instructional methods, as they will help you achieve the stated learning objectives.

Review Questions

The review questions accompanying this course are designed to assist you in achieving the course learning objectives. The review section is not graded; do not submit it in place of your qualified assessment. While completing the review questions, it may be helpful to study any unfamiliar terms in the glossary in addition to course content. After completing the review questions, proceed to the review question answers and rationales.

Review Question Answers and Rationales

Review question answer choices are accompanied by unique, logical reasoning (rationales) as to why an answer is correct or incorrect. Evaluative feedback to incorrect responses and reinforcement feedback to correct responses are both provided.

Glossary

The glossary defines key terms. Please review the definition of any words you are not familiar with.

Index

The index allows you to quickly locate key terms or concepts as you progress through the instructional material.

Qualified Assessment

Qualified assessments measure (1) the extent to which the learning objectives have been met and (2) that you have gained the knowledge, skills, or abilities clearly defined by the learning objectives for each section of the course. Unless otherwise noted, you are required to earn a minimum score of 70% to pass a course. If you do not pass on your first attempt, please review the learning objectives, instructional materials, and review questions and answers before attempting to retake the qualified assessment to ensure all learning objectives have been successfully completed.

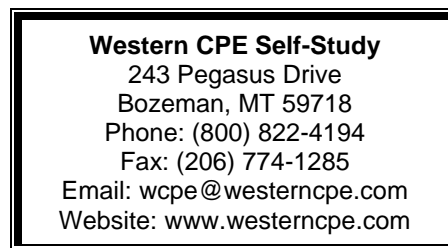
Answer Sheet

Feel free to fill the Answer Sheet out as you go over the course. To enter your answers online, follow these steps:

1. Go to www.westerncpe.com.
2. Log in with your username and password.
3. At the top right side of your screen, hover over “My Account” and click “My CPE.”
4. Click on the big orange button that says “View All Courses.”
5. Click on the appropriate course title.
6. Click on the blue wording that says “Qualified Assessment.”
7. Click on “Attempt assessment now.”

Evaluation

Upon successful completion of your online exam, we ask that you complete an online course evaluation. Your feedback is a vital component in our future course development.



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Learning Objectives

Section 1

After completing this section of the course, you will be able to:

- Recognize that honest people may steal when they can rationalize their specific financial need, and when they are presented with an opportunity to steal.
- Cite weaknesses within an organization's internal control that potentially present opportunities for individuals to commit fraud.

Section 2

After completing this section of the course, you will be able to:

- Identify weaknesses and failures committed by governing boards, banks, and auditors that permit fraud to go unnoticed.
- Recall proper policies and procedures that prevent fraud.



Welcome to Western CPE's
Presentation of:

Fraud Schemes: How & Why They Work

Presented by:
Dennis F. Dycus, CPA, CFE, CGFM

Crab Orchard Utility District

A Mother and Daughter Affair

Let's give ourselves a bonus

- Mother - \$129,000
- Daughter - \$50,000+

Unauthorized Payroll Checks

- Mother - \$29,000+



Crab Orchard Utility District

Overpayment for unused leave

- Mother - \$14,000
- Daughter - \$5,000

Need a Jeep?

- Blue Book trade-in value of \$11,900
 - Received \$534.94
 - Sold to daughter's friend for \$2,000
 - Titled to daughter – Drove it for several years
 - Later sold it for \$6,000

Crab Orchard Utility District

How about a good backhoe?

- Traded in for credit of \$5,000
 - Had a trade-in value of \$15,000
 - Manager's husband bought for \$5,000

Water's free for me

- Unmetered yard hydrants for both mother and daughter and a few other friends and commissioners

Crab Orchard Utility District

Can You Say "Kickback?"

- \$53,000

End Results

Mother and daughter both indicted for:

- Conspiring to commit theft over \$60,000
- Theft over \$60,000

Crab Orchard Utility District

- Two Counts – Money Laundering
- Forgery over \$60,000 (\$345,346)
- Official Misconduct

Crab Orchard Utility District

Update

Both Jewell Harris and her daughter, Tonya, pled guilty.

Tonya agreed to serve 90 days in jail and 8 years of supervision with the first 2 to be intensive.

Crab Orchard Utility District

In her initial screening, her blood tested positive for the following drugs:

- Benzodiazepam (Valium)
- Methamphetamine
- THC (Animal Tranquilizer)
- PCP (Animal Tranquilizer)
- Opiates
- Cocaine

Crab Orchard Utility District

Her current medications are:

- Prozac
- Restoril
- Valium
- Depakote
- Zantac

Crab Orchard Utility District

She also acknowledged to the judge that she used Hydrocodone, Tylox, cocaine, crack, methamphetamine, and marijuana.

She agreed to the 90-day sentence on a Wednesday. The judge ordered her to report to the jail by 5:00 p.m. the following Monday. She only had one question?

Crab Orchard Utility District

Will I be drug tested upon reporting in?

Crab Orchard Utility District

On Wednesday, June 7, 2006 Jewell Harris was sentenced to serve 10 years in one of the two prisons for women in Tennessee.

Her defense attorney presented 10 to 12 mitigating circumstances for the judge to consider in determining the sentence.

The judge determined that there were no mitigating circumstances.

Crab Orchard Utility District

The state suggested several enhancing circumstances.

The judge agreed with all enhancements.

She has stated that she intends to appeal the sentence.

The City of Rockwood—The Players

- Howard Butler, City Recorder and City Judge for 30 years
- David Woods, Parks & Rec. Director

The City of Rockwood—The Players

- William H. Cisson, a friend of Howard Butler
- Robert (Bobby) Cox, Jr., a friend of William Cisson

The City of Rockwood— What Happened?

- Butler misappropriated at least \$425,681.59
- Butler issued and cashed 272 unauthorized checks totaling almost \$423,000
 - The bank has a problem

The City of Rockwood— What Happened?

- Additional \$11,000 unaccounted for
- Additional checks totaling \$12,400 issued to and cashed by David Woods, Parks & Rec. Director

The City of Rockwood— Why Did it Happen?

- Total lack of segregation of duties
- Unnumbered checks were made out and cashed and proceeds used to pay:

The City of Rockwood— Why Did it Happen?

- Employee Christmas bonuses
- City fireman pay for in-service training and in lieu of compensatory time

The City of Rockwood— Why Did it Happen?

- Collections not properly reconciled and reports not properly prepared
- Cash over/under not recorded

**The City of Rockwood—
Why Did it Happen?**

Blind Trust
#1 Internal Control Weakness

**The City of Rockwood—
Issued Findings Related to:**

- Inadequate separation of duties
- Disbursements not made by prenumbered checks
 - \$60,000
 - To avoid IRS taxes

The City of Rockwood— Issued Findings Related to:

- Improper petty cash procedures
 - Disbursed \$58,600 with support for \$11,600

The City of Rockwood— Issued Findings Related to:

- Inadequate internal controls for receipt of mail
- Inadequate receipt records
 - Parks & Recreation
 - Room rental, accident reports, employee loans

The City of Rockwood— Issued Findings Related to:

- Business licenses
- Airport receipts
- Building permits
- General fund, property tax, and sanitation receipts—no indication as to cash or check

The City of Rockwood— Issued Findings Related to:

- No indication on general fund receipts as to date deposited
- Collections not deposited intact and promptly—used as petty cash and to cash checks, pay lifeguards

**The City of Rockwood—
Issued Findings Related to:**

- Deposit slips not properly completed and some deposit slips not retained
- Inadequate controls over traffic citations and court docket
 - Case dispositions often not recorded

**The City of Rockwood—
Issued Findings Related to:**

- Traffic citations not properly accounted for
- Receipts for court collections did not include applicable ticket number
- Judge did not sign record of dispositions

The City of Rockwood— Issued Findings Related to:

- Inadequate controls over parks and recreation department collections
 - Failure to use duplicate or prenumbered receipts
 - Failure to maintain record of source of revenues related to sporting events

The City of Rockwood— Issued Findings Related to:

- Use of park cash collections to purchase concession supplies and pay lifeguards
- City maintained over 20 bank accounts
- Lack of accounting of vending machine revenues

The City of Rockwood— Issued Findings Related to:

- No Cash Receipts Journal
- No Cash Disbursements Journal
- Loaned city employees money
- Over \$1.1 million in noninterest bearing accounts

Hixon Utility District

- Mr. William "Bill" Beene, General Manager since 1955, employed by the district for 37 years
- Sitting District Commissioners had served for 32, 20, and 18 years

Hixon Utility District

- The Auditors – James B. Frost & Co.

The Chain of Events

- In August, auditors notified us that the manager had withdrawn more than \$1,000,000 from the general operating fund

Hixon Utility District

- Previous year, \$446,000 (of which \$221,000 was authorized)

Hixon Utility District

- “The Agreement”—First time-Second time
- Nine checks totaling \$1,075,000
 - One CD for \$100,000
 - Seven cashier’s checks payable to Merrill Lynch

Hixon Utility District

- One check paid off a note for Mr. Beene in the amount of \$212,765 and deposited \$6,234 into personal account
- Commissioners were “surprised”
 - At this time, our office was contacted
 - Checks required only one signature

Summary

- \$397,765 used to pay personal bank notes
- \$450,000 used to purchase cashier's checks payable to Merrill Lynch
- \$100,000 purchase of CD
- \$6,234 deposited into checking account

Other Tidbits of Information

American Waterworks Association's Annual conference

- Annual conference was in Dallas in 1984
 - Two Commissioners and their wives, along with Mr. Beene and Mrs. Pangle and Mr. Walker (the independent auditor) and his wife all attended the conference

Other Tidbits of Information

- After the conference in 1984, all parties stopped over in Las Vegas for 3 days and stayed at the MGM Grand Hotel
 - Total bill: \$14,479 plus \$8,829 airfare
 - Plus \$1,000 "Walking Around Money"
- In 82, Miami/Jamaica
 - \$11,546 plus airfare of \$7,240
 - Plus \$5,000 "Walking Around Money"

Pangle Construction Company

- Owned by husband of Mrs. Pangle, Administrative Assistant for Mr. Beene
- In charge of all construction for Hixon Utility District
- Contract last bid out over 10 years ago
- Everybody was happy

Pangle Construction Company

And the Rest of the Story...

Payback:

- \$50,000 Cash
- Sold "the Lake House"
 - Two lots bought from the Pangles
 - Deed was never recorded
 - House was built on lots

Pangle Construction Company

All telling quote from one of the Commissioners:

"When I saw it (the withdrawals) I knew immediately there was going to be a problem as to how to present it. We went into several meetings and tried to reconstruct and to put back in place the things that had happened, so that we were not exposed."

My Favorite Frauds and How They Occurred

And the rest of the story

My Favorite Frauds and How They Occurred

**Let's All Go To School
(Because It's A Great Place To Steal)**

Fayette-Ware High School

Fayette County Schools

Fayette-Ware High School Fayette County Schools

Vending Machine Revenues

- Per analysis of snack vending machine purchases vs. sales, 3 year shortage of \$28,560 (Guess who took care of the vending machines!)
- School supply vending purchases: \$1,792, Deposits: \$142

Fayette-Ware High School Fayette County Schools

- Spanish Club fundraiser collections were \$1,166 less than projections.
 - Total collections were less than the cost of the items sold, resulting in a \$771 loss
- Concession revenue from Holiday Basketball Classic tournament was not deposited

Fayette-Ware High School Fayette County Schools

- Ticket sales revenue from one freshmen basketball game was not deposited
- School revenues and expenditures were either not recorded or were improperly classified in the school's books and records

Fayette-Ware High School Fayette County Schools

- Prenumbered receipts not issued
 - Most collections were remitted directly to the principal – bookkeeper was located in another building
- Some student activity funds had deficit fund balances

Fayette-Ware High School Fayette County Schools

- Over 1,500 tickets were unaccounted for during the 1992-93 and 1991-92 school year
- Concession receipts were not counted or receipted prior to being turned in for deposit

Fayette-Ware High School Fayette County Schools

- Student activity funds were used to purchase a Christmas advertisement in the local newspaper, an advertisement in the "Police Combat Shooter," and tickets for a secretary's luncheon/fashion show, as well as donations to local charities

Fayette-Ware High School Fayette County Schools

- More free meals were claimed as being served than the number of eligible students attending school

The report contained a total of 25 findings, of which the principal did not concur with 8.



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The City of Dresden



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The City of Dresden

Loans given to private interest

- Businessman told the city officials that he needed a building
- City said OK
- Businessman hired the contractor
- (No bids)

The City of Dresden

- Businessman presented construction bills to city which they paid
- At the end of construction, he signed a promissory note for \$662,445
- First payment was due in May, our report was issued in August – No payment had been received

The City of Dresden

- Mayor and Board voted to lend \$125,126 of city funds to pay the medical school expense incurred by two doctors
- In addition, they also transferred title of property owned by the city in exchange for a \$100,000 promissory note

The City of Dresden

- In both instances, the debit would be forgiven over 5 years for each year the doctors practice in Dresden
- The Mayor and Board also approved loaning city fund to pay the medical school cost of a student who was the daughter of a board member

The City of Dresden

- As of the date of our report, the loan amount was \$94,500
 - Subsequent to the issuance of our report, the city loaned an additional \$10,000 to the student
 - The same 5-year forgiveness clause was in the loan agreement

The City of Dresden

- City personnel collected scrap metal and sold it to a local salvage yard and did not deposit the proceeds into a city bank account
 - Quote from a board member: "This has been going on for 22 years. We tried to adopt policies and procedures, but it never left the board room."

The City of Dresden

Closing comment from one alderman:

"The mayor has said we were the dumbest board he had ever seen. I guess we were for believing all this time he was working within the law."

The City of Dresden

- During the period covered by our report, including the time the Mayor and Board responded to our findings, the Mayor was an employee of the Municipal Technical Advisory Service with the responsibility of advising municipalities how to maintain their financial records and comply with state laws.

Granbery Elementary School Parent-Teacher Organization

The Subject

- Ms. Julie Buchanan, Co-President
 - Her children had graduated from the school several years ago and she was still working in the school's PTO - ????????

Granbery Elementary School Parent-Teacher Organization

- Diverted more than \$140,000 in PTO funds for her personal use
- Issued a check made payable to Helen Grace Choc. Co Innisbrook for \$3,250 which was deposited into her personal bank account

Granbery Elementary School Parent-Teacher Organization

- Opened at least 4 additional (unauthorized) bank accounts in the PTO's name
- Diverted \$1,562 in funds she solicited to help pay the medical bills of a terminally ill 5th grader to her personal bank account

Granbery Elementary School Parent-Teacher Organization

- Lost a deposit bag containing \$25,000 in cash
 - She said that she must have thrown it away in the trash
- Issued at least 150 checks to herself for which she could not determine any legitimate or authorized purpose

Granbery Elementary School Parent-Teacher Organization

- Forged the second signature on checks at least 100 times
- Altered numerous receipts by photocopying them
- Submitted false medical documents to the court
 - Including a 5 page letter from her former doctor

Granbery Elementary School Parent-Teacher Organization

- When she was removed from her position as co-president of the PTO, it was discovered that there were unrecorded liabilities of at least \$45,000 and a bank overdraft of \$7,343

Granbery Elementary School Parent-Teacher Organization

- She pled not guilty and requested, and was granted, two trial postponements
- After the judge denied the request for a third postponement, she changed her plea to guilty
 - The judge was not happy

Granbery Elementary School Parent-Teacher Organization

- In her elocution, she admitted that she had had numerous affairs while married
- It was also disclosed that she used a portion of funds to have her breasts enhanced and a butt lift

Granbery Elementary School Parent-Teacher Organization

- Was also disclosed that she hosted underage parties where liquor was served
- Paid for over 12 friends of her daughter to fly to Miami and go on a cruise

Granbery Elementary School Parent-Teacher Organization

- The judge sentenced Ms. Buchanan to 16 years in the women's prison in Nashville
- May have lost her deposit on a Florida condo where she had rented it for a "Did Not Have To Go To Jail" celebration

Granbery Elementary School Parent-Teacher Organization

- After serving two years, she was considered for early parole because of prison overcrowding
 - Her parole officer recommended against

Granbery Elementary School Parent-Teacher Organization

- The parole board denied her request

Note: It is my understanding that her cellmate is a female teacher that was convicted of having sex with one of her high school students

Granbery Elementary School Parent-Teacher Organization

Update

Upon appeal, the court ruled that the judge should not have taken into consideration certain enhancing factors because the law that allowed such was passed after Ms. Buchanan committed her crimes.

Granbery Elementary School Parent-Teacher Organization

The End Result:

The judge reduced her sentence to time served (30 months of a 16-year sentence) and ordered her to perform public service at Vanderbilt Children's Hospital in the cancer patient ward

The hospital declined her services because she was a convicted [felon](#)

Gladeville Utility District

- The former manager received payments totaling \$300,211 that were either not approved and/or were in violation of district policy

Gladeville Utility District

- Unapproved salary - \$13,362
- Unapproved sale of sick leave - \$150,032
- Unapproved sale of vacation - \$38,602
- Unapproved pay raise - \$71,440
- Unearned (unauthorized) salary advance - \$26,775

Gladeville Utility District Summary - Findings



\$4,250

Gladeville Utility District—Direct Conflict of Interest

- Prepared a fake invoice to make it appear that he purchased a used Toro lawn mower from a lawn service when in fact he purchased it from himself
 - Bought it from his daughter's failed lawn service company

Gladeville Utility District Indictment

- Two counts of theft over \$60,000
- Eight counts of theft over \$10,000
- One count of official Misconduct



Recent UD Investigations

Sewanee Utility District

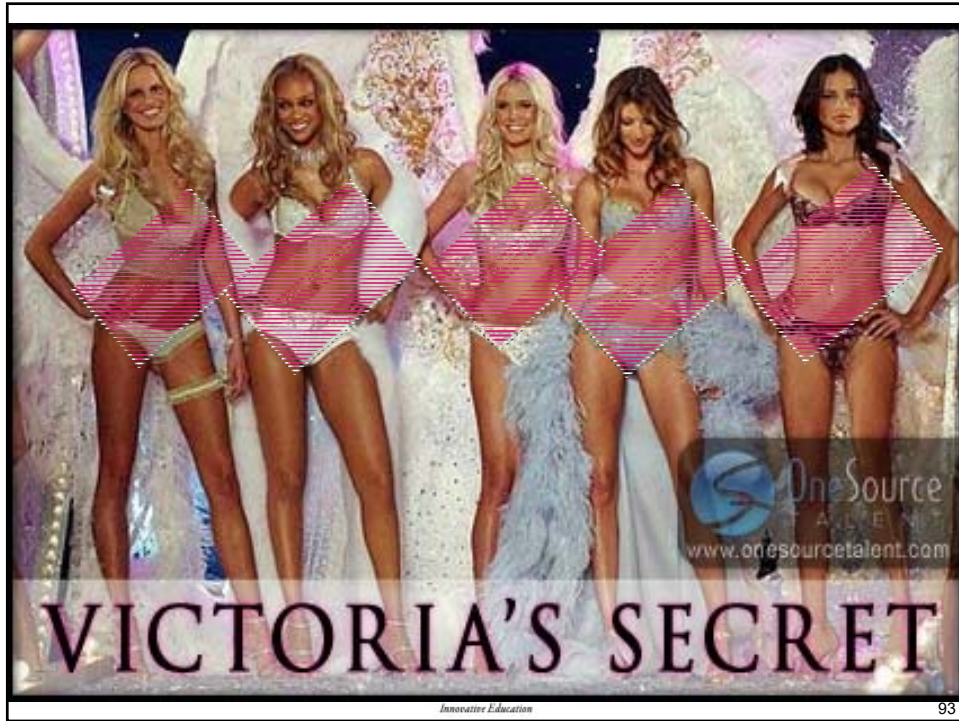


Indictment

- In July 2009, the Franklin County Grand Jury indicted Theresa Patton, former district office manager, on 11 counts, including theft over \$60,000, forgery, passing forged instruments, official misconduct, and destruction or tampering with governmental records.

Recent UD Investigations

- Ms. Patton charged personal purchases to a credit card issued in the name of the utility district.
- She then prepared checks or made payment by telephone from district bank accounts totaling \$58,849 to pay her personal charges.



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VICTORIA'S SECRET
GIFT CARD

old navy

DIRECTV.
SATELLITE TELEVISION

ROOMS
TO GO

Also....numerous Cash Advances

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Recent UD Investigations

- Ms. Patton also obtained several cash advances using the district's card which she then repaid with district funds
- Ms. Patton prepared a check to DT Services but recorded the check being paid to another legitimate vendor in the district's accounting records
 - She then deposited the check into her personal credit union account

Recent UD Investigations

- Ms. Patton also prepared and issued to herself an unauthorized check for \$3,169
 - Apparently she forged the second signature on the check
- Fraudulent petty cash expenditures of \$781

Hendersonville High School

Former bookkeeper was indicted for theft over \$60,000 - (\$76,122)

- Simply failed to record cash collections turned over to her
- Switched nonreoccurring revenue checks for cash

Hendersonville High School

- Altered numerous dates/amounts on teacher collection logs
- Issued and then destroyed hand issued receipts
- Destroyed original collection logs (found some in her trash)

Memphis City Schools Board of Education

- Paid for \$335,610 in air conditioner motors that were never delivered
- Clyde Green (vendor) and Randle Taylor (BOE employee) plead guilty to federal mail fraud charges

Athens Police Department

- Cash shortage of \$46,030
- 700 prescription pills missing
- At least 1.75 lbs. of marijuana missing
- At least 2 oz. of cocaine missing

Athens Police Department

- One handgun with an estimated value of \$1,000 was missing
- Although a former policeman signed a written confession that he took a portion of these funds, the McMinn County Grand Jury refused to indict him

Memphis Police Association

- Associate president was indicted for theft over \$10,000
 - He took \$26,239
- Diverted a refund check in the amount of \$5,996 to his personal bank account
 - Double paid American Express

Memphis Police Association

- Reimbursed \$5,934 for expenses never incurred
- Retained \$5,859 from a association sponsored softball tournament
- Issued a check for \$4,403 to pay his personal American Express bill

Memphis Police Association

- Deposited a refund check from the association's law firm into his personal bank account in the amount of \$2,878
- Made purchases with association funds, returned purchased merchandised, and kept the refund in the amount of \$1,169

Memphis Police Association

Update

It was recently reported by a local Memphis TV station that Mr. Turner had recently been arrested for shoplifting at Costco where he had been working in security. He was out of jail on bond awaiting trial related to the Police Association report when he was arrested.

Memphis Police Association End Results

- 66 Firearms unaccounted for
- 116.6 kilos of cocaine were sold out of the evidence room
- Over 560 pounds of marijuana was missing
- Up to \$10,000,000 in cash missing

My Favorite Frauds and How They Occurred

Business Is Good!

Finding fraud is like hunting.
The forest is full of animals.
You just have to look for them.
And know where they hide.



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Thank You for Attending
Western CPE's Presentation of:

My Favorite Frauds and How They Occurred

Presented by:
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Review Questions

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Section 1

1. _____ occurs when a person justifies his or her stealing by either intending to repay the funds later, or by determining that the stolen funds are “deserved.”
 - A. Fabrication.
 - B. Rationalization.
 - C. Presumption.
 - D. Indiscretion.

2. _____ of fraudulent actions are committed by honest people.
 - A. 10%.
 - B. 25%.
 - C. 60%.
 - D. 90%.

3. Which of the following represents an ineffective internal control measure?
 - A. Reconciliation of receipts and disbursements, and recording of cash over and under.
 - B. Using funds from petty cash to pay employees.
 - C. Using pre-numbered checks to make disbursements.
 - D. Segregation of duties.

Section 2

4. In the City of Dresden case, the governing board knew for over 22 years that city employees were stealing the proceeds from the sale of scrap metal that had been collected as a function of city government. What was the main failure of this governing board?
 - A. The board assumed the scrap metal was worthless.
 - B. The board adopted ineffective policies and procedures regarding the sale of scrap metal.
 - C. The board could never agree on how to handle the theft.
 - D. The board excused the theft because the city employees were in need of the stolen income generated from the sale of the scrap.

5. Which of the following policies regarding personal use of company credit cards could potentially lead to fraud?
- A. All credit card purchases must be reviewed by the bookkeeper on a timely basis to identify personal expenses charged by employees.
 - B. All personal expenses on credit cards must be compiled by the employee and reimbursed every quarter.
 - C. Any personal expenses on the company credit card must be reimbursed immediately by the employee.
 - D. If there is more than one personal expense on a company credit card, the employee must surrender the card immediately.
6. Which type of income is most likely to be stolen?
- A. Non-recurring sources of revenue.
 - B. Concession sales counted by two people and receipted prior to deposit.
 - C. Revenue sources electronically transferred into a bank account.
 - D. Sources of income arriving on a consistent basis.

Review Question Answers and Rationales

Review question answer choices are accompanied by unique, logical reasoning (rationales) as to why an answer is correct or incorrect. Evaluative feedback to incorrect responses and reinforcement feedback to correct responses are both provided.

Section 1

1. _____ occurs when a person justifies his or her stealing by either intending to repay the funds later, or by determining that the stolen funds are “deserved.”
 - A. Fabrication. Incorrect. In order to steal or commit fraud, an individual must lie or present a falsehood, which is fabrication. However, fabrication does not produce a justification for stealing.
 - B. Rationalization. Correct. A person who rationalizes his or her fraudulent acts by attributing creditable motives to these actions is able to create an excuse for committing fraud.**
 - C. Presumption. Incorrect. An individual committing a fraud by stealing does not justify his or her actions by presumption. Rather, a person presumes, or assumes, that stealing is beneficial for the individual regardless of justification of the action.
 - D. Indiscretion. Incorrect. Certainly committing fraud by stealing is an indiscretion and is at variance with the accepted morality of a society; however, an individual who justifies stealing is not concerned with the impact on society.

2. _____ of fraudulent actions are committed by honest people.
 - A. 10%. Incorrect. Certainly society would like to believe that only 10% of honest people commit fraudulent actions; however, 90% of fraud is committed by honest people who permit the justification of their actions.
 - B. 25%. Incorrect. 25% is arbitrary and does not represent the percentage of people who are honest and commit fraud.
 - C. 60%. Incorrect. 60% is also an arbitrary percentage.
 - D. 90%. Correct. Unfortunately, 90% of fraudulent acts are committed by people who are honest and are trusted by their communities. These are people who possess a specific financial need and are able to justify their fraudulent actions either by intending to repay the funds or by convincing themselves they “deserve” the funds. Further, an opportunity must exist that paves an easy path to stealing.**

3. Which of the following represents an ineffective internal control measure?
- A. Reconciliation of receipts and disbursements, and recording of cash over and under. Incorrect. A regular reconciliation of cash received and disbursed, accompanied by a recording of cash over and under, will reflect any material variances from what is expected.
 - B. Using funds from petty cash to pay employees. Correct. This is not only an ineffective internal control measure, but is also highly irregular. Petty cash funds should be used to pay incidental expenses and not employees. Employees should be paid from a bank account using pre-numbered checks. By doing so, compliance with payroll tax laws is higher, along with ensuring the ease of meeting federal and state wage reporting requirements.**
 - C. Using pre-numbered checks to make disbursements. Incorrect. This is an excellent internal control measure whereby disbursements are tracked sequentially via pre-numbered checks.
 - D. Segregation of duties. Incorrect. Probably the most important internal control measure is the separation of duties. When different people are assigned different tasks, a system of checks and balances exists limiting the opportunity to steal.

Section 2

4. In the City of Dresden case, the governing board knew for over 22 years that city employees were stealing the proceeds from the sale of scrap metal that had been collected as a function of city government. What was the main failure of this governing board?
- A. The board assumed the scrap metal was worthless. Incorrect. The value of scrap metal (especially copper) can be very high. The case analysis does not mention whether the board knew the approximate value of the scrap metal.
 - B. The board adopted ineffective policies and procedures regarding the sale of scrap metal. Incorrect. The board never actually adopted any policies or procedures regarding the collection and sale of scrap metal because they could never agree on how to handle the theft.
 - C. The board could never agree on how to handle the theft. Correct. The board, for over 22 years, could never agree on how to address the theft of the sales proceeds. Because of the disagreement, no policies or procedures—or even solutions to this problem—ever left the boardroom.**
 - D. The board excused the theft because the city employees were in need of the stolen income generated from the sale of the scrap. Incorrect. This was not a failure of the board. There is no discussion of this factor in the case analysis.

5. Which of the following policies regarding personal use of company credit cards could potentially lead to fraud?
- A. All credit card purchases must be reviewed by the bookkeeper on a timely basis to identify personal expenses charged by employees. Incorrect. This is an excellent policy regarding employee use of credit cards because it will facilitate the prompt identification of all personal expenses charged by employees to credit cards.
 - B. All personal expenses on credit cards must be compiled by the employee and reimbursed every quarter. Correct. This policy is weak and could lead to fraud because personal charges are actually permitted on the company credit card. Additionally, the employee is given the responsibility of identifying personal charges, which creates an opportunity to lie without any accountability. Finally, the quarterly reimbursement plan is not timely and could result in faded memories as to whether an expense was business or personal.**
 - C. Any personal expenses on the company credit card must be reimbursed immediately by the employee. Incorrect. If personal use of a company credit card is permitted, then immediate reimbursement is an effective policy to ensure prompt reimbursement and documentation of such expenses.
 - D. If there is more than one personal expense on a company credit card, the employee must surrender the card immediately. Incorrect. This is an excellent, zero-tolerance policy regarding the personal use of a company card that leaves little room for fraud.
6. Which type of income is most likely to be stolen?
- A. Non-recurring sources of revenue. Correct. A non-recurring, or one-time, source of revenue is most likely to be stolen because it is an unexpected source of revenue. No one is looking for (or expecting) it to be deposited. If it “disappears,” no one notices.**
 - B. Concession sales counted by two people and receipted prior to deposit. Incorrect. When more than one person is counting cash sales simultaneously, and a written receipt of the amount is recorded, then the opportunities for theft are greatly reduced.
 - C. Revenue sources electronically transferred into a bank account. Incorrect. Electronically deposited funds are impossible to steal at the point of collection.
 - D. Sources of income arriving on a consistent basis. Incorrect. Sources of income that are consistently deposited into a bank are expected to be received. In other words, someone is looking for that deposit to occur. When that expected deposit is missing at the time it should be received, then a red flag arises as to why the deposit has not been made.

Glossary

This is a glossary of key terms with definitions. Please review any terms with which you are not familiar.

Blind trust: A deep level of trust in an employee that causes management to circumvent internal control. Blind trust is the number one reason fraud occurs and that internal control measures fail.

Enhancing circumstances: Circumstances or reasons to apply the maximum penalty or sentence to the defendant.

Fraud: An intentional act to deceive or steal.

Internal control: Policies and procedures within an organization designed to ensure the integrity and reliability of financial data and reporting.

Kickback: The return of part of a contract price for the purpose of influencing future contracts.

Mitigating circumstances: Circumstances that are considered out of mercy or fairness in deciding the degree of the charges or penalties brought against a defendant.

Need: A lack of something required, desirable, or useful.

Opportunity: A favorable set of circumstances permitting an outcome.

Rationalization: To attribute, or justify, one's actions to give credit to motives without analysis of the true motives.

Segregation of duties: A key concept of internal control whereby more than one person is required to complete a financial task in order to reduce the instance of error and fraud.

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Qualified Assessment
Fraud Schemes: How and Why They Work
Course # 1123346, Version 2004

Publication/Revision Date:
April 2020

Course Expiration Date

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1. In the Crab Orchard Utility District case, what prompted the manager and her daughter to steal from the district?
 - A. An inability to afford childcare for the daughter's children.
 - B. A need for the daughter's friend to purchase a jeep.
 - C. An addiction to illegal drugs and narcotics.
 - D. A need for free water for the district commissioners and their friends.

2. The number one internal control weakness is:
 - A. Failure to use pre-numbered checks.
 - B. Lack of separation of duties.
 - C. Nepotism.
 - D. Blind trust in an individual.

3. In the City of Rockwood case, the city recorder and judge, Mr. Howard Butler, rationalized his need for stealing from the city by:
 - A. Resolving to repay the funds as soon as his friend received a large workman's compensation settlement.
 - B. Feeling he deserved the funds because he had worked for the city for 30 years.
 - C. Feeling he deserved the funds because he was underpaid as the church organist.
 - D. Resolving to use the stolen funds to repay the church for money he had stolen from the church treasury.

4. In the City of Rockwood case and the Hixon Utility District case, the respective banks were participants in fraudulent acts because:
 - A. Bank personnel refused to cash un-numbered checks.
 - B. Bank personnel violated bank policies because they knew well and trusted the individuals committing the fraudulent acts.
 - C. Bank personnel cashed large checks with no identification.
 - D. Bank personnel granted loans to the city of Rockwood without performing proper credit analyses.

5. In the Fayette-Ware High School case, the principal and school personnel were innocent of which of the following actions?
 - A. Using school funds to purchase personal vacations.
 - B. Failing to deposit vending machine and concession sales.
 - C. Misusing student-activity funds and improper bookkeeping.
 - D. Misrepresenting the number of eligible free meals to the USDA.

6. In the City of Dresden case, the mayor used city funds to provide credit to private interests, to recruit doctors by paying their medical school bills, and by providing free office space. Apart from his part-time job as mayor, what was his full-time profession?
 - A. A real estate developer designed to attract businesses to the area.
 - B. A recruiter for physicians to small municipalities.
 - C. A bank loan officer providing credit to medical students and local businesses.
 - D. An advisor to municipalities on how to maintain proper financial records and comply with state laws.

7. In the Granberry Elementary School PTO case, the fraud committed by the co-president was discovered because of which of the following incidents?
 - A. People became suspicious of her recent plastic surgeries and stylish wardrobe.
 - B. The bank statement for the fraudulent account was mistakenly put into the school bookkeeper's mail cubby.
 - C. People became suspicious because she continued serving on the PTO board for many years after her children had left the school.
 - D. She threw under-age drinking parties for her daughter and her daughter's friends.

8. In the Sewanee Utility District case, the independent auditor—who issued an unqualified opinion on the audit—never questioned expenditures to Victoria's Secret, Old Navy, Direct TV, and Rooms To Go because:
 - A. The auditor was receiving gifts from the Utility District to issue an unqualified opinion.
 - B. The expenses were reasonable considering the Utility District was responsible for providing clothing, cable service, and furniture to qualifying citizens.
 - C. The auditor merely tied the receipts to the amount of expenditures without ever examining the substance of the documentation.
 - D. The audit firm contracted out the audit to untrained individuals.

9. Which of the following actions would be considered proper by a fraud examiner?
- A. Checks from an organization have been made payable to an unknown acronym (i.e. DT Services).
 - B. The treasurer of an organization maintains a large quantity of photo-copied receipts.
 - C. Cash is counted and a receipt is issued each time the cash changes hands within an organization.
 - D. Several checks made payable to an individual are deposited into that individual's bank account in a single deposit, including one check made payable to a school district.
10. Which of the following methods of accounting for vending machine sales is most likely to lead to theft?
- A. At the beginning of each day, an individual collects the cash in the machine. The individual takes the cash to a bookkeeper who puts the cash into the company vault to count when he or she has time later in the day.
 - B. Operating the vending machine on a commission basis, whereby a counter is installed on the machine and checked on the first of each month. All cash is turned into the vending machine company, who then pays a commission on the sales of the products.
 - C. Two people open the machine together at the same daily appointed time. The cash is counted immediately by the two people, receipted, and then put into the company vault to await deposit.
 - D. Each month, a profit analysis is performed on the vending machine taking into account the cost of products installed, the number of products sold, and the sales price of the products. The result of this analysis is compared to the actual profit derived from the machine to determine whether profit is less than expected.



Answer Sheet
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