

Fraud Prevention and Detection

Division of Local Government and School
Accountability

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What is Fraud?

- An illegal act involving obtaining something of value through willful misrepresentation.



Examples of Fraud

- Theft of cash
- Forgery
- Falsifying accounting records
- Theft of service



What is Abuse?

- Behavior that is improper when compared with behavior that a prudent person would consider a reasonable and necessary business practice given the facts and circumstances.



Examples of Abuse

- Incurring excessive expenses
- Misuse of municipal equipment or supplies



What is a Red Flag?

- A set of circumstances that are unusual in nature or vary from the normal activity. It is a signal that something is out of the ordinary and may need to be investigated further.



Examples of a Red Flag

- A weak internal control environment.
- Refusal to take vacation or sick leave.
- Management decisions are dominated by an individual or small group.
- Excessive number of year end adjustments.
- Photocopied or missing documents.

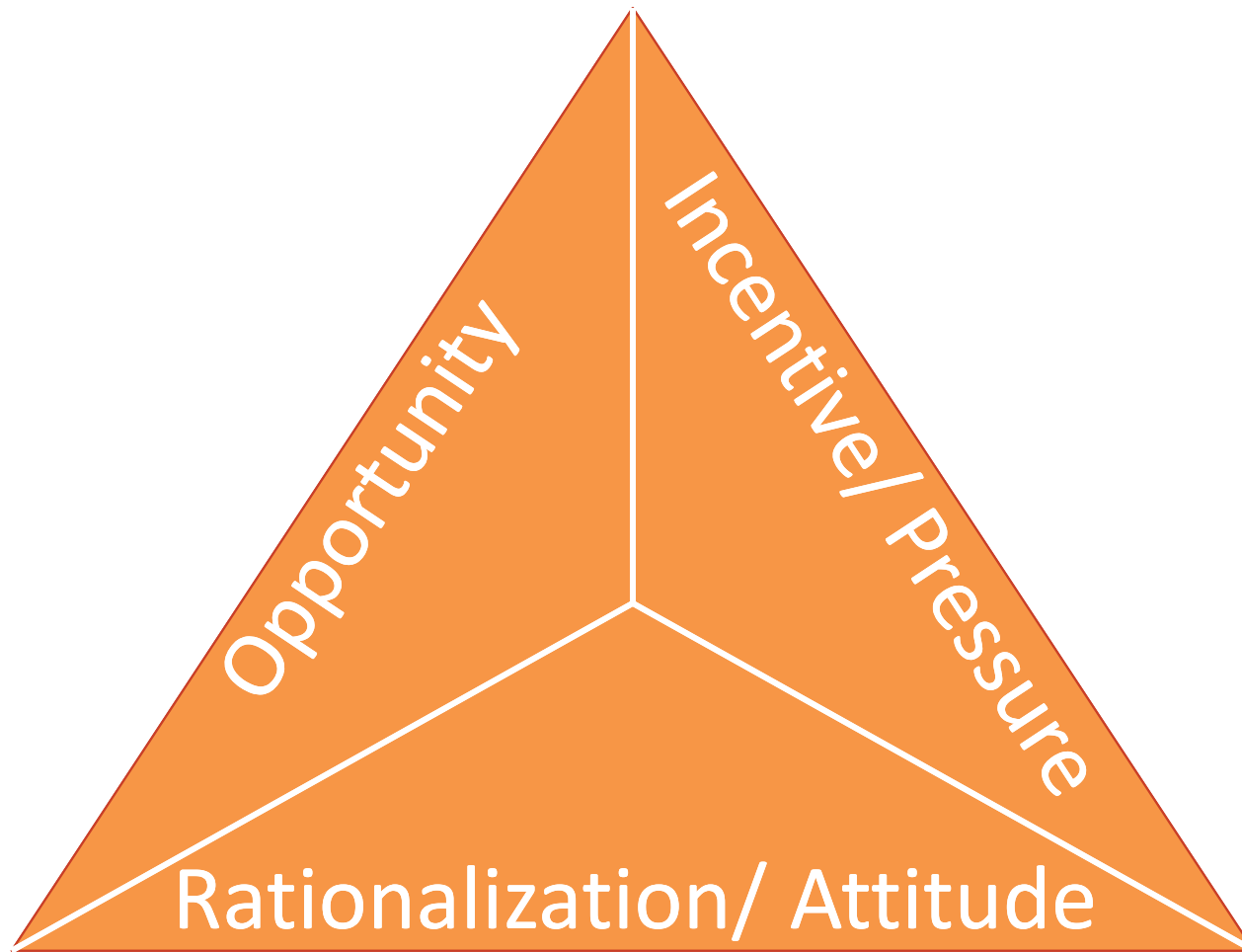


Implications

- Impose large costs on organizations
- Public confidence and reputation of municipality and/or individuals involved



The Fraud Triangle



Incentive/Pressure

- Management or other employees may have an incentive or be under pressure, which provides motivation to commit fraud.



Incentive/Pressure - Risk Factors

- Personal financial obligations
- Requirements or expectations of third parties
- Personal net worth threatened by financial performance



Rationalization/Attitude

- The attitude, character or set of ethical values that allows them to intentionally commit a dishonest act.



Rationalization/Attitude - Risk Factors

- Disregard for internal controls, the need for monitoring or reducing risks
- Behavior indicating dissatisfaction
- Changes in lifestyle



Opportunity

- Circumstances exist that provide an opportunity for fraud:
 - The absence of controls
 - Ineffective controls
 - Management override



Opportunity - Risk Factors

- Lack of or deficiencies relating to:
 - Policies
 - Records
 - Duties
 - Reconciliations
 - Oversight



Internal Control

- A process affected by the governing board, management and other personnel designed to provide reasonable assurance that:
 - Financial reporting is reliable
 - Operations are effective and efficient
 - Laws and regulations are complied with



Limitations of Internal Control

- No matter how well designed, controls can only provide reasonable assurance!
 - Errors
 - Collusion
 - Management override



Cost/Benefit of Controls

- The cost of an entity's internal controls should not exceed the benefits that are expected to be derived.



Prevention vs. Detection

- Preventive controls are designed to keep fraud and abuse from occurring in the first place.
- Detective controls are designed to detect fraud and abuse that may have occurred.



Steps to Prevention and Detection

- Step # 1 – Communication
 - Establish, communicate and reinforce expectations for behavior
- Step # 2 – Checks and Balances
 - Implement and monitor controls
- Step # 3 – Follow Through
 - Ensure there are consequences



Step #1: Communicate Expectations

- Policies:
 - Code of ethics
 - Policies and procedures manuals
 - Job descriptions
- Lead by Example



Code of Ethics

- Establishes standards of conduct to avoid:
 - Appearance of impropriety
 - Use of position for personal gain
 - Private employment in conflict with official duties
- Also addresses:
 - Confidential information
 - Gifts
 - Enforcement



Policies

- Establish:
 - Employee responsibilities
 - Limits to authority
 - Performance standards
 - Control procedures
 - Reporting relationships

Example: Internet and email computer use policy



Leading by Example

- Modeling the ethical behavior set forth in the policies.



Effects of a Poor Tone at the Top

- A nonexistent or ineffective means of establishing, communicating and supporting the local government's accountability for public resources and ethics, especially regarding codes of conduct, conflicts of interest and acceptable business practices **increases the risk of fraud and abuse.**



Step #2: Checks and Balances

- Where is the greatest risk?
 - External and internal sources
 - Opportunity fraud risk factors
 - System monitoring issues



Tempting Assets

- Cash
- Fixed assets that are small in size, marketable or lacking in observable identification of ownership



Controls - Cash and Other Desirable Assets

- Limit physical access
 - Cash
 - Check stock and signature plates
 - Information technology system
- Place ID on high-risk inventory



Controls - Segregation of Duties

- Separate the basic functions:
 - Authorizing transactions
 - Maintaining records
 - Having custody of assets
- Helps prevent errors, fraud and/or abuse from occurring and remaining undetected.



Controls - Monitoring

- Remain alert to the possibility
- Use the IT tools you already have
- Encourage reporting
- Audits



Step #3: Follow Through

- Investigate allegations of fraud or abuse
- Ensure there are consequences
- Maintain transparency



No Consequences

- A substantial internal control deficiency that increases the perception of opportunity
 - No negative ramifications for fraud or abuse



Unique Fraud Risk Factors

- Management override of controls
- Information technology



Management Override

- Management has the unique ability to commit fraud because it is in a position to directly or indirectly manipulate and/or influence records, processes and people.



Information Technology

- Fraud often involves the use of technology
- A thorough understanding and review of IT controls is essential whether IT function is in-house or out-sourced



Common IT Deficiencies

- Lack of access controls
 - Access rights too broad
 - Sign-in passwords not required
 - Rights changed without approval
 - System cannot be monitored
- Monitoring
 - Audit logs
 - Exception reports



Summary

- Costly, intentional acts
- Pressure, opportunity and rationalization
- Prevention and detection
 - Communication by words and actions
 - Checks and balances that are monitored
 - Follow through



Resources

- Division of Local Government & School Accountability
 - www.osc.state.ny.us/localgov/contact.htm
 - 1-866-321-8503 or (518) 408-4934
 - localgov@osc.ny.gov
- Division of Investigations
 - www.osc.state.ny.us/investigations/index.htm
 - 1-888-672-4555
 - investigations@osc.ny.gov
- Local Official Training Unit
 - » LocalTraining@osc.ny.gov



Thank You

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