New & Existing Council
Extension Training

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Protecting Public Assets

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Deputy Auditor of State
Fiduciary Duties

- Understanding fiduciary duties
  - Duty to the public
  - Oversight
  - Accountability
Public Purpose

- Public Purpose/Public Benefit
- Constitution of the State of Iowa
  - Article III, Section 31
- Public purpose test
  - Criteria
- Documenting public purpose
Creating an Ethical Environment

- Setting the right tone at the top
- Common ethical violations
- Determinants of ethical behavior
- Negative work environment
- Positive work environment
- Four steps to create and maintain a good ethical climate
Setting the Right Tone at the Top

- According to National Business Ethics Surveys by the Ethics Resource Center:
  - Ethical atmosphere is created in the workplace by the organization's leadership
  - Good or bad, tone set at the top tends to trickle down to employees
  - Employees pay close attention to the behavior and actions of their bosses and follow their lead
Common Ethical Violations

- Abusive or intimidating behavior of supervisors toward employees
- Lying to employees, customers, vendors or the public
- Conflicts of interest
- Violations of safety standards
- Misreporting actual time or hours worked
- Email and internet abuse
- Discrimination
- Stealing, theft or related fraud
- Sexual harassment
Positive Work Environment

- Helps deter fraud
- Recognition and reward systems are in tandem with goals and results
- Equal employment opportunities exist
- Team-oriented, collaborative decision-making policies are encouraged
- Compensation and training programs are professionally administered
Four Steps to Create and Maintain a Good Ethical Climate

1. Communicate what is expected of employees
2. Lead by example
3. Provide a safe mechanism for reporting violations
4. Reward integrity
Doing the Right Thing

- If you have to work through a complex and/or convoluted line of reasoning to justify an action, you probably should not be doing what you are doing
- It is always the right time to do the right thing
- Good judgment comes from experience, experience comes from bad judgment
Internal Control Defined

- Process effected by an entity’s governing board, management, and other personnel designed to provide reasonable assurance regarding the achievement of objectives in three categories:
  - Effectiveness and efficiency of operations
  - Reliability of financial reporting
  - Compliance with laws and regulations
Segregation of Duties

- An internal control procedure whereby no one individual is placed in a position of being able to both commit and conceal an irregularity by performing incompatible duties.
Components of Internal Control

- Control Environment
- Risk Assessment
- Information and Communication
- Control Activities
- Monitoring Controls
Auditor’s Responsibility

- “The auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud.”

- Auditors should provide guidance and suggestions.
Management’s Responsibility

It is management’s responsibility to design and implement programs and controls to prevent, deter, and detect fraud, including:

- Setting the proper tone
- Creating and maintaining a culture of honesty and ethics
- Establishing appropriate controls
There are two significant types of financial fraud . . .

- Misappropriation of assets
  - (aka employee fraud)
    - higher number of cases
    - lower dollar impact

- Fraudulent financial reporting
  - (aka management fraud)
    - lower number of cases
    - higher dollar impact
Fraud in Government Accounting

Factors contributing to fraud in governmental entities:

- Frequent cash collections
- Limited administrative and other personnel
- Lack of segregation of duties
- Lack of oversight—“blind” trust
- Lack of profit-motive
- Perception that “money is unlimited” compared to employee’s finances
Fraud in Government Accounting

- Internal Controls
  - Very important deterrent
  - Provides fear of detection and punishment
  - Helps remove/reduce temptation
Why Controls Don’t Always Work

- Inadequate knowledge of policies or governing regulations. “I didn’t know that!”
- Inadequate segregation of duties. “We trust ‘A’ who does all of those things.”
- Inappropriate access to assets. Passwords shared, cash not secured...
- Form over substance. “You mean I’m supposed to do something besides initial/sign it?”
- Control override. “I know that’s the policy, but we do it this way. Just get it done, I don’t care how!”
Fraud in Government Accounting

Since 1996*, 266 Special Investigations have been issued on governmental entities in Iowa:

- Most common type of entities:
  - Cities – 104
  - Schools – 44
  - Counties – 47
  - State Agencies, Universities, and Community Colleges – 32
  - 28Es – 18
  - Other – 21

*through 9/19/2014
Common Findings

- Lack of administrative oversight
- Lack of segregation of duties
- Lack of bank reconciliations
- Lack of supporting documentation
- Lack of public purpose
Common Findings

- Excessive payroll payments
- Excessive travel/expense reimbursements
- Checks written to “Cash”
- Unauthorized and/or inappropriate use of government’s credit card
- Unauthorized bank accounts
Methods Used to Carryout Frauds

- In 61% of the cases there were undeposited collections
- In 56% of the cases there were improper purchases from vendors
- In 39% of the cases there were payroll/extra pay
- In 31% of the cases there were improper reimbursements
- In 21% of the cases there were improper credit card payments or purchases
- In 14% of the cases there were cash withdrawals
Fraud in Government Accounting

Here is a 5-Step approach for fraud detection:

1. Know fraud exposures in specific terms.
2. Know exposure-specific symptoms of fraud:
   - Symptom is defined as a condition that is directly attributable to dishonest or fraudulent activity.
3. Be alert for fraud symptoms
4. Incorporate steps into routine processes that are likely to reveal fraud
5. Follow through on all observed symptoms
Fraud in Government Accounting

Finding from fraud investigation:

Administrative Oversight: The Council received very limited financial information. In addition, although it inquired about the government’s declining financial position, the Council did not appropriately follow up on questions which were not resolved to its satisfaction.
**Recommendation**: Due to the government’s financial condition and because of the Council’s fiduciary responsibilities, a healthy level of skepticism should be maintained at all times. Specifically,

- Council Members should ask explicit questions about the government’s finances as frequently as necessary to have a complete understanding of the government’s financial condition.
- Council Members should also follow up on any questions which are not clearly resolved to their satisfaction.
Fraud in Government Accounting

In areas with lack of segregation of duties must insist on appropriate oversight—

Examples:

- Finance officials should:
  - Should review and approve invoices and compare to checks before counter signing
  - Don’t ever sign blank checks
  - Receive bank statements directly
Fraud in Government Accounting

In areas with lack of segregation of duties, insist on appropriate oversight (cont.)—

Another employee or official should:

- Review and approve bank reconciliations
- Review and approve payroll
- Document all decisions in minutes (payroll increased, changes in policies, etc.)
Fraud in Government Accounting

Oversight provides protection:

- Oversight by Council officials is the most critical ingredient to fraud prevention/detection especially in areas with a lack of segregation of duties.
- Even the governing body must sometimes play a more active role to compensate for lack of segregation of duties.
Fraud in Government Accounting

- Fraud prevention/detection techniques—

  Be alert for misuse of government assets:

  - Credit cards
  - Vehicles/gas
  - Supplies
  - Cell phones
  - Office telephones
  - Computers/internet
Here are Some Red Flags of Fraud

Fraud Danger Signals… (Red Flags)

- Regularly borrowing money from coworkers
- Creditors or collectors appearing at the workplace
- Gambling beyond the ability to stand the loss
- Excessive drinking or other personal habits
- Becomes easily annoyed at reasonable questioning
Red Flags of Fraud
(cont.)

- Providing unreasonable responses to questions
- Refusing vacations or promotions (fear of detection)
- Bragging about significant new purchases
- Carrying unusually large sums of money
- Rewriting records under the guise of neatness in presentation
Parting Thoughts & Suggestions

- **Authorize** - Employees shouldn’t have the ability to do or spend whatever they want.
- **Reconcile** - Make sure things match to a reliable source.
- **Segregate duties** - never give one person too much control over any function.
- **Safeguard assets** – as if they are your own.
- **Supporting documentation** – As the old saying goes, if you didn’t write it down, it didn’t happen.
What To Do When You Suspect or Discover Fraud

- Notify Office of Auditor of State
  - Annette Campbell 515-281-5834
  - Tami Kusian 515-281-7002

Note: The remaining steps must be tailored to each specific situation

- Notify:
  - CPA firm
  - Governing body (Consider quorums)
What To Do When You Suspect or Discover Fraud (cont.)

- Secure all necessary records
- Consider:
  - Stopping access to bank accounts
  - Stopping access to certain financial records and/or processes
  - Securing physical access to items at risk
    - Change locks if necessary
What To Do When You Suspect or Discover Fraud (cont.)

- Discuss with management and legal counsel advisability of placing individual on administrative leave.
- Take notes and write up any pertinent information.
Office of Auditor of State
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