



Washington State Auditor's Office

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Independence • Respect • Integrity

Payments: Fraud Prevention and Detection

September 2013

Agenda

- Fraud trends
- Background information on internal controls
- Case study and lessons learned
- By the end of the session, I hope you will understand:
 - How to identify red flags
 - Why effective internal controls and monitoring are crucial
 - What to do if fraud happens at your entity

Fraud Program 2012 Highlights

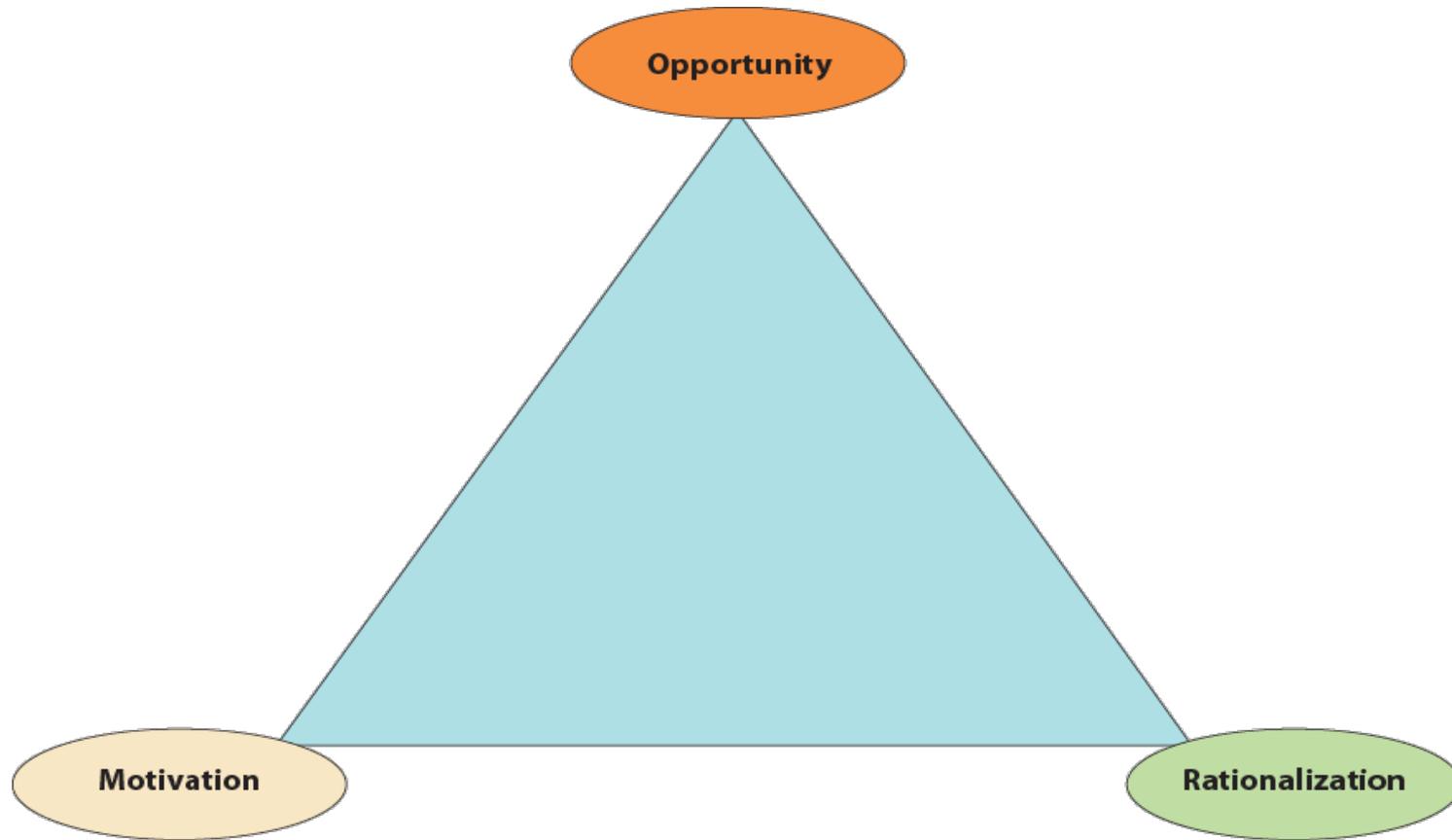
- During 2012, government reported 460 known or suspected losses to our Office.
- In 2012, we reported on 64 frauds totaling \$3,490,235.
- Some of the larger investigations are:
 - Bullerville Utility District, \$344,875
 - Northwest EMS, \$389,692
 - Franklin County, \$1,786,232

Fraud History

Year	Cases	Amounts
1987	32	\$388,936
1988	26	\$451,122
1989	31	\$358,654
1990	15	\$120,121
1991	15	\$264,027
1992	20	\$226,629
1993	18	\$642,439
1994	30	\$903,304
1995	37	\$689,080
1996	48	\$958,805
1997	33	\$1,540,368
1998	31	\$597,479
1999	42	\$1,047,113
2000	30	\$167,363

Year	Cases	Amounts
2001	68	\$484,060
2002	56	\$1,122,328
2003	62	\$2,253,394
2004	47	\$331,803
2005	57	\$258,960
2006	33	\$611,711
2007	24	\$1,722,207
2008	35	\$548,855
2009	53	\$2,055,775
2010	75	\$1,864,652
2011	50	1,352,396
2012	64	3,490,235
Totals	1032	\$24,451,816

The Association of Certified Fraud Examiners Fraud Triangle



Why are Internal Controls Important?

Effective internal controls

- Safeguard public resources
- Protect employees
- Assist in fraud prevention

Designing Internal Controls

- It is management's responsibility to design effective internal controls
- It is management's responsibility to ensure internal controls are operating as designed
- When designing/establishing internal controls break the system into segments and for each consider:
 - Will I be able to identify a loss? Will I identify the entire loss?
 - Will I be able to identify who is responsible?

Designing Internal Controls

- What makes auditors cringe?
 - Auditor question: “How do you ensure all of the funds make it to the bank?”
 - Response: “Joe takes the money to the bank. He has worked here for 32 years. *We trust him*”.
- Beware of “trusted employee syndrome”
- When designing internal controls, don’t forget the top of the organizational chart
 - Who typically has the easiest access to the most money?

Payments

Examples of Payment Frauds

- Personal purchases
- Purchase and return schemes
- Fake vendor/converting funds for personal use
- Employee reimbursements

Examples of Accounts

- Accounts payable/vouchers
- Manual warrants
- Electronic transfers
- “Other” accounts: Advance travel, revolving, petty cash, imprest, credit cards

Summary

- Accounts payable—Public Works Department
- Our investigation covered January 1, 1996 to January 30, 2012
- Misappropriation totaled at least \$1,786,232
- Questionable payments totaling \$1,029,266
- The former Public Works Accounting Director pleaded guilty
- Sentenced to 16 years in prison

Franklin County

How was it detected?

- The County Auditor's Office sent IRS forms requesting information to all vendors the County had done business with in the past two years.
- The form sent to one vendor came back "return to sender" The County Auditor sent additional requests to other address it had for this vendor that also were returned or unanswered.
- County Auditor's Office staff called the telephone number on a recent invoice from the vendor. The number belonged to a trucking equipment company that had purchased the vendor's assets in December 2001. Although the vendor was no longer in business, County payments had been made to the vendor.

Franklin County

Example Critzer invoice

Critzer Equipment Company Invoice No. 251427
P.O. Box 3225
Spokane, Washington 99210-3225
(509) 534-0446

INVOICE

Name FRANKLIN COUNTY PUBLIC WORKS DEPARTMENT Date 8/23/2008
Address 3416 STEARMAN AVENUE
City PASCO State WA ZIP 99301 Ordered By [REDACTED]
Phone (509) 545-3514

Quantity	Description	Price Each	TOTAL
50	5D9659 Edge	91.10	4,555.00
6	RC1 1/2 Cambridge Bearing	143.59	861.54
8	10435233 Shroud - Fan	198.00	1,188.00
20	D748QS Brake Pad	64.15	1,283.00
		SubTotal	\$7,887.54
		Tax	\$631.00
		TOTAL	\$8,518.54

ACCOUNT 545-48
R.O. NO. Inventory
APPROVAL Zain

SEP 15 2008
FRANKLIN COUNTY

What did we find?

- Our investigation compared payments recorded in the County's vendor payment system to available bank records and invoices.
- Total misappropriation of \$1,786,232 between 2002 and 2012.
- Total questionable payments of \$1,029,266 between 1996 and 2001.
- The account used for depositing the vendor checks was opened in 1990 .

Franklin County

- Where did the money go?
- How was the fraud concealed?

Lessons learned

- The former Public Works Accounting Director was a trusted employee. He worked for the County for over 20 years.
- The Public Works employee responsible for monitoring inventory was not given a report showing all the vendor payments by fund.
- Warrants were given to Public Works Department after being processed by the County Auditor's office.
- The former Public Works Director did not perform an adequate review of expenditures.
- There was not adequate oversight of the decentralized Public Works accounting department.

Payment Internal Controls

- Scanned documents, know what you are looking for
- Review bank reconciliations in a timely manner
- Ensure voided transactions are truly voided
- Only pay original invoices
- Ensure payments made outside normal process are approved, supported and for a public purpose
- Establish policies and procedures and ensure they are enforced (practice = policy)
- Establish controls over electronic invoice process (if used)

Payment Internal Controls

- Review vendor lists for unusual vendors or excessive payments (W-9's/comfirmations)
- Review for transactions that are out of the ordinary
- Look for unusual or excessive reimbursements to one employee
- Ask questions and get a supported answer. Confirm with a third party if necessary
- Create and review error reports (example: same bank account number or address)
- Look for unusual journal entries, such as entries to cash

Payment Internal Controls

- Review for inventory discrepancies. Verify inventory records reconcile with purchases and use
- Know the “universe” of what you are reviewing
- Lock up unsecured check stock.
- Require detailed expense reports with original receipts and documentation attached
- Review employee reimbursements for expenses claimed on days the employee did not work
- Look for payments or employee reimbursements approved by someone outside the department. These are high risk.

Payment Internal Controls

- Ensure items purchased were received and are onsite
- If you use positive pay, make sure you know what the bank is verifying
- Preliminary vs. final reports: know what you are reviewing
- Call your software company and inquire about known system weaknesses (ability to change vendors/payees after entry, inability to detect duplicate payments, etc.)
- Review for expenses that end in round numbers
- Employee background checks

Payment Internal Controls

- Review accounts payable transactions for excess goods and services
- Have an expectation of reasonable expenses and compare it to actual payments entered into the system and what cleared the bank
- Look for unusual endorsements
- Review for expenses that exceed budgeted amounts or prior year totals
- Warrants/checks should never go back to the department or person that initiated the payment

Payment Internal Controls

- Review credit card bills and support documentation to ensure the purchases are approved, supported and for a public purpose
- Who approves the purchases?
- Take a step back and look at your credit card use. Is it appropriate and necessary?

Fraud Happens

What to do if it happens to you:

- Immediately notify State Auditor's Office on the Web at www.sao.wa.gov | Special Investigations | Fraud Program | Report a loss (RCW 43.09.185).
- Protect accounting records from loss or destruction.
- Don't enter a restitution agreement with an employee (Auditor/Attorney General approval required).
- Ensure personnel action taken for violating policies and procedures, not for misappropriating public funds.
- File a police report (consult our Office on timing).
- Change bank account access (credit cards, too).

Fraud Happens

What to do if it happens to you:

- Do not try to be the investigator. But do start a record: how it came to your attention, records of conversations, etc.
- Do not physically prevent an employee from leaving the room or leaving the building.
- Do not agree to let the employee repay money to “make it go away”.

Summary

- Remember the fraud triangle.
 - You control the opportunity.
- When designing internal controls, break down the system into segments and analyze:
 - If you could identify a loss.
 - If you could identify who is responsible.
- Beware of the “trusted employee” trap.
 - Who has the most access to funds?
 - Sometimes good people do bad things.
- Remember our Office doesn't review every transaction. Don't rely on auditors to find the fraud. That is your job!

Questions?



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