

1  **Auditing Cash and the Related Risks of Fraud and Error**

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2  **Introduction**

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Jake has over 13 years experience providing auditing, outsourcing, and consulting services to state and local governments. He is a volunteer reviewer under the GFOA CAFR review program, and has assisted several clients in preparing a CAFR for the first time. Jake has also volunteered as the Associate Board Member of the WGFOA. He has presented regionally and nationally on various topics of interest to state and local government employees and their auditors. As leader of the Public Sector practice in Wisconsin, Jake is responsible for 13 offices across the state and the services CLA provides to our state and local government clients.

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Jordan has been a part of CliftonLarsonAllen's Public Sector Group for 5 years, with a primary focus on serving clients who report under the Governmental Accounting Standards Board (GASB) standards. He has many experiences working with clients on complex issues including the implementation of new GASB standards, accounting for complex transactions, preparation and review of financial statements, and implementation guidance of internal controls recommendations. He has developed and presented trainings tailored for his clients' individualized needs related to internal control and compliance.

3  **Agenda**

Understanding the COSO Framework  
Deep Dives into Risk Assessment and Control Activities  
Examples  
Break out sessions

4  **COSO Framework**

5  **Control Environment**

- Tone at the top
  - Code of conduct
  - Respect for compliance

- Clear responsibilities
- Knowledgeable staff
- Support for adequate information

6  **Risk Assessment**

- What can go wrong?
  - Identify objectives
  - Identify risks
  - Identify unique considerations
  - Categorize the risk
  - Develop a plan

7  **What are the Risks?**

8  **Assertion based Risk Assessment**

9  **Risk Assessment**

- Identify Risks in Cash
  - Existence
  - Completeness
  - Rights
  - Accuracy
  - Valuation
  - Presentation
  - Cutoff

10  **Example Cash Risk Matrix**

11  **Example Audit Procedures**

12  **Example - Receipt Process Flow**

13  **Detailed Receipt Process Flow**

14  **Receipt Process Flow**

15  **Receipt Process Flow**

16  **Perceived Financial Process Risks**

17  **Group Exercise**

Identify a cash receipt or disbursement process in your group. Map the process as it stands. Identify risks and controls. Evaluate. Be prepared to share any insights you may have gained.

18  **CAUSES OF FRAUD**

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20  **CLUES TO FRAUD-FRAUD SYMPTOMS**

- Clues to fraud symptoms can be found in:
- Accounting records

- Analytical reviews
- Behavioral changes
- Tips or complaints
- Organizational structures

21  **CLUES TO FRAUD-FRAUD SYMPTOMS**

- Outsider/related party relationships
- Internal control systems
- Life-styles
- Environment

22  **ACCOUNTING SYMPTOMS**

- √ Altered, forged or unusual documents
- √ Large, unusual or complex transactions at year-end
- √ Numerous adjusting entries at year-end
- √ Unusual journal entries
- √ Ledger problems
- √ Selecting/changing to more liberal accounting practices
- √ "Going Concern" or adverse opinions
- √ Premature recognition of revenue
- √ Current expenses moved to a later period

23  **ANALYTICAL SYMPTOMS**

- √ Financial statement review
- √ Ratio/Trend analysis
- √ Unrealistic/Unusual relationships or conditions

24  **OUTSIDER/RELATED PARTY SYMPTOMS**

- Frequent change of auditors or lawyers
- Strained relationships between management and current/predecessor auditor
- Several different auditing or legal firms or banks
- Unusual large expenditures to lawyers, consultants or agents
- Significant litigation

25  **OUTSIDER/RELATED PARTY SYMPTOMS**

- Prior/ongoing problems with regulatory agencies
- Difficulty borrowing from lending institutions
- Pressures to restructure
- Pending legislation with potentially serious impact on entity's operations
- Long-term purchasing contracts at prices significantly below current prices

26  **OUTSIDER/RELATED PARTY SYMPTOMS**

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- Disproportionate amount of purchasing from one or a few vendors
- Increased reliance on one or more customers

- Significant related-party transactions not in ordinary course of business
- Intercompany transactions with related entities not audited or audited by another firm

27  **INTERNAL CONTROL SYMPTOMS**

- Lack of segregation of duties
- Domineering management
- Persons with propensity to circumvent internal controls
- Lack of adequate oversight from management

28  **ENVIRONMENTAL SYMPTOMS**

- Confusion about honesty and ethics
- Past occurrences of fraud
- Domineering/overbearing management
- Organization does not prosecute fraud perpetrators
- Organization does not conduct background checks on all potential employees (but especially on persons in a position of trust)

29  **ENVIRONMENTAL SYMPTOMS**

- Organization frequently operates in crisis or rush mode
- Management carelessly inattentive to details/failure to correct errors/problems on timely basis
- Management routinely disregards company guidelines/controls
- Compensation plans contingent upon achieving unduly aggressive sales/profitability/other goals
- Unrealistic performance standards

30  **ENVIRONMENTAL SYMPTOMS**

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- Low employee morale or loyalty
- Company in poor financial condition
- Absence of employee support/assistance programs
- Lack of a fraud policy

31  **FRAUD PREVENTION**

- Minimize Motive
- Minimize Opportunity
- Minimize Rationalization

32  **FRAUD PREVENTION**

- Will I get caught?
- What will happen if I do get caught?
- What is the worst that can happen?

33  **FRAUD TRUISM**

34  **Control Activities**

- The principles of good cash management include:

- Approvals
- Authorizations
- Verifications
- Reconciliations
- Reviews of Operating Performance
- Security of Assets
- Segregation of Duties

35  **Control Activities - Segregation of Duties**

- Separates the following responsibilities in a business process
  - Custody of assets
  - Record Keeping
  - Authorization
  - Reconciliation
- Provides for checks and balances
- Most effective control in combating employee fraud

36  **Control Activities – Custody of Assets**

- Custody of assets
  - Having physical control over assets
  - Any employee having cash collection responsibility
  - Deposit preparer or employee assigned to make deposit
  - Designated custodians of petty cash and change funds
  - Anyone with access to secured assets are responsible and will be held accountable for those assets
  - Assets must be secured when you have physical control and placed in a secure location when leaving it when you do not have physical custody.

37  **Control Activities – Custody of Assets**

- Custody of assets (continued)
  - Receipting
    - ◇ Incoming mail opened and receipts listed by persons having no access to cash receipts or accounts receivable records
    - ◇ Listing of mail receipts subsequently compared to cash receipts records and deposit slips by an employee having no access to cash
    - ◇ Cash deposited on a daily basis
    - ◇ Restrictively endorse checks
    - ◇ Provide manual cash receipt, register receipt or other system generated receipt

38  **Control Activities – Custody of Assets**

- Custody of assets (continued)
  - Properly Void unused checks
  - Close old accounts and destroy unused checks
  - Review petty cash controls
  - Dual signatures on checks

- No checks to cash
- Technology controls

39  **Control Activities – Record Keeping**

- The process of maintaining up-to-date financial data
- Record keeping may be a manual or highly automated process
  - ◇ Handwritten cash receipts
  - ◇ Cash register receipts
  - ◇ Electronic funds notifications
  - ◇ Credit card receipts
  - ◇ Computer generated journals and reports

40  **Control Activities - Authorization**

- Authorization
  - The process that allows designated employees to perform certain restricted functions:
    - ◇ Approval of refunds or voided transactions
    - ◇ Verification of daily reports and processes
    - ◇ Employee responsible for making accounts receivable adjustments and write-offs
  - Segregate recording the original transaction from voiding, adjusting or writing-off a customer transaction or balance.

41  **Control Activities - Reconciliation**

- The following reconciliation examples should be performed by someone without cash handling responsibilities:
  - Reconcile the deposit logs to the actual deposit after the deposit has been made
  - Reconcile all receipts to financial reports to ensure all transactions are being recorded
  - Maintain signed proof of reconciliation

42  **Control Activities - Reconciliation**

- If duties cannot be segregated due to limited resources compensating controls must be in place
  - Preventative controls
  - Detective controls
  - Monitoring controls
- These compensating control activities must be conducted by a supervisory-level employee who has no involvement in the actual business process

43  **Control Activities - Review**

- Bank Statements
- General Ledger
- Bank Reconciliations
- Cleared Checks
- Manual Checks
- Check sequences

44  **Control Activities - Risk**

- Without proper controls, we risk:
  - Unsafe environments for employees
  - Loss of cash
  - Theft of cash
  - Bank statements and accounting record do not agree
  - Limited audit trail
  - Accusations
  - Lost revenues

45  **Example Case Study**

46  **Background**

- County government located in the Midwest
- Demographics
  - Rural County government
  - Agriculture is the primary industry
  - Population: approximately 15,000
- Financial Information
  - Annual budgeted expenditures: approximately \$20 million
  - Cash basis accounting
  - 9 employees share financial accounting responsibilities
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47  **Financial Accounting Responsibilities**

48  **Financial Accounting Responsibilities (continued)**

- 1 Treasurer's Office
- 2 • Custodian of ALL County financial assets
  - Reconciliation of cash and investment accounts
  - Performance, review and reporting related to the revenue cycle
- Responsible for 25 cash and investment accounts with 5 different financial institutions
- Carrying value of bank accounts approximated \$21.9 million
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- 3 Auditor's Office
- 4 • Responsible for the expenditure cycle
  - General disbursements and related expenditures
  - Payroll and related expenditures
- All County expenditures are required to be reviewed and approved through the Office
- \$20.8 million in annual expenditures processed through the Offices disbursements process.
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49  **Structure**

50  **WHY**

Management's Rationale

- Readily available funds were needed to pay the vendor.
- Vendor did not want to extend a customer line on the County's account.
- Cash was needed for emergency purposes to ensure "the best" customer experience.

51  **The Receipt Process**

Process or Control?

- Step 1: Process
- Step 2: Control
- Step 3: Process
- Step 4: Control
- Step 5: Control

Does this appear reasonable?

52  **The Receipt Process**

What's Missing?

1. Where's the financial reporting in this process?
2. Where is the best place for interaction with the Treasurer's Office?
3. What is an alternate process for the issues management has brought to our attention?

53  **Recommendation**

Step 3: Alternate

1. Brings the process into the Treasurer's Office
  1. Added layer of controls
2. Proper interaction with the County's financial reporting system
3. Ability to generate appropriate financial and performance reports
4. Protection of County assets

54  **The Disbursement Process**

Process or Control?

- Step 1: Process
- Step 2: Control
- Step 3: Process
- Step 4: Control
- Step 5: Control

Does this appear reasonable?

55  **The Disbursement Process**

What's Missing?

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57  **What are your stories?**

Group breakout to discuss situations that you have identified and discuss methods of correcting the issues.

58  **Breakout**

- Take 10 minutes to discuss scenarios in which internal control processes failed to detect fraud or error.
- Please be ready to discuss:
  - A situation in which a control failure resulted in financial misstatement?
  - The cause of the control failure?
  - The extent of the loss due to the failure of the controls?
  - What happened to those involved?
  - How was it corrected?
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59  **Information and Communication**

- Management support for developing and maintaining supporting systems
- Open door policy with respect to risk issues
- Defined channels of communication for employees to report suspected fraud or other illegal acts
- Hotline established to report suspected fraud, waste or abuse

60  **Monitoring**

- Monitoring can include:
  - Periodic evaluation of controls
  - Supervisory reviews of controls
  - Analysis of financial reports that might identify a control failure
- Ongoing evaluation allows management to analyze whether the controls in place are functioning over time
- Internal control deficiencies should be identified and reported to those responsible for the modification of existing controls.

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