

Internal Controls: Just the Start of a Fraud, Waste and Abuse Prevention Program

How It Relates to Government Entities

Ever since the Committee of Sponsoring Organizations (COSO) framework was published in 1992, for-profit, not-for-profit and government entities have implemented some form of internal controls. If anything, governments preceded for-profit organizations because the single audit act has been in existence since 1984. But fraud still occurs, despite the recent, renewed focus on internal controls.

In the spring of 2009, an intriguing example of fraud brought this question to the forefront. Fraudsters were able to set up bank accounts in the name of legitimate vendors to states. Before they were arrested, the fraudsters had defrauded West Virginia of \$2 million and attempted thefts in a number of other states as well. These fraudsters didn't bother stealing from individuals – they went right to corporate America because they realized individuals are small fry.

The key to the fraud's success: West Virginia *thought* it was paying a legitimate vendor. The state had received paperwork asking for deposits in legitimate new accounts, and all the documents required to make changes to the vendor's account had been provided to accounts payable personnel. However, those seemingly legitimate accounts were in fact mechanisms to illicitly sweep funds overseas. In addition to the state of West Virginia, a number of well-known consulting firms fell victim to the scheme.

What occurred in West Virginia and other states was an act of social engineering: the fraudsters spent time learning the system and working to look as legitimate as possible. They filed the right forms, because all of those forms were publicly available on the government's websites (instructions for how to fill them out and who to file them with also were publicly available). Finally, their timing was right: because of the recession, back office operations were not fully staffed and the staff may not have had time to do all the necessary reviews and checks. In essence, the fraudsters learned the internal controls and exploited them.



How could this fraud have been prevented?

It's not that easy. The passage of the American Recovery and Reinvestment Act of 2009 (ARRA) has raised internal controls to the next level. ARRA requires governments to not only have effective internal controls, but to have a program to *prevent, combat and react and report* on fraud, waste and abuse. This program needs to be balanced with the seemingly opposite challenge required by ARRA: that those funds are awarded and distributed promptly, fairly, reasonably and transparently. But fraud, waste and abuse is not just limited to ARRA funds. Governments – and, for that matter, all organizations – need to have a program that crosses all funding sources. And of course, to prevent further West Virginia-type frauds, transparency must be balanced with handing over the keys to the castle.

To develop its fraud-prevention program, the Commonwealth of Massachusetts' managers queried its Stop Fraud Task Force, which comprises law enforcement officials, the state auditor and inspectors general. The managers asked questions of federal inspectors general, and even looked in textbooks. But there was minimal guidance in terms of “to prevent X from occurring, do Y.” So managers did the next best thing – they used common sense.

The Commonwealth's program consists of a simple tri-fold brochure titled “It's Everyone's Job to Prevent Fraud, Waste and Abuse of Public Funds” and a toolkit for the Commonwealth's departments. The 23-page toolkit contains an overview, checklist, website links and whistleblower hotline numbers. (The brochure also includes some of this information.)

Within the brochure, Commonwealth management included some things that should be self-evident:

- Have a code of conduct
- Do a fraud risk assessment for all programs
- Update department-specific internal controls for any changes in programs or organization
- Document that all staff that have anything to do with the finances of the department are properly trained
- If at all possible, have segregation of duties and cross-training. If not possible, partner with another department for assistance, if allowed by law
- Review reconciliations and transactions for unusual items, corrections, over-

For More Information and Tools**Recovery Act Resource Center**

gaqc.aicpa.org/Resources/Recovery+Act+Resource+Center/

Members in Government Guide to Internal Control and Internal Control Services

http://imcenter.aicpa.org/NR/rdonlyres/E3E77384-E4BA-4F90-BAE4-FEAE8569CECB/0/FINAL_Understanding_Internal_Control_Services_government.pdf

Managing the Business Risk of Fraud: A Practical Guide

http://www.aicpa.org/download/audcommctr/Managing_the_Business_Risk_of_Fraud.pdf

The American Reinvestment and Recovery Act of 2009: A Primer for Audit Committees

http://www.aicpa.org/download/audcommctr/AC_and_ARRA_2009.pdf

The AICPA Audit Committee Toolkit: Government Organizations

<http://www.aicpa.org/Audcommctr/toolkitgovt/homepage.htm>

rides and duplications

- Make sure that vendors and sub-recipients know the program is in place and monitor them for compliance
- Perform background checks on new employees and random checks on existing employees
- Spot-check timesheets to match computer records of activity
- Buy goods and services only when needed

Some of these items have little or no cost – aside from time and effort. For example, “Think like a taxpayer, because you are one.” That phrase should be on every government manager’s desk.

And there are other things that can be done. The Commonwealth has printed whistleblower posters and posted them near elevators. The toolkit contains links to spreadsheets, standard contracts and other pieces of information that don’t require reinventing the wheel. Similarly, another state has developed a monthly anti-fraud, waste and abuse newsletter with tips, techniques and case histories.

Looking ahead

Governments and all types of businesses have to be proactive to combat fraud, waste and abuse. The President’s Council on Integrity and Efficiency Report for 2008 stated that \$18.6 billion of federal payments alone in federal fiscal 2008 were susceptible to abuse, questionable practices or should be investigated for recovery. Compared with outlays of \$3 trillion in total, approximately one-half of one percent of spending could be fraudulent, wasteful and abusive. However, this could be a small estimate. The National Health Care Anti-Fraud Association estimates conservatively that at least three percent of health care spending is lost to fraud. This might not seem like much – until one looks at the federal stimulus bill. The range of percentages for potential fraud, waste and abuse yields anywhere from \$3.8 billion to nearly \$24 billion of questionable spending. Think of the schools that could be built, the public safety that could be provided, the environment that could be cleaned...with that in mind, it’s easy to see why we all must work to combat fraud, waste and abuse of public funds.

Author bio

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