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Prevent and Detect Employee Theft

By Rebecca Otto, Minnesota State Auditor

As a city official, the last thing you want to have happen under your watch is theft of city funds. Some think, "It would never happen in our community." Unfortunately, employee theft happens. Therefore, to be proactive and prevent employee theft, it is important to have sound internal controls in place.

This article will provide guidance on implementing procedures that reduce the risk of theft and increase the chance of early detection.

Types of Employee Thefts

Employee thefts may take several forms. It may be as simple as a city employee writing a check to themselves, but recording it in the city records as a check to a vendor or that the check is "void." It may involve a failure to deposit all city funds into city accounts, or depositing a check intended for the city into a personal account. It may involve submitting personal expenses as employee expenses, or altering invoices presented to the city for payment.

Procedures to Reduce the Risk of Theft

To reduce the risk of employee theft, every city should implement basic safeguards. An environment of accountability should be created and communicated. Some important safeguards include:

Segregation of Duties Simply put, no employee should be in a position to commit an irregularity and then conceal it. A concrete example of segregation of duties is a movie theater, where one person sells tickets and separate person collects the tickets. This separation of duties helps prevent the person selling the tickets from: (1) collecting the price of the ticket, but allowing entry without a ticket (allowing the ticket seller to pocket the ticket payment without being detected) or (2) allowing entrance without the purchase of a ticket.

Examples of incompatible duties that should be performed by separate individuals are:

- Receipting collections, posting collections to registers, and making bank deposits; and
- Signing checks and reconciling the bank accounts.

Internal Control Procedures Many internal control procedures are common-sense methods used to track city funds. Here are a few procedures that may help prevent thefts or allow earlier detection of thefts:

- Require that checks be made out to the city;
- Endorse checks for deposit as they are received;
- Make daily deposits;
- Reconcile receipts with deposits;
- Instruct your bank to prohibit cash withdrawals and check-cashing from the city account;
- Be sure that authorized signatures at the bank are up-to-date;
- Reference approved claims and amounts in meeting minutes;
- Do not pre-sign any checks;
- Reconcile bank statements monthly;
- Require detailed original receipts for the reimbursement of employee expenses; and
- Have written policies (e.g., checks may only be for the amount of purchase, no cashing of personal checks).

If possible, we also encourage cities to obtain the city's cancelled checks or optical images of the checks from their banks. By comparing the cancelled checks with the register each month, discrepancies will be detected.

Environment Finally, cities should promote an environment of accountability. Everyone should comply with the city's internal control procedures, no exceptions.

Red Flags in Detecting Theft

Theft can result from poor segregation of duties. Red flags may be raised when employees:

- Take records home;
- Take on duties that should be segregated;
- Work hours when others are absent; and/or
- Refuse to take vacations.

Theft can result from noncompliance with internal control procedures. Some red flags to watch out for:

- Copies of invoices being submitted for payment, rather than the original invoices, may indicate that an altered document is being submitted;
- Deposits are late;
- Old checks remain outstanding;
- Receipts are not reconciling with deposits; and/or
- Checks are written out of order.

Special Situations Presenting Risks

Situations involving cash transactions present special risks and require extra diligence. When a city receives cash, it must implement internal control procedures to prevent theft.

When Theft is Suspected

Whenever a city employee or officer discovers evidence of theft, embezzlement, or the unlawful use of public funds or property, that person is required to promptly submit a written report to the Office of the State Auditor providing a detailed description of the alleged incident(s). *See* Minn. Stat. § 609.456, subd. 1. The person must also report the incident(s) to law enforcement.

Employee thefts may implicate disciplinary actions as well as criminal charges. As a result, Tennessee Warnings may be required. Before approaching the employee or officer involved, consult with a supervisor, the city attorney, local law enforcement, or the Office of the State Auditor for guidance on what actions to take.

To contact the Office of the State Auditor regarding evidence of employee theft or if you have further questions, please call (651) 296-2551 or e-mail us at state.auditor@osa.state.mn.us.

For additional information on internal controls or to view investigative reports, visit the Office of the State Auditor website: www.auditor.state.mn.us.