

Turn a negative into a positive: Five audit issues to learn from

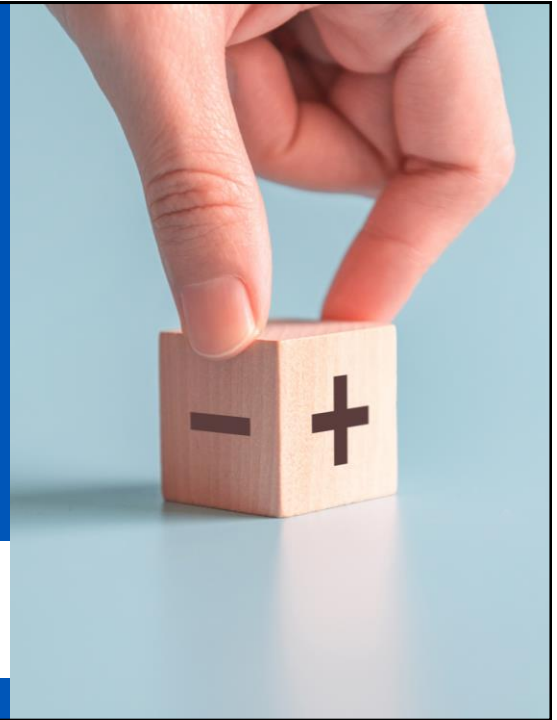
AWC Annual Conference

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Center for Government Innovation

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Today's topics

Recognize the warning signs and learn valuable safeguards that can prevent audit findings or misappropriation in five common areas:

- Cash receipting
- Automated Clearing House (ACH) payments and cyberloss
- Government oversight and monitoring
- Payroll
- Declining financial condition



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Cash receipting

Auditor's Office finds former clerk responsible for fraudulent transactions

The City did not have adequate controls over cash receipting at City Hall or effective monitoring of cemetery inventory billing and receipting to safeguard public funds.

The City did not have adequate internal controls over cash receipting, increasing the risk that undetected errors or potential misappropriation could occur.



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How did this situation happen?

\$22,000 misappropriated

- Unexpected revenues weren't tracked or monitored:
 - Business and occupation (B&O) taxes
 - Utility close-out payments, such as escrow payments
- Account adjustments weren't independently reviewed
- An employee had access to bill, receipt and deposit funds

Auditor's Office finds former clerk responsible for fraudulent transactions



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How did this situation happen?

AUDIT FINDING

The City did not have adequate controls over cash receipting at City Hall or effective monitoring of cemetery inventory billing and receipting to safeguard public funds.



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\$13,000 in cemetery revenue not billed or receipted

- Items for sale, such as cemetery plots, weren't inventoried or updated
- Billings and receipts weren't monitored or reconciled
- An employee had access to bill, receipt and deposit funds

How did this situation happen?

AUDIT FINDING

The City did not have adequate internal controls over cash receipting, increasing the risk that undetected errors or potential misappropriation could occur.



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\$4,500 RV Park receipts were not deposited

- Receipts weren't deposited timely
- Manual receipts weren't issued in order
- An employee had access to bill, receipt and deposit funds



How to prevent it

Regularly monitor your unexpected revenues

Expect the unexpected:

- Know what types of unexpected revenues you're likely to receive
- Make sure all revenue, including donations, are collected at an approved receiving location
- Require that two employees open mail together



How to prevent it

Perform multiple independent reviews

- **Daily deposits** – Ensure cash collected reconciles to daily deposits
- **Adjustments to receipts and billing accounts** – Verify they are legitimate
- **Decentralized billings** – Ensure all services were billed and collected
- **Inventory items** – Verify inventory has been updated when items are sold
- **Monthly bank reconciliations** – Verify deposits made it to the bank





How to prevent it

Segregate duties

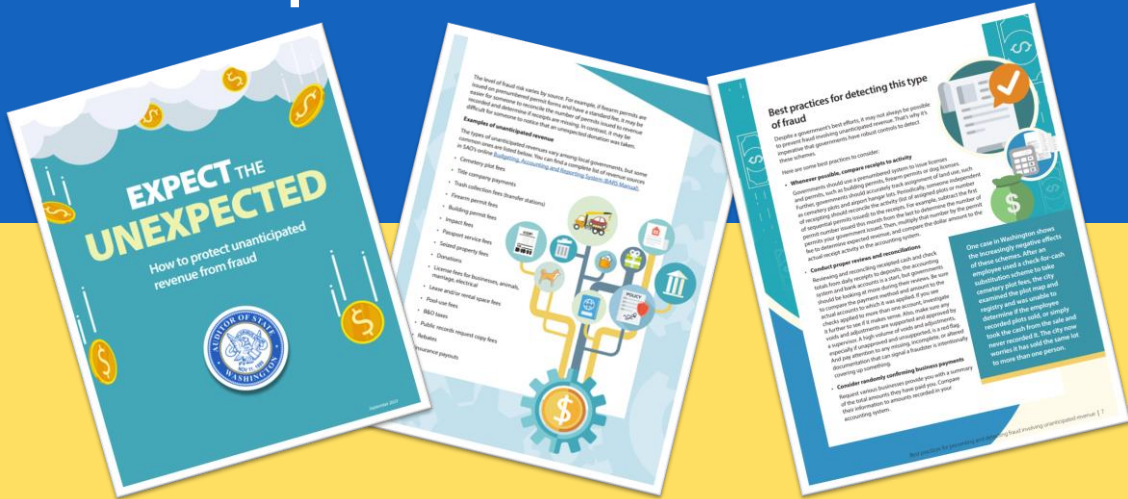
- Collecting payments through the mail
- Receipting and reconciling payments
- Preparing account adjustments
- Depositing to the bank
- Reconciling deposits to the bank statements



Resources and best practices



More best practices



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Hundreds of county residents linked to recent data breach

Port loses \$500,000 in public funds to cyberfraud

City paid \$185,897 to fraudulent vendor

ACH payments and cyberloss



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**Bad actors
manipulate our
trusting human
nature to perpetrate
their attacks.**

How do cyber threats happen?



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Fraudulent email messages

- #1 method used by hackers to access your government's data
- Designed to trick you into revealing sensitive information

How do cyber threats happen?



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Bad actors are clever. They ...

- Learn your operations and timetables
- Use pretexting to improve their chances of success
- Pose as an employee, vendor or executive management

How do cyber threats happen?



Put it in writing

Strong written policies

- Standardized process to initiate, approve and execute ACH transactions
- Additional segregation of duties
- Require reporting of suspicious activity immediately



How to prevent it



Educate employees to be responsibly suspicious

Slow down

- Consider the source
- Question the unusual
- Know the red flags



How to prevent it



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Educate employees to be responsibly suspicious

Follow best practices

- Validate internally transferred emails
- Provide notifications of account changes using multiple channels
- Use data encryption



How to prevent it



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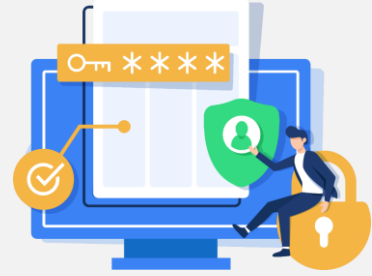
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Educate employees to be responsibly suspicious

Follow best practices

- Start a new email chain
- Use known, reliable contact information
- Scrutinize email addresses for lookalikes



How to prevent it



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Resources

Best Practices for Sending Wire Transfers

Center for Government Innovation
Office of the Washington State Auditor
Pat McCauley

Wire transfers move money from one bank account to another almost instantaneously. They are generally considered safe as long as the sender is confident the transaction is valid and the wiring instructions are accurate. In today's environment, there can be hefty assumptions.

Wire transfers are typically used to transfer larger sums of money and usually only for limited purposes due to the higher transactional cost. But increasingly governments might use them to make investment purchases, wire payments to privately to purchase property.

Best Practices for ACH Electronic Payments

Center for Government Innovation
Office of the Washington State Auditor
Pat McCauley

Governments are increasingly using Automated Clearing House (ACH) payments to pay employees and vendors, replacing more costly checks and wires. These are electronic bank-to-bank payments processed in batches through the ACH network. They have their own unique risks that are different from checks and wires, and these risks are too large to ignore.

Today, bad actors target ACH transactions using social engineering or by having direct system access. In social engineering schemes, bad actors may pose as vendors to get employees to approve changes to contacts and to bank account information in order to divert payments. Employees and others with system access can also perpetrate fraud, such as by adding fictitious vendors or changing a vendor's bank account information to their own or that of an accomplice.

IT Policies Guide



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Government Oversight and Monitoring



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Attorney General suing city official after auditor's report finds ethics violations

Former mayor sentenced to 90 days in jail, restitution for slew of theft charges

How did this situation happen?

Mayor abused his position and received special privileges

Council didn't verify:

- Contracts met policy and state law
- Mayor was acting within his authority

Attorney General suing city official after auditor's report finds ethics violations



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How to prevent it

Monitor contracts

- The governing body and employees should take appropriate training over contracts, state ethics and conflict of interest laws
- Ensure governing body is aware of, and approving, appropriate contracts and agreements
- Verify that contracts and agreements are following policies and state law
- When in doubt about a transaction or contract, ask a legal professional



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How did this situation happen?

Mayor didn't deposit donations and used \$10,000 of City money for personal purchases

Former mayor sentenced to 90 days in jail, restitution for slew of theft charges

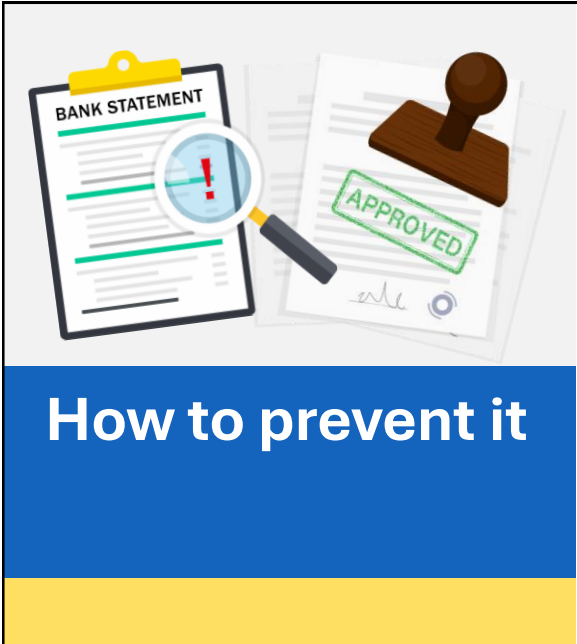
- Donations weren't receipted at a centralized location or monitored
- Bank account reconciliations weren't prepared timely or independently reviewed
- Itemized receipts weren't obtained for debit or credit card transactions



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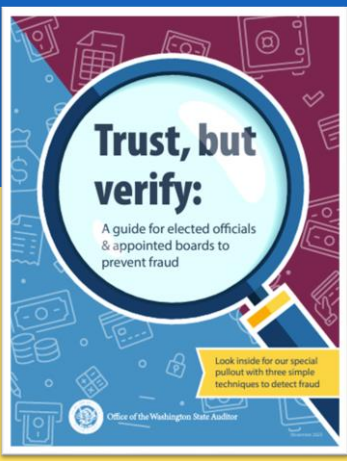
How to prevent it

Establish adequate oversight of operations

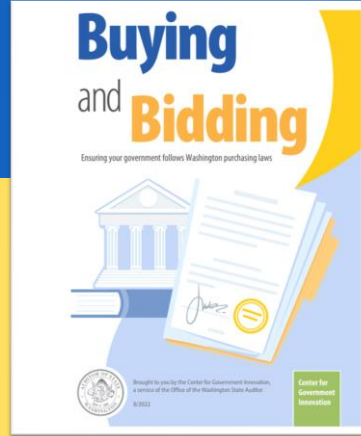
- Perform an independent review of the bank statement and reconciliations
- Ensure all payments are supported and approved by the governing body before payment
- Ensure all city revenue and expense activity is processed through the proper centralized procedures



Where to get started



Where to get started



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Fire battalion chief falsified time sheets

The Town lacked adequate controls over payroll expenditures to ensure employee pay and leave accruals were accurate.

Superintendent's contract outside the norm, review finds

Payroll



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Misappropriation of leave for \$8,300

- An employee had access to adjust his own hours worked
- These adjustments were not reviewed or approved

How did this situation happen?

Fire battalion chief falsified time sheets



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Unallowable accruals and overtime; inaccurate overtime calculations

- Payroll policies weren't clear for holiday pay, overtime, leave accruals and cash-outs
- The Town didn't provide appropriate training over payroll procedures

How did this situation happen?

AUDIT FINDING

The Town lacked adequate controls over payroll expenditures to ensure employee pay and leave accruals were accurate.



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\$37,800 overpayment

- The governing body didn't approve appropriate contracts, amendments or pay increases
- No independent review of payroll, incentives or stipends
- No policies in place over retroactive payments

How did this situation happen?

Superintendent's contract outside the norm, review finds



Limit access and provide training

- Limit access to those that:
 - Process payroll
 - Review payroll
- Provide training over payroll calculations, software, payroll regulations and policies



How to prevent it



Perform multiple independent reviews

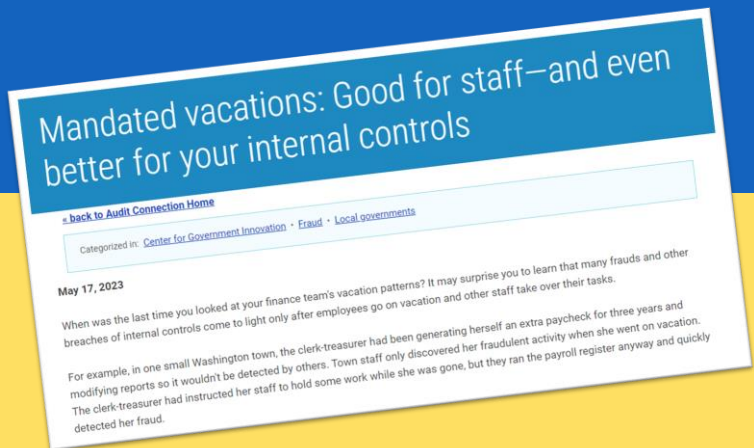
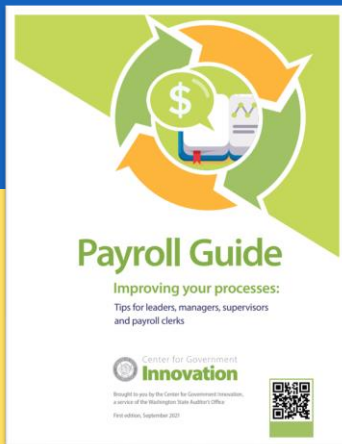
- The governing body should review and approve contracts, amendments and pay increases under its authority
- Review payroll transactions to verify they are calculated correctly and allowed by contracts and policies
- Verify that payments are for actual hours worked or leave balances earned
- Avoid retroactive payments, unless allowed by policy and state law



How to prevent it



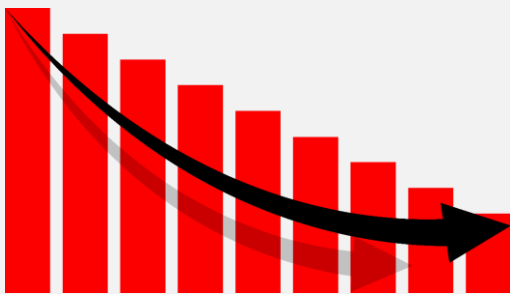
Where to get started



Declining financial condition

The City did not monitor its financial activity or comply with state law, placing it at risk of not meeting its financial obligations or providing services at current levels.

The City did not effectively plan for necessary repairs and replacement of water/sewer fund assets, resulting in a continued decline in its financial condition.



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How did this situation happen?

Overspent budget by \$72,000; spent \$145,000 more cash than available

AUDIT FINDING

The City did not monitor its financial activity or comply with state law, placing it at risk of not meeting its financial obligations or providing services at current levels.

- Inadequate review of cash reconciliations
- Budgets weren't monitored
- Cash was spent without making sure that the street fund had sufficient money available.
- Utility rate studies weren't performed to assess future needs



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How did this situation happen?

AUDIT FINDING

The City did not effectively plan for necessary repairs and replacement of water/sewer fund assets, resulting in a continued decline in its financial condition.

Spent \$135,000 more cash than available; may not be able to meet future obligations

- Cash was spent without making sure that the utility fund had sufficient money available
- Utility rate studies weren't performed to assess future needs



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How to prevent it

Start with approving a balanced budget

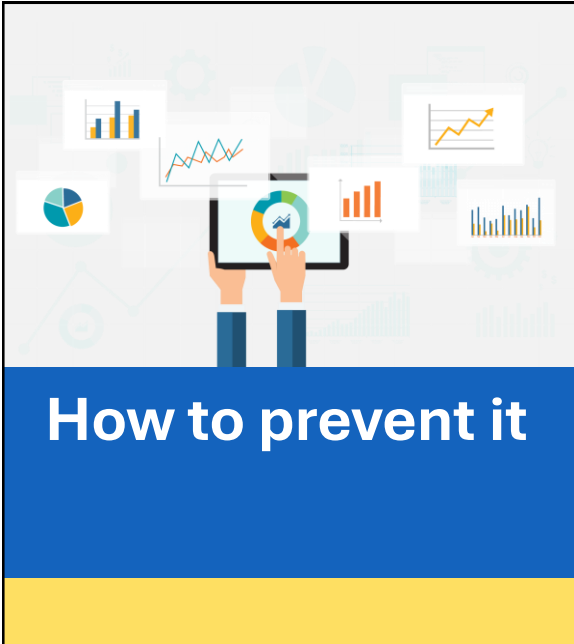
- Anticipate and budget for expenses
- Forecast anticipated revenues and do utility rate studies to assess needs
- Ensure that revenues and available resources are adequate to pay for appropriations
- If the financial condition is declining, evaluate solutions, develop a plan to address it, and actively monitor the plan



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How to prevent it

Actively monitor your financial activity

- Compare actual revenues to anticipated revenues regularly
- When approving expenses, verify the applicable fund:
 - Hasn't exceeded its budgeted appropriations
 - Has the available resources to pay for the expenses



Resources

Look to the future: Cash forecasting is key to strong financial controls

Jun 17, 2020

It is critical to forecast your cash inflows, outflows, and balances into the near-term future to anticipate liquidity shortfalls and remain solvent. Annual budgets tell you your spending authority for a year, whereas a cash forecast will tell you whether you have sufficient cash in the future on a month to month (or even daily) basis.

Why do it?

Cash forecasts:

- Provide information for leaders to make informed financial decisions
- Demonstrate the government has solid financial controls and is well-managed
- Identify shortfalls early so you have the most options available to mitigate the concern
- Inform investment decisions, both buying and selling, to maximize interest earnings and maintain liquidity
- Plan for anticipated future cash needs, such as paying for large purchases

Fiscal First Aid Resource Center

What is Fiscal First Aid?

To help local governments deal with the many short-term and long-term financial challenges, the GFOA has provided a program called Fiscal First Aid. Fiscal First Aid is the process of recognizing, arresting, and reversing a pattern of financial decline. GFOA has put this page together as a central resource for local government finance officers. At the core of this program are the Three Stages of Recovery: Bridge, Reform, and Transform. In *Bridge*, the goal is to meet immediate revenue. In *Reform*, the goal is...

CASH IS KING

Cash is King infographic showing the importance of cash flow management.

Fiscal First Aid
Three Stages of Recovery

BRIDGE REFORM TRANSFORM

<https://sao.wa.gov/the-audit-connection-blog>

<https://www.gfoa.org/materials/gfr-cash-is-king>

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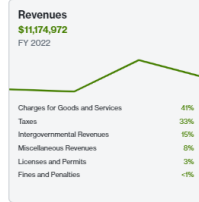
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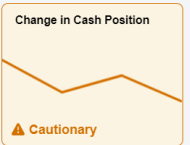
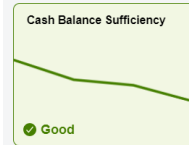
Finances at a Glance

FY 2022



How are you monitoring your city's financial health?

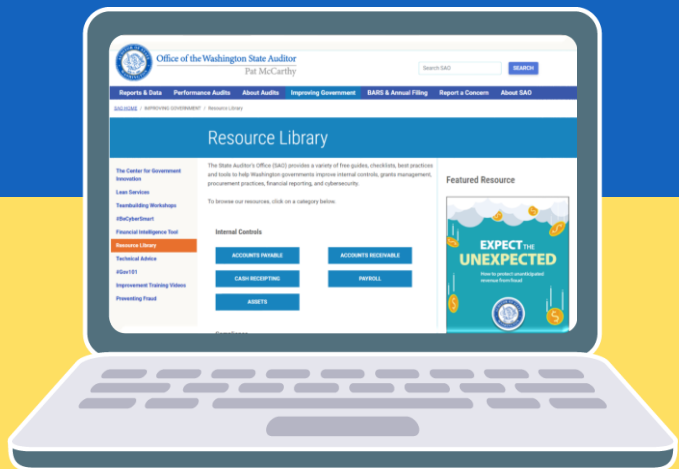
General Fund 3 indicators



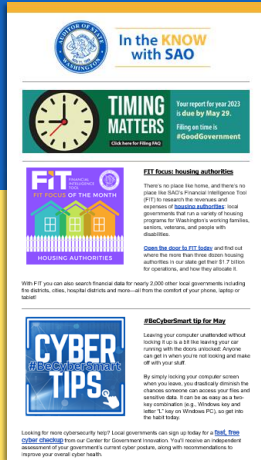
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Questions?



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