


# Fraud Prevention and Detection

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Division of Local Government and School  
Accountability



New York State Comptroller  
THOMAS P. DiNAPOLI

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## What is Fraud?

- An illegal act involving obtaining something of value through willful misrepresentation.



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## Examples of Fraud

- Theft of cash
- Forgery
- Falsifying accounting records
- Theft of service



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## What is Abuse?

- Behavior that is improper when compared with behavior that a prudent person would consider a reasonable and necessary business practice given the facts and circumstances.

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## Examples of Abuse

- Incurring excessive expenses
- Misuse of municipal equipment or supplies

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## What is a Red Flag?

- A set of circumstances that are unusual in nature or vary from the normal activity. It is a signal that something is out of the ordinary and may need to be investigated further.

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## Examples of a Red Flag

- A weak internal control environment.
- Refusal to take vacation or sick leave.
- Management decisions are dominated by an individual or small group.
- Excessive number of year end adjustments.
- Photocopied or missing documents.

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## Implications

- Impose large costs on organizations
- Public confidence and reputation of municipality and/or individuals involved

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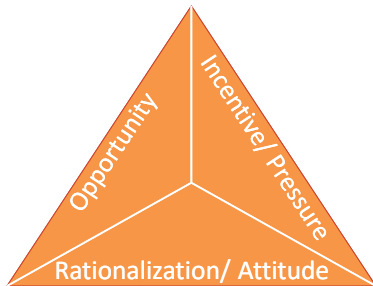
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## The Fraud Triangle



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## Incentive/Pressure

- Management or other employees may have an incentive or be under pressure, which provides motivation to commit fraud.

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## Incentive/Pressure - Risk Factors

- Personal financial obligations
- Requirements or expectations of third parties
- Personal net worth threatened by financial performance

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## Rationalization/Attitude

- The attitude, character or set of ethical values that allows them to intentionally commit a dishonest act.

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## Rationalization/Attitude - Risk Factors

- Disregard for internal controls, the need for monitoring or reducing risks
- Behavior indicating dissatisfaction
- Changes in lifestyle

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## Opportunity

- Circumstances exist that provide an opportunity for fraud:
  - The absence of controls
  - Ineffective controls
  - Management override

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## Opportunity - Risk Factors

- Lack of or deficiencies relating to:
  - Policies
  - Records
  - Duties
  - Reconciliations
  - Oversight

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## Internal Control

- A process affected by the governing board, management and other personnel designed to provide reasonable assurance that:
  - Financial reporting is reliable
  - Operations are effective and efficient
  - Laws and regulations are complied with

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## Limitations of Internal Control

- No matter how well designed, controls can only provide reasonable assurance!
  - Errors
  - Collusion
  - Management override

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## Cost/Benefit of Controls

- The cost of an entity's internal controls should not exceed the benefits that are expected to be derived.

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## Prevention vs. Detection

- Preventive controls are designed to keep fraud and abuse from occurring in the first place.
- Detective controls are designed to detect fraud and abuse that may have occurred.

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## Steps to Prevention and Detection

- Step # 1 – Communication
  - Establish, communicate and reinforce expectations for behavior
- Step # 2 – Checks and Balances
  - Implement and monitor controls
- Step # 3 – Follow Through
  - Ensure there are consequences

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## Step #1: Communicate Expectations

- Policies:
  - Code of ethics
  - Policies and procedures manuals
  - Job descriptions
- Lead by Example

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## Code of Ethics

- Establishes standards of conduct to avoid:
  - Appearance of impropriety
  - Use of position for personal gain
  - Private employment in conflict with official duties
- Also addresses:
  - Confidential information
  - Gifts
  - Enforcement

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## Policies

- Establish:
  - Employee responsibilities
  - Limits to authority
  - Performance standards
  - Control procedures
  - Reporting relationships

Example: Internet and email computer use policy

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## Leading by Example

- Modeling the ethical behavior set forth in the policies.

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## Effects of a Poor Tone at the Top

- A nonexistent or ineffective means of establishing, communicating and supporting the local government's accountability for public resources and ethics, especially regarding codes of conduct, conflicts of interest and acceptable business practices **increases the risk of fraud and abuse.**

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## Step #2: Checks and Balances

- Where is the greatest risk?
  - External and internal sources
  - Opportunity fraud risk factors
  - System monitoring issues

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## Tempting Assets

- Cash
- Fixed assets that are small in size, marketable or lacking in observable identification of ownership

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## Controls - Cash and Other Desirable Assets

- Limit physical access
  - Cash
  - Check stock and signature plates
  - Information technology system
- Place ID on high-risk inventory

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## Controls - Segregation of Duties

- Separate the basic functions:
  - Authorizing transactions
  - Maintaining records
  - Having custody of assets
- Helps prevent errors, fraud and/or abuse from occurring and remaining undetected.

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## Controls - Monitoring

- Remain alert to the possibility
- Use the IT tools you already have
- Encourage reporting
- Audits

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## Step #3: Follow Through

- Investigate allegations of fraud or abuse
- Ensure there are consequences
- Maintain transparency

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## No Consequences

- A substantial internal control deficiency that increases the perception of opportunity
  - No negative ramifications for fraud or abuse

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## Unique Fraud Risk Factors

- Management override of controls
- Information technology

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## Management Override

- Management has the unique ability to commit fraud because it is in a position to directly or indirectly manipulate and/or influence records, processes and people.

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## Information Technology

- Fraud often involves the use of technology
- A thorough understanding and review of IT controls is essential whether IT function is in-house or out-sourced

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## Common IT Deficiencies

- Lack of access controls
  - Access rights too broad
  - Sign-in passwords not required
  - Rights changed without approval
  - System cannot be monitored
- Monitoring
  - Audit logs
  - Exception reports

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## Summary

- Costly, intentional acts
- Pressure, opportunity and rationalization
- Prevention and detection
  - Communication by words and actions
  - Checks and balances that are monitored
  - Follow through

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## Resources

- Division of Local Government & School Accountability
  - [www.osc.state.ny.us/localgov/contact.htm](http://www.osc.state.ny.us/localgov/contact.htm)
  - 1-866-321-8503 or (518) 408-4934
  - [localgov@osc.ny.gov](mailto:localgov@osc.ny.gov)
- Division of Investigations
  - [www.osc.state.ny.us/investigations/index.htm](http://www.osc.state.ny.us/investigations/index.htm)
  - 1-888-672-4555
  - [investigations@osc.ny.gov](mailto:investigations@osc.ny.gov)
- Local Official Training Unit
  - » [LocalTraining@osc.ny.gov](mailto:LocalTraining@osc.ny.gov)

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## Thank You

Division of Local Government and School Accountability  
[localtraining@osc.ny.gov](mailto:localtraining@osc.ny.gov)



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