VERMONT
DEPARTMENT OF FINANCE AND MANAGEMENT

# Summer 2022 - Internal Control News

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**The purpose of this quarterly newsletter is to provide agencies and departments with articles on good business practices, fraud prevention, and Internal Control responsibilities. Through articles intended to promote educational and professional development opportunities for employees, this newsletter seeks to raise awareness across state government on the importance of internal control. We hope that by providing you this array of information, we can keep you informed of internal control related activities, and help you implement and maintain effective controls.**

https://finance.vermont.gov **Volume 3, Issue 10**

## DFM Internal Control Standards - Helpful Web Links

***Website Resources:***
https://finance.vermont.gov/policies-and-procedures/internal-controls
***Standards Guide:***
https://finance.vermont.gov/sites/finance/files/documents/Pol_Proc/IC/FIN-Internal_Control_Standards_Managers_Guide_Master.pdf
***Quick Reference PDF Guide:***
Finance/files/documents/Pol_Proc/IC/Guidelines.pdf

***Newly Added to the DFM Newsletter (State Auditor's Fraud Hotline) ------> Fraud, Waste, and Abuse Hotline:***
***1-877-290-1400 or*** Reporting Various Potential Fraud, Waste or Abuse
***DFM, IC Questions? Contact:***
fin.internalcontrol@vermont.gov

## • Delegation of Authority Request for (DOA) Signature Verification Form

Recently the ***Department of Finance & Management*** (DFM) was asked how an internal agency could obtain a copy of another agency's ***Delegation of Authority*** form for signature verification. There are times when business signatures & transactions need to be verified between two agencies i.e., Contracts, Grants, etc. DFM is developing a formal DOA Inquiry Request form. In the meantime, please contact Jeff Montgomery at DFM, IC at fin.internalcontrol@vermont.gov if you need a copy of a legalized ***Delegation of Authority*** form.

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Agency of Administration
Delegation of Authority for Signature Authorization
VISION

**Summary:** Authority for signing the documents listed below rests solely with the exempt Agency Secretary; Department Commissioner; Elected Official; Exempt Department Head; and heads of divisions, boards, committees and commissions not reporting to an agency secretary or department commissioner (collectively "Appointing Authority"). This authority may be delegated to the exempt Agency/ Department Deputy Secretary or Deputy Commissioner ("exempt designee") by executing and submitting this form to the Agency of Administration, Secretary's Office through VISION Security. Non-exempt directors and managers may not be assigned as designees except in emergency situations and with separate written approval by the Secretary of Administration.

**Agency/Dept. Name:** **Appointing Authority Name (print):**
**For Calendar Year (YYYY):** **Appointing Authority Title:**

- # VISION Service Request (VSR's) **Attn: All VISION END Users:**

***The Department of Finance and Management*** is not accepting any new VSR's until further notice. If you have an extremely urgent need, you can send an email to Vision.FinHelpdesk@vermont.gov and someone will assess your need and get back to you ASAP.

- # Fraud Prevention & Detection for State and Local Governments

***State of Vermont April 14, 2022 – Presented by:***

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***WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING***

**Investment advisory services are offered through CliftonLarsonAllen Wealth Advisors, LLC, an SEC-registered investment advisor.**

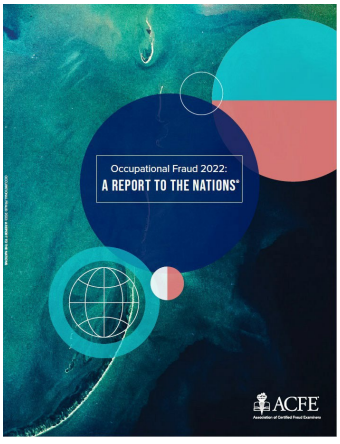
Recently CLA, our external Auditors, presented a 4-hour web presentation on Fraud Prevention & Detection to the State of Vermont. The Department of Finance and Management's Internal Control Unit would like to highlight some of the critical pieces of the presentation of Fraud that could potentially impact any and/or all agencies. Below are some of the highlighted bullet points.

## *Certifications and Resources*

- ***Association of Certified Fraud Examiners (ACFE)***

World's largest anti-fraud organization,
Provides Certified Fraud Examiner (CFE) credential.
Requires meeting professional, educational, and ethical standards and passing a rigorous exam on the four major disciplines that comprise the fraud examination body of knowledge: Fraud Prevention and Deterrence, Financial Transactions and Fraud Schemes, Investigation, and Law.
Headquartered in Austin, TX with 85,000+ members and 196 Chapters worldwide.

- ***2022 ACFE Report to the Nations***




Report to the Nations Global Study on Occupational Fraud and Abuse. Bi-Annual Report. Analysis of 2,110 cases of occupational fraud across 133 countries. Results based on 2021 Global Fraud Survey opened to CFEs about their single largest fraud case investigation completed between January 2020 and September 2021. First ACFE Report to the Nations was issued in 1996.

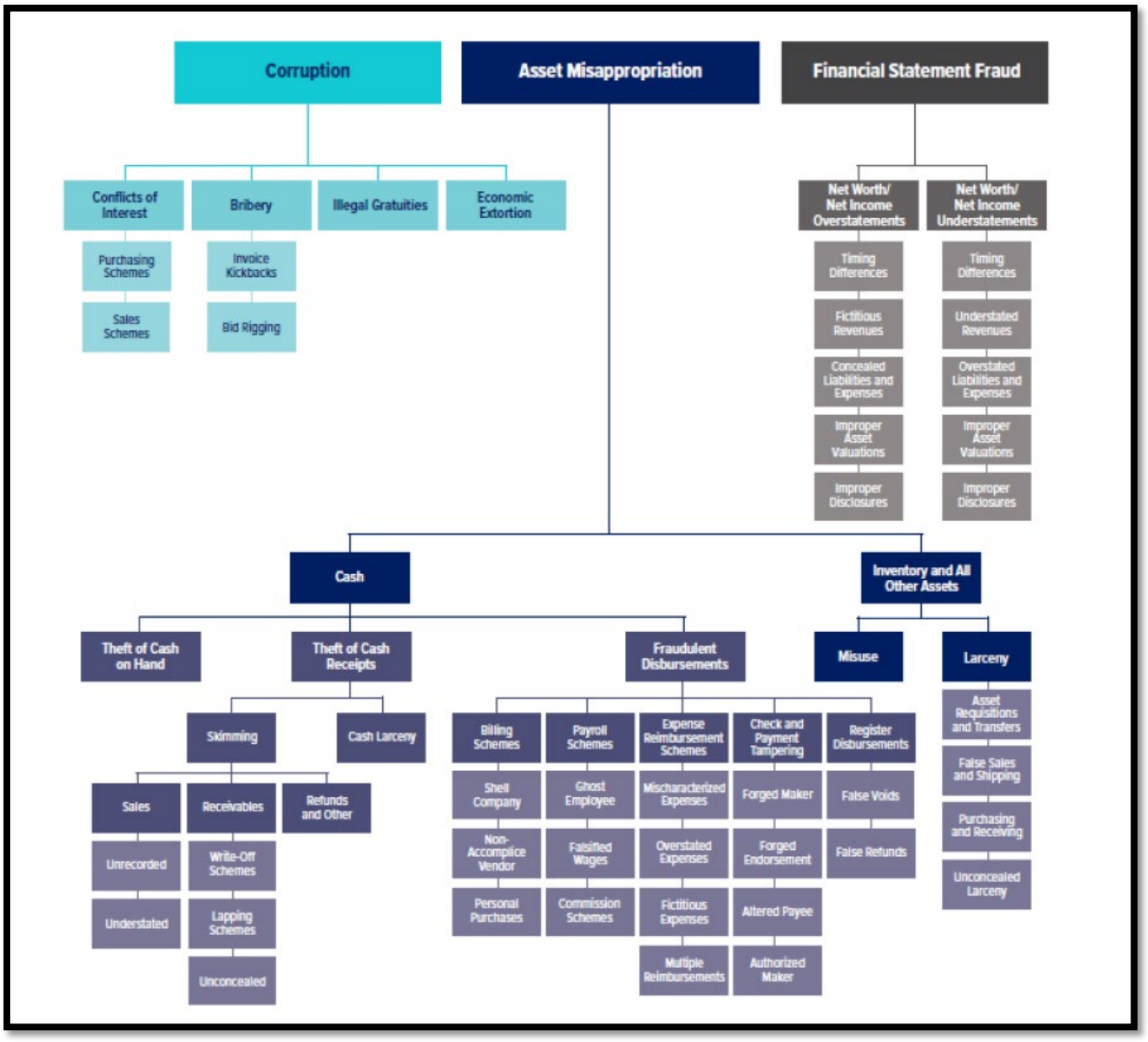
## *Occupational Fraud*

- ***What is Occupational Fraud?***

The term "occupational fraud" may be defined as: "The use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets."

# *The Fraud Tree*

Fraud Tree are those in which an employee, manager, officer, or owner of an organization commits fraud to the detriment of that organization. The three major types of occupational fraud are:
**Corruption, Asset Misappropriation, and Fraudulent Statements**.




## *Corruption*

- Involves an employee's use of his / her influence in a business transaction in a way that violates their duty to their employer for the purpose of obtaining a benefit for themselves or someone else. Often involves collusion between an internal employee and an outside party. Can be difficult to detect.

## *Financial Statement Fraud*

- Manipulation, falsification, or alteration of accounting records or supporting documentation from which the financial statements are prepared. Misrepresentation in, or intentional omission from, the financial statements of events, transactions, or other significant information. Intentional misapplication of accounting principles.

# Occupational Fraud by Organization Type

FIG. 21 WHAT ARE THE MOST COMMON OCCUPATIONAL FRAUD SCHEMES IN VARIOUS INDUSTRIES?

| | INDUSTRY | Cases | Billing | Cash larceny | Cash on hand | Check and payment tampering | Corruption | Expense reimbursements | Financial statement fraud | Noncash | Payroll | Register disbursements | Skimming |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2022 | Government and public administration | 198 | 21% | 8% | 7% | 9% | 57% | 12% | 8% | 16% | 16% | 3% | 8% |
| 2020 | Government and public administration | 189 | 18% | 5% | 9% | 4% | 48% | 17% | 4% | 17% | 17% | 0% | 7% |

*Basic Facts of Fraud*

A typical organization loses 5% of revenue each year because of fraud. Fraud exists in every organization and every industry type – top 5 industries with the highest occurrence of fraud:

- Banking & financial services (351 cases; median loss: $100,000)
- Government & public administration (198 cases; median loss: $150,000)
- Manufacturing (194 cases; median loss: $177,000)
- Health care (130 cases; median loss: $100,000)
- Energy (97 cases; median loss: $100,000)

Prominent weakness – lack of internal controls or override of existing controls. Most common form of occupational fraud – asset misappropriation, check / payment tampering, and billing schemes represent the greatest risk.

Most perpetrators are first time offenders (only 6% had prior convictions). Frauds with highest frequency occur in operations, accounting, executive / upper management, and sales.

Most occupational frauds are not material to the financial statements (frequent, small transactions taking place over an extended period).

*How Does Fraud Occur?* Two sample types of Fraud: *The **Triangle** and The **Diamond***:

## The Fraud Triangle

**Opportunity:**
Ability to carry out fraud due to lack of internal controls

**Fraud Triangle**

**Pressure:**
Motivation or incentive to commit fraud

**Rationalization:**
Justification of dishonest actions

Understanding the Fraud Triangle is critical to:

- Minimize the risk of abuse
- Minimize the risk of fraud
- Develop strong internal controls

## The Fraud Diamond

Incorporates the human element - ***CAPABILITY***

**Opportunity**

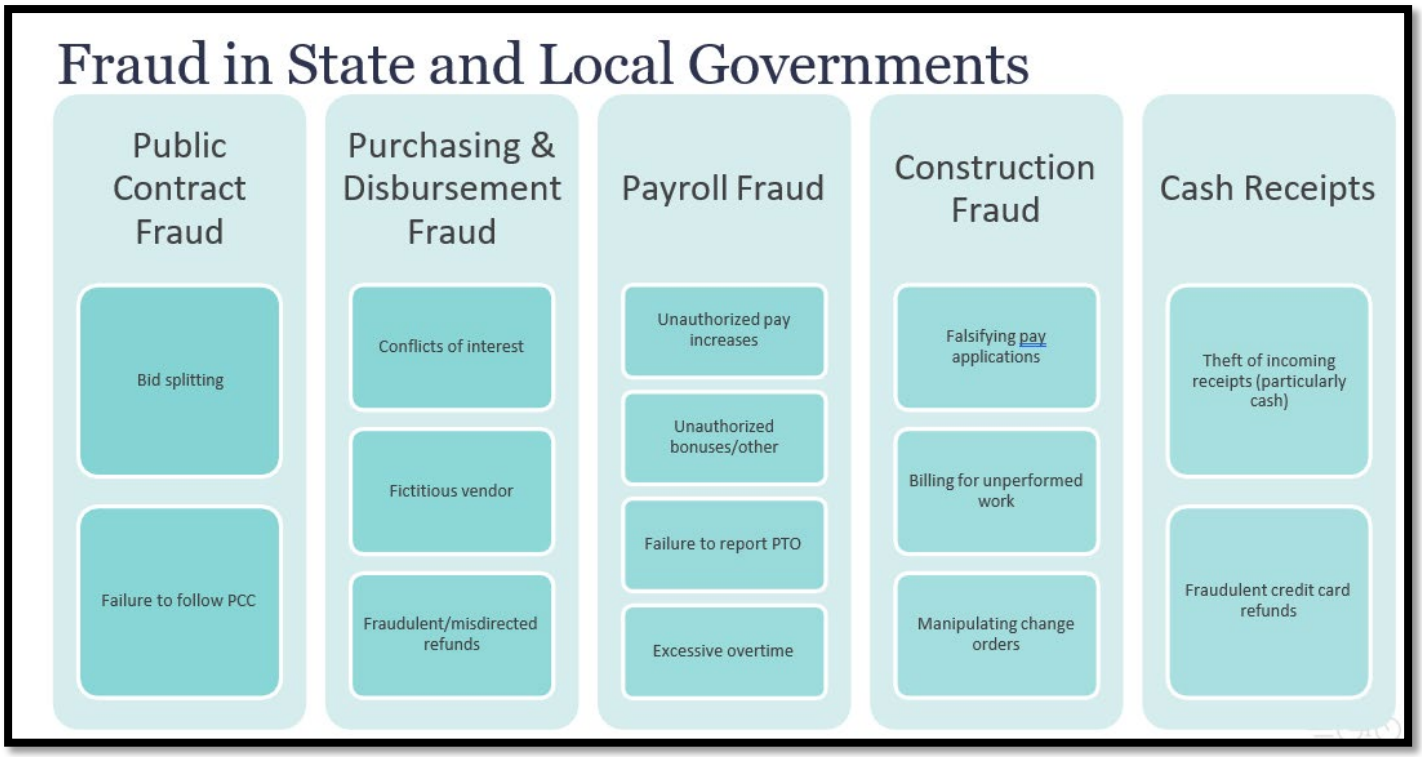
**Pressure** — **The Fraud Diamond** — **Rationalization**

**Capability**

"Opportunity opens the doorway to fraud, and incentive (pressure) and rationalization can draw a person toward it; but the person must have the ***capability*** to recognize the open doorway as an opportunity and to take advantage of it by walking through, not just once, but time and time again."

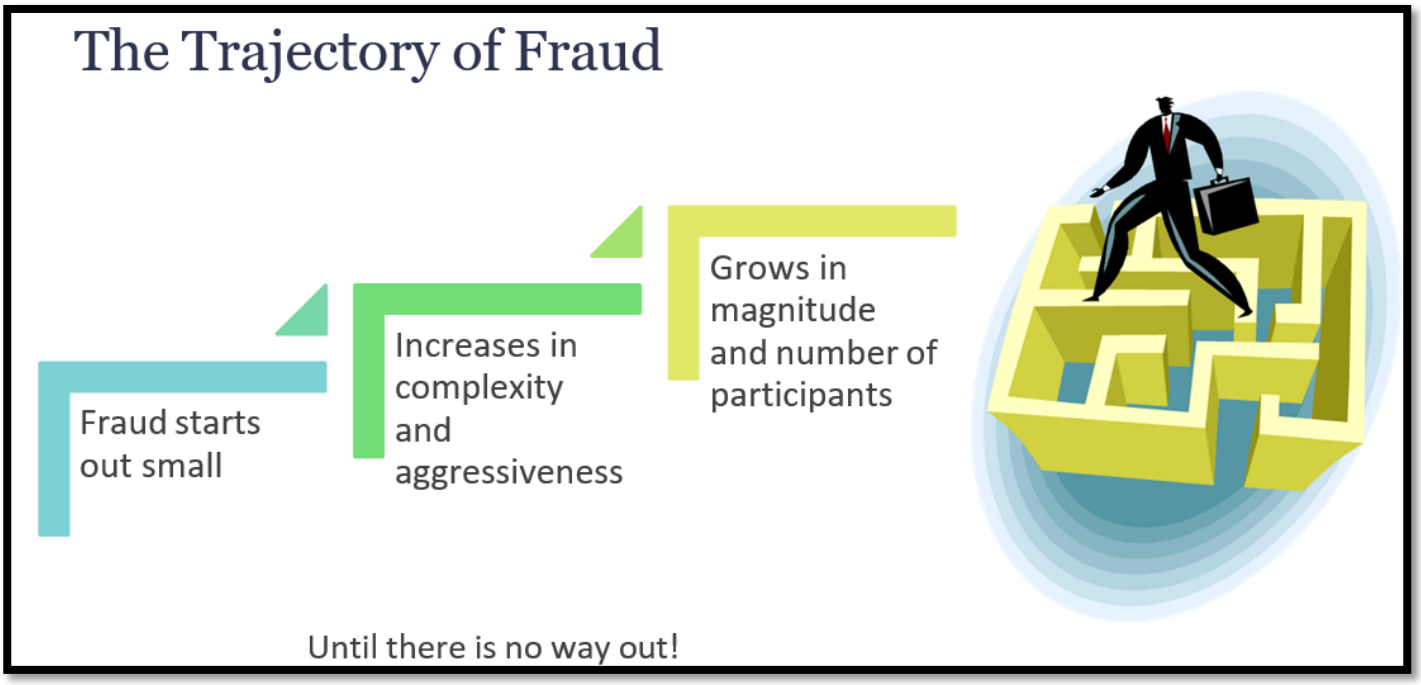
-David Wolfe & Dana Hermanson

## *Types of Fraud in State and Local Governments*




## *Internal Control Weaknesses*

One of the main purposes of internal control procedures is to safeguard assets. When controls are absent or weak (or overridden) they can facilitate fraud: 1. Lack of segregation of duties, 2. Lack of physical safeguards, 3. Lack of independent checks, 4. Lack of proper documents and records



*Fraud Risk Assessment*

- Looks at business processes and controls and identifies areas of fraud risk
- Organization-wide
- Higher risk areas/processes
- Involve an anti-fraud professional
- Free tool (ACFE): https://www.acfe.com/fraudrisktools/guide.aspx

*Recommendations & Limitations to Mitigate Fraud*

- At least two people are looking at every transaction (adequate segregation of duties)
- Ensure secondary approval by someone with knowledge of the business area
- Trust is not an internal control – ensure proper and sufficient supporting documentation.
- Ensure regular and timely reconciliation of asset accounts, review reconciliations
- Conduct regular monitoring and management review
- Mandatory job rotation and/or vacations
- Implement positive pay with your bank (if available, include payee/account name positive pay)
- EFT/ACH/Wires – Third-party services that verify bank account information
- Require confirmation when vendor change requests are received
- There is no set of internal controls that is guaranteed to prevent the incident of fraud
- What is your fraud risk tolerance? Lower tolerance = more controls
- Critical component – monitoring and management review
- Vendor master change report, One-time/temporary vendor number
- Manual check request/refunds, Payroll change report, Review reconciliations

CLAconnect.com

*Full presentation is located here:* **PowerPoint Presentation (vermont.gov)**

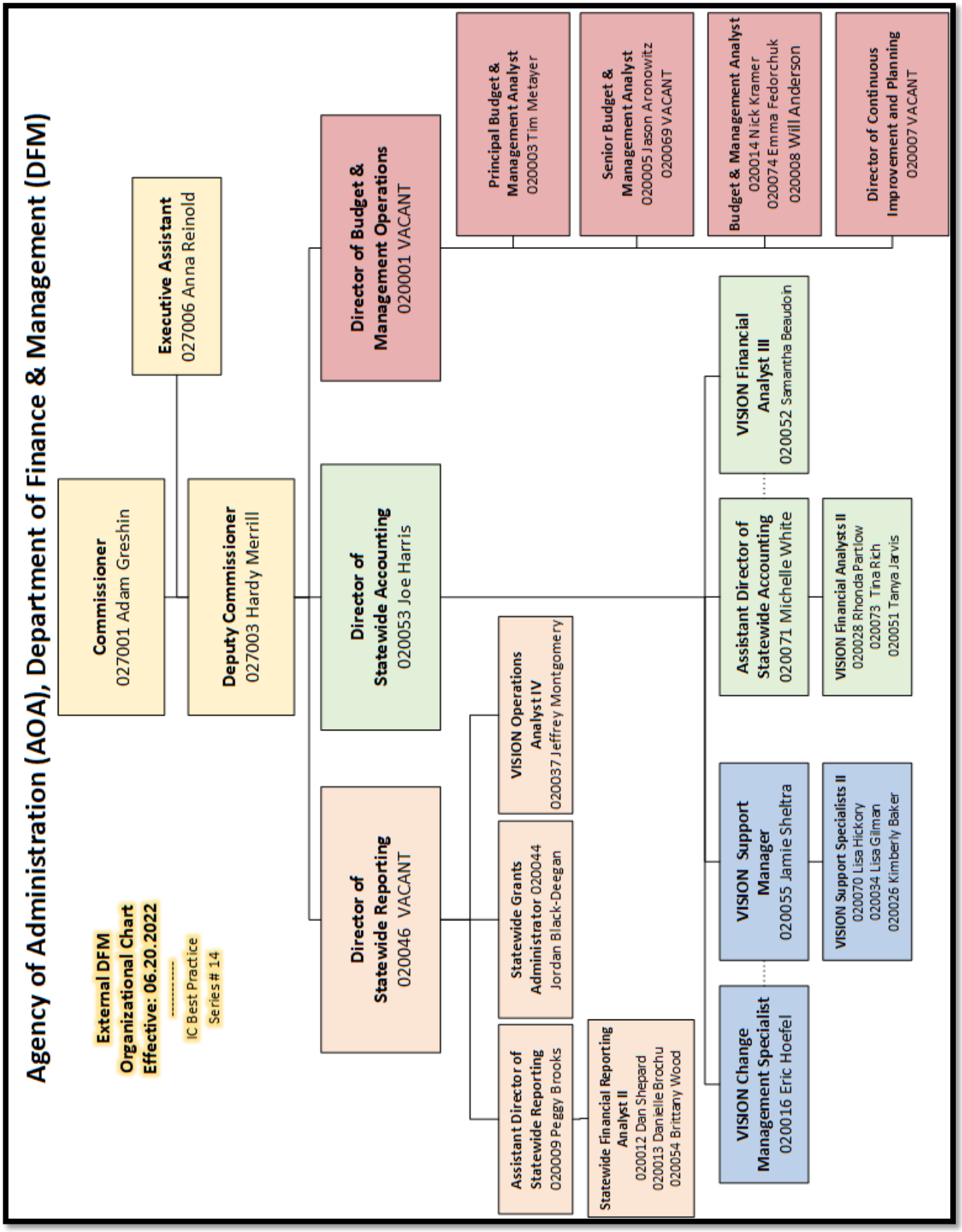
## DFM Staff Happenings - *New Hires:*

***Will Anderson, Budget and Management Analyst.*** Will is currently obtaining his Master of Public Administration from the University of Vermont. He graduated from McGill University and has done graduate work at SUNY Albany. Welcome, Will!

- ***Hardy Merrill, Deputy Commissioner, DFM***

***Brittany Wood, Statewide Financial Analyst II***. We are fortunate and excited to have her join our reporting team. She has been working for the Agency of Transportation, A/P for the last couple years and working towards her Masters in Managerial Accounting from Southern New Hampshire University. Please join me in welcoming Brittany!

- ***Peggy Brooks, MSA Assistant Director of Statewide Reporting, DFM***

***Our Internal Control News*** is published quarterly in the ***Spring, Summer, Fall,*** *and* ***Winter*** by The Department of Finance and Management (DFM). Please contact fin.internalcontrol@vermont.gov with comments or future article suggestions.

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