



REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA

OFFICE OF THE STATE AUDITOR

SUITE 500
525 PARK STREET
SAINT PAUL, MN 55103-2139

(651) 296-2551 (Voice)
(651) 296-4755 (Fax)
state.auditor@state.mn.us (E-mail)
1-800-627-3529 (Relay Service)

October, 2008

Article for *Minnesota Counties*

Avoiding Fraud

By Rebecca Otto, State Auditor

A report released by the Association of Certified Fraud Examiners (ACFE) has estimated that U.S. organizations lose 7% of their annual revenues to fraud. Workplace fraud schemes occur across all types of organizations including corporations, small businesses, not-for-profit organizations and government. Occupational fraud, also known as internal fraud or employee theft, is uncommon in Minnesota government. But when it does occur, it can be traumatic for the community where it occurs.

What to watch out for

Recently the ACFE released its 2008 Report to the Nation on Occupational Fraud & Abuse, and the findings provide “guidance on where to focus efforts to prevent occupational fraud.

The most commonly reported offenses in the government and public administration sector were billing schemes, skimming, theft of non-cash assets, theft of cash on hand, payroll fraud and expense reimbursement fraud.

- In billing schemes, the employee causes the government to issue a payment by submitting invoices for fictitious goods or services, inflated invoices, or invoices for personal purchases. An example would include “phantom vendors” -- where an employee creates a shell company and bills the employer for nonexistent services.
- “Skimming” involves taking cash before it is recorded on the organization’s books and records. An example would be an employee accepting payment from a customer but not recording the payment/sale and keeping the cash.
- “Theft of cash on hand” cases refer to an employee taking cash kept at the government office.

- Payroll fraud includes claims of overtime for hours not actually worked, or the addition of “ghost employees” to the payroll.
- Expense reimbursement cases include employees filing false expense reports, claiming nonexistent meals, etc.

The most common fraud for small organizations involved check tampering. This occurs when one individual has access to the checkbook and also the responsibility for recording payments and/or reconciling the entity’s bank statement. Small organizations, where a limited staff can make it difficult to segregate duties, can be particularly susceptible to this type of fraud.

Smaller organizations and entities suffer disproportionately large losses. The study found that the amounts lost in each incident, also called median losses, which were suffered by organizations with fewer than 100 employees, was higher than median losses in even the largest organizations. The good news for government entities is that they were among those found to have the lowest median losses.

How Fraud Happens

The 2008 ACFE study confirmed a finding from prior studies: in fraud, the more authority a person has in the organization, the greater the loss. This makes sense because a person with more authority has greater access to resources and the greater ability to override controls in order to conceal the fraud.

The study also found a direct correlation between the length of time an employee has been employed by an organization and the size of the loss. An employee’s tenure is likely related both to trust and to opportunity. The more trust an organization places in an employee, the greater the person’s opportunity to commit fraud. Long-term employees may also be the most familiar with gaps in the organization’s operations and controls, which may help them avoid detection more easily.

Exposing Fraud

Frauds are generally ongoing crimes that can continue for months or even years before they are detected. In spite of this, workplaces are benefiting from many effective means of uncovering fraud schemes. According to the study, the most common method of detecting occupational fraud was by a tip or complaint -- when another person becomes suspicious of fraudulent activity and notifies someone. Frauds are also detected by internal and external audits, internal controls, and even by accident. Among the most effective internal controls a workplace can employ are job rotation and mandatory vacation.

The study showed that over half of the tips were from fellow employees. This reinforces the need for entities to maintain open channels of communication so employees are comfortable bringing forward their concerns. The finding also serves as a good reminder

to all local government employees that Minnesota law requires that evidence of theft or embezzlement must be reported to the Office of the State Auditor.

Fraud is preventable and can be stopped through strong internal controls and internal and external audits. Fostering an atmosphere of open communication with county staff can also be a strong measure to prevent and detect fraud.