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Internal Controls & Fraud

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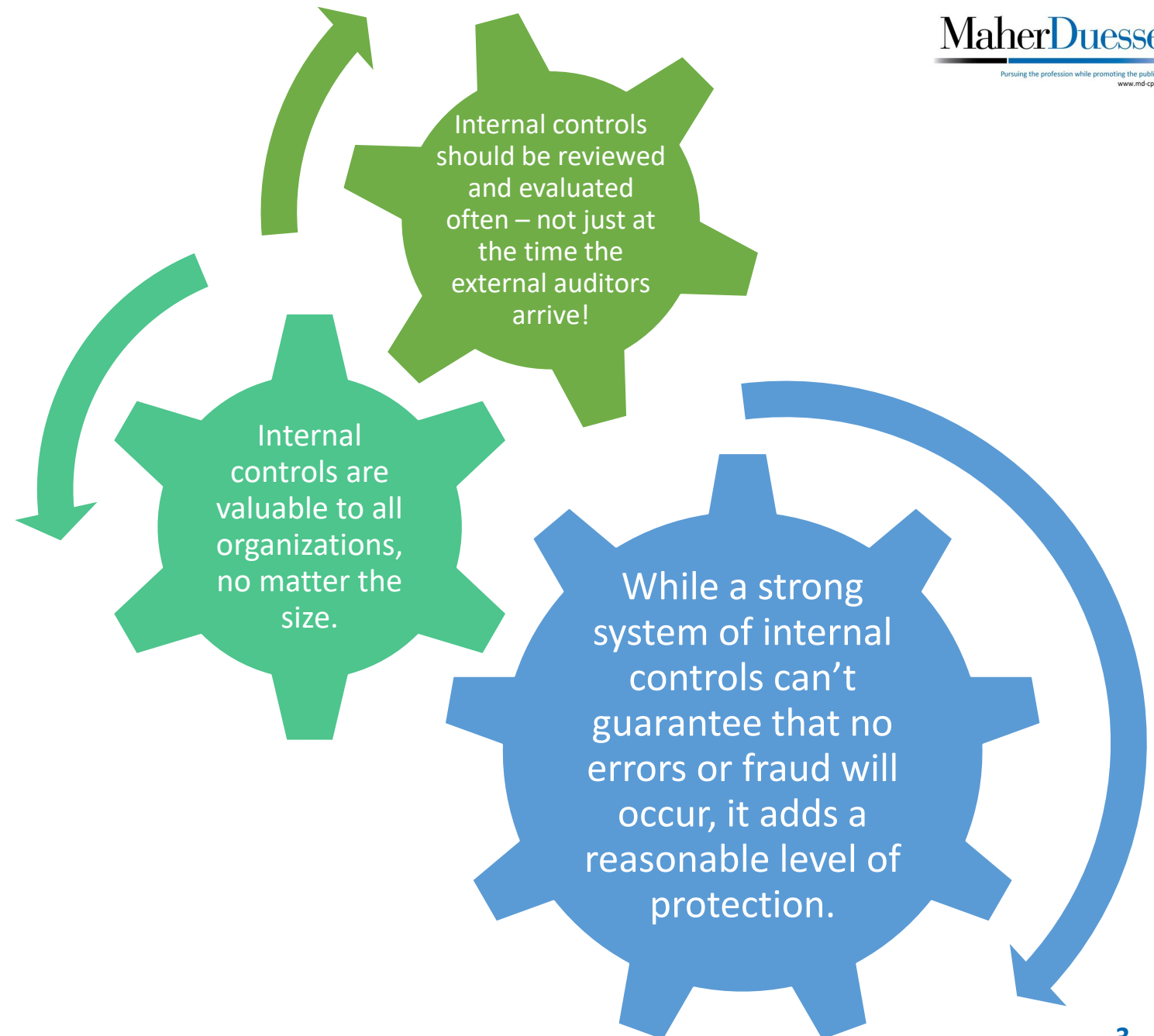
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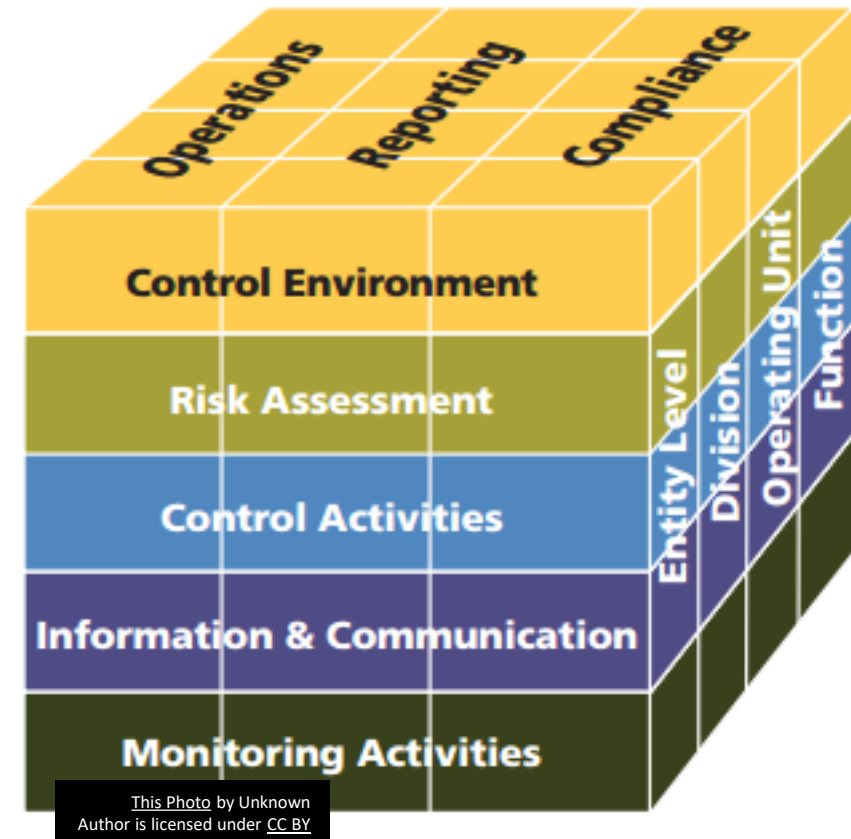
December 17, 2021

OBJECTIVES FOR THIS PRESENTATION

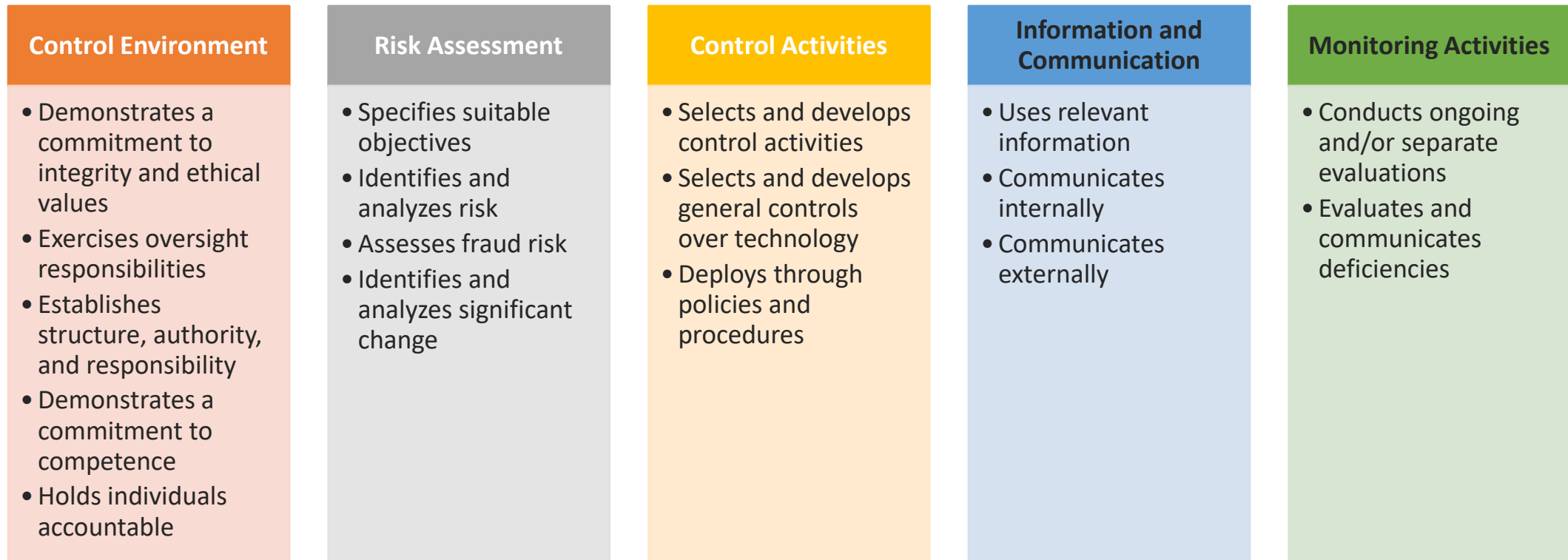


The COSO Cube

- ❑ Helps entities design, implement, and evaluate internal control
- ❑ Aids in understanding the requirements for effective internal control
- ❑ Provides clarity when designing and implementing systems of internal control



Let's Break It Down





CONTROL ENVIRONMENT

The core of any business is its people – their individual attributes, including integrity, ethical values and competence – and the environment in which they operate.

Credit: www.coso.org

Control Environment Documentation

- Code of Conduct
- New employee orientation
- Whistleblower policies
- Training



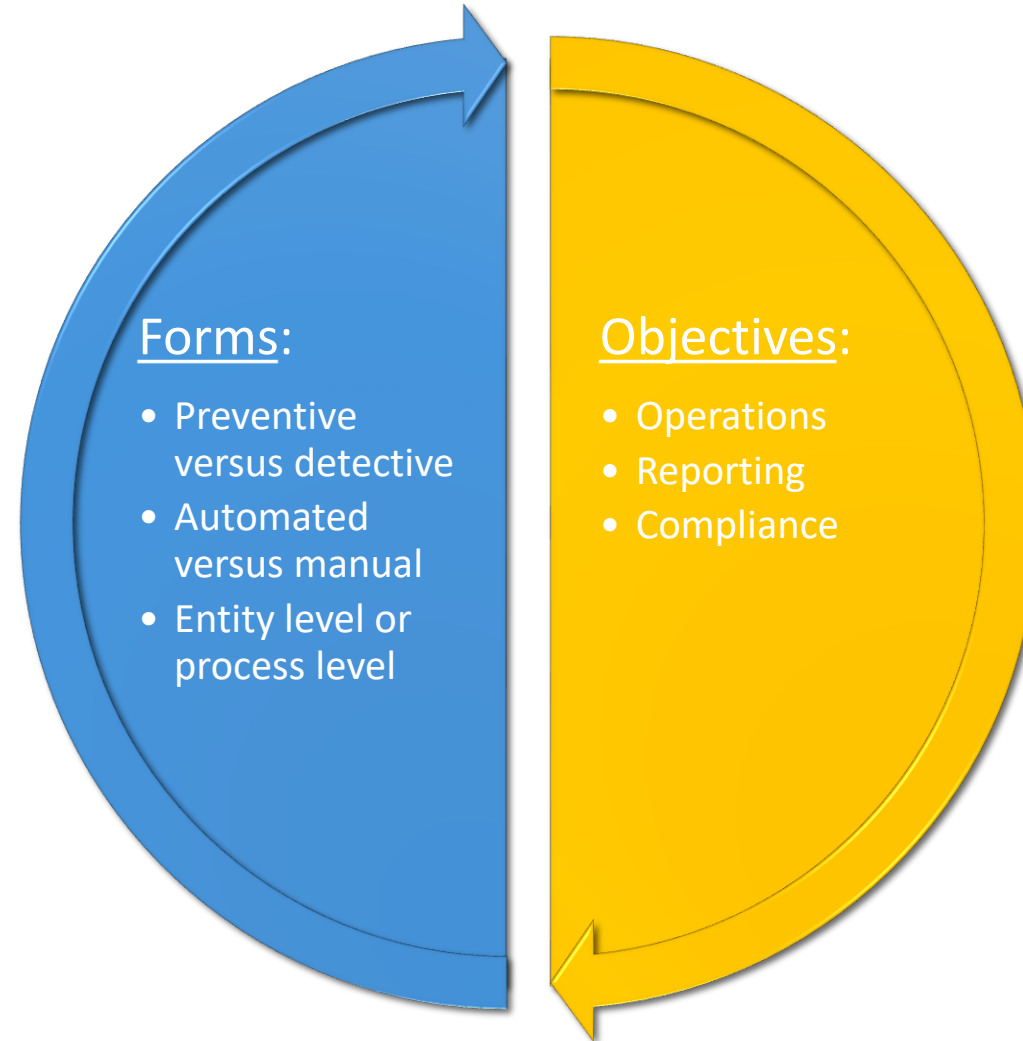
- ❑ An organization's strategic direction and its ability to execute on that direction are both fundamental to the risks it undertakes.
- ❑ Risks are implicit in any organization's strategy.

RISK ASSESSMENT

Risk Assessment Documentation

- ❑ Management considers “what could go wrong?”
- ❑ Changes in personnel, operations, activities, etc. may create new opportunities and threats that must be considered

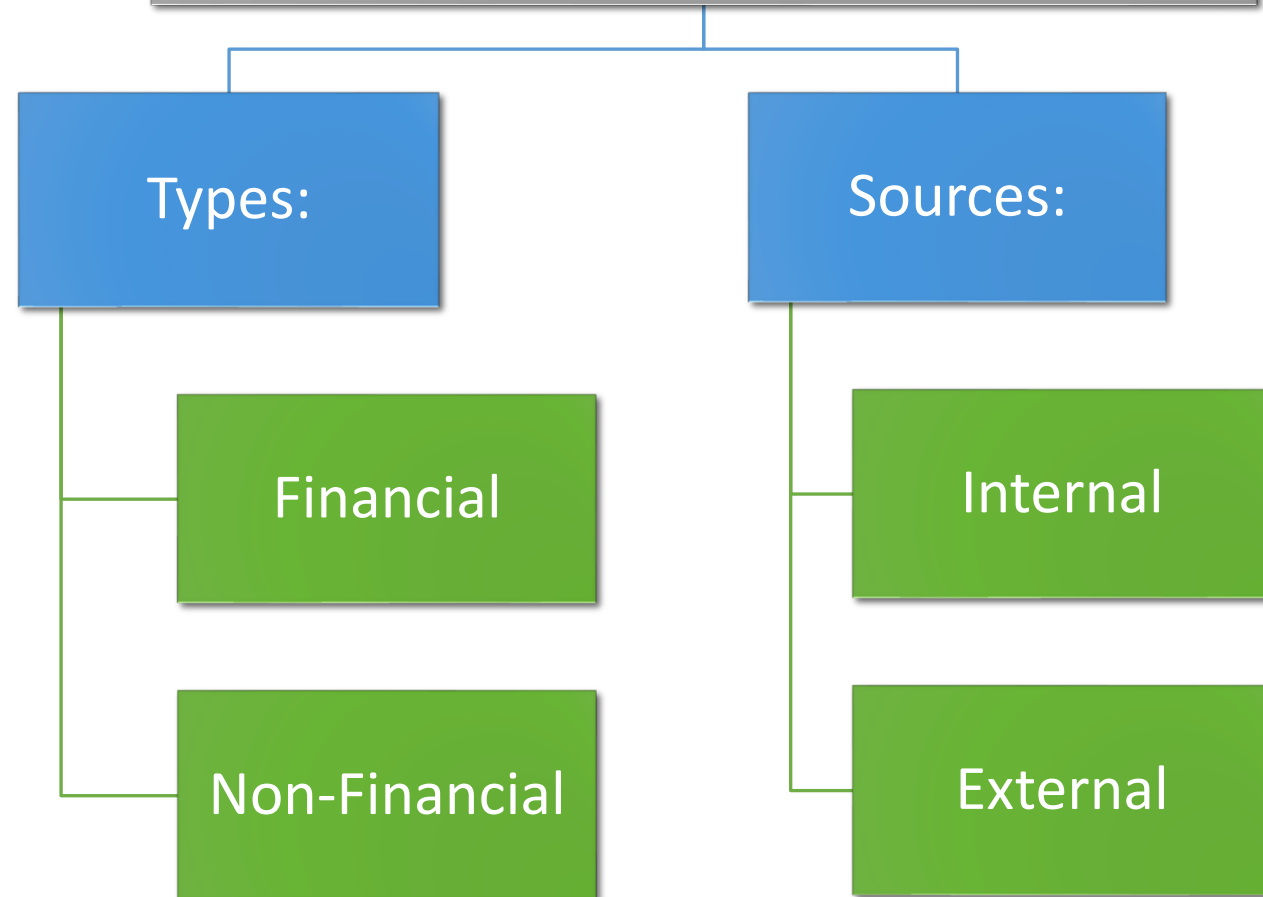
CONTROL ACTIVITIES



Control Activities Documentation

- Documented policies and procedures
- Review and approval of transactions
- IT controls
- Segregation of duties

Information is vital to all aspects of the organization and informs decisions made.



INFORMATION AND COMMUNICATION

Information and Communication Documentation

- ❑ Transactions are recorded by function, fund, funding source (if applicable)
- ❑ Regulations and contracts/grants requirements are communicated
- ❑ Effective communication across the organization

Business conditions change and with that come new and changed risks



Risk responses that were once effective may become irrelevant or obsolete and/or control activities may become less effective or may no longer be performed



It is vital that these changes can be identified so that the organization can adapt

MONITORING ACTIVITIES

Monitoring Documentation

- ❑ Management monitors internal control processes and evaluates changes at the organization
 - Are there ways to be more efficient or effective?
- ❑ Findings by internal/external auditors are reviewed and addressed
- ❑ Corrective action plans are followed

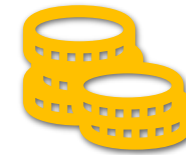
Interference



Political influences



Laws, regulations, and provisions of contracts and grants



Limited financial resources



Inflexible environments, resistance to change



What Are Some Best Practices For Internal Control?

CASH RECEIPTS



Identify what is received and where it is received



Identify how cash is received – cash, check, debit/credit cards, ACH, wire transfer, other



Develop policies and procedures to address all aspects of cash receipts – all departments, all types



Consider use of sophisticated systems:

- Payment consolidation systems
- Lockbox services
- Remote deposit capture



Ask Yourself

IF SOMEONE STOLE MONEY BEFORE IT GOT
INTO THE BANK, WOULD ANYONE KNOW?
HOW LONG WOULD IT TAKE TO FIND IT?

Things to Consider – Cash Receipts

- ❑ Who establishes the rate/fee that is being charged? How is that communicated?
- ❑ How do you ensure that all reimbursable costs are billed to the appropriate grant/funding?
- ❑ Where do you collect cash/currency (if any)? Is there proper oversight to ensure none goes missing?
- ❑ How do you monitor accounts receivable? Is there a reliable system to determine how much is owed to you? Who follows up on old items?
- ❑ Who is able to write off delinquent amounts – do they have access to collections?
- ❑ Is your current tax collector the same as your delinquent tax collector? If not, is there a review process at the end of the year to ensure that delinquent balances are reasonable?
- ❑ What reports are you getting from outside collection agencies to reconcile to deposits received?
- ❑ Where applicable, are you receiving/preparing a rollforward to ensure that amounts being reported are reasonable and close to expectations?
- ❑ Do you perform monthly bank reconciliations? Who receives the bank statements?

CASH PAYMENTS



Identify what is paid
and how it is paid

- Checks
- Petty cash
- Credit cards
- ACH
- Wire transfers
- P-cards



Ensure record retention guidelines are
established and followed

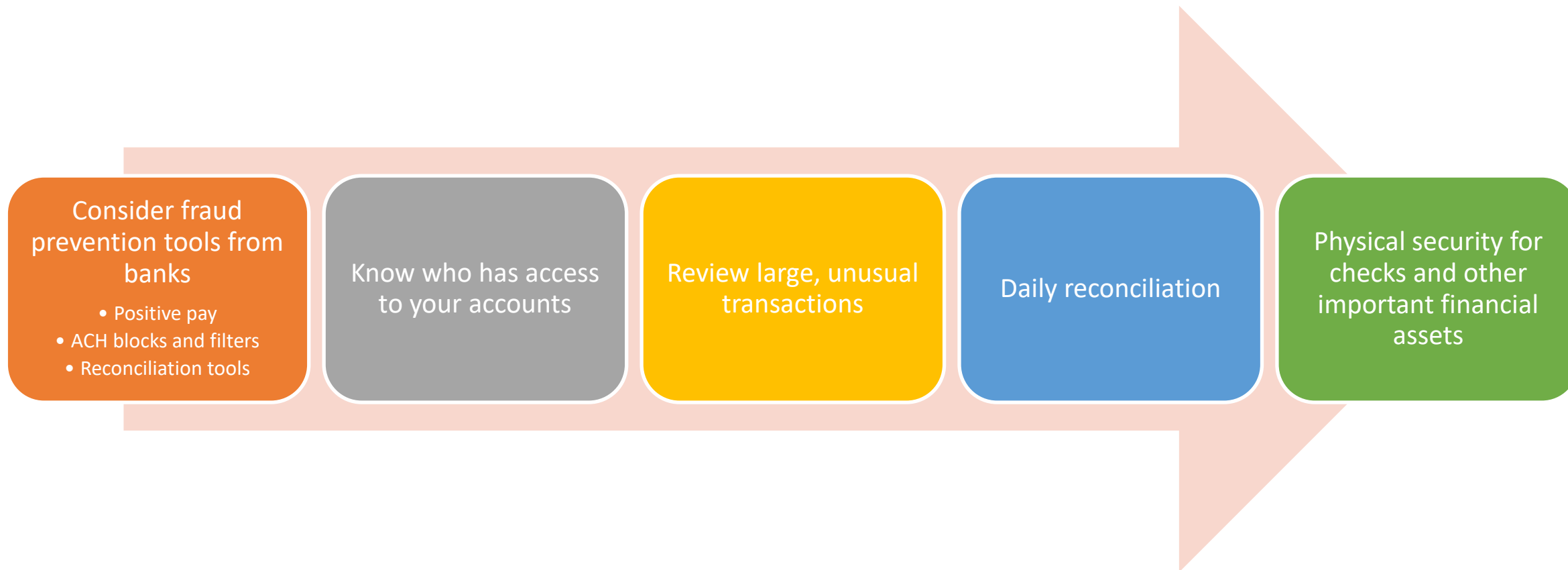


Control vendor selection with adherence
to policies and procedures



Ensure procurement policies are
established and followed

Bank Account Fraud



Electronic Payment Fraud

Email schemes are getting more complicated

Beware of Phishing Emails

- Carefully review the email address of the sender – look for addresses that are similar to, but not exactly the same, as a trusted vendor
- Do not open attachments that are not trusted
- Pick up the phone and call if you are not sure



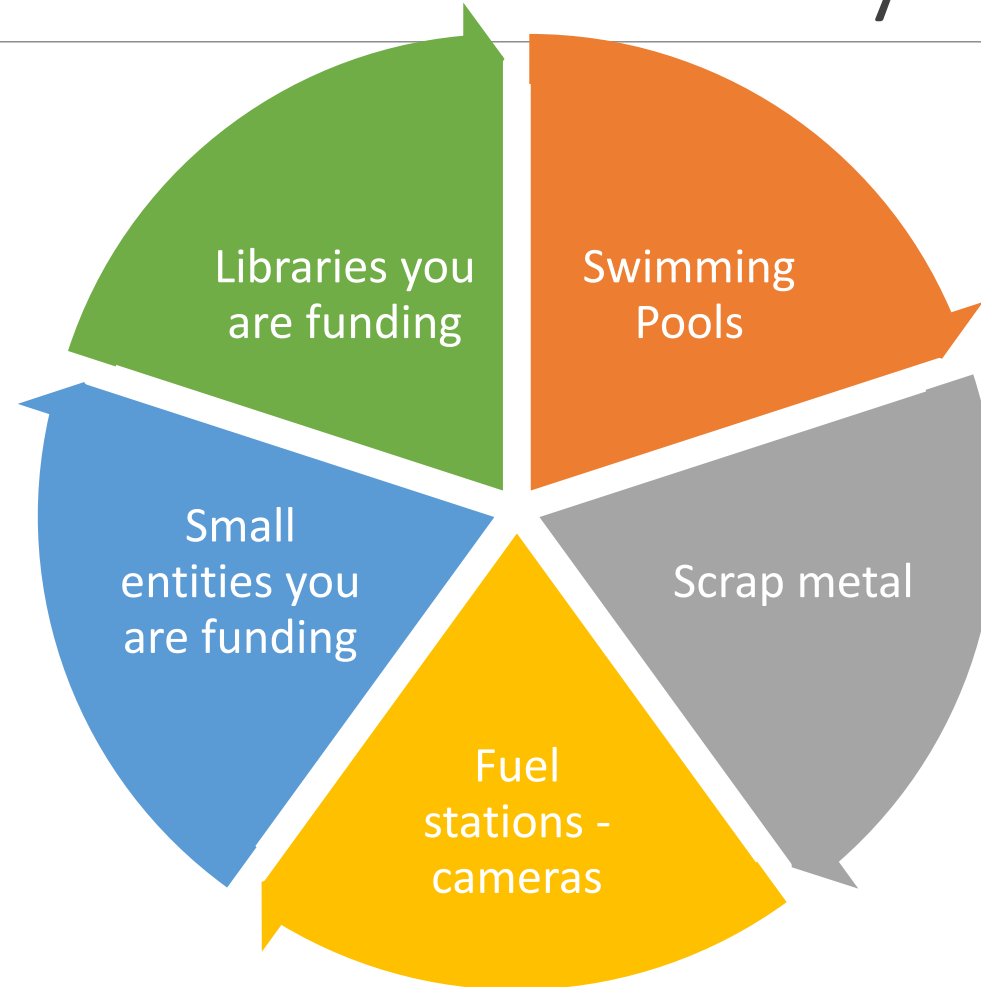
Ask Yourself

IF AN UNAUTHORIZED DISBURSEMENT WAS MADE, WOULD ANYONE KNOW? HOW LONG WOULD IT TAKE TO FIND IT?

Things To Consider – Cash Payments

- ❑ What are your procurement policies and levels?
 - Are they reasonable?
 - Are they enforced?
 - Consider CARES/ARPA requirements – are you in compliance?
- ❑ How do you ensure that a particular good/service was received (by your organization) before making payment?
- ❑ Who sets up a new vendor in the system?
- ❑ Who reviews and approves disbursements? Are they aware of all applicable regulations and requirements to ensure the item is allowable?
- ❑ Is it possible for a check to be altered once it has been approved for mailing?
- ❑ Is it possible for a vendor invoice to be paid twice?
- ❑ Is the check stock locked up? How about the signature plate? How about an electronically applied signature – who knows the password?
- ❑ What is the process to initiate/approve wire transfers and online payments?
- ❑ How many credit cards do you have? How are they monitored?
- ❑ Do you perform monthly bank reconciliations? Who receives the bank statements?

Fringe Areas – Don't Just Focus On Your System



PAYROLL



Identify who gets paid and how much they get paid



Identify how each employee is paid

Check or direct deposit
Hourly or salary



Develop policies and procedures to address all aspects of payroll – distinguish HR duties from payroll duties



Determine if payroll is processed internally or externally



Ask Yourself

IF AN EMPLOYEE WAS PAID THE WRONG AMOUNT,
WOULD ANYONE BESIDES THE EMPLOYEE KNOW?
HOW LONG WOULD IT TAKE TO FIND IT?

DOES YOUR ANSWER CHANGE IF THE ERROR WAS AN
OVERPAYMENT VERSUS AN UNDERPAYMENT?

Things To Consider – Payroll

- ❑ Who has access to the payroll master file?
- ❑ How are changes to the master file reviewed and approved?
- ❑ Who establishes approved pay rates? Are those approved rates documented?
- ❑ Are payroll registers reviewed and approved by someone other than the preparer?
 - Does this review include a comparison to previous payrolls, and investigation into payroll changes?
- ❑ When an employee leaves, is there a process to ensure the final pay is calculated correctly and they do not receive payment (and benefits) beyond their covered period?
- ❑ When an employee begins, how do you make sure they exist (are not a ghost employee)?
- ❑ If timesheets are used, who is responsible for reviewing and approving time submitted?
 - Is that person reasonably able to vouch that the person did, in fact, work those hours?
- ❑ How do you ensure that you are making all appropriate tax/withholding remittances?
 - Are you reconciling your payroll tax liability accounts?
 - Are deductions/withholdings being taken at the appropriate amounts?
- ❑ If you have an outside service provider, what oversight are you performing on them?
- ❑ Do you perform monthly bank reconciliations? Who receives the bank statements?



How Can You Test Internal Controls?

ANSWER!

WRONG!

Wait for your
auditors to
show up!

A Practical Approach

□ Obtain an understanding of the controls in place.

- Is there a narrative, flowchart, questionnaire, or a policy/procedures manual that could provide you with this information?
- Are there individuals that you can interview to learn about the process?
 - Don't just talk to managers – ask the staff who are processing the transactions.
- Start at the beginning of the process and work your way through to the end.
- Determine if there are recent changes (staff, system, regulations, etc.) that impact the internal controls.

TIP! Ensure your understanding covers the normal procedures, as well as the abnormal ones.

A Practical Approach (cont.)

□ Perform a walkthrough of the process.

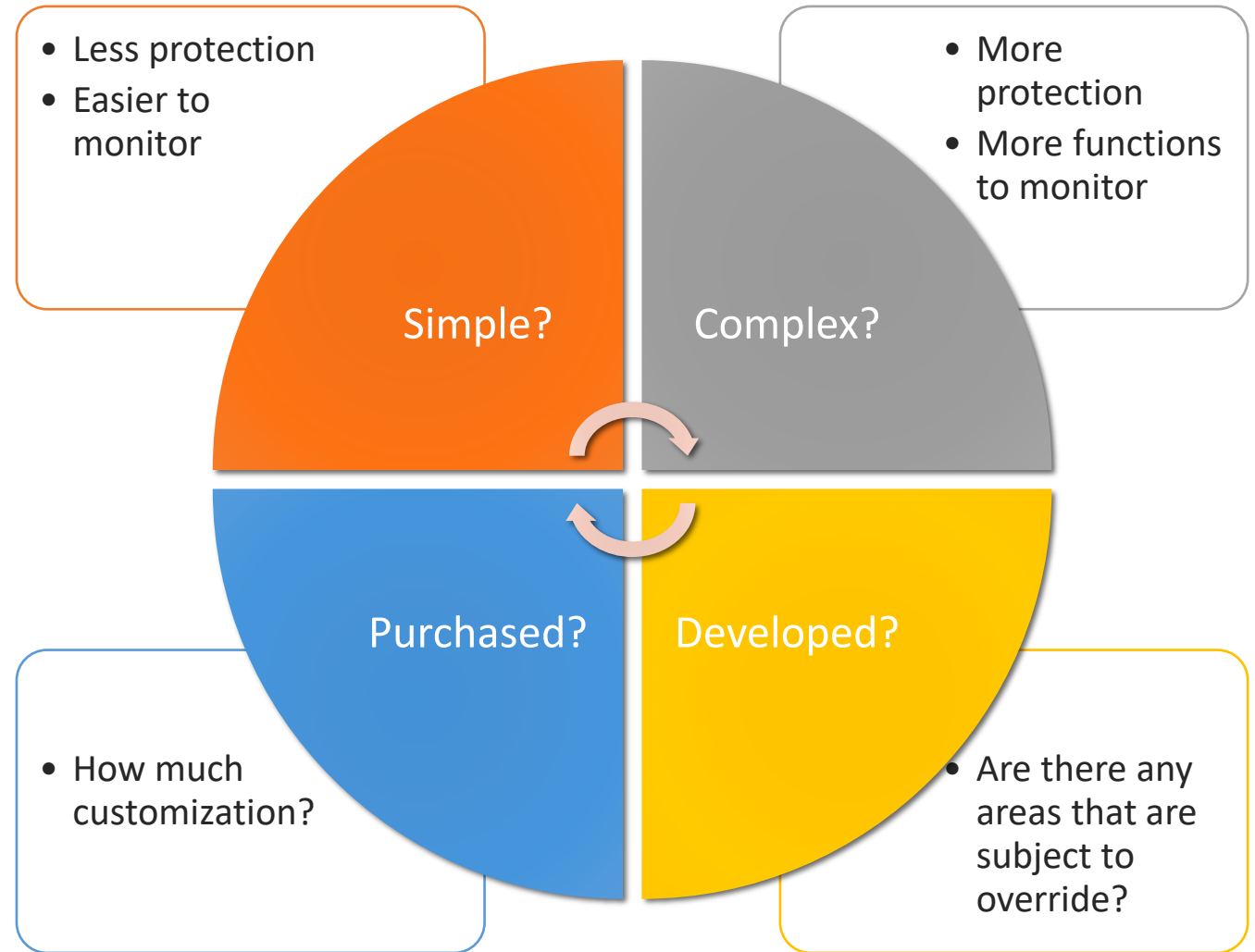
- Randomly select a completed transaction and follow it through the process.
- Or, observe a transaction being processed in real time.
- Do the steps mirror the internal control documentation that you have?
- Are there places where the controls are being circumvented or places where the controls are not as described?
- Keep copies of documentation viewed for future reference.

TIP! If the actual processes used are not reflective of your documentation, make additional inquiries to correct your understanding.

A Practical Approach (cont.)

- **Analyze the controls.**
 - Distinguish processes from controls.
 - What are the key controls?
 - Is there proper segregation?

TIP! No one person should be able to initiate, record, authorize and reconcile a transaction.



DON'T FORGET
IT CONTROLS!

How Involved is Management In:

1

Designing and approving
the financial reporting
system?

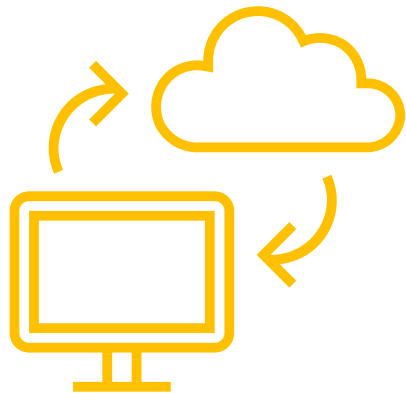
2

Authorizing transactions
and approving changes
to software code?

3

Controlling access to
and use of software,
including coding and
data files?

What Do You Use IT For?



Accounting records



Supporting documents



Journal entries



Financial statement preparation

Do You Have Controls To:

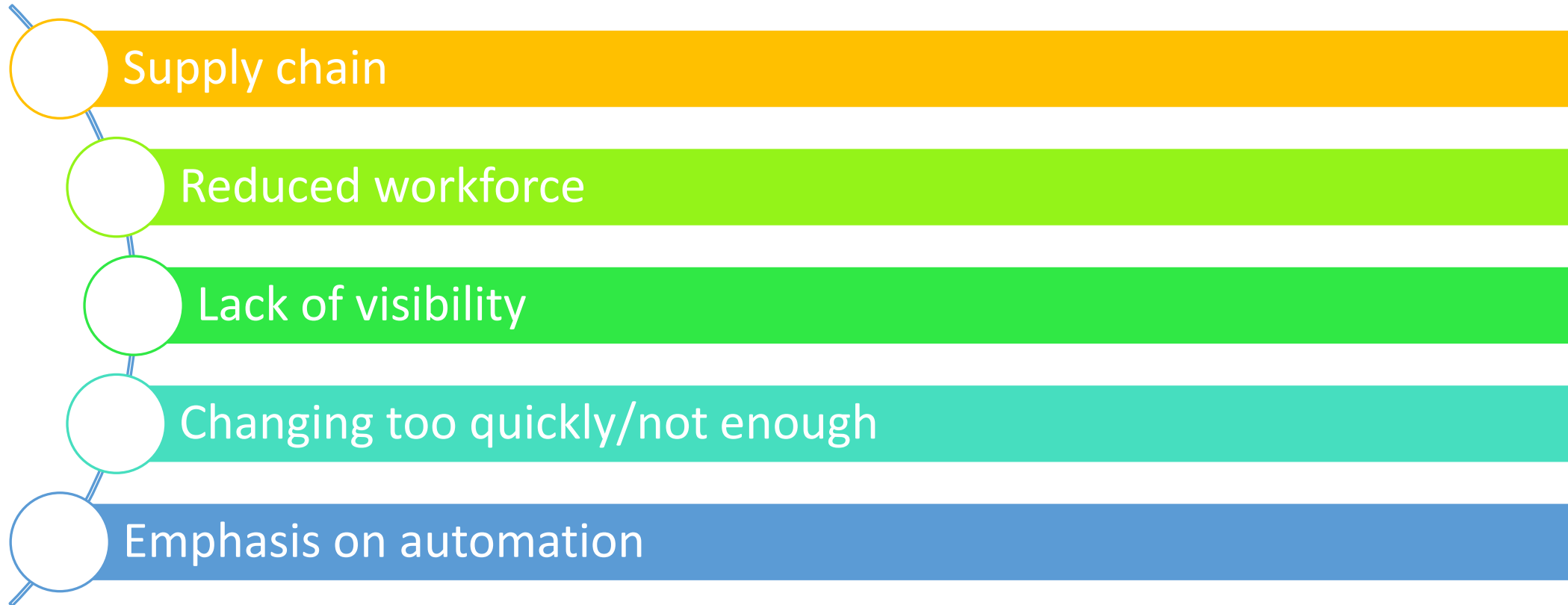
- Test that the data generated from electronically-processed transactions is accurate?
- Follow up on exception reports?
- Purchase and maintain software?
- Access data?



FINANCIAL REPORTING CONTROLS

- ❑ Monthly balancing of assets/liabilities
- ❑ Budget vs actual analysis
 - By program/function
 - By fund
 - By department
 - By funding source (if applicable)
- ❑ Prior year vs current year analysis
- ❑ Scan detail for revenue and expenses
- ❑ Open communication with department heads/management outside of finance

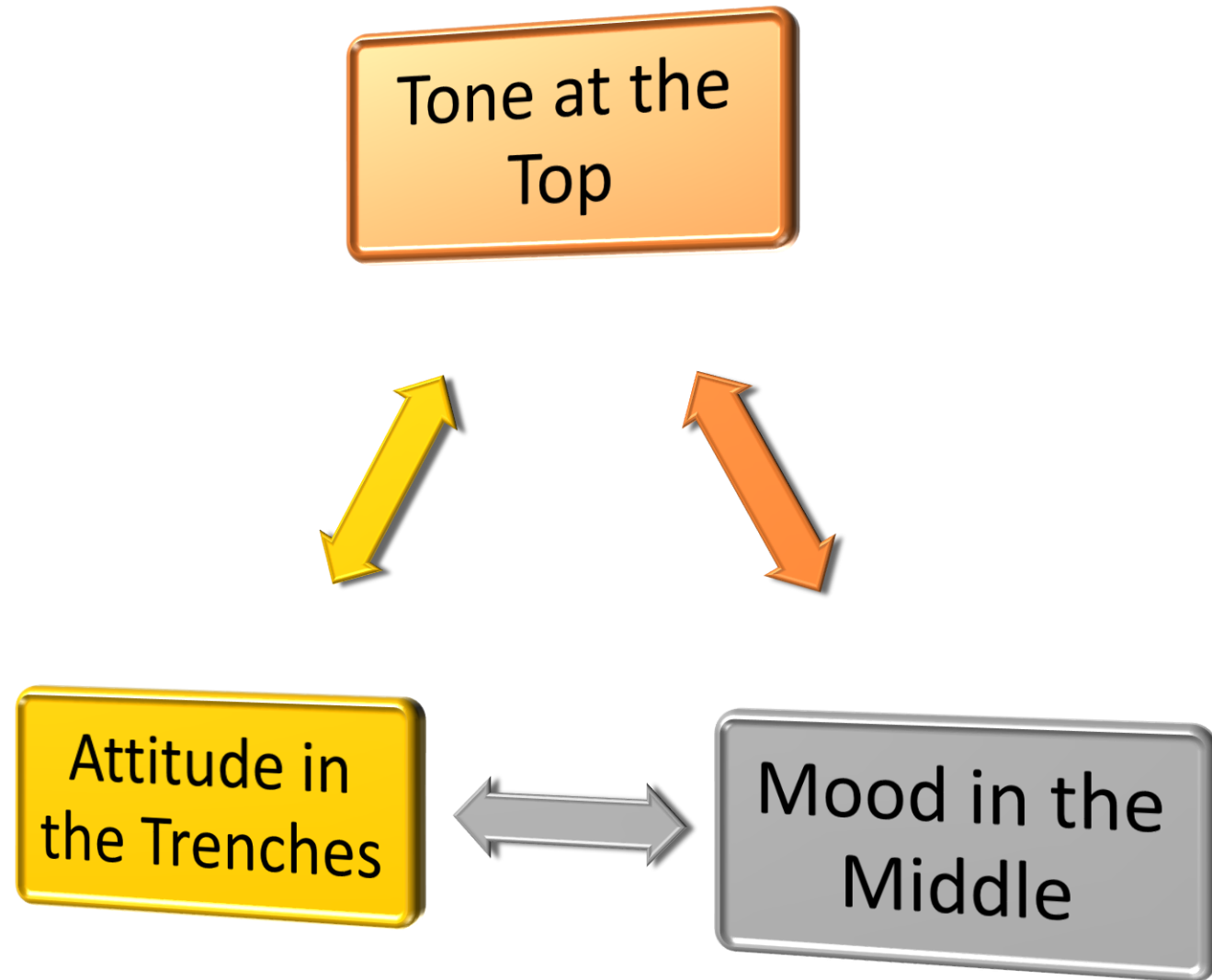
Post-Pandemic Concerns





How Can I Position Myself For Internal Control Success?

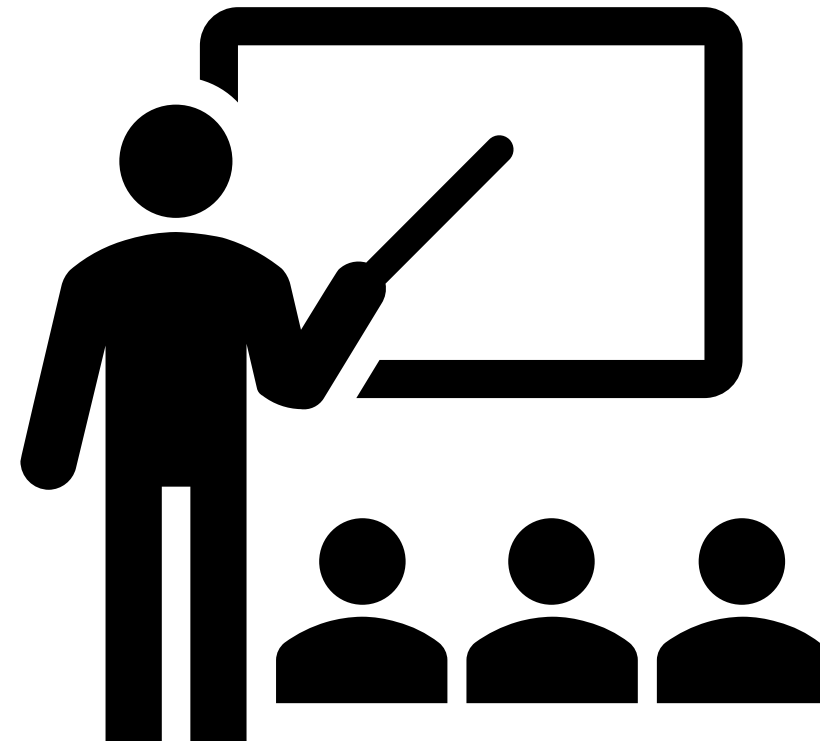
ESTABLISH A STRONG CORPORATE CULTURE





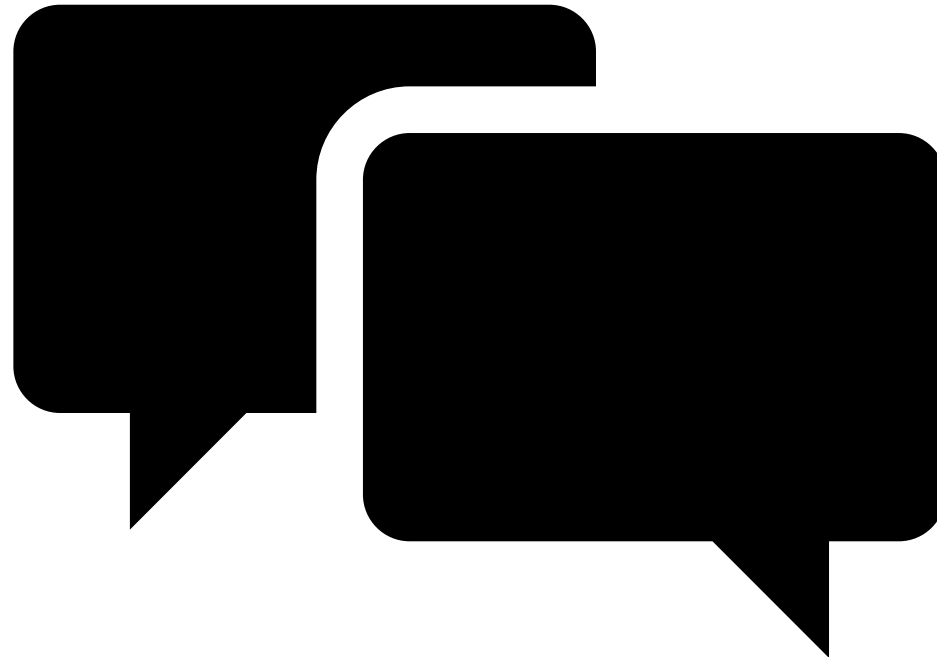
HIRE AND RETAIN GOOD EMPLOYEES

PROVIDE
TRAINING AND
CONSISTENT
REINFORCEMENT

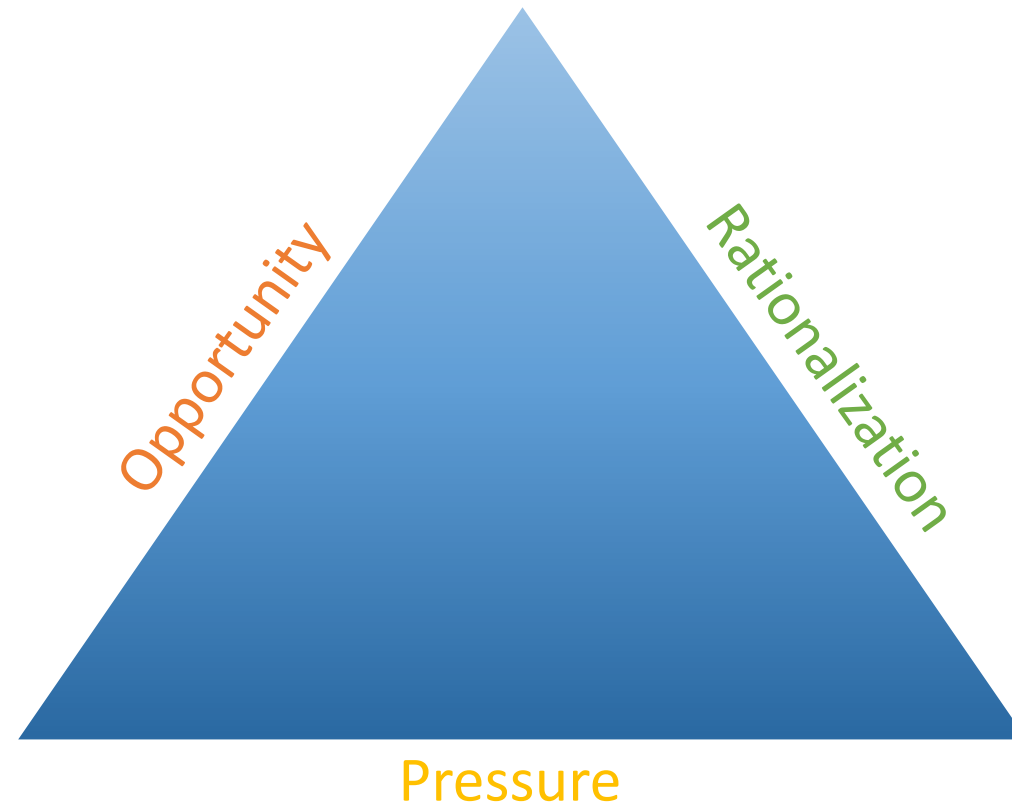




LET'S TALK
FRAUD!



The Fraud Triangle



Association of Certified Fraud Examiners’ “Report to the Nations – 2020 Global Study on Occupational Fraud and Abuse”

4% of fraud is
initially detected
by external
auditors

43% came from
employee tips
What process do you
have?

12% was detected
by management
reviews

15% came from
internal audits

Types of Fraud

ASSET MISAPPROPRIATION (stealing or misusing resources)

- 86% of cases
- Average loss of \$100,000

CORRUPTION (bribery, conflicts of interest, extortion)

- 43% of cases
- Average loss of \$200,000

FINANCIAL STATEMENT FRAUD (misstatement or omission in financial statements)

- 10% of cases
- Average loss of \$954,000

Breakdown Of Fraud In Government Organizations (189 Cases)

- ❑ Billing – 18%
- ❑ Cash larceny – 5%
- ❑ Cash on hand – 9%
- ❑ Check and payment tampering – 4%
- ❑ Corruption – 48%
- ❑ Expense reimbursements – 17%
- ❑ Financial statement fraud – 4%
- ❑ Noncash – 17%
- ❑ Payroll – 17%
- ❑ Skimming – 7%



Internal Control Factors Contributing To Fraud – Top 5

Lack of internal controls

Override of existing internal controls

Lack of management review

Poor tone at the top

Lack of competent personnel in oversight roles

Methods to Conceal Fraud

Create fraudulent
physical
documents

Alter physical
documents

Alter electronic
documents/files

Create fraudulent
documents/files

No attempts to
conceal the fraud
– 12% of cases!

Others

Who Do Whistleblowers Report To?

Direct supervisor – 28%

Fraud investigation team- 15%

Internal audit – 12%

Executive team - 11%

Coworker – 10%

Law enforcement/regulator – 7%

Owner – 7%

Board or audit committee – 6%

Human resources – 6%

In-house counsel – 4%

External audit – 1%

Other – 15%



Behavioral Red Flags

- ❑ Living beyond means
- ❑ Financial difficulties
- ❑ Unusually close association with a vendor or customer
- ❑ Excessive control issues or unwillingness to share duties
- ❑ Unusual irritability, suspiciousness, or defensiveness
- ❑ Shrewd or unscrupulous behavior
- ❑ Recent divorce or family problems

COSO Areas

- Control Environment
- Risk Assessment
- Control Activities
- Information & Communication
- Monitoring Activities

Manage Your System of Internal Controls

- Obtain an Understanding of the Controls in Place
- Re-perform the Control
- Analyze the System; Make Changes as Necessary

Be Alert for Fraud Indicators

Provide Training

LET'S RECAP