Creating An Environment Hostile To Fraud

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Murfreesboro, TN
April 15, 2015
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The Committee of Sponsoring Organizations of the Treadway Commission

The Tone At The Top
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- Management sets the “Tone” of an organization
- It does not matter what management says
- What matters is what management does
- Employees will always follow management’s example
39 Years In the Making

MY BMT

Big

Monkey

Theory
Monkey See

Monkey Do
Be A Leader

But remember, in order to be a true leader, you have to convince people to follow you
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THINGS TO DO

◆ SET THE “TONE AT THE TOP”
◆ LEAD BY EXAMPLE
◆ WALKING, TALKING, LOOKING AND LISTENING
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WALKING

- Get up out of your seat and go visit your employees ..... be seen!
  - Manage by walking around

- Visit the employees in remote locations for which you are responsible

- Show-up unexpectedly
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Talking

- You initiate the conversation …. don’t wait for them to start
- Talk to your employees, officials and citizens
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Talking

◆ Be a little personable … not all business
◆ Be someone that others enjoy (or at least don’t mind) talking to
◆ Use “Information-Seeking Predicates” instead of questions
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Talking

- Don’t “beg for a no” answer when trying to obtain information from an individual

- Do you *understand* the answer
  - *Does it Make Sense*

- “Sounds good to me”
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LOOKING

◆ Do you see what you see?
  – Gaining an understanding
◆ Do you know what you are looking for? (No, but I’ll know it when I see it!)
◆ Looks Good To Me!
There is a $100 bill laying on the floor. Do you see it?
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IMPORTANT OBSERVATION

FRAUD AND STUPID
OFTEN LOOK
EXACTLY THE SAME
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LOOKING
Observe your employees
◆ Be aware of their:
  − Lifestyles
  − Dress
  − Home life
  − Family
  − Personality
ACFE’s 2014
*Report to the Nations on Occupational Fraud & Abuse*

Almost 77% of the time, one of two indicators are present when an employee steals:

1. Living beyond their means (43.8%)
2. Financial difficulties (33.0%)
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Acknowledge Success
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PROFESSIONAL SKEPTICISM

An attitude that includes a questioning mind and a critical assessment of evidence
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Given the right set of circumstances, the vast majority of individuals will commit fraud
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The general population is made up of three types of individuals:

1. **Absolute thieves**
2. **Absolutely honest people**
3. **Basically honest people**

Which ones do we have to look out for?
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Are you a basically honest person? Who Steals?

Basically Honest People

Would You Steal?
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Three things must be present in order for a “basically honest” person to commit fraud:
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OPPORTUNITY
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NEED
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RATIONALIZATION
The Fraud Triangle

PRESSURE
(UNSHARABLE NEED)

(PERCEIVED) OPPORTUNITY

RATIONALIZATION
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Of these three things, management can control only one:

OPPORTUNITY
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A Proper Segregation of Duties

- No one individual should have complete control of a transaction from beginning to end
REMEMBER
Employees Will Circumvent Internal Controls
Not In Order To Steal But …
To Make Their Job Easier
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Opportunities in:

- Cash (95/85)
- Accounts Receivable
- Purchasing
- Accounts Payable
- Inventory
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- As a municipal clerk or recorder, you are statutorily responsible for the safekeeping and accounting for the public assets entrusted to you.

  - You are responsible for complying with the policies and procedures the local governing body has adopted
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When the governing body has either:

- Failed to adopt adequate P&F
- Adopted inadequate P&F
- Adopted P&F but fails to see that they are compiled with
When Leadership Fails

BAD THINGS CAN HAPPEN AND OFTEN DO
When Leadership Fails

SUCH AS

- Inefficient operation of the government
- Failure to adequately maintain the government’s infrastructure
- Misappropriation of the government’s assets
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The best laid plan (P&P) is worthless unless it is put into operation and monitored.

From time to time look at the records to make sure that:

- Adequate collection records are being created and retained;
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- Adequate supporting documentation for disbursements is being obtained and retained.

If there is a documentation problem, it should not be discovered when the board reads their annual audit report.

- The poorest response to such a finding is we were not aware of this.
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- It’s your job to be aware of it because you are the leader
- You should be familiar with the functioning of the office staff
- You should bring issues to the attention of the auditor, not the other way around
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- Documentation deficiencies identified during the periodic reviews should not be tolerated
  - Such deficiencies may very well provide an opportunity

- There should not be any excuses for inadequate records
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- If discrepancies are blamed on computer software glitches, have the software vendor come out immediately and determine if the problems are with the software.
- If reports are not printed because of printer problems, investigate the problem, and if necessary replace the printer.
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- If discrepancies are blamed on a bank error, contact the banker and get the issue straightened our immediately
- Noncompliance with municipal P&P should not be tolerated
  ✓ One warning, and then they are gone
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- Do not allow an employee to entrench themselves with certain tasks
  - Resistance to giving up a task should be viewed with suspicion
  - So should resistance to change in procedures; especially in strengthening internal controls
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- Be suspicious of procedures that serve no purpose other than, *we’ve always done it this way*

The above suggestions may appear to be a lot of extra work; but which is worse, the extra work or the embarrassment of a fraud occurring on your watch?
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Now let’s talk about situations that create opportunities for bad things to happen
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- Always No. 1 on the list of OPPORTUNITIES – Lack of the proper segregation of duties;
- Cash receipts not deposited on a timely basis;
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- Failure to observe bid requirements
- Failure to maintain capital asset records
  - If you don’t know what you have, you also don’t know what you’re missing
- Failure to either itemize or make deposits intact
- Using cash to make small purchases
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- No approval of billing adjustments or such approval made by the billing clerk
- Failure to stamp *Date Paid* on billing stubs
- Failure to reconcile the bank account or failure to reconcile on a *timely* basis
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- Failure to reconcile A/R subsidiary records to the GL
- The water utility has a water loss rate in excess of 20%
- Allowing the individual who opens the mail to make the bank deposits
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- Cashing personal checks through either the petty cash fund or daily receipts
- Allowing more than one employee access to the same cash drawer
- Allowing the individual who collects receipts to also post those receipts
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- Failure to run a background check on employees, especially those responsible for handling cash
- Failure of the members of the board to comply with the district’s P&P
- Failure by the designated individual to properly review invoices prior to payment
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- Presigning checks
- Failure to review credit card/gas card charges/payments
- Failure to have an adequate travel reimbursement policy
- Allowing personal use of government’s assets
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- Failure to bill members of the board or board employees for services provided by the government (monthly water bill or tap fee)
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The Concept of Materiality

The SEC, the US Supreme Court and the ASB all agreed:

- Something that would change the judgment of a reasonable person
When Leadership Fails

The Concept of Materiality

The Dycus definition of Materiality:

Materiality is Determined by Public Perception
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Question?

Will Your Government Be Next?
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And I will personally guarantee you one thing.

If *opportunity* is available, fraud will occur!

Maybe not today;
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Maybe not tomorrow;
Maybe not next month or year;
But it will occur
It’s just a matter of time
I guarantee it!
HAVE A GREAT DAY