



**February 17-21, 2007
San Diego, California**

Catch the Pirates: The Many Faces of Fraud

Presented by:
Ed McMillan, CPA, CAE
Fraud Examiner
Forest Hill, MD

February 19, 2007

THE MANY FACES OF FRAUD!

Edward J. McMillan, CPA, CAE

Post Office Box 771

Forest Hill, MD 21050

Telephone: 410/893-2308

FAX: 410/838-7696

Email Address:

emcmillan@sprintmail.com

Website Address:

www.nonprofitguru.com

INTERNAL CONTROLS

An effective and documented system of internal controls is an *absolute must* if your organization is serious about protecting itself against employee dishonesty.

The adequacy of your internal controls currently used by your organization can be gauged quickly by answering the following questions:

	<u>YES</u>	<u>NO</u>
1. Are copies of bank statements forwarded off-site to the CEO and are checks and debit memorandums reviewed?	_____	_____
2. Are copies of the credit card detail forward off-site to the CEO and are charges reviewed?	_____	_____
3. Are two signatures required on all checks and wire transfers?	_____	_____
4. Does accounting attach a copy of the bank reconciliation to the monthly financial statements?	_____	_____
5. Are finance personnel prohibited from being signers on all bank accounts?	_____	_____
6. For remittances via the mail, do you take advantage of a bank's Lock Box service?	_____	_____
7. Are checks that are received in the mail immediately endorsed by whoever opens the mail?	_____	_____
8. After checks have been endorsed do you prohibit employees other than accounting from coming into contact with original checks?	_____	_____
9. Does your restrictive endorsement stamp <i>not</i> include your account number?	_____	_____
10. Is the amount on manual checks protected with a check protector machine?	_____	_____

Copyright 2005, Edward J. McMillan, CPA, CAE

YES NO

11. Does your CPA firm undertake a thorough analysis of your internal controls and do you take their recommendations for improvement seriously? _____
12. Are all employees who handle cash and checks bonded? _____
13. Is the amount of your Fidelity Bond adequate and are you aware of any contractual obligations concerning it? _____
14. Do you require employees to take at least of one full uninterrupted week of vacation annually? _____
15. Do you require key employees to be subject to a “Management Day”? _____
16. Is the check supply under lock and key? _____
17. Are all checks signed manually? _____
18. Is the check stock non-scannable? _____
19. Are *two* people involved in preparing payroll and remitting payroll taxes? _____
20. Do you have a “Conditions of Employment Agreement”? _____
21. Do you have a “Conflict of Interest Agreement”? _____
22. Are you internal control policies in writing? _____
23. Does your CPA firm or Internal Audit Committee visit the office during the “Window of Opportunity” for embezzlement? _____
24. Have you instructed the bank to not change authorized signers without approval of management? _____
25. Do you occasionally test cash, check and credit card transactions? _____

YES NO

26. When employees terminate, do you conduct an “Exit Interview”? _____
27. Do you prohibit making checks payable to acronyms? _____
28. If your organization is known by its’ acronym, do you encourage payment be made to its’ full legal name? _____
29. Do you take advantage of your bank’s Positive Pay service? _____
30. Did you eliminate employee credit cards? _____
31. Do you do thorough background checks on key employees? _____
32. Do you have approved vendor files and do you investigate new vendors? _____
33. Do you have a system in place whereby employees are encouraged to report suspicious or unethical activity? _____
34. Do you have a formal “Whistle Blower Protection” policy? _____

This checklist is of course just a short *managerial* evaluation of your existing controls. Hopefully, the answers to most if not all of the above questions are “yes.” If not, give serious consideration to a thorough analysis your internal controls and make changes for improvement accordingly to ensure your organization’s assets are protected.

THE FRAUD TRIANGLE

Incentive



Opportunity

Rationalization

Copyright 2005, Edward J. McMillan, CPA, CAE

A few facts:

- You do not know what is going on in peoples' personal lives!
- In almost every situation where fraud has been discovered, the guilty party is the person *above* suspicion!
- And finally...remember that the purpose of effective internal controls is to *keep honest people honest* by removing the "opportunity" factor of the fraud triangle!

**IF YOU FIND YOURSELF THE VICTIM:
HAVE A PREDETERMINED “PLAN OF ACTION”:**

1. Call your attorney and CPA for advice on how to handle a situation initially.
2. Call your bank and *freeze all accounts* until the situation is resolved.
3. Change computer passwords.
4. *Preserve the evidence.* Safeguard all original documents and work from copies.
5. Take detailed and copious notes of the incident and follow up.
6. Know the requirements of your Fidelity Bond.
7. When confronting the person:
 - Protect yourself and fellow employees if there is any possibility of an incident
 - The discussion should never take place in the offender’s office, etc. Meet in a neutral location
 - The discussion should take place before or after work hours.
 - *Always have a witness present.* This is of particular importance if this is a male-female discussion
 - Make sure you get credit cards, keys, etc. from the offender and consider changing door locks if necessary
 - The offender should be escorted out of the building and not be allowed back to his office, etc. (Note the “Conditions of Employment Agreement”)

8. Get advice from counsel on how to relate the circumstances of dismissal to other employees, etc. and how to handle references.
9. *And when it's all over...* work with an experienced CPA to thoroughly review your system of internal controls and correct whatever deficiencies that led to the problem!

Notes: