FRAUD PREVENTION STRATEGIES FOR HEALTH CARE – A FORENSIC ACCOUNTANT’S PERSPECTIVE

AGENDA

// Explore various strategies & controls that can help mitigate risk of fraud & embezzlement.
// Discuss how certain strategically placed controls can help mitigate fraud risk.
// Provide examples of what happens when these controls are missing.
// Provide information that links certain controls with fraud losses.
IMPACT OF ANTI-FRAUD CONTROLS

// Can’t create completely fraud-proof
// Can take preventative anti-fraud actions
// Decrease duration of schemes that occur
// Decrease dollar amount of losses
// Insurance as a backstop

COST OF FRAUD & ABUSE

// $3.7 trillion worldwide
// 5% of revenues
// Over half recover nothing after fraud is discovered

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### TOP 5 INDUSTRIES VICTIMIZED BY FRAUD – BY FREQUENCY

<table>
<thead>
<tr>
<th>Ranking</th>
<th>Industry</th>
<th>Median Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>#1</td>
<td>Banking and Financial Services</td>
<td>$200,000</td>
</tr>
<tr>
<td>#2</td>
<td>Government and Public Administration</td>
<td>$64,000</td>
</tr>
<tr>
<td>#3</td>
<td>Manufacturing</td>
<td>$250,000</td>
</tr>
<tr>
<td>#4</td>
<td>Health Care</td>
<td>$175,000</td>
</tr>
<tr>
<td>#5</td>
<td>Education</td>
<td>$ 58,000</td>
</tr>
</tbody>
</table>

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1. FRAUD AWARENESS TRAINING

// Targeted training for employees & managers
// Can’t solve fraud from accounting or internal audit department
// Organization wide awareness is critical
// Lower losses & shorter duration can be correlated to awareness training for employees

“At a minimum, staff members should be educated regarding what actions constitute fraud, how fraud harms everyone in the organization and how to report questionable activity.”

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2. USE BANK ACCOUNT CONTROLS

// Positive pay
  // Protects bank account against counterfeit checks
  // Protects against schemes you have no other way to prevent
  // Over past few years, most corporate account holders have implemented
// ACH block & filter
  // Corporate account takeover is latest fraud plague
  // If you don’t utilize ACH transactions, block them with your bank
  // If you do utilize ACH transactions, place restrictions with your bank
  // Protect credentials
2. USE BANK ACCOUNT CONTROLS

// Wire transfer controls
// Most banks have good systems available now
// Tiered approvals
// Multiple approvals required for high-dollar transactions
// Protect your credentials
// Lockbox
// Great options available
// Same-day deposit
// Same-day access to images of checks received

3. OVERSIGHT OF OFFICE MANAGERS

// Make sure every office manager has oversight
// Build in checks & balances
// Independent review of bank statements & reconciliations
// Approval structure for purchases
// Review of credit cards & expense reimbursements
// Centralized financial statement preparation
// Includes acquired practices & joint ventures
// Consider other positions that lack oversight
A SURGERY CENTER EMBEZZLEMENT

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
<th>Reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unauthorized Cash Disbursements through AP</td>
<td>$21,097</td>
<td>Exhibit 2</td>
</tr>
<tr>
<td>Suspicious Cash Disbursements through AP</td>
<td>8,486</td>
<td>Exhibit 2</td>
</tr>
<tr>
<td>Over-the-Counter Cash Transactions</td>
<td>7,850</td>
<td>Report p.4</td>
</tr>
<tr>
<td>Bookkeeper Payroll</td>
<td>41,198</td>
<td>Exhibit 3</td>
</tr>
<tr>
<td>Other Employee Payroll</td>
<td>35,815</td>
<td>Exhibit 4</td>
</tr>
<tr>
<td>Subsidiary Payroll</td>
<td>2,866</td>
<td>Report p.6</td>
</tr>
<tr>
<td>Bookkeeper Credit Card Use</td>
<td>22,521</td>
<td>Exhibit 5</td>
</tr>
<tr>
<td>Office Mgr Credit Card Use</td>
<td>36,671</td>
<td>Exhibit 6</td>
</tr>
<tr>
<td>Former Office Mgr Card Use</td>
<td>5,808</td>
<td>Exhibit 7</td>
</tr>
<tr>
<td>Office Mgr-School Checks</td>
<td>38,782</td>
<td>Exhibit 8</td>
</tr>
<tr>
<td>Electronic Payments from Bank</td>
<td>53,948</td>
<td>Exhibit 9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$275,040</strong></td>
<td></td>
</tr>
</tbody>
</table>

4. LOG COMPLAINTS

// Complaints about payments, timeliness of posting, statements, etc.
// Often complaints are directed to perpetrator
// Allows scheme to continue
// Patterns in complaints are seldom recognized until it’s too late
// A lot can be learned by knowing about complaints
5. GOOD HR PRACTICES

// Background checks
// Credit checks
// Performance evaluation processes
// Exit interviews

6. REVIEW OF BANK STATEMENTS & CANCELLED CHECKS

// Someone outside accounting department
  // Owner in a small business
  // Member of senior management for medium-sized organization
// Review bank statement for ATM transactions, counter withdrawals, unusual
  ACH transactions, credit card payments, etc.
// Review cancelled checks for unusual payees, endorsements & amounts
// Every cancelled check doesn’t have to be reviewed every month
WHERE DID THE MONEY GO?

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Number of Fraudulent Checks</th>
<th>Total Dollar Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>76</td>
<td>$2,149,137.06</td>
</tr>
<tr>
<td>2006</td>
<td>139</td>
<td>$2,286,182.98</td>
</tr>
<tr>
<td>2007</td>
<td>149</td>
<td>$2,685,994.06</td>
</tr>
<tr>
<td>2008</td>
<td>127</td>
<td>$2,220,485.83</td>
</tr>
<tr>
<td>2009</td>
<td>106</td>
<td>$1,732,594.64</td>
</tr>
<tr>
<td>2010</td>
<td>97</td>
<td>$1,615,750.49</td>
</tr>
<tr>
<td>2011</td>
<td>18</td>
<td>$1,866,883.43</td>
</tr>
<tr>
<td>2012</td>
<td>51</td>
<td>$1,749,328.75</td>
</tr>
<tr>
<td>2013*</td>
<td>24</td>
<td>$545,388.48</td>
</tr>
<tr>
<td>Grand Total</td>
<td>888</td>
<td>$16,445,786.31</td>
</tr>
</tbody>
</table>

*January 1, 2013 to June 21, 2013
7. MANDATORY VACATIONS

- Someone must fill in for employee on vacation & perform their duties
- Job rotation can also be used
- Many problems are identified during perpetrator vacations

8. CREDIT CARD & EXPENSE REIMBURSEMENT POLICIES

- "Business purpose" is not good enough
- What types of expenses do you really want to be paying?
- What types of expenses are not acceptable?
- What documentation is required?
- Soft expenses need better documentation of business purpose & who was present
  - Meals & entertainment, sporting events, etc.
- Policies need more detail & enforcement
9. REVIEW OF CREDIT CARDS & EXPENSES
   // Diligent review is needed
   // Assign to the right person
   // Need support to perform appropriate review

10. FRAUD RISK ASSESSMENT
    // Have formal fraud risk assessment
    // Allows you to understand your fraud risks & focus your efforts
    // Should be performed by someone that looks at fraud issues on a regular basis
11. INTERNAL AUDIT

// Independent of management & accounting
// Not feasible for all organizations
// If not feasible for you, have “tire-kicking” procedures performed by someone
  // Consider doing one or two high-risk areas per year

12. MANAGEMENT REVIEWS

// Review of key financial reports
  // A/P check register
  // Payroll detail report
  // Write-offs
  // Etc.
// Some reports may be appropriate for board-level review
// Ask questions about it
// Follow up when something doesn’t seem right
// Establish “perception of detection”
13. SEGREGATION OF DUTIES

// Custody vs. Authorization vs. Recordkeeping
// Objective is more than one pair of eyes
// Oversight
// A few to focus on (there are many more)
// A/P access to signed checks
// Internal delivery of checks
// A/P clerks that can set up vendors
// Payroll clerks that can set up new employees
// Payment handlers that can post contractuals

14. RECONCILE PAYMENTS POSTED TO BANK DEPOSIT

// Three way match
// Patient accounting needs to reconcile to daily deposit
// Independent verification best
// No bank deposit preparation by key accounting employees
15. CODE OF CONDUCT

- Including anti-fraud policy
- Conflict of interest policy
- Policy related to gifts & gratuities
- Consider annual acknowledgment & disclosure of
  - Any awareness of inappropriate activity
  - Any conflicts of interest with vendors or customers
ETHICAL CULTURE

// Excerpt from Enron's Business Ethics Policy
// “Employees of Enron Corp., its subsidiaries, and its affiliated companies (collectively the “Company”) are charged with conducting their business affairs in accordance with the highest ethical standards. An employee shall not conduct himself or herself in a manner which directly or indirectly would be detrimental to the best interest of the Company or in a manner which would bring to the employee financial gain separately derived as direct consequence of his or her employment with the Company...”

16. CREATE THE RIGHT CULTURE

// Tone at the top
// Positive workplace environment
// Culture of honesty & high ethics
// Emphasis on doing the right thing
// Management must walk the talk
17. PROSECUTE

// If you are a victim, please prosecute
// Huge deterrent impact
// Criminal record for perpetrator
// Lack of enforcement undermines all your anti-fraud efforts
18. VENDOR CONTROLS

// Seeing more mandatory approved vendor lists
// Control over selection of new vendors
  // Who can select?
  // How are they selected?
// Due diligence performed on new vendors
  // Is vendor real?
  // Is pricing reasonable?
  // Is vendor related to an employee?
// Periodically reassess vendor relationships
// Minimize or eliminate conflicts of interest
19. DATA MINING & CONTINUOUS AUDITING

- Especially related to accounts payable & vendors
- Pattern recognition
- Identify patterns indicative of fraud schemes
- Find things you’ll never find by looking at documents

DATA MINING

“The process of discovering meaningful new relationships, patterns and trends by sifting through data using pattern recognition technologies as well as statistical and mathematical techniques.”
WHY DATA MINING AND DATA ANALYTICS?

// Majority of data is in electronic format

// Data sets are massive in size and often proprietary in format

// “100% analysis is the most effective way to analyze for fraud”
   (Dr. Conan Albrecht, BYU)

// Efficiency and effectiveness

COMMON DATA MINING AREAS

// Employees & Payroll
// Vendors & Accounts Payable
// P-Cards & Credit Cards
// Expense Reimbursement
// Inventory (not as common)
20. CONFIDENTIAL HOTLINE

// Single most cost effective anti-fraud action you can take
// Tips are number one way that frauds are detected
// Most tips come from employees
// Both deterrent & detection method
// Lower losses are observed where hotline is present
// Puts employees on notice that you want to know

“Providing individuals a means to report suspicious activity is a critical part of an anti-fraud program.”

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VICTIM ORGANIZATIONS

WHISTLE-BLOWERS – MOTIVATING FACTORS

Awareness

// Recognition that there is a wrong that needs to be made right.
WHISTLE-BLOWERS

PERCENTAGE WHO REPORTED MISCONDUCT THEY OBSERVED: 2000-2011

Agency

Believe their act of courage make a difference
72% of employees who agreed their companies reward ethical conduct did report

#1 reason for reporting – BELIEVED corrective action would take place (79%)
#1 reason for NOT reporting – No corrective action would take place (59%)
ACFE – ANTIFRAUD CONTROLS

/// Presence of antifraud controls is notably correlated with significant decreases in the cost & duration of occupational fraud schemes. Organizations that had implemented antifraud controls experienced considerably lower losses & time-to-detection than organizations lacking these controls.

/// Perpetrators with higher levels of authority tend to cause much larger losses. Median loss among frauds committed by owner/executives was $573,000, median loss caused by managers was $180,000 & median loss caused by employees was $60,000.

12 months faster!
Losses 44% less!

WHISTLE-BLOWER — MOTIVATING FACTORS

Security & investment

/// Employees who feel more secure, financially and regarding protection from the company, are more likely to report—either internally or to the federal government.
WHISTLE-BLOWERS – MOTIVATING FACTORS

Support & connectedness

// Employees who are more connected are more likely to report.

- Work support
- Family support

Strong connectivity yields an 80% reporting rate.
Weak connectivity, a 38% reporting rate.

Source: “Inside the Mind of a Whistleblower” © 2012 Ethics Resource Center
RISKS & REWARDS OF FRAUD HOTLINES

All types of reports will be received
- Unethical, illegal or wasteful conduct
- Sexual harassment
- Hostile work environment
- Personality differences
- Gossip
- Bad hair day

THE INVESTIGATION

- Predetermined investigation protocols & plan of action
- Defined roles & responsibilities for evaluation team
- Defined timeline for evaluation & response
- Specifies treatment of the whistle-blower
- Clear line of reporting
  - Who is privy to initial report
  - Who is assigned to evaluation team
- Determine type of evidence to gather
  - Appropriate amount varies
  - PROTECT THE EVIDENCE!!!
EVALUATION TEAM

- Human resources
- General legal counsel
- Risk management
- Internal audit
- Information technology
- Public & investor relations
- Third-party investigator

EVALUATION EVIDENCE

- Interviews
  - Personnel files
    - Beyond official HR file
  - Business files
  - Emails
  - Calendar
  - Browser activity
  - Text messages
  - Instant message chats
  - Other computer forensics
OUTCOME OF TIPS

// Document, document, document!
// Legal counsel involved
// Reporting the outcome
  // Upper management
  // Whistle-blower
  // Employees
// Retaliation
  // Be aware of/prevent
// Rewards