

Fraud Prevention and Detection

William D. Naylor, CIA, CFE

Division of Local Government and School Accountability



NYS COMPTROLLER

THOMAS P. DiNAPOLI

A professional portrait of Dave Lucas, a middle-aged man with thinning hair, wearing round glasses, a dark blue suit jacket, a light blue striped shirt, and a red and white patterned tie. He is smiling slightly and standing outdoors in front of a stone building. The background is softly blurred, showing architectural details and greenery.

Dave Lucas

Director, Finance &
Intergovernmental Affairs
NYSAC

THANK YOU TO OUR SPONSOR

PERMA

Leah Demo, Sales Executive

9 Cornell Road, Latham, NY 12110

518-220-0342

ldemo@perma.org

www.perma.org



P E R M ASM

The Public Employer Risk Management Association (PERMA) is the largest and most successful self-insurance pool for public entities in New York State. We have been providing workers' compensation benefits for over 35 years to more than 550 municipalities who have chosen PERMA to manage their claims and ensure workplace health and safety.



NYSAC

ASSOCIATE PARTNER™

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

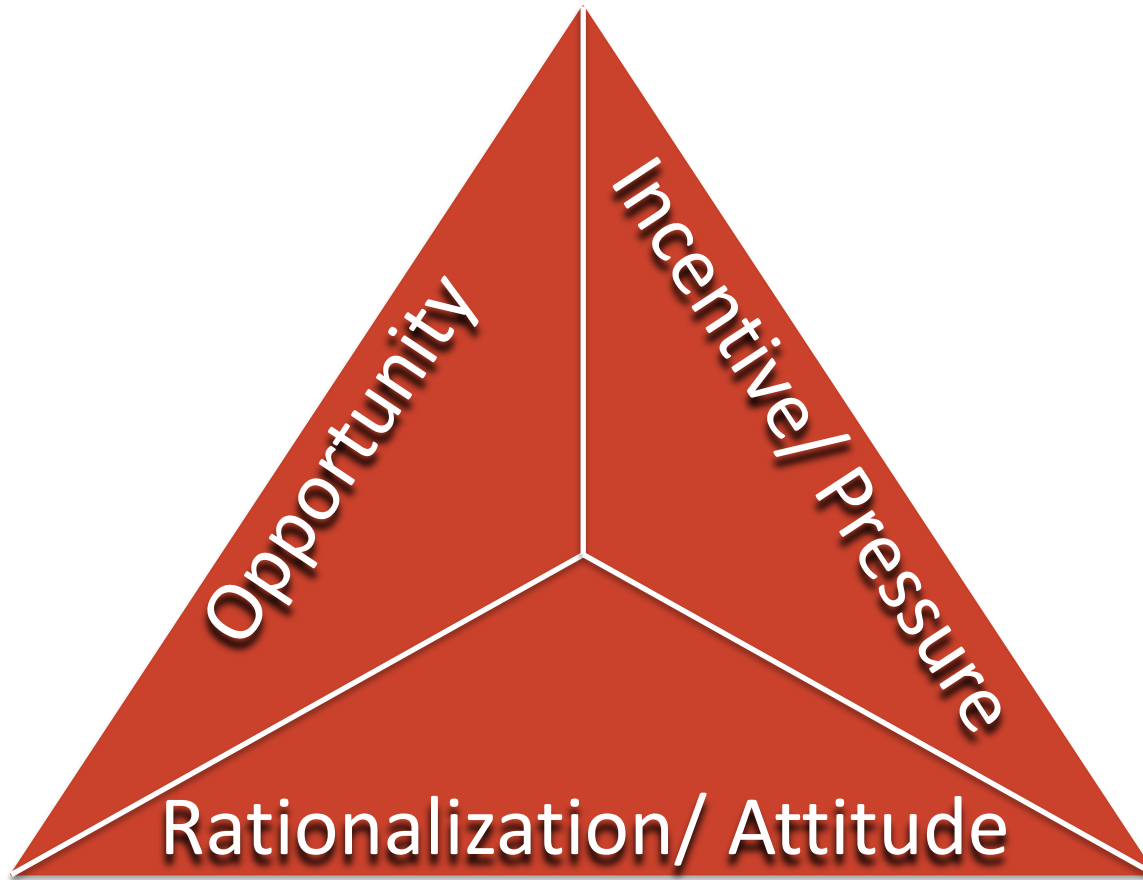


Implications

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



The Fraud Triangle



Incentive/Pressure

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



Incentive/Pressure - Risk Factors

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



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 outsourced.



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



Thank You

Division of Local Government and School Accountability

localtraining@osc.ny.gov



NYS COMPTROLLER

THOMAS P. DiNAPOLI

THANK YOU TO OUR SPONSOR

PERMA

Leah Demo, Sales Executive

9 Cornell Road, Latham, NY 12110

518-220-0342

ldemo@perma.org

www.perma.org



P E R M ASM

The Public Employer Risk Management Association (PERMA) is the largest and most successful self-insurance pool for public entities in New York State. We have been providing workers' compensation benefits for over 35 years to more than 550 municipalities who have chosen PERMA to manage their claims and ensure workplace health and safety.



NYSAC

ASSOCIATE PARTNER™