



Safeguarding Against Fraud

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Learning Objectives

At the end of this session, the participant will be able to:

- Recall the definition of internal control
- Define fraud
- Discuss the fraud triangle
- Recall categories of fraud



Fraud Happens.....

U.S. Department of Education
Office of Inspector General
Investigative Reports

- **\$50,000** in school district funds used to build and operate an employee's side business
- **\$16,500** mis-appropriated school district funds used to pay an unapproved retirement stipend
- **\$14,000** of school district funds paid to employee by falsely describing it as compensation for unused vacation days



Who did it?

- Superintendent
- Accountant
- School principal
- Teacher

U.S. Department of Education
Office of Inspector General
Investigative Reports

\$530,000 fraudulently obtained through placing orders with a fictitious company for books and educational materials that were never provided to the schools.



Who did it?

- Superintendent
- Accountant
- School principal
- Teacher

U.S. Department of Education
Office of Inspector General
Investigative Reports

\$75,000 stolen by replacing the names of legitimate vendors with those of fictitious vendors and then **forging the signature** on the checks



Who did it?

- Superintendent
- Accountant
- School principal
- Teacher

Fraud

An Overview

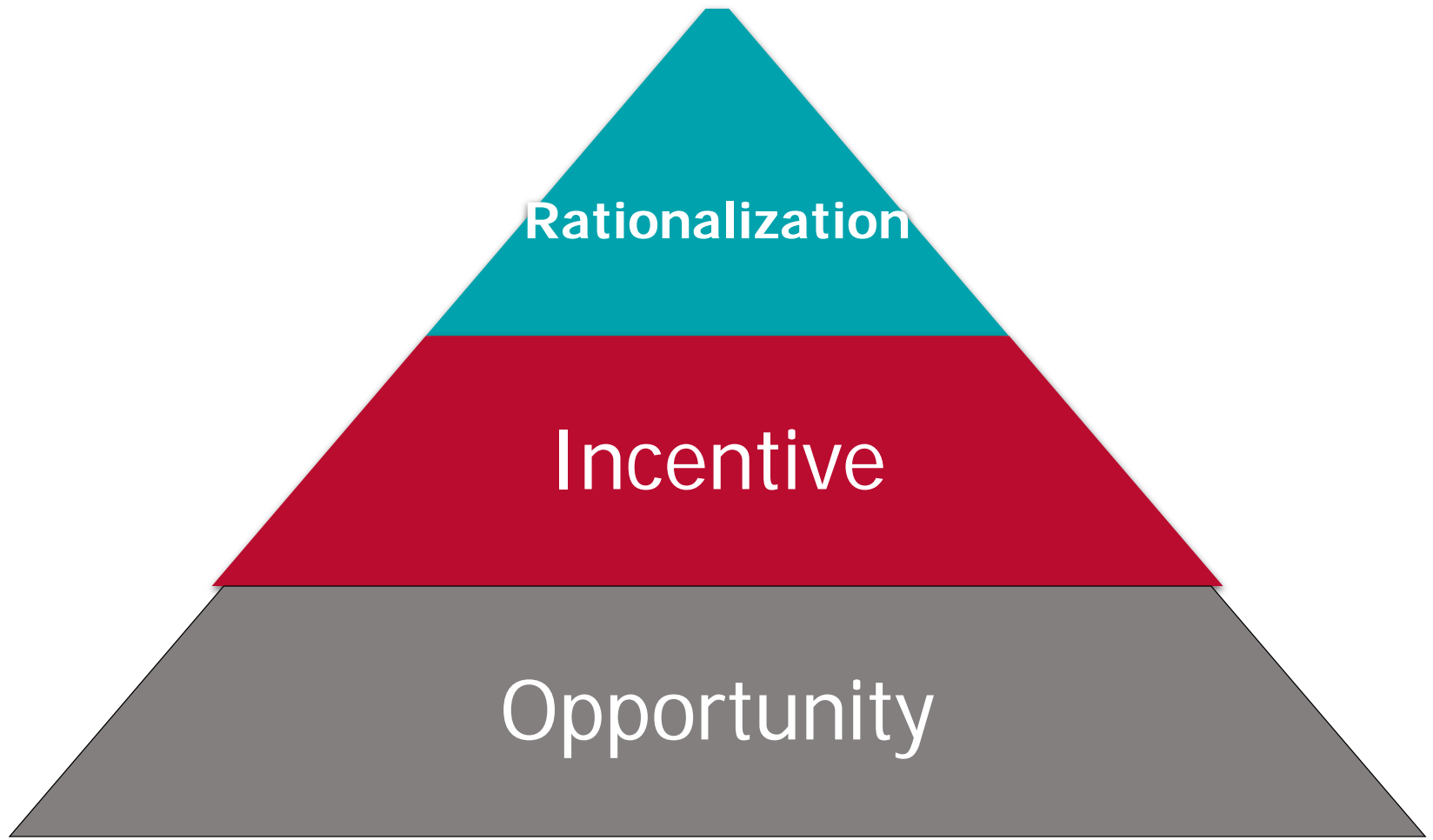


Association of Certified Fraud Examiners (ACFE) Definition

*Fraud is the use of one's occupation for **personal enrichment** through the deliberate misuse or misapplication of the employing organization's resources or assets*



Fraud Triangle



Rationalization

Behaviors are logically justified

Examples include:

- “I get no respect and I will get even.”
- “Joe makes more money than I do and I have more experience.”
- “I only got a 2% raise this year – everybody else got more.”

Incentive

Something that motivates someone to commit fraud

Examples of incentives include:

Financial stress – Unpaid medical bills

Addictions – Gambling, drug, alcohol

Pathologies – Intellectual challenge



Opportunity

Not only permits fraud to occur, but actually promotes it

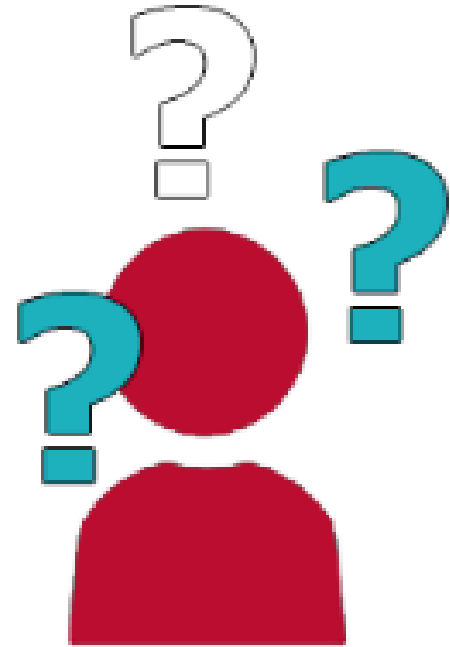
Lack of sound and comprehensive framework of internal controls



Question

Think out about the operations of a school. In which areas do you think opportunities might exist to commit fraud?

- ❖ Cash receipts
- ❖ Cash disbursements
- ❖ Capital assets
- ❖ Payroll
- ❖ Other areas - nonfinancial



Fraud Categories



Three Fraud Categories

- Asset Misappropriation
- Corruption
- Financial Statement Fraud



Asset Misappropriation Examples

- ❖ Theft of cash
- ❖ False billing schemes (e.g., fake invoices)
- ❖ Inflated expense reports



Corruption Examples

- Kickbacks to purchasing agent or elected official
- Bid rigging (government gives preference to one bidder; makes it appear that bidding occurred when it did not)
- Gratuities (favors or gifts provided to government official for particular actions)



Financial Statement Examples

- Increasing revenues with no justification or documentation
- Failing to post expenses
- Postponing transactions to future periods to avoid recognizing losses or going over budget

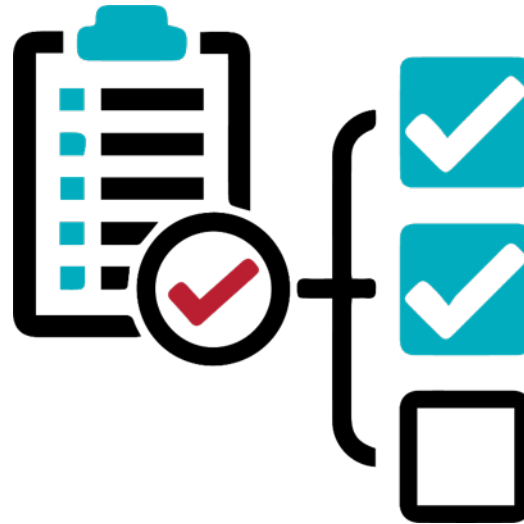


Fraud Prevention and Detection



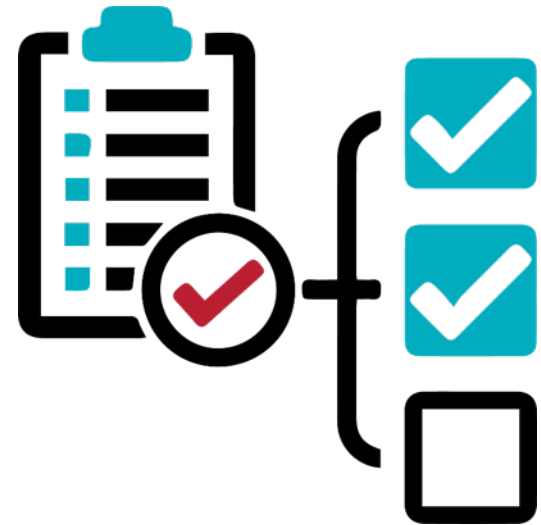
General Fraud Prevention

- ❖ Explain misconceptions about controls and audits
- ❖ Segregation of duties
- ❖ Whistleblower Programs



Misconceptions

- Clean audit opinion does not = no fraud
- Audit determines if financial statements are fairly presented
- Internal controls considered for audit procedures performed
- Internal control may have weakness that goes undetected that might lead to fraud



Segregate the Following Duties

No one person should perform the following duties:

Custody of Assets

Reconciliations

Authorization

Bookkeeping



Segregation Test

Custody

- E. Johnson

Reconciliation

- I. Cheatum

Authorization

- I. Cheatum

Bookkeeping

- Suzy Que



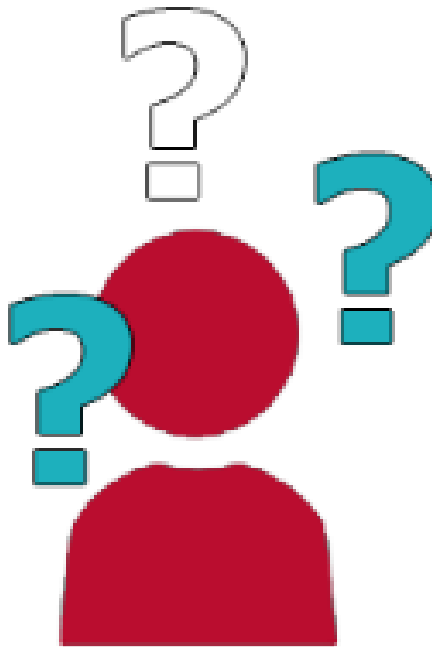
Whistleblower Program

Providing an anonymous method to report suspicious activity

- Fraud hotline

Question

What is the most common method of detecting fraud?



External Red Flags of Fraud

- ❖ Unexplained increases in wealth
- ❖ Employee personal problems
- ❖ Employee living beyond his/her means
- ❖ Unusually close relationships with vendors





Internal Controls Defined



Internal Control Definition

Internal control is “a process, effected by an entity’s oversight body, management and other personnel, designed to provide reasonable assurance that the objectives of an entity will be achieved in the following categories:

Effectiveness and efficiency of operations

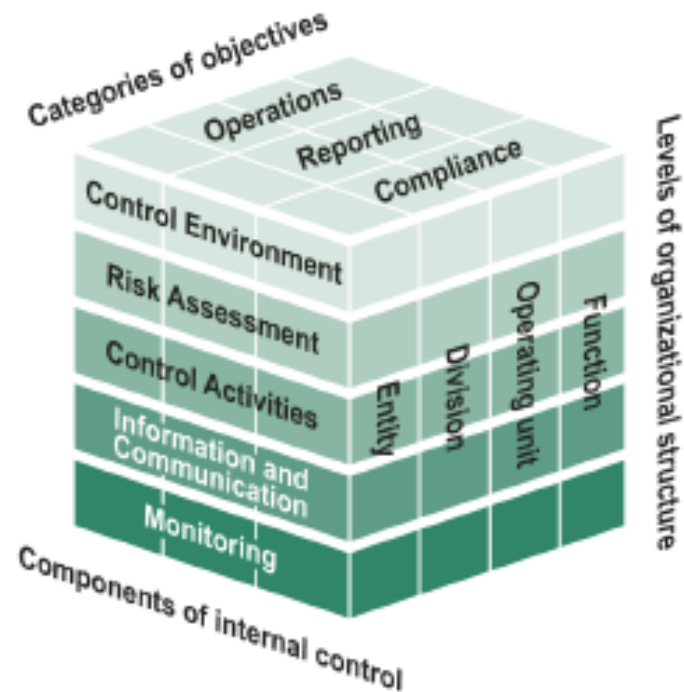
Reliability of financial reporting

Compliance with applicable laws and regulations.”



Internal Control

Figure 4: The Components, Objectives, and Organizational Structure of Internal Control



Sources: COSO and GAO. | GAO-14-704G

Signs of Fraud – General



Signs of Fraud and Controls – Payroll



Payroll Red Flags

- ❖ Employee with Little or No Payroll Deductions
- ❖ Excessive Overtime Expenses
- ❖ Excessive Payroll Expenses When Compared to Budget



Ghost Employee Example

- ❖ Employee A retires but remains in payroll system
- ❖ Payroll clerk changes Employee A's direct deposit number to his own bank account number
- ❖ Employee A's payroll is processed each week, the direct deposit goes to payroll clerk's personal bank account



Inflating Pay Rate and Hours Worked

- ❖ Department head inflates his friend's hours worked and signs off on the departmental hours worked
- ❖ Payroll clerk inflates her pay rate in the master pay rate file



Payroll Controls

- ❖ Compare salaries to budget
- ❖ Compare salaries to prior year
- ❖ Immediately remove terminated employees from payroll system
- ❖ Review number of employees regularly paid
- ❖ Compare pay rates in computer to approved rates in personnel file
- ❖ Review recurring gross salary and hourly payments for reasonableness



Signs of Fraud and Controls – Capital Assets



Capital Asset Red Flags

- ❖ All Contractors Submit Consistently High Bids
- ❖ Qualified Contractors Not Submitting Bids
- ❖ Reports of Missing Capital Assets
- ❖ A Lack of Accountability for Capital Assets



Capital Asset Controls

- ❖ Create a bid policy
- ❖ Require sealed bids for all amounts over your government's threshold
- ❖ Open sealed bids in a public meeting
- ❖ Request bids from multiple companies
- ❖ For major construction projects, hire a construction monitor



Know Your Risks and Take Action!

Internal control is a **process** in which the oversight body, management and employees participate

Purpose is to make it more likely to achieve your **objectives**

Objectives related to reporting, compliance, and operations

First Step	Establish objectives
Second Step	Create a strong control environment
Third Step	Assess risk to achieving objectives
Fourth Step	Determine response to risk (accept, avoid, reduce)
Fifth Step	Create or refine control activities
Sixth Step	Communicate information
Seventh Step	Monitor

Closing Thoughts



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