

Internal Controls: Things You Can Do To Prevent Fraud

WHAT ARE INTERNAL CONTROLS?

Internal controls are procedures that help your operations deter fraud and keep you in compliance with the law.

WHY ARE THEY IMPORTANT?

Taxpayers depend on you to protect assets, promote efficiency, detect fraud, and provide reliable financial reports. Internal controls help you do that.

TYPES OF INTERNAL CONTROLS

Detective: Designed to **detect** errors or fraud that happened

Corrective: Designed to **correct** errors or fraud

Preventative: Designed to **stop** errors and fraud from happening

Who is
responsible for
controls?
Management!

Basic Detective Controls:

- 1** Perform reconciliations of key accounts monthly. Timely detection of unusual transactions can help deter misappropriation or fraud.
- 2** Physically count assets on hand like cash or inventory. Frequent counts of assets like cash ensure you can pinpoint a timeframe when money went missing.
- 3** Perform monthly budget-to-actual reviews and review financial statements as often as possible. Even if the financial statements are monthly cash basis statements, review your expenditures for unusual balances.

Basic Corrective Controls:

- 1** Provide training for employees in their job functions. Watch employees closely until the employee has experience.
- 2** Implement SPAM filters for email and ensure computer data is backed up regularly. Keep a backup offsite and offline in case of fire.
- 3** Conduct employee evaluations, at least annually. When controls are disregarded, perform appropriate disciplinary actions. Employees need to understand that following controls are important and that breaking the rules have consequences.

Remember: trust is NEVER a control!

Basic Preventative Controls:

- 1 Establish clear, concise, and written policies for employees. Explain processes in detail. Include accurate job descriptions in your employee files and records.
- 2 Ensure no one employee has too much control over multiple functions. For example, the person who reconciles the bank statement should not be the person who writes or signs checks. This is called "segregation of duties."
- 3 Perform background checks before hiring employees, especially employees that will handle money or financial matters. Check references and always ask if the employee would be eligible for "rehire."
- 4 Post OSA's Fraud Hotline number, 1-800-321-1275, in a public place and make sure employees know they can call and report fraud anonymously.

A Board Member's Role in Internal Controls:

Teach employees the RIGHT thing MATTERS!

Board members do not actively take part in the day-to-day operations of the government. Their role is to manage the management. So how do they stay involved in internal controls?

- Tone at the top! Employees look to the Board for guidance for what's right and wrong. Setting a strong, ethical example as a Board Member is important. Don't bend or break rules, and others around you will follow your lead.
- Establish a secure, anonymous way for employees to report suspicious activity. Whistleblower employees are usually the reason fraud or theft is uncovered, so make it easy and comfortable for employees to inform you.
- Hire the right staff and invest in their training.
- Be consistent and clear on consequences for bad behavior. Provide discipline and structure. Immediately address acts of misconduct or wrongdoing.
- Review bank statements and reconciliations. If possible, find out when bank statements come in the mail, and be on site to open and review them. This helps prevent forged documents.

Other Good Controls to Adopt:

- Require employees to take vacations annually. This prevents someone from covering up fraud.
- Do not let one employee control a process. Make sure multiple people know how things work. Train at least two employees for every job function.
- Randomly rotate a job function for the day. For example, ask someone new to open the mail or take the deposit.
- Number documents like purchase orders, checks, deposits, etc. sequentially and keep them secure when not in use.
- Conduct periodic reviews of your vendors to see if any unusual names exist.
- If cash is kept on site, perform surprise cash counts of registers, draws, etc.
- If possible, install basic video cameras, especially in areas where assets are kept.
- Require employees to change computer passwords frequently. Make sure they are kept confidential.

Watch out for these Red Flags for Fraud:

- Employees living beyond their means or showing sudden increases in personal spending.
- Employees that have had dramatic changes in personality, lifestyle, or attendance patterns.
- Employees working overtime without pay or refusing to take vacations.
- Employees that are “protective” of processes and refuse to help train new staff.
- Managers who refuse to delegate responsibilities and control the flow of information.
- Multiple checks written to “Cash” without valid reasons.
- Transaction logs that have multiple overrides or “voids” in a single day.
- Cash deposits that do not agree with daily records, or multiple days of cash are deposited at the same time.
- Supporting documentation that is always “misplaced.”

Internal controls cannot prevent 100% of fraud, but good controls can usually reduce the amount of lost revenue.



If you have any additional questions about internal controls you can implement, or questions about legal compliance in the State of Mississippi, contact the Office of the State Auditor Technical Assistance Division at 601-576-2800.