

How 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
 - Watershed 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

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- 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 Reviewed by the Office of the State Auditor

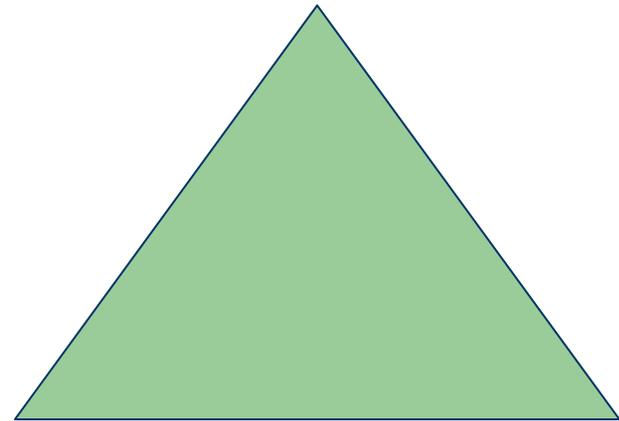
- Theft
 - Minn. Stat. § 609.52
 - Includes temporary taking
 - Even small amount of public funds is a felony
- Embezzlement
 - Minn. Stat. §§ 609.445 and 609.54
 - Refuse or omit to turn over public funds
 - Felonies

Type of Fraud Reviewed by the Office of the State Auditor (continued)

- False Claims
 - presenting (Minn. Stat. § 609.465)
 - allowing or paying (Minn. Stat. § 609.455)
 - felonies
- Forgery
 - altering a public record with intent to defraud (Minn. Stat. §§ 609.625 or 609.63)
 - felonies
- Misuse of Public Funds/Assets

The Fraud Triangle

- Opportunity
 - We can control
- Rationalization
 - I'll pay it back
 - They don't pay me enough
 - They'll never miss it
- Motive/Incentive (Financial Pressure)
 - Often gambling



Reduce Risk of Fraud: Tools of Protection

- Segregation of Duties
- Internal Control Procedures
- Environment

Segregation of Duties

- No employee should be in a position to commit fraud and then conceal it
- No employee should have access to money (physical assets) & related accounting records or to all phases of the transaction
- Example: Person collecting/receipting cash should not:
 - Post cash receipts to the general ledger system
 - Prepare billings
 - Process cash disbursements
 - Prepare/make bank deposits, wire transfers

No Segregation of Duties Employee Writes Self Check

- Check written to employee
- Recorded in records as “void” or as written to a vendor
- Change amount from that approved
- Creates and pays a “phantom vendor”
- No one notices

Segregation of Duties

Bank Statements

- Review of bank statement and canceled checks (optical images) by someone not involved with check writing
 - Amount altered?
 - Void check cashed?
 - Unauthorized checks written?
 - Checks out of sequence?
- Compare with claims approved
- Small districts: Involve a manager, or other employee

Internal Controls Funds Received

- Use sequentially numbered receipts
- Note if payment is by cash or check (record check number)
- From whom received
- Date payment received
- Amount received
- Purpose of payment (fund/account code)
- Initials/signature of person receiving payment
- Why?
- Record of receipts
- If no receipt, no one notices if not deposited
- Detect “lapping” (replace cash with non-receipted check)
- Reduce risk of “skimming” (take cash before recorded on the books)

Internal Controls Funds Received

- Daily deposits
- Do not leave receipts unattended
- Reconcile receipts with deposits daily – does composition of deposit match receipts?
- Why?
- Reduce risk of loss
- Detect receipts never deposited

Internal Controls

Cash Received: **Special Risks**

- Fees (permits, inspections, engineer reviews, wetland delineations, stormwater utility)
- Levies, special assessments, bond sales
- Know the amount in any change fund (starting balance)
- No “borrowing” from public funds (no IOUs)
- Segregation of duties
- Internal controls
- Environment

Internal Controls Checks Received

- Endorse check “for deposit only” as received
- Cash personal checks?
- Amount over purchase?
- Made out to public entity
- Why?
- Reduce chance checks will be taken and cashed
- Public entity is not a bank
- Reduce nsf checks

Internal Controls Signatures

- Do not pre-sign checks or deposit slips
- Obtain all required signatures on checks (more than one)
- Avoid signature stamps
- Why?
- Bylaw requirements
- Defeats segregation of duties
- Was payment authorized?

Internal Controls

Expense Reimbursement

- “Managers are entitled to reimbursement for traveling and other necessary expenses incurred in the performance of official duties.” Minn. Stat. § 103D.315, subd. 8.
- “Managers may reimburse members of the advisory committee for actual traveling and other necessary expenses incurred in the performance of duties in the amount as provided for state employees.” Minn. Stat. § 103D.331.
- Appraisers may be paid for “actual and necessary” expenses. Minn. Stat. § 103D.715, subd. 5.

Internal Controls Expense Reimbursement

- Detailed receipts
- Original receipts
- Reference claims approved (with amounts) in minutes
- Why?
- Prevent unauthorized payments
- Prevent “slice and dice”
- See also Minn. Stat. § 471.38 (other LGU – itemized claims required)

Internal Controls

Credit Cards

- Minn. Stat. § 103D.325, subd. 4
- Managers must authorize any credit card use
- Only officer/employee otherwise authorized to make district purchases may use credit card
- Purchase must meet all purchasing laws & policies
- If managers do not approve purchase, officer/employee is liable for purchase

Internal Controls Credit Card Policy

OSA's Statement of Position 2007-1005

- Identify specific vendors, not just credit card company, on claims list approved by managers
- Pay off credit card charges monthly – not a method for creating debt
- Identify who may use credit card and for what purchases
- Restrict the dollar amount of charges permitted

Internal Controls

Credit Card Policy

- Require invoices/original itemized receipts for credit card purchases (think “slice and dice”)
- Set up a review process for all credit card purchases
- Prohibit use of the credit card for personal purchases
- Do not use for gas in personal vehicles – use mileage reimbursement instead

Internal Controls

Petty Cash

- Cash funds used if impractical to pay claims in other manner
- Disburse funds
 - Reimbursement method preferred (personal funds used for purchase; reimbursed when turn in detailed, original receipts)
 - Advance method (receive cash; return receipt and change after purchase)
- Replenish funds
 - Present claim itemizing all disbursements to managers at next meeting
 - Custodian personally liable for non-approved claims

Internal Controls

Petty Cash

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)

Internal Controls Work with Your Bank

- No cash withdrawals
- No check cashing
- No fund transfers without a resolution
- Up-to-date authorized signatures
- All signatures required on checks
- Obtain optical images of checks

Internal Controls Written Policies

- Check handling procedures
- Cash collections
- Credit cards
- Expense reimbursements
- Use of district's property
 - Cell phones
 - Computers
 - Vehicles
- Why?
- Avoid problems
- Allow discipline where appropriate
- Consistency for all employees
- Protect yourself
- Sets environment

Environment

- The same rules apply to all
- Don't belittle internal control procedures
- Don't allow management to override procedures
- Be alert to employee's outside interests
- It's the public's money

Red Flags: Segregation of Duties

- No vacations
- Takes records home
- Takes on segregated duties
- Works when others gone
- Time sheets not reviewed or signed
- Only person who knows the job/computer

Red Flags: Internal Controls

- Noncompliance with internal controls
- Missing or late reports
- Missing or late documentation
- Late deposits
- Outstanding or out of sequence checks

Red Flags: Environment

- Unexpected or poorly explained losses
- High level of refunds, returns, voids
- The “bully”
- Too busy to deal with “mere details”
- The employee who has been there “forever” and is never questioned
- The “sweetheart”

Bonds

- Bonds authorized for officers or employees (Minn. Stat. § 103D.325, subd. 2)
- Managers must be bonded (Minn. Stat. § 103D.315, subd. 2) –
 - \$1,000 minimum
 - Board may increase (recommended)
- Have bonds in place
- Paid for by watershed district

Suspected Fraud

Criminal?

Disciplinary Action?

Get Advice

Suspected Fraud

Minn. Stat. § 609.456

Report to:

State Auditor (in writing)

Law Enforcement

www.auditor.state.mn.us

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