

Fraud Happens — Prevention Starts with a Plan

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There is a common misconception among elected officials, staff and citizens that detecting fraud arising from employee dishonesty is the work of the external auditor. Many believe that a clean opinion also means that there is no fraud occurring in the jurisdiction. There is no doubt that the external audit that utilizes a strong protocol to test the internal controls of the operation is an essential tool in managing the risk of fraud, but this process has its limitations. The management letter is a helpful guide to areas of concern and should be acted upon by the Board and staff when it is received. But the external audit is only part of the comprehensive plan that every municipality must have in place to prevent dishonesty and to deal with it professionally and effectively when it is suspected or discovered. This plan starts with the Board who accepts responsibility for its creation and management and who sets the tone at the top that employee dishonesty cannot be tolerated.

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Generally speaking, there are only a few operational areas within the municipality where employee dishonesty that involves the theft of money can occur. These money hot spots are where cash and payments are handled, a check is written and where goods are received and stored. Therefore, cash and payment operations, accounts payable, payroll and purchasing are key areas of focus in the prevention process. Often these areas are short staffed due to tight budgets and in an effort to save money, management overlooks the real danger of theft that can occur where too few employees cover too many sensitive jobs. The danger is further compounded when one or two trusted employees have administrative access and password control to manipulate the accounting system as well as control over financial reports to the Board as their means to cover thefts. The system and plan to prevent employee dishonesty rests on an effective internal control system which is tailored

to the realities of each locality and an adequate separation of duties among the employees operating those controls.

A practical program starts with a clear understanding of how the financial system actually works. Written policies and procedures often do not reflect how the organization really gets the job done. And while this analysis usually occurs in the Finance Department, it should be expanded to include all departments that handle money of any kind, collect payments, order goods and receive these goods. The first step is to create a visual picture or map which documents the flow of paper among the various financial functions of the organization and the persons responsible to handle these tasks. Control issues quickly become apparent from this map, and these are the areas where management should focus their attention. For example, an accounts payable clerk may have the ability to create and approve a new vendor. The same clerk may also be responsible to receive an invoice from a vendor, approve a voucher, create a check and cause the check to be signed. Clearly, these functions need to be separated or at least regularly audited internally because a ghost vendor can easily be paid in such a poorly controlled system. These payments can go undetected for many years. Another example is the human resources manager who is able to input an employee into the payroll system, create timecards and a paycheck. A ghost employee could be created without much effort, and payments could be concealed for many payroll cycles.

Once the deficiencies in the control system are identified, the operational system should be reorganized to provide a check and balance to all entry and approval functions. A system of surprise internal audits should be implemented. Policies should be implemented that move employees into the daily work life of other employees. All personnel should be cross trained in several financial functions and rotated at least semi-annually. All financial personnel should be required to take their vacations and alternate staff allowed to do their job for a period of at least a week. The same policies and surprise internal audits should be required of all personnel throughout the municipality who handle money or payments of any kind or authorize payments such as the Police or Recreation Departments.

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All government units, as a minimum measure to prevent employee dishonesty, should install an effective whistleblower system. Overwhelmingly, employee dishonesty is discovered through a tip from another employee. For the system to be effective, it must be anonymous and the employee must not have any fear of reprisal. And employees need to see that valid and vetted tips are acted upon and not ignored.

FRAUD HAPPENS: PLANNING FOR THE GOVERNMENT'S RESPONSE IS CRITICAL

The worst day in any elected official's public life or professional administrator's work life is news that a fraud is suspected or known. Usually the reaction is fear that a career may be lost, betrayal that a trusted employee or vendor could do such a thing and panic as to what to do next. Emotions run high and mistakes are inevitably made that can jeopardize the future of the organization. Most governments are simply not prepared to handle the situation professionally because they believe it could not happen to them – so they do not plan for this eventuality. This is a mistaken belief – fraud indeed happens to almost every public or private organization at some time, and the way it is handled must be planned in advance, just as the response to a natural disaster is planned in advance by all responsible governments.

Every government should complete the preparedness process. This is as critical as the prevention plan. While there are many particulars and details, the important point to remember is that once the organization receives credible information that a fraud may be occurring, a designated "need-to-know" group is assembled that will manage the investigation from start to finish. Managing does not mean conducting the investigation, but rather assuming responsibility for credibility of any tips, engagement of the best legal advice possible, managing the

MUNICIPAL CALENDAR - FEBRUARY

On or before February 1 of each year, the chief administrative officer of each unit of local government or his/her designee shall certify to the county clerk the names and mailing addresses of those persons required to file statements of economic interest pursuant to the Illinois Governmental Ethics Act. The chief executive officer or his/her designee shall set forth the names in alphabetical order by county of residence and shall certify the list to the county clerk of the counties in which those persons reside. (If the person resides outside of Illinois or in another county, the list shall be sent to the county clerk of the county where the principal office of the unit of local government with which the person is associated is located). (5 ILCS 420/4A-106.)

Municipalities choosing to levy a tax for the payment of principal and interest on general obligation bonds or limited bonds may do so at any time prior to March 1 of the calendar year during which the tax will be collected, notwithstanding the December deadline to pass the annual tax levy ordinance. (30 ILCS 350/16.)

By March 31 of each year, the corporate authorities shall cause the zoning map to be published. If there are no changes from the preceding year, no map shall be published. (65 ILCS 5/11-13-19.)

The annual budget must be passed before the start of the fiscal year by municipalities that have adopted the Optional Budget Officer System (65 ILCS 5/8-2-9.1 through 8-2-9.10) in lieu of the Appropriations Ordinance System. (65 ILCS 5/8-2-9.)

FOR IMLRMA MEMBERS

The IMLRMA coverage grants include Employee Dishonesty coverage as part of our overall Crime Coverage benefits. We have an experienced team who can work with you to help handle and mitigate such losses. If you have any questions regarding your coverages, or if you have an actual or suspected loss, promptly contact our Member Services Team and/or our Claims Department with questions.

scope and conduct of the inquiry, as well as issues related to evidence preservation and chain of custody. This team will take the lead in decisions related to administrative leave, use of a public relations consultant, engagement of the forensics team and computer forensics expert, and acting as the liaison with law enforcement. The work of this team must be confidential and this need to know group will manage and evaluate the work of the investigative team throughout the process. It will limit the investigation to the evidence at hand and will call a halt to a fruitless process or pass the information to law enforcement for prosecution. It will lead the work of possible restitution and manage the process to file an insurance claim.

There are many benefits to this type of planning, but the greatest is the entity's ability to report to its citizens that it is in control, not hiding from any situations, and working to understand and solve a problem in a way that will limit fraud risk in the future.

Every municipality faces the eventual act of employee dishonesty. Creating a prevention plan and actively working that plan in itself creates a hostile environment for fraud and will limit its occurrence. And creating a plan to deal with an incident limits the fall out from the act.

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The annual appropriation ordinance or budget, as well as an estimate of revenues anticipated to be received by the municipality in the following fiscal year, must be filed with the county clerk within 30 days of the adoption of the appropriation ordinance or budget. (35 ILCS 200/18-50.)

Any municipality with a population of less than 500,000 which attempts to impose, amend or repeal the Simplified Municipal Telecommunications Tax must file a certified copy of such ordinance with the Illinois Department of Revenue prior to March 20, or September 20. Ordinances received prior to March 20 will be collected on or after the following July 1. Ordinances received prior to September 20 will be collected on or after the following January 1. (35 ILCS 636/5-20.)

On or before the first day of April, home rule and non-home rule municipalities imposing or discontinuing a retailer's occupation tax or effecting a change in the rate thereof must file a certified copy of any ordinance or resolution (and referendum if appropriate) with the Department of Revenue. Ordinances received by the Illinois Department of Revenue by April 1 will be collected July 1. Ordinances received by October 1 will be collected January 1. (65 ILCS 5/8-11-1, and 65 ILCS 8-11-1.1.)

On or before March 1 of each calendar year, every law enforcement agency is required to submit racial profiling information and other data required to be collected from traffic stops during July through December of the previous calendar year to the Illinois Department of Transportation. (625 ILCS 5/11-212.)