



Ways to Prevent and Detect Fraud: Implementing Internal Controls

Office of the State Auditor
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Office of the State Auditor

Role and Responsibility

- Financial oversight includes:
 - Counties
 - Cities
 - School Districts
 - Towns
 - Police and Volunteer Fire Relief Ass'n Pension Funds
 - Soil and Water Conservation Districts
 - Port Authorities
 - TIF Districts
 - As well as approximately 150 other special districts



Office of the State Auditor

Divisions

- Audit Practice
- Pension
- Tax Increment Financing
- Government Information
- Legal/Special Investigations

Legal/Special Investigations Division

The Legal/Special Investigations Division investigates allegations of theft or misuse of public funds. It also provides legal compliance information and training to local government officials.





Types of Fraud

- Theft
 - Minn. Stat. § 609.52
 - Includes temporary taking
 - Even small amount of public funds is a felony
- Embezzlement
 - Minn. Stat. §§ 609.445 and 609.54
 - Refusing or omitting to turn over public funds
 - Felonies



Types of Fraud (continued)

- False Claims
 - Presenting (Minn. Stat. § 609.465)
 - Allowing or paying (Minn. Stat. § 609.455)
 - Felonies
- Forgery
 - Check forgery (Minn. Stat. § 609.631)
 - Altering a public record with intent to defraud (Minn. Stat. §§ 609.625 or 609.63)
 - Felonies
- Misuse of Public Funds/Assets

Suspect Fraud?

LGU's Reporting Requirement

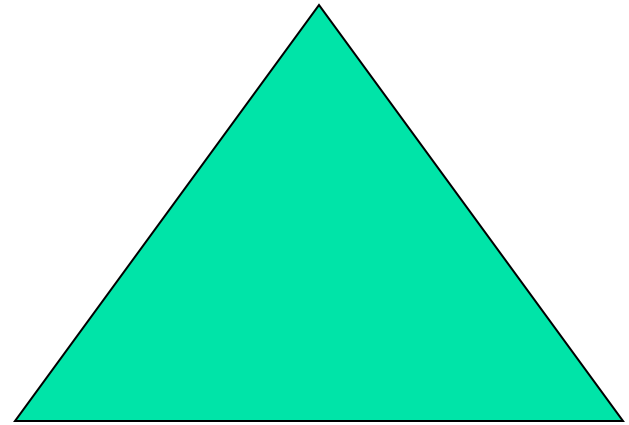
Minn. Stat. § 609.456

- LGU employee/officer who discovers evidence of theft, embezzlement, unlawful use or misuse of public funds or property
- Must *promptly* report to state auditor (in writing) and to law enforcement
- Identity of 609.456 reporter is private data (Minn. Stat. § 6.715, subd. 2)
- Reporting form is on OSA website



The Fraud Triangle

- Motive/Incentive
(Financial Pressure)
- Rationalization
- Opportunity



Fraud Triangle: Motive/Incentive



- Gambling
- Medical issues
- Spouse's layoff or anticipated layoffs
- Declining financial condition



Fraud Triangle: Rationalization

- Minimize
 - “I’ll pay it back” (just borrowed the money)
 - Compensate for overtime
 - A mistake/accident
 - “They’ll never miss it”
 - Could have been worse (e.g., amount, frequency)
- Blame
 - “They don’t pay me enough”
 - Fellow employee created the opportunity
 - Unusual expenses in personal life

Fraud Triangle: Opportunity

- Cash
- Lack segregation of duties
- Inadequate internal controls
- Management override
- Poor environment

This is the one that can be controlled



Increased Risk of Fraud

- Economic Downturn
 - Increased motive/incentive
 - Increased rationalization with bad financial news
 - Increased “opportunity”
 - Increased “fees”
 - Staff reductions eliminate internal controls
 - “Ponzi” schemes collapse
- ACFE 2010 Report to the Nations on Occupational Fraud and Abuse:
<http://www.acfe.com/rtn/2010-rtn.asp>





609.456 Reports Received

2007 – 34 Reports

2008 – 64 Reports

2009 – 54 Reports

2010 – 51 Reports (as of 9/15/10)



Reduce Risk of Fraud: Tools of Protection

Reduce “opportunity” with:

- Segregation of Duties
- Internal Control Procedures
- Environment



Tools of Protection: Segregation of Duties

- One person does not control an entire transaction (separate authorization, recording & custody)
- No employee should be in a position to commit fraud and then conceal it
- Build double-checks into process
- Cross-training (assignment/job rotation)
- “Trust but verify”

Problem: Receipts Not Deposited

- Skimming
 - Cash removed prior to deposit (unreceipted cash)
- Lapping
 - Receipted cash replaced with unreceipted checks





Solution: Build in Double Checks

- Someone other than person collecting money compares items sold to money collected (movie theatre example)
- Person collecting money is not person preparing deposit
- Person collecting money receives periodic report of deposits
- Second person OKs all voids/refunds
- Small LGU or departments: involve elected officials or other employees

Tools of Protection: Internal Controls

- Safeguard funds
- Efficient & effective management of assets
- Maintain integrity of financial systems



Problem: Special Risk of Cash Receipts

- Permits
- Fees
- Fines
- Copies of records
- Risk increases in small LGUs/departments
- Skimming
- Lapping



Solution: Internal Controls for Receipts

- Daily deposits
- Reconcile receipts with deposits daily
- Do not leave receipts unattended
- Consolidate cash collection points
- Periodic report of deposits to department collecting payments
- Know the amount in any change/petty cash fund (starting balance)





Solution: Internal Controls for Receipts (continued)

- Pre-numbered receipts for all payments/sales
- Note if payment is by cash or check (& check number) & compare to deposit
- Deposits made intact
- Beware of voids & refunds
- No cashing of personal checks out of undeposited receipts
- No “borrowing” from public funds (no IOUs or “markers”)

Problem: Unauthorized Payments

- LGU funds used for personal purchases
 - Credit card
 - Petty cash
 - Expense reimbursements



Solution: Internal Controls for Credit Card Purchases



- Require original invoices & original itemized receipts ("slice & dice")
- County board authorization required for credit card use (Minn. Stat. § 375.171)
- Purchase must meet all purchasing laws & policies
- If county board does not approve purchase, officer/employee is liable for purchase
- Specific vendors, not just credit card company, on claims list approved by governing body

Solution: Internal Controls for Credit Card Purchases (continued)

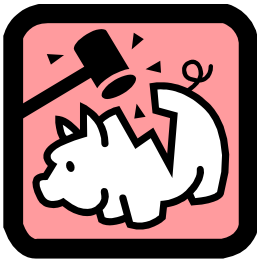
OSA's Statement of Position -

- Identify who may use credit card and for what purchases
- Restrict the dollar amount of charges permitted
- Set up a review process for all credit card purchases
- Prohibit use of the credit card for personal purchases



Solution: Internal Controls for Petty Cash (“Imprest Cash Fund”)

- Cash funds established by county board with appointed custodian to be used if “it is impractical” to pay claims in other manner or for travel (Minn. Stat. § 375.162)
 - Use employee reimbursement procedures instead of petty cash
- Disburse funds
 - Reimbursement method preferred over advance method
 - Advance method specifically authorized for travel – but board must authorize out-of-county travel in advance
- Replenish funds
 - Present claim itemizing disbursements to county board at next meeting (if travel fund advance, claimant then repays amount advanced per Minn. Stat. § 375.162, subd. 2)
 - Custodian personally liable for non-approved claims





Solution: Internal Controls for Petty Cash (continued)

OSA's Statement of Position:

- Physical security of cash box (locked up)
- Amount of cash on hand + receipts (+ documented outstanding advances) = amount of approved cash fund
- Keep original/detailed receipts as documentation
- Reconciliations by someone other than custodian (person approving disbursements)
- Adopt policy on use of petty cash (when may use; disbursement method; etc.)

Solution: Internal Controls for Employee Expenses

- Detailed, original receipts
- Minn. Stat. § 471.38 (itemization of claims)
- Approved by supervisor (county board for county administrator)





Solution: Internal Controls for Travel Expenses

- Follow county's travel policy
 - Out-of-state travel policy required by Minn. Stat. § 471.661 (OSA Statement of Position)
 - Approve out-of-county travel in advance (Minn. Stat. § 375.162, subd. 2)
- Determine in advance:
 - What travel expenses are reimbursable or prohibited
 - Who may approve travel expenses
 - What supporting documentation is needed
- Require documentation of:
 - Method of mileage determination
 - Date, time and purpose of travel

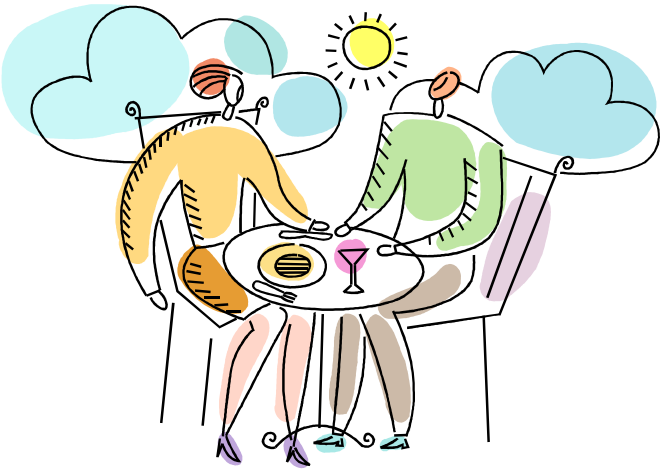
Solution: Internal Controls for Fuel Purchases



- Maintain fuel purchase log for LGU vehicles
 - Who is making purchase
 - Type & amount of fuel purchased
 - Vehicle being fueled & odometer reading
 - Date, time & location of purchase
 - Require original, detailed receipts
- Monthly review
 - Calculate fuel consumption
 - Unleaded fuel for diesel vehicle?

Problem: Misuse of LGU's Property/Time

- Timesheet fraud
- Personal use of LGU's vehicles/equipment





Solution: Written Policies and Procedures

- Use of LGU property
- Check handling & cash collections
- Employee and travel expenses
- OSA Statements of Position:
 - Credit cards
 - Petty cash
 - Timesheets
 - And more
- Why?
- Avoid problems
- Allow discipline where appropriate
- Consistency for all employees
- Sets environment

Tools of Protection: Environment



- Set the tone at the top
- Create a culture of accountability
- All employees understand the importance of internal controls & their role



Problem: Weak Control Environment

- Disengaged or otherwise engaged governing body or management
- Employees reluctant to voice concerns
- No action taken when noncompliance with internal controls, late deposits or reports
- Governing body and management fail to set the “tone at the top”



Solution: Control Environment

- The same rules apply to all
- Don't belittle internal control procedures
- Don't allow management to override procedures
- Avoid conflicts of interest (Minn. Stat. §§ 471.87 – 471.89)
- Take appropriate discipline for violations
- Be alert to employee's outside interests
- It's the public's money



Common Myth

- “No fraud here – see our recent audit”
- Reality: LGU’s over-rely on audits to detect fraud
- ACFE 2010 Report to the Nations for gov’t entities:
 - 46.3% tips (40.2% all entities; of those, 49.2% were from employees)
 - 11.6% management review (15.4% all entities)
 - 15.1% internal audit (13.9% all entities)
 - 7.4% external audit (4.6% all entities)

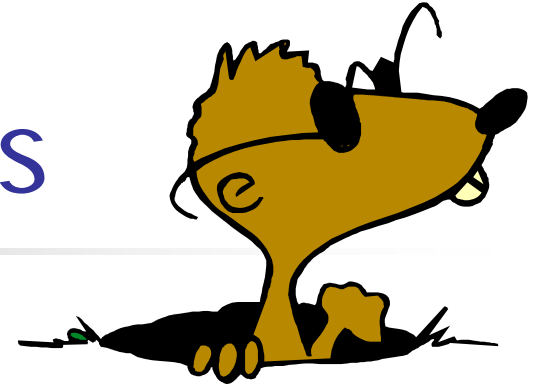




More Common Myths

- The accountants/auditors are responsible for internal controls
- Sound internal controls will eliminate all fraud
- We have an accounting policy & procedure manual, so we're all set
 - We copied the neighboring LGU's manual, so we're all set

More Common Myths



- It can't happen here
- Only big entities (with big budgets) can have internal controls
- Reality: Small entities are particularly vulnerable to fraud (ACFE 2010 Report to the Nations)

Suspect Fraud?

Other Considerations

- Criminal?
- Disciplinary action?
- Insurance coverage?
- Get advice





Website:

www.auditor.state.mn.us

- Statements of Position
- Investigative Reports
- Internal Control Letters
- E-Updates (Avoiding Pitfalls)
- 609.456 Reporting Forms
- And More . . .



Contact Information

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