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**GEORGIA**

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# Safeguarding Against Fraud

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PROMOTING EXCELLENCE IN GOVERNMENT

# Learning Objectives

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

- Recall definition of internal control
- Define fraud
- Discuss the fraud triangle
- Recall categories of fraud
- Identify fraud prevention and detection for common transactions



# SCHOOL FRAUD



# Alleged Theft by School Principal

- Purchasing card used in an inappropriate manner
- Took money from a school cash fund
  - Cash from student parking passes, the sale of replacement student planners, and parent cash donations—all kept in a “zippered pouch near” the principal’s office



# Alleged Theft by School Principal

Prosecutors assert the money was used for:

- \$7,932 for Cutco knife sets
- \$539 Bod-e BURN drinks
- \$252 for iTunes gift cards
- \$1,149 for iPad and iTunes gift cards
- \$357 for softball equipment
- \$363 for tools



# Question

How do you think this principal was able to commit fraud?



# What Can You Do?

Establish a Strong System  
of Internal Control



# Internal Control Definition

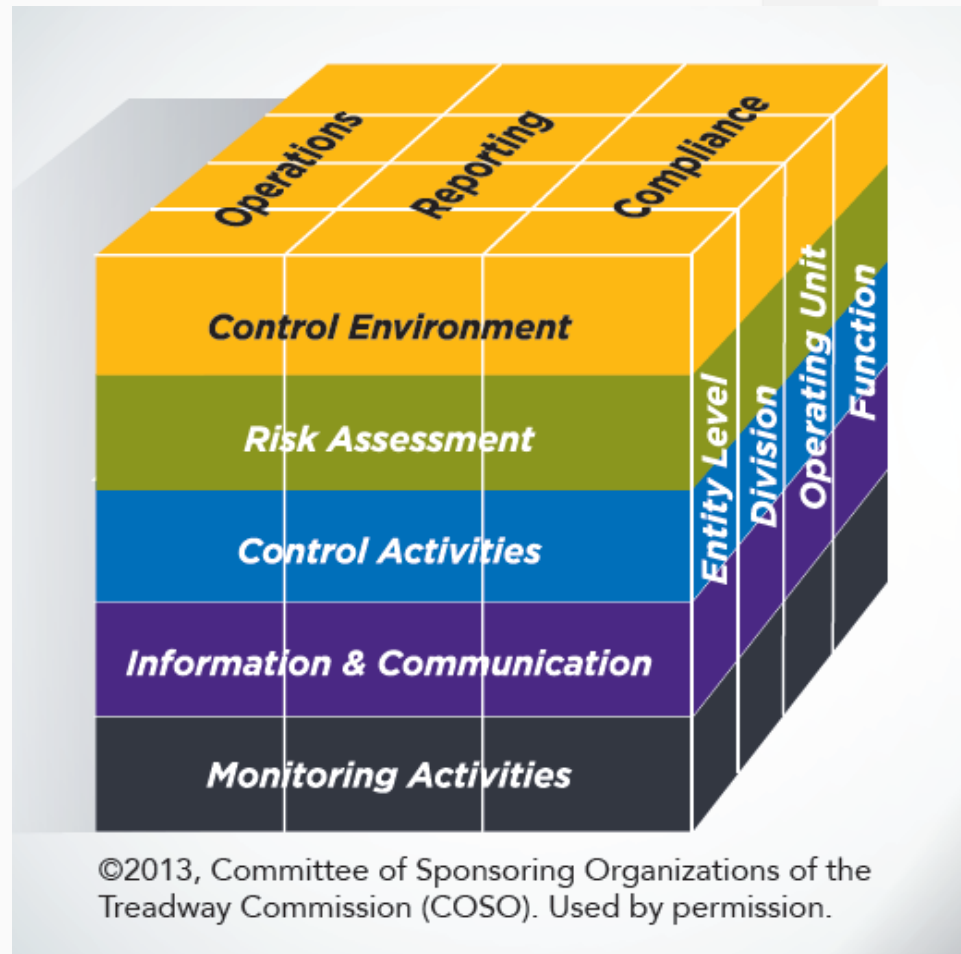
Internal control is “a **process**, effected by an entity’s board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations.”





# Internal Control



# Control Environment

- Integrity and ethical values
- Parameters for governing body's oversight
- Assignment of authority and responsibility
- Process for attracting, developing and retaining competent individuals



# Risk Assessment

- Possibility an event will occur and adversely affect the achievement of objectives
- Cannot eliminate risk completely
- Estimating the likelihood and frequency of occurrence



# Control Activities

- Methods used to reduce risk
- Control activities are:
  - Tools – both manual and automated
  - Policies and procedures
  - Preventive or detective



# Information and Communication

- Enables the organization to share relevant and quality information
- Facilitates the sharing of information up, down and across the entity



# Monitoring

- Ongoing assessments of whether controls are in place and working as designed



# Breakdown in Internal Control

Increases Opportunity for Fraud



# Fraud

## An Overview

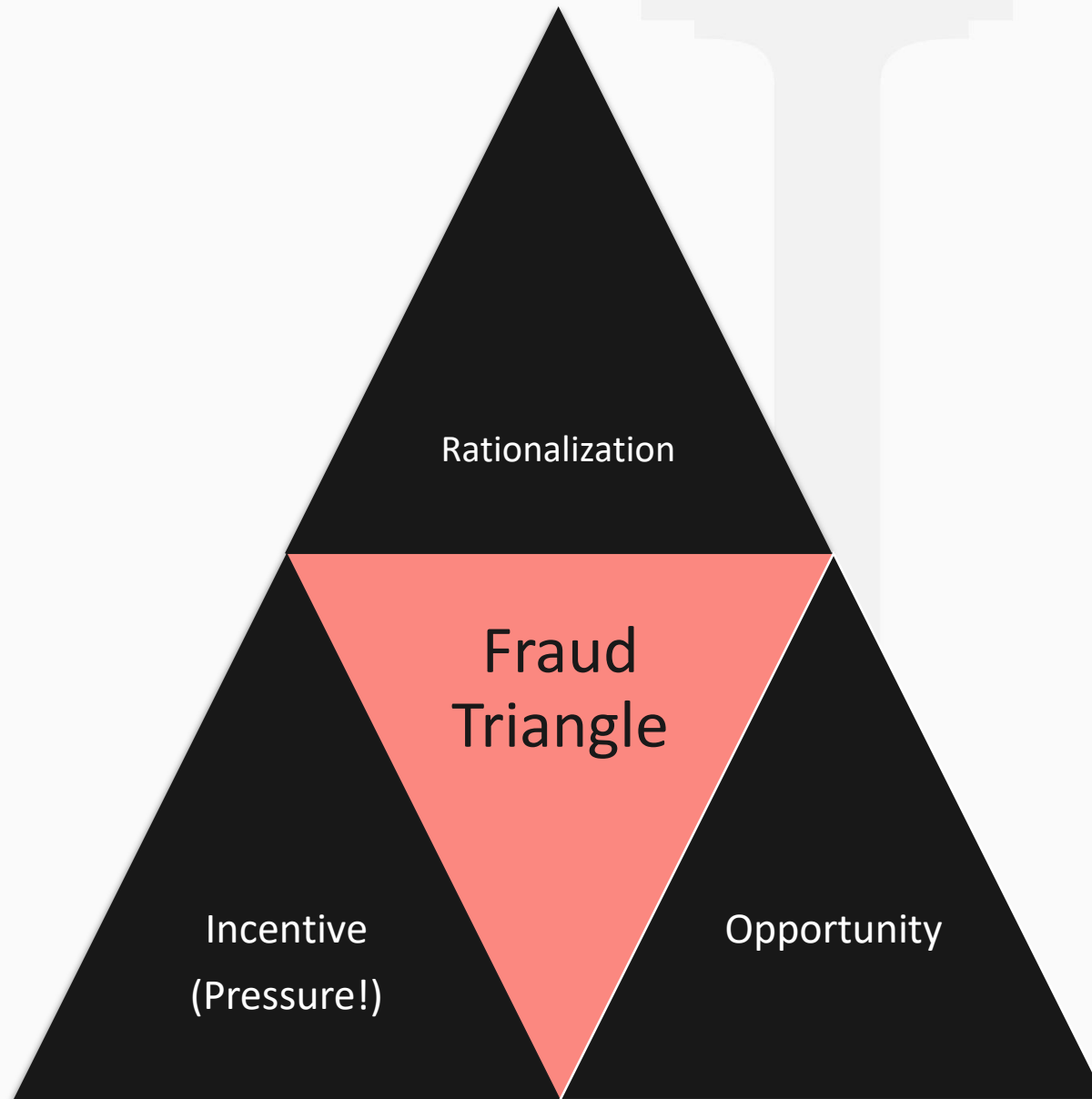




# Association of Certified Fraud Examiners (ACFE) Definition

*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.*





# 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



# 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)





# Abuse Examples

- Employee calling in sick when they are well
- Employees driving public vehicles for personal purposes
- Employees making excessive personal phone calls during work
- Employees using government-owned equipment at home



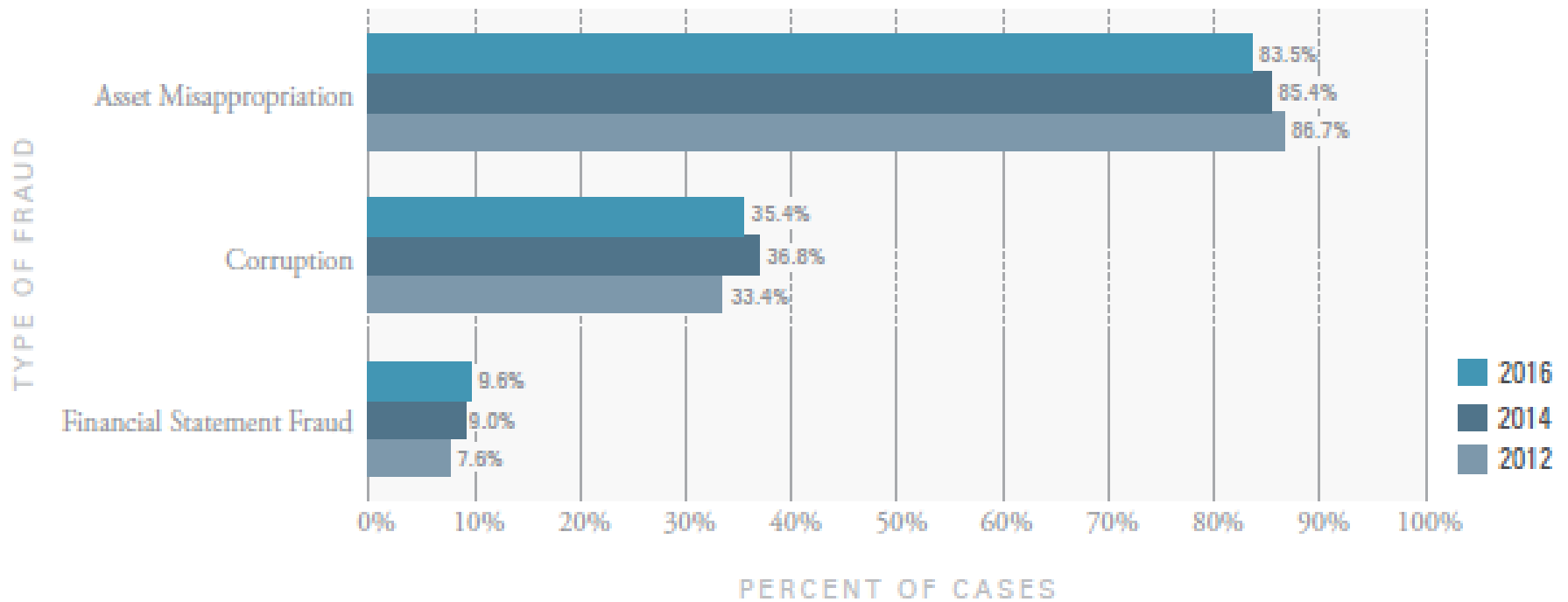
# Question

Which category of fraud do you think is the largest?



# 2016 ACFE Fraud Survey

Figure 4: Occupational Frauds by Category—Frequency



# Average Life of Fraud Before Detection:

18 Months



# General Fraud Prevention

- Misconceptions about Controls and Audits
- Segregation of Duties
- A Simple Segregation of Duties Test
- Whistleblower Programs



# Misconceptions

- Clean audit opinion does not mean no fraud
- Audit determine 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



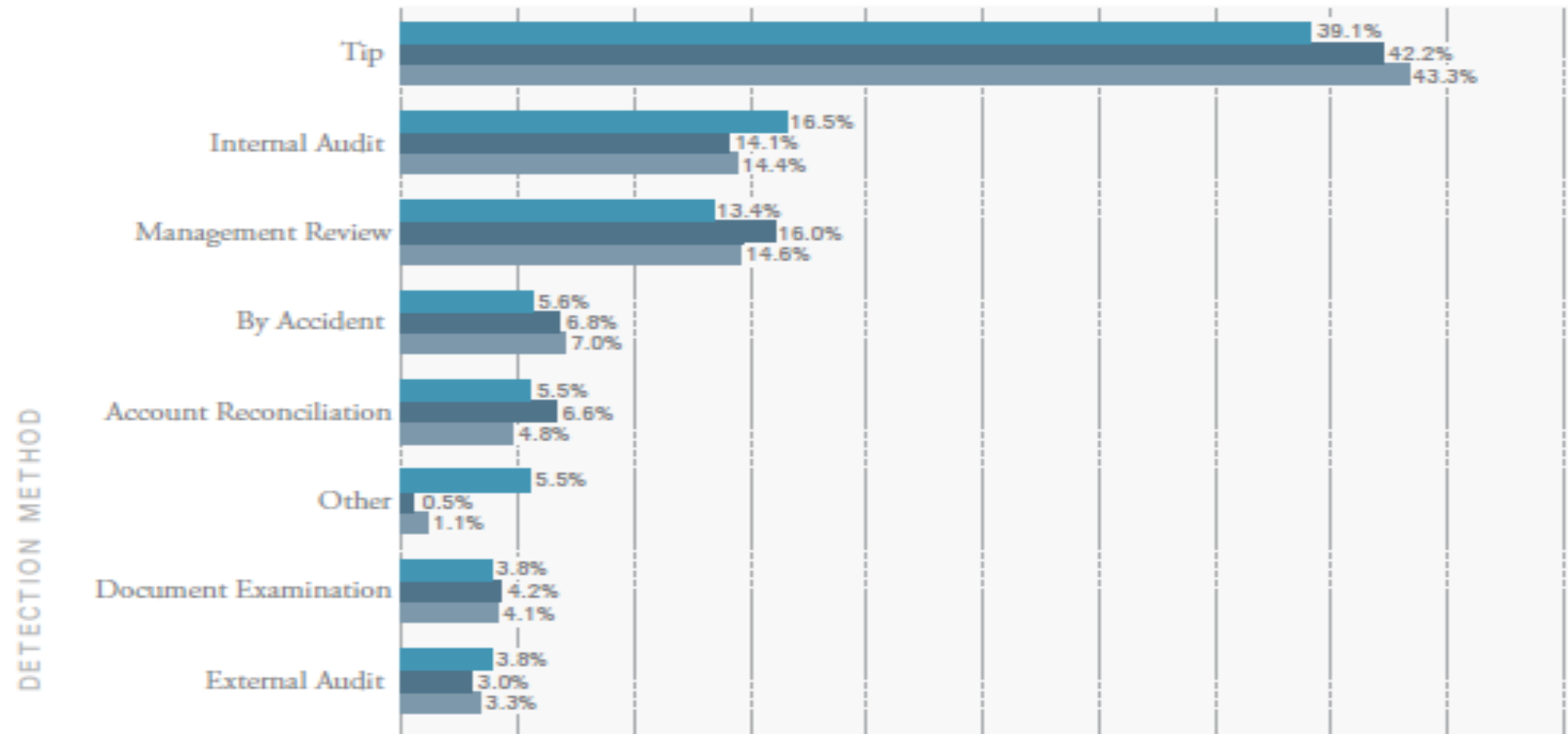


# Question

What is the most common method of detecting fraud?



Figure 21: Initial Detection of Occupational Frauds



# Signs of Fraud – General



# External Red Flags of Fraud

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



# 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 – Disbursements



# Disbursements and Purchasing Red Flags

- Altered or Incomplete Supporting Documentation for Disbursements
- Purchasing Party (e.g., Department Head) Picking Up Processed Checks
- Unexplained Increases in Expenses
- Excessive Expenses When Compared to Budget



# Bribery Example

- Vendor gives \$4,000 to a school purchasing clerk (as a bribe)
- The purchasing clerk awards the contract to vendor
- Vendor inflates invoices by \$10,000 and provides an inferior product to the school



# Fictitious Vendor Example

- Accounts payable clerk adds a fictitious vendor to the vendor list
- The accounts payable clerk enters her own address (or a P.O. box) as that of vendor
- The accounts payable clerk creates a fictitious invoice and then enters the invoice into the accounts payable module
- Check is processed and mailed to AP clerk



# Fictitious Vendor Example

- Accounts payable clerk sets up a bank account in the name of fictitious vendor
- She is the sole authorized check signer
- She deposits the check from the school
- She writes checks from the fictitious vendor bank account to herself



# Wire Transfer Controls

- Require two persons to complete external wire transfers
- If wire is by phone or fax, require bank to call back before transfer is made
- Limit personnel with wire capability and do not share passwords



# Wire Transfer Controls

- Require second person approval of the journal entry used to record the wire transfer
- Use all bank-provided wire transfer controls (if not, school may be liable)





# 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



# Signs of Fraud and Controls – Cash Receipts



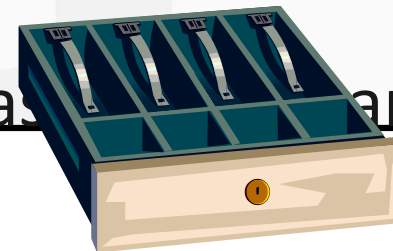
# Cash Receipts Overview

- Always use a pre-numbered receipt when possible
- Keep cash in a secure location accessible by limited staff
- Make deposits daily or at least weekly depending on amount on hand



# Cash Drawer Safety

- No two people should work from one cash drawer
- Create receipts immediately
- Restrictively endorse (For Deposit Only) checks
- Personal checks (including employee checks) should not be cashed from cash drawers
- Balance cash and checks with receipts or report of transactions (such as lunches sold)
  - Supervisor should review cash and supporting documentation



# Closing Comments



# Closing Comments

- Fraud comes in many forms; today we have covered some examples of frauds and related controls
- If you encounter fraud, report using your school protocol
- Be aware of your role in preventing and detecting fraud





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