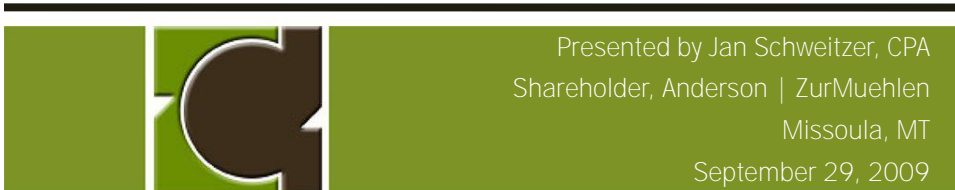


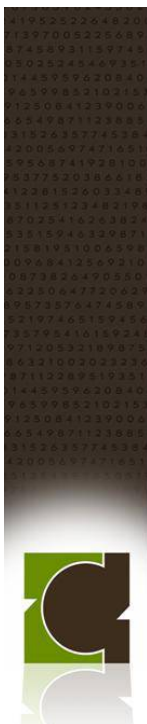
When Opportunity Knocks, **Don't Answer!**

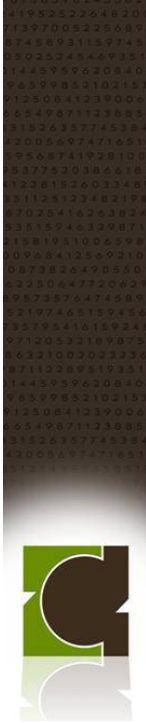
Keys to Implementing Effective Internal Controls



Session Objectives

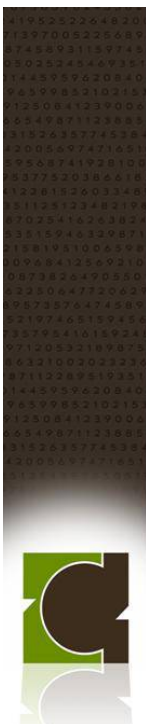
- Understand why internal controls should be an area of focus
- Fraud/errors
- Discuss the general types of fraud
- Discover how fraud occurs
- Explore how to control opportunity





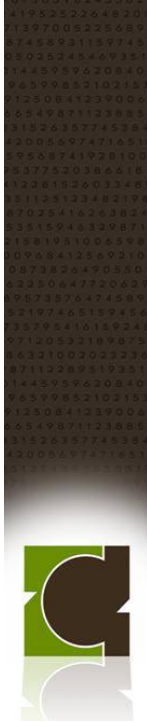
Why should this be an area of focus?

- Recent survey by conducted by the Association of Certified Fraud Examiners indicates that intense financial pressures due to economic crisis have led to an increase of fraud



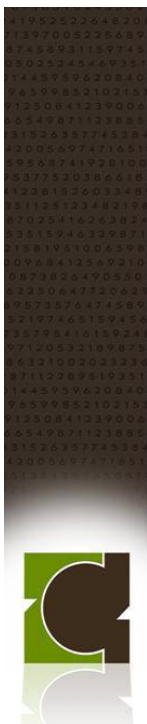
Why should this be an area of focus?

- Survey indicates that employees pose the greatest fraud threat
- Layoffs are creating issues with internal controls
- Instances of fraud are expected to increase, specifically embezzlement



Why should this be an area of focus?

- Survey indicates that small businesses (fewer than 100 employees) suffered median losses of \$200,000



Occupational fraud defined

“The use of one’s occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization’s resources or assets.”

(Source: ACFE Report to the Nation on Occupational Fraud & Abuse)



Quotable Quote

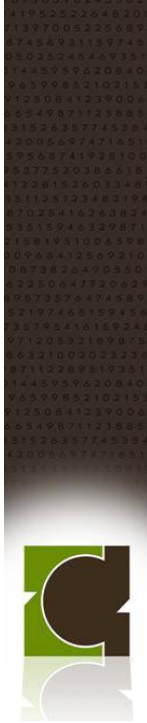
“Rather fail with honor than succeed by fraud.”

-Sophocles



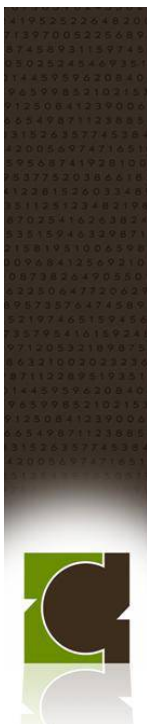
General types of fraud

- Asset misappropriation
- Corruption
- Financial statement fraud



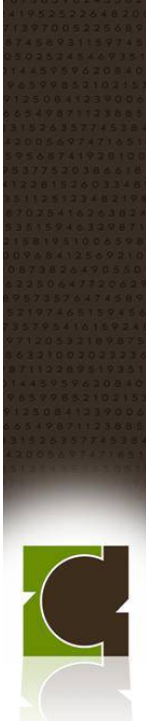
Specific Schemes – Cash Receipts and Cash on Hand, Non-Cash

- Skimming – Cash stolen before it has been recorded
- Larceny – Cash stolen after it has been recorded
- Cash on Hand – Diversion of cash kept **on hand at the organization’s premises**
- Non-Cash – Asset stolen or used improperly



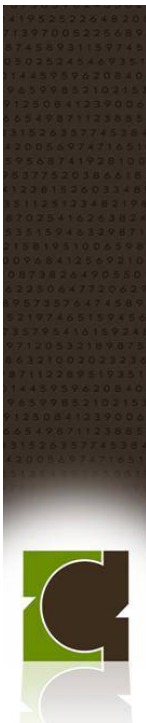
Specific Schemes – Fraudulent Disbursements

- Billing – Payment issued for fictitious goods or services, inflated invoices or invoices for personal purchases
- Expense Reimbursements – Payment issued for fictitious or inflated business expenses



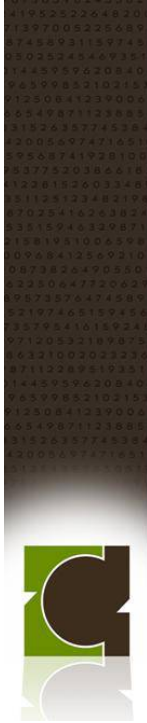
Specific Schemes – Fraudulent Disbursements

- Check Tampering – Forgery, alteration or stolen check
- Payroll – Payment issued for false claims for compensation



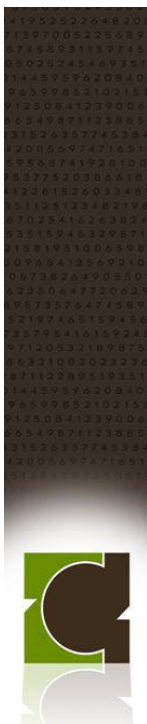
Specific Schemes – Fraudulent Disbursements

- Wire Transfers – Diversion of funds out of **organization's bank accounts**
- Register disbursements – False entries on a cash register to cover up removal of cash



Specific Schemes – Financial Statement Manipulation

- Concealed liabilities – Improper recording of liabilities and/or expenses
- Fictitious revenues – Recording revenue that never occurred or inflating the revenue



Specific Schemes – Financial Statement Manipulation

- Improper Asset Valuations
- Improper Disclosures – Failure to disclose information in an attempt to mislead users
- Timing Differences – Recording revenues in a different accounting period than the related expenses



Specific Schemes – Corruption

- Conflicts of interest – Undisclosed economic or personal interest in a transaction that adversely affects the organization
- Bribery – Offers, gives, receives, or solicits something of value for the purpose of influencing a decision
- Extortion – Coercion of another



Who commits fraud?

- The person committing fraud is usually the person that an organization would least suspect
- **Think of employee as “family” and trust that person with their professional and personal matters**



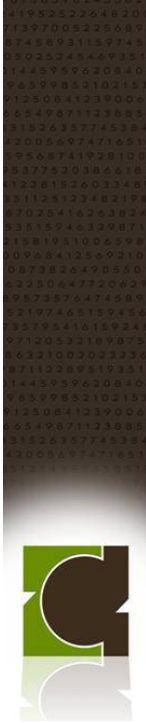
True Story -- Facts

- Controller had Administrator rights to computer system
- Processed payroll and controlled direct deposit process
- Authority to sign checks
- Authority to initiate and complete EFT transactions
- Access to credit cards
- Reconciled bank accounts



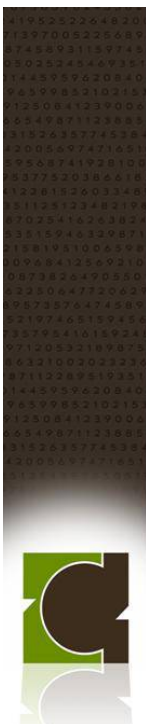
True Story -- Outcome

- Embezzled \$60,000 over 3 years
- Inflated amount of direct deposits
- Added overtime, holiday pay and vacation pay to her paychecks on a weekly basis
- Wrote payroll checks to herself in addition to receiving direct deposit



True Story -- Outcome

- Diverted EFT transactions for personal use
- Charged personal expenses to the company credit card
- Bought personal items and got reimbursed for them
- Made journal entries to balance cash
- Changed vendor name and amounts of checks



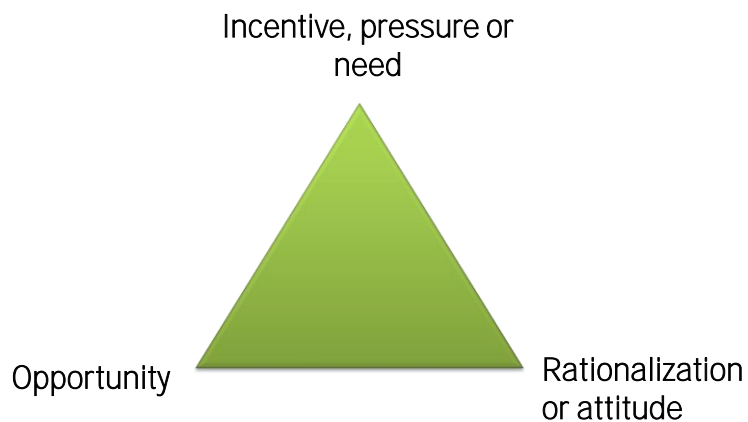
How did THAT happen?

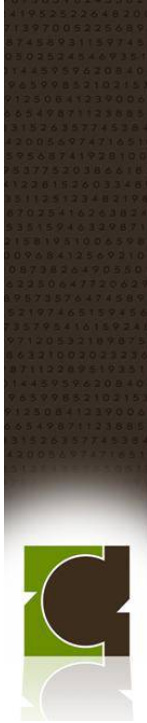
- Employee implicitly trusted
- Had committed fraud in the past - no reference or background checks
- No system of internal controls

Another True Story

- Local bank – woman stole \$800,000 over 10 years
- Her position allowed her to conceal stolen cash and adjust **the bank's accounting records**
- Shopping, paying personal bills, traveling

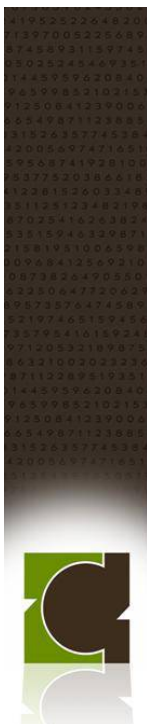
How does fraud occur?





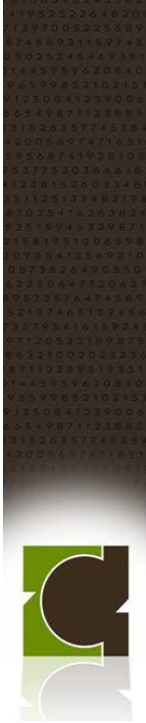
Incentive, Pressure or Need

- Personal financial distress
- Medical emergency
- Addiction
- Greed
- Pressure from management or others



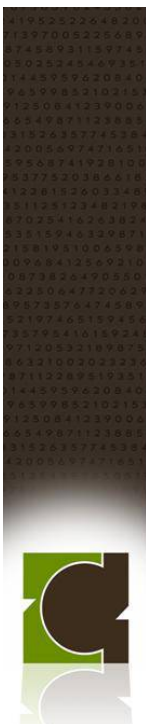
Rationalization or Attitude

- Lack of appreciation
- Anger (retaliation)
- Jealousy
- Challenge
- “I’ll pay it back”



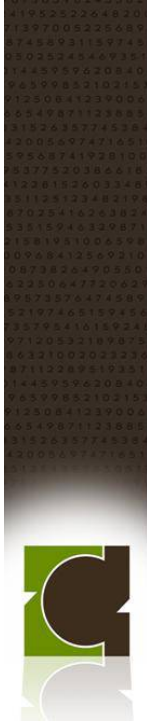
Opportunity

- Access to information/system without being detected
- Management override of existing controls
- No internal control structure



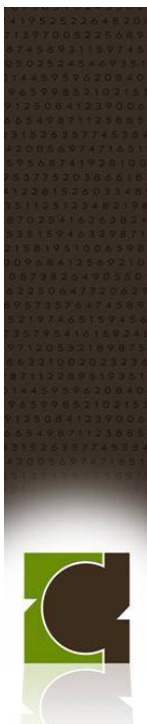
Controlling Opportunity

- Designing and implementing a control environment that prevents, detects and deters
- Independent audit committee
- Conduct detailed fraud risk assessments



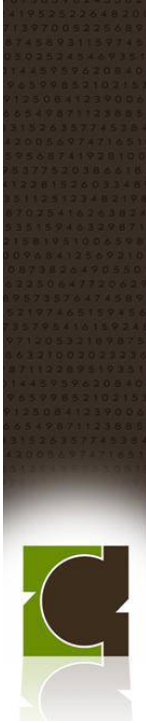
Controlling Opportunity

- Promote tools for effective reporting of suspicious activities (whistleblower policy)
- Anti-fraud policy and training
- Response to allegations



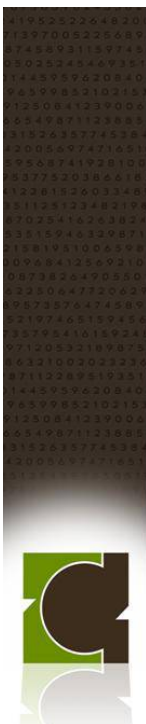
Fundamental Controls

- Authorization
- Segregation of duties
- Safeguarding of assets
- Reconciliation
- Reporting



Entity Level Controls

- Tone at the top
- Review by management or others
- System security



Tone at the Top

- Communicate expectations to employees
- Lead by example
- Provide a safe mechanism for reporting violations (whistleblower policy)
- Reward integrity

Question

What is the most significant threat to your organization?



Answer

Loss of an effective “Tone at the Top”



- Keep “Tone at the Top” “Top of Mind”



Barriers to implementing controls

- Cost versus benefit
- Support from others within the organization
- Money/time
- Others?

Where does responsibility lie?



Management!

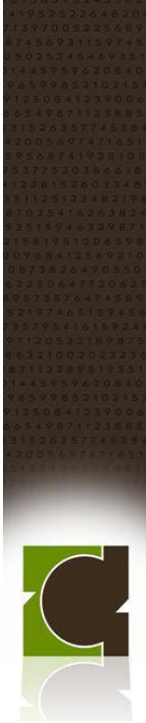
- Risk assessment
- Every organization will be different
- Larger versus smaller organizations will have different issues
- Assess the highest risk



“Any change, even a change for the better, is always accompanied by drawbacks and discomforts.”

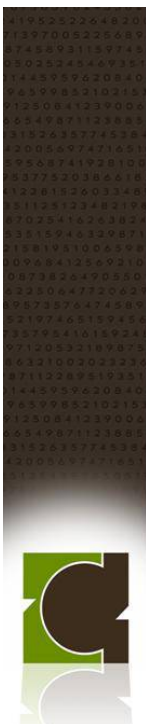
Arnold Bennett





Start with the hiring process

- Review resume
- Account for all gaps in employment
- Check references
- Formal employment application that asks about felony conviction
- Background checks



Where do you start internally?

- Prepare a chart of duties
- Interview employees
- Determine present controls in place
- Evaluate the level of risk that can be tolerated
- What are expectations?



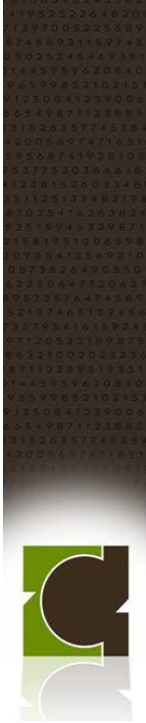
Example of questions to ask

- Who opens the mail?
- Who writes checks for disbursements?
- Who can sign checks?
- Where is blank check stock kept?
- Is a signature stamp used?
- What are the controls over credit cards?



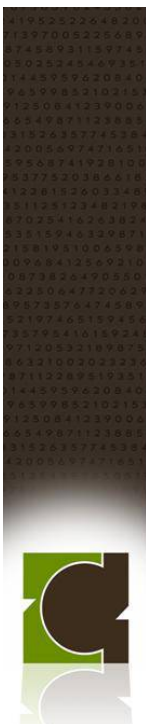
Specific Controls – Cash Receipts

- Person opening mail should not have access to bank accounts, posting of payments or adjustments
- Immediately endorsed with a bank stamp, name of organization, account number and **“For Deposit Only”**



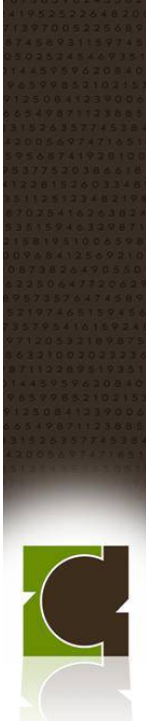
Specific Controls – Cash Receipts

- Receipts should be deposited on pre-printed deposit slips
- Payments should be posted to accounts by someone other than the person receiving payment



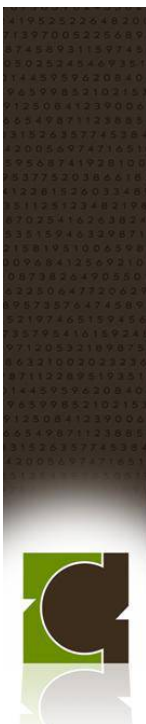
Specific Controls – Cash Receipts

- Adjustments to accounts should not be done by the same person receiving payments or posting payments
- Adjustments should be authorized and reviewed



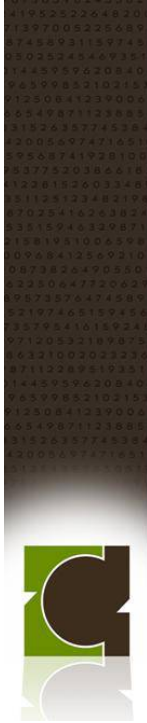
Specific Controls – Cash Receipts

- Payments should be reconciled to log of incoming payments and reconciled with deposit slips
- Bank reconciliation should be prepared monthly with deposit slips compared to the bank deposit entries



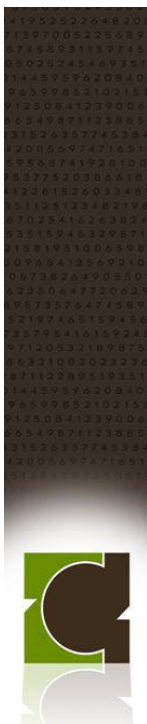
Specific Controls – Cash Receipts

- A/R should be aged monthly. Outstanding balances over 60 days should be followed up by someone other than the person posting payments
- Donor inquiries should be directed to someone other than person posting payments



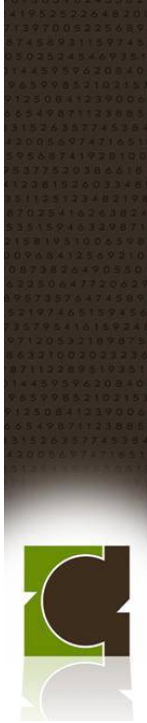
Specific Controls – Cash Receipts

- Consider having bank statement sent **to member of management’s personal residence**
- Mandatory vacation policy for employees



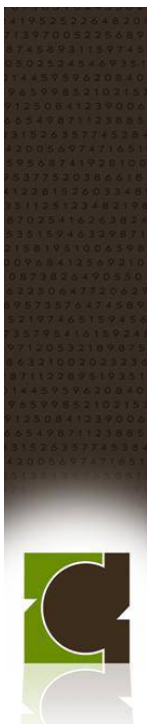
Specific Controls – Cash Disbursements

- Disburse by pre-numbered checks only (or via secure online payments)
- Review and pay from original invoices, not statements, and not photocopies
- Review for vendor name and address
- Checks should have supporting documentation
- **Cancel invoices as “Paid”**



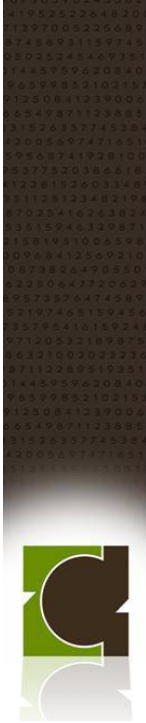
Specific Controls – Cash Disbursements

- Keep checks in locked cabinet with limited access
- Compare totals of checks signed to bank statement in the reconciliation process
- Lockbox or safe for cash until daily deposit made
- Do not sign blank checks



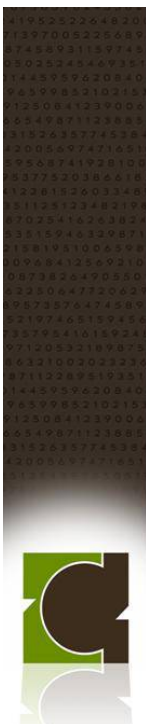
Specific Controls – Cash Disbursements

- Independent petty cash reconciliation
- Compare checks cashed on bank statement to computer records
- Items that require additional oversight due to frequent abuse:
 - Credit cards
 - Expense reimbursements
 - Gasoline cards



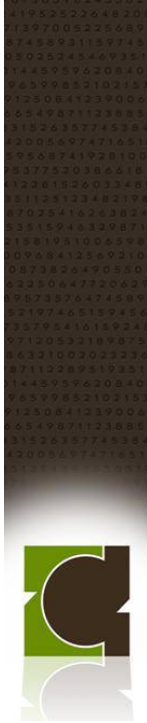
Specific Controls – Payroll

- Management involved with hiring and termination
- Use pre-numbered payroll checks only
- Separate initiation and authorization of direct deposits
- Approval of timesheets
- Authorized and documented status changes



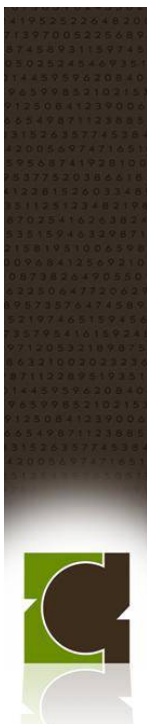
Specific Controls – Computer

- Passwords changed periodically
- Passwords should not be shared
- Administrator – access to everything
- Backups
- Restrict ability of users to change/delete transactions



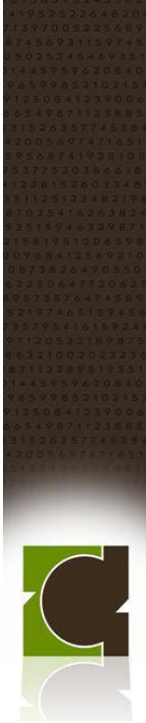
Specific Controls -- General

- Bank statements sent directly to **member of management's house** or opened directly by senior management
- Bank reconciliation – separate duties
- Review of reconciliation
- Year-to-year comparison of financial information
- Be involved



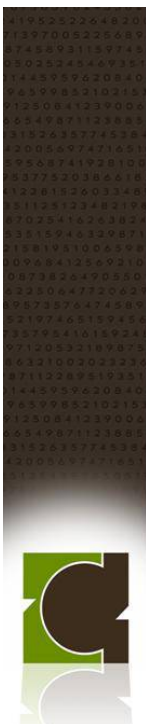
Specific Controls -- General

- One of the biggest deterrents besides tone at the top is psychological
- The knowledge that some else is reviewing their work
- **You don't leave your car unlocked with keys in the ignition** – why would you leave your organization unprotected?



Warning Signs

- Bill collectors call your organization looking for an employee
- Increase in standard of living with no explanation
- Employee performs certain functions after work hours or takes work home



Warning Signs

- **Employee doesn't ask for help or** refuses help in completing tasks
- Employee refuses to go on vacation
- Unusual employee relationships with vendors

Warning Signs

- Financial difficulties
- Divorce/family issues
- Irritability, suspiciousness, defensiveness
- Complaints about level of pay
- Complaints about lack of authority



