



The Fun of Finding Fraud



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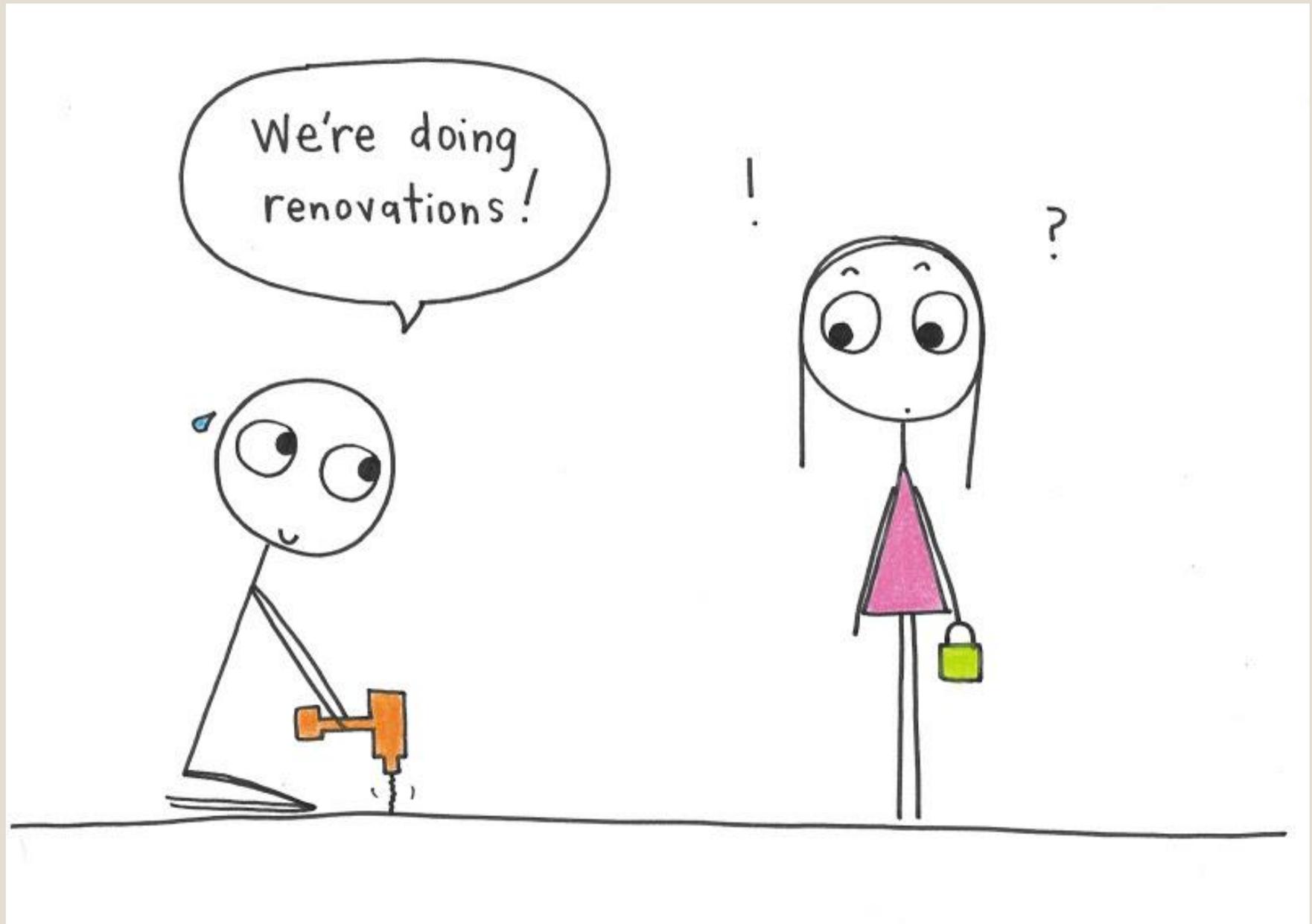
Central Florida Regional Planning Council



It may not be this kind of fun!



It could look as innocent as this.



Fraud



- Asset Misappropriation: theft or misuse of assets
- Corruption: using influence in a transaction to obtain an unauthorized benefit (e.g., a bribe)
- Fraudulent Statements: falsification of financial transactions

The Profile of a Perpetrator



- Male
- Intelligent and in management
- Married and under some type of significant stress (not necessarily causal)
- Risk takers and not afraid to fail
- Rule breakers
- Long-time, hard working employees
- Typically, the older the perpetrator, the greater the theft

The Fraud Equation



Fraud =

| Need | + | Opportunity | + | Rationalization |
|--|----------|--|----------|---|
| <ul style="list-style-type: none">○ Money | | <ul style="list-style-type: none">○ Temptation | | <ul style="list-style-type: none">○ Lack of criminal intent |
| <ul style="list-style-type: none">○ Success | | <ul style="list-style-type: none">○ Trust | | <ul style="list-style-type: none">○ Societal reinforcement |
| <ul style="list-style-type: none">○ Revenge | | <ul style="list-style-type: none">○ Lack of controls | | <ul style="list-style-type: none">○ Treatment of employee |
| <ul style="list-style-type: none">○ Excitement | | <ul style="list-style-type: none">○ Lack of Punishment | | <ul style="list-style-type: none">○ Workplace behavior |

Prevention of Fraud



Internal controls are procedures that help to prevent errors or irregularities or to ensure that errors or irregularities are detected within a reasonable amount of time. The design of a system of internal controls begins with an evaluation of the objectives and potential weaknesses in an organization's accounting process. There are cost/benefit considerations. For example, the cost of lost assets must be weighed against the cost of lost productivity, and a system that is too complex may lead to non-compliance.

Separation of Duties –An auditor's favorite management letter comment

The separation of incompatible duties involves separating job functions so that *ideally* no one individual is able to

- Authorize a transaction
- Record the transaction in the accounting records
- Maintain custody of the asset resulting from the transaction
- Reconciliation to verify authorization and proper recording on a timely basis

Examples of Separation of Duties



Cash receipts

- One person receives the payment (opens mail)
- Another person records the cash receipt in the accounting system
- A third person makes the deposit into the bank account
- A fourth person reconciles the bank statement
- Then management reviews

Purchasing

- One person authorizes the purchase
- Another person pays the invoice and records the asset in the accounting system
- A third person maintains custody of the asset (inventory)
- Periodic physical inspection of fixed assets by outside party or management

Reconciliation includes following-up on any differences or discrepancies identified—the sooner the better!

Never Enough Employees for Separation of Duties

especially in smaller agency



A compensating control is to increase management oversight such as direct participation by management in the business activities, reviewing invoices, reviewing key financial reports and monitoring the accounting system and preparation of financial statements.

Management duties:

- Periodic verification - review source documents and reconciliations
- Analytical review – investigate unusual variances
- Reasonableness test – red flags must be investigated, take appropriate action; keep in mind that sometimes an error is just an honest mistake that needs to be corrected

Perception is Important



Only a person you trust can commit fraud. Internal controls do not provide complete assurance. They are subject to management override and collusion, but management's perceived commitment to the prevention of fraud will be a strong deterrent.

Lessons Learned



- Review W-2 forms for all employees before they are distributed—have the employees sign for pick-up and verification of accuracy.
- There is no less possibility of theft from using an outside payroll or bookkeeping service.
- Always have two people involved in preparing payroll—three is better.
- It is just as easy for an employee to get a credit card in the agency's name as it is for someone to get a personal credit card through a stolen identity—most credit card companies accept on face value that whoever says they are authorized and has valid information can be the signer.

Lessons Learned



- Good news is that banks make it almost impossible to set up bank accounts without valid authorization.
- There is always the possibility that the report you see does not agree with other reports—at least periodically look at every conceivable report from your accounting system.
- Make sure miscellaneous cash receipts are checked before and after deposits.
- Make sure that your liability coverage is not limited to a small amount per person recovery if there are certain individuals who are a greater risk to financial loss—including ED's!
- We wary of employees who do not embrace updating accounting systems—it may not be just reluctance to change in general.

Lessons Learned



- Clean audits do not ensure that fraud or theft is not occurring.
- Management letter recommendations from your auditors should be addressed, no matter how minor.
- Prior years findings in an audit for more than two years is a bad sign of business as usual.
- Either hire a new audit firm every three years or ask for a different member on the audit team every few years. Putting fresh eyes on your books is a good idea.

New Source of Revenue



- \$12,000 Miscellaneous Revenue from the Department of Corrections Annually

(and only 22 years to go to end probation!)

