

Thursday, March 19, 2015

8:30am – 10:30am

Anatomy of Fraud

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Government Division

Fraud Prevention Checklist

The most cost-effective way to limit fraud losses is to prevent fraud from occurring. This checklist is designed to help organizations test the effectiveness of their fraud prevention measures.

1. Is ongoing anti-fraud training provided to all employees of the organization?

- ☐ Do employees understand what constitutes fraud?
- ☐ Have the costs of fraud to the company and everyone in it — including lost profits, adverse publicity, job loss and decreased morale and productivity — been made clear to employees?
- ☐ Do employees know where to seek advice when faced with uncertain ethical decisions, and do they believe that they can speak freely?
- ☐ Has a policy of zero-tolerance for fraud been communicated to employees through words and actions?

2. Is an effective fraud reporting mechanism in place?

- ☐ Have employees been taught how to communicate concerns about known or potential wrongdoing?
- ☐ Is there an anonymous reporting channel available to employees, such as a third-party hotline?
- ☐ Do employees trust that they can report suspicious activity anonymously and/or confidentially and without fear of reprisal?
- ☐ Has it been made clear to employees that reports of suspicious activity will be promptly and thoroughly evaluated?
- ☐ Do reporting policies and mechanisms extend to vendors, customers and other outside parties?

3. To increase employees' perception of detection, are the following proactive measures taken and publicized to employees?

- ☐ Is possible fraudulent conduct aggressively sought out, rather than dealt with passively?
- ☐ Does the organization send the message that it actively seeks out fraudulent conduct through fraud assessment questioning by auditors?
- ☐ Are surprise fraud audits performed in addition to regularly scheduled audits?
- ☐ Is continuous auditing software used to detect fraud and, if so, has the use of such software been made known throughout the organization?

4. Is the management climate/tone at the top one of honesty and integrity?

- ☐ Are employees surveyed to determine the extent to which they believe management acts with honesty and integrity?
- ☐ Are performance goals realistic?
- ☐ Have fraud prevention goals been incorporated into the performance measures against which managers are evaluated and which are used to determine performance-related compensation?
- ☐ Has the organization established, implemented and tested a process for oversight of fraud risks by the board of directors or others charged with governance (e.g., the audit committee)?

- 5. Are fraud risk assessments performed to proactively identify and mitigate the company's vulnerabilities to internal and external fraud?**
- 6. Are strong anti-fraud controls in place and operating effectively, including the following?**
 - ☐ Proper separation of duties
 - ☐ Use of authorizations
 - ☐ Physical safeguards
 - ☐ Job rotations
 - ☐ Mandatory vacations
- 7. Does the internal audit department, if one exists, have adequate resources and authority to operate effectively and without undue influence from senior management?**
- 8. Does the hiring policy include the following (where permitted by law)?**
 - ☐ Past employment verification
 - ☐ Criminal and civil background checks
 - ☐ Credit checks
 - ☐ Drug screening
 - ☐ Education verification
 - ☐ References check
- 9. Are employee support programs in place to assist employees struggling with addictions, mental/emotional health, family or financial problems?**
- 10. Is an open-door policy in place that allows employees to speak freely about pressures, providing management the opportunity to alleviate such pressures before they become acute?**
- 11. Are anonymous surveys conducted to assess employee morale?**

The Anatomy of Fraud and Ethics

Utah Municipal Clerks Institute
March 19th, 2015

Ryan Roberts, CPA
Utah State Auditor's Office

Healthy Utah Checkout

- ▶ Blood pressure
- ▶ Cholesterol
- ▶ Blood glucose
- ▶ Waist circumference
- ▶ BMI
- ▶ Separation of duties
- ▶ Independent Checks
- ▶ Management Review
- ▶ Budgeting
- ▶ Internal Controls
- ▶ Policies and procedures



Separation of Duties

- ▶ **Custody of assets** – Custodian of cash and checks received (Treasurer)
- ▶ **Recording and Reporting** – Maintains financial records and prepares disbursements (City Clerk)
- ▶ **Authorization** – Provides authorization and review of transactions (City Council)

Separation of Duties Exercise


SEPARATION OF DUTIES FORM (1/96)

Audit: _____ Prepared by: Ryan Roberts

#	Duties	Conflicting Areas (Mark appropriate letters)	Note or FR Ref (Include conflicting box)	Write Applicable Names
RECEIPTS				
A	Cashier opens mail, or has access to cash/checks received	<input checked="" type="radio"/> A <input checked="" type="radio"/> D <input checked="" type="radio"/> F <input checked="" type="radio"/> G <input checked="" type="radio"/> H <input checked="" type="radio"/> I J K L M N O P		Maria Fandi (C) Cindy Gantz (B,E)
B	Reconciles receipt records to validated deposit			Cindy Gantz
C	Handles NSF checks	E F G O P		Maria Fandi
D	Commits entity to exchange	H <input checked="" type="radio"/> I G O		Auston Johnson (F)
E	Prepares / Sends billings	F G		Cindy Gantz
F	Approves or initiates write-off	G		Auston Johnson
G	Reviews expected receipts			Jon Johnson

Independent Checks

- ▶ Cash drawer counts
 - Proactive audit approach
- ▶ Bank reconciliations
 - Monthly
 - Resolve all unreconciled items
 - Dixie College example
- ▶ Unexpected receipts
 - Follow receipting policies and procedures
 - DABC and Snow College South examples



Management Review

- Financial statements
- Quarterly reports
- Response to audit findings
 - Lack of separation of duties
 - Lack of accounting expertise



Monthly and Quarterly Reports

The governing body shall review monthly summary financial reports and quarterly detailed financial reports.

—UCA 10-6-148



Quarterly Reports

- Detail List of Receipts
- Detail List of Expenditures
- Cash balance in bank account.
- List of liabilities.
- Comparison to Bank Statements.
- Invoices supporting payments available for inspection.



Budget

The budget shall:

- ▶ Provide a financial plan.
- ▶ Specify:
 - estimates of all anticipated revenues, and
 - all appropriations for expenditures.



Budget Officer's Duties

The budget officer (Clerk or Treasurer) shall require all expenditures to conform with the budget.



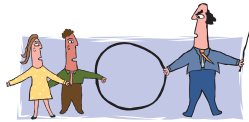
Budgeting

- ▶ Public has the opportunity to provide input.
- ▶ The budget constitutes spending authority.
- ▶ The local govt body legally binds itself to spend this much and no more.
- ▶ Any expenditure in excess of the budget is illegal, even if the local government has money available to spend.



Internal Control

- ▶ Internal Control is a process designed to provide reasonable assurance regarding the achievement of objectives.
 - One employee reviews another's work.



Why Internal Controls are important

- ▶ They keep honest people... honest!
- ▶ They protect you against false accusations
- ▶ They ensure safeguarding of assets and resources
- ▶ They protect the public trust



Process vs. Control Exercise

PROCESS vs. CONTROL EXERCISE

Instructions: Identify the following items as either a process or as a control. Indicate with either a P for process or C for Control.

1. Cashier uses pre-numbered receipt documents as cash is received.
2. The sequence of pre-numbered receipts is accounted for.
3. Accountant reconciles data originating from two different information streams.
4. Budget and Accounting Officer prepares a journal entry.
5. Controller reviews and approves a journal entry.

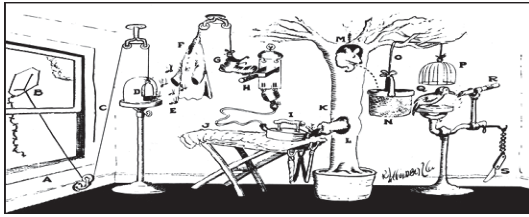
Process vs. Control
"Action Words"

<p>► Process</p> <ul style="list-style-type: none">◦ Uses◦ Performs◦ Prepares◦ Entered 	<p>► Control</p> <ul style="list-style-type: none">◦ Reviews◦ Reconciles◦ Compares◦ Verifies 
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Internal Control & Complexity

Rube Goldberg (rōōb göld'berg) n. a comically involved, complicated invention, laboriously contrived to perform a simple operation — *Webster's New World Dictionary*

Internal Control & Complexity



Rube Goldberg gets his think-tank working and evolves the simplified pencil-sharpener. Open window (A) and fly kite (B). String (C) lifts small door (D) allowing moths (E) to escape and eat red flannel shirt (F). As weight of shirt becomes less, shoe (G) steps on switch (H) which heats electric iron (I) and burns hole in pants (J). Smoke (K) enters hole in tree (L), smoking out opossum (M) which jumps into basket (N), pulling rope (O) and lifting cage (P), allowing woodpecker (Q) to chew wood from pencil (R), exposing lead. Emergency knife (S) is always handy in case opossum or the woodpecker gets sick and can't work.

Internal Control Limitations

- ▶ Human Judgment
 - Errors
 - Mistakes
- ▶ Management Override
- ▶ Collusion
- ▶ Cost Benefit
- ▶ Complexity of Controls

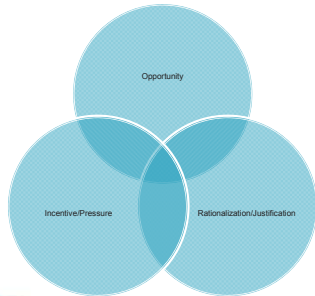


Perception of Detection

- ▶ ACFE Says:
 - Controls do little to forestall theft if their presence is not known by those at risk.
 - Employee education
 - Reporting programs
 - Hotlines
 - Rewards
 - Proactive audit policies



Fraud Triangle



Which of the following individuals most fits the statistical profile of an occupational fraudster?

- a) 22-yr old customer service rep, employed for 5 mo., HS diploma and charged with petty theft at 19
- b) 38-yr old college graduate, employed for 3.5 yrs, with no criminal background
- c) 53 yr old vice president, employed for 25 yrs, charged and cleared for passing two bad checks
- d) 57 yr old warehouse foreman, HS dropout, employed for 10 years, two prior convictions of assault

Profile of a fraudster

- In a staff-level position
- Male
- Between the ages of 31 and 45
- Between one and five years of tenure at the victim organization
- The holder of an undergraduate degree
- Employed in the accounting, primary operations, or sales departments
- First-time offenders

Recent Headlines

Recent Headlines

- ▶ Utah "City Bookkeeper Booked" – May 2012
 - Pocketed cash receipts and altered financial records to conceal fraud
 - Age: 34
 - Tenure: 3 years
 - Loss: \$80,000
 - Discovered: Routine audit
 - Sentence: Unknown

Recent Headlines

- ▶ "Former employee of Online University Pleads Guilty to Fraud" – March 2012
 - Forged checks
 - Age: 45
 - Tenure: 3.5 yrs
 - Loss: \$500,000
 - Discovered: Tip from successor
 - Sentence: restitution, probation, community service, and 8 days in jail

Recent Headlines

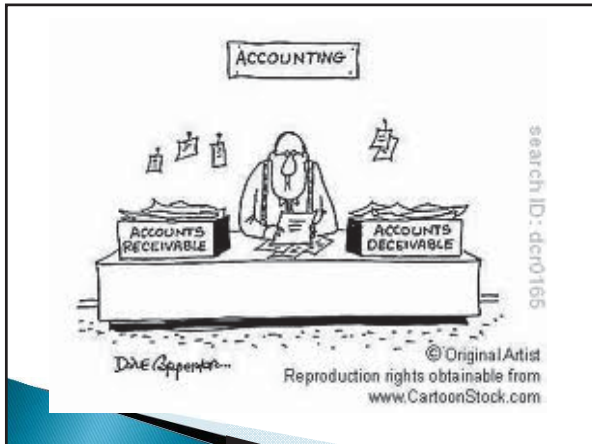
- ▶ “Ex-Utah utility executive gets probation for stealing thousands...” – February 2015
 - Attempted theft by deception
 - Age: 54
 - Tenure: 5 yrs
 - Loss: \$70,000
 - Discovered: Inside tip
 - Sentence: 10 days jail, probation and restitution

Recent Headlines

- ▶ “Former town clerk devastates tiny Utah town's finances, sent to prison” – June 2011
 - Forgery, depositing checks in personal account
 - Age: 36
 - Tenure: 4 yrs
 - Loss: \$184,000
 - Discovered: Tip from Mayor
 - Sentence: 27 mo. in jail and restitution

Recent Headlines

- ▶ “Historic Utah Park Fires Director Accused of Theft” – January 2011
 - Submitted reimbursement requests for personal expenses
 - Age: 41
 - Tenure: 5 yrs
 - Loss: \$240,000
 - Discovered: Internal audit
 - Sentence: 6 mo in jail and restitution



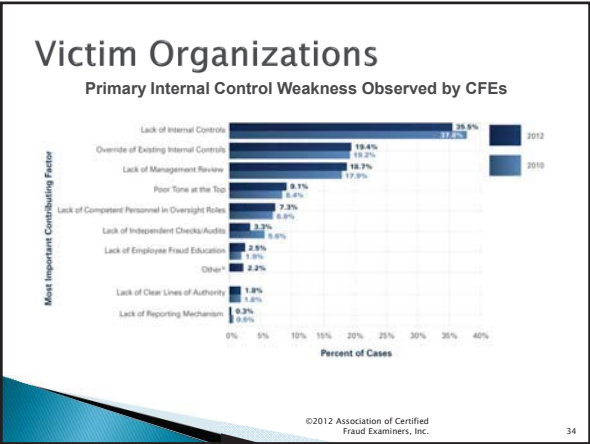
Fraud Prevention Measures

1. Establish a "Tone at the Top" that encourages ethical conduct
2. Implement and enforce strong internal controls
3. Identify and mitigate risks in financial operations
4. Provide employee education and a fraud hotline
5. Address and follow-up on audit findings

Set the "Tone at the Top"

- ▶ Lead by Example
- ▶ Communicate to employees what is expected of them (Code of Ethics)
- ▶ Provide a Safe Mechanism for Reporting Violations
- ▶ Reward Integrity





Identify and Mitigate Risks

- ▶ Cash Receipts and Disbursements
- ▶ Purchase cards
- ▶ Petty cash
- ▶ Unexpected Receipts





Employee Education and Fraud Hotline

- › Mandate Fraud and Ethics Training
- › Establish a Code of Conduct
- › Implement a confidential hotline
- › Establish a whistleblower policy
- › Implement effective disciplinary policies



Trust (Blind/Willful): BEWARE!

- › "I'm an engineer, educator, etc. not an accountant, I trust my finance officer"
- › "I'm new here, I must not understand"
- › Choosing not to see, "It's not my department"



Handling Complaints

- › 76% of employees in business have observed a high level of illegal or unethical conduct at work in the past 12 months.
- › 49% of employees in business have observed misconduct that, if revealed, would cause their firms to "significantly lose public trust"

◦ KPMG 2000 Organizational Integrity Survey



Handling Complaints

- ▶ MOST (65%) DON'T REPORT
- ▶ 96% feared being accused of not being a team player
- ▶ 81% feared corrective action would not be taken
- ▶ 68% feared retribution from their supervisors
 - (Society of Human Resource Managers, 1999)



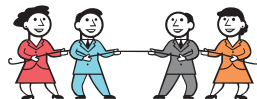
Code of Conduct Statement

- ▶ Signed annually by employees exposed to risk.
- ▶ Individual understands expectations
- ▶ Has complied with code of conduct.
- ▶ Is not aware of any violations.



Conflicts of Interest

- ▶ An employee owns an undisclosed interest in a supplier. The employee negotiates a contract between his employer and the supplier, purchasing materials at an inflated price. (School District)



Non-Cash

- ▶ Employees steal or (borrow) inventory, equipment or supplies.
 - Sometimes volunteers feel a sense of ownership over equipment.



Detection of Fraud Schemes



Employee Education and Fraud Hotline

- ▶ Providing individuals a means to report suspicious activity is a critical part of an anti-fraud program.
- ▶ Fraud reporting mechanisms, such as hotlines, should be set up to receive tips from both internal and external sources and should allow anonymity and confidentiality.
- ▶ Management should actively encourage employees to report suspicious activity, as well as enact and emphasize an anti-retaliation policy.

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Employee Education and Fraud Hotline

- ▶ Targeted fraud awareness training for employees and managers is a critical component of a well-rounded program for preventing and detecting fraud.
- ▶ Not only are employee tips the most common way occupational fraud is detected, but our research shows organizations that have anti-fraud training programs for employees, managers and executives experience lower losses and shorter frauds than organizations without such programs in place.
- ▶ 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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Address and Follow-up on Audit Findings

- ▶ Prepare a corrective action plan
 - Identify who, how, and when
- ▶ Follow-up with management



Summary

- ▶ Ethical environment
- ▶ Internal controls
- ▶ Education
- ▶ Hotline
- ▶ Active involvement



Fraud Prevention Checklist

- ▶ The most cost-effective way to limit fraud losses is to prevent fraud from occurring. This checklist is designed to help organizations test the effectiveness of their fraud prevention measures.



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Ethics

What is ethics?


“Moral principles that govern a person’s or group’s behavior”

– Google.com

Business Culture

- Business ethics vs. personal ethics
- If its allowed, does it make it right?
 - Example: State Agency audit

Ethics



“Ethics is knowing the difference between what you have a right to do and what is right to do.”
 –Potter Stewart, former Supreme Court Justice

Ethics

- Illegal (criminal) – Embezzling funds
- Unethical – Using official position for personal gain
- Dishonest – Spending all your time at work on Facebook



Ethics Act

- ▶ Cities and Towns – *Utah Code* 10-3-1300
- ▶ *Utah Code* 67-16 Utah Public Officers and Employees' Ethics Act (State and all other political subdivisions of the State, including school districts)

Ethics Act

- ▶ Purpose:
 - "To set forth standards of conduct for officers and employees of the State of Utah and its political subdivisions in areas where there are **actual** or **potential** conflicts of interest between their public duties and their private interests."



Ethics Act

- ▶ "It is an offense for a public officer, public employee, or legislator to:"
 - "(b) disclose or improperly use controlled, private, or protected information acquired by reason of his official position...in order to further substantially the officer's economic interest..."
 - Special Projects manager defrauds city
 - Board member benefits from land purchase

Ethics Act

- "(c) Use or attempt to use official position to further substantially the officer's or employee's personal economic interest..."
- Recent case with the Attorney General – May 2014
- Top Utah Regulator granted favors – March 2013
- City Councilman uses position to defraud others – July 2011

Ethics Act

- ▶ Cannot accept or solicit:
 - Gifts
 - Compensation
 - Loans
- ▶ Conflicts of Interest require full disclosure



Ethics Act

- ▶ Penalties:
 - Any public officer who knowingly or intentionally violates this chapter
 - Dismissed from employment or office, and
 - Charged with a misdemeanor or a felony depending on the severity of the violation



Loyalty Conflict

- ▶ Who should a person be loyal to?
 - Law
 - Policy
 - Governing Board
 - General Manager
 - Immediate Supervisor
 - Co-worker



Honesty vs. Loyalty

“Sometimes people face a conflict between loyalty to one person and loyalty to another.”



Quinn McKay – “The Bottom Line on Integrity”

Honesty vs. Loyalty

- “Loyalty and honesty are frequently in conflict when people are asked to express their judgments about others, particularly when one person is the other person’s boss or subordinate.”
- You like your supervisor on a personal level, but ineffective as a leader. One day VP asks you how good of a leader is your boss?

Quinn McKay – “The Bottom Line on Integrity”

Honesty vs. Loyalty

- ▶ Unabomber and David Kaczynski



Honesty vs. Loyalty

“Our culture’s ethic teaches that people should be honest, but it also teaches that they should be loyal and obedient.”

Quinn McKay – “The Bottom Line on Integrity”



Perils Of Whistle Blowing

- ▶ Man left company but still charged with conspiracy to commit fraud.
- ▶ Finance Officer blew whistle, allegations validated, subsequently left the organization.

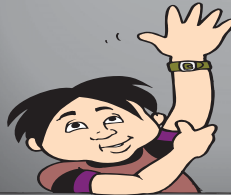


Perils Of Whistle Blowing

- ▶ “Most organizations and society in general, prefer loyalty over honesty and give it the greater reward”.
- ▶ “Honesty is rarely rewarded when it is chosen over loyalty. In fact it is generally punished either formally or in subtle ways.”

Quinn McKay - “The Bottom Line on Integrity”

Questions



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