

First Friday Fraud Facts

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Welcome to First Friday Fraud Facts (F⁴). This issue will address the effectiveness of internal controls in the fight against fraud, waste, and abuse, as well as several of the common controls that can be useful for organizations in the prevention and detection of fraud.

EFFECTIVENESS OF INTERNAL CONTROLS

All controls are not created equal, meaning that not all controls are as effective as others against fraud. In addition, some controls are very useful against certain types of fraud, but not other types.

In a recent ACFE study (2010 Report to the Nation on Fraud and Abuse), participants indicated what they felt were the most important controls in detecting or limiting fraud. The top three controls cited as “very important” were:

- Internal Audit Departments—over 60% of respondents
- Management Review—over 50% of respondents
- Surprise audits—49% of respondents

CONTROL WEAKNESSES THAT CONTRIBUTE TO FRAUD

Participants in the same recent ACFE study were asked to indicate which of several common issues they considered to be the primary weakness that contributed to the fraud. The top three results were:

- Lack of internal controls—over 37% of cases
- Override of existing internal controls—over 19% of cases
- Lack of management review—almost 18% of cases

Tips and hotlines generally have the highest detection rate of the techniques analyzed in the ACFE study. Considering almost half of the organizations included in the study did not have a hotline in place, it is surprising that a lack of reporting mechanism was the least commonly cited control deficiency.

INTERNAL CONTROLS TO PREVENT AND DETECT FRAUD



Many controls can be utilized in the fight against fraud, waste, and abuse. The following nine controls are generally thought to go a long way in helping to prevent and detect fraud:

Segregation of duties

- Require appropriate authorization for all purchases, payroll, and disbursements
- Separate handling (receipt and deposit) from record keeping functions
- Separate purchasing functions from payables functions
- Ensure that the same person isn't authorized to write and sign checks
- When opening mail, stamp checks "For Deposit Only" and list checks on a log before turning them over to the person responsible for depositing receipts; periodically reconcile incoming check log against deposits
- Require supervisors to approve employees' time sheets before payroll is prepared
- Require paychecks to be distributed by a person other than the one authorizing or recording payroll transactions or preparing payroll checks

Monthly reconciliations

- Require the reconciliation to be completed by an independent person who does not have bookkeeping or check signing responsibilities
- Examine bank statements and cancelled checks to ensure checks are not issued out of sequence and that checks are issued to legitimate vendors for business purposes
- Appropriately document that a review and reconciliation were performed and maintain the information on file for the appropriate time

Restricting/limiting the use of credit cards, and verifying all charges made to cards in order to ensure they are business related

- Limit the number of agency credit cards and users
- Establish a policy that credit cards are for business use only; prohibit use of cards for personal purposes with subsequent reimbursement
- Set account limits
- Inform employees of appropriate use of the cards and purchases that are not allowed
- Require employees to submit itemized, original receipts for all purchases
- Examine credit card statements and corresponding receipts each month to ensure charges are appropriate and for agency business

Ensure adequate oversight of agency operations

- Monitor agency operations on a regular basis, comparing budget to

actual revenues and expenditures; require an explanation for significant variations from budgeted amounts

Ensure all policies and procedures, especially fiscal, are up-to-date and documented in writing. Ensure the following policies are included:

- Cash disbursements; attendance and leave; expense and travel reimbursement; use of agency assets; purchasing guidelines; petty cash; and conflicts of interest

Ensure agency assets such as vehicles, cell phones, equipment, and other resources are used only for official business

- Examine expense reports, credit card charges, and telephone bills periodically to ensure charges are appropriate and for agency business
- Maintain vehicle usage logs, including the name of the employee; periodically review logs to ensure usage is appropriate and for agency business
- Maintain an equipment list and periodically complete an inventory

Adequately protect petty cash funds and other cash funds

- Limit access to petty cash funds. Keep funds in a locked box or drawer and restrict the number of employees who have access to the key
- Require receipts for all petty cash disbursement with the date, amount received, purpose or use for the funds, and name of the employee receiving the funds listed on the receipt
- Reconcile the petty cash fund before replenishing it
- Limit the petty cash replenishment amount to a total that will require replenishment at least monthly

Ensure adequate safeguards are in place to protect checks from misuse

- Prohibit writing checks payable to cash
- Deface and retain voided checks
- Store blank checks in a locked drawer or cabinet, and limit access
- Require that checks are to be signed only when all required information is completed and supporting documentation is attached
- Require two signatures for checks above a specified limit.
- Mark invoices "Paid" with the check number when checks are issued

Protect cash and check collections

- Ensure cash and checks received are promptly recorded and deposited
- Issue receipts for cash, using a pre-numbered receipt book
- Conduct unannounced cash counts
- Reconcile cash receipts daily with appropriate documentation
- Centralize cash receipts whenever possible

