

Back to the basics:

Overcoming common internal control weaknesses

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**“They help governments
get what they want.”**

- Fiscal accountability & trust
- Compliance with regulations, laws, restrictions
- Preventing, deterring & detecting fraud
- Efficiency & effectiveness
- Safeguarding assets



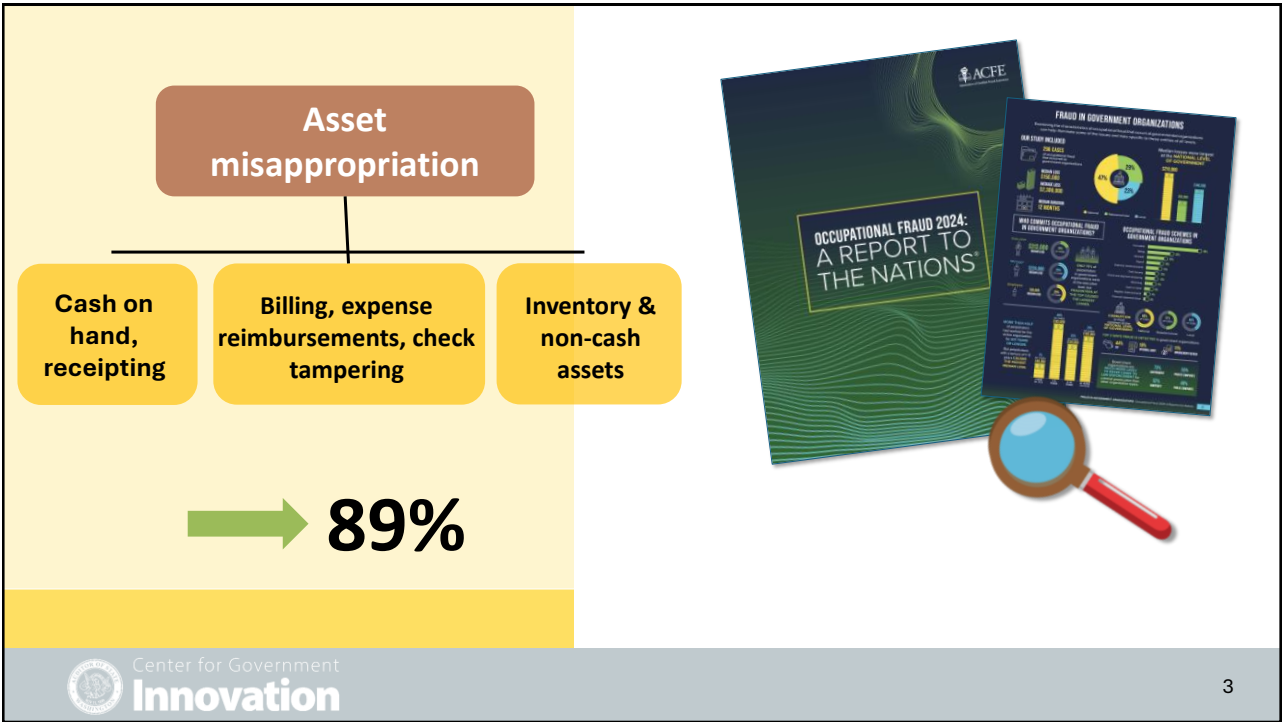
**Importance of
internal controls**



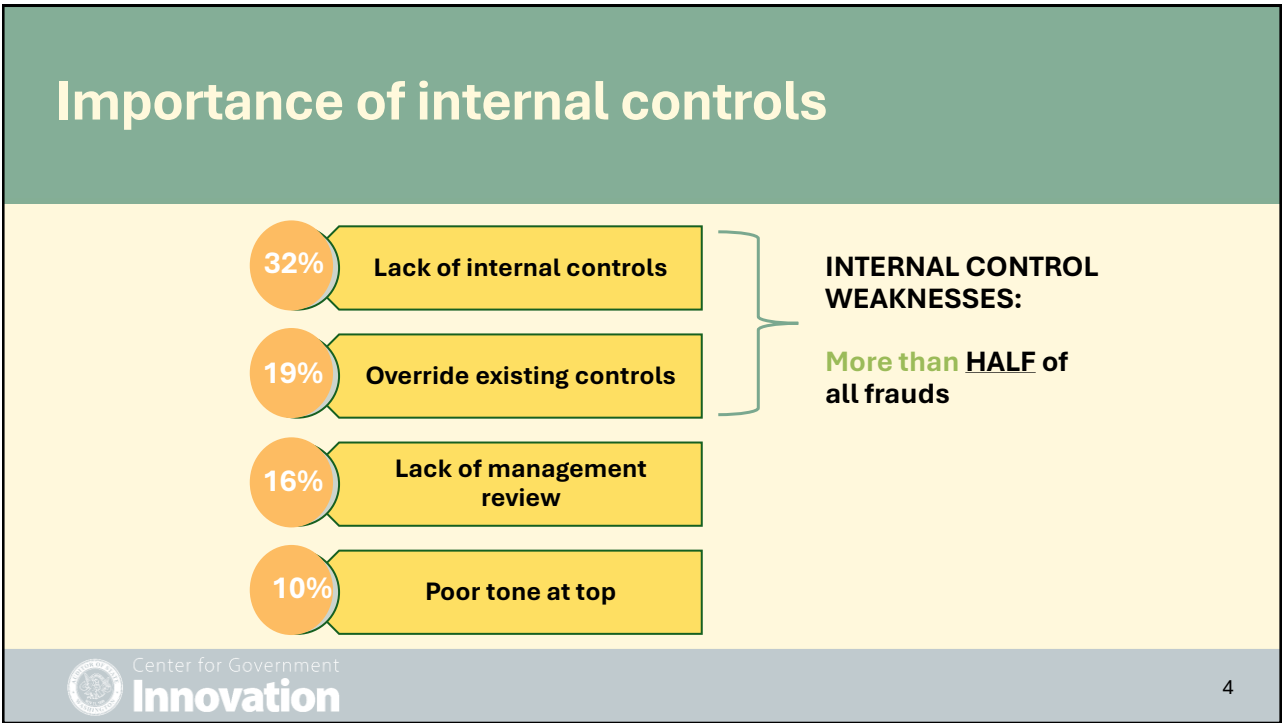
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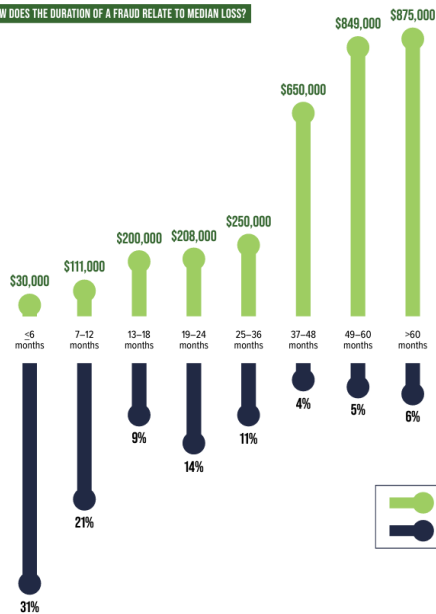


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FIG. 7. HOW DOES THE DURATION OF A FRAUD RELATE TO MEDIAN LOSS?



Importance of internal controls



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Faster detection often leads to smaller loss.

Fast detection relies on adequate controls



Importance of internal controls

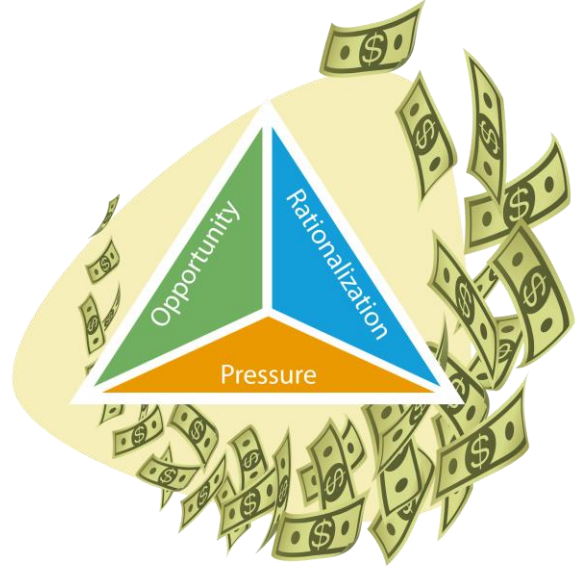


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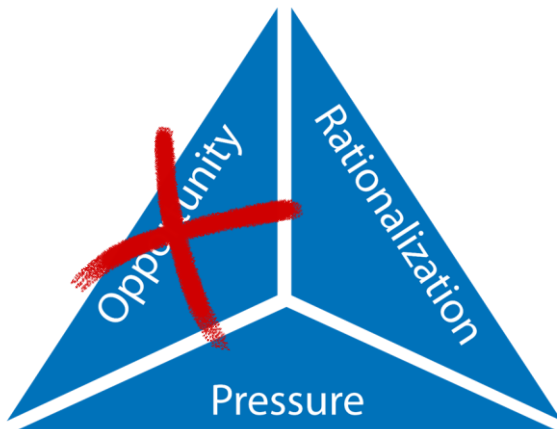
Importance of internal controls



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Importance of internal controls



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Types of internal controls

Preventative



- ✓ Define process
- ✓ Develop expectations
- ✓ Develop forms & reports

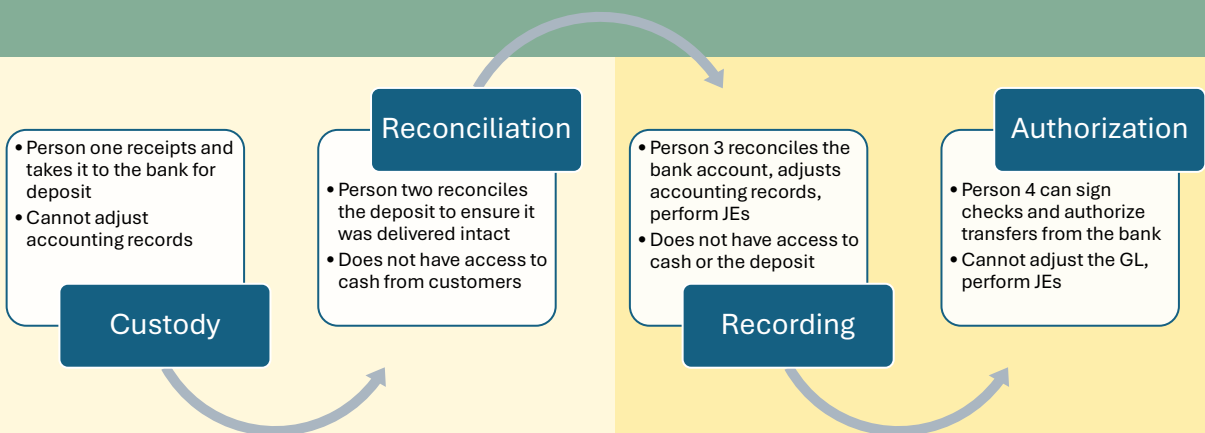
Detective



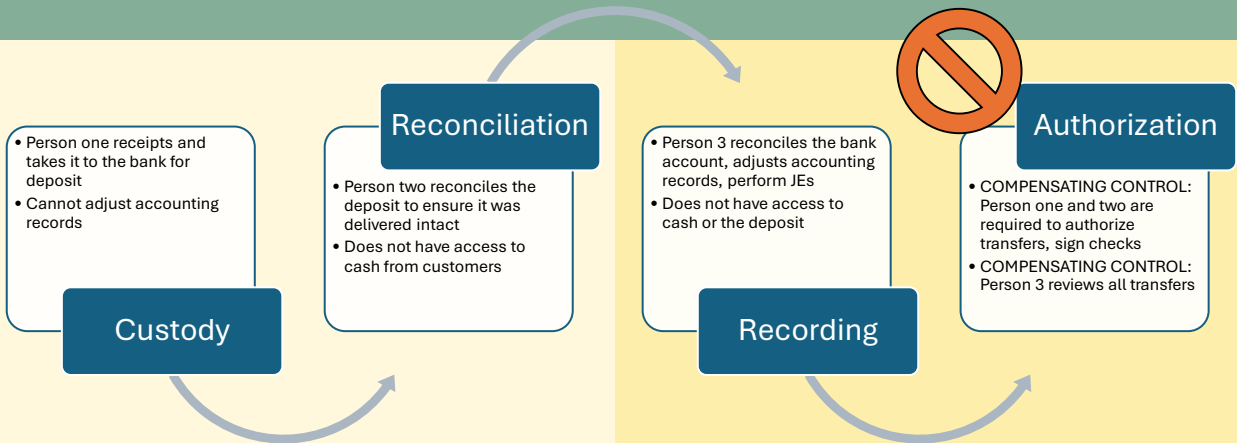
- ✓ Review documents
- ✓ Observe & monitor activities



Types of internal controls



Types of internal controls



Types of internal controls

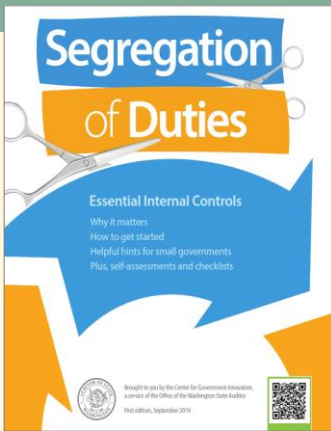
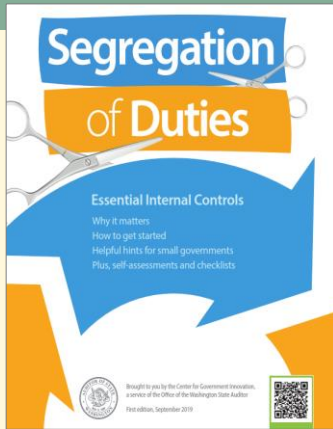


Table 1 – If the employee's job is to receive payments and produce receipts for customers, or have other access to money, whether cash or checks, for deposit, then:

Other roles this employee should not have	The risk if the employee does both roles	The compensating controls you could put in place include
Issuing receipts without supervision	<p>Skimming schemes. One version involves taking cash before it has been recorded or before issuing a receipt for the payment.</p> <p>Another trick involves using a manual or unauthorized receipt book, to hide the funds that are pocketed.</p> <p>Note: Risk for such schemes is lower when all cash intake is expected. However, even in these settings, unexpected or miscellaneous revenues can be at risk.</p>	<ul style="list-style-type: none"> • Place surveillance cameras on receipting operations • Place signs telling customers to expect a receipt, and urging them to contact a manager if they have concerns • Use cash drawers that capture zero receipts (drawer was opened but no receipt was given) • Monitor the daily deposit for reasonableness, in total and amount of cash • Conduct surprise cash counts, and look for unauthorized receipt books during the count • Put in place additional controls to monitor unexpected revenue streams • Conduct an internal audit test: Have an auditor pose as a customer, pay in cash, and not ask for a receipt. Assess whether the funds are properly recorded and the cashier insisted on providing a receipt. • Monitor inventory for unexplained shortages



Types of internal controls



Bill for goods or services

A clerk who can modify the customer's invoice so that it demands more than is actually due, and also then open the over-payment when it arrives, is in a position to skim the amount over-paid.

- Periodically trace transactions through the accounting system from origination to billing to payment as a spot check, possibly during an internal audit.
- Periodically review billings before they are mailed
- Independently send customers a separate statement, asking them to call management directly with questions about their bills.
- Monitor active accounts to ensure all are being correctly billed for services. For example, many utilities can produce account reports to identify any with high or low billings.

Adjust customer accounts

Write-off schemes. When the cashier can also adjust the customer's account to reduce the apparent amount owed, it becomes easier to conceal a stolen payment.

- Require supporting documentation for all customer account adjustments
- Periodically review customer account adjustments for reasonableness and for the presence of supporting documentation
- Independently send customers detailed statements reflecting all activity on their account. Ask them to call management directly with questions about their bills.



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Avoid the trusted employee trap:

- No segregation of duties
- Inadequate monitoring & review

**Trust is not
control**



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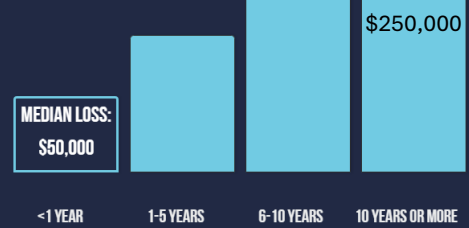
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Trust is not
control

THE LONGER A
FRAUDSTER HAS WORKED FOR AN
ORGANIZATION, THE MORE
COSTLY THE FRAUD.



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Survey says...

What percentage of fraudsters are first-time offenders?



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A look at fraud in Washington



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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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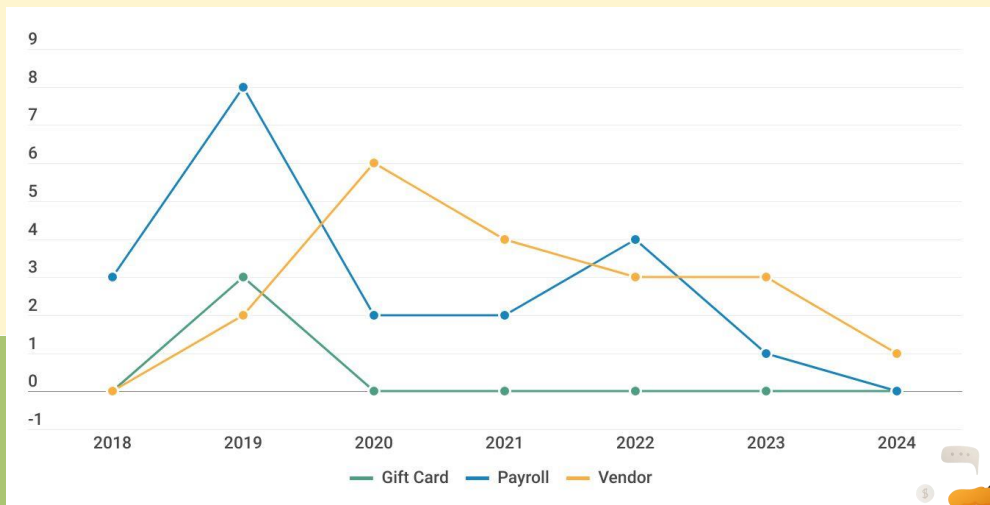
Bad actors manipulate
our trusting human
nature to perpetrate
their attacks

How do cyber
threats happen



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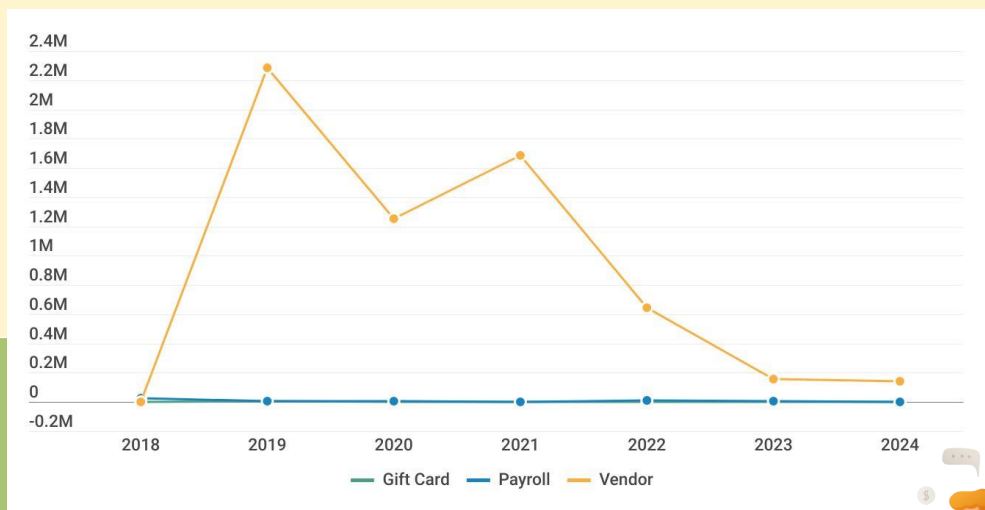


Cyber loss - cases



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Cyber loss - losses

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Financial controls help ward off cyber criminals

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

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Financial controls help ward off cyber criminals

Best practices

- Require two to execute ACH
- Segregate duties:

Process A/P	Process A/P	ACH processing
Should not edit vendor files	Should not create / handle / approve ACH	Should not prepare bank reconciliations



How to prevent it

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How to prevent it

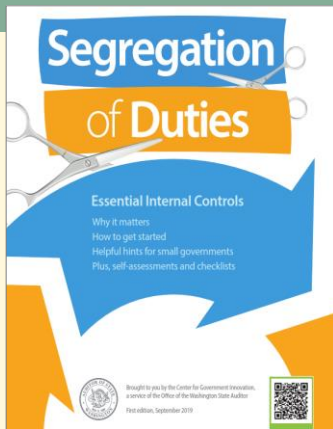


Table 4 – If the employee's job is to process vendor payments (typically as an accounts payable clerk), then:

Other roles this employee should not have	The risk if the employee does both roles	The compensating controls you could put in place include
Create new vendors or make other changes to the vendor master file	<p>Fictitious vendor schemes. An accounts payable clerk who can also create a new vendor can set up a fictitious payee using a personal address and/or bank account and direct payments to that account.</p> <p>A variation redirects payment for a legitimate vendor to the clerk's own address or bank account.</p>	<ul style="list-style-type: none"> • Require management approval to set up new vendors or to make changes to existing vendors • Verify new vendors are legitimate businesses before approving set up • Periodically review a financial system report for any changes to vendor information and verify it is correct • Periodically compare employee addresses and phone numbers to those of vendors • Periodically evaluate that the vendor's efforts to carry out contracted work match expectations • When approving payments, monitor for and follow up on new or unfamiliar vendors, or those with unfamiliar "ship-to" addresses.

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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

- Start a new email chain
- Use reliable contact information
- Scrutinize emails requesting payment or changes to accounts
- Require notifications of account changes before they happen using multiple channels



How to prevent it

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Resources



Office of the Washington State Auditor



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Government Oversight and Monitoring

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



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Government Oversight and Monitoring



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

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

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Government Oversight and Monitoring



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2: The entity performed virtually no monitoring of financial activities

- No one completed a secondary review of bank activity or credit card statements, or documentation supporting transactions listed on the statements.
- No one scrutinized disbursements, including those for payroll, in sufficient detail to detect possible problems.

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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



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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 own hours worked
- Adjustments were not reviewed or approved

Fire battalion chief falsified time sheets

How did this happen?

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Limit access, provide training, independent reviews

- Limit access to those that:
 - Process payroll
 - Review payroll
- Provide training over payroll calculations, regulations and policies
- Verify payments are for actual hours worked or leave balances earned
- Avoid retroactive payments, unless allowed by policy and state law

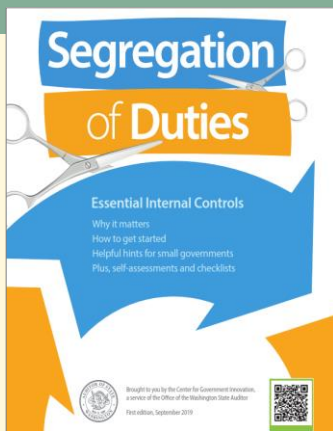


How to prevent it

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How to prevent it



Approve time sheets or process unapproved time sheets

Increasing personal compensation for self, friends, family, or in collusion with another employee

- If the final payroll register has been prepared by one person with these conflicting duties, pay special attention to issues in this list when you conduct the detailed review of payroll
- Set a policy requiring managers to regularly review their employee payroll reports

Authorize leave buyouts, and also track leave usage for all employees (including self)

When a payroll clerk can also process leave buyouts, it is easier to add unauthorized payments.

A payroll clerk that can adjust all leave might not record their own leave accurately.

- Monitor leave buyouts and review supporting documentation to ensure they comply with policy and were authorized
- Monitor the payroll clerk's leave use and balances

Make changes to employee benefits

The payroll clerk might allow health care benefits to non-qualifying persons he/she is connected with (such as a spouse after divorce) or make additional contributions for retirement purposes for personal benefit.

- Periodically review supporting documentation for health benefits and retirement benefit payments to ensure they are correct

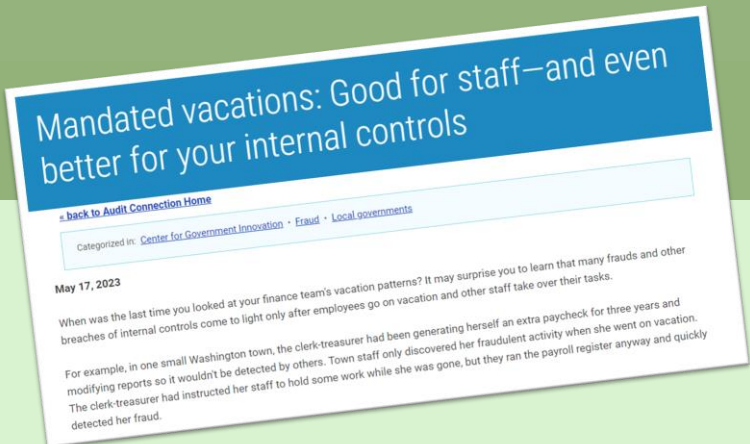
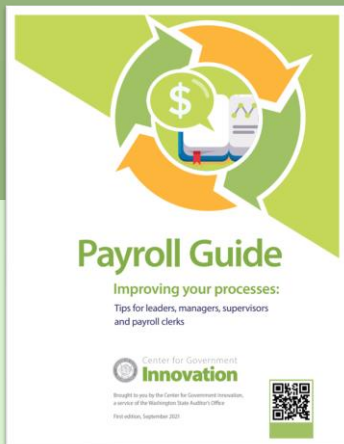


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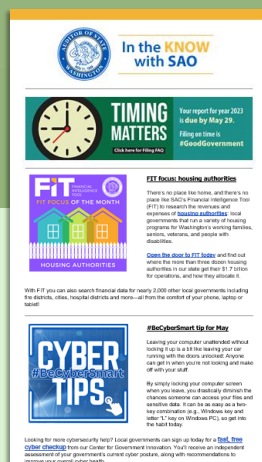
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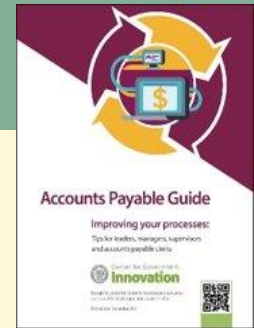
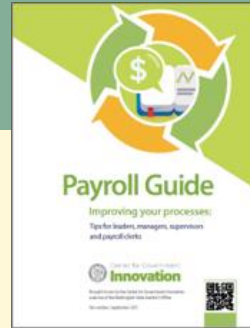
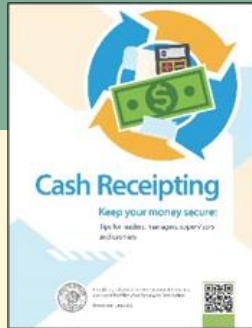
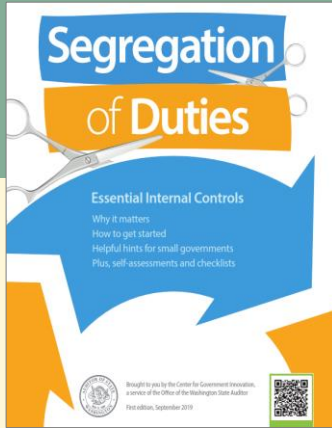
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Where to get started...



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