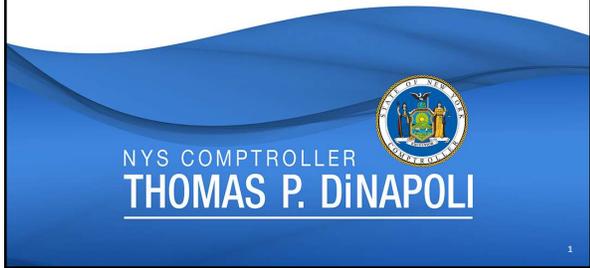


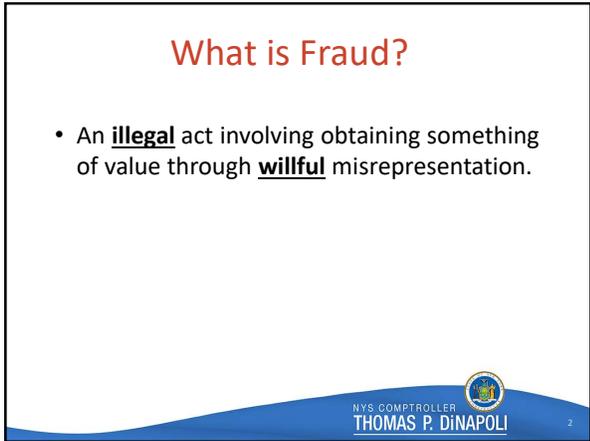
Fraud Prevention and Detection

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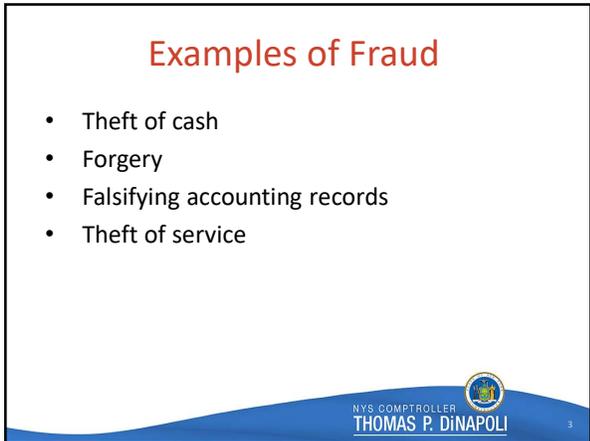
What is Fraud?

- 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?

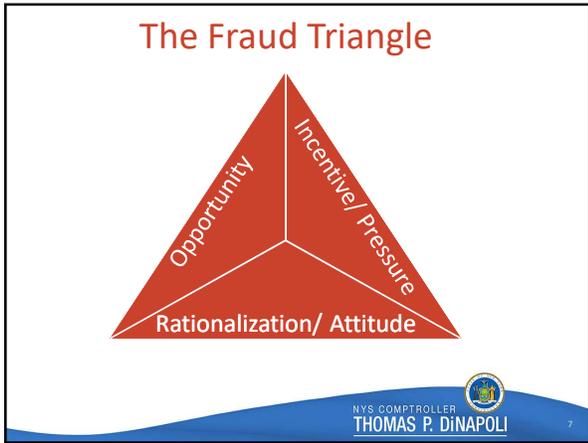
- Behavior that is improper when compared with behavior that a prudent person would consider a reasonable and necessary business practice given the facts and circumstances.

Examples of Abuse

- Incurring excessive expenses
- Misuse of municipal equipment or supplies

Implications

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



Incentive/Pressure

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

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Incentive/Pressure - Risk Factors

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

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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

Questions?



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Thank You



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