



WEDNESDAY'S
News You Can Use

How a Breakdown *in* Internal Control Can Lead to Fraud

Presented by **Beth Grimes, CPA**



Carl Vinson
Institute of Government
UNIVERSITY OF GEORGIA



Today's Presenter



Beth is responsible for the firm's governmental practice. Since joining BatesCarter in 1996, Beth has gained substantial experience serving clients in the local governmental sector. These services include financial and compliance audits, compilations, bond comfort and consent procedures, internal control assessments and general consulting services. She is committed to continuous learning and customer focused initiatives. She has taught courses for the Georgia Government Finance Officers Association and the Georgia Society of CPAs in the area of governmental accounting.

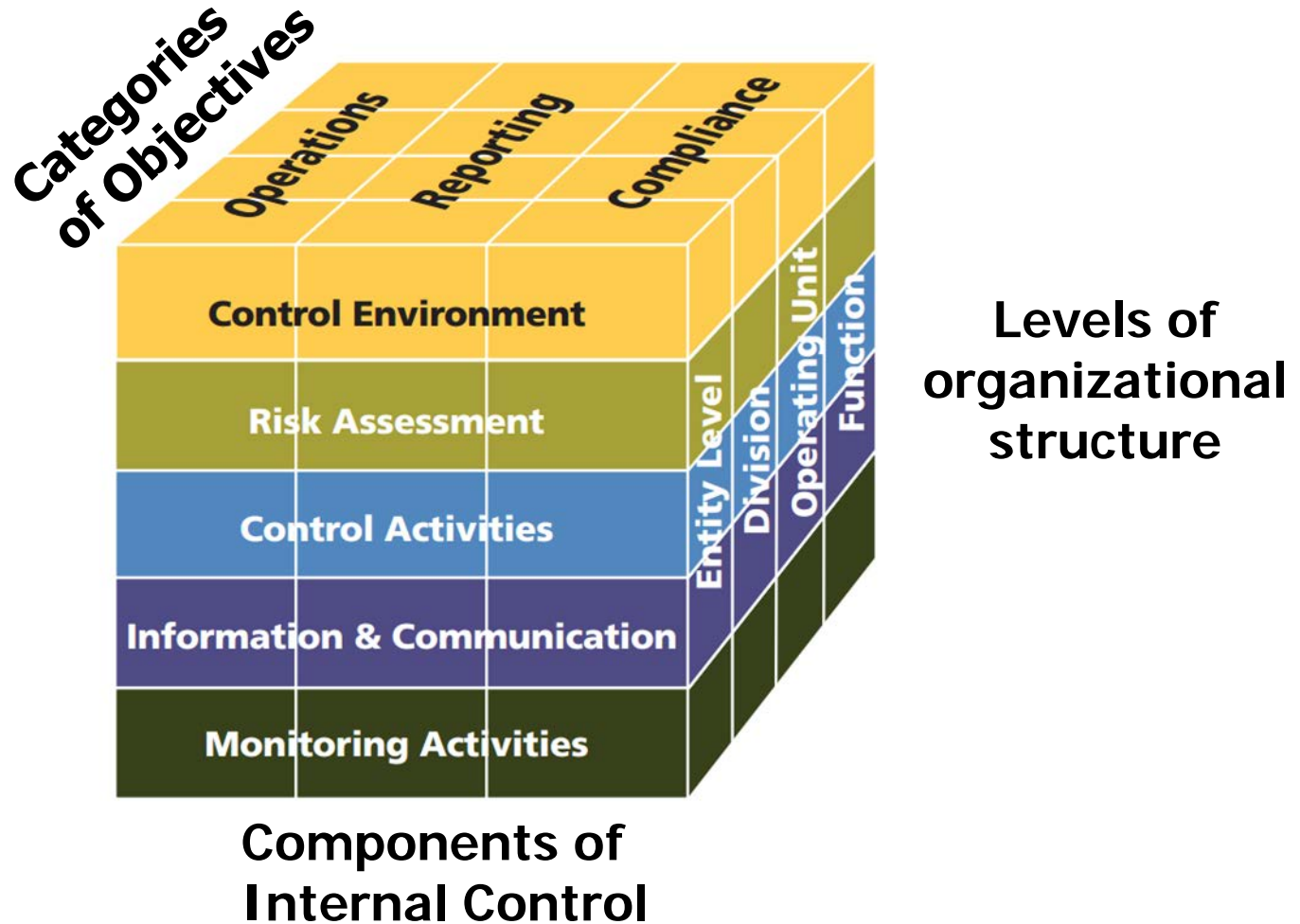
Beth is active in her community as well as in her professional organizations. She is a member of the American Institute of Certified Public Accountants, the Georgia Society of CPAs, the Government Finance Officers Association and the Georgia Government Finance Officers Association.

Learning Objectives

At the end of this session, you should be able to:

- Recall the importance of a comprehensive framework of internal control
- Identify examples of how a breakdown in internal control can leave your government vulnerable to fraud
- Recall steps you can use to prevent a breakdown in internal control

Internal Control Components



Lessons from the Trenches

Fraud!!! We hear about it occurring almost everyday!

- Many large cases stick out in our mind and make us scratch our heads
 - Rita Crundwell, Dixon Illinois Comptroller
 - \$53 million stolen over 20 year period
 - Audited every year
- Real fraud cases that occurred in Georgia
 - Case A – County Government, Clerk of Court
 - Case B – County Government, Juvenile Court
 - Case B – Small City Government
- Where did it all go wrong?

Case A – County Government, Clerk of Court

- Overview of how this office typically operates
 - Elected Official
 - Fiduciary Fund
 - Decentralized from County Finance Department
- \$1.2 million stolen cash
 - Started small, but not concealed
 - Grew over time with complicated scheme to conceal stolen cash
- Occurred over a 7 year period
- Bookkeeper responsible for:
 - Preparing checks-not signing checks
 - Reconciling Bank Statements
 - Reconciling deposits to till reports
 - Making deposits
 - Picking up the mail
- Classic lapping scheme occurred as a result of lack of segregation of duties
- Clerk of Court was going through cancer during this time period
 - Clerk at the time would sign checks without support documentation
 - Clerk trusted the bookkeeper
- Strong internal control framework did not exist in the office

Case A – County Government, Clerk of Court

- Audit findings every year
 - Findings were vague
- During this time period as a result of an audit finding a change was made to involve another person in the transactions cycle-Fraud still continued to occur
- Elected official did not understand fraud risk of various transaction cycles
- Signs that something was wrong
 - Bookkeeper had a very high standard of living
 - Sloppy bookkeeping
 - Audit findings
 - NSF fees on bank statements
 - Lack of or weak internal controls
- Case is awaiting trial

Knowledge Check

Why was the change in procedures not effective in preventing the fraud from occurring?

- A. Clerk responsible for receipting should have been responsible for reconciling deposit to till reports
- B. Deputy Clerk responsible for reconciling till reports should have made deposits
- C. Bookkeeper received unlocked cash bags and also made the deposit

Case B – County Government, Juvenile Court

- Overview of how this office typically operates
 - Elected Official
 - Fiduciary Fund
 - Decentralized from County Finance Department
- Only \$38 thousand stolen
 - If this had been a larger office, this could have easily been much more
- Majority of theft occurred in a six month time period
- Theft of cash, it was not concealed
 - Could have easily been detected
- Bookkeeper responsible for:
 - Preparing checks-not signing checks
 - Reconciling Bank Statements
 - Making deposits

Case B – County Government, Juvenile Court

- Office had good internal controls, just did not follow them
 - Process was not monitored
- No audit finding in the past
 - If this had been a larger office, this could have easily been much more
- Elected official did not understand fraud risk
- Signs that something was not right
 - Sloppy bookkeeping
 - Clerk responsible was faced with financial hardships
 - Constant delays in scheduling audit to begin
- Case has just been turned over to law enforcement

Knowledge Check

How could this theft have been easily detected?

- A. Comparing amount of deposit to daily till report
- B. By reviewing the bank reconciliation
- C. By verifying deposit agreed with daily till report prior to turning over to the clerk responsible for making the deposit

Case C – Small City Government

- Overview of this office
 - General Fund
 - Water Utility Fund
 - Not decentralized
- \$600 thousand stolen over a several year period
- Auditors finally detected, but after it was too late
 - Could have easily been detected
- Auditors did not understand the environment they were auditing
- City Manager did not understand fraud risk
- No one was ever prosecuted because controls were so weak it could not be determined who did it

Knowledge Check

How could this fraud have been prevented?

- A. Reconciling daily cash receipts report to deposit
- B. Reconciling monthly revenue postings in the general ledger to the utility billings monthly revenue report
- C. Both A and B are correct

FRAUD PREVENTION TAKEAWAYS

- Your auditor is not part of your internal control structure
- Make sure you are properly insured
- Understand the environment you operate in
- Follow up on internal control weaknesses identified by the auditor
 - They generally do not take care of themselves
 - Auditors-make sure you findings are clear and not vague
- Just because you have a system of internal control, make sure it is working
- Understand the symptoms and signs of fraud and potential risk
- Educate your employees about fraud and what signs of fraud may look like
- Trust no one!!

FRAUD PREVENTION TAKEAWAYS

- Understand the cost of fraud, it is not just money
 - Loss of public confidence in government
 - Loss of reputation of the innocent
 - Punishment of the perpetrator
- Prosecute perpetrators
- Majority of frauds are reported by employees
- The single most important step that can be taken to prevent fraud
 - Management establishing and maintaining an effective internal control structure which is supported by the government's elected officials

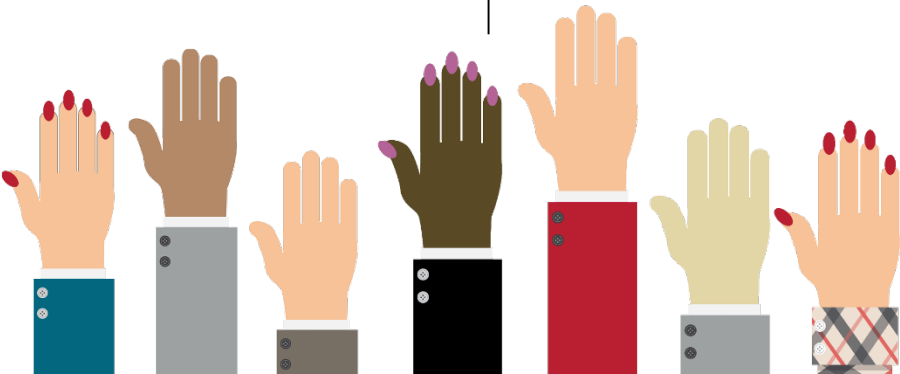
QUESTIONS?

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Thank You!



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