Red Flags for Fraud / Internal Controls for Town & Village Boards

Tug Hill Commission’s 26th Annual Local Government Conference

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What is Fraud?

An illegal act involving the obtaining of something of value through willful misrepresentation.
The Fraud Triangle

- **Pressure**
- **Opportunity**
- **Rationalization**

Board Can Control This

Board Can Not Control These
What has the Office of the State Comptroller (OSC) found?

From 1994 thru 2013, the Division of Local Government’s audits disclosed 268 cases of fraud, waste and abuse amounting to over $33.6 million.
## Summary of Fraud, Waste & Abuse by Class

<table>
<thead>
<tr>
<th>Class of Government</th>
<th>Number of Cases</th>
<th>Amount</th>
<th>% of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Counties</td>
<td>15</td>
<td>$3,301,801</td>
<td>6%</td>
</tr>
<tr>
<td>Cities</td>
<td>9</td>
<td>$4,199,089</td>
<td>3%</td>
</tr>
<tr>
<td>Villages</td>
<td>48</td>
<td>$1,289,735</td>
<td>18%</td>
</tr>
<tr>
<td>Towns</td>
<td>132</td>
<td>$3,229,870</td>
<td>49%</td>
</tr>
<tr>
<td>School Districts</td>
<td>26</td>
<td>$18,742,320</td>
<td>10%</td>
</tr>
<tr>
<td>Fire Districts</td>
<td>22</td>
<td>$1,540,284</td>
<td>8%</td>
</tr>
<tr>
<td>Public Authorities</td>
<td>3</td>
<td>$732,506</td>
<td>1%</td>
</tr>
<tr>
<td>Other</td>
<td>13</td>
<td>$612,974</td>
<td>5%</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>268</strong></td>
<td><strong>$33,648,579</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>
OSC Facts about Fraud

From 2003 - 2013, a review of 167 cases disclosed that:

- 82 of the cases were found by OSC Auditors
- 85 of the cases were brought to OSC’s attention by others
2014 SHORTAGES / FRAUD REPORTS

17 reports issued totaling $810,241

- Crystal Beach VFD (2014M-243), Treasurer - $95,000
- Village of Riverside (2013M-349), Treasurer - $83,000
- Town of Erin (2013M-282), Highway Supt.- $68,501
- Town of Fishkill (2013M-246), Rec Director - $45,189
- Village of Le Roy (2014M-26), Treasurer - $34,465
- Wyandanch Pub Library (2013M-39), Treasurer - $31,07
- Minetto VFD (2014M-222), Chief - $22,618
- Almond VFD (2014M-113), Treasurer - $22,000
Board Oversight Responsibilities

- Safeguard Government Assets
  - Develop adequate internal Controls
    - Policies and procedures
    - Preventative and detection controls
  - Monitor Adopted Policies
  - Perform Periodic Risk Assessments
  - Perform an Annual Audit of Records
Policies & Procedures

- Investment Policy
- Procurement Policy
- Credit Card Policy
- Travel Reimbursement Policy
- Code of Ethics
- Cash Receipt and Disbursement Procedures
Perform a Risk Assessment

- The identification and analysis of opportunities that exist for the loss or misuse of municipal assets
  - An ongoing monitoring process
  - Determine how much risk you are willing to accept (cost/benefit analysis)
  - Initiate policies or actions to address risks
    - Prevention and Detection Controls
WHERE ARE ASSETS MOST AT RISK?

- **Cash** (receipts and disbursements)
  - Segregation of duties
- **Capital Assets** (equipment)
  - Physical inventories
- **Materials and supplies**
  - Perpetual inventories / reconciliations
- **Data and sensitive information**
SAFEGUARDING CASH

- Are duties relating to cash receipts sufficiently segregated?
  - Does the same person who receives cash also make deposits and record entries?
  - Who opens the mail?
  - Is a daily cash receipt log maintained?
  - Is cash deposited frequently?
  - Is a safe used?
  - Are duplicate receipts provided?
  - Are inventories reconciled to cash receipts records (permits, garbage stickers, etc)?
SAFEGUARDING CASH

- Are duties relating to cash disbursements sufficiently segregated?
  - Does the same person who signs checks also record entries?
    - Are signature procedures adequately controlled?
  - Is check stock controlled and sequences monitored?
  - Is online banking allowed?
    - Are confirmations required?
    - Is a dedicated wireless computer used?
SAFEGUARDING CASH

Bank Reconciliations

- Are they performed on a timely basis, documented and available for review?
- Does the bank balance agree with accounting records?
- Who reconciles the bank account?
  - Is it someone independent of cash duties?
- Does anyone verify it?
- Do balances support liabilities (clerks, justices)?
### Bank Balances @ 9/30/14

<table>
<thead>
<tr>
<th>Acct #</th>
<th>Bank Balance</th>
<th>Add: Deposits in Transit</th>
<th>Less: Outstanding Checks</th>
<th>Adjusted Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>80123</td>
<td>$1,245.89</td>
<td>$4,500.00</td>
<td>$5,678.98</td>
<td>$66.91</td>
</tr>
<tr>
<td>80234</td>
<td>$56,890.00</td>
<td>0</td>
<td>12,567.89</td>
<td>$44,322.11</td>
</tr>
<tr>
<td>80345</td>
<td>$36,890.45</td>
<td>$56,000.00</td>
<td>$4,567.89</td>
<td>$88,322.56</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
<td>$132,711.58</td>
</tr>
</tbody>
</table>

### Book Balances @ 9/30/14

<table>
<thead>
<tr>
<th>Acct #</th>
<th>Bank Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>A200</td>
<td>$13,459.18</td>
</tr>
<tr>
<td>A201</td>
<td>$54,456.24</td>
</tr>
<tr>
<td>H201</td>
<td>$64,796.16</td>
</tr>
<tr>
<td>Total</td>
<td>$132,711.58</td>
</tr>
</tbody>
</table>
## Reconciliation of Balances & Liabilities

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance per bank @9/30/14</td>
<td>$2,500</td>
</tr>
<tr>
<td>Add: Deposits in transit</td>
<td>$100</td>
</tr>
<tr>
<td>Less: Checks not cleared</td>
<td>($190)</td>
</tr>
<tr>
<td>Adjusted balance per bank:</td>
<td>$2,410</td>
</tr>
<tr>
<td>Balance per cash book @9/30/14</td>
<td>$2,410</td>
</tr>
<tr>
<td>Liabilities @ 9/30/14</td>
<td></td>
</tr>
<tr>
<td>Due to DEC</td>
<td>$1,340</td>
</tr>
<tr>
<td>Due to Supervisor</td>
<td>$746</td>
</tr>
<tr>
<td>Due to NYS Dept. of Health</td>
<td>$324</td>
</tr>
<tr>
<td>Total Liabilities @ 9/30/14:</td>
<td>$2,410</td>
</tr>
</tbody>
</table>
SAFEGUARDING CAPITAL ASSETS

- Are capital asset records maintained?
- Are asset tags used?
- Are unannounced physical inventories conducted by someone independent of purchasing and recording?
  - Focus on assets that can be converted to personal use.
SAFEGUARDING MATERIALS & SUPPLIES

- Diesel and gasoline
  - Are usage records maintained?
  - Are perpetual inventory records maintained and reconciled to usage records?
  - Are significant differences investigated?
  - Is access to tanks restricted / controlled?
  - Are the locations of tanks well lighted and visible from the street?

- Other materials & supplies
  - Are inventories adequately secured?
## Reconciliation of Fuel Inventory Records

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ending Level @ 8/31/13</td>
<td>250 gallons</td>
</tr>
<tr>
<td>Add: Delivery 9/5/13</td>
<td>720 gallons</td>
</tr>
<tr>
<td>Delivery 9/17/13</td>
<td>565 gallons</td>
</tr>
<tr>
<td>Total Fuel Available for use</td>
<td>1,535 gallons</td>
</tr>
<tr>
<td>Less: Recorded fuel use</td>
<td>1,275 gallons</td>
</tr>
<tr>
<td>Expected Level @ 9/30/13</td>
<td>260 gallons</td>
</tr>
<tr>
<td>Actual Level @ 9/30/13</td>
<td>240 gallons</td>
</tr>
<tr>
<td>Difference</td>
<td>(20 gallons)</td>
</tr>
</tbody>
</table>
SAFEGUARDING DATA

- Is access to server and computer workstations controlled?
- Are user access rights appropriate for job duties?
- Are passwords appropriate and required to be changed periodically?
- Are audit logs maintained and monitored?
- Are networks and wireless connections secure from unauthorized access?
- Are backups performed, tested and kept in a secure area?
The Annual Audit Requirement

“Fraud and Falsehood dread examination. Truth invites it”.  
Samuel Johnson

It is the responsibility of the governing board to conduct an audit (or contract for an audit) of the records and reports of all employees and officials who disburse and receive cash on behalf of the municipality.

- Town Law §123
- Village Law §4-408(e)
- Uniform Justice Court Act §2019(a)
What is an Audit?

- The definition of audit is “To Examine”
- As part of the annual audit, the board may examine:
  - Accounting Records
  - Dockets (Justices)
  - Receipts
  - Warrants or Abstracts
  - Vouchers
  - Bank statements and canceled checks
  - Monthly/Annual reports
When Should the AUDIT Be Done?

- Shortly after year-end
- More frequently?
  - Spot Checks
  - As Need Arises
Annual Audit Check List

- **LGMG - Fiscal Oversight Responsibilities**
  - Chief Fiscal Officer
    - Town Supervisor
    - Village Treasurer
  - Town Clerk
  - Tax Collector
  - Justices
  - Other Departments
### Appendix C – General Recordkeeping Requirements for Chief Fiscal Officers continued

**Checklist for Review of Chief Fiscal Officer’s Records**

Determine the types of funds in use, and whether separate cash receipts and disbursements books are maintained for the various funds or whether a single cash receipts and single cash disbursements book is maintained. The following checklist can be used for each fund maintained.

<table>
<thead>
<tr>
<th>Cash Receipts</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Is the cash receipts journal up-to-date?</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Is the cash receipts journal maintained in a manner that identifies the date received, payer, purpose and the amount either individually or totals referenced to subsidiary receipt records (e.g., water rents receipts register)?</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Are un-deposited cash receipts safeguarded?</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Are duplicate deposit slips kept?</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Do deposit amounts agree with cash receipt amounts?</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Are deposits made timely and recorded up-to-date?</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Last Recorded Deposit: Date ___________  Amount ___________</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Is the cash receipts journal totaled and summarized monthly?</td>
<td>□</td>
<td>□</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cash Disbursements</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Is the cash disbursements journal up-to-date?</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Is the cash disbursements journal maintained in a manner to identify amounts disbursed either individually or totals referenced to abstracts or payrolls?</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Are pre-numbered checks used for all disbursements (other than petty cash)?</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Are all checks signed by the chief fiscal officer and co-signed if required?</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>If checks are signed electronically, is the signature stamp or software in the custody and control of the chief fiscal officer?</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Are canceled checks or check images returned with bank statements and maintained on file?</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Are all unused checks properly controlled (blank check stock)?</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Are checks recorded up-to-date?</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Last Recorded Check: #_____  Date_____  Amount _____</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Is the cash disbursements journal totaled and summarized monthly?</td>
<td>□</td>
<td>□</td>
</tr>
<tr>
<td>Are payments supported by appropriate documentation? Consider comparing a sample of disbursements with supporting documentation.</td>
<td>□</td>
<td>□</td>
</tr>
</tbody>
</table>
Watch for Red Flags

Indicators that something is out of the ordinary

Red Flags are warnings and should not be ignored
Management Red Flags

- Reluctance to provide information to Board Members
- Excessive number of checking accounts
- Excessive number of year-end transactions
- Missing Records
Employee Red Flags

- Lifestyle changes
- Credit problems
- Behavioral changes
- Refusal to stay home (vacation sick leave)
Red Flags in Cash Collection / Accounts Receivable

- Duplicate cash receipts not being issued or issued out of sequence
- Significant decreases in “cash” revenues
- Large number of write-offs of accounts
- Taxpayer complaints about non-payment notices
- Discrepancies between bank deposits and postings
Red Flags in Cash Disbursements

- Canceled checks (or copies) not available
- Checks issued out of sequence
- Checks issued not shown on abstracts or payroll reports
- Unexplained changes made to abstracts
- Unexplained transfers from bank accounts
- Use of signature stamps to sign municipal checks
Red Flags in Payroll

- Employees with few or no deductions
- Employees charged to multiple account codes
- Unreasonable hours charged (overtime for snow plowing in June)
Red Flags In Purchasing

- Suspicious shipping address
- Vendor addresses matching employee addresses
- High volume of purchases from new vendors
- Abnormal inventory shrinkage
- Vouchers lacking adequate description of goods or services purchased
What if you have concerns?

- First discuss your concerns with the Officer/Dept Head whose records are being reviewed
- If you still have concerns - contact your OSC Regional Office for further guidance
  - Syracuse (315) 428-4192
Questions / Concerns?

Contact the Syracuse Regional Office
Muni-Syracuse@osc.state.ny.us
315-428-4192