

Issue #26
April 2014

GREAT AMERICAN and LOWERS & ASSOCIATES

Fidelity / Crime Observer

Contact List



Great American Insurance Group

Dennis Burns, VP
Fidelity / Crime Division
212.513.4017
dburns@GAIC.com



Lowers Risk Group

Steve Yesko, ARM
VP, Bus. Development
540.338.7151
syesko@lowersriskgroup.com

Inside This Issue

- The Fox Was Watching The Hen House 1
- How You Can Cut Your Organization's Fraud 2
- The Fraud Triangle: A Model For ... Fraud 3
- NEWS: International ATM Fraud Scheme 4
- RIMS Annual Conference & Exhibition



The Fox Was Watching The Hen House

The State Controller's Office placed auditors in the Department of Mental Health (DMH) to oversee programs DMH was involved in. Jim was the principal auditor assigned to DMH which provided community based programs that were administrated through contracts with outside companies. As a principal auditor for DMH, Jim and his staff had administrative responsibilities with contracts that included making sure all the components of the contract were present, submitting the completed contract to the Attorney General's office as well as approving vouchers for vendor services.

DMH retained outside companies to conduct feasibility studies on potential sites where DMH could provide services. The companies tried to match possible sites with particular programs. Vouchers for their services were reviewed and approved by Jim and his staff.

Jim lived an interesting life to say the least. He resided in a new house with his second wife and two children. He had a love for classic Corvettes, owning two 1958 models, a 1964 model, and a 1968 model. He was a charter member of the local Corvette Owners Club. To keep his precious classics safe, he purchased a garage big enough to store all four vehicles. Jim also owned a second home where his mistress and the children he fathered with her resided. Then there was the alimony obligation with his ex-wife. All this on a state auditor's salary? Not quite.

It was through his ability to approve vouchers that Jim found an opportunity to supplement his income. He came across a flaw in the voucher system by accident. A voucher was paid twice yet the system did not flag or stop the duplicate payment. Jim established a company called Very Important Properties (VIP). Because of his position, Jim approved payments to VIP using valid voucher numbers. Jim and his staff were considered the safeguards of the operation so internal audit never reviewed the department. The scheme continued for eight years.

Unfortunately for Jim, a new administration was voted in with the intent of "cleaning up government." With that came audits of DMH. Part of the audit included looking for vendors with PO Boxes as addresses, a vendor fraud red flag. VIP was identified as one such vendor. A phone number could not be located for VIP either, another red flag. These red flags raised the suspicion of the auditor who after conducting further investigation determined VIP was a sham entity created by Jim, the principal auditor for DMH.

By the time the scheme was discovered, VIP was paid \$3,232,000 for phantom surveys. Jim was arrested and lost everything, his wife, mistress, children, homes, property, bank account, brokerage account, and most of all his beloved Corvettes.

Jim was a trusted employee put in a position to be a watch dog. Trust, lack of regular audits, and flaws in the system gave Jim the means and opportunity to steal. His lifestyle was the motivation that led him to his life of crime.

*By Tom Maloney, Vice President, Crime Claims
Great American Insurance Group
Fidelity / Crime Division*

How You Can Cut Your Organization's Risk Of Fraud By 50%?

You've seen the data before: Organizational fraud is a huge annual cost. Managers want to reduce the costs, so the real questions are to learn why fraud occurs and what to do about it.

The most compelling explanation for organizational fraud is the [Fraud Triangle](#), as summarized in our infographic on the next page. Frauds occur when there is opportunity, one or more employees are under perceived financial pressure (incentives exist), and they can rationalize their fraudulent behavior. These three factors correspond to the legs of the Fraud Triangle.

1. Control the Opportunities to Reduce the Chances of Fraud

In our experience, organizations can reduce the probability of organizational fraud by just removing one of the legs of the triangle. There are things you can't control, such as employees' spending habits, but if you remove the opportunity for employees to get their hands on an asset without the potential of getting caught, then you've reduced that probability by 50 percent.



2. Opportunities for Fraud Can Emerge as Unintended Consequences

Some of the factors that can promote opportunities for fraud can be linked to cost reducing strategies since modern businesses try to run very lean. In other words, these opportunities become unintended consequences of well-motivated management decisions.

For instance, coupled with technology, companies can turn more complex processes over to one or a few people, reducing the number of controls required to protect precious assets. For example, in a situation where a single person can balance accounts, and write and sign checks, an opportunity is created. At the same time, managers have fewer avenues for personal oversight of complex organizational structure; they may even cut back on the frequency and depth of internal or external audits.

The fraud opportunities you are trying to suppress are often the unintended consequences of the actions you take to grow your business.

3. Tactics for Thwarting Fraud

Taking steps to reduce fraud not only saves the company money directly, it also addresses the underwriting criteria insurance companies are likely to use in evaluating a company. Some of the tactics you can use to prevent and detect fraud, as well as demonstrate your program to the insurance companies, include:

- Internal controls
- Segregation of duties
- Comprehensive employee background screening
- Vendor screening and due diligence
- Establishment of a tip line or whistleblower program
- Set the "Tone At the Top"

Controlling organizational fraud requires management review and an organizational culture that promotes healthy behavior. Removing the opportunities for fraud is a vital first step, but one that needs to be revisited on a regular basis as the organization evolves. The opportunities you are trying to suppress are often the unintended consequences of the actions you take to grow your business.



The Fraud Triangle: A Model for Understanding Why People Commit Fraud

THE FRAUD TRIANGLE

A MODEL FOR UNDERSTANDING WHY PEOPLE COMMIT FRAUD

The Fraud Triangle model, developed by famed criminologist Donald R. Cressey, is useful in understanding the circumstances and rationale behind occupational fraud. How can the damaging acts of an employee be explained?

> OPPORTUNITY

Potential fraudsters identify an opportunity to use/abuse their position of trust for personal gain and they believe they have a low risk of getting caught in the act.

Opportunities stem from...

- Weak internal controls
- Poor security
- Unchecked management access
- Low likelihood of detection
- Lack of policy enforcement
- Uncontrolled vendor relationships

Opportunity can sway the otherwise honest.

> INCENTIVE

Need and greed are common incentives for committing fraud. When coupled with opportunity, the temptation can be all too great.

Common pressures that lead to fraud:

- Financial difficulties
- Living beyond means
- Control issues, unwillingness to share duties
- Divorce/family problems
- Wheeler-dealer attitude
- Unusually close association with vendors

> RATIONALIZATION

Some individuals possess an attitude or set of ethical values that allows them to knowingly and intentionally commit a dishonest act. Others may be able to rationalize a fraudulent act as being consistent with their personal code of ethics.

Common rationalizations:

"I was only borrowing the money."
 "I was entitled to the money."
 "I had to steal to provide for my family."
 "I was underpaid; my employer cheated me."
 "My employer is dishonest and deserved to be fleeced."

6 WAYS TO COMBAT FRAUD

The best way to prevent employee fraud is to adopt practices that will decrease opportunity and incentive. Here are 6 ways to strengthen your risk posture in order to reduce the risk of fraud.

- > Form internal audit programs
- > Establish a code of conduct
- > Conduct pre-employment screening
- > Perform management reviews
- > Screen suppliers and third parties
- > Watch for "red flag" fraud indicators

LowersRiskGroup®

LEARN MORE ABOUT FRAUD RISK PROTECTION
VISIT WWW.LOWERSRISKGROUP.COM >

Potential fraudsters identify an opportunity to use/abuse their positions of trust for personal gain and believe they have a low risk of being caught.



The best way to prevent employee fraud is to adopt practices that will decrease opportunity and incentive.

(Source: ACFE)

NEWS: Seventeen Indicted in International ATM Fraud Scheme

March 28 2014 — Seventeen individuals are facing federal fraud or related charges for their alleged roles in an international ATM skimming scheme that netted approximately \$250,000 in fraud and money laundering proceeds. Two defendants were arrested in Sofia, Bulgaria, and 13 defendants were arrested March 25th in the Chicago area.

The scheme involved using ATM and debit card numbers fraudulently obtained in Europe, as well as the PINs associated with them, to withdraw money from victims' accounts using ATMs at various locations in the Chicago area, prosecutors say.

Fraud Operation

The indictment alleges that three defendants fraudulently obtained ATM and debit card numbers and PINs from locations in Europe and elsewhere without the account holders' knowledge. The defendants, along with others they directed, then allegedly transferred the fraudulently obtained information, often by Skype or e-mail, to one defendant who directed the scheme in the Chicago area, prosecutors say.

The scheme director then gave the information to numerous co-defendants to make the fraudulent withdrawals from area ATMs, the charges allege, and the defendants divided the money they obtained. The defendants allegedly used counterfeit cards they manufactured with the stolen card numbers to make the fraudulent withdrawals. The withdrawals were allegedly made shortly before and after midnight in the time zone of the issuing banks, in an attempt to circumvent daily withdrawal limits. The defendants allegedly also coordinated ATM transactions to withdraw money before the issuing banks could detect the fraud and deactivate the card numbers. One of the defendants charged in the case owned and operated a business in the Chicago area that allegedly transmitted funds via MoneyGram.

*By Jeffrey Roman
BankInfoSecurity*

Risk & Insurance Management Society (RIMS) Annual Conference & Exhibition Elevate: Take Your Knowledge to New Heights



This year, the RIMS 2014 Annual Conference & Exhibition is all about more — more educational sessions, more expertise, more inspiring keynotes, more networking opportunities, and more discovery zones.

Attend the conference for three days of presentations by leading experts who will share their expertise on trends and business strategies in the areas of claims management, enterprise risk management, insurance, legal legislation, strategic risk management, and much more.

April 27-30, 2014
Colorado Convention Center
Denver, CO
www.rims.org/RIMS14