AGENDA

- Fraud

- Internal Controls

- *OMB Uniform Guidance*

- Practical Considerations/Specific Controls

Non-profits in the News!!!

▶ "Two longtime officials of a federally funded Head Start program run by the Roman Catholic Archdiocese of New York siphoned more than $800,000 from the program,…by burying additional payments to themselves…they nearly tripled their salaries,…" The New York Times, June 2, 2005

▶ "Head Start director in Maryland…stole $335,777…South Dakota woman on charges that she embezzled $185,000…" The New York Times, March 18, 2005

▶ "..mismanaged $140,000…and collected roughly $30,000 in bonuses…in violation of employment policies… and not reported to tax authorities." The New York Times, July 1, 2004

Non-profits in the News!!!

▶ "Undercover investigators trying to enroll a handful of fictitious children in federally funded Head Start child care centers found that in about half of the cases, workers fraudulently misrepresented parents' incomes, addresses and other information to allow kids to qualify for a slot." USA Today, May 19, 2010

▶ **"…director of food services for Open Arms of Minnesota from 2009 to 2012. He allegedly made contractual arrangements for food deliveries with at least four charity organizations and two private individuals, delivered Open Arms' food and kept the money($155,000) for himself."** Pioneer Press, August 6, 2012

Non-profits in the News!!!

▶ **"Seattle police are investigating allegations that the nonprofit's (Senior Services of Seattle-King County) employee, who was fired in March, created a fake company to bill the agency for moving and hauling services that clients never received. Senior Services estimates that $89,000 in city money was appropriated."** The Seattle Times, September 28, 2012

▶ "The former executive director of a southwest Florida nonprofit is accused of misappropriating more than $900,000." CBS, July 24, 2012

▶ "The former CFO of a Kansas nonprofit was charged Wednesday with stealing more than $2 million in Medicaid money. Prosecutors said Sellers diverted Medicaid funds to a shell company billing for work supposedly done by the nonexistent business." Kansas City Business Journal, August 22, 2012

Non-profits in the News!!!

- …a senior program officer with the Buffett Foundation was charged with stealing $46,000. Patel, who made $190,000 a year, turned in false receipts for various types of expenses. Omaha World-Herald, May 22, 2012

- The Trauma Intervention Program in Vista, California prosecuted 79-year-old Judy G_____ for writing 181 checks to herself worth $300,000 over a four year period. Omaha World-Herald, May 22, 2012

- "The former accounting director of the Roman Catholic Archdiocese of St. Paul and Minneapolis has been accused of stealing more than $670,000 from the church. …Diverted archdiocese checks to pay personal credit card bills, private school tuition for children and other personal expenses." Pioneer Press, June 15, 2012

Fraud Happens

▶ U.S. organizations lose _____% of their annual revenues to fraud.

▶ The median loss caused by occupational fraud was $_____. More than one-quarter of the frauds involved losses of at least $_____.

▶ The typical fraud lasted _____ months until the time it was caught by the victim organization.

Why do people commit fraud?

- The key is to focus on prevention

- If we prevent fraud, we avoid the losses

- In order to prevent the loss, we must understand why fraud occurs

Why do they do it?

- Vast majority are not career criminals

- Most are trusted employees with no criminal history

- When 3 elements come together, the basically honest person will commit fraud...

Oxygen

Fuel

Spark

Oxygen (Environment)

Fuel (Opportunity)

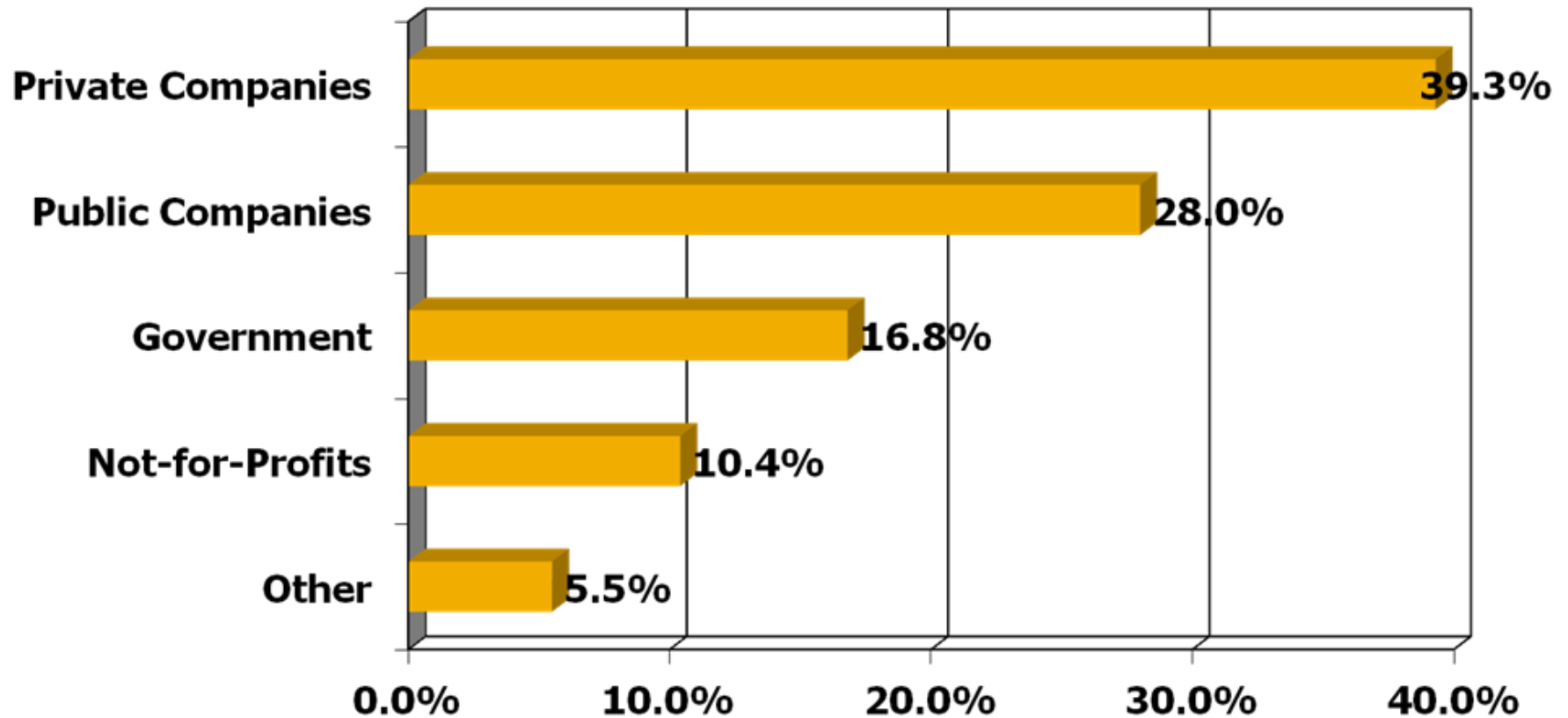Spark (Motive)

Elements of Fraud

Motive (Need) – Individual has some financial problem he is unable to solve through legitimate means:

- ▶ Inability to pay one's bills

- ▶ Vice (Booze, person on the side, gambling, and/or drugs)

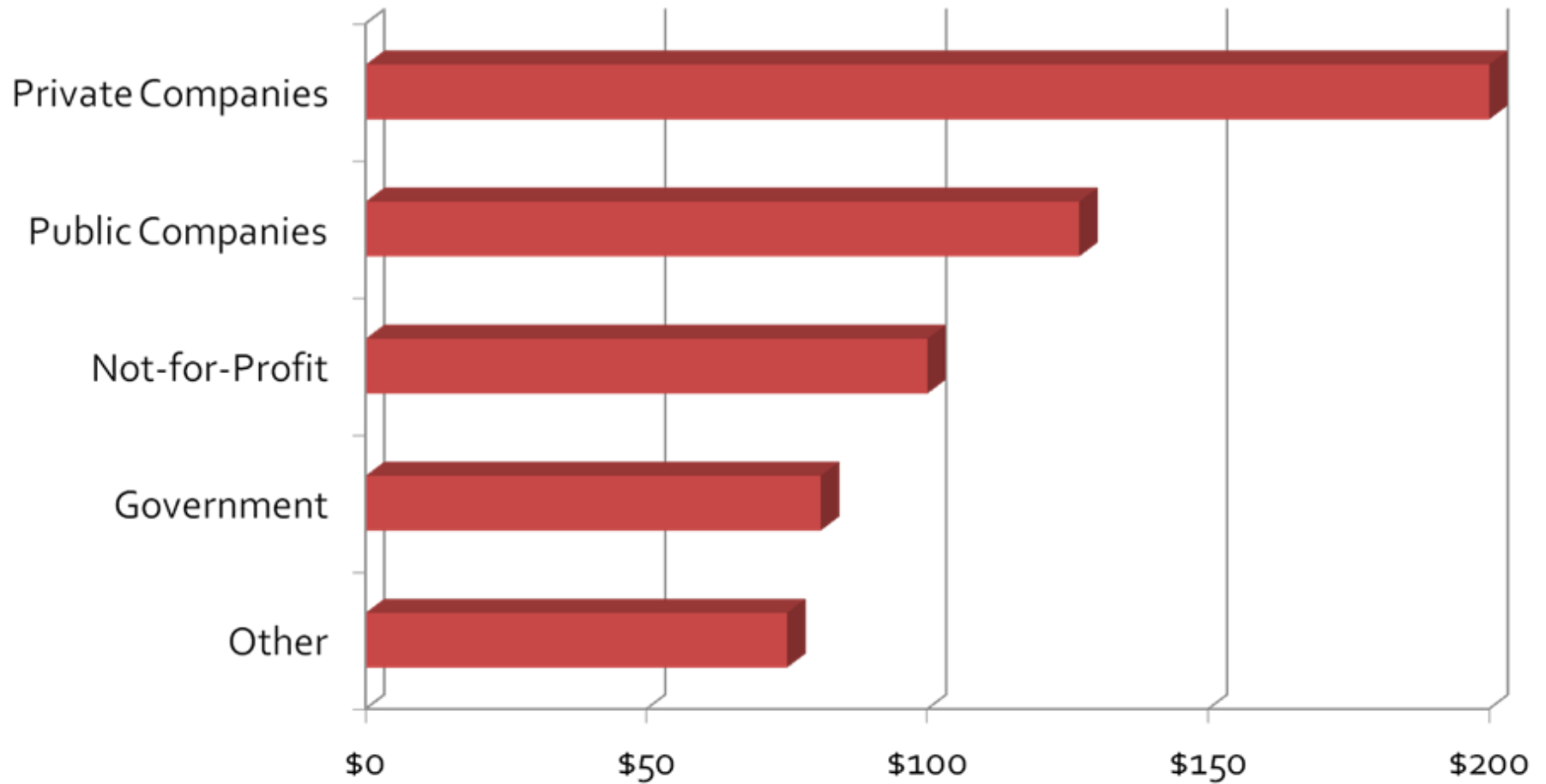- ▶ Status – keeping up with the neighbors

Elements of Fraud

▶ Opportunity – The person must see a way of using his position with a low perceived risk of detection

▶ Environment – Lack of controls must be present to enable the desired action to occur.

▶ The fraudster rationalizes the crime to himself *before* he commits the crime, *after* the act takes place, rationalization no longer important.

Organization Victim of Fraud

Organization	Percentage
Private Companies	39.3%
Public Companies	28.0%
Government	16.8%
Not-for-Profits	10.4%
Other	5.5%

Median Loss by Organization Type

| Category	Examples	% of all Cases	Median Loss
Asset Mis-appropriation	▪Fraudulent invoices ▪Payroll fraud ▪Skimming Revenues	86.3%	$135,000
Corruption	▪Accepting or paying bribe ▪Conflict of interest	32.8%	$250,000
Fraudulent Statements	▪Fictitious sales ▪Expenses in wrong period	4.8%	$4.1 million

Distribution of Dollar Loss

Percent of Cases
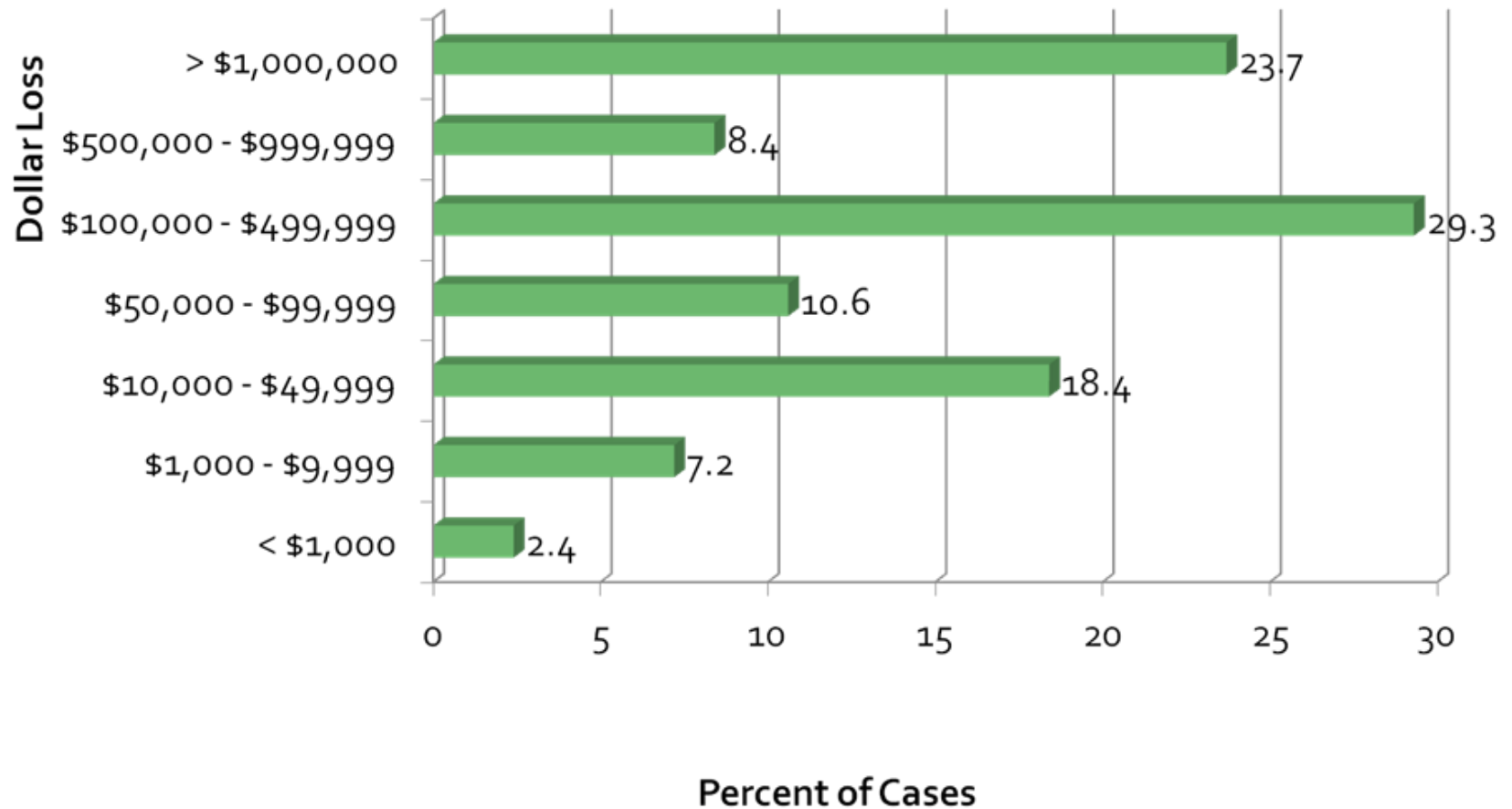
Median Duration of Fraud
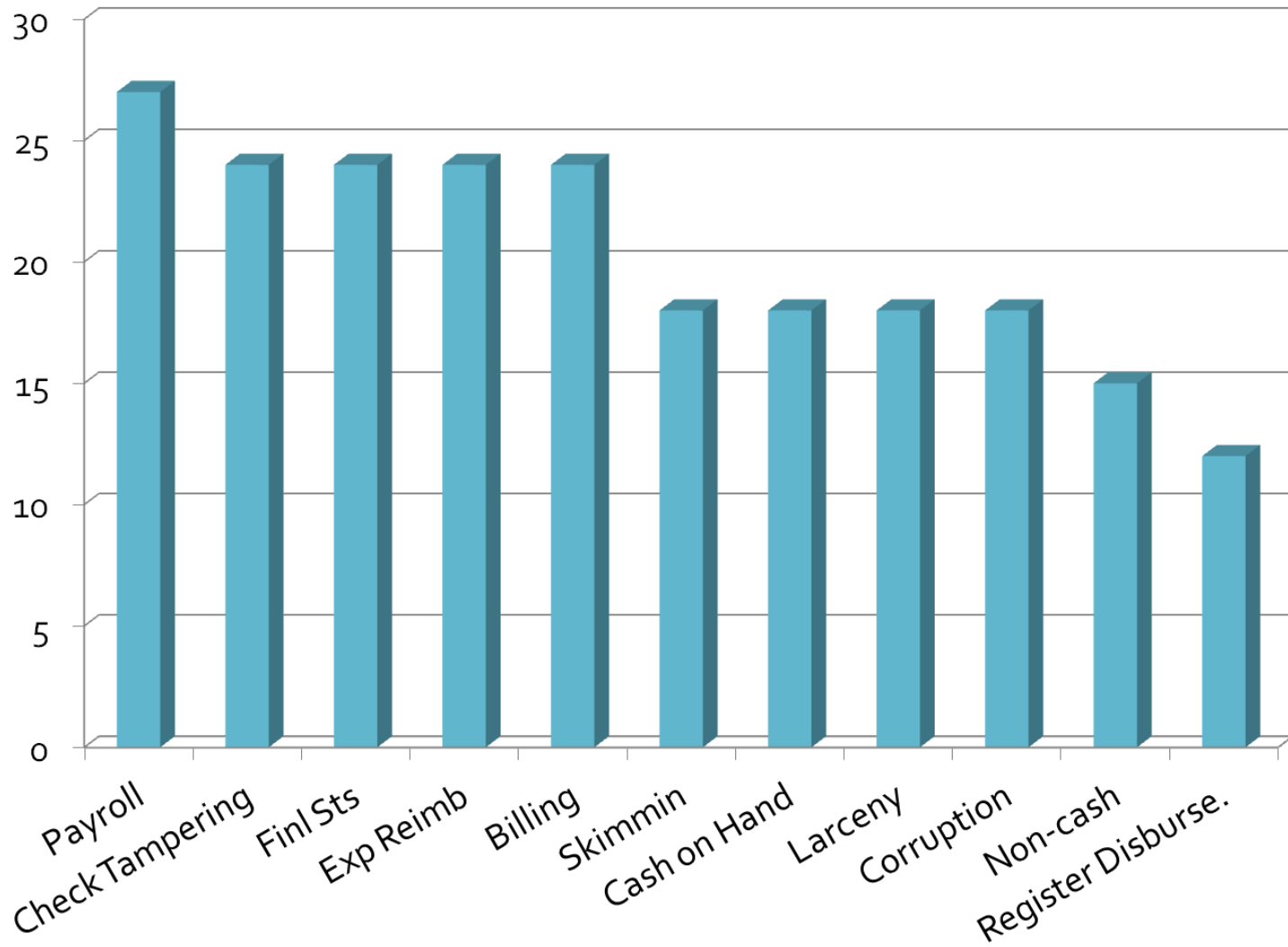
Initial Detection of frauds

Percent of Cases
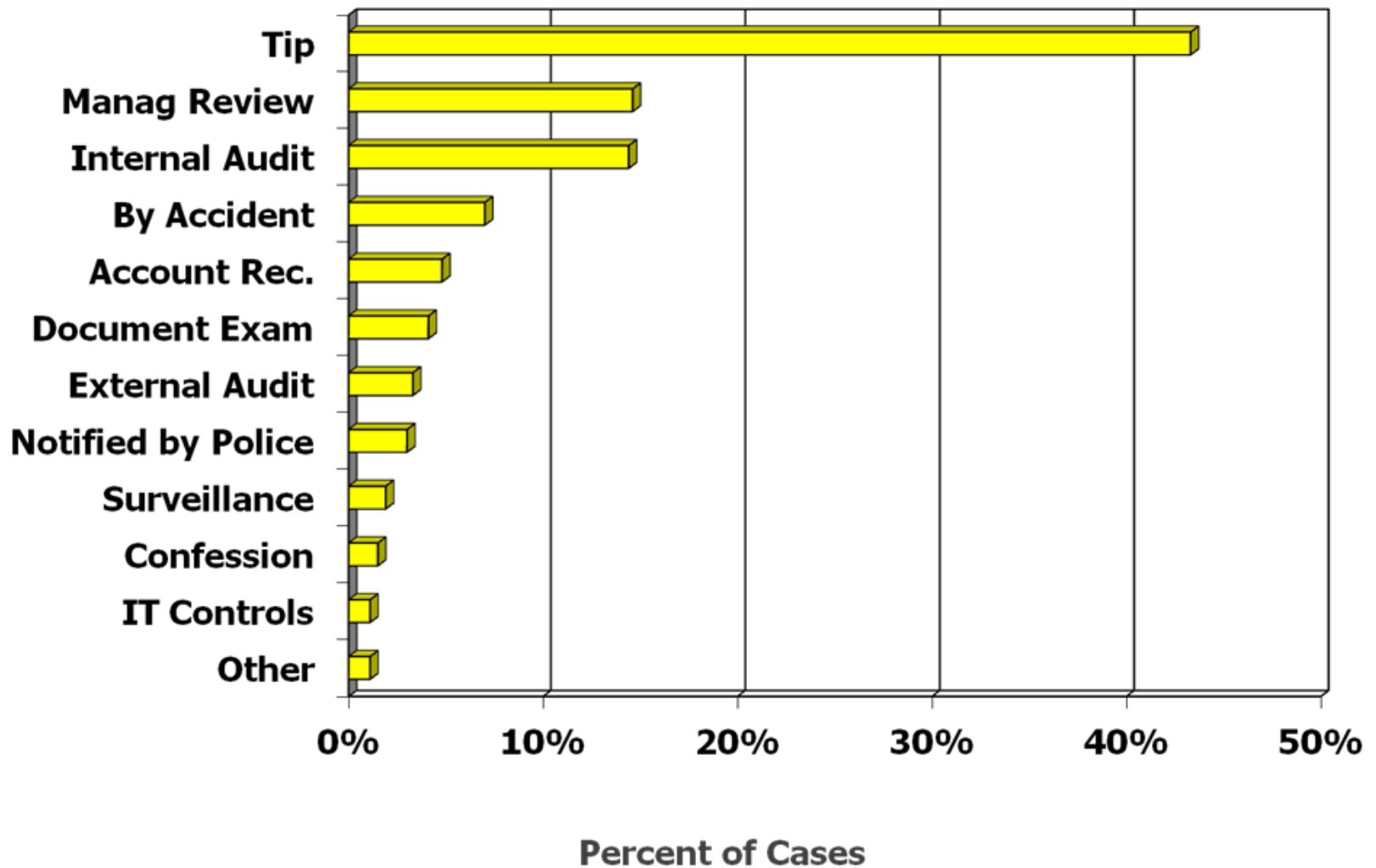
Frequency of Anti-Fraud Controls

Percent of Cases
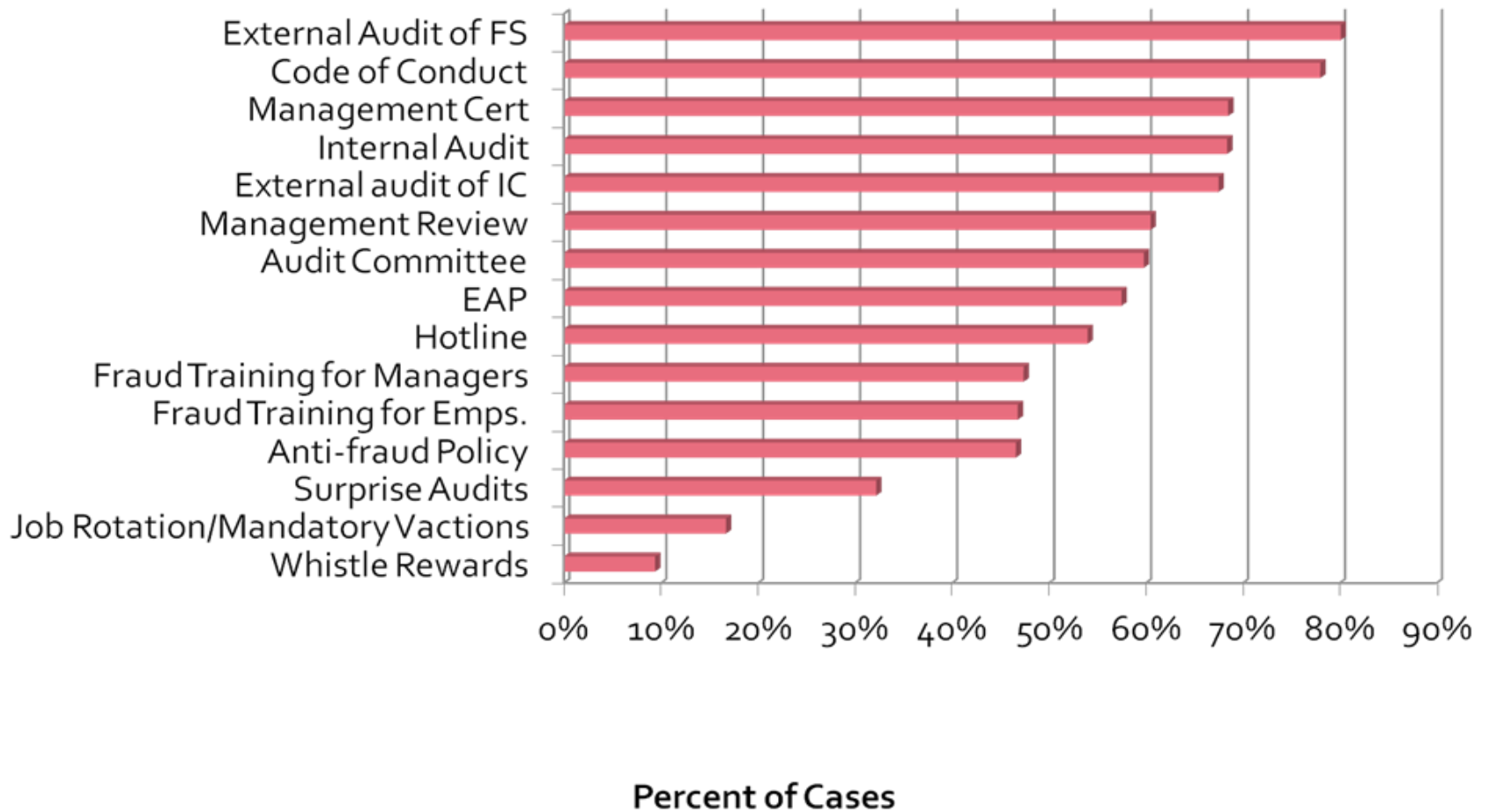
Effectiveness of Controls

Control	Used	Yes	No	Reduction
Management Review	60.5%	$ 100,000	$ 185,000	45.9%
Employee Support Programs	54.5%	100,000	180,000	44.4%
Hotline	54.0%	100,000	180,000	44.4%
Fraud Training for Managers	47.4%	100,000	158,000	36.7%
External Audit of IC	67.5%	120,000	187,000	35.8%
Fraud Training for Emps.	46.8%	100,000	155,000	35.5%
Anti-Fraud Policy	46.6%	100,000	150,000	33.3%
Formal Fraud Assessments	35.5%	100,000	150,000	33.3%
Internal Audit	68.4%	120,000	180,000	33.3%
Job Rotation/Mandatory Vac	16.7%	100,000	150,000	33.3%
Surprise Audits	32.2%	100,000	150,000	33.3%
Rewards for Whistleblowers	9.4%	100,000	145,000	31.0%
Code of Conduct	78.0%	120,000	164,000	26.8%
Independent Audit Commit	59.8%	125,000	150,000	16.7%
Management Certification of FS	68.5%	138,000	164,000	15.9%
External Audit of FS	80.1%	140,000	145,000	3.4%

Primary Weakness Observed

Lack of Internal Controls	
Override of Existing Internal Controls	
Lack of Management Review	
Poor Tone at the Top	
Lack of Competent Personnel in Oversight..	
Lack of Audit	
Lack of Fraud Education	
Other	

Percent of Cases
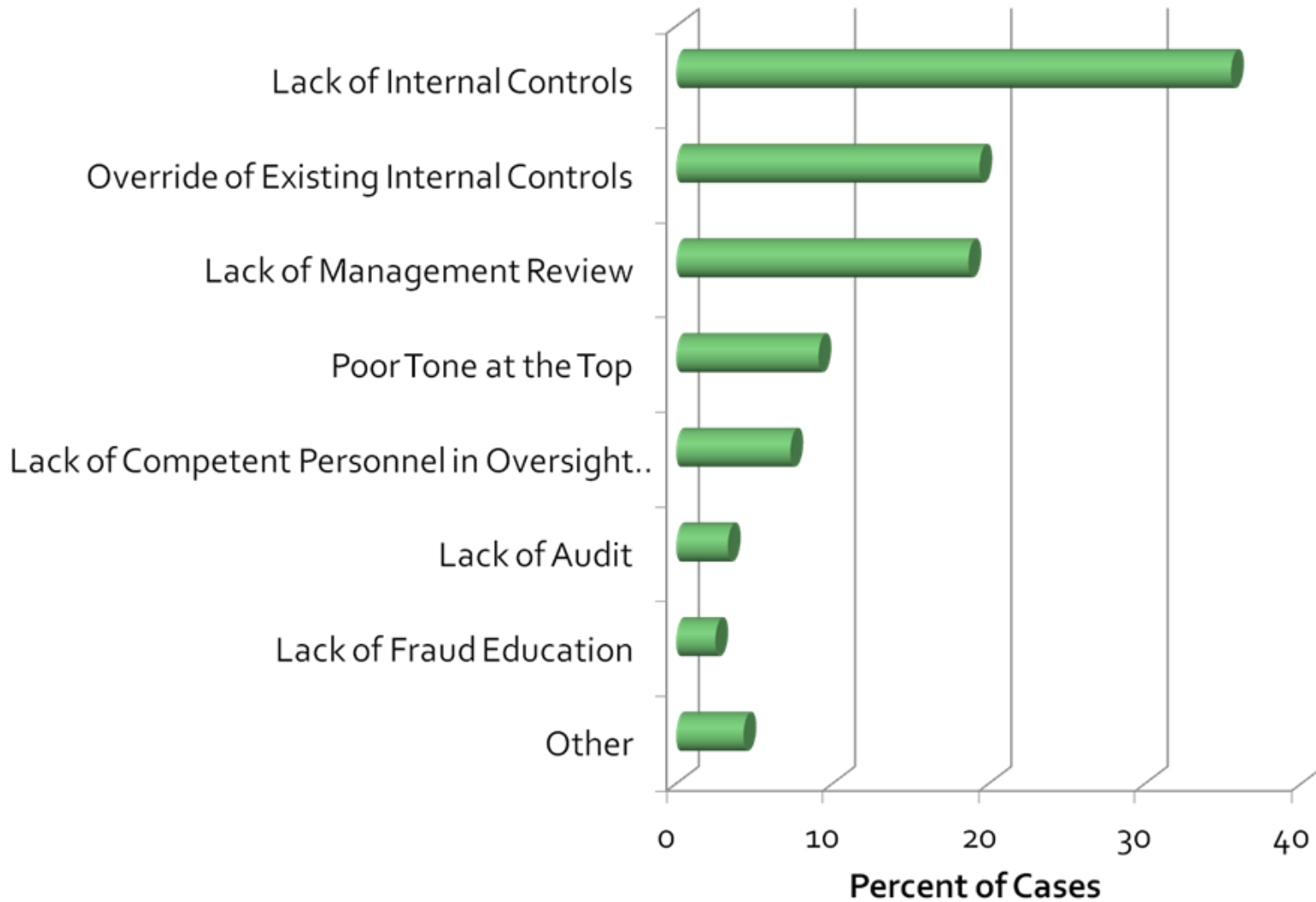
Identify the Perp

Age:

- > 60
- 51 - 60
- 41 – 50
- 36 – 40
- 31 – 35
- 26 – 30
- < 26

Identify the Perp

Age:

- \> 60   3.1%
- 56 – 60   5.2%
- 51 – 55   9.0%
- 46 – 50   13.5%
- **41 – 45**   **19.6%**
- 36 – 40   18.0%
- 31 – 35   16.1%
- 26 – 30   9.8%
- \< 26   5.8%

- Largest dollar losses are in the 51 – 55 category ($600,000) followed by over 60 at $250,000

Identify the Perp

Tenure

- ❑ < 1 Year
- ❑ 1 – 5 Years
- ❑ 6 – 10 Years
- ❑ > 10 Years

Identify the Perp

Tenure
- < 1 Year
- **1 – 5 Years** 41.5% of cases
- 6 – 10 Years
- > 10 Years

Largest dollar losses are more than 10 Years followed closely by 6 – 10.

Identify the Perp

Annual Income

- ❖ < $50,000
- ❖ $50,000 - $99,999
- ❖ $100,000 - $149,999
- ❖ $150,000 - $199,999
- ❖ $200,000 - $499,999
- ❖ $500,000 +

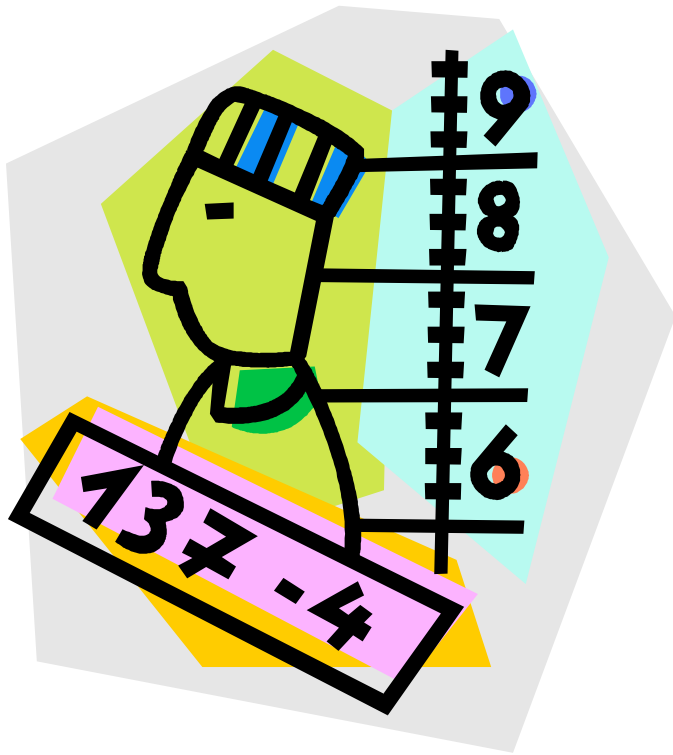# Identify the Perp

▶ Annual Income
  ▶ **< $50,000**   40.8%
  ▶ $50,000 - $99,999
  ▶ $100,000 - $149,999
  ▶ $150,000 - $199,999
  ▶ $200,000 - $499,999
  ▶ $500,000 +
▶ Median loss relates proportionately to annual income
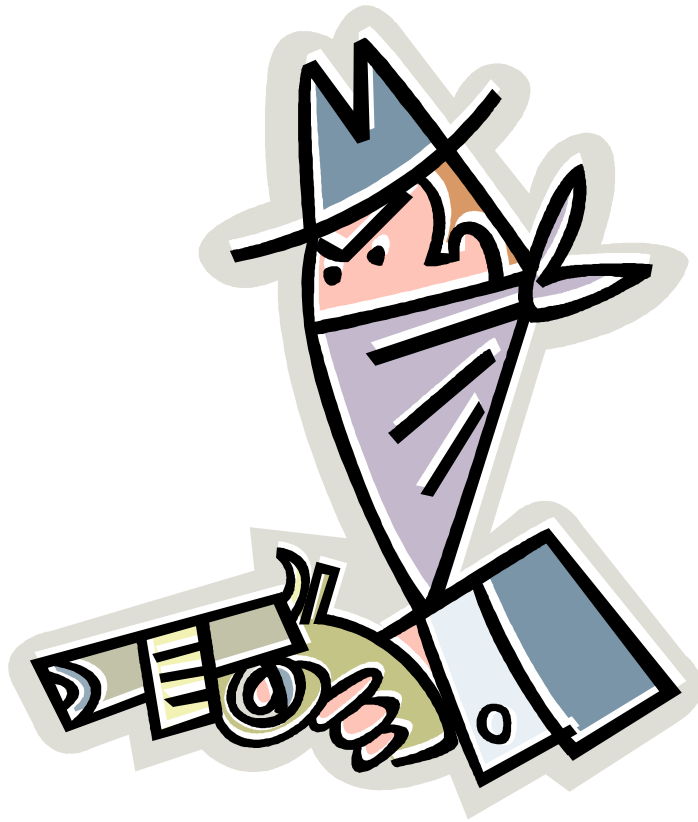
Identify the Perp

Gender
- Male
- Female

Education
- Postgraduate degree
- Bachelor's degree
- Some College
- High School Grad

Identify the Perp

Gender

❖ **Male**   **65.0 %**

❖ Female

Education

▪ Postgraduate degree

▪ **Bachelor's degree 36.9%**

▪ Some College

▪ High School Grad

Identify the Perp

Position in Organization

- ➢ Accounting
- ➢ Operations
- ➢ Sales
- ➢ Executive/Upper Management
- ➢ Customer Service
- ➢ Purchasing
- ➢ Board of Directors
- ➢ Human Resources

Identify the Perp

Identify the Perp

Why Internal Controls?

- ❖ Internal controls are the systems that are in place to prevent a loss from occurring

- ❖ Easier to *prevent* a loss from occurring than *discovering* it after it has occurred

Subpart D – Post Award Requirements

Internal Controls *(___.303)*

- Establish and maintain effective internal control over Federal awards
- In compliance with:
  - "Standards for Internal Control in the Federal Government" (Comptroller General of the United States)
  - "Internal Control Integrated Framework" (COSO)
- Comply with Federal statutes, regulations and the terms and conditions of the awards
- Evaluate and monitor compliance
- Take prompt action when instances of noncompliance are identified in audit findings
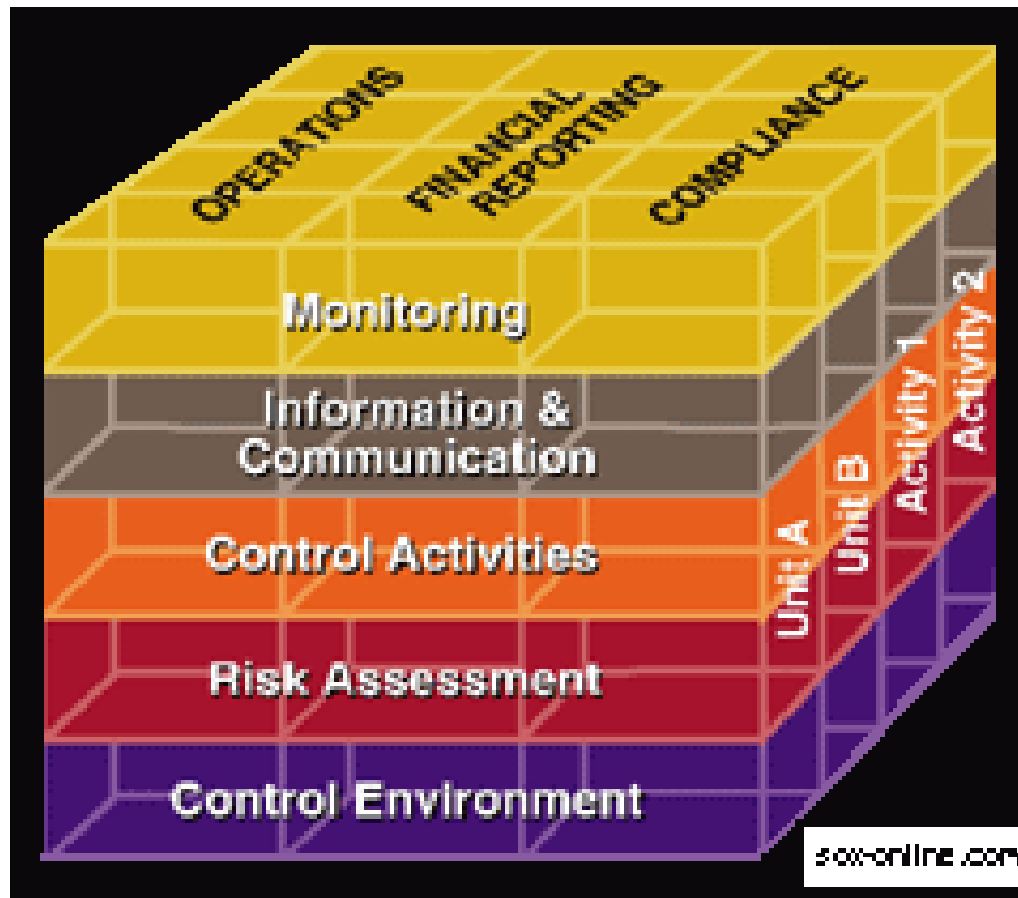
COSO Framework

- ## Key Concepts:
  - Internal control is process
  - Internal control is impacted by people, not just policies and manuals
  - Internal control provides reasonable assurance, not absolute
- ## Definition
  - A process, effected by an entity's board of directors, management and other staff, designed to provided reasonable assurance regarding achievement of objectives:
    - Effectiveness and efficiency of operations
    - Reliability of financial reporting
    - Compliance with applicable laws and regulations
    - Safeguarding of assets

Subpart D –
Post Award Requirements

INTERNAL CONTROL FRAMEWORK

- ➢ **Control Environment** – Organization's culture that influences ethical behavior.

- ➢ **Risk Assessment** – Process of identifying risks that threaten achievement of goals.

- ➢ **Control Activities** – Processes and procedures to support compliance and mitigate risk.

- ➢ **Information and Communication** – Providing right information to the right people at the right time.

- ➢ **Monitoring** – Process to verify that the controls are working as intended.

COSO - Internal Control:

▶ **CAN:**

  ▶ Help an entity achieve its performance goals

  ▶ Help prevent loss of resources

  ▶ Help ensure reliable financial reporting

  ▶ Help ensure compliance with laws & regulations

  ▶ Help avoid damage to reputation

▶ **CANNOT:**

  ▶ Ensure an entity's success

  ▶ Change poor management

  ▶ Ensure the right business or program decisions are made

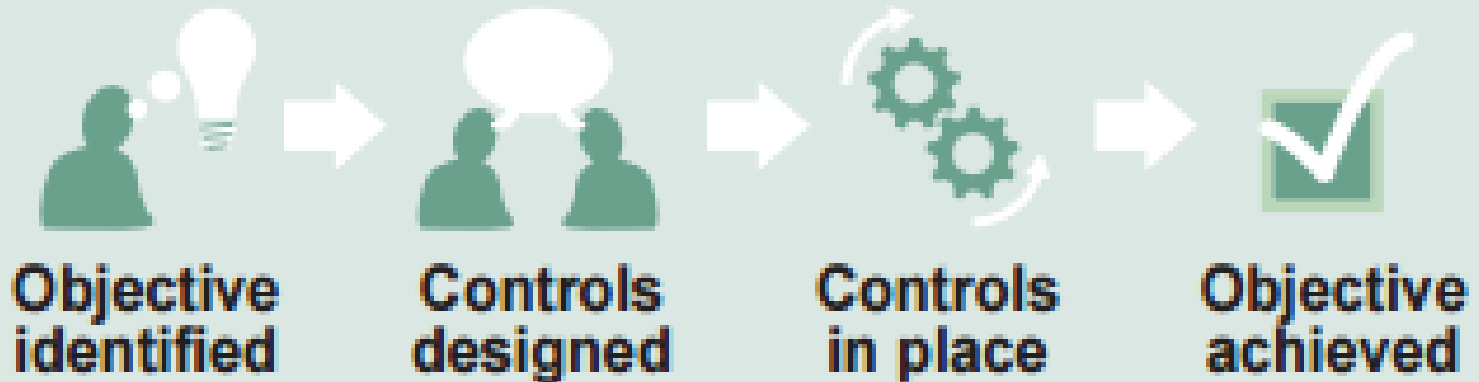 ▶ Prevent circumvention by collusion or management override of controls

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Green Book

Same 5 Components

Adds 17 principles

How does an entity use the Green Book?

Objective identified → Controls designed → Controls in place → Objective achieved

Green book

United States General Accounting Office

Internal Control

November 1999

Standards for Internal Control in the Federal Government

G A O
Accountability * Integrity * Reliability

GAO/AIMD-00-21.3.1

Control Environment

1. The oversight body and management should demonstrate a commitment to integrity and ethical values.

2. The oversight body should oversee the entity's internal control system.

3. Management should establish an organizational structure, assign responsibility, and delegate authority to achieve the entity's objectives.

4. Management should demonstrate a commitment to recruit, develop, and retain competent individuals.

5. Management should evaluate performance and hold individuals accountable for their internal control responsibilities.

Green book

Risk Assessment

6. Management should define objectives clearly to enable the identification of risks and define risk tolerances.

7. Management should identify, analyze, and respond to risks related to achieving the defined objectives.

8. Management should consider the potential for fraud when identifying, analyzing, and responding to risks.

9. Management should identify, analyze, and respond to significant changes that could impact the internal control system.

Green book

Control Activities

10. Management should design control activities to achieve objectives and respond to risks.

11. Management should design the entity's information system and related control activities to achieve objectives and respond to risks.

12. Management should implement control activities through policies.

- Top level reviews of actual performance,
- Reviews by management at the functional or activity level,
- Management of human capital,
- Controls over information processing,
- Physical control over vulnerable assets,
- Establishment and review of performance measures and indicators,
- Segregation of duties,
- Proper execution of transactions and events,
- Accurate and timely recording of transactions and events,
- Access restrictions to and accountability for resources and records, and
- Appropriate documentation of transactions and internal control.

Green book

Information and Communication

13. Management should use quality information to achieve the entity's objectives.

14. Management should internally communicate the necessary quality information to achieve the entity's objectives.

15. Management should externally communicate the necessary quality information to achieve the entity's objectives.

Monitoring

16. Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results.

17. Management should remediate identified internal control deficiencies on a timely basis.

Green book

▶ Internal controls are an integral part of each system within an entity's operations

   ▶ It is <u>not</u> one event or activity, but rather a series of actions

   ▶ It is <u>not</u> a separate stand alone process, but rather integrated into the entirety of organization

Common Internal Control Deficiencies

1. Lack of Segregation of Duties
   - Especially in smaller organizations
2. Lack of or outdated policies and procedures
   - Review every 3 years
3. Untimely information
4. Undocumented procedures
5. Lack of controls over specific exposures:
   - Ghost employees
   - Fictitious vendors
   - Journal entries
6. Inadequate Board or Management oversight

7. Inadequate account reconciliation
8. Lack of adequate documentation
   - adjusting journal entries
9. Staff lacking appropriate accounting skills
10. Undocumented cost allocation process
11. Reimbursement requests not reconciled to general ledger
12. Credit cards, credit cards, credit cards……

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Flow of information

Input
(Source Documents)

Process
(Approve, compute, and record)

Output
(Reporting)

Flow of Information

1. Initiating and authorizing transactions:
   - ▶ How and by whom
   - ▶ Source documents
2. Recording and processing transactions
3. How is incorrect processing resolved:
   - ▶ How are errors identified
   - ▶ How are they corrected
4. Reconciling and reporting financial information

Practical Considerations

Segregation of Duties

Separate the roles:

- ▶ Initiate
- ▶ Authorize
- ▶ Record
- ▶ Reconcile/Review

Smaller organizations:

- ▶ Executive Director
- ▶ Board members
- ▶ Contract Accountants
- ▶ Program Staff

Practical Considerations

JOURNAL ENTRIES

- ▶ How originated?
- ▶ Documentation required
- ▶ Reviewed and approved

FICTITIOUS

- ▶ Vendors
- ▶ Employees

WATCH OUT!

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Must Haves

- Appropriate systems
    - Written financial policies and procedures
    - Proper segregation of duties
    - Timely reconciliations
    - Journal entry control
- Qualified and competent people
    - Written personnel policies and procedures
    - Staff development and appraisals
- Sound governance
    - Timely review of budget vs. actuals
- Audit

EVALUATION QR CODE